Law Offices
HOLLAND & KNIGHT LLP

315 South Calhoun Street
Suite 600
P.O. Drawer 810 (ZIP 32302-0810)
Tallahassee, Florida 32301

850-224-7000
FAX 850-224-8832
www.hklaw.com

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ORIGINAL

June 5, 2000

KAREN D. WALKER
850-425-5612

Internet Address:
kwalker@hklaw.com

VIA HAND DELIVERY

Blanca S. Bayo
Director, Division of Records & Reporting
Florida Public Service Commission
Capital Circle Office Center
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

000691-GU

Re: In re: Application of Southern Union Company for Authority to Issue and Sell Securities Pursuant to Section 366.04, Florida Statutes and Chapter 25-8, Florida Administrative Code; and Request for Approval to Borrow Funds for Short-Term Financing Purposes.

Dear Ms. Bayo:

Enclosed for filing on behalf of Southern Union Company are the original and five (5) copies of its Application for Authority to Issue and Sell Securities Pursuant to Section 366.04, Florida Statutes and Chapter 25-8, Florida Administrative Code; and Request for Approval to Borrow Funds for Short-term Financing Purposes ("Application") and exhibits thereto. Exhibit "C" to the Application is being filed under seal and under cover of a Request for Confidential Classification. A diskette containing the Application and Request for Confidential Classification in Wordperfect format has been provided.

For our records, please acknowledge your receipt of this filing on the enclosed copy of this letter. Thank you for your consideration.

Sincerely,

HOLLAND & KNIGHT LLP

Karen D. Walker

KDW:kjg
Enclosure

cc: Andrew Maurey, Public Utility Supervisor

TAL1 #218533 v1

ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application of Southern Union Company for Authority to Issue and Sell Securities Pursuant to Section 366.04, Florida Statutes, and Chapter 25-8, Florida Administrative Code; and Request for Approval to Borrow Funds for Short-term Financing Purposes

Docket No. 000691-GU
Filed: June 5, 2000

/

APPLICATION OF SOUTHERN UNION COMPANY FOR AUTHORITY TO ISSUE AND SELL SECURITIES PURSUANT TO SECTION 366.04, FLORIDA STATUTES AND CHAPTER 25-8, FLORIDA ADMINISTRATIVE CODE; AND REQUEST FOR APPROVAL TO BORROW FUNDS FOR SHORT-TERM FINANCING PURPOSES

Southern Union Company ("Southern Union"), by and through undersigned counsel, pursuant to Section 366.04, Florida Statutes, and Chapter 25-8, Florida Administrative Code, hereby files this application for authority to issue and sell securities, and to borrow funds for short-term financing purposes during the twelve month period ending July 31, 2001. In support of its application, Southern Union states:

1. **Applicant Information**

The name and principal business address of the applicant are as follows:

Southern Union Company
504 Lavaca Street, Suite 800
Austin, Texas 78701.

Southern Union is a public utility engaged in the distribution of natural gas to the public. As of March 31, 2000, Southern Union had approximately $1.9 billion in assets and four natural gas divisions which provide service to more than 1.2 million

customers in Texas, Missouri, Pennsylvania, and Florida. [1] Southern Union conducts its natural gas operations in Florida through its Atlantic Utilities Division doing business as South Florida Natural Gas ("SFNG"), which provides service to approximately 4,400 natural gas customers in New Smyrna Beach, Edgewater, and portions of Volusia County, Florida. Southern Union is regulated by the Florida Public Service Commission (the "Commission") as a public utility pursuant to Chapter 366, Florida Statutes.

2. Incorporation

Southern Union was incorporated in Delaware in 1932. Southern Union is authorized to transact business in Arizona, Florida, Massachusetts, Missouri, New Mexico, Pennsylvania, Rhode Island and Texas.

3. Persons Authorized To Receive Notices and Communications

The names and addresses of the persons authorized to receive notices and communications with respect to this application are as follows:

Dennis K. Morgan
Senior Vice President – Legal and Secretary
Southern Union Company
504 Lavaca Street, Suite 800
Austin, Texas 78701
(517) 370-8310

D. Bruce May
Karen D. Walker
HOLLAND & KNIGHT LLP

[1] Through its Southern Union Gas Division, Southern Union serves approximately 523,000 customers in Texas, including customers in the cities of Austin, El Paso, Brownsville, Galveston, and Port Arthur. The Missouri Gas Energy Division serves approximately 487,000 customers in western Missouri, including customers in the cities of Kansas City, St. Joseph, Joplin and Monett. In Pennsylvania, PG Energy serves approximately 154,000 customers, including the cities of Wilkes-Barre, Scranton, and Williamsport.

P.O. Drawer 810
315 South Calhoun Street, Suite 600
Tallahassee, Florida 32302 (32301)
(850) 224-7000.

4. **Capital Stock and Funded Debt**

Southern Union and its consolidated financing subsidiaries are authorized by their organizational documents, including Southern Union's Restated Certificate of Incorporation, as amended to date, to issue common stock, and preferred stock of Southern Union, and trust preferred securities of certain financing subsidiary business trusts as follows:

(a) Brief Description: Currently, the authorized capital stock of Southern Union consists of: (i) 200,000,000 shares of Southern Union Common Stock with a face value of 200,000,000 ($1 par value per share); and (ii) 1,500,000 shares of Southern Union Cumulative Preferred Stock (no par value). The authorized securities of Southern Union Financing I ("Subsidiary Trust"), a consolidated wholly-owned subsidiary of Southern Union, consist of: (i) shares of common securities, all of which are issued, outstanding and held by Southern Union; and (ii) 4,000,000 shares of Trust Originated Preferred Securities.

(b) Amount Authorized: The amount authorized is set forth above.

(c) Amount Outstanding: As of March 31, 2000 there were 48,134,860 shares of Southern Union Common Stock issued and outstanding. No shares of Southern Union Cumulative Preferred Stock are issued or outstanding. As

of March 31, 2000, 4,000,000 shares of Trust Originated Preferred Securities ("Preferred Securities") issued by the Subsidiary Trust were outstanding with a face amount of $100,000,000 ($25 par value per share). In connection with the issuance of the Preferred Securities and the related purchase by Southern Union of all of the Subsidiary Trust's common securities ("Common Securities"), Southern Union issued the Subsidiary Trust $103,092,000 principal amount of its 9.48% Subordinated Deferrable Interest Notes, due 2025 ("Subordinated Notes"). Both the Preferred Securities and the Subordinated Notes bear a rate of 9.48%.

(d) Amount Held As Reacquired Securities: None.

(e) Amount Pledged: None.

(f) Amount Owned By Affiliated Corporations: None.

(g) Amount Held In Funds: None.

The funded consolidated indebtedness of Southern Union not held by the Subsidiary Trust is as follows:

(a) Brief Description: On January 31, 1994, 475,000 notes of 7.6% Senior Debt Securities ("7.6 Senior Notes") were issued for a face amount of $475,000,000. These notes come due in February, 2024. Since the initial issuance of the 475,000 Senior Notes, 110,485 Senior Notes (with a face value of $110,485,000) have been repurchased and retired.

On November 3, 1999, 300,000 notes of 8.25% Senior Debt Securities ("8.25 Senior Notes") were issued in a face amount of $300,000,000. These notes come due November 15, 2029.

(b) Amount Authorized: The amounts authorized are set forth above.

(c) Amount Outstanding: As of March 31, 2000, there are 364,515 of the 7.6 Senior Notes and 300,000 of the 8.25 Senior Notes outstanding, which reflects an outstanding balance of $364,515,000 and $300,000,000, respectively.

(d) Amount Held As Reacquired Securities: None.

(e) Amount Pledged: None.

(f) Amount Owned By Affiliated Corporations: None.

(g) Amount Held In Funds: None.

5. Proposed Transactions

Southern Union seeks authority to issue and sell and/or exchange any combination of the long-term debt and equity securities described below and/or to assume liabilities or obligations directly or as guarantor, endorser, or surety in an aggregate amount not to exceed $1 billion during the twelve month period from August 1, 2000 through July 31, 2001. In addition, Southern Union seeks authority to borrow up to $300,000,000 for short-term financing purposes.

The long-term debt securities may include first mortgage bonds, medium-term notes, debentures, convertible or exchangeable debentures, notes, convertible or exchangeable notes, or other straight debt or hybrid debt securities, whether

secured or unsecured, with maturities ranging from one to fifty years. Southern Union may enter into related options, rights, interest rate swaps or other derivative instruments.

The equity securities may include common stock, preferred stock, preference stock, convertible preferred or preference stock, or warrants, options or rights to acquire such securities, or other equity securities, with such par values, terms and conditions and relative rights and preferences as deemed appropriate by Southern Union and any consolidated financing subsidiary, and as are permitted by Southern Union's Restated Certificate of Incorporation, as amended from time to time, and by any such financing subsidiary's organizational documents.

Any such consolidated financing subsidiary of Southern Union may issue preferred securities similar to that currently outstanding, whereby Southern Union would establish and make an equity investment in a special purpose limited partnership, trust or other entity. Southern Union, a wholly-owned subsidiary of Southern Union or Southern Union designees would act as the general partner, trustee or trustees, or similar manager of the entity. The entity would offer preferred securities to the public and lend the proceeds to Southern Union. Southern Union would issue debt securities to the entity equal to the aggregate of its equity investment and the amount of preferred securities issued. Southern Union may also guarantee, among other things, the distributions to be paid by the affiliated entity to the holders of the preferred securities.

The interest rate Southern Union could pay on debt securities will vary depending on the type of debt instruments and the terms thereof, including specifically the length of maturity as well as market conditions. On May 31, 2000, a new issue of 10-year senior notes of Southern Union would have carried a yield to maturity of approximately 8.9%. The dividend rate for preferred securities is similarly affected by the terms of the offering. On May 31, 2000, a new issue of thirty-year tax deductible preferred securities of Southern Union would have carried a dividend yield of approximately 10.5%.

In addition, Southern Union may from time to time issue instruments of guaranty, collateralize debt and other obligations, issue securities, and arrange for the issuance of letters of credit and guaranties, in any such case to be issued by or on behalf of one of more of its subsidiaries or affiliates for the benefit of Southern Union's utility operations, or in connection with other financings by Southern Union and its subsidiaries, or on its or any of their behalf.

Southern Union will file a consummation report with the Commission in compliance with Rule 25-8.009, Florida Administrative Code, within 90 days after the end of any fiscal year in which it issues securities.

6. Purposes For Which Securities Are To Be Issued or Assumed

The net proceeds to be received from the issuance and sale and/or exchange of the additional long-term debt and equity securities will be added to Southern Union's general funds and will be used in connection with the mergers of Providence Energy Corporation ("PVY"), Valley Resources, Inc. ("VR"), and Fall

River Gas Company ("FRG"), (together the "New England Mergers") into Southern Union[2], to reacquire, by redemption, purchase, exchange or otherwise, any of its outstanding debt securities and equity securities as market conditions warrant; to repay all or a portion of any maturing long-term debt obligations; to repay all or a portion of short-term bank borrowings; and/or for other general corporate purposes. Excess proceeds, if any, will be temporarily invested in short-term instruments pending their application to the foregoing purposes.

Southern Union has for some time had the goal of selected growth and expansion within the utility industry including the acquisition of natural gas distribution or transmission businesses. Over the past eight years, Southern Union has acquired a number of such businesses, adding approximately 700,000 customers to its operations (including the recent PNT merger). The pending mergers with PVY, VR, and FRG will further contribute to Southern Union's goal of selected growth and expansion. Up to $150,000,000 of common equity, up to $200 million in preferred securities or preferred stock, and/or up to $625,000,000 of debt securities as previously described will be used to accomplish this merger.

In connection with these mergers, Southern Union may assume and/or issue up to $250,000,000 of debt securities as described in the previous section to refinance certain short-term debt of these companies, the current portion of long-term debt of these companies, and depending on market conditions and the terms and covenants for each issue, assume and/or refinance some or all of the long-term

[2] The New England Mergers is summarized in Exhibit "A".

debt of these companies. Some or all of the debt securities of these companies, if assumed upon closing of the mergers, may be refinanced after such merger.

Southern Union maintains a continuous construction program, principally for gas distribution facilities. Assuming consummation of the New England Mergers, Southern Union estimates that construction expenditures under its fiscal year 2001 construction program will be approximately $120,000,000.

Southern Union's 9.48% preferred securities (face value of $100,000,000) issued in May, 1995, became callable by Southern Union in May, 2000. Depending on market conditions, any mixture of debt, preferred or common equity may be issued to redeem some or all of those securities.

Under future market conditions, the interest rate on new issue long-term debt or the dividend rate on new issue preferred securities of Southern Union may be such that it becomes economically attractive to reacquire a portion or all of certain of its long-term debt securities or equity securities, providing an opportunity for Southern Union to reduce interest or dividend expense, or simplify or reduce covenant restrictions and/or requirements. Other important considerations in making such a decision would include an assessment of anticipated future interest and dividend rates and Southern Union's ability to raise enough new capital to finance its expansion and construction programs while currently pursuing any refinancing opportunities.

Remaining funds would be used for general corporate purposes that may include, but not be limited to, investments in new technologies to provide quality

service to Southern Union's customers, development of related energy businesses or expansion opportunities in the gas distribution business.

Southern Union, from time to time, may issue instruments of guaranty, collateralized debt and other obligations, issue securities and arrange for the issuance of letters of credit and guaranties by or on behalf of itself or of one or more of its subsidiaries or affiliates.

Southern Union will require short-term borrowing not to exceed $300,000,000 to provide funds for working capital needs, temporary financing of its construction program and capital commitments, temporary funding of maturing or called long-term debt or preferred securities, and any other corporate purposes. Southern Union's working capital requirements arise largely from the seasonality of its natural gas business. Southern Union's borrowing requirements of up to $300,000,000 will be priced based on LIBOR and/or the prime rate of interest, and thus will fluctuate with market conditions.

7. **Lawful Object and Purpose**

The New England Mergers present opportunities for numerous benefits to Southern Union and its customers. The mergers will allow Southern Union to diversify its risk associated with any one region's weather and economic conditions. This should help reduce earnings fluctuations. In addition, economies may result through consolidation of "public company" functions such as director and shareholder meetings, annual reports and Securities and Exchange Commission ("SEC") filing requirements.

The New England Mergers will be entirely transparent to Southern Union's Florida customers served by SFNG and will not adversely affect SFNG's service to its customers. SFNG's customers will continue to experience quality day-to-day natural gas service at reasonable rates approved pursuant to SFNG's tariff on file with the Commission.

In addition to the reasons described above, the proposed issues are consistent with the proper performance by Southern Union of service as a public utility, will better enable Southern Union to perform that service, and are necessary and appropriate for such purpose and/or other corporate purposes.

8. Counsel Passing On Legality of the Proposed Issues

The counsel that will pass on the legality of the proposed issues is:

Fleischman and Walsh, L.L.P.
Suite 600
1400 Sixteenth Street, N.W.
Washington, D.C. 20036
Attention: Stephen A. Bouchard, Esq.

As to matters of Florida law, Fleishman and Walsh, L.L.P. will rely on

Holland & Knight LLP
P.O. Drawer 810
Tallahassee, Florida 32302.

9. Filings With Other State or Federal Regulatory Bodies

If required, a Registration Statement with respect to each public sale of securities hereunder subject to the Securities Act of 1933, as amended, will be filed with the SEC. In addition, certain state securities or "blue sky" laws may require the filing of consents to service of process or other documents with applicable state securities commissions.

10. Control or Ownership

There is no measure of control or ownership exercised by or over Southern Union by any other public utility.

11. Exhibits

Composite Exhibit "B" and Exhibit "C" are attached hereto as required by Rule 25-8.003, Florida Administrative Code. Composite Exhibit "B" consists of: (a) Southern Union's financial statements and accompanying footnotes as they appear in Southern Union's Annual Report on Form 10-K as filed with the SEC for the fiscal year ended June 30, 1999; and (b) Southern Union's financial statements and accompanying footnotes as they appear in Southern Union's most recent Quarterly Report on Form 10-Q (March 31, 2000), as filed with the SEC.

Exhibit "C" consists of Southern Union's sources and uses of funds forecast, including a construction budget. Exhibit "C" is filed under seal along with a Request for Confidential Classification. In addition, attached hereto as Exhibit "D" is a copy of the Agreement between Southern Union and PVY; attached hereto as Exhibit "E" is a copy of the Agreement between Southern Union and VR; and, attached hereto as Exhibit "F" is a copy of the Agreement between Southern Union and FRG.

WHEREFORE, Southern Union respectfully requests that the Commission:

(a) authorize Southern Union to issue and sell and/or exchange any combination of the long-term debt and equity securities described in this Application and/or to assume liabilities or obligations directly or as

guarantor, endorser, or surety in an aggregate amount not to exceed $1 billion and to borrow up to $300,000,000 for short-term financing purposes during the twelve month period from August 1, 2000 through July 31, 2001; and

(b) grant such other relief as the Commission deems appropriate.

Respectfully submitted this 5TH day of June, 2000.

D. Bruce May
Florida Bar No. 354473
Karen D. Walker
Florida Bar No. 0982921
HOLLAND & KNIGHT LLP
P.O. Drawer 810
315 South Calhoun Street, Suite 600
Tallahassee, Florida 32302 (32301)
(850) 224-7000
Attorneys for Southern Union Company

EXHIBIT A
Summary of New England Mergers

- **Providence Energy Corporation Merger.** On November 15, 1999, Southern Union, GUS Acquisition Corporation and Providence Energy Corporation ("PVY") entered into a definitive merger agreement. The merger calls for PVY to merge into Southern Union in a transaction valued at approximately $400 million, including the assumption of debt. PVY shareholders will receive $42.50 in cash for each of the approximately 6.1 million shares of PVY common stock outstanding. Under the merger agreement, GUS Acquisition Corporation, a direct wholly owned subsidiary of Southern Union will be merged into PVY. PVY will be the surviving corporation of this initial merger. Immediately after the initial merger, PVY will adopt an agreement and plan of merger pursuant to which North Attleboro Gas Company, a wholly owned utility subsidiary of PVY, will merge with and into PVY on the closing date, with PVY being the surviving corporation. Immediately following the consummation of the North Attleboro Gas Company merger, PVY will adopt an agreement and plan of merger pursuant to which Providence Gas Company (ProvGas), another wholly-owned utility subsidiary of PVY, will merge with and into PVY on the closing date with PVY being the surviving corporation. Immediately following the consummation of the ProvGas merger, Southern Union will adopt an agreement and plan of merger pursuant to which PVY will merge with and into Southern Union on the closing date, with Southern Union being the surviving corporation. PVY and North Attleboro Gas Company will become divisions of Southern Union.

- **Valley Resources, Inc. Merger.** On November 30, 1999, Southern Union, SUG Acquisition Corporation and Valley Resources, Inc. ("VR") entered into a definitive merger agreement. The agreement calls for VR to merge into Southern Union in a transaction valued at approximately $160 million, including the assumption of debt. VR shareholders will receive $25.00 in cash for each of the approximately 4.98 million shares of VR common stock outstanding. Under the merger agreement, SUG Acquisition Corporation, a wholly owned subsidiary of Southern Union, will merge into VR. VR will be the surviving corporation of this initial merger. Immediately after the initial merger, Valley Gas, a wholly owned utility subsidiary of VR, will merge into VR. Immediately after the consummation of the Valley Gas merger, Bristol and Warren Gas will merge into VR. After the subsidiary mergers, VR will be merged into Southern Union. Southern Union will continue as the surviving corporation and VR will become a division of Southern Union.

- **Fall River Gas Company Merger.** Fall River Gas Company ("FRG") is a Massachusetts corporation that provides natural gas distribution service to approximately 48,000 customers in southeastern Massachusetts. On October 4, 1999, Southern Union and FRG entered into an Agreement of Merger (the "Agreement") pursuant to which FRG and its utility subsidiaries will merge into Southern Union in a transaction valued at approximately $72 million, including the assumption of long-term indebtedness. For each share of FRG common stock, FRG stockholders will receive a combination of Southern Union common stock or cash valued at $23.50 per share of FRG common stock. The Agreement calls for at least 50 percent of the approximately 2.2 million outstanding shares of common stock of FRG to be converted into Southern Union common stock and up to the remaining 50 percent of FRG shares to be converted into cash. The number of shares received for each FRG share will depend on the average closing price of Southern Union's stock for a period of ten consecutive trading days ending on the third day before the transaction is completed, as explained in Article II of the Agreement. As of the Effective Time, as described in Article III of the Agreement, FRG will be merged with and into Southern Union, which will be the surviving corporation. Following the merger, FRG will become a division of Southern Union.

- All of the referenced mergers are conditioned upon, among other things, approvals or concurrence of various state and federal regulatory agencies, including the Commission's approval of this Application.

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

FORM 10-K

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

For the Fiscal Year Ended June 30, 1999

OR

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

Commission File No. 1-6407

SOUTHERN UNION COMPANY

(Exact name of registrant as specified in its charter)

Delaware	75-0571592
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
504 Lavaca Street, Eighth Floor Austin, Texas (Address of principal executive offices)	78701 (Zip Code)

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

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $1 per share	New York Stock Exchange

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

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant on August 31, 1999, was $371,256,150. The number of shares of the registrant's Common Stock outstanding on August 31, 1999 was 31,235,009.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Annual Report to Stockholders for the year ended June 30, 1999, are incorporated by reference in Parts II and IV.

Portions of the registrant's proxy statement for its annual meeting of stockholders to be held on October 19, 1999, are incorporated by reference into Part III.

PART I

ITEM 1. *Business.*

Introduction

Southern Union Company (*Southern Union* and together with its subsidiaries, the *Company*) was incorporated under the laws of the State of Delaware in 1932. Southern Union is one of the top 15 gas utilities in the United States, as measured by number of customers. The Company's principal line of business is the distribution of natural gas as a public utility through Southern Union Gas, Missouri Gas Energy and Atlantic Utilities, doing business as South Florida Natural Gas (SFNG), each of which is a division of Southern Union. Southern Union Gas, headquartered in Austin, Texas, serves 513,000 customers in Texas (including the cities of Austin, Brownsville, El Paso, Galveston, Harlingen, McAllen and Port Arthur). Missouri Gas Energy, headquartered in Kansas City, Missouri, serves 484,000 customers in central and western Missouri (including the cities of Kansas City, St. Joseph, Joplin and Monett). SFNG, headquartered in New Smyrna Beach, Florida, serves 4,400 customers in central Florida (including the cities of New Smyrna Beach, Edgewater and areas of Volusia County, Florida.) The diverse geographic area of the Company's natural gas distribution systems reduces the sensitivity of Southern Union's operations to weather risk and local economic conditions.

Subsidiaries of Southern Union have been established to support and expand natural gas sales and to capitalize on the Company's gas energy expertise. These subsidiaries market natural gas to end-users, operate natural gas pipeline systems, distribute propane and sell commercial gas air conditioning and other gas-fired engine-driven applications. By providing "one-stop shopping," the Company can serve its various customers' specific energy needs, which encompass substantially all of the natural gas distribution and sales businesses from natural gas sales to specialized energy consulting services. The Company distributes propane to 11,000 and 1,100 customers in Texas and Florida, respectively. Additionally, certain subsidiaries own or hold interests in real estate and other assets, which are primarily used in the Company's utility business. Central to all of the Company's present businesses and strategies is the sale and transportation of natural gas. See *Company Operations and Investments.*

The Company is a sales and market-driven energy company whose management is committed to achieving profitable growth of its utility businesses in an increasingly competitive business environment. Management's strategies for achieving these objectives principally consist of: (i) promoting new sales opportunities and markets for natural gas and propane; (ii) enhancing financial and operating performance; and (iii) expanding the Company through development of existing utility businesses and selective acquisition of new utility businesses. Management develops and continually evaluates these strategies and their implementation by applying their experience and expertise in analyzing the energy industry, technological advances, market opportunities and general business trends. Each of these strategies, as implemented throughout the Company's existing businesses, reflects the Company's commitment to its core gas utility business.

The Company has a goal of selected growth and expansion, primarily in the utilities industry. To that extent, the Company intends to consider, when appropriate, and if financially practicable to pursue, the acquisition of other utility distribution or transmission businesses. The nature and location of any such properties, the structure of any such acquisitions, and the method of financing any such expansion or growth will be determined by management and the Southern Union Board of Directors. See *Management's Discussion and Analysis of Results of Operations and Financial Condition (MD&A) – Cautionary Statement Regarding Forward-Looking Information* contained in the Company's Annual Report to Stockholders for the year ended June 30, 1999 (the *Annual Report*), portions of which are filed as Exhibit 13 hereto.

Acquisitions

On June 7, 1999, Southern Union and Pennsylvania Enterprises, Inc. (PEI) announced a definitive merger agreement. The agreement calls for PEI to merge into Southern Union in a transaction valued at approximately $500 million, including assumption of debt. If approved, each PEI shareholder will receive Southern Union common stock having a value of $32.00, plus $3.00 in cash, subject to adjustment. PEI is a multifaceted energy company headquartered in Wilkes-Barre, Pennsylvania with natural gas distribution being its primary business. PEI's principal subsidiary, PG Energy, together with Honesdale Gas Company serve more than 152,000 gas customers in

northeastern and central Pennsylvania. In addition, PEI markets electricity to more than 20,000 customers through PG Energy Power Plus. Southern Union anticipates having Southern Union and PEI shareholders approvals and all regulatory approvals for this merger in the second quarter of the Company's fiscal year 2000.

Effective December 31, 1997, Southern Union acquired Atlantic Utilities Corporation and Subsidiaries (Atlantic) for 755,650 pre-split and pre-stock dividend shares of common stock valued at $18,041,000 and cash of $4,436,000. Atlantic is operated as SFNG, a natural gas division of Southern Union, and Atlantic Gas Corporation, a propane subsidiary of the Company. Atlantic currently serves 4,400 natural gas customers and 1,100 propane customers in central Florida.

On July 23, 1997, two subsidiaries of Southern Union acquired an equity ownership in a natural gas distribution company and other related operations in Piedras Negras, Mexico for $2,700,000. Southern Union currently has a 43% equity ownership in this company. The natural gas distribution company currently serves 19,500 customers and is across the border from the Company's Eagle Pass, Texas service area. On September 8, 1997, the Company purchased a 45-mile intrastate pipeline, which augments the Company's gas supply to the city of Eagle Pass and, subject to necessary regulatory approvals, ultimately Piedras Negras.

Company Operations and Investments

The Company's principal line of business is the distribution of natural gas through its Southern Union Gas, Missouri Gas Energy and SFNG divisions. Southern Union Gas provides service to a number of communities and rural areas in Texas, including the municipalities of Austin, Brownsville, El Paso, Galveston, Harlingen, McAllen and Port Arthur. Missouri Gas Energy provides service to various cities and communities in central and western Missouri including Kansas City, St. Joseph, Joplin and Monett. SFNG provides service to various cities and communities in central Florida including New Smyrna Beach and Edgewater. The Company's gas utility operations are generally seasonal in nature, with a significant percentage of its annual revenues and earnings occurring in the traditional winter heating season.

Southern Union Energy International, Inc. (SUEI) and Southern Union International Investments, Inc. (Investments), both wholly-owned subsidiaries of Southern Union, participate in energy-related projects internationally. Energía Estrella del Sur, S. A. de C. V. (Estrella), a wholly-owned Mexican subsidiary of SUEI and Investments, seeks to participate in energy-related projects in Mexico. Estrella has a 43% equity ownership in a natural gas distribution company, along with other related operations, which currently serves 19,500 customers in Piedras Negras, Mexico, across the border from Southern Union Gas' Eagle Pass, Texas service area.

Mercado Gas Services Inc. (Mercado), a wholly-owned subsidiary of Southern Union, markets natural gas to approximately 240 commercial and industrial customers. Mercado's sales and purchasing activities are made through short-term and long-term contracts. These contracts and business activities are not subject to direct rate regulation. Mercado had gas sales of 19,304 MMcf and 18,352 MMcf for the year ended June 30, 1999 and 1998, respectively.

Southern Transmission Company (Southern), a wholly-owned subsidiary of Southern Union, owns and operates intrastate pipelines which connect the cities of Lockhart, Luling, Cuero, Shiner, Yoakum, and Gonzales, Texas, as well as a line that provides gas to an industrial customer in Port Arthur, Texas. Southern also owns a transmission line which supplies gas to the community of Sabine Pass, Texas. On September 8, 1997, Southern purchased a 45-mile intrastate pipeline which augments gas supply to the city of Eagle Pass, Texas, and ultimately into Piedras Negras, Mexico. Southern transported 873 MMcf and 915 MMcf of gas for the year ended June 30, 1999 and 1998, respectively.

Norteño Pipeline Company (Norteño), a wholly-owned subsidiary of Southern Union, operates interstate pipeline systems principally serving the Company's gas distribution properties in the El Paso, Texas area. Norteño transported a combined 6.3 billion cubic feet (Bcf) for the city of Juarez, Mexico and the Samalayuca Power Plant in north Mexico in fiscal 1999. Norteño transported 6,377 MMcf and 11,538 MMcf of gas for the year ended June 30, 1999 and 1998, respectively.

SUPro Energy Company (SUPro), a wholly-owned subsidiary of Southern Union, provides propane gas services to 11,000 customers located principally in El Paso and Alpine, Texas and Las Cruces, New Mexico and surrounding communities. SUPro sold 5,945,000 and 5,125,000 gallons of propane for the year ended June 30, 1999 and 1998, respectively.

Atlantic Gas Corporation, a wholly-owned subsidiary of Southern Union, provides propane gas services to 1,100 customers located in and around the communities of New Symma Beach, Lauderhill and Dunnellon, Florida. Atlantic Gas Corporation sold 1,348,000 gallons of propane during the twelve months ended June 30, 1999 and 633,000 gallons of propane during the six months ended June 30, 1998.

Energy WorX, a wholly-owned subsidiary of Southern Union, provides interactive computer-based training for the natural gas transmission and distribution industry.

Southern Union Total Energy Systems, Inc., a wholly-owned subsidiary of Southern Union, markets and sells commercial gas air conditioning, irrigation pumps and other gas-fired engine-driven applications and related services.

ConTigo, Inc., a wholly-owned subsidiary of Southern Union formed in January 1996, provides centralized call center services for the majority of the Texas service areas. Effective July 1, 1999, ConTigo was dissolved and became part of Southern Union Gas and will henceforth be operated as Southern Union Gas Customer Service.

During fiscal 1998 and 1999, the Company made equity investments in a leading developer of advanced gas turbine-driven generator technology and a developer of a mobile workforce management system. The Company also holds investments in commercially developed real estate in Austin, El Paso, Harlingen and Kansas City through Southern Union's wholly-owned subsidiary, Lavaca Realty Company (Lavaca Realty).

Competition

The Company's gas distribution divisions are not currently in significant direct competition with any other distributors of natural gas to residential and small commercial customers within their service areas. However, in recent years, certain large volume customers, primarily industrial and significant commercial customers, have had opportunities to access alternative natural gas supplies and, in some instances, delivery service from other pipeline systems. The Company has offered transportation arrangements to customers who secure their own gas supplies. These transportation arrangements, coupled with the efforts of Southern Union's unregulated marketing subsidiary, Mercado, enable the Company to provide competitively priced gas service to these large volume customers. In addition, the Company has successfully used flexible rate provisions, when needed, to retain customers who may have access to alternative energy sources.

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

Competition between the use of fuel oils, natural gas and propane, particularly by industrial, electric generation and agricultural customers, has also increased due to the volatility of natural gas prices and increased marketing efforts from various energy companies. While competition between such fuels is generally more intense outside the Company's service areas, this competition affects the nationwide market for natural gas. Additionally, the general economic conditions in its service areas continue to affect certain customers and market areas, thus impacting the results of the Company's operations.

Gas Supply

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

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

The majority of Southern Union Gas' 1999 gas requirements for utility operations were delivered under long-term transportation contracts through four major pipeline companies. The majority of Missouri Gas Energy's 1999 gas requirements were delivered under short- and long-term transportation contracts through four major pipeline companies. The majority of SFNG's 1999 gas requirements were delivered under a management supply contract through one major pipeline company. These contracts have various expiration dates ranging from calendar year 2000 through 2018. Southern Union Gas also purchases significant volumes of gas under long- and short-term arrangements with suppliers. The amounts of such short-term purchases are contingent upon price. Southern Union Gas, Missouri Gas Energy and SFNG all have firm supply commitments for all areas that are supplied with gas purchased under short-term arrangements. Missouri Gas Energy also holds contract rights to over 16 Bcf of storage capacity to assist in meeting peak demands.

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

The Company is committed under various agreements to purchase certain quantities of gas in the future. At June 30, 1999, the Company has purchase commitments for certain quantities of gas at variable, market-based prices that have an annual value of $94,275,000. The Company's purchase commitments may extend over a period of several years depending upon when the required quantity is purchased. The Company has purchase gas tariffs in effect for all its utility service areas that provide for recovery of its purchase gas costs under defined methodologies.

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

The MPSC approved a three year, experimental gas supply incentive plan for Missouri Gas Energy effective July 1, 1996. Under the plan, the Company and Missouri Gas Energy's customers share in certain savings below benchmark levels of gas costs achieved as a result of the Company's gas procurement activities. Likewise, if natural gas is acquired above benchmark levels, both the Company and customers share in such costs. For the years ended June 30, 1999, 1998 and 1997, the incentive plan achieved a reduction of overall gas costs of $6,900,000, $9,200,000 and $10,200,000, respectively, resulting in savings to Missouri customers of $4,000,000, $5,100,000 and $5,600,000, respectively. The Company recorded revenues of $2,900,000, $4,100,000 and $4,600,000 in 1999, 1998 and 1997, respectively, under this plan. Missouri Gas Energy is currently working with the MPSC to develop an alternate plan due to the July 1, 1999 expiration of the experimental gas supply incentive plan, however, there can be no assurance that this or any similar plan will be approved by the MPSC for Missouri Gas Energy.

Utility Regulation and Rates

The Company's rates and operations are subject to regulation by local, state and federal authorities. In Texas, municipalities have primary jurisdiction over natural gas rates within their respective incorporated areas. Rates in adjacent environs and appellate matters are the responsibility of the Railroad Commission of Texas (RRC). In Missouri, natural gas rates are established by the MPSC on a system-wide basis. In Florida, natural gas rates are

established by the Florida Public Service Commission on a system-wide basis. The FERC and the RRC have jurisdiction over rates, facilities and services of Norteño and Southern, respectively.

The Company holds non-exclusive franchises with varying expiration dates in all incorporated communities where it is necessary to carry on its business as it is now being conducted. Kansas City, Missouri; El Paso, Texas; Austin, Texas; Port Arthur, Texas; and St. Joseph, Missouri are the five largest cities in which the Company's utility customers are located. The Kansas City, Missouri franchise expired in May 1998. The Company is currently in franchise renewal negotiations with Kansas City and expects to obtain renewal of such franchise before the end of calendar year 1999. The franchises in the following cities expire as follows: El Paso, Texas in 2000, in which the Company is currently in discussions; Austin, Texas in 2006; and Port Arthur, Texas in 2013. The Company fully expects these franchises to be renewed upon their expiration. The franchise in St. Joseph, Missouri is perpetual.

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

The Company must support any service rate changes to its regulators using a historic test year of operating results adjusted to normal conditions and for any known and measurable revenue or expense changes. Because the regulatory process has certain inherent time delays, rate orders may not reflect the operating costs at the time new rates are put into effect.

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

On August 21, 1998, Missouri Gas Energy was notified by the MPSC of its decision to grant a $13,300,000 annual increase to revenue effective on September 2, 1998, which is primarily earned volumetrically. The MPSC rate order reflected a 10.93% return on common equity. The rate order, however, disallowed certain previously recorded deferred costs requiring a non-cash write-off of $2,221,000. Generally accepted accounting principles required the Company to immediately record this charge to earnings which Southern Union did as of June 30, 1998. On December 8, 1998, the MPSC denied rehearing requests made by all parties other than Missouri Gas Energy and granted a portion of Missouri Gas Energy's rehearing request. The MPSC will conduct further proceedings to take additional evidence on those matters for which it granted Missouri Gas Energy a rehearing. If the MPSC adopts Missouri Gas Energy's positions on rehearing, then Missouri Gas Energy would be authorized an additional $2,200,000 of base revenues increasing the $13,300,000 initially authorized in its August 21, 1998 order to $15,500,000. The MPSC's orders may be subject to judicial review and although certain parties may argue for a reduction in Missouri Gas Energy's authorized base revenue increase on judicial review, Missouri Gas Energy expects such arguments to be unsuccessful.

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

On January 22, 1997, Missouri Gas Energy was notified by the MPSC of its decision to grant an $8,847,000 annual increase to revenue effective on February 1, 1997. Pursuant to a 1989 MPSC order, Missouri Gas Energy is engaged in a major gas safety program in its service area (Missouri Safety Program). In connection with this program, the MPSC issued an accounting authority order (AAO) in Case No. GO-92-234 in 1994 which authorized Missouri Gas Energy to defer depreciation expenses, property taxes and carrying costs at a rate of 10.54% on the costs incurred in the Missouri Safety Program. This AAO was consistent with those which were issued by the MPSC

from 1990 to 1993 to Missouri Gas Energy's prior owner. The MPSC rate order of January 22, 1997, however, retroactively reduced the carrying cost rate applied by the Company on the expenditures incurred on the Missouri Safety Program since early 1994 to an Allowance for Funds Used During Construction (AFUDC) rate of approximately 6%. The Company filed an appeal of that portion of the rate order in the Missouri State Court of Appeals, Western District. On August 18, 1998, the Missouri State Court of Appeals denied the Company's appeal resulting in a one-time non-cash write-off of $5,942,000 of previously recorded deferred costs which was recorded as of June 30, 1998. The Company believes that the inconsistent treatment by the MPSC in subsequently changing to the AFUDC rate from the previously ordered 10.54% rate constitutes retroactive ratemaking. Unfortunately, the decision by the Missouri State Court of Appeals failed to address certain specific language within the 1994 AAO that the Company believed prevented the MPSC from retroactively changing the carrying cost rate. Southern Union requested transfer to the Missouri Supreme Court, but was denied that request.

On September 18, 1997, the MPSC approved a global settlement among the Company, the Missouri Office of Public Counsel (OPC) and MPSC staff to resolve complaints brought by the OPC and the MPSC staff regarding billing errors during the 1995/1996 and 1996/1997 winter heating seasons. The settlement called for credits to gas bills by Missouri Gas Energy totaling $1,575,000 to those customers overbilled and a $550,000 contribution by Missouri Gas Energy to a social service organization for the express purpose of assisting needy Missouri Gas Energy customers in paying their gas bills. These balances were recorded as of June 30, 1997.

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

During the three-year period ended June 30, 1999, the Company did not file for any other rate increases in any of its major service areas, although several annual cost of service adjustments were filed.

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

Environmental

The Company assumed responsibility for certain environmental matters in connection with the acquisition of Missouri Gas Energy. Additionally, the Company is investigating the possibility that the Company or predecessor companies may have been associated with manufactured gas plant sites in other of its former service territories, principally in Arizona and New Mexico, and present service territories in Texas. See *MD&A -- Cautionary Statement Regarding Forward-Looking Information* and *Commitments and Contingencies* in the Notes to the Consolidated Financial Statements contained in the Annual Report.

Investments in Real Estate

Lavaca Realty owns a commercially developed tract of land in the central business district of Austin, Texas, containing a combined 11-story office building, parking garage and drive-through bank (Lavaca Plaza). Approximately 52% of the office space at Lavaca Plaza is used in the Company's business while the remainder is leased to non-affiliated entities. Lavaca Realty also owns a two-story office building in El Paso, Texas as well as a one-story office building in Harlingen, Texas. Other significant real estate investments held at June 30, 1999 include 39,341 square feet of undeveloped land in McAllen, Texas and 25,000 square feet of improved property in Kansas City, Missouri, of which 40% is occupied by Missouri Gas Energy and the remainder by a non-affiliated entity.

Employees

As of July 31, 1999, the Company had 1,563 employees, of whom 1,220 are paid on an hourly basis and 343 are paid on a salary basis. Of the 1,220 hourly paid employees, 45% are represented by unions. Of those employees represented by unions, 95% are employed by Missouri Gas Energy. In December 1998, the Company agreed to five-year contracts with each bargaining-unit representing Missouri employees, which were effective in May 1999.

On June 4, 1997, Southern Union Gas employees in Austin, Texas covered by a collective bargaining agreement voted to decertify their representing union. Additionally, effective May 1, 1998, employees in Galveston, Texas chose to withdraw their membership from their representing union.

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

Statistics of Principal Utility and Related Operations

The following table shows certain operating statistics of the Company's gas distribution divisions with operations in Texas and Missouri:

	Year Ended June 30,		
	1999	1998	1997
Southern Union Gas:			
Average number of gas sales customers served:			
Residential	473,563	465,844	456,972
Commercial	30,847	29,828	29,030
Industrial and irrigation	258	252	274
Public authorities and other	2,849	2,755	2,673
Total average customers served	507,517	498,679	488,949
Gas sales in millions of cubic feet (MMcf):			
Residential	19,553	23,217	23,135
Commercial	8,539	9,425	9,759
Industrial and irrigation	1,082	1,208	1,562
Public authorities and other	2,266	2,752	2,756
Gas sales billed	31,440	36,602	37,212
Net change in unbilled gas sales	175	(82)	(70)
Total gas sales	31,615	36,520	37,142
Weather:			
Degree days (a)	1,576	2,118	1,962
Percent of 30-year measure (b)	74%	99%	92%
Gas transported in MMcf	16,668	16,535	15,118
Missouri Gas Energy:			
Average number of gas sales customers served:			
Residential	418,266	413,703	407,505
Commercial	57,247	57,693	56,967
Industrial	313	312	312
Total average customers served	475,826	471,708	464,784
Gas sales in MMcf:			
Residential	36,578	41,104	45,074
Commercial	16,842	18,705	20,893
Industrial	375	400	490
Gas sales billed	53,795	60,209	66,457
Net change in unbilled gas sales	204	35	(88)
Total gas sales	53,999	60,244	66,369
Weather:			
Degree days (a)	4,438	4,723	5,506
Percent of 30-year measure (b)	85%	90%	105%
Gas transported in MMcf	31,774	30,165	29,638

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

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

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

	Gas Utility Customers as of June 30,		
	1999	1998	1997
Southern Union Gas:			
Austin and other central and south Texas communities	175,596	173,228	163,938
El Paso and other west Texas communities	182,516	178,812	173,825
Galveston and Port Arthur	50,543	50,673	50,856
Panhandle and north Texas communities	24,728	24,900	24,903
Rio Grande Valley communities and Eagle Pass	75,983	76,840	76,704
	509,366	504,453	490,226
Missouri Gas Energy:			
Kansas City, Missouri Metropolitan Area	354,189	348,543	346,060
St. Joseph, Joplin, Monett and others	122,883	121,766	122,946
	477,072	470,309	469,006
Other (a)	24,947	20,874	3,647
Total	1,011,385	995,636	962,879

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

ITEM 2. *Properties.*

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

Southern Union Gas has 7,898 miles of mains, 4,305 miles of service lines and 218 miles of transmission lines. Southern and Nortefio have 171 miles and 7 miles, respectively, of transmission lines. Missouri Gas Energy has 7,441 miles of mains, 4,972 miles of service lines and 47 miles of transmission lines. SFNG has 135 miles of mains and 80 miles of service lines. The Company considers its systems to be in good condition and well-maintained, and it has continuing replacement programs based on historical performance and system surveillance.

ITEM 3. *Legal Proceedings.*

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

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

There were no matters submitted to a vote of security holders of Southern Union during the quarter ended June 30, 1999.

PART II

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

Market Information

Southern Union's common stock is traded on the New York Stock Exchange under the symbol "SUG". The high and low sales prices (adjusted for any stock dividends and stock splits) for shares of Southern Union common stock since July 1, 1997 are set forth below:

	$/Share	
	High	Low
July 1 to August 31, 1999	$ 21.31	$ 18.25
(Quarter Ended)		
June 30, 1999	21.79	17.62
March 31, 1999	23.21	16.55
December 31, 1998	23.33	17.63
September 30, 1998	20.30	14.17
(Quarter Ended)		
June 30, 1998	19.73	14.43
March 31, 1998	14.97	13.84
December 31, 1997	15.61	13.10
September 30, 1997	14.11	12.53

Holders

As of August 31, 1999, there were 1,142 holders of record of Southern Union's common stock. This number does not include persons whose shares are held of record by a bank, brokerage house or clearing agency, but does include any such bank, brokerage house or clearing agency that is a holder of record.

There were 31,235,009 shares of Southern Union's common stock outstanding on August 31, 1999 of which 17,731,637 shares were held by non-affiliates (i.e., not beneficially held by directors, executive officers, their immediate family members, or holders of 10% or more of shares outstanding).

Dividends

Southern Union's policy is to pay an annual stock dividend of approximately 5% and, therefore, the Company paid no cash dividends on its common stock during the last ten years ended June 30, 1999. Provisions in certain of Southern Union's long-term notes and its bank credit facilities limit the payment of cash or asset dividends on capital stock. Under the most restrictive provisions in effect, Southern Union may not declare or pay any cash or asset dividends on its common stock or acquire or retire any of Southern Union's common stock, unless no event of default exists and the Company meets certain financial ratio requirements, which presently are met.

On August 6, 1999, December 9, 1998 and December 10, 1997, the Company distributed its annual 5% common stock dividend to stockholders of record on July 23, 1999, November 23, 1998 and November 21, 1997, respectively. A portion of the 5% stock dividend distributed on August 6, 1999 and December 9, 1998 was characterized as a distribution of capital due to the level of the Company's retained earnings available for distribution as of the declaration date. The 5% stock dividends are consistent with Southern Union's Board of Directors' February 1994 decision to commence regular stock dividends of approximately 5% annually. The specific amount and declaration, record and distribution dates for an annual stock dividend will be determined by the Board and announced at a date that is not expected to be later than the annual stockholders meeting each year. Traditionally, Southern Union has declared its stock dividend so as to coincide with its annual shareholder meeting in November. In 1999, and in the future, the Company expects to declare and pay its stock dividend prior to the distribution of its annual report to shareholders, so that the Company's year-end reporting will reflect the effect of the annual stock dividend.

On July 13, 1998, Southern Union effected a 3-for-2 stock split by distributing a 50% stock dividend to holders of record on June 30, 1998.

ITEM 6. ***Selected Financial Data.***

	Year Ended June 30,				
	1999(a)(b)	1998(a)(b)	1997(a)	1996(a)	1995
	(dollars in thousands, except per share amounts)				
Total operating revenues	$ 605,231	$ 669,304	$ 717,031	$ 620,391	$ 479,983
Earnings from continuing operations (c)	10,445	12,229	19,032	20,839	16,069
Earnings per common and common share equivalents (d)	.32	.39	.62	.68	.54
Total assets	1,087,348	1,047,764	990,403	964,460	992,597
Common stockholders' equity	301,058	296,834	267,462	245,915	225,664
Short-term debt and capital lease obligation	2,066	1,777	687	615	770
Long-term debt and capital lease obligation, excluding current portion	390,931	406,407	386,157	385,394	462,503
Company-obligated mandatorily redeemable preferred securities of subsidiary trust	100,000	100,000	100,000	100,000	100,000
Average customers served	998,476	979,186	955,838	952,934	947,691

(a) Certain Texas and Oklahoma Panhandle distribution operations and Western Gas Interstate, exclusive of the Del Norte interconnect, were sold on May 1, 1996.

(b) On December 31, 1997, Southern Union acquired Atlantic for 755,650 pre-split and pre-stock dividend shares of common stock valued at $18,041,000 and cash of $4,436,000.

(c) As of June 30, 1998, Missouri Gas Energy wrote off $8,163,000 pre-tax in previously recorded regulatory assets as a result of announced rate orders and court rulings.

(d) Earnings per share for all periods presented were computed based on the weighted average number of shares of common stock and common stock equivalents outstanding during the year adjusted for (i) the 5% stock dividends distributed on August 6, 1999, December 9, 1998, December 10, 1997, December 10, 1996 and November 27, 1995, and (ii) the 50% stock dividend distributed on July 13, 1998, and the 33⅓% stock dividend distributed on March 11, 1996.

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

"Management's Discussion and Analysis of Results of Operations and Financial Condition" on pages 28 through 38 of the Company's Annual Report to Stockholders for the year ended June 30, 1999, is incorporated herein by reference.

ITEM 8. ***Financial Statements and Supplementary Data.***

The following consolidated financial statements of Southern Union and its consolidated subsidiaries, included in the Company's Annual Report to Stockholders for the year ended June 30, 1999 are incorporated herein by reference:

Consolidated statement of operations -- years ended June 30, 1999, 1998 and 1997.
Consolidated balance sheet -- June 30, 1999 and 1998.
Consolidated statement of cash flows -- years ended June 30, 1999, 1998 and 1997.
Consolidated statement of common stockholders' equity -- years ended June 30, 1999, 1998 and 1997.
Notes to consolidated financial statements.
Report of independent accountants.

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

None.

PART III

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

There is incorporated in this Item 10 by reference the information in the Company's definitive proxy statement for the 1999 Annual Meeting of Stockholders under the captions *Board of Directors -- Board Size and Composition* and *Executive Officers and Compensation -- Executive Officers Who Are Not Directors.*

ITEM 11. ***Executive Compensation.***

There is incorporated in this Item 11 by reference the information in the Company's definitive proxy statement for the 1999 Annual Meeting of Stockholders under the captions *Executive Officers and Compensation -- Executive Compensation* and *Certain Relationships*.

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

There is incorporated in this Item 12 by reference the information in the Company's definitive proxy statement for the 1999 Annual Meeting of Stockholders under the caption *Security Ownership.*

ITEM 13. ***Certain Relationships and Related Transactions.***

There is incorporated in this Item 13 by reference the information in the Company's definitive proxy statement for the 1999 Annual Meeting of Stockholders under the caption *Certain Relationships.*

PART IV

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

(a)(1) Financial Statements. The following consolidated financial statements of Southern Union and its consolidated subsidiaries, included in the Company's Annual Report to Stockholders for the year ended June 30, 1999, are incorporated by reference to Part II, Item 8:

Consolidated statement of operations -- years ended June 30, 1999, 1998 and 1997.

Consolidated balance sheet -- June 30, 1999 and 1998.

Consolidated statement of cash flows -- years ended June 30, 1999, 1998 and 1997.

Consolidated statement of common stockholders' equity -- years ended June 30, 1999, 1998 and 1997.

Notes to consolidated financial statements.

Report of independent accountants.

(a)(2) Financial Statement Schedules. All schedules are omitted as the required information is not applicable or the information is presented in the consolidated financial statements or related notes.

a)(3) Exhibits.

Exhibit No.	Description
3(a)	Restated Certificate of Incorporation of Southern Union Company. (Filed as Exhibit 3(a) to Southern Union's Transition Report on Form 10-K for the year ended June 30, 1994 and incorporated herein by reference.)

Exhibit No.	Description
3(b)	Southern Union Company Bylaws, as amended. (Filed as Exhibit 3(b) to Southern Union's Transition Report on Form 10-K for the year ended June 30, 1994 and incorporated herein by reference.)
4(a)	Specimen Common Stock Certificate. (Filed as Exhibit 4(a) to Southern Union's Annual Report on Form 10-K for the year ended December 31, 1989 and incorporated herein by reference.)
4(b)	Indenture between Chase Manhattan Bank, N.A., as trustee, and Southern Union Company dated January 31, 1994. (Filed as Exhibit 4.1 to Southern Union's Current Report on Form 8-K dated February 15, 1994 and incorporated herein by reference.)
4(c)	Officers' Certificate dated January 31, 1994 setting forth the terms of the 7.60% Senior Debt Securities due 2024. (Filed as Exhibit 4.2 to Southern Union's Current Report on Form 8-K dated February 15, 1994 and incorporated herein by reference.)
4(d)	Certificate of Trust of Southern Union Financing I. (Filed as Exhibit 4-A to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
4(e)	Certificate of Trust of Southern Union Financing II. (Filed as Exhibit 4-B to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
4(f)	Certificate of Trust of Southern Union Financing III. (Filed as Exhibit 4-C to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
4(g)	Form of Amended and Restated Declaration of Trust of Southern Union Financing I. (Filed as Exhibit 4-D to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
4(h)	Form of Subordinated Debt Securities Indenture among Southern Union Company and The Chase Manhattan Bank, N. A., as Trustee. (Filed as Exhibit 4-G to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
4(i)	Form of Supplemental Indenture to Subordinated Debt Securities Indenture with respect to the Subordinated Debt Securities issued in connection with the Southern Union Financing I Preferred Securities. (Filed as Exhibit 4-H to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
4(j)	Form of Southern Union Financing I Preferred Security (included in 4(g) above.) (Filed as Exhibit 4-I to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
4(k)	Form of Subordinated Debt Security (included in 4(i) above.) (Filed as Exhibit 4-J to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
4(l)	Form of Guarantee with respect to Southern Union Financing I Preferred Securities. (Filed as Exhibit 4-K to Southern Union's Registration Statement on Form S-3 (No. 33-58297) and incorporated herein by reference.)
4(m)	The Company is a party to other debt instruments, none of which authorizes the issuance of debt securities in an amount which exceeds 10% of the total assets of the Company. The Company hereby agrees to furnish a copy of any of these instruments to the Commission upon request.
10(a)	Revolving Credit Agreement (Long-Term Credit Facility) between Southern Union Company and the Banks named therein dated November 10, 1998. (Filed as Exhibit 10(a) to Southern Union's Quarterly Report on Form 10-Q for the quarter ended December 31, 1998 and incorporated herein by reference.)

Exhibit No.	Description
10(b)	Revolving Credit Agreement (Short-Term Credit Facility) between Southern Union Company and the Banks named therein dated November 10, 1998. (Filed as Exhibit 10(b) to Southern Union's Quarterly Report on Form 10-Q for the quarter ended December 31, 1998 and incorporated herein by reference.)
10(c)	Southern Union Company 1982 Incentive Stock Option Plan and form of related Stock Option Agreement. (Filed as Exhibits 4.1 and 4.2 to Form S-8, File No. 2-79612 and incorporated herein by reference.)(*)
10(d)	Form of Indemnification Agreement between Southern Union Company and each of the Directors of Southern Union Company. (Filed as Exhibit 10(i) to Southern Union's Annual Report on Form 10-K for the year ended December 31, 1986 and incorporated herein by reference.)
10(e)	Southern Union Company 1992 Long-Term Stock Incentive Plan, As Amended. (Filed as Exhibit 10(l) to Southern Union's Annual Report on Form 10-K for the year ended June 30, 1998 and incorporated herein by reference.)(*)
10(f)	Southern Union Company Director's Deferred Compensation Plan. (Filed as Exhibit 10(g) to Southern Union's Annual Report on Form 10-K for the year ended December 31, 1993 and incorporated herein by reference.)(*)
10(g)	Southern Union Company Amended Supplemental Deferred Compensation Plan with Amendments. (Filed as Exhibit 4 to Southern Union's Form S-8 filed March 27, 1999 and incorporated herein by reference.)(*)
10(h)	Form of warrant granted to Fleischman and Walsh L.L.P. (Filed as Exhibit 10(j) to Southern Union's Transition Report on Form 10-K for the year ended June 30, 1994 and incorporated herein by reference.)
10(i)	Renewal Promissory Note Agreement between Peter H. Kelley and Southern Union Company dated May 31, 1995. (Filed as Exhibit 10(i) to Southern Union's Annual Report on Form 10-K for the year ended June 30, 1995 and incorporated herein by reference.)
13	Portions of Company's Annual Report to Stockholders.
21	Subsidiaries of the Company.
23	Consent of Independent Accountants.
24	Power of Attorney.
27	Financial Data Schedule.

(*) Indicates a Management Compensation Plan.

(b) Reports on Form 8-K. Southern Union's Current Report on Form 8-K dated June 15, 1999 announcing the definitive merger agreement with Pennsylvania Enterprises, Inc.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Southern Union has duly caused this report to be signed by the undersigned, thereunto duly authorized, on September 10, 1999.

SOUTHERN UNION COMPANY

By PETER H. KELLEY
Peter H. Kelley
President and Chief Operating Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of Southern Union and in the capacities indicated as of September 10, 1999.

Signature/Name	Title
GEORGE L. LINDEMANN*	Chairman of the Board, Chief Executive Officer and Director
JOHN E. BRENNAN*	Director
FRANK W. DENIUS*	Director
AARON I. FLEISCHMAN*	Director
KURT A. GITTER, M.D.*	Director
PETER H. KELLEY Peter H. Kelley	Director
ADAM M. LINDEMANN*	Director
ROGER J. PEARSON*	Director
GEORGE ROUNTREE, III*	Director
DAN K. WASSONG*	Director
RONALD J. ENDRES Ronald J. Endres	Executive Vice President and Chief Financial Officer
DAVID J. KVAPIL David J. Kvapil	Senior Vice President and Corporate Controller (Principal Accounting Officer)

*By PETER H. KELLEY
Peter H. Kelley
Attorney-in-fact

INDEX TO EXHIBITS

Exhibit 13	Portions of Company's Annual Report to Stockholders
Exhibit 21	Subsidiaries of the Company
Exhibit 23	Consent of Independent Accountants
Exhibit 24	Power of Attorney
Exhibit 27	Financial Data Schedule

EXHIBIT 13

PORTIONS OF COMPANY'S ANNUAL REPORT TO STOCKHOLDERS

Management's Discussion and Analysis of Results of Operations and Financial Condition

Overview Southern Union Company's core business is the distribution of natural gas as a public utility through three divisions: Southern Union Gas, Missouri Gas Energy and Atlantic Utilities doing business as South Florida Natural Gas (SFNG). Southern Union Gas serves 513,000 customers in Texas (including the cities of Austin, Brownsville, El Paso, Galveston, Harlingen, McAllen and Port Arthur), Missouri Gas Energy serves 484,000 customers in central and western Missouri (including the cities of Kansas City, St. Joseph, Joplin and Monett) and SFNG, acquired as of December 31, 1997, serves 4,400 customers in portions of central Florida (including the cities of New Smyrna Beach, Edgewater and areas of Volusia County, Florida).

The Company also operates natural gas pipeline systems, markets natural gas to end-users, distributes propane and holds investments in real estate and other assets. To achieve profitability and continued growth, the Company continues to emphasize gas sales in nontraditional markets, operating efficiencies of existing systems, and expansion through selective acquisitions of new systems.

Results of Operations

Net Earnings Southern Union Company's 1999 (fiscal year ended June 30) net earnings were $10,445,000 ($.32 per common share, diluted for outstanding options and warrants -- hereafter referred to as *per share*), compared with $12,229,000 ($.39 per share) in 1998. The decrease was primarily due to the extremely warm winter of 1998/1999, which was experienced in all of the Company's service territories. Weather in the Southern Union Gas service territories during 1999 was 25% warmer than 1998 while gas sales volumes in the corresponding period decreased 13%. Weather in the Missouri service territories during 1999 was 6% warmer than 1998 while gas sales volumes in the corresponding period decreased 10%. A $13,300,000 annual rate increase, to be earned volumetrically, was granted by the MPSC to Missouri Gas Energy effective as of September 2, 1998. As a result of the volumetric nature of revenues and unusually warm weather, net earnings were only marginally impacted by the rate increase. The decrease in net earnings for 1999 is also attributed to $3,839,000 of pre-tax costs associated with various acquisition efforts, impacting per share earnings by $.07. Average common and common share equivalents outstanding increased 3.2% in 1999 due to the issuance of 755,650 pre-split and pre-stock dividend shares of the Company's common stock on December 31, 1997 in connection with the acquisition of Atlantic Utilities Corporation and Subsidiaries (Atlantic). The Company earned 3.5% on average common equity in 1999.

The Company's 1998 net earnings were $12,229,000 ($.39 per share), compared with $19,032,000 ($.62 per share) in 1997. The decrease was primarily due to the pre-tax write-off of previously recorded regulatory assets as ordered by the Missouri Public Service Commission (MPSC). On August 18, 1998, the Missouri Court of Appeals denied the previously disclosed appeal by the Company of the MPSC's January 1997 rate order granted to Missouri Gas Energy. Because of this decision, the Company recorded a one-time non-cash write-off of $5,942,000 of deferred costs recorded since 1994. On August 21, 1998, the MPSC also granted Missouri Gas Energy a rate increase which, among other things, disallowed certain previously recorded deferred costs requiring an additional pre-tax non-cash write-off of $2,221,000. Significantly warmer weather in the winter of 1997/1998, especially in Missouri, also contributed to the decrease in earnings, despite an $8,847,000 annual increase to Missouri Gas Energy revenues granted by the MPSC effective February 1, 1997. Weather in the Missouri service territories during 1998 was 14% warmer than 1997 while gas sales volumes in the corresponding period decreased 9%. Average common and common share equivalents outstanding increased 2.5% in 1998 due to the previously discussed issuance of the Company's common stock on December 31, 1997 in connection with the acquisition of Atlantic. The Company earned 4.3% and 7.4% on average common equity in 1998 and 1997, respectively.

Operating Revenues Operating revenues in 1999 decreased $64,073,000, or 10%, to $605,231,000, while gas purchase costs decreased $63,279,000, or 16%, to $342,301,000.

Operating revenues and gas purchase costs in 1999 were affected by both a reduction in gas sales volumes and decreases in the cost of gas. Gas sales volumes decreased 9% in 1999 to 105,156 MMcf due to the significantly warmer winter weather in the Missouri and Texas service territories. Gas sales volumes were also impacted by a

reduction in average usage per customer throughout the Company's service territories as a result of more energy efficient housing and appliances. The average cost of gas decreased $.26 to $3.23 per Mcf in 1999 due to decreases in average spot market gas prices throughout the Company's distribution system as a result of seasonal impacts on demands for natural gas and the ensuing competitive pricing within the industry. The average spot market price of natural gas decreased 16% to $1.88 per million British thermal units (MMBtu) in 1999. Additionally impacting operating revenues in 1999 was a $2,852,000 decrease in gross receipt taxes due to the mild weather in 1999. Gross receipt taxes are levied on sales revenues billed to the customers and remitted to the various taxing authorities. Operating revenues in 1999 compared with 1998 were also impacted by a $1,200,000 decrease in revenues under a gas supply incentive plan approved by the MPSC in July, 1996. Under the plan, Southern Union and its Missouri customers share in certain savings below benchmark levels of gas costs incurred as a result of the Company's gas procurement activities. Operating revenues were favorably impacted by the $13,300,000 annual increase to revenues granted to Missouri Gas Energy, effective as of September 2, 1998. However, as previously stated, the impact from this rate increase was marginal as it is earned volumetrically.

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

Gas transportation volumes in 1999 decreased 3,461 MMcf to 55,692 MMcf at an average transportation rate per Mcf of $.36 compared with $.33 in 1998. Transportation volumes increased from 30,165 MMcf to 31,774 MMcf in 1999 for Missouri Gas Energy and decreased from 28,988 MMcf to 23,918 MMcf in 1999 for Southern Union Gas and the Company's pipeline subsidiaries. This decrease was mainly caused by a 45% decrease, or 5,190 MMcf, in the amount of volumes transported into Mexico by Norteño Pipeline Company (Norteño), a subsidiary of the Company.

Operating revenues in 1998 compared with 1997 decreased $47,727,000, or 7%, to $669,304,000 while gas purchase costs decreased $43,608,000, or 10%, to $405,580,000.

Operating revenues and gas purchase costs in 1998 were affected by both a reduction in gas sales volumes and decreases in the cost of gas. Gas sales volumes decreased 6% in 1998 compared with 1997 to 115,261 MMcf due to the warmer winter weather in the Missouri service territories. Gas sales volumes were also impacted by a reduction in average usage per customer throughout the Company's service territories as a result of more energy efficient housing and appliances. The average cost of gas decreased $.18 to $3.49 per Mcf in 1998 due to decreases in average spot market gas prices throughout the Company's distribution system as a result of seasonal impacts on demands for natural gas and the ensuing competitive pricing within the industry. The average spot market price of natural gas decreased 3% to $2.24 per MMBtu in 1998. Additionally impacting operating revenues in 1998 was a $4,616,000 decrease in gross receipt taxes, a $2,104,000 decrease in gas transportation revenues at Missouri Gas Energy, and decreased revenues of $500,000 under the previously discussed gas supply incentive plan. Operating revenues were favorably impacted by an $8,847,000 annual increase to revenues granted by the MPSC effective as of February 1, 1997.

Gas transportation volumes in 1998 decreased 3,380 MMcf to 59,153 MMcf at an average transportation rate per Mcf of $.33 compared with $.34 in 1997. Transportation volumes increased from 29,638 MMcf to 30,165 MMcf in 1998 for Missouri Gas Energy and decreased from 32,895 MMcf to 28,988 MMcf in 1998 for Southern Union Gas and the Company's pipeline subsidiaries. This decrease was mainly caused by a 32% decrease, or 5,531 MMcf, in the amount of volumes transported into Mexico by Norteño.

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

Net Operating Margin Net operating margin in 1999 (operating revenues less gas purchase costs and revenue-related taxes) increased by $2,058,000, compared with an increase of $497,000, in 1998. Operating margins and earnings are primarily dependent upon gas sales volumes, gas service rates and timing of acquisitions. The level of gas sales volumes is sensitive to the variability of the weather. If normal weather had been present throughout

the Company's service territories in 1999 and 1998, net operating margin would have increased by approximately $20,334,000 and $8,443,000, respectively. Texas and Missouri accounted for 40% and 55%, respectively, of the Company's net operating margin in 1999 and 43% and 52%, respectively, in 1998.

Weather Weather in the Missouri Gas Energy service territories in 1999 was 85% of a 30-year measure, 6% warmer than in 1998. Weather in the Southern Union Gas service territories in 1999 was 74% of a 30-year measure, 25% warmer than in 1998. Weather in Missouri in 1998 was 90% of a 30-year measure, 14% warmer than in 1997, while weather in Texas in 1998 was 99% of a 30-year measure, 8% colder than in 1997.

Customers The average number of customers served in 1999, 1998 and 1997 was 998,476, 979,186 and 955,838, respectively. These customer totals exclude Southern Union's 43% equity ownership in a natural gas distribution company in Piedras Negras, Mexico which currently serves 19,500 customers. Southern Union Gas served 507,517 customers in Texas during 1999. Missouri Gas Energy served 475,826 customers in central and western Missouri during 1999. SFNG and Atlantic Gas Corporation, a propane subsidiary of the Company, served 4,160 and 953 customers, respectively, during 1999. SUPro Energy Company (SUPro), a subsidiary of the Company, served 9,785 propane customers during 1999.

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

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

Operating, maintenance and general expenses in 1998 decreased $2,361,000, or 2%, to $107,527,000. Included in this decrease was $5,637,000 in reduced bad debt expense due to a reduction in delinquent customer accounts in 1998 compared with 1997. The significant increase in natural gas prices during 1997 caused many customers to receive considerably higher heating bills. Partially offsetting this factor was an increase in reserves for litigation claims and settlements in 1998 compared with 1997.

Depreciation and amortization expense in 1998 increased $3,610,000 to $38,439,000 as a result of including certain costs into rate base that were previously deferred as provided in the Missouri Gas Energy revenue increase effective as of February 1, 1997 and normal growth in plant. Taxes other than on income and revenues increased $2,051,000 to $14,205,000 in 1998. The increase was primarily due to increases in property taxes resulting from the inclusion of certain plant assets pursuant to the Missouri Gas Energy Safety Program that were deferred prior to the February 1, 1997 revenue increase in Missouri.

Employees The Company employed 1,554, 1,594 and 1,595 individuals as of June 30, 1999, 1998, and 1997, respectively. After gas purchases and taxes, employee costs and related benefits are the Company's most significant expense. Such expense includes salaries, payroll and related taxes and employee benefits such as health, savings, retirement and educational assistance. In December 1998, the Company agreed to new five-year contracts with each bargaining-unit representing Missouri employees, which were effective in May 1999.

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

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

Total interest expense in 1998 increased by $1,419,000, or 4%, to $34,884,000. Interest expense on long-term debt and capital leases increased by $577,000 in 1998 primarily due to Missouri Gas Energy's capital lease obligation of $22,151,000 incurred in 1998 for the installation of the AMR system.

Interest expense on short-term debt in 1998 increased $566,000 to $2,399,000, due to the average short-term debt outstanding during 1998 increasing $9,333,000 to $39,105,000. The average rate of interest on short-term debt was 6.1% in both 1998 and 1997.

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

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

Other Income (Expense), Net Other expense, net, in 1999 was $1,814,000, compared to other income, net, of $4,073,000 in 1998. Other expense in 1999 included $3,839,000 of costs associated with various acquisition efforts and a net expense of $619,000 related to the amortization and current deferral of interest and other expenses associated with the Missouri Gas Energy Safety Program. This was partially offset by net rental income of Lavaca Realty Company (Lavaca Realty), the Company's real estate subsidiary, of $1,448,000 and equity earnings of $609,000 from Southern Union's 43% equity ownership of a natural gas distribution company in Piedras Negras, Mexico.

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

Other income in 1997 included $3,729,000 in deferral of interest and other expenses associated with the Missouri Gas Energy Safety Program; realized gains on the sale of investment securities of $2,545,000; and net rental income of Lavaca Realty of $1,329,000. This was partially offset by the payment of $2,125,000 for the settlement with the Missouri Office of Public Counsel (OPC) and the MPSC for certain billing errors primarily from the 1996/1997 winter heating season; costs of $1,750,000 associated with various acquisition efforts; and a $257,000 donation of emissions analysis equipment and software to a Texas university.

Federal and State Income Taxes Federal and state income tax expense in 1999, 1998, and 1997 was $7,109,000, $7,984,000 and $12,373,000, respectively. The decrease in income taxes during 1999 and 1998 was due to the decrease in pre-tax income, previously discussed.

Liquidity and Capital Resources

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

The Company's strategic plan is to increase the scale of its operations and the size of its customer base by pursuing and consummating future business combination transactions. The Company has entered into a merger agreement with Pennsylvania Enterprises, Inc. (PEI). See *"Other Matters -- Merger Agreement with Pennsylvania Enterprises, Inc."* Acquisitions may require substantial financial expenditures that will need to be financed through cash flow from operations or future debt and equity offerings. The availability and terms of any such financing sources will depend upon various factors and conditions such as the Company's combined cash flow and earnings, the Company's resulting capital structure, and conditions in financial markets at the time of such offerings. Acquisitions and financings will also affect the Company's combined results due to factors such as the Company's ability to realize any anticipated benefits from the PEI merger and any other acquisitions, successful integration of new and different operations and businesses, and effects of different regional economic and weather conditions. Future acquisitions may involve the issuance of shares of the Company's common stock, which could have a dilutive effect on the then-current stockholders of the Company. See *"Other Matters -- Cautionary Statement Regarding Forward-Looking Information."*

Despite the abnormally warm weather, cash flow from operating activities in 1999 increased by $8,596,000 to $76,853,000, and increased by $20,263,000 to $68,257,000 in 1998. Operating activities were impacted by a reduction in net earnings in 1999 and 1998, the non-cash write-off of previously recorded regulatory assets in 1998 discussed above, increased accounts receivable balances in 1997 due to increases in delinquent customer accounts discussed above, the timing of natural gas stored in inventory at Missouri Gas Energy and general changes in other operating accounts.

At June 30, 1999, 1998 and 1997, the Company's primary source of liquidity included borrowings available under the Company's credit facilities. A balance of $21,000,000 and $1,600,000 was outstanding under the credit facilities at June 30, 1999 and 1998, respectively. A balance of $17,900,000 was outstanding under the facilities at July 31, 1999.

Investing Activities Cash flow used in investing activities in 1999 increased by $15,575,000 to $81,209,000, and increased by $11,619,000 to $65,634,000 in 1998. Investing activity cash flow was primarily affected by additions to property, plant and equipment, acquisition of operations and sales and purchases of investment securities.

During 1999, 1998 and 1997, the Company expended $73,147,000, $77,018,000 and $64,463,000, respectively, for capital expenditures excluding acquisitions. These expenditures primarily related to distribution system replacement and expansion. Included in these capital expenditures were $17,951,000, $21,125,000 and $20,972,000 for the Missouri Gas Energy Safety Program in 1999, 1998 and 1997, respectively. Cash flow from operations has historically been utilized to finance capital expenditures and is expected to be the primary source for future capital expenditures.

On December 31, 1997, Southern Union acquired Atlantic for 755,650 pre-split and pre-stock dividend shares of common stock and $4,436,000 of cash. On the date of acquisition, Atlantic had $11,683,000 of cash and cash equivalents.

During 1999, the Company purchased investment securities of $7,000,000. During 1998, the Company purchased investment securities of $5,000,000 and had proceeds from the sale of investment securities of $6,531,000. During 1997, the Company purchased $5,363,000 in investment securities and had proceeds from the sale of investment securities of $13,327,000. As of June 30, 1999, the investment securities are accounted for under the cost method.

The Company completed the installation of an AMR system at Missouri Gas Energy during the first quarter of fiscal year 1999. The installation of the AMR system involved an investment of approximately $30,000,000 which is accounted for as a capital lease obligation. As of June 30, 1999, the capital lease obligation outstanding was $26,894,000.

Financing Activities Cash flow from financing activities was $4,356,000 in 1999. Cash flow used in financing activities was $2,623,000 in 1998, while cash flow from financing activities was $3,134,000 in 1997. Financing activity cash flow changes were primarily due to repayment of debt, net borrowings under the revolving credit facilities and changes in cash overdrafts. As a result of these financing transactions, the Company's total debt to total capital ratio at June 30, 1999 was 49.0%, compared with 50.6% and 51.2% at June 30, 1998 and 1997, respectively. The Company's effective debt cost rate under the current debt structure is 7.7% (which includes interest and the amortization of debt issuance costs and redemption premiums on refinanced debt).

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

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

The Company has availability under two revolving credit facilities (Revolving Credit Facilities) underwritten by a syndicate of banks. Of the Revolving Credit Facilities, $40,000,000 is available under a short-term facility which expires June 29, 2000, while $60,000,000 is available under a long-term facility which expires June 30, 2002. The Company has additional availability under uncommitted line of credit facilities (Uncommitted Facilities) with various banks. Covenants under the Revolving Credit Facilities allow for up to $35,000,000 of borrowings under Uncommitted Facilities at any one time. Borrowings under the facilities are available for Southern Union's working capital, letter of credit requirements and other general corporate purposes. The Revolving Credit Facility is subject to a commitment fee based on the rating of the Senior Notes. As of June 30, 1999, the commitment fee was an annualized .15% on the unused balance. The interest rate on borrowings on the Revolving Credit Facility is calculated based on a formula using the LIBOR or prime interest rates.

The Company had standby letters of credit outstanding of $1,622,000 at June 30, 1999 and $2,947,000 at June 30, 1998, which guarantee payment of various insurance premiums and state taxes.

Quantitative and Qualitative Disclosures About Market Risk

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

At June 30, 1999, the Company had issued fixed-rate long-term debt and Preferred Securities aggregating $466,103,000 in principal amount and having a fair value of $442,865,000. These instruments are fixed-rate and, therefore, do not expose the Company to the risk of earnings loss due to changes in market interest rates. However, the fair value of these instruments would increase by approximately $22,832,000 if interest and dividend rates were to decline by 10% from their levels at June 30, 1999. In general, such an increase in fair value would impact earnings and cash flows only if the Company were to reacquire all or a portion of these instruments in the open market prior to their maturity.

The Company's floating-rate obligations aggregated $21,003,000 at June 30, 1999 and primarily consisted of amounts borrowed under Revolving Credit Facilities of the Company. These floating-rate obligations expose the Company to the risk of increased interest expense in the event of increases in short-term interest rates. If the floating rates were to increase by 10% from June 30, 1999 levels, the Company's consolidated interest expense would increase by a total of approximately $14,000 each month in which such increase continued.

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

The change in exposure to loss in earnings and cash flow related to interest rate risk from June 30, 1998 to June 30, 1999 is not material to the Company.

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

Other Matters

Merger Agreement with Pennsylvania Enterprises, Inc. On June 7, 1999, Southern Union and Pennsylvania Enterprises, Inc. announced a definitive merger agreement. The agreement calls for PEI to merge into Southern Union in a transaction valued at approximately $500 million, including assumption of debt. If approved, each PEI shareholder will receive Southern Union common stock having a value of $32.00, plus $3.00 in cash, subject to adjustment. PEI is a multifaceted energy company headquartered in Wilkes-Barre, Pennsylvania with natural gas distribution being its primary business. PEI's principal subsidiary, PG Energy, together with Honesdale Gas Company serve more than 152,000 gas customers in northeastern and central Pennsylvania. In addition, PEI markets electricity to more than 20,000 customers through PG Energy Power Plus. Southern Union anticipates having shareholder and all regulatory approvals for this merger in the second quarter of the Company's fiscal year 2000.

The amount of Southern Union common stock to be issued in connection with the PEI merger and cash to be paid to PEI's stockholders may vary as a result of fluctuations in the price of the Company's common stock. Management anticipates that substantially all of the cash portion of the merger consideration to be paid to PEI's stockholders under the merger agreement and other merger-related costs (approximately $35 to $55 million) will be financed through external sources. In addition, the Company anticipates refinancing substantially all of the current portion of outstanding long-term debt of PEI and its subsidiaries, and the preferred stock of a PEI subsidiary in connection with or soon after completion of the PEI merger. Sources of financing may include commercial and investment banks, institutional lenders and investors, and the public securities markets. Management believes that the Company will have access to many sources and types of short-term and long-term capital financing; however, the terms of such financing or refinancing arrangements may contain covenants that could adversely affect the financial condition and flexibility of the Company.

Propane Operations SUPro and Atlantic Gas Corporation currently serve 11,000 and 1,100 customers, respectively. These propane operations sold 7,293,000 and 5,758,000 gallons of propane during 1999 and 1998, respectively.

Foreign Operations On July 23, 1997, Energía Estrella del Sur, S. A. de C. V., a wholly-owned subsidiary of Southern Union Energy International, Inc. and Southern Union International Investments, Inc., both subsidiaries of the Company, acquired an equity ownership in a natural gas distribution company and other operations which currently serves 19,500 customers in Piedras Negras, Mexico, which is across the border from the Company's Eagle Pass, Texas service area. Southern Union currently has a 43% equity ownership in this company. On September 8, 1997, Southern Transmission Company, another subsidiary of the Company, purchased a 45-mile intrastate pipeline for $305,000 which augments the Company's gas supply to the city of Eagle Pass and, subject to necessary regulatory approvals, ultimately Piedras Negras. Financial results of these foreign operations did not have a significant impact on the Company's financial results during 1999 and 1998.

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

Contingencies The Company assumed responsibility for certain environmental matters in connection with the acquisition of Missouri Gas Energy. Additionally, the Company is investigating the possibility that the Company or predecessor companies may have been associated with Manufactured Gas Plant sites in other of its former service territories, principally in Arizona and New Mexico, and present service territories in Texas.

On February 1, 1999, Southern Union submitted a proposal to the Board of Directors of Southwest Gas Corporation (Southwest) to acquire all of Southwest's outstanding common stock for $32.00 per share. Southwest then had a pending merger agreement with ONEOK, Inc. (ONEOK) at $28.50 per share. On February 22, 1999, Southern Union and Southwest both publicly announced Southern Union's proposal, after the Southwest Board of Directors determined that Southern Union's proposal was a Superior Proposal (as defined in the Southwest merger agreement with ONEOK). At that time Southern Union entered into a Confidentiality and Standstill Agreement with Southwest

at Southwest's insistence. On April 25, 1999, Southwest's Board of Directors rejected Southern Union's $32.00 per share offer and accepted an amended offer of $30.00 per share from ONEOK. On April 27, 1999, Southern Union increased its offer to $33.50 per share and agreed to pay interest which, together with dividends, would provide Southwest shareholders with a 6% annual rate of return on its $33.50 offer, commencing February 15, 2000, until closing. According to public statements by Southwest, Southern Union's revised proposal has also been rejected by Southwest's Board of Directors.

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

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

On August 18, 1998, the Missouri State Court of Appeals, Western District, denied the Company's appeal of the February 1, 1997 rate order which retroactively reduced the carrying cost rate applied by the Company on expenditures incurred on the Missouri Gas Energy Safety Program. The Company believes that the inconsistent treatment by the MPSC in subsequently changing to the Allowance for Funds Used During Construction rate of approximately 6% from the previously ordered rate of 10.54% constitutes retroactive ratemaking. Unfortunately, the decision by the Missouri State Court of Appeals failed to address certain specific language within a 1994 MPSC accounting authority order that the Company believed prevented the MPSC from retroactively changing the carrying cost rate. Southern Union sought a transfer of the case to the Missouri Supreme Court which was denied on November 24, 1998.

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

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

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

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

On September 18, 1997, the MPSC approved a global settlement among the Company, the OPC and MPSC to resolve complaints brought by the OPC and the MPSC staff regarding billing errors during the 1995/1996 and

1996/1997 winter heating seasons. The settlement called for credits to gas bills by Missouri Gas Energy totaling $1,575,000 to those customers overbilled and a $550,000 contribution by Missouri Gas Energy to a social service organization for the express purpose of assisting needy Missouri Gas Energy customers in paying their gas bills. These balances were recorded as of June 30, 1997.

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

The MPSC approved a three-year, experimental gas supply incentive plan for Missouri Gas Energy effective July 1, 1996. Under the plan, the Company and Missouri Gas Energy's customers share in certain savings below benchmark levels of gas costs achieved as a result of the Company's gas procurement activities. Likewise, if natural gas is acquired above benchmark levels, both the Company and customers share in such costs. For the years ended June 30, 1999, 1998 and 1997, the incentive plan achieved a reduction of overall gas costs of $6,900,000, $9,200,000 and $10,200,000, respectively, resulting in savings to Missouri customers of $4,000,000, $5,100,000 and $5,600,000, respectively. The Company recorded revenues of $2,900,000, $4,100,000 and $4,600,000 in 1999, 1998 and 1997, respectively under this plan. Missouri Gas Energy is currently working with the MPSC to develop an alternate plan due to the July 1, 1999 expiration of the experimental gas supply incentive plan, however, there can be no assurance that this or any similar plan will be approved by the MPSC for Missouri Gas Energy.

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

On August 21, 1998, Missouri Gas Energy was notified by the MPSC of its decision to grant a $13,300,000 rate increase which also disallowed certain previously recorded deferred costs, in which Missouri Gas Energy requested a rehearing on significant portions of these disallowances. On December 8, 1998, the MPSC denied rehearing requests made by all parties other than Missouri Gas Energy and granted a portion of Missouri Gas Energy's rehearing request. The MPSC will conduct further proceedings to take additional evidence on those matters for which it granted Missouri Gas Energy a rehearing. If the MPSC adopts Missouri Gas Energy's positions on rehearing, then Missouri Gas Energy would be authorized an additional $2,200,000 of base revenues increasing the $13,300,000 initially authorized in its August 21, 1998 order to $15,500,000. The MPSC's orders may be subject to judicial review and although certain parties may argue for a reduction in Missouri Gas Energy's authorized base revenue increase on judicial review, Missouri Gas Energy expects such arguments to be unsuccessful.

On January 22, 1997, Missouri Gas Energy was notified by the MPSC of its decision to grant an $8,647,000 annual increase to revenue effective as of February 1, 1997. Southern Union Gas also received several annual cost of service adjustments in 1999, 1998 and 1997. See *Utility Regulation and Rates* and *Commitments and Contingencies* in the Notes to Consolidated Financial Statements.

Pursuant to a 1989 MPSC order, Missouri Gas Energy is engaged in a major gas safety program in its service territories. This program includes replacement of company- and customer-owned gas service and yard lines, the movement and resetting of meters, the replacement of cast iron mains and the replacement and cathodic protection of bare steel mains. In recognition of the significant capital expenditures associated with this safety program, the MPSC permits the deferral, and subsequent recovery through rates, of depreciation expense, property taxes and associated carrying costs. The continuation of the Missouri Gas Energy Safety Program will result in significant levels of future capital expenditures. The Company estimates incurring capital expenditures of $14,372,000 in fiscal 2000 related to this program which are expected to be financed through cash flow from operations. See *Utility Regulation and Rates* and *Commitments and Contingencies* in the Notes to Consolidated Financial Statements.

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

Year 2000 Similar to all business entities, the Company will be impacted by the inability of computer application software programs to distinguish between the year 1900 and 2000 due to a commonly-used programming convention. Unless such programs are modified or replaced prior to 2000, calculations and interpretations based on date-based arithmetic or logical operations performed by such programs may be incorrect.

Management's plan addressing the impact of the Year 2000 issue on the Company focuses on the following areas: application systems, process control systems (embedded chips), technology infrastructure, physical infrastructure, and third party business partners and suppliers with which the Company has significant relationships. Management's analysis and review of these areas is comprised primarily of five phases: developing an inventory of hardware, software and embedded chips; assessing the degree to which each area is currently Year 2000 ready; performing renovations and repairs as needed to attain Year 2000 readiness; testing to ensure Year 2000 readiness; and developing a contingency plan if repair and renovation efforts are either unsuccessful or untimely.

Management has completed the inventory, assessment and testing phases regarding application systems, process control systems and technology infrastructure, and is performing renovations and repairs in each of these categories. The Company's renovation and repair efforts are substantially complete. Validation and confirmation testing of affected areas will continue through calendar year 1999. The review of critical business partners, gas transporters and suppliers is in the assessment stage and the Company will continue to confirm the readiness of these third parties through calendar year 1999. Costs incurred to date have primarily consisted of labor from the redeployment of existing information technology, legal and operational resources. The Company has incurred costs to date on this project of approximately $2,000,000. The Company expects to spend approximately $6,500,000 for these Year 2000 readiness efforts. Included in this estimate are equipment leasing expenses of approximately $1,500,000 that will be incurred over the life of the equipment. Also included in this estimate are costs associated with contingency planning, software licensing and consulting expenses that will be incurred prior to the end of 1999. To the extent that such costs are incurred in Year 2000 readiness efforts, the Company will attempt recovery for such costs through regulatory relief.

During the past several years the Company has replaced most of its financial and operating software programs and Year 2000 testing has established that these programs are now Year 2000 ready. These new programs have significantly reduced the costs the Company expects to incur to become Year 2000 ready. Additionally, the Company has developed a contingency plan in the event that supplier or internal operational failures do occur and that plan is being implemented throughout the Company. The costs associated with this effort are being evaluated and cannot yet be determined. Although the Company does not presently anticipate a material business interruption as a result of the Year 2000, the worst case scenario if all of the Company's Year 2000 efforts failed, including the failure of third party providers to deliver services, could result in daily lost revenues of approximately $3,200,000. This estimate is based on historical revenues recognized in the months of January, February and March.

Accounting Pronouncements In June 1998, the Financial Accounting Standards Board issued *Accounting for Derivative Instruments and Hedging Activities,* as amended, is required to be adopted by the Company on July 1, 2000. The Statement permits early adoption as of the beginning of any fiscal quarter after its issuance. The Statement will require the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings. The Company has not yet determined what the effect of this statement will have on the earnings and financial position of the Company.

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

Cautionary Statement Regarding Forward-Looking Information This Management's Discussion and Analysis of Results of Operations and Financial Condition and other sections of this Annual Report on Form 10-K contain

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

Factors that could cause or contribute to actual results differing materially from such forward-looking statements include the following: cost of gas; gas sales volumes; weather conditions in the Company's service territories; the achievement of operating efficiencies and the purchases and implementation of new technologies for attaining such efficiencies; impact of relations with labor unions of bargaining-unit employees; the receipt of timely and adequate rate relief; the outcome of pending and future litigation; governmental regulations and proceedings affecting or involving the Company; the impact of any Year 2000 disruption; and the nature and impact of any extraordinary transactions such as any acquisition or divestiture of a business unit or any assets. These are representative of the factors that could affect the outcome of the forward-looking statements. In addition, such statements could be affected by general industry and market conditions, and general economic conditions, including interest rate fluctuations, federal, state and local laws and regulations affecting the retail gas industry or the energy industry generally, and other factors.

SOUTHERN UNION COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS

	Year Ended June 30,		
	1999	1998	1997
	(thousands of dollars, except shares and per share amounts)		
Operating revenues	$ 605,231	$ 669,304	$ 717,031
Gas purchase costs	342,301	405,580	449,188
Operating margin	262,930	263,724	267,843
Revenue related taxes	(32,034)	(34,886)	(39,502)
Net operating margin	230,896	228,838	228,341
Operating expenses:			
Operating, maintenance and general	109,693	107,527	109,888
Depreciation and amortization	41,855	38,439	34,829
Taxes, other than on income and revenues	14,501	14,205	12,154
Total operating expenses	166,049	160,171	156,871
Net operating revenues	64,847	68,667	71,470
Other income (expenses):			
Interest	(35,999)	(34,884)	(33,465)
Dividends on preferred securities of subsidiary trust	(9,480)	(9,480)	(9,480)
Write-off of regulatory assets	--	(8,163)	--
Other, net	(1,814)	4,073	2,880
Total other expenses, net	(47,293)	(48,454)	(40,065)
Earnings before income taxes	17,554	20,213	31,405
Federal and state income taxes	7,109	7,984	12,373
Net earnings available for common stock	$ 10,445	$ 12,229	$ 19,032
Net earnings per share:			
Basic	$ .34	$ .40	$ .64
Diluted	$ .32	$ .39	$ .62
Weighted average shares outstanding:			
Basic	30,894,613	30,406,832	29,641,523
Diluted	32,589,610	31,591,811	30,812,248

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

ASSETS

	June 30, 1999	June 30, 1998
	(thousands of dollars)	
Property, plant and equipment:		
Plant in service	$ 1,106,905	$1,057,675
Construction work in progress	13,271	7,783
	1,120,176	1,065,458
Less accumulated depreciation and amortization	(376,212)	(355,430)
	743,964	710,028
Additional purchase cost assigned to utility plant, net of accumulated amortization of $31,115,000 and $27,030,000, respectively	134,296	138,381
Net property, plant and equipment	878,260	848,409
Current assets:		
Accounts receivable, billed and unbilled, net	50,693	53,760
Inventories, principally at average cost	29,373	26,160
Prepayments and other	4,692	4,747
Total current assets	84,758	84,667
Deferred charges	96,635	94,550
Investment securities	12,000	5,000
Real estate	9,420	9,741
Other	6,275	5,397
Total assets	$ 1,087,348	$1,047,764

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET (Continued)

STOCKHOLDERS' EQUITY AND LIABILITIES

	June 30, 1999	June 30, 1998
	(thousands of dollars)	
Common stockholders' equity:		
Common stock, $1 par value; authorized 50,000,000 shares; issued 31,239,662 (including 1,484,988 shares issued on August 6, 1999 as a stock dividend) shares at June 30, 1999	$ 31,240	$ 28,252
Premium on capital stock	276,610	252,638
Less treasury stock: 51,625 shares at cost	(794)	(794)
Less common stock held in Trust: 268,513 shares	(5,562)	--
Accumulated other comprehensive income	(436)	--
Retained earnings	--	16,738
	301,058	296,834
Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated notes of Southern Union	100,000	100,000
Long-term debt and capital lease obligation	390,931	406,407
Total capitalization	791,989	803,241
Current liabilities:		
Long-term debt and capital lease obligation due within one year	2,066	1,777
Notes payable	21,003	1,600
Accounts payable	37,834	26,570
Federal, state and local taxes	13,300	14,017
Accrued interest	12,176	12,699
Customer deposits	17,682	17,686
Deferred gas purchases	22,955	12,257
Other	16,612	21,095
Total current liabilities	143,628	107,701
Deferred credits and other	81,493	74,217
Accumulated deferred income taxes	70,238	62,605
Commitments and contingencies	--	--
Total stockholders' equity and liabilities	$1,087,348	$1,047,764

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended June 30,		
	1999	1998	1997
	(thousands of dollars)		
Cash flows from operating activities:			
Net earnings	$ 10,445	$ 12,229	$ 19,032
Adjustments to reconcile net earnings to net cash flows from operating activities:			
Depreciation and amortization	41,855	38,439	34,829
Deferred income taxes	7,867	6,363	7,340
Provision for bad debts	3,279	5,461	11,298
Write-off of regulatory assets	--	8,163	--
Deferred interest expense	619	(1,671)	(3,729)
Gain on sale of investment securities	--	(1,088)	(2,545)
Other	1,004	1,447	1,077
Changes in assets and liabilities, net of acquisitions:			
Accounts receivable, billed and unbilled	(212)	132	(22,111)
Accounts payable	5,228	(7,066)	(6,978)
Taxes and other liabilities	(1,240)	146	(2,975)
Customer deposits	(4)	201	1,558
Deferred gas purchases	10,698	8,693	6,215
Inventories	(3,213)	(4,361)	5,691
Other	527	1,169	(708)
Net cash flows from operating activities	76,853	68,257	47,994
Cash flows from (used in) investing activities:			
Additions to property, plant and equipment	(73,147)	(77,018)	(64,463)
Acquisition of operations, net of cash received	--	6,502	(1,861)
Purchase of investment securities	(7,000)	(5,000)	(5,363)
Increase in customer advances	2,139	3,562	2,470
Increase (decrease) in deferred charges and credits	(4,086)	(1,786)	6
Proceeds from sale of land	--	--	1,096
Proceeds from sale of investment securities	--	6,531	13,327
Other	885	1,575	773
Net cash flows used in investing activities	(81,209)	(65,634)	(54,015)
Cash flows from (used in) financing activities:			
Repayment of debt and capital lease obligation	(20,837)	(1,309)	(640)
Net borrowings under revolving credit facilities	19,403	--	1,600
Increase (decrease) in cash overdrafts	6,033	(945)	1,567
Other	(243)	(369)	607
Net cash flows from (used in) financing activities	4,356	(2,623)	3,134
Decrease in cash and cash equivalents	--	--	(2,887)
Cash and cash equivalents at beginning of year	--	--	2,887
Cash and cash equivalents at end of year	$ --	$ --	$ --

Cash paid for interest, net of amounts capitalized, in 1999, 1998 and 1997 was $45,039,000, $33,997,000 and $32,282,000, respectively. Cash paid for income taxes in 1999, 1998 and 1997 was $1,194,000, $4,511,000 and $5,871,000, respectively.

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock, $1 Par Value	Premium on Capital Stock	Treasury Stock and Other	Accumulated Other Comprehen-sive Income	Retained Earnings	Total
			(thousands of dollars)			
Balance July 1, 1996	$16,275	$ 206,047	$ (794)	$ (1,244)	$ 25,631	$245,915
Comprehensive income:						
Net earnings	--	--	--	--	19,032	19,032
Unrealized holding gain, net of tax and reclassification adjustment	--	--	--	1,908	--	1,908
Comprehensive income						20,940
5% stock dividend	813	18,681	--	--	(19,494)	--
Exercise of stock options	83	524	--	--	--	607
Balance June 30, 1997	17,171	225,252	(794)	664	25,169	267,462
Comprehensive income:						
Net earnings	--	--	--	--	12,229	12,229
Reclassification adjustment for gains included in net income	--	--	--	(664)	--	(664)
Comprehensive income						11,565
5% stock dividend	856	19,802	--	--	(20,658)	--
Three-for-two stock split	9,400	(9,400)	--	--	(2)	(2)
Issuance of stock for acquisition	756	17,285	--	--	--	18,041
Exercise of stock options	69	(301)	--	--	--	(232)
Balance June 30, 1998	28,252	252,638	(794)	--	16,738	296,834
Comprehensive income:						
Net earnings	--	--	--	--	10,445	10,445
Minimum pension liability adjustment; net of tax	--	--	--	(436)	--	(436)
Comprehensive income						10,009
Common stock held in Trust	--	--	(5,562)	--	--	(5,562)
5% stock dividend -- declared November 11, 1998	1,411	7,483	--	--	(8,898)	(4)
5% stock dividend -- declared July 13, 1999	1,485	16,797	--	--	(18,285)	(3)
Exercise of stock options	92	(308)	--	--	--	(216)
Balance June 30, 1999	$31,240	$ 276,610	$(6,356)	$ (436)	$ --	$ 301,058

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

I Summary of Significant Accounting Policies

Operations Southern Union Company (*Southern Union* and, together with its wholly-owned subsidiaries, the *Company*), is a public utility primarily engaged in the distribution and sale of natural gas to residential, commercial and industrial customers located primarily in Texas and Missouri. Subsidiaries of Southern Union also market natural gas to end-users, distribute propane, operate natural gas pipeline systems and sell commercial gas air conditioning and other gas-fired engine-driven applications. Certain subsidiaries own or hold interests in real estate and other assets, which are primarily used in the Company's utility business. Substantial operations of the Company are subject to regulation.

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

Gas Utility Revenues and Gas Purchase Costs Gas utility customers are billed on a monthly-cycle basis. The related cost of gas and revenue taxes are matched with cycle-billed revenues through utilization of purchased gas adjustment provisions in tariffs approved by the regulatory agencies having jurisdiction. Revenues from gas delivered but not yet billed are accrued, along with the related gas purchase costs and revenue-related taxes. The distribution and sale of natural gas in Texas and Missouri contributed in excess of 85% of the Company's total revenue, net earnings and identifiable assets in 1999, 1998 and 1997. Four suppliers provided 50%, 45% and 44% of the Company's gas purchases in 1999, 1998 and 1997, respectively.

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

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

Unrealized holding gains on investment securities were nil, nil and $3,562,000 in 1999, 1998 and 1997, respectively. The reclassification adjustment for gains included in net income, net of tax, for reporting other comprehensive income was nil, $664,000 and $1,654,000 in 1999, 1998 and 1997, respectively. The unrealized holding gains on investment securities and the reclassification adjustment for gains are combined and reflected on the consolidated statement of stockholders' equity.

Credit Risk Concentrations of credit risk in trade receivables are limited due to the large customer base with relatively small individual account balances. In addition, Company policy requires a deposit from certain customers. The Company has recorded an allowance for doubtful accounts totaling $6,588,000, $8,267,000, $10,765,000 and $3,779,000 at June 30, 1999, 1998, 1997 and 1996, respectively. The allowance for doubtful accounts is increased for estimated uncollectible accounts and reduced for the write-off of trade receivables.

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

Inventories Inventories consist of natural gas in underground storage and materials and supplies. Natural gas in underground storage of $23,680,000 and $20,545,000 at June 30, 1999 and 1998, respectively, consists of 10,429,000 and 9,118,000 British thermal units, respectively.

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

New Pronouncements In June 1998, the Financial Accounting Standards Board issued *Accounting for Derivative Instruments and Hedging Activities*, as amended. The Statement is required to be adopted by the Company on July 1, 2000 with early adoption permitted as of the beginning of any fiscal quarter after its issuance. The Statement will require the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings. The Company has not yet determined what the effect of this statement will have on the earnings and financial position of the Company.

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

II Acquisitions

On June 7, 1999, Southern Union and Pennsylvania Enterprises, Inc. (PEI) announced a definitive merger agreement. The agreement calls for PEI to merge into Southern Union in a transaction valued at approximately $500 million, including assumption of debt of approximately $150 million. If approved, each PEI shareholder will receive Southern Union common stock having a value of $32.00, plus $3.00 in cash, subject to adjustment. PEI is a multifaceted energy company headquartered in Wilkes-Barre, Pennsylvania with natural gas distribution being its primary business. PEI's principal subsidiary, PG Energy, together with Honesdale Gas Company serve more than 152,000 gas customers in northeastern and central Pennsylvania. In addition, PEI markets electricity to more than 20,000 customers through PG Energy Power Plus. Southern Union anticipates having shareholder and all regulatory approvals for this merger in the second quarter of the Company's fiscal year 2000.

Effective December 31, 1997, the Company acquired Atlantic Utilities Corporation and Subsidiaries (Atlantic) for 755,650 pre-split and pre-stock dividend shares of common stock valued at $18,041,000 and $4,436,000 of cash. Atlantic is operated as South Florida Natural Gas, a natural gas division of Southern Union, and Atlantic Gas Corporation, a propane subsidiary of the Company. Atlantic currently serves 5,500 customers in central Florida. The assets of Atlantic were included in the Company's consolidated balance sheet at January 1, 1998 and its results of operations have been included in the Company's statements of consolidated operations and cash flows since January 1, 1998. On the date of acquisition, Atlantic had $11,683,000 of cash and cash equivalents. The acquisition was accounted for using the purchase method. The additional purchase cost assigned to utility plant of $10,000,000 reflects the excess of the purchase price over the historical book carrying value of the net assets acquired. The additional purchase cost is amortized on a straight-line basis over forty years.

On July 23, 1997 two subsidiaries of Southern Union acquired an equity ownership in a natural gas distribution company and other related operations currently serving 19,500 customers in Piedras Negras, Mexico for $2,700,000. Southern Union currently has a 43% equity ownership in this company. This system is across the border from the Company's Eagle Pass, Texas service area. On September 8, 1997, the Company purchased a 45-mile intrastate

pipeline, which augments the Company's gas supply to the city of Eagle Pass and, subject to necessary regulatory approvals, ultimately Piedras Negras.

On August 30, 1996, SUPro Energy Company, a wholly-owned subsidiary of the Company, purchased certain propane distribution operations in El Paso, Texas and on June 30, 1997, acquired propane operations located in and around Alpine, Texas. These acquisitions, which serve 3,600 customers, were for $1,861,000 in cash and the assumption of $1,475,000 in long-term debt.

III Write-Off of Regulatory Assets

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

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

IV Other Income (Expense), Net

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

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

Other income of $2,880,000 in 1997 included: $3,729,000 related to the deferral of interest and other expenses associated with the Missouri Gas Energy Safety Program; realized gains on the sale of investment securities of $2,545,000; and net rental income of Lavaca Realty, of $1,329,000. This was partially offset by the payment of $2,125,000 for the settlement with the Missouri Office of Public Counsel and the MPSC for certain billing errors primarily from the 1996/1997 winter heating season; costs of $1,750,000 associated with various acquisition efforts; and a $257,000 donation of emissions analysis equipment and software to a Texas university.

V Cash Flow Information

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Short-term investments are highly liquid investments with maturities of more than three months when purchased, and are carried at cost, which approximates market. The Company places its temporary cash

investments with a high credit quality financial institution which, in turn, invests the temporary funds in a variety of high-quality short-term financial securities.

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

VI Earnings Per Share

During the three-year period ended June 30, 1999, no adjustments were required in net earnings available for common stock for the earnings per share calculations. Average shares outstanding for basic earnings per share were 30,894,613, 30,406,832 and 29,641,523 for the years ended June 30, 1999, 1998 and 1997, respectively. Diluted earnings per share includes average shares outstanding as well as common stock equivalents from stock options and warrants. Common stock equivalents were 1,694,997, 1,184,979 and 1,170,725 for the years ended June 30, 1999, 1998 and 1997, respectively.

VII Property, Plant and Equipment

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

	June 30, 1999	June 30, 1998
Distribution plant	$ 1,033,281	$ 984,580
General plant	109,178	106,444
Other	16,648	16,172
Total plant	1,159,107	1,107,196
Less contributions in aid of construction	(52,202)	(49,521)
Plant in service	1,106,905	1,057,675
Construction work in progress	13,271	7,783
	1,120,176	1,065,458
Less accumulated depreciation and amortization	(376,212)	(355,430)
	743,964	710,028
Additional purchase cost assigned to utility plant, net	134,296	138,381
Net property, plant and equipment	$ 878,260	$ 848,409

Acquisitions of rate-regulated entities are recorded at the historical book carrying value of utility plant. On December 31, 1997, Atlantic was acquired in which historical utility plant and equipment had a cost and accumulated depreciation and amortization of $5,253,000 and $2,540,000, respectively. Additional purchase cost assigned to utility plant is the excess of the purchase price over the book carrying value of the net assets acquired. In general, the Company has not been allowed recovery of additional purchase cost assigned to utility plant in rates. Periodically, the Company evaluates the carrying value of its additional purchase cost assigned to utility plant, long-lived assets, capital leases and other identifiable intangibles by comparing the anticipated future operating income from the businesses giving rise to the respective asset with the original cost or unamortized balance. No impairment was indicated or expected at June 30, 1999.

Depreciation and Amortization Depreciation of utility plant is provided at an average straight-line rate of approximately 3% per annum of the cost of such depreciable properties less applicable salvage. Franchises are

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

Depreciation of property, plant and equipment in 1999, 1998, and 1997 was $37,771,000, $34,477,000 and $31,051,000, respectively.

VIII Investment Securities

At June 30, 1999 and 1998, all securities owned by the Company are accounted for under the cost method. These securities consist of preferred stock in non-public companies whose value is not readily determinable. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the Consolidated Statement of Operations when incurred, and dividends are recognized as income when received.

IX Stockholders' Equity

Stock Splits and Dividends On August 6, 1999, December 9, 1998, December 10, 1997 and December 10, 1996, Southern Union distributed its annual 5% common stock dividend to stockholders of record on July 23, 1999, November 23, 1998, November 21, 1997 and November 22, 1996, respectively. A portion of the 5% stock dividend distributed on August 6, 1999 and December 9, 1998 was characterized as a distribution of capital due to the level of the Company's retained earnings available for distribution as of the declaration date. On July 13, 1998, Southern Union distributed a three-for-two stock split in the form of a 50% stock dividend to stockholders of record on June 30, 1998. Unless otherwise stated, all per share and share data included herein have been restated to give effect to the dividends and split. The 5% common stock dividend declared on July 13, 1999, is reflected in the Consolidated Balance Sheet at June 30, 1999.

Common Stock The Company maintains its 1992 Long-Term Stock Incentive Plan (1992 Plan) under which options to purchase 3,653,343 shares were provided to be granted to officers and key employees at prices not less than the fair market value on the date of grant. The 1992 Plan allows for the granting of stock appreciation rights, dividend equivalents, performance shares and restricted stock. The Company also had an incentive stock option plan (1982 Plan) which provided for the granting of 787,500 options, until December 31, 1991. Upon exercise of an option granted under the 1982 Plan, the Company may elect, instead of issuing shares, to make a cash payment equal to the difference at the date of exercise between the option price and the market price of the shares as to which such option is being exercised. Options granted under both the 1992 Plan and the 1982 Plan are exercisable for periods of ten years from the date of grant or such lesser period as may be designated for particular options, and become exercisable after a specified period of time from the date of grant in cumulative annual installments. Options typically vest 20% per year for five years but may be a lesser or greater period as designated for particular options.

The Company accounts for its incentive plans under an Accounting Principles Board opinion, *Accounting for Stock Issued to Employees*. As a result, the Company recorded no compensation expense for 1999, 1998 and 1997. During 1997, the Company adopted the FASB standard, *Accounting for Stock-Based Compensation*, for footnote disclosure purposes only. Had compensation cost for these incentive plans been determined consistent with this standard, the Company's net income and diluted earnings per share would have been $9,429,000 and $.29, respectively, in 1999, $11,141,000 and $.35, respectively, in 1998 and $18,489,000 and $.60, respectively, in 1997. Because this standard has not been applied to options granted prior to July 1, 1995, the resulting pro forma compensation cost may not be representative of that to be expected in future years.

The fair value of each option is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants in 1998 and 1997, respectively: dividend yield of nil for both years; volatility

of 19.5% and 21%; risk-free interest rate of 5.5% and 6.2%; and expected life outstanding of 5.5 to 7.2 years for both years. There were no options granted during 1999.

	1992 Plan		1982 Plan	
	Shares Under Option	Weighted Average Exercise Price	Shares Under Option	Weighted Average Exercise Price
Outstanding July 1, 1996	1,526,150	$ 6.53	539,592	$ 3.08
Granted	491,974	13.12	--	--
Exercised	(61,182)	5.68	(85,612)	3.08
Canceled	(13,162)	6.58	--	--
Outstanding June 30, 1997	1,943,780	8.23	453,980	3.08
Granted	743,710	16.93	--	--
Exercised	(84,983)	4.48	(89,258)	3.08
Canceled	(21,634)	12.58	--	--
Outstanding June 30, 1998	2,580,873	10.82	364,722	3.08
Exercised	(107,785)	6.41	(41,706)	3.09
Canceled	(42,302)	14.93	--	--
Outstanding June 30, 1999	2,430,786	10.94	323,016	3.08

The following table summarizes information about stock options outstanding under the 1992 Plan at June 30, 1999:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
$ 0.00 - $ 5.00	372,261	3.3 years	$ 3.87	372,261	$ 3.87
5.01 - 10.00	871,582	5.1 years	7.88	659,361	7.63
10.01 - 15.00	457,926	7.8 years	13.04	187,620	13.01
15.01 - 20.00	729,017	8.8 years	16.89	139,250	16.93
	2,430,786			1,358,492	

The shares exercisable under the 1992 Plan and the corresponding weighted average exercise price at June 30, 1999, 1998 and 1997 were 1,358,492 and $8.29; 1,032,594 and $6.57; and 756,974 and $5.55, respectively. The shares exercisable under the 1982 Plan and the corresponding weighted average exercise price at June 30, 1999, 1998 and 1997 were 323,016 and $3.08; 364,722 and $3.08; and 453,980 and $3.08, respectively. The weighted average remaining contractual life of options outstanding under the 1982 Plan at June 30, 1999 was 0.9 years. There were 889,792 shares available for future option grants under the 1992 Plan at June 30, 1999. No shares were available for future option grants under the 1982 Plan at June 30, 1999.

On February 10, 1994, Southern Union granted a warrant which expires on February 10, 2004, to purchase up to 100,506 shares of Common Stock at an exercise price of $6.90 to the Company's outside legal counsel.

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

X Preferred Securities of Subsidiary Trust

On May 17, 1995, Southern Union Financing I (Subsidiary Trust), a consolidated wholly-owned subsidiary of Southern Union, issued $100,000,000 of 9.48% Trust Originated Preferred Securities (Preferred Securities). In connection with the Subsidiary Trust's issuance of the Preferred Securities and the related purchase by Southern Union of all of the Subsidiary Trust's common securities (Common Securities), Southern Union issued to the Subsidiary Trust $103,092,800 principal amount of its 9.48% Subordinated Deferrable Interest Notes, due 2025 (Subordinated Notes). The sole assets of the Subsidiary Trust are the Subordinated Notes. The interest and other payment dates on the Subordinated Notes correspond to the distribution and other payment dates on the Preferred Securities and the Common Securities. Under certain circumstances, the Subordinated Notes may be distributed to holders of the Preferred Securities and holders of the Common Securities in liquidation of the Subsidiary Trust. The Subordinated Notes are redeemable at the option of the Company on or after May 17, 2000, at a redemption price of $25 per Subordinated Note plus accrued and unpaid interest. The Preferred Securities and the Common Securities will be redeemed on a pro rata basis to the same extent as the Subordinated Notes are repaid, at $25 per Preferred Security and Common Security plus accumulated and unpaid distributions. Southern Union's obligations under the Subordinated Notes and related agreements, taken together, constitute a full and unconditional guarantee by Southern Union of payments due on the Preferred Securities. As of June 30, 1999, the quoted market price per Preferred Security was $25.38. As of June 30, 1999 and 1998, 4,000,000 shares of Preferred Securities were outstanding.

XI Debt and Capital Lease

	June 30, 1999	June 30, 1998
7.60% Senior Notes, due 2024	$ 364,515	$ 384,515
Capital lease and other	28,482	23,669
Total long-term debt	$ 392,997	$ 408,184

The maturities of long-term debt and capital lease payments for each of the next five years ending June 30 are: 2000 -- $2,066,000; 2001 -- $2,188,000; 2002 -- $2,330,000; 2003 -- $12,660,000; 2004 -- $8,849,000 and thereafter -- $364,904,000.

Senior Notes On January 31, 1994, Southern Union completed the sale of the 7.60% Senior Debt Securities (Senior Notes). During 1999, $20,000,000 of Senior Notes were repurchased at $941 per $1,000 note resulting in a net pre-tax gain of $425,000, net of related debt expense. Debt issuance costs and premiums on the early extinguishment of debt are accounted for in accordance with that required by its various regulatory bodies having jurisdiction over the Company's operations. The Company recognizes gains or losses on the early extinguishment of debt to the extent it is provided for by its regulatory authorities and in some cases such gains or losses are deferred and amortized over the term of the new or replacement debt issues.

The Senior Notes traded at $936 and $895 (per $1,000 note) on June 30 and July 31, 1999, respectively, as quoted by a major brokerage firm. The carrying amount of long-term debt at June 30, 1999 and 1998 was $392,997,000 and $408,184,000, respectively. The fair value of long-term debt at June 30, 1999 and 1998 was $369,759,000 and $431,628,000, respectively.

Capital Lease The Company completed the installation of an Automated Meter Reading (AMR) system at Missouri Gas Energy during the first quarter of fiscal year 1999. The installation of the AMR system involved an investment of approximately $30,000,000 which is accounted for as a capital lease obligation. As of June 30, 1999, the capital lease obligation outstanding was $26,894,000 with a fixed rate of 5.79%. During 1999, the Company recorded an increase in plant and long-term debt of $6,824,000. This system will improve meter reading accuracy and provide electronic accessibility to meters in residential customers' basements, thereby assisting in the reduction of the number of estimated bills. Depreciation on the AMR system is provided at an average straight-line rate of approximately 5% per annum of the cost of such property.

Credit Facilities The Company has availability under two revolving credit facilities (Revolving Credit Facilities) underwritten by a syndicate of banks. Of the Revolving Credit Facilities, $40,000,000 is available under a short-term facility which expires June 29, 2000, while $60,000,000 is available under a long-term facility which expires June 30, 2002. The Company has additional availability under uncommitted line of credit facilities (Uncommitted Facilities) with various banks. Covenants under the Revolving Credit Facilities allow for up to $35,000,000 of borrowings under Uncommitted Facilities at any one time. Borrowings under the facilities are available for Southern Union's working capital, letter of credit requirements and other general corporate purposes. The Revolving Credit Facility is subject to a commitment fee based on the rating of the Senior Notes. As of June 30, 1999, the commitment fee was an annualized .15% on the unused balance. The interest rate on borrowings on the Revolving Credit Facility is calculated based on a formula using the LIBOR or prime interest rates. The average interest rate under the facilities was 5.6% for the year ended June 30, 1999 and 6.1% for the year ended June 30, 1998. A $21,000,000 and $1,600,000 balance was outstanding under the facilities at June 30, 1999 and 1998, respectively. A balance of $17,900,000 was outstanding under the facilities at July 31, 1999.

XII Employee Benefits

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

The Company maintains two trusteed non-contributory defined benefit retirement plans (Plans) which cover substantially all employees. The Company funds the Plans' cost in accordance with federal regulations, not to exceed the amounts deductible for income tax purposes. The Plans' assets are invested in cash and bond and stock funds. The Company also has a supplemental non-contributory retirement plan for certain executive employees and other post-retirement benefit plans for its employees. Post-retirement medical and other benefit liabilities are accrued on an actuarial basis during the years an employee provides services. The following table represents a reconciliation of the plans at June 30, 1999 and 1998.

	1999	
Change in Benefit Obligation		
Benefit obligation at beginning of year	$ 188,038	$ 172,225
Service cost	3,364	3,302
Interest cost	13,829	13,658
Benefits paid	(13,563)	(12,382)
Actuarial loss	7,968	11,235
Plan amendments	7,027	--
Curtailment	(2,202)	--
Benefit obligation at end of year	$ 204,461	$ 188,038
Change in Plan Assets		
Fair value of plan assets at beginning of year	$ 166,353	$ 132,599
Return on plan assets	3,420	40,262
Employer contributions	6,411	5,874
Benefits paid	(13,563)	(12,382)
Fair value of plan assets at end of year	$ 162,621	$ 166,353
Funded Status		
Funded status at end of year	$ (41,839)	$ (21,685)
Unrecognized transition obligation	2,764	2,891
Unrecognized net actuarial (gain)	(7,404)	(25,977)
Unrecognized prior service cost	9,913	3,455
Accrued benefit cost	$ (36,566)	$ (41,316)
Amounts Recognized in the Consolidated Balance Sheet		
Prepaid benefit cost	$ 4,880	$ 2,339
Accrued benefit liability	(52,618)	(45,806)
Intangible asset	10,501	2,151
Accumulated other comprehensive income	671	--
Net amount recognized	$ (36,566)	$ (41,316)

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for the plans with accumulated benefit obligations in excess of plan assets as of June 30, 1999 were $58,985,000; $58,985,000; and $42,181,000, respectively, and for those same plans were $46,158,000; $37,783,000; and $41,907,000, respectively as of June 30, 1998.

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

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

Net periodic benefit cost for the year ended June 30, 1999, 1998 and 1997 includes the following components:

	1999	1998	1997
Service cost	$ 3,364	$ 3,302	$ 3,258
Interest cost	13,829	13,658	13,240
Expected return on plan assets	(13,006)	(11,737)	(10,335)
Amortization of transition amount	127	127	127
Amortization of prior service cost	438	340	291
Recognized actuarial (gain)	(3,319)	(4,828)	(1,980)
Curtailment	131	--	--
Net periodic pension cost	$ 1,564	$ 862	$ 4,601

The assumed health care cost trend rate used in measuring the accumulated post-retirement benefit obligation was 7.25% during 1999. This rate was assumed to decrease gradually each year to a rate of 6.0% for 2004 and remain at that level thereafter.

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

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

	One Percentage Point Increase in Health Care Trend Rate	One Percentage Point Decrease in Health Care Trend Rate
Effect on total service and interest cost components	$ 29,000	$ (28,000)
Effect on post-retirement benefit obligation	322,000	(319,000)

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

Defined Contribution Plan The Company provides a Savings Plan available to all employees. Since January 1, 1997, the Company contributes $.50 of Company stock for each $1.00 contributed by a non-Missouri Gas Energy participant up to 5% of the employee's salary. Additionally, the Company contributes $.75 of Company stock for each $1.00 contributed by a non-Missouri Gas Energy participant from 6% to 10% of the employee's salary. Effective July 1, 1998, Company contributions for Missouri Gas Energy non-union employees were revised to coincide with that of non-Missouri Gas Energy participants as described above. For Missouri Gas Energy union employees, the Company contributes $.50 of Company stock for each $1.00 contributed by such a participant up to 7% of the employee's salary. Company contributions are 100% vested after six years of continuous service. Company contributions to the plan during 1999, 1998 and 1997, were $1,717,000, $1,656,000 and $1,476,000, respectively.

Effective January 1, 1999 the Company amended its defined contribution plan to provide contributions of certain employees who were employed as of December 31, 1998. These contributions were designed to replace certain benefits previously provided under defined benefit plans. Employer contributions to these separate accounts,

referred to as Retirement Power Accounts, within the defined contribution plan were determined based on the employee's age plus years of service plus accumulated sick leave as of December 31, 1998. The contribution amounts are determined as a percentage of compensation and range from 3.5% to 8.5%. Company contributions to Retirement Power Accounts during 1999 were $1,118,000.

Post-employment Benefits Certain post-employment benefits such as disability and health care continuation coverage provided to former or inactive employees after employment but before retirement, are accrued if attributable to an employees' previously rendered service. The Company has recorded a regulatory asset to the extent it intends to file rate applications to include such costs in rates and such recovery is probable. As of both June 30, 1999 and 1998, the Company has recorded a regulatory asset and a related liability of $1,343,000.

Common Stock Held in Trust From time to time, the Company repurchases outstanding shares of common stock of Southern Union to fund certain Company employee stock-based compensation plans. At June 30, 1999, 268,513 shares of common stock were held by various rabbi trusts for certain of the Company's benefit plans.

XIII Taxes on Income

	Year Ended June 30,		
	1999	1998	1997
Current:			
Federal	$ (516)	$ 1,381	$ 4,437
State	(242)	240	596
	(758)	1,621	5,033
Deferred:			
Federal	7,024	5,984	6,690
State	843	379	650
	7,867	6,363	7,340
Total provision	$ 7,109	$ 7,984	$ 12,373

Deferred credits and other liabilities also include $560,000 and $593,000 of unamortized deferred investment tax credit as of June 30, 1999 and 1998, respectively.

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

	June 30,	
	1999	1998
Deferred tax assets:		
Estimated alternative minimum tax credit	$ 9,557	$ 10,554
Insurance accruals	2,297	3,074
Bad debt reserves	2,715	--
Post-retirement benefits	1,466	1,079
Minimum pension liability	234	--
Other	3,020	1,230
Total deferred tax assets	19,289	15,937
Deferred tax liabilities:		
Property, plant and equipment	(74,909)	(65,564)
Unamortized debt expense	(5,049)	(5,270)
Other	(6,731)	(5,330)
Total deferred tax liabilities	(86,689)	(76,164)
Net deferred tax liability	(67,400)	(60,227)
Less current tax assets	2,838	2,378
Accumulated deferred income taxes	$ (70,238)	$ (62,605)

The Company accounts for income taxes utilizing the liability method which bases the amounts of current and future tax assets and liabilities on events recognized in the financial statements and on income tax laws and rates existing at the balance sheet date.

	Year Ended June 30,		
	1999	1998	1997
Computed statutory tax expense at 35%	$ 6,144	$ 7,075	$ 10,992
Changes in taxes resulting from:			
State income taxes, net of federal income tax benefit	348	402	811
Amortization of acquisition adjustment	830	723	724
Other	(213)	(216)	(154)
Actual tax expense	$ 7,109	$ 7,984	$ 12,373

XIV Utility Regulation and Rates

On August 21, 1998, Missouri Gas Energy was notified by the MPSC of its decision to grant a $13,300,000 annual increase to revenue effective on September 2, 1998, which is primarily earned volumetrically. The MPSC rate order reflected a 10.93% return on common equity. The rate order, however, disallowed certain previously recorded deferred costs requiring a non-cash write-off of $2,221,000. The Company recorded this charge to earnings in its fiscal year ended June 30, 1998. On December 8, 1998, the MPSC denied rehearing requests made by all parties other than Missouri Gas Energy and granted a portion of Missouri Gas Energy's rehearing request. The MPSC will conduct further proceedings to take additional evidence on those matters for which it granted Missouri Gas Energy a rehearing. If the MPSC adopts Missouri Gas Energy's positions on rehearing, then Missouri Gas Energy would be authorized an additional $2,200,000 of base revenues increasing the $13,300,000 initially authorized in its August 21, 1998 order to $15,500,000. The MPSC's orders may be subject to judicial review and although certain parties may argue for a reduction in Missouri Gas Energy's authorized base revenue increase on judicial review, Missouri Gas Energy expects such arguments to be unsuccessful.

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

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

The MPSC approved a three-year, experimental gas supply incentive plan for Missouri Gas Energy effective July 1, 1996. Under the plan, the Company and Missouri Gas Energy's customers share in certain savings below benchmark levels of gas costs achieved as a result of the Company's gas procurement activities. Likewise, if natural gas is acquired above benchmark levels, both the Company and customers share in such costs. For the years ended June 30, 1999, 1998 and 1997, the incentive plan achieved a reduction of overall gas costs of $6,900,000, $9,200,000 and $10,200,000, respectively, resulting in savings to Missouri customers of $4,000,000, $5,100,000 and $5,600,000, respectively. The Company recorded revenues of $2,900,000, $4,100,000 and $4,600,000 in 1999, 1998 and 1997, respectively, under this plan. Missouri Gas Energy is currently working with the MPSC to develop an alternate plan due to the July 1, 1999 expiration of the experimental gas supply incentive plan, however, there can be no assurance that this or any similar plan will be approved by the MPSC for Missouri Gas Energy.

Under the order of the Federal Energy Regulatory Commission, a major supplier of gas to Missouri Gas Energy is allowed recovery of certain previously unrecovered deferred gas costs with a remaining balance of $669,000 at

June 30, 1999. Missouri Gas Energy is allowed to recover these costs from its Missouri customers through a purchase gas adjustment mechanism which is filed with and approved by the MPSC. The receivable and liability associated with these costs have been recorded as a deferred charge and a deferred credit, respectively, on the consolidated balance sheet as of June 30, 1999 and 1998.

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

XV Leases

The Company leases certain facilities, equipment and office space under cancelable and noncancelable operating leases. The minimum annual rentals under operating leases for the next five years ending June 30 are as follows: 2000 -- $6,062,000; 2001 -- $4,973,000; 2002 -- $4,039,000; 2003 -- $2,236,000; 2004 -- $1,225,000 and thereafter $11,162,000. Rental expense was $7,732,000, $6,054,000 and $6,797,000 for the years ended June 30, 1999, 1998 and 1997, respectively.

XVI Commitments and Contingencies

Environmental Southern Union and Western Resources, Inc. entered into an Environmental Liability Agreement (Environmental Liability Agreement) at the time of the closing of the acquisition of Missouri Gas Energy. Subject to the accuracy of certain representations made by Western Resources in the Missouri Asset Purchase Agreement, the Environmental Liability Agreement provides for a tiered approach to the allocation of certain liabilities under environmental laws that may exist or arise with respect to Missouri Gas Energy. The Environmental Liability Agreement contemplates Southern Union first seeking reimbursement from other potentially responsible parties, or recovery of such costs under insurance or through rates charged to customers. To the extent certain environmental liabilities were discovered by Southern Union prior to January 31, 1996, and are not so reimbursed or recovered, Southern Union will be responsible for the first $3,000,000, if any, of out-of-pocket costs and expenses incurred to respond to and remediate any such environmental claim. Thereafter, Western Resources would share one-half of the next $15,000,000 of any such costs and expenses, and Southern Union would be solely liable for any such costs and expenses in excess of $18,000,000. At the present time and based upon information available to management, the Company believes that the costs of any remediation efforts that may be required for these sites for which it may ultimately have responsibility will not exceed the aggregate amount subject to substantial sharing by Western Resources. In a letter dated May 10, 1999, the Missouri Department of Natural Resources (MDNR) sent notice of a planned Site Inspection/Removal Site Evaluation of the Kansas City Coal Gas Former Manufactured Gas Plant (FMGP) site. This site (comprised of two FMGP operations previously owned by two separate companies) is located at East 1st Street and Campbell in Kansas City, Missouri and is owned by Missouri Gas Energy. A 1988 investigation of the site performed by an Environmental Protection Agency (EPA) contractor determined that further remedial assessment was not required under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), as amended by the Superfund Amendments and Reauthorization Act of 1986. The MDNR has stated that the reassessment of the Kansas City Coal Gas site is part of a statewide effort to identify, evaluate, and prioritize the potential hazards posed by all of Missouri's FMGP sites. During July 1999, the Company sent applications to MDNR submitting the two sites to the agency's Voluntary Cleanup Program. In two letters, both dated August 2, 1999, the MDNR accepted the sites into the Voluntary Cleanup Program. The Company subsequently submitted two work plans for the environmental assessment of the sites to MDNR.

In addition to the various Missouri Gas Energy sites described above, the Company is investigating the possibility that the Company or predecessor companies may have been associated with Manufactured Gas Plant (MGP) sites in other of its former service territories, principally in Arizona and New Mexico, and present service territories in Texas. At the present time, the Company is aware of certain plant sites in some of these areas and is investigating those and certain other locations. While the Company's evaluation of these Texas, Arizona and New Mexico MGP

sites is in its preliminary stages, it is likely that some compliance costs may be identified and become subject to reasonable quantification. To the extent that such potential costs are quantified, the Company expects to provide any appropriate accruals and seek recovery for such remediation costs through all appropriate means, including insurance and regulatory relief. Although significant charges to earnings could be required prior to rate recovery, management does not believe that environmental expenditures for such MGP sites will have a material adverse effect on the Company's financial position, results of operations or cash flows.

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

Regulatory On August 18, 1998, the Missouri State Court of Appeals, Western District, denied the Company's appeal of the February 1, 1997 rate order which retroactively reduced the carrying cost rate applied by the Company on expenditures incurred on the Missouri Gas Energy Safety Program. The Company believes that the inconsistent treatment by the MPSC in subsequently changing to the Allowance for Funds Used During Construction rate of approximately 6% from the previously ordered rate of 10.54% constitutes retroactive ratemaking. Unfortunately, the decision by the Missouri State Court of Appeals failed to address certain specific language within a 1994 MPSC accounting authority order that the Company believed prevented the MPSC from retroactively changing the carrying cost rate. Southern Union sought a transfer of the case to the Missouri Supreme Court which was denied on November 24, 1998.

The continuation of the Missouri Safety Program will result in significant levels of future capital expenditures. The Company estimates incurring capital expenditures of $14,372,000 in fiscal 2000 related to this program.

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

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

There are four lawsuits pending that relate to activities surrounding Southern Union's efforts to acquire Southwest. In addition, there is before the U.S. Court of Appeals for the Tenth Circuit, an appeal by Southern Union of a

preliminary injunction entered by the U.S. District Court for the Northern District of Oklahoma. Southern Union intends to vigorously pursue its claims against Southwest, ONEOK, and certain individual defendants, and vigorously defend itself against the claims by Southwest and ONEOK.

California Action -- Pursuant to notice given by Southern Union to Southwest on April 28, 1999, the Superior Court of California for San Diego County on May 4, 1999, granted a motion by Southern Union and SU Acquisition Corporation, a Southern Union subsidiary, for leave to file a complaint in intervention in a pending Southwest shareholders' derivative suit styled, *Klein v. Southwest Gas Corp.* Southern Union's complaint sought partial rescission of the Confidentiality and Standstill Agreement, a declaration of the rights of the parties under the Confidentiality and Standstill Agreement, and a request for a preliminary injunction barring Southwest from submitting proxies to its shareholders seeking their approval of a merger with ONEOK until the merits of Southern Union's claims could be adjudicated. On May 17, 1999, Southwest removed the *Klein* case to the United States District Court for the Southern District of California. The shareholder plaintiffs and Southern Union then moved to remand the case back to the California Superior Court. According to the definitive Southwest proxy statement with respect to the ONEOK merger (released on June 29, 1999) on June 9, 1999, Southwest signed a Memorandum of Understanding (MOU) with the shareholder plaintiffs' counsel to settle this action as to all plaintiffs, except Southern Union. The MOU sets forth the parties' agreement in principle settling all of the shareholders' claims arising out of the actions of Southwest and its directors relating to the ONEOK merger, and will be incorporated into a final Stipulation Settlement. The MOU is not an admission of any of the plaintiffs' allegations. Southwest and its directors have denied and continue to deny that they have committed or attempted to commit any wrongdoing or breached any duty owed to Southwest or its shareholders. The MOU is subject to several conditions, including the consummation of the ONEOK merger and the entry of a final judgment of dismissal with prejudice by the U. S. District Court that is binding on all shareholders from December 14, 1998 through the date that the shareholders approve the ONEOK merger. By Order dated August 3, 1999, the federal district court granted Southern Union's motion to remand the case to California Superior Court. On August 5, 1999, Southern Union moved the California Superior Court to sever its claims against Southwest and also sought a temporary restraining order barring Southwest from participating in any further proceedings before the California Public Service Commission and from taking any other action to consummate its pending merger with ONEOK until the court determined the merits of Southern Union's claims. Following a hearing on August 5, the California superior court judge denied Southern Union's request for a temporary restraining order in a ruling announced from the bench. Also on August 5, Southwest moved the court to stay all proceedings in the case. On August 16, the Court granted Southern Union's motion to sever. On August 24, 1999, the court ruled on Southwest's motion and stayed action in the state court proceeding pending resolution of the federal actions filed by the parties.

Nevada Action -- On April 20, 1999, Southwest filed an action against Southern Union Company in the United States District Court for the District of Nevada. The complaint alleged breach of the Confidentiality and Standstill Agreement between Southern Union and Southwest, misappropriation of original trade secrets in violation of California statutes, intentional interference with the ONEOK merger agreement, intentional interference with prospective advantage, breach of a common-law duty of good faith and fair dealing, and unfair business practices in violation of California statutes. On May 6, 1999, Southwest filed an amended complaint that added a claim for breach of the Securities Exchange Act of 1934 to the claims in the original complaint. Southwest seeks declaratory and injunctive relief together with money damages "in excess of $75,000.00." Southern Union has answered the complaint, denying liability under all counts. Southern Union has filed a counterclaim alleging breach of contract, breach of duty of good faith and fair dealing, mistake of fact and fraudulent inducement with respect to the Confidentiality and Standstill Agreement. The counterclaim seeks partial rescission of the Confidentiality and Standstill Agreement, or a declaration that Southern Union is entitled to take all actions legal and necessary to directly solicit Southwest's shareholders to oppose Southwest's agreement to merge with ONEOK or any other party, and to support Southern Union's efforts to merge with or acquire Southwest, or acquire all or some of Southwest's outstanding common shares. Southwest has filed a motion to transfer the case to the United States District Court for the Northern District of Oklahoma, which Southern Union has opposed. That motion is currently awaiting decision by the court. On June 30, 1999, Southern Union filed a motion for partial judgment on the pleadings with respect to Southwest's state law claims. The motion is based on Nevada Revised Statute 41.650 which, in part, provides

for immunity from civil liability for "good faith communications in connection with the right to petition." That motion also is pending currently.

Oklahoma Action -- On May 5, 1999, ONEOK filed an action against Southern Union in the United States District Court for the Northern District of Oklahoma, asserting third-party beneficiary status under the Confidentiality and Standstill Agreement between Southern Union and Southwest, and alleging a claim for breach of that Agreement as well as a claim for intentional interference with the ONEOK-Southwest merger agreement. That same day, ONEOK moved for a temporary restraining order against Southern Union to bar Southern Union from making any attempt to solicit proxies from or influence the shareholders of Southwest with respect to Southern Union's offer to purchase Southwest, from taking any actions in the regulatory proceedings that concern the proposed merger of ONEOK and Southwest, from taking any actions in the *Klein v Southwest Gas Corp.* case and from taking any actions that seek to control or influence the shareholders, management, directors or policies of Southwest, either alone or in concert with others. On May 10, 1999 the Court entered a temporary restraining order that barred Southern Union from breaching the standstill provisions of the Confidentiality and Standstill Agreement. By agreement of the parties, the temporary restraining order was converted to a preliminary injunction on May 17, 1999. Southern Union has filed a motion to dismiss the ONEOK complaint in lieu of an answer denying ONEOK's allegations. On July 19, 1999, Southern Union moved the Oklahoma district court to vacate or suspend its preliminary injunction on the basis of newly-discovered evidence (which also is the basis for Southern Union's Arizona action described below) that showed that ONEOK came to court with "unclean hands" and that Southwest had fraudulently induced Southern Union to enter into the Confidentiality and Standstill Agreement that was the basis for the court's injunction. This motion was denied on jurisdictional grounds by order dated July 23, 1999. On August 3, 1999, ONEOK moved the court to hold Southern Union in contempt for having filed the Arizona action assertedly in violation of the Oklahoma court's May 17, 1999 preliminary injunction. At a status hearing on August 11, 1999, the judge said that the May 17, 1999 preliminary injunction did not bar Southern Union from filing the Arizona action. While he did not expressly deny ONEOK's motion, the judge orally directed ONEOK to amend its motion if it wished the court to give it any further consideration. ONEOK subsequently moved for an emergency hearing (to show cause) regarding the preliminary injunction. The court heard arguments on that motion on August 30, 1999. The judge has taken the matter under advisement and has requested that additional information be provided to the court.

Appeal of Oklahoma Action -- On May 17, 1999, Southern Union noticed its appeal of the Oklahoma district court's preliminary injunction in the United States Court of Appeals for the Tenth Circuit. At the same time Southern Union sought from the court of appeals a stay of the district court's injunction pending a decision on the merits of the appeal. On June 1, 1999, the Tenth Circuit issued a "temporary stay" of the district court's order to permit Southern Union to file a motion in the *Klein* case to Southwest Gas' motion to transfer it to the Northern District of Oklahoma. On June 3, 1999 Southern Union supplemented its request for a stay of the district court's order to permit Southern Union to resume its participation in the various state public utility commission proceedings considering the proposed ONEOK-Southwest Gas merger. On June 10, 1999, the Tenth Circuit issued an order denying Southern Union's request for the further stay and on August 24, 1999 the Tenth Circuit vacated its temporary stay of June 3, 1999 as moot and denied Southern Union's request for any further stay of the district court order pending appeal. Briefing for the appeal has been completed.

Arizona Action -- On July 19, 1999, Southern Union filed an action in the United States Court for the District of Arizona against Southwest, ONEOK, Michael O. Maffie (Southwest's President), Thomas Y. Hartley (Southwest's Chairman), Eugene N. Dubay (President of Kansas Gas Service, a division of ONEOK), James M. Irvin (an Arizona Corporation Commissioner), Jack D. Rose (former Executive Director of the Arizona Corporation Commission), Thomas R. Sheets (Southwest's General Counsel), and John A. Gaberino, Jr. (ONEOK's General Counsel). The suit alleges racketeering under federal and state law, fraud in the inducement, breach of contract, Securities Exchange Act violations, breach of the covenant of good faith and fair dealing, rescission, intentional interference with business relationship, tortious interference with contractual relations and civil conspiracy. Southern Union seeks damages of $750 million on each of the two racketeering counts, to be trebled; $750 million on six other counts; punitive damages on four counts; and rescission of its Standstill Agreement with Southwest. On August 2, 1999,

Southern Union moved for a temporary restraining order barring both Southwest and ONEOK from participating in any further regulatory proceedings before the Arizona Corporation Commission. Southern Union also asked the Arizona court to bar Arizona Corporation Commissioner James Irvin "from any involvement in ongoing procedures concerning regulatory approval by the ACC." On August 5, 1999, the court held a hearing on the motion and, at the conclusion of the hearing, orally denied Southern Union's request.

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

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

Commitments The Company is committed under various agreements to purchase certain quantities of gas in the future. At June 30, 1999, the Company has purchase commitments for certain quantities of gas at variable, market-based prices that have an annual value of $94,275,000. The Company's purchase commitments may extend over a period of several years depending upon when the required quantity is purchased. The Company has purchase gas tariffs in effect for all its utility service areas that provide for recovery of its purchase gas costs under defined methodologies.

In December 1998, the Company agreed to five-year contracts with each bargaining-unit representing Missouri employees, which were effective in May 1999. Of the Company's employees represented by unions, 95% are employed by Missouri Gas Energy.

The Company had standby letters of credit outstanding of $1,622,000 and $2,947,000 at June 30, 1999 and 1998, respectively, which guarantee payment of various insurance premiums and state taxes.

XVII Quarterly Operations (Unaudited)

Year Ended June 30, 1999	Quarter Ended September 30	December 31	March 31	June 30	Total
Total operating revenues	$ 77,455	$ 174,224	$251,863	$ 101,689	$ 605,231
Operating margin	42,781	70,286	98,106	51,757	262,930
Net operating revenues (loss)	(627)	19,986	40,647	4,841	64,847
Net earnings (loss) available for common stock	(7,048)	5,374	17,624	(5,505)	10,445
Earnings (loss) per share – diluted[1]	(.23)	.16	.54	(.18)	.32

Year Ended June 30, 1998	Quarter Ended September 30	December 31	March 31	June 30	Total
Total operating revenues	$ 74,039	$ 221,162	$265,176	$ 108,927	$ 669,304
Operating margin	41,597	77,328	94,676	50,123	263,724
Net operating revenues	1,405	26,530	36,940	3,792	68,667
Net earnings (loss) available for common stock[2]	(4,909)	9,738	16,249	(8,849)	12,229
Earnings (loss) per share – diluted[1]	(.17)	.31	.50	(.28)	.39

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

(2) During the quarter ended June 30, 1998, Missouri Gas Energy wrote off $8,163,000 pre-tax in previously recorded regulatory assets as a result of announced rate orders and court rulings.

REPORT OF INDEPENDENT ACCOUNTANTS

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

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, cash flows and stockholders' equity present fairly, in all material respects, the financial position of Southern Union Company and its subsidiaries at June 30, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 1999, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

Austin, Texas
August 12, 1999, except for Note XVI as to
which the date is September 3, 1999

EXHIBIT 21

SUBSIDIARIES OF THE COMPANY

Name	State or Country of Incorporation
Atlantic Gas Corporation	Delaware
ConTigo, Inc.	Delaware
Energía Estrella del Sur, S. A. de C. V.	Mexico
Energy WorX, Inc.	Delaware
KellAir Aviation Company	Delaware
Lavaca Realty Company	Delaware
Mercado Gas Services Inc.	Delaware
Norteño Pipeline Company	Delaware
Southern Transmission Company	Delaware
Southern Union Energy International, Inc.	Delaware
Southern Union Financing I	Delaware
Southern Union International Investments, Inc.	Delaware
Southern Union Total Energy Systems, Inc.	Delaware
SUPro Energy Company	Delaware

Note: Seven other wholly-owned subsidiaries of Southern Union Company, Southern Union Financing II (a Delaware corporation), Southern Union Financing III (a Delaware corporation), Southern Union Gas Company, Inc. (a Delaware corporation), Southern Union Gas Company, Inc. (a Texas corporation), SU Acquisition Corporation (a California corporation), Western Utilities, Inc. (a Delaware corporation) and Western Utilities, Inc. (a New Mexico corporation), conduct no business except to the extent necessary to maintain their corporate existence.

EXHIBIT 23

CONSENT OF INDEPENDENT ACCOUNTANTS

CONSENT OF INDEPENDENT ACCOUNTANTS

Exhibit 23

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (File Nos. 33-58297, 333-02965 and 333-10585) and Form S-8 (File Nos. 2-79612, 33-37261, 33-69596, 33-69598, 33-61558 and 333-79443) of Southern Union Company and Subsidiaries of our report dated August 12, 1999, except for Note XVI as to which the date is September 3, 1999, relating to the consolidated financial statements, which appears in the Annual Report to Stockholders, which is incorporated in this Annual Report on Form 10-K.

PricewaterhouseCoopers LLP

Austin, Texas
September 10, 1999

EXHIBIT 24

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS that each person whose signature appears below constitutes and appoints Peter H. Kelley, Ronald J. Endres and David J. Kvapil, or any of them, as such person's true and lawful attorney-in-fact and agent, with full power of substitution and revocation, for such person and in such person's name, place and stead, in any and all capacities, to sign the Annual Report on Form 10-K for the fiscal year ended June 30, 1999 of Southern Union Company, a Delaware corporation, and any amendments thereto, and to file the same with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission and the New York Stock Exchange.

Dated: August 12, 1999

JOHN E. BRENNAN
John E. Brennan

GEORGE L. LINDEMANN
George L. Lindemann

FRANK W. DENIUS
Frank W. Denius

ROGER J. PEARSON
Roger J. Pearson

AARON I. FLEISCHMAN
Aaron I. Fleischman

GEORGE ROUNTREE, III
George Rountree, III

ADAM M. LINDEMANN
Adam M. Lindemann

DAN K. WASSONG
Dan K. Wassong

KURT A. GITTER, M.D.
Kurt A. Gitter

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

FORM 10-Q

For the quarterly period ended

March 31, 2000

Commission File No. 1-6407

SOUTHERN UNION COMPANY

(Exact name of registrant as specified in its charter)

Delaware	**75-0571592**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
504 Lavaca Street, Eighth Floor Austin, Texas	**78701**
(Address of principal executive offices)	(Zip Code)

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

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

Title of each class	**Name of each exchange in which registered**
Common Stock, par value $1 per share	New York Stock Exchange

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

The number of shares of the registrant's Common Stock outstanding on May 5, 2000 was 47,135,583.

SOUTHERN UNION COMPANY AND SUBSIDIARIES
FORM 10-Q
March 31, 2000
Index

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

	Three Months Ended March 31, 2000	1999
	(thousands of dollars, except shares and per share amounts)	
Operating revenues	$ 344,789	$ 251,863
Cost of gas and other energy	217,793	153,757
Operating margin	126,996	98,106
Revenue-related taxes	14,195	14,487
Net operating margin	112,801	83,619
Operating expenses:		
Operating, maintenance and general	39,189	28,655
Depreciation and amortization	15,191	10,535
Taxes, other than on income and revenues	5,520	3,782
Total operating expenses	59,900	42,972
Net operating revenues	52,901	40,647
Other income (expenses):		
Interest	(14,940)	(8,962)
Dividends on preferred securities of subsidiary trust	(2,370)	(2,370)
Other, net	(1,034)	(252)
Total other expenses, net	(18,344)	(11,584)
Earnings before income taxes	34,557	29,063
Federal and state income taxes	15,042	11,439
Net earnings available for common stock	$ 19,515	$ 17,624
Net earnings per share:		
Basic	$ .42	$ .57
Diluted	$ .40	$ .54
Weighted average shares outstanding:		
Basic	46,919,654	31,170,179
Diluted	48,877,873	32,624,604

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

	Nine Months Ended March 31,	
	2000	1999
	(thousands of dollars, except shares and per share amounts)	
Operating revenues	$ 669,170	$ 503,543
Cost of gas and other energy	402,182	292,370
Operating margin	266,988	211,173
Revenue-related taxes	29,416	27,169
Net operating margin	237,572	184,004
Operating expenses:		
Operating, maintenance and general	98,647	81,776
Depreciation and amortization	39,539	31,449
Taxes, other than on income and revenues	13,779	10,774
Total operating expenses	151,965	123,999
Net operating revenues	85,607	60,005
Other income (expenses):		
Interest	(36,603)	(26,843)
Dividends on preferred securities of subsidiary trust	(7,110)	(7,110)
Other, net	(5,527)	311
Total other expenses, net	(49,240)	(33,642)
Earnings before income taxes	36,367	26,363
Federal and state income taxes	15,820	10,413
Net earnings available for common stock	$ 20,547	$ 15,950
Net earnings per share:		
Basic	$ .52	$ .51
Diluted	$ .49	$ .49
Weighted average shares outstanding:		
Basic	39,706,933	31,129,919
Diluted	41,654,456	32,571,140

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

	Twelve Months Ended March 31, 2000	1999
	(thousands of dollars, except shares and per share amounts)	
Operating revenues	$ 770,858	$ 612,469
Cost of gas and other energy	452,113	351,174
Operating margin	318,745	261,295
Revenue-related taxes	34,281	32,183
Net operating margin	284,464	229,112
Operating expenses:		
Operating, maintenance and general	126,563	109,701
Depreciation and amortization	49,946	40,963
Taxes, other than on income and revenues	17,506	14,649
Total operating expenses	194,015	165,313
Net operating revenues	90,449	63,799
Other income (expenses):		
Interest	(45,759)	(35,182)
Dividends on preferred securities of subsidiary trust	(9,480)	(9,480)
Write-off of regulatory assets	--	(8,163)
Other, net	(7,651)	763
Total other expenses, net	(62,890)	(52,062)
Earnings before income taxes	27,559	11,737
Federal and state income taxes	12,516	4,636
Net earnings available for common stock	$ 15,043	$ 7,101
Net earnings per share:		
Basic	$ .40	$ .23
Diluted	$ .38	$ .22
Weighted average shares outstanding:		
Basic	37,586,705	31,119,598
Diluted	39,474,512	32,500,561

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

ASSETS

	March 31, 2000	March 31, 1999	June 30, 1999
	(thousands of dollars)		
Property, plant and equipment:			
Plant in service	$1,545,099	$1,093,881	$1,106,905
Construction work in progress	37,306	13,199	13,271
	1,582,405	1,107,080	1,120,176
Less accumulated depreciation and amortization	(497,227)	(376,629)	(376,212)
	1,085,178	730,451	743,964
Additional purchase cost assigned to utility plant, net	378,085	135,317	134,296
Net property, plant and equipment	1,463,263	865,768	878,260
Current assets:			
Cash and cash equivalents	52,327	–	–
Accounts receivable, billed and unbilled	129,650	101,553	50,693
Inventories, principally at average cost	26,698	25,716	29,373
Prepayments and other	7,854	2,179	4,692
Total current assets	216,529	129,448	84,758
Deferred charges	139,313	90,218	96,635
Investment securities	15,587	10,000	12,000
Real estate	9,438	9,438	9,420
Other	20,841	7,953	6,275
Total	$1,864,971	$1,112,825	$1,087,348

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET (Continued)

STOCKHOLDERS' EQUITY AND LIABILITIES

	March 31, 2000	March 31, 1999	June 30, 1999
	(thousands of dollars)		
Common stockholders' equity:			
Common stock, $1 par value; authorized 200,000,000 shares; issued 48,134,860 shares	$ 48,135	$ 29,741	$ 31,240
Premium on capital stock	592,274	260,167	276,610
Less treasury stock, at cost	(14,313)	(794)	(794)
Less common stock held in trust	(15,254)	--	(5,562)
Accumulated other comprehensive loss	(436)	--	(436)
Retained earnings	20,547	23,790	--
Total common stockholders' equity	630,953	312,904	301,058
Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated notes of Southern Union	100,000	100,000	100,000
Long-term debt and capital lease obligation	734,320	411,460	390,931
Total capitalization	1,465,273	824,364	791,989
Current liabilities:			
Long-term debt and capital lease obligation due within one year	2,169	2,033	2,066
Notes payable	3	18,603	21,003
Accounts payable	64,660	49,917	37,834
Federal, state and local taxes	22,526	28,448	13,300
Accrued interest	16,067	5,256	12,176
Customer deposits	17,805	18,352	17,682
Deferred gas purchase costs	21,674	14,968	22,955
Other	16,052	16,642	16,612
Total current liabilities	160,956	154,219	143,628
Deferred credits and other	112,581	71,763	81,493
Accumulated deferred income taxes	126,161	62,479	70,238
Commitments and contingencies	--	--	--
Total	$1,864,971	$1,112,825	$1,087,348

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock, $1 Par Value	Premium on Capital Stock	Treasury Stock, at Cost	Common Stock Held in Trust	Accumulated Other Comprehensive Loss	Retained Earnings	Total
			(thousands of dollars)				
Balance July 1, 1998	$28,252	$252,638	$ (794)	$ --	$ --	$ 16,738	$ 296,834
Net earnings	--	--	--	--	--	10,445	10,445
Minimum pension liability adjustment; net of tax	--	--	--	--	(436)	--	(436)
Comprehensive income							10,009
Common stock held in trust	--	--	--	(5,562)	--	--	(5,562)
5% stock dividend -- declared November 11, 1998	1,411	7,483	--	--	--	(8,898)	(4)
5% stock dividend -- declared July 13, 1999	1,485	16,797	--	--	--	(18,285)	(3)
Exercise of stock options	92	(308)	--	--	--	--	(216)
Balance June 30, 1999 ..	31,240	276,610	(794)	(5,562)	(436)	--	301,058
Net earnings	--	--	--	--	--	20,547	20,547
Issuance of stock for acquisition	16,714	315,235	--	--	--	--	331,949
Purchase of treasury stock	--	--	(13,519)	--	--	--	(13,519)
Common stock held in trust	--	--	--	(9,692)	--	--	(9,692)
Exercise of stock options	181	429	--	--	--	--	610
Balance March 31, 2000 .	$48,135	$592,274	$(14,313)	$(15,254)	$ (436)	$ 20,547	$ 630,953

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

	Three Months Ended March 31,	
	2000	1999
	(thousands of dollars)	
Cash flows from operating activities:		
Net earnings	$ 19,515	$ 17,624
Adjustments to reconcile net earnings to net cash flows from operating activities:		
Depreciation and amortization	15,191	10,535
Deferred income taxes	3,585	1,133
Provision for bad debts	2,011	1,192
Deferred interest expense	108	153
Other	428	358
Changes in assets and liabilities, net of acquisitions and dispositions:		
Accounts receivable, billed and unbilled	17,577	(980)
Accounts payable	(10,635)	1,429
Taxes and other liabilities	9,807	6,714
Customer deposits	(29)	(311)
Deferred gas purchase costs	2,382	10,554
Inventories	43,706	10,718
Other	(10,099)	725
Net cash flows from operating activities	93,547	59,844
Cash flows used in investing activities:		
Additions to property, plant and equipment	(26,608)	(15,433)
Acquisitions of operations	(2,252)	--
Proceeds from sale of subsidiary	12,150	--
Purchase of investment securities	(2,961)	(5,000)
Increase (decrease) in customer advances	608	(98)
Increase (decrease) in deferred charges and credits	1,667	(1,024)
Other	1,538	(233)
Net cash flows used in investing activities	(15,858)	(21,788)
Cash flows used in financing activities:		
Repayment of debt and capital lease obligation	(361)	(477)
Net payments under revolving credit facility	(12,900)	(31,400)
Purchase of treasury stock	(12,193)	--
Decrease in cash overdrafts	--	(6,250)
Other	92	71
Net cash flows used in financing activities	(25,362)	(38,056)
Change in cash and cash equivalents	52,327	--
Cash and cash equivalents at beginning of period	--	--
Cash and cash equivalents at end of period	$ 52,327	$ --
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 17,295	$ 15,654
Income taxes	$ 1,711	$ 1

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

	Nine Months Ended March 31, 2000	1999
	(thousands of dollars)	
Cash flows from operating activities:		
Net earnings	$ 20,547	$ 15,950
Adjustments to reconcile net earnings to net cash flows from operating activities:		
Depreciation and amortization	39,539	31,449
Deferred income taxes	3,355	(127)
Provision for bad debts	1,665	2,371
Deferred interest expense	187	517
Other	1,225	1,069
Changes in assets and liabilities, net of acquisitions and dispositions:		
Accounts receivable, billed and unbilled	(55,167)	(50,165)
Accounts payable	10,235	23,368
Taxes and other liabilities	9,719	6,989
Customer deposits	123	665
Deferred gas purchase costs	(5,149)	2,710
Inventories	33,652	445
Other	(10,090)	1,393
Net cash flows from operating activities	49,841	36,634
Cash flows used in investing activities:		
Additions to property, plant and equipment	(69,430)	(50,398)
Acquisition of operations, net of cash received	(38,083)	--
Proceeds from sale of subsidiary	12,150	--
Purchase of investment securities	(15,008)	(5,000)
Note receivable	(4,000)	--
Net change in customer advances	1,442	1,610
Net change in deferred charges and credits	(241)	71
Other	1,959	1,518
Net cash flows used in investing activities	(111,211)	(52,199)
Cash flows from financing activities:		
Issuance of long-term debt	300,000	--
Issuance cost of debt	(6,643)	--
Repayment of debt and capital lease obligation	(138,269)	(1,516)
Premium on early extinguishment of acquired debt	(745)	--
(Payments)/ borrowings under revolving credit facility	(21,000)	17,003
Purchase of treasury stock	(13,519)	--
Decrease in cash overdrafts	(6,655)	(19)
Other	528	97
Net cash flows from financing activities	113,697	15,565
Change in cash and cash equivalents	52,327	--
Cash and cash equivalents at beginning of period	--	--
Cash and cash equivalents at end of period	$ 52,327	$ --
Supplemental disclosures of cash flow information:		
Cash paid (refunded) during the period for:		
Interest	$ 40,512	$ 33,434
Income taxes	$ 1,711	$ (933)

See accompanying notes.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

	Twelve Months Ended March 31, 2000	1999
	(thousands of dollars)	
Cash flows from operating activities:		
Net earnings	$ 15,043	$ 7,101
Adjustments to reconcile net earnings to net cash flows from operating activities:		
Depreciation and amortization	49,946	40,963
Deferred income taxes	11,349	5,165
Provision for bad debts	2,573	3,521
Deferred interest expense	289	92
Write-off of regulatory assets	–	8,163
Other	1,160	1,760
Changes in assets and liabilities, net of acquisitions and dispositions:		
Accounts receivable, billed and unbilled	(5,216)	13,754
Accounts payable	(7,905)	(11,437)
Taxes and other liabilities	1,490	(1,376)
Customer deposits	(546)	437
Deferred gas purchase costs	2,839	12,777
Inventories	29,994	(8,073)
Other	(10,956)	(615)
Net cash flows from operating activities	90,060	72,232
Cash flows used in investing activities:		
Additions to property, plant and equipment	(92,179)	(75,588)
Acquisition of operations, net of cash received	(38,083)	–
Proceeds from sale of subsidiary	12,150	–
Purchase of investment securities	(17,008)	(5,000)
Note receivable	(4,000)	–
Increase in customer advances	1,971	2,349
Deferred charges and credits	(4,398)	1,480
Other	1,326	4,389
Net cash flows used in investing activities	(140,221)	(72,370)
Cash flows from (used in) financing activities:		
Issuance of long-term debt	300,000	–
Issuance cost of debt	(6,643)	–
Repayment of debt and capital lease obligation	(157,590)	(2,004)
Premium on early extinguishment of debt	(745)	–
Net borrowings (payments) under revolving credit facility	(18,600)	1,603
Purchase of treasury stock	(13,519)	–
Increase in cash overdraft	(603)	603
Other	188	(329)
Net cash flows from (used in) financing activities	102,488	(127)
Change in cash and cash equivalents	52,327	(265)
Cash and cash equivalents at beginning of period	–	265
Cash and cash equivalents at end of period	$ 52,327	$ –
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 52,117	$ 34,114
Income taxes	$ 3,617	$ 1,503

See accompanying notes.

FINANCIAL STATEMENTS

These financial statements should be read in conjunction with the financial statements and notes thereto contained in Southern Union Company's (*Southern Union* and, together with its wholly-owned subsidiaries, the *Company*) Annual Report on Form 10-K for the fiscal year ended June 30, 1999. Certain prior period amounts have been reclassified to conform with the current period presentation.

The interim financial statements are unaudited but, in the opinion of management, reflect all adjustments (including both normal recurring as well as any non-recurring) necessary for a fair presentation of the results of operations for such periods. Because of the seasonal nature of the Company's operations, the results of operations and cash flows for any interim period are not necessarily indicative of results for the full year. Also, as described below, the Company acquired Pennsylvania Enterprises, Inc. on November 4, 1999. Accordingly, the operating activities of the acquired operations are consolidated with the Company beginning on that date. Thus, the results of operations for the three-, nine- and twelve-month periods ended March 31, 2000 are not indicative of results that would necessarily be achieved for a full year since the majority of the Company's operating margin is recorded during the winter heating season. For these reasons, the results of operations of the Company for the periods subsequent to this acquisition are not comparable to those periods prior to the acquisition nor are the fiscal 2000 results of operations comparable with prior periods.

ACQUISITION ACTIVITIES

Pennsylvania Enterprises, Inc.

On November 4, 1999, the Company acquired Pennsylvania Enterprises, Inc. (hereafter referred to as the "Pennsylvania Operations") in a transaction valued at approximately $500 million, including assumption of debt of approximately $150 million. The Company issued approximately 17 million shares of common stock and paid approximately $36 million in cash to complete the transaction. The Pennsylvania Operations are headquartered in Wilkes-Barre, Pennsylvania with natural gas distribution being its primary business. The principal operating division of the Pennsylvania Operations is the PG Energy division of the Company which serves more than 152,000 gas customers in northeastern and central Pennsylvania. Subsidiaries of the Company included in the Pennsylvania Operations include PG Energy Services Inc., Keystone Pipeline Services, Inc. (a wholly-owned subsidiary of PG Energy Services, Inc.), PEI Power Corporation, and Theta Land Corporation. PG Energy Services Inc. markets a diversified range of energy-related products and services under the name of PG Energy Power Plus and supplies propane under the name of PG Energy Propane. Keystone Pipeline Services, Inc. provides pipeline and fiber optic cable construction, installation, maintenance, and rehabilitation services. PEI Power Corporation operates a cogeneration plant that generates steam and electricity for resale. Theta Land Corporation, which provided land management and development services for more than 44,000 acres of land, was sold for $12,150,000 in January, 2000. In accordance with generally accepted accounting principles relative to business combinations, no gain or loss was recognized on this transaction.

The Company funded the acquisition of the Pennsylvania Operations and related refinancings with the sale of $300,000,000 of 8.25% Senior Notes due 2029 completed on November 3, 1999 (8.25% Senior Notes). See *Debt and Capital Lease*. The assets of the Pennsylvania Operations are included in the consolidated balance sheet of the Company at March 31, 2000 and income from the Pennsylvania Operations has been included in the statement of consolidated operations beginning November 4, 1999. The acquisition was accounted for using the purchase method. The additional purchase cost assigned to utility plant of approximately $249,477,000 reflects the excess of the purchase price over the historical book carrying value of the utility plant purchased. Amortization of the additional purchase cost assigned to utility plant is provided on a straight-line basis over forty years. The final allocation of the purchase price of the Pennsylvania Operations acquisition is expected to be completed in the fourth quarter of fiscal year 2000.

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

Pro Forma Financial Information

The following unaudited pro forma financial information for the nine-month periods ended March 31, 2000 and 1999 is presented as though the following events had occurred at the beginning of the earliest period presented: (i) the acquisition of Pennsylvania Enterprises, Inc.; (ii) the sale of the 8.25% Senior Notes; and (iii) the refinancing of certain short-term and long-term debt at the time of acquisition. The pro forma financial information is not necessarily indicative of the results which would have actually been obtained had the acquisition of Pennsylvania Enterprises, Inc., the sale of senior notes or the refinancings been completed as of the assumed date for the periods presented or which may be obtained in the future.

	Nine Months Ended March 31,	
	2000	1999
Operating revenues	$ 717,655	$ 693,388
Income (loss) before extraordinary item	9,835	16,625
Net earnings (loss) available for common stock	9,835	16,625
Net earnings (loss) per common stock:		
Basic	.21	.35
Diluted	.20	.34

Other Acquisitions

On December 1, 1999, Southern Union and Valley Resources, Inc. ("Valley Resources") (AMEX: VR) announced a definitive merger agreement. The agreement calls for Valley Resources to merge into Southern Union in a transaction valued at approximately $160 million, including the assumption of debt of approximately $30 million. If approved, each Valley Resources shareholder will receive $25.00 per Valley Resources share in cash. The merger will be accounted for using the purchase method. Valley Resources is a public utility holding company with natural gas distribution systems in northeastern and eastern Rhode Island serving a total of 66,000 customers.

On November 15, 1999, Southern Union and Providence Energy Corporation ("Providence Energy") (NYSE: PVY) announced a definitive merger agreement. The agreement calls for Providence Energy to merge into Southern Union in a transaction valued at approximately $400 million, including the assumption of debt of approximately $93 million. If approved, each Providence Energy shareholder will receive $42.50 per Providence Energy share in cash. The merger will be accounted for using the purchase method. Providence Energy distributes and markets natural gas, heating oil, and petroleum products and also markets electricity and energy services. Providence Energy serves approximately 181,000 customers principally in Rhode Island and Massachusetts.

On October 5, 1999, Southern Union announced a definitive merger agreement with Fall River Gas Company ("Fall River") (AMEX: FAL) in a transaction valued at approximately $75 million, including the assumption of debt of approximately $20 million. If approved, each Fall River shareholder will receive Southern Union common stock and/or cash having a value of $23.50, subject to adjustment. At least half of the outstanding Fall River shares must be exchanged for Southern Union common stock. The merger will be accounted for using the purchase method. Fall River is a natural gas distribution company that serves nearly 48,000 customers in the city of Fall River and the towns of Somerset, Swansea and Westport, all located in Southeastern Massachusetts.

Southern Union anticipates having all necessary approvals for each of these mergers by September 2000.

WRITE-OFF OF REGULATORY ASSETS

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

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

EARNINGS PER SHARE

Average shares outstanding for basic earnings per share were 46,919,654 and 31,170,179 for the three-month period ended March 31, 2000 and 1999, respectively; 39,706,933 and 31,129,919 for the nine-month period ended March 31, 2000 and 1999, respectively; and 37,586,705 and 31,119,598 for the twelve-month period ended March 31, 2000 and 1999, respectively. Diluted earnings per share includes average shares outstanding as well as common stock equivalents from stock options and warrants. Common stock equivalents were 1,156,945 and 1,454,425 for the three-month period ended March 31, 2000 and 1999, respectively; 1,450,730 and 1,441,221 for the nine-month period ended March 31, 2000 and 1999, respectively; and 1,514,534 and 1,380,963 for the twelve-month period ended March 31, 2000 and 1999, respectively. At March 31, 2000, 894,297 shares of common stock were held by various rabbi trusts for certain of the Company's benefit plans.

INVESTMENT SECURITIES

In March 2000, the Company acquired an 11% interest in a development stage communications company for $2,000,000.

At March 31, 2000, all securities owned by the Company are accounted for under the cost method. These securities consist of equity ownership in non-public companies. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the Consolidated Statement of Operations when incurred, and dividends are recognized as income when received.

PREFERRED SECURITIES OF SUBSIDIARY TRUST

On May 17, 1995, Southern Union Financing I (Subsidiary Trust), a consolidated wholly-owned subsidiary of Southern Union, issued $100,000,000 of 9.48% Trust Originated Preferred Securities (Preferred Securities). In connection with the Subsidiary Trust's issuance of the Preferred Securities and the related purchase by Southern Union of all of the Subsidiary Trust's common securities (Common Securities), Southern Union issued to the Subsidiary Trust $103,092,800 principal amount of its 9.48% Subordinated Deferrable Interest Notes, due 2025 (Subordinated Notes). The sole assets of the Subsidiary Trust are the Subordinated Notes. The interest and other payment dates on the Subordinated Notes correspond to the distribution and other payment dates on the Preferred Securities and the Common Securities. Under certain circumstances, the Subordinated Notes may be distributed to holders of the Preferred Securities and holders of the Common Securities in liquidation of the Subsidiary Trust.

The Subordinated Notes are redeemable at the option of the Company on or after May 17, 2000, at a redemption price of $25 per Subordinated Note plus accrued and unpaid interest. The Preferred Securities and the Common Securities will be redeemed on a pro rata basis to the same extent as the Subordinated Notes are repaid, at $25 per Preferred Security and Common Security plus accumulated and unpaid distributions. Southern Union's obligations under the Subordinated Notes and related agreements, taken together, constitute a full and unconditional guarantee by Southern Union of payments due on the Preferred Securities. As of March 31, 2000 and 1999, 4,000,000 shares of Preferred Securities were outstanding.

DEBT AND CAPITAL LEASE

	March 31, 2000	June 30, 1999
	(thousands of dollars)	
7.60% Senior Notes due 2024	$ 364,515	$ 364,515
8.25% Senior Notes due 2029	300,000	–
8.375% First Mortgage Bonds, due 2002	30,000	–
9.34% First Mortgage Bonds, due 2019	15,000	–
Capital lease and other	26,974	28,482
Total debt and capital lease	736,489	392,997
Less current portion	2,169	2,066
Total long-term debt and capital lease	$ 734,320	$ 390,931

On November 3, 1999, the Company completed the sale of $300,000,000 of 8.25% Senior Notes due 2029. The net proceeds from the sale of these senior notes were used to: (i) fund the acquisition of Pennsylvania Enterprises, Inc.; (ii) repay approximately $109,900,000 of borrowings under the revolving credit facility, and (iii) repay approximately $136,000,000 of debt assumed in the acquisition. See *Management's Discussion and Analysis of Financial Condition and Results of Operations -- Financial Condition.*

Credit Facilities The Company has availability under two revolving credit facilities (Revolving Credit Facilities) underwritten by a syndicate of banks. Of the Revolving Credit Facilities, $40,000,000 is available under a short-term facility which expires June 29, 2000, while $60,000,000 is available under a long-term facility expiring on June 30, 2002. The Company has additional availability under uncommitted line of credit facilities (Uncommitted Facilities) with various banks. Covenants under the Revolving Credit Facilities allow for up to $50,000,000 of borrowings under Uncommitted Facilities at any one time. Borrowings under the facilities are available for Southern Union's working capital, letter of credit requirements and other general corporate purposes. The Company had no balance outstanding under the facilities at March 31, 2000.

Capital Lease The Company completed the installation of an Automated Meter Reading (AMR) system at Missouri Gas Energy during fiscal year 1999. The installation of the AMR system involved an investment of approximately $30,000,000 which is accounted for as a capital lease obligation. As of March 31, 2000, the capital lease obligation outstanding was $25,561,000 with a fixed rate of 5.79%. This system has improved meter reading accuracy and provided electronic accessibility to meters in residential customers' basements, thereby assisting in the reduction of the number of estimated bills.

UTILITY REGULATION AND RATES

On April 3, 2000, PG Energy, a division of the Company, filed an application with the Pennsylvania Public Utility Commission (the PPUC) seeking an increase in its base rates designed to produce $17.9 million in additional annual

revenues. On May 11, 2000, the PPUC suspended this rate increase request for seven months, until January 2, 2001, in order to investigate the reasonableness of the proposed rates.

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

On August 21, 1998, Missouri Gas Energy, a division of the Company, was notified by the MPSC of its decision to grant a $13,300,000 annual increase to revenue effective on September 2, 1998, which is primarily earned volumetrically. The MPSC rate order reflected a 10.93% return on common equity. The rate order, however, disallowed certain previously recorded deferred costs requiring a non-cash write-off of $2,221,000. The Company recorded this charge to earnings in its fiscal year ended June 30, 1998. On December 8, 1998, the MPSC denied rehearing requests made by all parties other than Missouri Gas Energy and granted a portion of Missouri Gas Energy's rehearing request. The MPSC will conduct further proceedings to take additional evidence on those matters for which it granted Missouri Gas Energy a rehearing. If the MPSC adopts Missouri Gas Energy's positions on rehearing, then Missouri Gas Energy would be authorized an additional $2,200,000 of base revenues increasing the $13,300,000 initially authorized in its August 21, 1998 order to $15,500,000. The MPSC's orders are subject to judicial review and although certain parties have argued for a reduction in Missouri Gas Energy's authorized base revenue increase on judicial review, Missouri Gas Energy expects such arguments to be unsuccessful.

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

COMMITMENTS AND CONTINGENCIES

Environmental Southern Union and Western Resources entered into an Environmental Liability Agreement at the closing of the Missouri Acquisition. Subject to the accuracy of certain representations made by Western Resources in the Missouri Asset Purchase Agreement, the Environmental Liability Agreement provides for a tiered approach to the allocation of substantially all liabilities under environmental laws that may exist or arise with respect to Missouri Gas Energy. At the present time and based upon information available to management, the Company believes that the costs of any remediation efforts that may be required for these sites for which it may ultimately have responsibility will not exceed the aggregate amount subject to substantial sharing by Western Resources.

In a letter dated May 10, 1999, the Missouri Department of Natural Resources ("MDNR") sent notice of a planned site inspection/removal site evaluation of the Kansas City Coal Gas Former Manufactured Gas Plant ("FMGP") site. This site (comprised of two FMGP operations previously owned by two separate companies) is located at East First Street and Campbell in Kansas City, Missouri and is owned by Missouri Gas Energy. A 1988 investigation of the site performed by an Environmental Protection Agency ("EPA") contractor determined that further remedial assessment was not required under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), as amended by the Superfund Amendments and Reauthorization Act of 1986. The MDNR has stated that the reassessment of the Kansas City coal gas site is part of a statewide effort to identify, evaluate, and prioritize the potential hazards posed by all of Missouri's FMGP sites. During July 1999, the Company sent applications to MDNR submitting the two sites to the agency's Voluntary Cleanup Program ("VCP"). The sites were

accepted into the VCP on August 2, 1999 and MDNR subsequently approved the Company's proposed workplans for the environmental assessment of the sites. The final environmental reports were sent to the state on March 6, 2000.

The Company received a letter dated December 16, 1999 from MDNR notifying the Company of a Pre-CERCLIS Site Screening (SS) investigation of a former manufactured gas plant located at Pacific Avenue & South River Boulevard in Independence, Missouri. The Company has contacted the MDNR to inform the state that, as this property is not owned by the Company, it cannot grant access to the property for MDNR's investigation.

In addition to the various Missouri Gas Energy sites described above, the Company is investigating the possibility that the Company or predecessor companies may have been associated with Manufactured Gas Plant (MGP) sites in other of its former service territories, principally in Arizona and New Mexico, and present service territories in Texas and its newly acquired service territories in Pennsylvania. At the present time, the Company is aware of certain plant sites in some of these areas and is investigating those and certain other locations.

While the Company's evaluation of these Texas, Arizona, New Mexico and Pennsylvania MGP sites is in its preliminary stages, it is likely that some compliance costs may be identified and become subject to reasonable quantification. To the extent that such potential costs are quantified, the Company expects to provide any appropriate accruals and seek recovery for such remediation costs through all appropriate means, including insurance and regulatory relief. Although significant charges to earnings could be required prior to rate recovery, management does not believe that environmental expenditures for such FMGP and MGP sites will have a material adverse effect on the Company's financial position, results of operations or cash flows.

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

There are four lawsuits pending in two federal district courts -- in Arizona and Oklahoma -- that relate to activities surrounding Southern Union's efforts to acquire Southwest. In addition, there is before the U. S. Court of Appeals for the Tenth Circuit, an appeal by Southern Union of a preliminary injunction entered by the Oklahoma federal district court. On October 11, 1999, Southern Union filed its first amended complaint in the Arizona action to include additional individual defendants and to incorporate additional facts required in the discovery process. On January 21, 2000, ONEOK terminated its agreement to merge with Southwest, and additionally filed an action against Southwest in federal district court in Oklahoma. On January 24, 2000, Southwest filed an action against ONEOK and Southern Union in federal district court in Arizona.

Southern Union is vigorously pursuing its claims against Southwest, ONEOK, and certain individual defendants, and is also vigorously defending itself against claims by Southwest and ONEOK. The Company believes that the results of the above-noted Southwest Gas litigation will not have a materially adverse effect on the Company's financial condition, results of operations or cash flows.

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

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

In December 1999, the Company advanced $4,000,000 and entered into a note agreement with an executive officer. Also in December 1999, the Company entered into an employment contract with the executive officer. The aggregate minimum commitment for future compensation under this employment contract is approximately $6,400,000.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Company's core business is the distribution of natural gas as a public utility principally through four divisions: Southern Union Gas, Missouri Gas Energy (MGE), Atlantic Utilities, doing business as South Florida Natural Gas (SFNG), and effective as of November 4, 1999, PG Energy. In addition, subsidiaries of Southern Union have been established to support and expand natural gas sales and to capitalize on the Company's gas energy expertise. These subsidiaries operate natural gas pipeline systems, market natural gas and electricity to end-users and distribute propane. By providing "one-stop shopping," the Company can serve its various customers' specific energy needs, which encompass substantially all of the natural gas distribution and sales businesses from natural gas sales to specialized energy consulting services. Certain subsidiaries own or hold interests in real estate and other assets, which are primarily used in the Company's utility business.

Several of these business activities are subject to regulation by federal, state or local authorities where the Company operates. Thus, the Company's financial condition and results of operations have been and will continue to be dependent upon the receipt of adequate and timely adjustments in rates. In addition, the Company's business is affected by seasonal weather impacts, competitive factors within the energy industry and economic development and residential growth in its service areas.

The Company acquired Pennsylvania Enterprises, Inc. (hereafter referred to as the "Pennsylvania Operations") on November 4, 1999. In addition to the PG Energy division of the Company, the following subsidiaries of the Company are included in the Pennsylvania Operations: PG Energy Services Inc., Keystone Pipeline Services, Inc. (a wholly-owned subsidiary of PG Energy Services, Inc.), PEI Power Corporation and Theta Land Corporation. Theta Land Corporation provided land management and development services for more than 44,000 acres of land, was sold for $12,150,000 in January 2000. In accordance with generally accepted accounting principles relative to business combinations, no gain or loss was recognized on this transaction. PG Energy Services Inc. markets a diversified range of energy-related products and services under the name of PG Energy Power Plus and supplies propane under the name of PG Energy Propane. Keystone Pipeline Services, Inc. provides pipeline and fiber optic cable construction, installation, maintenance, and rehabilitation services. PEI Power Corporation operates a cogeneration plant that generates steam and electricity for resale. The income from the acquired Pennsylvania Operations is consolidated with the Company beginning on November 4, 1999. Thus, the results of operations for the three-, nine- and twelve-month periods ended March 31, 2000 are not indicative of results that would necessarily be achieved for a full year since the majority of the Company's operating margin is recorded during the winter heating season. For these reasons, the results of operations of the Company for the periods subsequent to this acquisition are not comparable to those periods prior to the acquisition nor are the 2000 results of operations comparable with prior periods.

RESULTS OF OPERATIONS

Three Months Ended March 31, 2000 and 1999

The Company recorded net earnings available for common stock of $19,515,000 for the three-month period ended March 31, 2000, an increase of 11%, compared with net earnings of $17,624,000 for the same period in 1999. Earnings per diluted share were $.40 in 2000 compared to $.54 in 1999. Weighted average shares outstanding increased 49% in 2000 primarily due to the issuance of 16,714,000 shares of the Company's common stock on November 4, 1999 in connection with the acquisition of the Pennsylvania Operations.

Operating revenues were $344,789,000 for the three-month period ended March 31, 2000, compared with operating revenues of $251,863,000 in 1999. Gas purchase and other energy costs for the three-month period ended March 31, 2000 were $217,793,000, compared with $153,757,000 in 1999. The Company's operating revenues are affected by the level of sales volumes and by the pass-through of increases or decreases in the Company's gas purchase costs through its purchased gas adjustment clauses. Additionally, revenues are affected by increases or

decreases in gross receipts taxes (revenue-related taxes) which are levied on sales revenue as collected from customers and remitted to the various taxing authorities. The increase in both operating revenues and gas purchase costs between periods was primarily due to a 15% increase in gas sales volume to 53,101 MMcf in 2000 from 46,068 MMcf in 1999 and by a 10% increase in the average cost of gas from $3.33 per Mcf in 1999 to $3.66 per Mcf in 2000. The acquisition of the Pennsylvania Operations contributed 11,038 MMcf of the increase while the remaining operations of the Company resulted in a gas sales volume decrease of 4,005 MMcf. These volume decreases were primarily the result of warmer than normal weather and the loss of certain marketing customers. Changes in the average cost of gas resulted from seasonal impacts on demands for natural gas and the ensuing competitive pricing within the industry. The Pennsylvania Operations contributed $96,023,000 to the overall increase in operating revenues and $63,249,000 in gas purchase and other energy costs.

Weather for MGE's service territories was 79% of a 30-year measure for the three-month period ended March 31, 2000, compared with 87% in 1999. Southern Union Gas service territories experienced weather that was 62% of a 30-year measure in 2000, compared with 65% in 1999. About half of the customers served by Southern Union Gas are weather normalized. Weather in PG Energy service territories was 92% of a 30-year measure for the three-month period ended March 31, 2000.

Net operating margin (operating margin less revenue-related taxes) increased $29,182,000 to $112,801,000 for the three-month period ended March 31, 2000 compared with the same period in 1999. Net operating margin increased due principally to the acquisition of the Pennsylvania Operations as previously discussed, which contributed $32,537,000 to net operating margin. This was partially offset by lower net operating margins in the MGE and Southern Union Gas service territories in 2000 compared to 1999 due to the warmer weather as previously discussed.

Operating expenses, which include operating, maintenance and general expenses, depreciation and amortization and taxes, other than on income and revenues, were $59,900,000 for the three-month period ended March 31, 2000, an increase of $16,928,000, compared with $42,972,000 in 1999. An increase of $15,336,000 was the result of the acquisition of the Pennsylvania Operations. Also impacting operating expenses during the three-month period ended March 31, 2000 was an increase in costs associated with certain employee benefits and increases in property taxes.

Interest expense was $14,940,000 for the three-month period ended March 31, 2000, compared with $8,962,000 in 1999. Interest expense increased in 2000 primarily due to the issuance of $300,000,000 of 8.25% Senior Notes on November 3, 1999, ("8.25% Senior Notes") which was used to extinguish $136,000,000 in existing debt of the Pennsylvania Operations at the time of the merger, and the assumption of $45,000,000 of Pennsylvania Operations' debt by the Company. This was partially offset by reduced interest expense on short-term debt due to a reduction in the average short-term debt outstanding during 2000 as a result of utilizing a portion of the 8.25% Senior Notes proceeds for working capital needs. See "Debt and Capital Lease" in the Notes to the Consolidated Financial Statements included herein.

Other expense of $1,034,000 for the three-month period ended March 31, 2000 primarily consists of $1,400,000 of costs associated with an unsuccessful acquisition. This amount was offset by $663,000 in net rental income from Lavaca Realty Company ("Lavaca Realty"), the Company's real estate subsidiary. Other expense of $252,000 for the three-month period ended March 31, 1999 primarily consisted of net expense of $153,000 related to the amortization and current deferral of interest and other expenses associated with the MGE Safety Program.

The Company's consolidated federal and state effective income tax rate was 43% and 39% for the three months ended March 31, 2000 and 1999, respectively. The increase in the effective federal and state income tax rate is a result of non-tax deductible amortization of additional purchase cost associated with the purchase of the Pennsylvania Operations.

Nine Months Ended March 31, 2000 and 1999

The Company recorded net earnings available for common stock of $20,547,000 for the nine-month period ended March 31, 2000, compared with net earnings of $15,950,000 for the same period in 1999. Earnings per diluted share were $.49 in both 2000 and 1999. Weighted average common and common share equivalents increased 27% during 2000 compared with 1999 due to the issuance of common stock for the acquisition of the Pennsylvania Operations as previously discussed.

Operating revenues were $669,170,000 for the nine-month period ended March 31, 2000, compared with operating revenues of $503,543,000 in 1999. Gas purchase and other energy costs for the nine-month period ended March 31, 2000 were $402,182,000 compared with $292,370,000 in 1999. The increase in both operating revenues and gas purchase costs between periods was primarily impacted by a 13% increase in gas sales volume to 101,225 MMcf in 2000 from 89,518 MMcf in 1999. The acquisition of the Pennsylvania Operations, previously discussed, accounted for 16,792 MMcf of the increase while the remaining operations of the Company resulted in a gas sales volume decrease of 5,085 MMcf. Additionally, operating revenues and gas purchase costs were affected by a 11% increase in the average cost of gas from $3.24 per Mcf in 1999 to $3.59 per Mcf in 2000, due to changes in average spot market gas prices. Also impacting operating revenues was a $13,300,000 annual increase to revenues granted to MGE, effective as of September 2, 1998. The effect of this rate order was marginal as it is earned volumetrically and therefore was impacted by the warmer than normal weather in both 2000 and 1999.

MGE's service territories experienced weather which was 79% of a 30-year measure for the nine months ended March 31, 2000 compared with 84% in 1999. Weather for Southern Union Gas service territories for the nine-month period ended March 31, 2000 was 72% of a 30-year measure compared with 73% in 1999. Weather in PG Energy service territories was 91% of a 30-year measure for the five-month period ended March 31, 2000.

Net operating margin increased $53,568,000 to $237,572,000 for the nine-month period ended March 31, 2000 compared with the same period in 1999. Net operating margin increased $51,659,000 due to increased gas sales volumes as a result of the acquisition of the Pennsylvania Operations, as previously discussed, and the effect of a $13,300,000 annual increase to revenues in the Missouri service territories granted by the MPSC effective as of September 2, 1998, also previously discussed. Also contributing to the increase in net operating margin was a one-time expense during the nine-month period ended March 31, 1999 of $1,000,000 associated with a cost of gas refund to the City of El Paso customers and a charge during the same period for certain lost and unaccounted for gas. This was partially offset by lower net operating margins in the MGE and Southern Union Gas service territories in 2000 compared to 1999 due to the warmer weather, also previously discussed.

Operating expenses were $151,965,000 for the nine-month period ended March 31, 2000, an increase of $27,966,000, compared with $123,999,000 in 1999. An increase of $24,835,000 was the result of the acquisition of the Pennsylvania Operations, as previously discussed. Also contributing to the increase was additional depreciation and amortization and property taxes as a result of including certain costs into rate base that had been previously deferred.

Interest expense was $36,603,000 for the nine-month period ended March 31, 2000, compared with $26,843,000 in 1999. The increase is primarily due to the issuance of the 8.25% Senior Notes, as previously discussed, which was used to extinguish $136,000,000 in existing debt of the Pennsylvania Operations at the time of the merger, and the assumption of $45,000,000 of Pennsylvania Operations debt by the Company. This was partially offset by reduced interest expense on short-term debt due to a reduction in the average short-term debt outstanding during 2000 as a result of utilizing a portion of the 8.25% Senior Notes proceeds for working capital needs. See "Debt and Capital Lease" in the Notes to the Financial Statements included herein.

Other expense for the nine-month period ended March 31, 2000 was $5,527,000 compared with other income of $311,000 in 1999. Other expense for the nine-month period ended March 31, 2000 primarily consists of $6,664,000 of litigation costs associated with an unsuccessful acquisition. This amount was offset by $1,327,000 in net rental income from Lavaca Realty. Other income for the nine-month period ended March 31, 1999 included net rental income from Lavaca Realty of $935,000, which was partially offset by net expense of $517,000 related to the amortization and current deferral of interest and other expenses associated with the MGE Safety Program.

The Company's consolidated federal and state effective income tax rate was 43% and 39% for the nine-month periods ended March 31, 2000 and 1999, respectively. The increase in the effective federal and state income tax rate is a result of non-tax deductible amortization of additional purchase cost associated with the purchase of the Pennsylvania Operations.

Twelve Months Ended March 31, 2000 and 1999

The Company recorded net earnings available for common stock of $15,043,000 for the twelve-month period ended March 31, 2000 compared with net earnings of $7,101,000 in 1999. Earnings per diluted share were $.38 in 2000 compared to $.22 in 1999. Weighted average common and common share equivalents increased 21% during the twelve-month period ended March 31, 2000 compared with 1999 due to the issuance of common stock in the acquisition of the Pennsylvania Operations as previously discussed.

During fiscal year 1998, the Company was impacted by pre-tax non-cash write-offs totaling $8,163,000 of previously recorded regulatory assets. On August 18, 1998, the Missouri Court of Appeals denied the previously disclosed appeal by the Company of the MPSC's January 1997 Rate Order granted to MGE. Because of this decision, the Company recorded a one-time non-cash write-off of $5,942,000 of deferred costs recorded since 1994. On August 21, 1998, the MPSC also granted MGE a rate increase which, among other things, disallowed certain previously recorded deferred costs requiring an additional pre-tax non-cash write-off of $2,221,000. See "Write-Off of Regulatory Assets" and "Commitments and Contingencies" in the Notes to the Consolidated Financial Statements included herein.

Operating revenues were $770,858,000 for the twelve-month period ended March 31, 2000 compared with operating revenues of $612,469,000 in 1999. Gas purchase and other energy costs for the twelve-month period ended March 31, 2000 were $452,113,000, compared with $351,174,000 in 1999. The increase in both operating revenues and gas purchase costs between periods was primarily the result of an increase in gas sales volume to 117,777 MMcf in 2000 from 108,113 MMcf in 1999. The increase in sales volumes was due to the acquisition of the Pennsylvania Operations, previously discussed, which was offset by a decrease in sales volumes in both Missouri and Texas due to warmer weather during the twelve-month period ended March 31, 2000 compared with 1999. Additionally, operating revenues and gas purchase costs were affected by an increase of 8% in the average cost of gas from $3.23 per Mcf in 1999 to $3.50 per Mcf in 2000, due to increases in average spot market gas prices. Operating revenues were also impacted by a $13,300,000 annual increase to revenues granted to MGE, effective as of September 2, 1998. The effect of this rate increase has been marginal as it earns volumetrically and has also been impacted by the warmer than normal weather.

MGE's service territories experienced weather that was 80% of the 30-year measure for the twelve-month period ended March 31, 2000 compared with 84% in 1999. Weather for Southern Union Gas service territories for the twelve-month period ended March 31, 2000 was 72% of a 30-year measure compared with 75% in 1999. About half of the customers served by Southern Union Gas are weather normalized.

Net operating margin increased $55,352,000 to $284,464,000 for the twelve-month period ended March 31, 2000 compared with the same period in 1999. Net operating margin increased $51,659,000 due to increased gas sales volumes as a result of the acquisition of the Pennsylvania Operations, as previously discussed, and the effect of a $13,300,000 annual increase to revenues in the Missouri service territories granted by the MPSC effective as of September 2, 1998, also previously discussed. Also contributing to the increase in net operating margin was a one-time expense during the twelve-month period ended March 31, 1999 of $1,000,000 associated with a cost of gas refund to the City of El Paso customers and a charge during the same period for certain lost and unaccounted for gas. This was partially offset by lower net operating margins in the MGE and Southern Union Gas service territories in 2000 compared to 1999 due to the warmer weather, also previously discussed.

Operating expenses were $194,015,000 for the twelve-month period ended March 31, 2000, an increase of $28,702,000, compared with operating expenses of $165,313,000 in 1999. The increase is primarily a result of the acquisition of the Pennsylvania Operations and an increase in depreciation and amortization and property taxes as a result of including certain costs into rate base that had been previously deferred.

Interest expense was $45,759,000 for the twelve-month period ended March 31, 2000, compared with $35,182,000 in 1999. The increase is primarily due to the issuance of the of 8.25% Senior Notes as previously discussed which was used to extinguish $136,000,000 in existing debt of the Pennsylvania Operations at the time of the merger, and the assumption of $45,000,000 of Pennsylvania Operations' debt by the Company. The increase was partially offset by reduced interest expense on short-term debt due to a reduction in the average short-term debt outstanding during 2000 as a result of utilizing a portion of the 8.25% Senior Notes proceeds for working capital needs. See "Debt and Capital Lease" in the Notes to the Consolidated Financial Statements included herein.

Other expense for the twelve-month period ended March 31, 2000 was $7,651,000 compared with other income of $763,000 in 1999. Other expense for the twelve-month period ended March 31, 2000 primarily consists of $10,503,000 of costs associated with unsuccessful acquisition activities and related litigation. This amount was partially offset by $1,841,000 in net rental income of Lavaca Realty. Other income for the twelve-month period ended March 31, 1999 included $1,298,000 in net rental income from Lavaca Realty.

The Company's consolidated federal and state effective income tax rate was 45% and 39% for the twelve-month periods ended March 31, 2000 and 1999, respectively. The increase in the effective federal and state income tax rate is a result of non-tax deductible amortization of additional purchase cost associated with the purchase of the Pennsylvania Operations.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following table sets forth certain information regarding the Company's gas utility operations for the three- and twelve-month periods ended March 31, 2000 and 1999:

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	2000	1999	2000	1999
Average number of gas sales customers served:				
Residential	1,062,100	906,268	965,954	892,196
Commercial	107,699	91,432	95,818	88,308
Industrial and irrigation	764	572	651	569
Pipeline and marketing	225	237	232	233
Public authorities and other	3,195	2,887	2,992	2,841
Total average customers served	1,173,983	1,001,396	1,065,647	984,147
Gas sales in millions of cubic feet (MMcf):				
Residential	36,566	30,156	67,166	57,438
Commercial	14,468	12,415	28,923	25,624
Industrial and irrigation	504	394	1,522	1,520
Pipeline and marketing	5,542	5,807	17,253	20,338
Public authorities and other	1,193	1,076	2,548	2,322
Gas sales billed	58,273	49,848	117,412	107,242
Net change in unbilled gas sales	(5,172)	(3,780)	365	871
Total gas sales	53,101	46,068	117,777	108,113
Gas sales revenues (thousands of dollars):				
Residential	$ 225,712	$ 172,746	$ 450,861	$ 368,947
Commercial	84,356	68,446	167,577	141,510
Industrial and irrigation	2,814	1,913	7,923	6,800
Pipeline and marketing	14,119	13,232	43,664	47,714
Public authorities and other	5,457	3,932	11,428	8,818
Gas sales revenues billed	332,458	260,269	681,453	573,789
Net change in unbilled gas sales revenues	(28,811)	(19,390)	3,660	4,261
Total gas sales revenues	$ 303,647	$ 240,879	$ 685,113	$ 578,050
Gas sales margin (thousands of dollars)	$ 95,223	$ 73,169	$ 238,484	$ 197,143
Gas sales revenue per thousand cubic feet (Mcf) billed:				
Residential	$ 6.17	$ 5.73	$ 6.71	$ 6.42
Commercial	5.83	5.51	5.79	5.52
Industrial and irrigation	5.59	4.86	5.21	4.47
Pipeline and marketing	2.55	2.28	2.53	2.35
Public authorities and other	4.57	3.65	4.49	3.80
Weather:				
Degree days:				
Southern Union Gas service territories	777	800	1,550	1,609
Missouri Gas Energy service territories	2,211	2,429	4,200	4,418
PG Energy service territories	2,929	--	4,524	--
Percent of normal, based on 30-year measure:				
Southern Union Gas service territories	62%	65%	72%	75%
Missouri Gas Energy service territories	79%	87%	80%	84%
PG Energy service territories	92%	--	91%	--
Gas transported in millions of cubic feet (MMcf)	25,738	16,700	70,093	55,314
Gas transportation revenues (thousands of dollars)	$ 12,174	$ 6,351	$ 29,405	$ 19,963

Information for PG Energy is included for the five months subsequent to the date of acquisition, November 4, 1999. The above information does not include the Company's 43% equity ownership in a natural gas distribution company serving 20,000 customers in Piedras Negras, Mexico.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FINANCIAL CONDITION

The Company's gas utility operations are seasonal in nature with a significant percentage of the annual revenues and earnings occurring in the traditional heating-load months. This seasonality results in a high level of cash flow needs immediately preceding the peak winter heating season months, resulting from the required payments to natural gas suppliers in advance of the receipt of cash payments from the Company's customers. The Company has historically used internally generated funds and its revolving loan and credit facilities to provide funding for its seasonal working capital, continuing construction and maintenance programs and operational requirements.

Concurrent with the closing of the Pennsylvania Enterprises, Inc. merger on November 4, 1999, the Company issued $300,000,000 of 8.25% Senior Notes due 2029 which were used to: (i) fund the cash portion of the consideration to be paid to the Pennsylvania Enterprises, Inc. shareholders; (ii) refinance and repay certain debt of Pennsylvania Enterprises, Inc., and (iii) repay outstanding borrowings under the Company's various credit facilities. These senior notes are senior unsecured obligations and will rank equally in right of payment with each other and with the Company's other unsecured and unsubordinated obligations, including the 7.60% Senior Notes due 2024.

The principal source of funds during the three-month period ended March 31, 2000 included $93,547,000 in cash flow from operations. This source provided funds for additions to property, plant and equipment of $26,608,000, $12,900,000 in net repayments under the Company's revolving credit facility, and $12,193,000 for the repurchase of Company stock.

The principal sources of funds during the nine-month period ended March 31, 2000 included $49,841,000 in cash flow from operations and $300,000,000 received from the issuance of the 8.25% Senior Notes, as noted above. The principal uses of funds during this period included: payments of $38,083,000 for the acquisition of Pennsylvania Enterprises, Inc.; $138,269,000 for the retirement of long-term debt which primarily consists of debt extinguished in the Pennsylvania Enterprises, Inc. acquisition; $21,000,000 for the pay-down of the Company's Revolving Credit Facilities; $15,008,000 for the purchase of investment securities; $6,643,000 in debt issuance costs on the 8.25% Senior Notes; and $69,430,000 for on-going property, plant and equipment additions as well as seasonal working capital needs of the Company.

The effective interest rate under the Company's current debt structure is 8.07% (including interest and the amortization of debt issuance costs and redemption premiums on refinanced debt).

The Company has availability under two revolving credit facilities (the "Revolving Credit Facilities") underwritten by a syndicate of banks. Of the Revolving Credit Facilities, $40,000,000 is a short-term facility which expires June 29, 2000, while $60,000,000 is a long-term facility which expires June 30, 2002. The Company has additional availability under uncommitted line of credit facilities (Uncommitted Facilities) with various banks. Covenants under the Revolving Credit Facilities allow for up to $50,000,000 of borrowings under Uncommitted Facilities at any one time. Borrowings under the facilities are available for the Company's working capital, letter of credit requirements and other general corporate purposes. The Company had no balance outstanding under the facilities at March 31, 2000.

The Company retains its borrowing availability under its Revolving Credit Facilities, as discussed above. Borrowings under these credit facilities will continue to be used, as needed, to provide funding for the seasonal working capital needs of the Company. Internally-generated funds from operations will be used principally for the Company's ongoing construction and maintenance programs and operational needs and may also be used periodically to reduce outstanding debt. From time to time, the Company may also repurchase shares of its common stock in the open market in order to minimize any adverse effect from potential selling activity that may result from the increase in its public float of its common stock subsequent to the Pennsylvania Enterprises, Inc. merger.

Before the completion of the Fall River Gas, ProvEnergy and Valley Resources mergers, Southern Union will evaluate various sources and methods of financing the amount necessary to fund the cash portion of the consideration to be paid to Fall River Gas stockholders, the all cash consideration to be paid to ProvEnergy stockholders, the all cash consideration to be paid to Valley Resources stockholders, and all related costs and refinancings anticipated in connection with these mergers. If all existing debt of the pending mergers is refinanced, Southern Union could require new financing of up to approximately $600 million, which may be in the form of bank lines of credit, debt and preferred securities of various maturities and terms and common stock.

YEAR 2000

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

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

The Company incurred costs of approximately $2,922,000 through March 31, 2000 to complete this project. The Company also expects to spend approximately $1,500,000 in equipment leasing expenses that will be incurred over the life of the equipment that were incurred in order to be Year 2000 compliant.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information contained in Item 3 updates, and should be read in conjunction with, information set forth in Part II, Item 7 in the Company's Annual Report on Form 10-K for the year ended June 30, 1999, in addition to the interim consolidated financial statements, accompanying notes, and Management's Discussion and Analysis of Financial Condition and Results of Operations presented in Items 1 and 2 of this Quarterly Report on Form 10-Q.

There are no material changes in market risks faced by the Company from those reported in the Company's Annual Report on Form 10-K for the year ended June 30, 1999.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Form 10-Q contain forward-looking statements that are based on current expectations, estimates and projections about the industry in which the Company operates, management's beliefs and assumptions made by management. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which are difficult to predict and many of which are outside the Company's control. Therefore, actual outcomes and results may differ

materially from what is expressed or forecasted in such forward-looking statements. The Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Readers are cautioned not to put undue reliance on such forward-looking statements. Stockholders may review the Company's reports filed in the future with the Securities and Exchange Commission for more current descriptions of developments that could cause actual results to differ materially from such forward-looking statements.

Factors that could cause or contribute to actual results differing materially from such forward-looking statements include the following: cost of gas; gas sales volumes; weather conditions in the Company's service territories; the achievement of operating efficiencies and the purchases and implementation of new technologies for attaining such efficiencies; impact of relations with labor unions of bargaining-unit employees; the receipt of timely and adequate rate relief; the outcome of pending and future litigation; governmental regulations and proceedings affecting or involving the Company; and the nature and impact of any extraordinary transactions such as any acquisition or divestiture of a business unit or any assets. These are representative of the factors that could affect the outcome of the forward-looking statements. In addition, such statements could be affected by general industry and market conditions, and general economic conditions, including interest rate fluctuations, federal, state and local laws and regulations affecting the retail gas industry or the energy industry generally, and other factors.

OTHER

On April 3, 2000, Kenneth M. Pollock resigned from the Board of Directors of Southern Union Company.

SOUTHERN UNION COMPANY AND SUBSIDIARIES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SOUTHERN UNION COMPANY
(Registrant)

Date May 15, 2000

By RONALD J. ENDRES
Ronald J. Endres
Executive Vice President and Chief Financial Officer

Date May 15, 2000

By DAVID J. KVAPIL
David J. Kvapil
Senior Vice President and Corporate Controller
(Principal Accounting Officer)

CONFIDENTIAL

AGREEMENT AND PLAN OF MERGER

among

SOUTHERN UNION COMPANY,

GUS ACQUISITION CORPORATION

and

PROVIDENCE ENERGY CORPORATION

Dated as of November 15, 1999

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AGREEMENT AND PLAN OF MERGER

This AGREEMENT AND PLAN OF MERGER (this "Agreement") is made as of the 15th day of November, 1999, among SOUTHERN UNION COMPANY, a Delaware corporation ("SUG"), GUS ACQUISITION CORPORATION, a Rhode Island corporation and a wholly-owned subsidiary of SUG ("Newco"), and PROVIDENCE ENERGY CORPORATION, a Rhode Island corporation ("PVY").

RECITALS

WHEREAS, the Board of Directors of each of SUG, Newco and PVY has approved and deems it advisable and in the best interests of their respective shareholders to consummate the merger of Newco with and into PVY upon the terms and subject to the conditions set forth herein; and

WHEREAS, in furtherance thereof, the Board of Directors of each of SUG, Newco and PVY has approved this Agreement and the merger (the "Merger") of Newco with and into PVY, with PVY being the surviving corporation in the Merger;

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants and agreements herein contained, and intending to be legally bound hereby, SUG, Newco and PVY hereby agree as follows:

ARTICLE I
DEFINITIONS

Section 1.1 Certain Defined Terms. For purposes of this Agreement, the following terms have the meanings specified or referred to in this Article I (such definitions to be equally applicable to both the singular and plural forms of the terms defined):

"*Acquired Companies*"--PVY and its Subsidiaries, collectively, and each, an "Acquired Company."

"*Affiliate*"--with respect to any Person, any other Person that directly, or through one or more intermediaries, controls or is controlled by or is under common control with such first Person. As used in this definition, "control" (including with correlative meanings, "controlled by" and "under common control with") shall mean possession, directly or indirectly, of power to direct or cause the direction of management or policies (whether through ownership of securities or partnership or other ownership interests, by contract or otherwise).

"*Applicable Contract*"--any Contract (a) under which any Acquired Company has any rights, (b) under which any Acquired Company has any obligation or liability, or (c) by which any Acquired Company or any of the assets owned or used by it is bound.

"*CERCLA*"--the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended.

"*Closing Date*"--the date on which the Closing actually takes place.

"*Contract*"--any agreement, contract, document, instrument, obligation, promise or undertaking (whether written or oral) that is legally binding.

"*DGCL*"--the Delaware General Corporation Law.

"*Encumbrance*"--any charge, adverse claim, lien, mortgage, pledge, security interest or other encumbrance.

"*Environment*"--soil, land surface or subsurface strata, surface waters (including navigable waters, ocean waters, streams, ponds, drainage basins, and wetlands), groundwaters, drinking water supply, stream sediments, ambient air (including indoor air), plant and animal life, and any other environmental medium or natural resource.

"*Environmental Law*"--any applicable Legal Requirement that requires or relates to:

(a) advising appropriate authorities, employees, and the public of intended or actual releases of pollutants or hazardous substances or materials, violations of discharge limits, or other prohibitions and of the commencements of activities, such as resource extraction or construction, that could have significant impact on the Environment;

(b) preventing or reducing to acceptable levels the release of pollutants or hazardous substances or materials into the Environment;

(c) reducing the quantities, preventing the release, or minimizing the hazardous characteristics of wastes that are generated;

(d) reducing to acceptable levels the risks inherent in the transportation of hazardous substances, pollutants, oil, or other potentially harmful substances; or

(e) making responsible parties pay private parties, or groups of them, for damages done to their health by reason of Releases of Hazardous Materials or to the Environment, or permitting self-appointed representatives of the public interest to recover for injuries done to public assets or for damages to natural resources.

"*ERISA*"--the Employee Retirement Income Security Act of 1974, as amended, or any successor law, and regulations and rules issued pursuant to that act or any successor law.

"*Exchange Act*"--the Securities Exchange Act of 1934, as amended, or any successor law, and regulations and rules issued by the SEC pursuant to that act or any successor law.

"*Facilities*"--any real property, leaseholds, or other interests currently or formerly owned or operated by any Acquired Company and any buildings, plants, structures, or equipment (including motor vehicles, tank cars, and rolling stock) currently or formerly owned or operated by any Acquired Company.

"*FERC*"--the Federal Energy Regulatory Commission or any successor agency.

"*Final Order*"--an action by the relevant Governmental Body that has not been reversed, stayed, enjoined, set aside, annulled or suspended, with respect to which any waiting period prescribed by law before the transactions contemplated hereby may be consummated has expired, and as to which all conditions to the consummation of such transactions prescribed by law, regulation or order have been satisfied.

"*GAAP*"--generally accepted United States accounting principles, applied on a consistent basis.

"*Governmental Authorization*"--any approval, consent, license, franchise, certificate of public convenience and necessity, permit, waiver or other authorization issued, granted, given, or otherwise made available by or under the authority of any Governmental Body or pursuant to any Legal Requirement.

"*Governmental Body*"--any:

(a) nation, state, county, city, town, village, district or other jurisdiction of any nature;

(b) federal, state, county, local, municipal or other government;

(c) governmental or quasi-governmental authority of any nature (including any governmental agency, branch, department, official or entity and any court or other tribunal); or

(d) body exercising, or entitled to exercise, any administrative, executive, judicial, legislative, police, regulatory or taxing authority or power of any nature.

"*Hazardous Activity*"--the distribution, generation, handling, importing, management, manufacturing, processing, production, refinement, Release, storage, transfer, transportation, treatment, or use (including any withdrawal or other use of groundwater) of Hazardous Materials in, on, under, about, or from the Facilities or any part thereof into the Environment, any other act, business, operation, or thing that unreasonably increases the danger, or risk of danger, or poses an unreasonable risk of harm to persons or property on or off the Facilities in any material respect.

"*Hazardous Materials*"--any waste or other substance that is listed, defined, designated, or classified as, or otherwise determined to be, hazardous, radioactive, or toxic or a pollutant or a contaminant under or pursuant to any Environmental Law, including any admixture or solution thereof, and specifically including petroleum and all derivatives thereof or synthetic substitutes therefor and asbestos or asbestos-containing materials.

"*HSR Act*"--the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, or any successor law, and regulations and rules issued by the U.S. Department of Justice or the Federal Trade Commission pursuant to that act or any successor law.

"*IRC*"--the Internal Revenue Code of 1986, as amended.

"*IRS*"--the Internal Revenue Service or any successor agency.

"*Knowledge*"--an individual will be deemed to have "Knowledge" of a particular fact or other matter if such individual is actually aware of such fact or other matter. A Person (other than an individual) will be deemed to have "Knowledge" of a particular fact or other matter if any individual who is serving as a director or officer of such Person or any material Subsidiary of it or other employee listed in Section 1.1 of the PVY Disclosure Schedule has actual knowledge of such fact or other matter.

"*Legal Requirement*"--any federal, state, county, local, municipal, foreign, international, multinational, or other administrative order, constitution, law, ordinance, principle of common law, regulation, rule, tariff, franchise agreement, statute or treaty.

"*Material Contract*"--a Contract involving a total commitment by or to any party thereto of at least $125,000 on an annual basis or at least $500,000 on its remaining term which cannot be terminated on less than sixty (60) days' notice, without penalty or additional cost to the Acquired Company as the terminating party.

"*Order*"--any award, decision, decree, injunction, judgment, order, writ, ruling, subpoena, or verdict entered, issued, made, or rendered by any court, administrative agency, or other Governmental Body or by any arbitrator.

"*Ordinary Course of Business*"--an action taken by a Person will be deemed to have been taken in the "Ordinary Course of Business" only if:

(a) such action and authorization therefor is consistent with the past practices of such Person and is taken in the ordinary course of the normal day-to-day operations of such Person; and

(b) such action is not required by law to be authorized by the board of directors (or similar authority) of such Person or of such Person's parent company (if any).

"*Organizational Documents*"--(a) the articles or certificate of incorporation or organization and the bylaws of a corporation; (b) the partnership agreement and any statement of partnership of a general partnership; (c) the limited partnership agreement and the certificate of limited partnership of a limited partnership; (d) the certificate of formation and the members, operating or similar agreement of a limited liability company; (e) any charter or similar document adopted or filed in connection with the creation, formation or organization of a Person; and (f) any amendment to any of the foregoing.

"*PBGC*"--the Pension Benefit Guaranty Corporation.

"*Person*"--any individual, corporation (including any non-profit corporation), general or limited partnership, limited liability company, joint venture, estate, trust, association,

organization, labor union, organized group of persons, entity of any other type, or Governmental Body.

"*Proceeding*"--any action, arbitration, hearing, litigation or suit (whether civil, criminal, administrative, investigative, or informal) commenced, brought, conducted, or heard by or before, or otherwise involving, any Governmental Body or arbitrator.

"*ProvGas Preferred Stock*"--the 8.70% redeemable cumulative preferred stock, par value $100.00 per share, of ProvGas.

"*PUHCA*"--the Public Utility Holding Company Act of 1935, as amended, or any successor law, and regulations and rules issued by the SEC pursuant to that act or any successor law.

"*PVY Audited Financials*"--the PVY Balance Sheet, the audited consolidated statement of income of the Acquired Companies for the year ended September 30, 1999, the audited consolidated statement of cash flows of the Acquired Companies for the year ended September 30, 1999, the consolidated statements of capitalization of the Acquired Companies at September 30, 1999, the consolidated statements of changes in common stockholders' investment of the Acquired Companies for the year ended September 30, 1999 (in each case, including the notes thereto), collectively.

"*PVY Balance Sheet*"--the audited consolidated balance sheet of the Acquired Companies at September 30, 1999 (including the notes thereto), provided by PVY to SUG as part of the PVY Financial Statements.

"*PVY Benefit Plans*"--all employee retirement, welfare, stock option, stock ownership, deferred compensation, bonus or other benefit plans, agreements, practices, policies, programs, or arrangements, that are applicable to any employee, director or consultant of the Acquired Companies or maintained by or contributed to by any of the Acquired Companies.

"*PVY Common Stock*"--the common stock, par value $1.00 per share, of PVY.

"*PVY Disclosure Schedule*"--the disclosure schedule delivered by PVY to SUG concurrently with the execution and delivery of this Agreement.

"*PVY Material Adverse Effect*"--a material adverse effect (i) on the business, financial condition or results of operations of PVY and its Subsidiaries, taken as a whole, or (ii) on the ability of PVY and its Subsidiaries to consummate the Mergers in accordance with this Agreement.

"*PVY PEIP*"--the Providence Energy Corporation 1992 Performance and Equity Incentive Plan.

"*PVY Performance Share*"--a phantom share awarded under and subject to the terms of the PVY Performance Share Plan and having a value equal to the fair market value of a share of PVY Common Stock.

"*PVY Performance Share Plan*"--the Providence Energy Corporation Performance Share Plan.

"*PVY Permitted Liens*"--Encumbrances securing Taxes, assessments, governmental charges or levies, or the claims of materialmen, mechanics, carriers and like persons, all of which are not yet due and payable or which are being contested in good faith; Encumbrances (other than any Encumbrance imposed by ERISA) incurred on deposits made in the Ordinary Course of Business in connection with worker's compensation, unemployment insurance or other types of social security; the Encumbrances created by and the Encumbrances permitted under the Indenture dated as of January 1, 1922 between ProvGas and State Street Bank and Trust Company (successor to Rhode Island Hospital Trust Company), as Trustee, as amended or supplemented from time to time (the "ProvGas Indenture"); in the case of leased real property, Encumbrances (not attributable to an Acquired Company as lessee) affecting the landlord's (and any underlying landlord's) interest in any leased real property; Encumbrances in respect of judgments or awards with respect to which PVY or one of its Subsidiaries shall in good faith currently be prosecuting an appeal or other proceeding for review and with respect to which PVY or such Subsidiary shall have secured a stay of execution pending such appeal or such proceeding for review; provided that PVY or such Subsidiary shall have set aside on its books adequate reserves with respect thereto; and such other Encumbrances which are not, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect.

"*PVY Restricted Stock*"--the shares of PVY Common Stock granted under and subject to the terms of the PVY PEIP.

"*Related Documents*"--any Contract provided for in this Agreement to be entered into by one or more of the parties hereto or their respective Subsidiaries in connection with the Mergers.

"*Release*"--any spilling, leaking, emitting, discharging, depositing, escaping, leaching, dumping, or other releasing into the Environment, whether intentional or unintentional.

"*Representative*"--with respect to a particular Person, any director, officer, employee, agent, consultant, advisor, or other representative of such Person, including legal counsel, accountants, and financial advisors.

"*RIBCA*"--the Rhode Island Business Corporation Act.

"*SEC*"--the United States Securities and Exchange Commission or any successor agency.

"*Securities Act*"--the Securities Act of 1933, as amended, or any successor law, and regulations and rules issued by the SEC pursuant to that act or any successor law.

"*Subsidiary*"--with respect to any Person (the "Owner"), any Person of which securities or other interests having the power to elect a majority of that other Person's board of directors or similar governing body, or otherwise having the power to direct the business and policies of that corporation or other Person (other than securities or other interests having such power only upon the happening of a contingency that has not occurred) are held by the Owner or one or more of its Subsidiaries; when used without reference to a particular Person, "Subsidiary" means a Subsidiary of PVY.

"*SUG Disclosure Schedule*"--the disclosure schedule delivered by SUG to PVY concurrently with the execution and delivery of this Agreement.

"*SUG Material Adverse Effect*"--a material adverse effect (i) on the business, financial condition or results of operations of SUG and its Subsidiaries, taken as a whole, or (ii) on the ability of SUG and Newco to consummate the Mergers in accordance with this Agreement.

"*Related Documents*"--any Contract provided for in this Agreement to be entered into by one or more of the parties hereto or their respective Subsidiaries in connection with the Mergers.

"*Tax*"--any tax (including any income tax, capital gains tax, value-added tax, sales and use tax, transfer tax, franchise tax, payroll tax, withholding tax or property tax), levy, assessment, tariff, duty (including any customs duty), deficiency, franchise fee or payment, payroll tax, utility tax, gross receipts tax or other fee or payment, and any related charge or amount (including any fine, penalty, interest or addition to tax), imposed, assessed or collected by or under the authority of any Governmental Body or payable pursuant to any tax-sharing agreement or any other Contract relating to the sharing or payment of any such tax, levy, assessment, tariff, duty, deficiency or fee.

"*Tax Return*"--any return (including any information return), report, statement, schedule, notice, form, or other document or information filed with or submitted to, or required to be filed with or submitted to, any Governmental Body in connection with the determination, assessment, collection, or payment of any Tax or in connection with the administration, implementation, or enforcement of or compliance with any Legal Requirement relating to any Tax, including any amendment thereto.

"*Threatened*"--a claim, Proceeding, dispute, action, or other matter will be deemed to have been "Threatened" if any demand or statement has been made (orally or in writing) or any notice has been given (orally or in writing) or if any other event has occurred or any other circumstance exists, that would lead a director or officer of a comparable gas distribution company to conclude that such a claim, Proceeding, dispute, action, or other matter is likely to be asserted, commenced, taken or otherwise pursued in the future.

Section 1.2 Other Defined Terms. In addition to the terms defined in Section 1.1, certain other terms are defined elsewhere in this Agreement as indicated below and, whenever such terms are used in this Agreement, they shall have their respective defined meanings.

Term	Section
Acquired Company Option Plans	3.3
Agreement	Introductory Paragraph
Attleboro	2.6
Attleboro Merger	2.6
Business Combination	6.1(h)(4)
Certificates	3.2(b)
Closing	2.3
Confidentiality Agreement	6.1(c)(1)
Effective Time	2.2
Employees	6.2(b)
Final Surviving Corporation	2.6
Indemnified Parties	9.1(a)
Initial Termination Date	8.1(i)
MBCL	2.6
Merger	Recitals
Merger Consideration	3.1(a)
Mergers	2.6
Newco	Introductory Paragraph
Owner	1.1
Paying Agent	3.2(a)
ProvGas	2.6
ProvGas Indenture	1.1
ProvGas Merger	2.6
Proxy Statement	6.3(a)
PVY	Introductory Paragraph
PVY Commonly Controlled Entity	5.18(a)(4)
PVY Financial Statements	5.9
PVY Meeting	6.1(j)(1)

PVY Merger	2.6
PVY Options	3.3
PVY Rights	3.1(a)
PVY SEC Documents	5.9
PVY Shareholders' Approval	5.24
PVY Stock Rights Agreements	3.1(a)
SUG	Introductory Paragraph
Superior Proposal	6.1(h)(4)
Surviving Corporation	2.1
Third Party Beneficiary	10.11
WARN	6.2(c)

ARTICLE II
THE MERGER; OTHER TRANSACTIONS

Section 2.1 The Merger. Upon the terms and subject to the conditions of this Agreement, at the Effective Time, Newco will be merged with and into PVY in accordance with the laws of the State of Rhode Island. As a result of the Merger, the separate corporate existence of Newco shall cease and PVY will be the surviving corporation in the Merger (the "Surviving Corporation") and will continue its corporate existence under the laws of the State of Rhode Island. The Merger will have the effect as provided in the applicable provisions of the RIBCA. Without limiting the generality of the foregoing, upon the Merger, all the property, rights, privileges, immunities, powers and franchises of Newco and PVY will vest in the Surviving Corporation and all obligations, duties, debts and liabilities of PVY and Newco will be the obligations, duties, debts and liabilities of the Surviving Corporation.

Section 2.2 Effective Time of the Merger. On the Closing Date, with respect to the Merger, a duly executed Articles of Merger complying with the requirements of the RIBCA will be filed with the Secretary of State of the State of Rhode Island. The Merger will become effective upon the issuance of a certificate of merger by the Secretary of State of the State of Rhode Island (the "Effective Time").

Section 2.3 Closing. Unless this Agreement has been terminated and the transactions contemplated herein have been abandoned pursuant to Article VIII hereof, the closing of the transactions contemplated by this Agreement (the "Closing") will take place at 10:00 a.m., Eastern Time, on the Closing Date to be specified by the parties, which shall be no later than the tenth business day after satisfaction or, if permissible, waiver of all of the conditions set forth in Article VII hereof (other than Sections 7.1(a), 7.1(b), 7.1(c), 7.1(f), 7.1(g), 7.2(a), 7.2(b), 7.2(c)

and 7.2(e), which shall be satisfied or waived on the Closing Date) at the offices of Hughes Hubbard & Reed LLP, New York, counsel to SUG, unless another date or place is agreed to in writing by the parties hereto.

Section 2.4 Articles of Incorporation; Bylaws. Pursuant to the Merger, (i) the Articles of Incorporation of the Surviving Corporation shall be amended and restated at and as of the Effective Time to be identical to the Articles of Incorporation of Newco, as in effect immediately prior to the Effective Time, until thereafter amended as provided by law, except that Article 1 of the Articles of Incorporation shall be changed so that the name of the Surviving Corporation shall be Providence Energy Corporation and (ii) the Bylaws of the Surviving Corporation shall be amended and restated at and as of the Effective Time to be identical to the Bylaws of Newco, as in effect immediately prior to the Effective Time, until thereafter amended as provided by law, except that the Bylaws shall be changed so that the name of the Surviving Corporation shall be Providence Energy Corporation.

Section 2.5 Directors and Officers. The directors and officers of PVY immediately prior to the Effective Time will be the directors and officers of the Surviving Corporation, each to hold office in accordance with the Articles of Incorporation and Bylaws of the Surviving Corporation.

Section 2.6 Other Transactions. Immediately after the Effective Time, PVY shall adopt an agreement and plan of merger pursuant to which North Attleboro Gas Company ("Attleboro"), a wholly-owned subsidiary of PVY, shall merge with and into PVY on the Closing Date, with PVY being the surviving corporation, by complying with the requirements of the Massachusetts Business Corporation Law ("MBCL") and the RIBCA (the "Attleboro Merger"). Immediately following the consummation of the Attleboro Merger, PVY shall adopt an agreement and plan of merger pursuant to which Providence Gas Company ("ProvGas"), a wholly-owned Subsidiary of PVY, shall merge with and into PVY on the Closing Date, with PVY being the surviving corporation, by complying with the requirements of the RIBCA (the "ProvGas Merger"). Immediately following the consummation of the ProvGas Merger, SUG shall adopt an agreement and plan of merger pursuant to which PVY shall merge with and into SUG on the Closing Date, with SUG being the surviving corporation (the "Final Surviving Corporation"), by complying with the requirements of the RIBCA and the DGCL (the "PVY Merger"). The Merger, the ProvGas Merger, the Attleboro Merger and the PVY Merger shall hereinafter be referred to collectively as the "Mergers."

Section 2.7 Certificate of Incorporation; Bylaws. Pursuant to the PVY Merger, the Restated Certificate of Incorporation of SUG, as in effect immediately prior to the Effective Time, shall be the Certificate of Incorporation of the Final Surviving Corporation until thereafter amended as provided by law and (ii) the Bylaws of SUG as in effect immediately prior to the Effective Time, shall be the Bylaws of the Final Surviving Corporation until thereafter amended as provided by law.

Section 2.8 Directors and Officers. The directors and officers of SUG immediately prior to the Effective Time will be the directors and officers of SUG after consummation of the

PVY Merger, each to hold office in accordance with the Certificate of Incorporation and Bylaws of the Final Surviving Corporation; provided that, immediately after the consummation of the Merger, the Chief Executive Officer of PVY immediately prior to the Effective Time will be elected or appointed as a member of the Board of Directors of SUG.

ARTICLE III
CONVERSION OF SHARES

Section 3.1 Effect of the Merger. As of the Effective Time, by virtue of the Merger and without any action on the part of the holders of any shares of PVY Common Stock and/or any shares of PVY Restricted Stock, all of which shall become fully vested immediately prior to the Effective Time:

(a) Each issued and outstanding share of PVY Common Stock (which shall be deemed to include (i) each issued and outstanding share of PVY Restricted Stock and (ii) each related associated stock purchase right (collectively, the "PVY Rights") issued pursuant to the Stock Rights Agreement, dated as of July 23, 1998 between PVY and The Bank of New York, as Rights Agent (the "PVY Stock Rights Agreement"), which will be terminated at the Effective Time (any reference in this Agreement to PVY Common Stock will be deemed to include the associated PVY Rights and all PVY Restricted Stock)), will be converted into the right of each holder thereof to receive $42.50 in cash (the "Merger Consideration").

(b) Each holder of PVY Common Stock shall surrender all such holder's certificates formerly representing ownership of PVY Common Stock in the manner provided in Section 3.2. All such shares of PVY Common Stock, when so converted, shall no longer be outstanding and shall be canceled and automatically converted into the right to receive the Merger Consideration therefor upon the surrender of such certificate in accordance with Section 3.2. Any payment made pursuant to this Section 3.1 shall be made net of applicable withholding taxes to the extent such withholding is required by law.

(c) Notwithstanding any provision of this Agreement to the contrary, each share of PVY Common Stock held in the treasury of PVY immediately prior to the Effective Time shall be canceled and extinguished without conversion thereof.

(d) Each share of common stock, par value $1.00 per share, of Newco issued and outstanding immediately prior to the Effective Time shall be converted into and become one share of common stock, par value $1.00 per share, of the Surviving Corporation.

Section 3.2 Exchange of PVY Common Stock Certificates.

(a) SUG's registrar and transfer agent, or such other bank or trust company which has a net capital of not less than $100,000,000, as may be selected by SUG and be reasonably acceptable to PVY, will act as paying agent ("Paying Agent") for the holders of PVY Common Stock in connection with the Merger, pursuant to an agreement providing for the matters set forth in this Section 3.2 and such other matters as may be appropriate and the terms of which shall be reasonably satisfactory to SUG and PVY, to receive the consideration to which

holders of PVY Common Stock become entitled pursuant to Section 3.1. Contemporaneous with the Effective Time, SUG will deposit in trust with the Paying Agent, for the benefit of holders of PVY Common Stock, the cash necessary to pay the aggregate Merger Consideration as contemplated by Section 3.1(a) with respect to each share of PVY Common Stock.

(b) At the Effective Time of the Merger, SUG will irrevocably instruct the Paying Agent to promptly, and in any event not later than eight (8) business days following the Effective Time, mail (and to make available for collection by hand) to each holder of record of a certificate or certificates, which immediately prior to the Effective Time represented outstanding shares of PVY Common Stock (the "Certificates"), whose shares of PVY Common Stock were converted pursuant to Section 3.1(a) into the right to receive the Merger Consideration (i) a letter of transmittal (which shall specify that delivery shall be effected, and risk of loss and title to the Certificates shall pass, only upon delivery of the Certificates to the Paying Agent and shall be in such form and have such other provisions as SUG may reasonably specify) and (ii) instructions (which shall provide that at the election of the surrendering holder Certificates may be surrendered, and payment therefor collected, by hand delivery) for use in effecting the surrender of the Certificates in exchange for payment of the Merger Consideration. Upon surrender of a Certificate for cancellation to the Paying Agent or to such other agent or agents as may be appointed by SUG, together with such letter of transmittal, duly executed, the holder of such Certificate shall be entitled to receive in exchange therefor the Merger Consideration for each share of PVY Common Stock formerly represented by such Certificate, to be mailed (or made available for collection by hand if so elected by the surrendering holder) within eight (8) business days of receipt thereof, and the Certificate so surrendered shall forthwith be canceled. If payment of the Merger Consideration is to be made to a Person other than the Person in whose name the surrendered Certificate is registered, it shall be a condition of payment that the Certificate so surrendered shall be properly endorsed or shall be otherwise in proper form for transfer and that the Person requesting such payment shall have paid any transfer and other Taxes required by reason of the payment of the Merger Consideration to a Person other than the registered holder of the Certificate surrendered or shall have established to the satisfaction of SUG that such Tax either has been paid or is not applicable. Until surrendered as contemplated by this Section 3.2, each Certificate (other than Certificates representing PVY Common Stock held by SUG) shall be deemed at any time after the Effective Time to represent only the right to receive the Merger Consideration as contemplated by this Section 3.2.

(c) The Paying Agent shall invest the funds representing the aggregate Merger Consideration, as directed by SUG, in (i) direct obligations of the United States of America (ii) obligations for which the full faith and credit of the United States of America is pledged to provide for the payment of principal and interest or (iii) commercial paper rated the highest quality by either Moody's Investors Service, Inc. or Standard and Poor's Ratings Services, a division of The McGraw Hill Companies, Inc.; provided, however, that, notwithstanding anything to the contrary in this Agreement, if the Paying Agent is not able or refuses to so invest such funds, SUG may deposit such funds in trust with another bank or trust company which has a net capital of not less than $100,000,000, as may be selected by SUG and be reasonably acceptable to PVY, so long as the Paying Agent is allowed to draw on such funds to the extent

required to pay the Merger Consideration. Any net earnings with respect to such funds shall be the property of and paid over to SUG as and when requested by SUG.

(d) In the event any Certificate shall have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the Person claiming such Certificate to be lost, stolen or destroyed, the Paying Agent will issue in exchange for such lost, stolen or destroyed Certificate the Merger Consideration deliverable in respect thereof as determined in accordance with this Article III; provided, however, that the Person to whom the Merger Consideration is paid shall, if required by SUG, as a condition precedent to the payment thereof, give the Paying Agent a bond in such sum as it may ordinarily require and indemnify SUG in a manner satisfactory to it against any claim that may be made against SUG with respect to the Certificate claimed to have been lost, stolen or destroyed.

(e) After the Effective Time, the stock transfer books of PVY shall be closed and there shall be no transfers on the stock transfer books of the Surviving Corporation of shares of PVY Common Stock that were outstanding immediately prior to the Effective Time. If, after the Effective Time, Certificates are presented to SUG, they shall be canceled and exchanged for the Merger Consideration as provided in this Article III.

(f) Any portion of the funds held by the Paying Agent that remain undistributed to the former shareholders of PVY for eighteen (18) months after the Effective Time shall be delivered by the Paying Agent, which shall thereafter act as the Paying Agent, and any former shareholders of PVY who have not complied with this Article III prior to eighteen (18) months after the Effective Time shall thereafter look only as a general creditor to SUG for payment of their claim for the Merger Consideration.

(g) Neither the Surviving Corporation nor SUG shall be liable to any holder of PVY Common Stock for Merger Consideration delivered to a public official pursuant to any applicable abandonment, escheat or similar law. Any amounts remaining unclaimed by holders of any such shares of PVY Common Stock five years after the Effective Time (or such earlier date immediately prior to the time at which such amounts would otherwise escheat to or become property of any Governmental Body) shall, to the extent permitted by applicable law, become the property of SUG, free and clear of any claims or interest of any such holders or their successors, assigns or personal representatives previously entitled thereto.

Section 3.3 PVY Options; PVY Performance Shares. (a) Each outstanding option to purchase shares of PVY Common Stock or other similar interest (collectively, the "PVY Options") granted under any stock option plans or under any other plan or arrangement of any Acquired Company (the "Acquired Company Option Plans"), together with the applicable exercise prices, are disclosed in Section 3.3(a) of the PVY Disclosure Schedule. Each PVY Option that is outstanding at the Effective Time shall be deemed fully vested and shall be converted at the Effective Time into a right to receive in respect thereof a cash payment in an amount equal to the product of (x) the amount by which (i) the Merger Consideration exceeds (ii) the exercise price of such PVY Option (if less than (i)) and (y) the number of shares of PVY

Common Stock subject thereto. Such cash payment (net of applicable withholding taxes) shall be made on the Closing Date or as promptly thereafter as reasonably practicable.

(b) Each outstanding award of PVY Performance Shares as determined pursuant to the PVY Performance Share Plan, is disclosed in Section 3.3(b) of the PVY Disclosure Schedule. Copies of the PVY Performance Share Plan and the agreements entered into pursuant to the PVY Performance Share Plan, which set forth the applicable performance measures and target opportunities, have been provided to SUG prior to the date of this Agreement. In accordance with the terms of the PVY Performance Share Plan, the target opportunities for each outstanding award of PVY Performance Shares outstanding at the Effective Time shall be deemed fully earned for the entire "Performance Periods" (as such term is defined in the PVY Performance Share Plan). Each PVY Performance Share outstanding at the Effective Time shall be canceled and automatically converted into a right to receive a cash payment in an amount equal to the Merger Consideration. Any payment made pursuant to this Section 3.3(b) shall be made net of applicable withholding taxes to the extent such withholding is required by law, and shall be made on the Closing Date or as promptly thereafter as reasonably practicable.

ARTICLE IV
REPRESENTATIONS AND WARRANTIES OF SUG

SUG, as to SUG and Newco, represents and warrants to PVY that:

Section 4.1 Organization, Existence and Qualification. SUG is a corporation duly incorporated, validly existing, and in good standing under the laws of the State of Delaware, with full corporate power and authority, and has been duly authorized by all necessary approvals and orders of the Florida, Missouri, Pennsylvania and Texas regulatory authorities and the Federal Energy Regulatory Commission (the "FERC"), to conduct its business as it is now being conducted, to own or use the properties and assets that it purports to own or use, to perform its obligations under all Contracts to which it is a party, and to execute and deliver this Agreement. Newco is a corporation duly incorporated, validly existing, and in good standing under the laws of the State of Rhode Island, with full corporate power and authority, to conduct its business as it is now being conducted, to own or use the properties and assets that it purports to own or use, to perform its obligations under all Contracts to which it is a party, and to execute and deliver this Agreement. Each of SUG and Newco is duly qualified to do business as a foreign corporation and is in good standing under the laws of each state or other jurisdiction in which either the ownership or use of the properties owned or used by it, or the nature of the business conducted by it, requires such qualification as a foreign corporation except for such failures to be so qualified or in good standing as are not, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect.

Section 4.2 Authority Relative to this Agreement and Binding Effect. The execution, delivery and performance of this Agreement and the Related Documents by each of SUG and Newco have been duly authorized by all requisite corporate action. The execution, delivery and performance of this Agreement and the Related Documents by SUG and Newco will

not result in a violation or breach of any term or provision of, or constitute a default, or require a consent, approval or notification, or accelerate the performance required under, the Organizational Documents of SUG or Newco, as the case may be, any indenture, mortgage, deed of trust, security agreement, loan agreement, or other Contract to which SUG or Newco is a party or by which its assets are bound, or violate any Order, with such exceptions as are not, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect. This Agreement constitutes and the Related Documents to be executed by SUG and Newco when executed and delivered will constitute valid and legally binding obligations of SUG and Newco, enforceable against SUG and Newco in accordance with their terms, except as enforceability may be limited by (i) bankruptcy or similar laws from time to time in effect affecting the enforcement of creditors' rights generally or (ii) the availability of equitable remedies generally.

Section 4.3 Governmental Approvals. Except as set forth in Section 4.3 of the SUG Disclosure Schedule and as required by the HSR Act, as of the date of this Agreement, no approval or authorization of any Governmental Body with respect to performance under this Agreement or the Related Documents by SUG and Newco is required to be obtained by SUG and Newco in connection with the execution and delivery by SUG and Newco of this Agreement or the Related Documents or the consummation by SUG and Newco of the transactions contemplated hereby or thereby, the failure to obtain which are, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect.

Section 4.4 Public Utility Holding Company Status; Regulation as a Public Utility. SUG is a "gas utility company" and a "public utility company" (as such terms are defined in PUHCA). SUG indirectly owns a minority interest in a "foreign utility company" (as such term is defined in PUHCA) that is exempt from, and is deemed not to be a public utility company for purposes of, PUHCA pursuant to Section 33 thereof with respect to which SUG has filed with the SEC a Form U-57 notification of foreign utility company status. Except as stated above in this Section 4.4 and with respect to their relationship with SUG, neither SUG nor any of its Subsidiaries is a "holding company," a "subsidiary company," a "public utility company" or an "affiliate" of a "public utility company," or a "holding company" within the meaning of such terms in PUHCA. As of the date of this Agreement, SUG is subject to regulation as a public utility or public service company (or similar designation) in the states of Florida, Missouri, Texas and Pennsylvania. Except as stated in the preceding sentence, as of the date of this Agreement, neither SUG nor its "affiliates" (as such term is defined in PUHCA) are subject to regulation as a public utility or public service company (or similar designation) in any other state.

Section 4.5 Legal Proceedings; Orders. Except as specifically described in a report, schedule, registration statement or definitive proxy statement filed by SUG with the SEC since September 1, 1999 and delivered to PVY prior to the date of this Agreement, as of the date of this Agreement, there is no pending Proceeding that challenges, or that may have the effect of preventing, delaying, making illegal, or otherwise interfering with, the Mergers or any of the transactions contemplated hereby.

Section 4.6 Brokers. Neither SUG nor Newco is a party to, or in any way obligated under any Contract, and there are no outstanding claims against SUG or Newco, for the payment

of any broker's or finder's fees in connection with the origin, negotiation, execution or performance of this Agreement.

Section 4.7 Disclaimer of Representations and Warranties. EXCEPT FOR THE REPRESENTATIONS AND WARRANTIES CONTAINED IN THIS ARTICLE IV, SUG MAKES NO OTHER REPRESENTATIONS OR WARRANTIES, EXPRESS OR IMPLIED, AND SUG HEREBY DISCLAIMS ANY SUCH OTHER REPRESENTATIONS OR WARRANTIES, WHETHER BY SUG, ANY SUBSIDIARY OF SUG, OR ANY OF THEIR RESPECTIVE OFFICERS, DIRECTORS, EMPLOYEES, AGENTS OR REPRESENTATIVES, OR ANY OTHER PERSON, WITH RESPECT TO THIS AGREEMENT AND THE TRANSACTIONS CONTEMPLATED HEREBY, NOTWITHSTANDING THE DELIVERY OR DISCLOSURE TO PVY OR ANY OF ITS DIRECTORS, OFFICERS, EMPLOYEES, AGENTS OR REPRESENTATIVES, OR ANY OTHER PERSON, OF ANY DOCUMENTATION OR OTHER INFORMATION BY SUG, ANY SUBSIDIARY OF SUG, OR ANY OF THEIR RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES, AGENTS OR REPRESENTATIVES, OR ANY OTHER PERSON, WITH RESPECT TO ANY OF THE FOREGOING.

ARTICLE V
REPRESENTATIONS AND WARRANTIES OF PVY

PVY, as to the Acquired Companies, represents and warrants to SUG as follows:

Section 5.1 Organization, Existence and Qualification.

(a) Each Acquired Company is a corporation duly incorporated, validly existing, and in good standing under the laws of its state of incorporation, with full corporate power and authority and has been duly authorized by all necessary approvals and orders of the Rhode Island, Massachusetts and all other relevant state regulatory authorities and the FERC to conduct its business as it is now being conducted, to own or use the properties and assets that it purports to own or use, and to perform all its obligations under Applicable Contracts. Section 5.1(a) of the PVY Disclosure Schedule sets forth the name of each Acquired Company, the state or jurisdiction of its incorporation or organization, and for each state or jurisdiction where such Acquired Company is duly qualified as a foreign corporation. Each Acquired Company is duly qualified to do business as a foreign corporation and is in good standing under the laws of each state or other jurisdiction in which either the ownership or use of the properties owned or used by it, or the nature of the business conducted by it, requires such qualification as a foreign corporation except for such failures to be so qualified or in good standing as are not, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect.

(b) PVY has delivered to SUG copies of the Organizational Documents, as currently in effect, of each Acquired Company.

Section 5.2 Capitalization. The capital stock of PVY consists of 20,000,000 shares of PVY Common Stock, of which 6,096,485 shares were issued and outstanding on October 31,

1999. Such shares include 28,620 shares of PVY Restricted Stock. ProvGas is authorized to issue 80,000 shares of ProvGas Preferred Stock, of which 32,000 shares were issued and outstanding on October 31, 1999. The issued and outstanding shares of PVY Common Stock and ProvGas Preferred Stock have been validly issued and are fully paid and nonassessable. Except as specifically described in the PVY SEC Documents delivered to SUG prior to the date of this Agreement or as set forth in Section 3.3(a) of the PVY Disclosure Schedule, no shares of PVY Common Stock or ProvGas Preferred Stock are held, in treasury or otherwise, by PVY or any of its Subsidiaries and there are no outstanding (i) securities convertible into PVY Common Stock, ProvGas Preferred Stock or other capital stock of PVY or any of its Subsidiaries, (ii) warrants or options to purchase PVY Common Stock or other securities of PVY or any of its Subsidiaries or (iii) other commitments to issue shares of PVY Common Stock, ProvGas Preferred Stock or other securities of PVY or any of its Subsidiaries. There are no voting trusts, proxies or other agreements, commitments or understandings of any character to which PVY or any of its Subsidiaries is a party or by which PVY or any of its Subsidiaries is bound with respect to the voting of any shares of capital stock of PVY or with respect to the registration of the offering, sale or delivery of any shares of capital stock of PVY under the Securities Act or otherwise.

Section 5.3 Subsidiaries; Investments. Except as set forth in Section 5.3 of the PVY Disclosure Schedule, PVY has no Subsidiaries or investments in any Person (except for marketable securities disclosed to SUG prior to the date of this Agreement) and, except for the issued and outstanding ProvGas Preferred Stock, PVY is the registered owner and holder of all of the issued and outstanding shares of capital stock of its Subsidiaries and has good title to such shares. The outstanding capital stock of each Subsidiary has been duly authorized, validly issued and is fully paid and nonassessable. All such capital stock owned by any Acquired Company is free and clear of any Encumbrance (except for any Encumbrance disclosed in the PVY SEC Documents delivered to SUG prior to the date of this Agreement, or created or incurred by this Agreement in favor of SUG, or imposed by federal or state securities laws).

Section 5.4 Authority Relative to this Agreement and Binding Effect. The execution, delivery and performance of this Agreement and the Related Documents by PVY have been duly authorized by all requisite corporate action, except, as of the date of this Agreement, for the PVY Shareholders' Approval. Except as set forth in Section 5.4 of the PVY Disclosure Schedule, the execution, delivery and performance of this Agreement and the Related Documents by PVY will not require a consent, approval or notification, will not result in a violation or breach of any term or provision of, or constitute a default or accelerate the performance required under, the Organizational Documents of any of the Acquired Companies, any indenture, mortgage, deed of trust, security agreement, loan agreement, or other Applicable Contract to which any of the Acquired Companies is a party or by which its assets are bound, or violate any Order, with such exceptions as are not, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect. This Agreement constitutes and the Related Documents to be executed by any of the Acquired Companies when executed and delivered will constitute valid and legally binding obligations of such Acquired Company, enforceable against such Acquired Company in accordance with their terms, except as enforceability may be limited by

(i) bankruptcy or similar laws from time to time in effect affecting the enforcement of creditors' rights generally or (ii) the availability of equitable remedies generally.

Section 5.5 Governmental Approvals. Except as set forth in Section 5.5 of the PVY Disclosure Schedule and as required by the HSR Act, no approval or authorization of any Governmental Body with respect to performance under this Agreement or the Related Documents by any Acquired Company is required to be obtained by any Acquired Company in connection with the execution and delivery by PVY of this Agreement or the Related Documents or the consummation by the Acquired Companies of the transactions contemplated hereby or thereby, the failure to obtain which are, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect.

Section 5.6 Public Utility Holding Company Status; Regulation as a Public Utility. PVY is a "holding company" (as such term is defined in PUHCA) exempt from all provisions of PUHCA (except Section 9(a)(2) thereof) pursuant to Section 3(a) of PUHCA, and has received no adverse notice from the SEC with respect to the validity of its exempt status. ProvGas and Attleboro are both "public utility companies" (as such term is defined in PUHCA). Each of ProvGas and Attleboro is a "subsidiary company" of PVY, and an "affiliate" of the other and of PVY (as such terms are defined in PUHCA). Except as set forth above in this Section 5.6 and with respect to their relationship to PVY, ProvGas and Attleboro, none of the Acquired Companies is a "holding company," a "subsidiary company," a "public utility company," or an "affiliate" of a "public utility company" or a "holding company," as such terms are defined in PUHCA. ProvGas is subject to regulation as a public utility or public service company (or similar designation) in the state of Rhode Island and Attleboro is subject to regulation as a public utility or public service company (or similar designation) in the state of Massachusetts. Except as stated in the preceding sentence, neither PVY and nor its "affiliates" (as such term is defined in PUHCA) are subject to regulation as a public utility or public service company (or similar designation) in any other state.

Section 5.7 Compliance with Legal Requirements; Governmental Authorizations.

(a) Except as set forth in Section 5.7(a) of the PVY Disclosure Schedule or as specifically described in the PVY SEC Documents delivered to SUG prior to the date of this Agreement, and subject to Section 5.19 of this Agreement, to the Knowledge of any Acquired Company, no Acquired Company is in violation of any Legal Requirement that is applicable to it, to the conduct or operation of its business, or to the ownership or use of any of its assets, other than such violations, if any, which are not, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect.

(b) The PVY SEC Documents delivered to SUG prior to the date of this Agreement accurately describe all material regulation of each Acquired Company that relates to the utility business of any Acquired Company. Except as set forth on Section 5.7(a) of the PVY Disclosure Schedule, each Acquired Company has and is in material compliance with all material Governmental Authorizations necessary to conduct its business and to own, operate and use all of its assets as currently conducted.

Section 5.8 Legal Proceedings; Orders. Except as set forth in Section 5.8 of the PVY Disclosure Schedule or as specifically described in the PVY SEC Documents delivered to SUG prior to the date of this Agreement, there is no pending Proceeding:

(1) that has been commenced by or against, or that otherwise relates to, any Acquired Company that is reasonably likely to have a PVY Material Adverse Effect; or

(2) as of the date of this Agreement, that challenges, or that may have the effect of preventing, delaying, making illegal, or otherwise interfering with, the Mergers or any of the transactions contemplated hereby.

To the Knowledge of PVY, except as set forth in Section 5.8 of the PVY Disclosure Schedule, as of the date of this Agreement, no such Proceedings, audits or investigations have been Threatened that are, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect. As of the date of this Agreement, none of the Acquired Companies is subject to any Orders that are, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect.

Section 5.9 SEC Documents. PVY has made (and, with respect to such documents filed after the date hereof through the Closing Date, will make) available to SUG a true and complete copy of (i) each report, schedule, registration statement (other than on Form S-8), and definitive proxy statement filed by PVY or ProvGas with the SEC since September 30, 1998 through the Closing Date in substantially the form filed with the SEC (the "PVY SEC Documents") and (ii) the PVY Audited Financials. As of their respective dates, the PVY SEC Documents, including without limitation any financial statements or schedules included therein, complied (or will comply), in all material respects with the requirements of the Securities Act or the Exchange Act, as the case may be, and the rules and regulations of the SEC thereunder applicable to such PVY SEC Documents, and did not (or will not) contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. The audited consolidated financial statements and unaudited interim financial statements of PVY and ProvGas included in the PVY SEC Documents and the PVY Audited Financials (collectively, the "PVY Financial Statements") were (or will be) prepared in accordance with GAAP (except as may be indicated therein or in the notes thereto and except with respect to unaudited statements as permitted by Form 10-Q) and fairly present (or will fairly present) in all material respects the financial position of PVY and its Subsidiaries, or ProvGas, as the case may be, as of the respective dates thereof or the results of operations and cash flows for the respective periods then ended, as the case may be, subject, in the case of unaudited interim financial statements, to normal adjustments which are not material in the aggregate.

Section 5.10 Taxes. Except as set forth in Section 5.10 of the PVY Disclosure Schedule:

(a) The Acquired Companies have timely filed all United States federal, state and local income Tax Returns required to be filed by or with respect to them or requests for extensions to file such Tax Returns have been timely filed, granted and have not expired, and the Acquired Companies have timely paid and discharged all Taxes due in connection with or with respect to the periods or transactions covered by such Tax Returns and have paid all other Taxes as are due or made adequate provision therefor in accordance with GAAP except where failures to so file, pay or discharge are not, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect. There are no pending audits or other examinations relating to any Tax matters. There are no Tax liens on any assets of the Acquired Companies. As of the date of this Agreement, none of the Acquired Companies has granted any waiver of any statute of limitations with respect to, or any extension of a period for the assessment of, any Tax. The accruals and reserves (including deferred taxes) reflected in the PVY Balance Sheet are in all material respects adequate to cover all material Taxes accruable through the date thereof (including interest and penalties, if any, thereon and Taxes being contested) in accordance with GAAP.

(b) None of the Acquired Companies is obligated under any Applicable Contract with respect to industrial development bonds or other obligations with respect to which the excludability from gross income of the holder for federal or state income tax purposes could be affected by the Merger or any of the transactions contemplated by this Agreement.

Section 5.11 Intellectual Property. Except as set forth in Section 5.11 of the PVY Disclosure Schedule, no Acquired Company has any Knowledge of (i) any infringement or claimed infringement by any Acquired Company of any patent rights or copyrights of others or (ii) any infringement of the patent or patent license rights, trademarks or copyrights owned by or under license to any Acquired Company, except for any such infringements of the type described in clause (i) or (ii) that are not, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect.

Section 5.12 Title to Assets. Except (i) as specifically described in the PVY SEC Documents delivered to SUG prior to the date of this Agreement, (ii) as set forth in Section 5.19 of this Agreement or (iii) as set forth in Section 5.19 of the PVY Disclosure Schedule, none of the Acquired Companies' assets are subject to any Encumbrance other than PVY Permitted Liens.

Section 5.13 Indebtedness. All outstanding principal amounts of indebtedness for borrowed money of the Acquired Companies as of October 30, 1999 are set forth in Section 5.13 of the PVY Disclosure Schedule.

Section 5.14 Machinery and Equipment. Except for normal wear and tear, and with such other exceptions as are not, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect, the machinery and equipment of the Acquired Companies

necessary for the conduct by the Acquired Companies of their respective businesses as presently conducted are in operating condition and in a state of reasonable maintenance and repair.

Section 5.15 Contracts. Set forth in Section 5.15(a) of the PVY Disclosure Schedule is a list as the date hereof of all Applicable Contracts which are Material Contracts. Except as described in Section 5.15(b) of the PVY Disclosure Schedule or as specifically described in the PVY SEC Documents delivered to SUG prior to the date of this Agreement, and with such exceptions as are not, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect, all Applicable Contracts of the Acquired Companies are in full force and effect and no Acquired Company nor, to the Knowledge of PVY, any other party thereto is in default thereunder nor has any event occurred or is any event occurring that with notice or the passage of time or otherwise, is reasonably likely to give rise to an event of default thereunder by any party thereto.

Section 5.16 Insurance. Section 5.16(a) of the PVY Disclosure Schedule sets forth a list of all policies of insurance held by the Acquired Companies as of the date of this Agreement. Except as set forth in Section 5.16(b) of the PVY Disclosure Schedule, since September 30, 1994, the assets and the business of the Acquired Companies have been continuously insured with what PVY reasonably believes are reputable insurers against all risks and in such amounts normally insured against by companies of the same type and in the same line of business as any of the Acquired Companies. As of the date of this Agreement, no notice of cancellation, non-renewal or material increase in premiums has been received by any of the Acquired Companies with respect to such policies, and no Acquired Company has Knowledge of any fact or circumstance that could reasonably be expected to form the basis for any cancellation, non-renewal or material increase in premiums, except for such cancellations, non-renewals and increases which are not, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect. None of the Acquired Companies is in default with respect to any provision contained in any such policy or binder nor has there been any failure to give notice or to present any claim relating to the business or the assets of the Acquired Companies under any such policy or binder in a timely fashion or in the manner or detail required by the policy or binder, except for such defaults or failures which are not, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect. As of the date of this Agreement, there are no outstanding unpaid premiums (except premiums not yet due and payable), and no notice of cancellation or renewal with respect to, or disallowance of any claim under, any such policy or binder has been received by the Acquired Companies as of the date hereof, except for such non-payments of premiums, cancellations, renewals or disallowances which are not, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect.

Section 5.17 Employees. PVY has made available to SUG prior to the date hereof a list as of no more than thirty (30) days prior to the date of this Agreement of all the then present officers and employees of the Acquired Companies, indicating each employee's base salary or wage rate and identifying those who are union employees and those who are part-time employees. Except as set forth in Section 5.17(a) of the PVY Disclosure Schedule, as of the date of this Agreement, no labor union or other collective bargaining unit has been certified or recognized by any of the Acquired Companies, and, to the Knowledge of the Acquired

Companies, as of the date of this Agreement, there are no elections, organizing drives or material controversies pending or Threatened between any of the Acquired Companies and any labor union or other collective bargaining unit representing any of the Acquired Companies' employees. There is no pending or, to the Knowledge of PVY, Threatened labor practice complaint, arbitration, labor strike or other labor dispute (excluding grievances) involving any of the Acquired Companies which are, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect. Except for collective bargaining agreements that have been provided to SUG prior to the date of this Agreement or as set forth in Section 5.17(b) of the PVY Disclosure Schedule, as of the date of this Agreement, none of the Acquired Companies is a party to any employment agreement with any employee pertaining to any of the Acquired Companies.

Section 5.18 Employee Benefit Plans.

(a) Except as would not, individually or in the aggregate, result in a PVY Material Adverse Effect:

(1) Each of the PVY Benefit Plans has been operated and administered in all respects in accordance with its governing documents and applicable federal and state laws (including, but not limited to, ERISA and the IRC).

(2) As to any PVY Benefit Plan subject to Title IV of ERISA, (i) there is no event or condition which presents the risk of plan termination, (ii) no reportable event within the meaning of Section 4043 of ERISA (for which the notice requirements of Regulation §4043 promulgated by the PBGC have not been waived) has occurred within the last six years, (iii) no notice of intent to terminate the PVY Benefit Plan has been given under Section 4041 of ERISA, (iv) no proceeding has been instituted under Section 4042 of ERISA to terminate the PVY Benefit Plan, (v) there has been no termination or partial termination of the PVY Benefit Plan within the meaning of Section 411(d)(3) of the IRC within the last six years, (vi) no event described in Sections 4062 or 4063 of ERISA has occurred, and (vii) all PBGC premiums have been timely paid and no liability to the PBGC has been incurred, except for PBGC premiums not yet due.

(3) Each trust funding a PVY Benefit Plan, which trust is intended to be exempt from federal income taxation pursuant to Section 501(c)(9) of the IRC, satisfies the requirements of such section and has received a favorable determination letter from the IRS regarding such exempt status and has not, since receipt of the most recent favorable determination letter, been amended or operated in any way which would adversely affect such exempt status.

(4) With respect to any PVY Benefit Plan or any other "employee benefit plan" as defined in Section 3(3) of ERISA which is established, sponsored, maintained or contributed to, or with respect to any such plan which has been established, sponsored, maintained or contributed to within six years prior to the Closing Date, by the Acquired Companies or any corporation, trade, business or

entity under common control or being a part of an affiliated service group with any of the Acquired Companies, within the meaning of Section 414(b), (c) or (m) of the IRC or Section 4001 of ERISA ("PVY Commonly Controlled Entity"), (i) no withdrawal liability, within the meaning of Section 4201 of ERISA, has been incurred, which withdrawal liability has not been satisfied and no such withdrawal liability is reasonably expected to be incurred, (ii) no liability under Title IV of ERISA (including, but not limited to, liability to the PBGC) has been incurred by the Acquired Companies or any PVY Commonly Controlled Entity, which liability has not been satisfied (other than for PBGC premiums not yet due), (iii) no accumulated funding deficiency, whether or not waived, within the meaning of Section 302 of ERISA or Section 412 of the IRC has been incurred for which any liability is outstanding, (iv) there has been no failure to make any contribution (including installments) to such plan required by Section 302 of ERISA and Section 412 of the IRC which has resulted in a lien under Section 302 of ERISA or Section 412 of the IRC and for which any liability is currently outstanding, (v) no action, omission or transaction has occurred with respect to any such plan or any other PVY Benefit Plan which could subject any of the Acquired Companies, the plan or trust forming a part thereof, or SUG to a civil liability or penalty under ERISA or other applicable laws, or a Tax under the IRC, (vi) any such plan which is a Group Health Plan has complied in all respects with the provisions of Sections 601-608 of ERISA and Section 4980B of the IRC, (vii) there are no pending or Threatened claims by or on behalf of any such plan or any other PVY Benefit Plan, by any employees, former employees or plan beneficiaries covered by such plan or otherwise by or on behalf of any person involving any such plan (other than routine non-contested claims for benefits) which could result in a liability to the Acquired Companies taken as a whole and (viii) neither the Acquired Companies nor any PVY Commonly Controlled Entity has engaged in, or is a successor or parent corporation to any entity or person that has engaged in, a transaction described in Section 4069 of ERISA.

(5) There is no matter pending (other than qualification determination applications and filings and other required periodic filings) with respect to any of the PVY Benefit Plans before the IRS, the Department of Labor, the PBGC or in or before any other Governmental Body.

(b) Except as set forth in Section 5.18(b) of the PVY Disclosure Schedule, the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby will not (i) increase the amount of benefits otherwise payable under any PVY Benefit Plan, (ii) result in the acceleration of the time of eligibility to participate in any PVY Benefit Plan, or any payment, exercisability, funding or vesting of any benefit under any PVY Benefit Plan, (iii) result in any payment becoming due to or with respect to any current or former employee, director or consultant, or (iv) result in any payment becoming due in the event of a termination of employment or service of any employee, director or consultant.

(c) Except as set forth in Section 5.18(c) of the PVY Disclosure Schedule, none of the Acquired Companies is a party to any Contract nor has it established any policy or practice, which would require it or SUG to make a payment or provide any other form of compensation or benefit to any Person performing (or who within the past twelve months performed) services for any of the Acquired Companies during or upon termination of such services which would not be payable or provided in the absence of the consummation of the transactions contemplated by this Agreement.

(d) Section 5.18(d) of the PVY Disclosure Schedule contains a true and complete list of each PVY Benefit Plan, all Acquired Company Option Plans and any management, employment, deferred compensation, severance (including any payment, right or benefit resulting from a change in control), bonus, or other contract for personal services with any current or former officer, director or employee, any consulting contract with any person who prior to entering such contract was a director or officer of any Acquired Company or any plan, agreement, arrangement or understanding similar to any of the foregoing. Except as set forth in Section 5.18(d) of the PVY Disclosure Schedule, there are no outstanding options to purchase capital stock or other securities of PVY or any of its Subsidiaries. PVY has provided to SUG a complete and correct copy of each PVY Benefit Plan (or written summary of any unwritten PVY Benefit Plan), and with respect to each PVY Benefit Plan, the current summary plan description, related trust agreements, related insurance contracts, the latest IRS determination letter, the last three annual reports on Form 5500 series (including all required schedules), and the most recent actuarial report and annual financial statements.

(e) None of the Acquired Companies has contributed or been obligated to contribute to any "multi-employer plan" within the meaning of Section 3(37) of ERISA within the last six years. None of the Acquired Companies has any outstanding liability with respect to any such plan which, individually or in the aggregate with the events or conditions described in Section 5.18(a), is reasonably likely to result in a PVY Material Adverse Effect.

Section 5.19 Environmental Matters. Except as set forth in Section 5.19 of the PVY Disclosure Schedule or as specifically described in the PVY SEC Documents delivered to SUG prior to the date of this Agreement, and with such other exceptions as are not, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect:

(a) To the Knowledge of any Acquired Company, no Facility owned or operated by any Acquired Company is currently, or was at any time, listed on the National Priorities List promulgated under CERCLA, or on any comparable state list, and no Acquired Company has received any written notification of potential or actual liability or a written request for information from any Person under or relating to CERCLA or any comparable Legal Requirement with respect to any Acquired Company or the Facilities;

(b) To the Knowledge of any Acquired Company, each Acquired Company and any Person for whose conduct any Acquired Company is reasonably likely to be held responsible, is currently and at all times has been, in material compliance with any Environmental Law. No Acquired Company has received any Order, written notice, or other

written communication from (i) any Governmental Body or private citizen acting in the public interest, or (ii) the current or prior owner or operator of any Facilities, of any violation or failure to comply with any Environmental Law, or of any obligation to undertake or bear the cost of any environmental cleanup, or seeking information regarding prior disposal at or with respect to potential liability regarding any property or Facility at which Hazardous Materials generated by any Acquired Company were transported for disposal;

(c) There are no pending or, to the Knowledge of any of the Acquired Companies, Threatened claims arising under or pursuant to any Environmental Law with respect to or affecting any of the Facilities or any other properties and assets (whether real, personal, or mixed) in which any Acquired Company has or had a direct or indirect interest (including by ownership or use); and

(d) PVY has delivered or made available to SUG true and complete copies and results of any environmental site assessments, studies, analyses, tests or monitoring possessed by any Acquired Company of which any Acquired Company has Knowledge pertaining to Hazardous Materials or Hazardous Activities in, on or under the Facilities, or concerning compliance by any Acquired Company or any other Person for whose conduct any Acquired Company is reasonably likely to be held responsible, with Environmental Laws.

Section 5.20 No Material Adverse Change. Since the date of the PVY Balance Sheet, except as specifically described in the PVY SEC Documents delivered to SUG prior to the date of this Agreement, there has not been any PVY Material Adverse Effect, and no events have occurred or circumstances exist that are, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect, except that any PVY Material Adverse Effect that results from or relates to (a) general business or economic conditions, (b) conditions generally affecting the industries in which the Acquired Companies compete or (c) the announcement and consummation of the transactions contemplated by this Agreement shall be disregarded.

Section 5.21 Brokers. Except as set forth in Section 5.21 of the PVY Disclosure Schedule, no Acquired Company is a party to, or in any way obligated under any Applicable Contract, and there are no outstanding claims against any Acquired Company, for the payment of any broker's or finder's fees in connection with the origin, negotiation, execution or performance of this Agreement.

Section 5.22 PVY Stock Rights Agreement. Prior to the date of this Agreement, PVY has delivered to SUG a true and complete copy of the PVY Stock Rights Agreement. The consummation of the transactions contemplated by this Agreement will not result in the triggering of any right or entitlement of the holders of the PVY Common Stock or other PVY securities under the PVY Stock Rights Agreement. Neither PVY nor any of its Subsidiaries is a party to any agreement similar to the PVY Stock Rights Agreement.

Section 5.23 Regulatory Proceedings. Except as set forth in Section 5.23 of the PVY Disclosure Schedule or in the PVY SEC Documents delivered to SUG prior to the date of this Agreement, other than purchase gas adjustment provisions, none of PVY or its Subsidiaries all or

part of whose rates or services are regulated by a Governmental Body (a) has rates that have been or are being collected subject to refund, pending final resolution of any rate proceeding pending before a Governmental Body or on appeal to the courts, or (b) is a party to any rate proceeding before a Governmental Body that are, individually or in the aggregate, reasonably likely to result in any Orders having a PVY Material Adverse Effect.

Section 5.24 Vote Required. Other than the approval of the Merger by the holders of a majority of the outstanding shares of PVY Common Stock (the "PVY Shareholders' Approval"), no vote of the holders of any class or series of the capital stock of any Acquired Company is required to approve this Agreement and the Mergers. The consent of the holders of 80% in aggregate principal amount of all First Mortgage Bonds outstanding under the ProvGas Indenture to each of the amendments to the ProvGas Indenture described on Schedule 6.1(n) hereto is the only consent required to adopt such amendments.

Section 5.25 Opinion of Financial Advisor. The Board of Directors of PVY has received the opinion of Salomon Smith Barney Inc., dated as of the date hereof, to the effect that, as of such date, the Merger Consideration is fair from a financial point of view, to the holders of PVY Common Stock. PVY will provide a copy of such opinion to SUG.

Section 5.26 Disclaimer of Representations and Warranties. EXCEPT FOR THE REPRESENTATIONS AND WARRANTIES CONTAINED IN THIS ARTICLE V, PVY MAKES NO OTHER REPRESENTATIONS OR WARRANTIES, EXPRESS OR IMPLIED, AND PVY HEREBY DISCLAIMS ANY SUCH OTHER REPRESENTATIONS OR WARRANTIES, WHETHER BY PVY, ANY SUBSIDIARY OF PVY, OR ANY OF THEIR RESPECTIVE OFFICERS, DIRECTORS, EMPLOYEES, AGENTS OR REPRESENTATIVES, OR ANY OTHER PERSON, WITH RESPECT TO THIS AGREEMENT AND THE TRANSACTIONS CONTEMPLATED HEREBY, NOTWITHSTANDING THE DELIVERY OR DISCLOSURE TO SUG OR ANY OF ITS DIRECTORS, OFFICERS, EMPLOYEES, AGENTS OR REPRESENTATIVES, OR ANY OTHER PERSON, OF ANY DOCUMENTATION OR OTHER INFORMATION BY PVY, ANY SUBSIDIARY OF PVY, OR ANY OF THEIR RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES, AGENTS OR REPRESENTATIVES, OR ANY OTHER PERSON, WITH RESPECT TO ANY OF THE FOREGOING.

ARTICLE VI
COVENANTS

Section 6.1 Covenants of PVY. PVY agrees to observe and perform the following covenants and agreements:

(a) Conduct of the Business Prior to the Closing Date. With respect to the Acquired Companies, except (i) as contemplated in this Agreement, (ii) as required by law or regulation, (iii) as set forth in the PVY capital budget, a written copy of which has been provided to SUG by letter dated November 15, 1999, which letter refers to this Agreement, (iv) for any redemption of First Mortgage Bonds outstanding under the ProvGas Indenture that is required to

be made by the terms thereof on the date of any such redemption (such redemption to be made in accordance with the applicable mandatory redemption provisions of such Indenture), (v) for any commercially reasonable action that PVY determines in good faith, after consulting with SUG, should be taken by ProvGas in order to satisfy the condition set forth in the second sentence of Section 7.1(e), or (vi) as otherwise expressly consented to in writing by SUG, which consent will not be unreasonably withheld or delayed, prior to the Closing, PVY will cause each Acquired Company to:

(1) Not make or permit any material change in the general nature of its business;

(2) Maintain its Ordinary Course of Business in accordance with prudent business judgment and consistent with past practice and policy, and maintain consistent with its Ordinary Course of Business its assets in good repair, order and condition, reasonable wear and tear excepted, subject to retirements in the Ordinary Course of Business;

(3) Use reasonable efforts to preserve the Acquired Company as an ongoing business and maintain the goodwill associated with the Acquired Company;

(4) Preserve all of the Acquired Companies' franchises, tariffs, certificates of public convenience and necessity, licenses, authorizations and other governmental rights and permits;

(5) Not enter into any material transaction or Material Contract other than in the Ordinary Course of Business;

(6) Not purchase, sell, lease, dispose of or otherwise transfer or make any contract for the purchase, sale, lease, disposition or transfer of, or subject to lien, any of the assets of the Acquired Company other than in the Ordinary Course of Business;

(7) Not hire any new employees except in the Ordinary Course of Business (and in no event hire, for any calendar month, a number of new employees greater than the average monthly number of new employees hired by the Acquired Company over the prior 12 calendar months);

(8) Not file any material applications, petitions, motions, orders, briefs, settlement or agreements in any material Proceeding before any Governmental Body which involves any Acquired Company, and appeals related thereto without, to the extent reasonably practicable, consulting SUG; provided, however, that if such Proceeding is reasonably likely to have a PVY Material Adverse Effect, PVY shall not make any such filing without the consent of SUG, which consent shall not be unreasonably withheld or delayed.

(9) Not engage in or modify, except in the Ordinary Course of Business, any material intercompany transactions involving any other Acquired Company;

(10) Not voluntarily change in any material respect or terminate any insurance policies disclosed on Section 5.16(a) of the PVY Disclosure Schedule that presently are in effect unless equivalent coverage is obtained;

(11) Except as disclosed or specifically contemplated in this Agreement and except with respect to budgeted expenditures known and specifically disclosed in writing to SUG, subject to adjustments in the Ordinary Course of Business and other deviations (which in the aggregate shall not exceed 5% on an annualized basis during the period from the date of this Agreement until the Closing Date), not make any capital expenditure or capital expenditure commitment;

(12) Not make any changes in financial policies or practices, or strategic or operating policies or practices, in each case which involve any Acquired Company;

(13) Comply in all material respects with all applicable material Legal Requirements and permits, including without limitation those relating to the filing of reports and the payment of Taxes due to be paid prior to the Closing, other than those contested in good faith;

(14) Not adopt, amend (other than amendments that reduce the amounts payable by SUG or any of its Subsidiaries or amendments required by law) or assume an obligation to contribute to any PVY Benefit Plan or collective bargaining agreement or enter into any employment, consulting, severance or similar Contract with any Person (including without limitation, contracts with management of any Acquired Company or any of its Affiliates that might require payments be made upon consummation of the transactions contemplated hereby) or amend any such existing contracts to increase any amounts payable thereunder or benefits provided thereunder;

(15) Except in the Ordinary Course of Business or as required by the terms of any existing Contract, PVY Benefit Plan or collective bargaining agreement, not grant any increase or change in total compensation, benefits or pay any bonus to any employee, director or consultant;

(16) Not grant or enter into or extend the term of any Contract with respect to continued employment or service for any employee, officer, director or consultant;

(17) Not make any loan or advance to any officer, director, stockholder, employee or any other Person other than in the Ordinary Course of Business;

(18) Not terminate any existing gas purchase, exchange or transportation contract necessary to supply firm gas at all city gate delivery points or enter into any new contract for the supply, transportation, storage or exchange of gas with respect to the Acquired Companies' regulated gas distribution operations or renew or extend or negotiate any existing contract providing for the same where such contract is not terminable within sixty (60) days without penalty other than in the Ordinary Course of Business;

(19) Not amend any of its Organizational Documents; and

(20) Subject to Section 6.1(k), not issue or assume any note, debenture or other evidence of indebtedness which by its terms does not mature within two years from the date of execution or issuance thereof, unless otherwise redeemable or subject to prepayment at any time at the option of the Acquired Company on not more than thirty (30) days' notice without penalty for such redemption or prepayment.

(b) Customer Notifications. At any time and from time to time reasonably requested by SUG prior to the Closing Date, each Acquired Company will permit SUG at SUG's expense to insert preprinted single-page customer education materials into billing documentation to be delivered to customers affected by this Agreement; provided, however, that PVY has reviewed in advance and consented to the content of such materials, which consent shall not be unreasonably withheld or delayed. Other means of notifying customers may be employed by either party, at the expense of the initiating party, but in no event shall any notification be initiated without the prior consent of the other party (which consent shall not be unreasonably withheld or delayed).

(c) Access to the Acquired Companies' Offices, Properties and Records; Updating Information.

(1) From and after the date hereof and until the Closing Date, the Acquired Companies shall permit SUG and its Representatives to have, on reasonable notice and at reasonable times, reasonable access to such of the offices, properties and employees of the Acquired Companies in a manner that will not unreasonably disrupt the operations of the Acquired Companies or their relationship with their customers, suppliers or employees, and shall disclose, and make available to SUG and its Representatives in a manner that will not unreasonably disrupt the operations of the Acquired Companies or their relationship with their customers, suppliers or employees, all books, papers and records (other than confidentiality agreements related to a possible sale of PVY entered into prior to the date of this Agreement) to the extent that they relate to the ownership, operation, obligations and liabilities of or pertaining to the Acquired Companies, their businesses, assets and liabilities. Without limiting the application of the Confidentiality Agreement dated October 6, 1999 between PVY and SUG (the "Confidentiality Agreement"), all documents or information

furnished by the Acquired Companies hereunder shall be subject to the Confidentiality Agreement.

(2) PVY will notify SUG as promptly as practicable of any significant change in the Ordinary Course of Business or operation of any of the Acquired Companies and of any material complaints, investigations or hearings (or communications indicating that the same may be contemplated) by any Governmental Body, or the institution or overt threat or settlement of any material Proceeding involving or affecting any of the Acquired Companies or the transactions contemplated by this Agreement, and shall use reasonable efforts to keep SUG fully informed of such events and permit SUG's Representatives access to all materials prepared in connection therewith, consistent with any applicable Legal Requirement or Contract.

(3) As promptly as practicable after SUG's request, PVY will furnish such financial and operating data and other information pertaining to the Acquired Companies and their businesses and assets as SUG may reasonably request; provided, however, that nothing herein will obligate any of the Acquired Companies to take actions that would unreasonably disrupt its Ordinary Course of Business or violate the terms of any Legal Requirement or Contract to which the Acquired Company is a party or to which any of its assets is subject in providing such information, or to incur any costs with respect to SUG's external auditors (or the Acquired Companies' external auditors in the event a report by such auditors is requested by SUG) providing accounting services with respect to issuing an auditor's report required by or for SUG.

(d) Governmental Approvals; Third Party Consents. PVY will use its commercially reasonable best efforts at PVY's sole expense (except as provided otherwise in the last sentence of Section 6.1(n))to obtain all necessary consents, approvals and waivers from any Person required in connection with the transactions contemplated hereby under any license, lease, permit or Contract applicable to the Acquired Companies, including, without limitation, the Letters of Tax Good Standing referred to in Section 7.1(i), the approvals of those Governmental Bodies and the consents of those third parties listed in Section 5.4 and Section 5.5 of the PVY Disclosure Schedule and as required by the HSR Act.

(e) Dividends. PVY shall not, nor shall it permit any of its Subsidiaries to: (i) declare or pay any dividends on or make other distributions in respect of any of its or their capital stock other than (A) dividends by a wholly-owned Subsidiary to PVY or another wholly-owned Subsidiary, (B) dividends by a less than wholly-owned Subsidiary consistent with past practice, (C) regular quarterly dividends on PVY Common Stock with usual record and payment dates that do not exceed the current rate of $1.08 per fiscal year, or (D) regular cumulative cash distributions on the ProvGas Preferred Stock not to exceed an annual rate of $8.70 per share; (ii) split, combine or reclassify any capital stock or the capital stock of any Subsidiary or issue or authorize or propose the issuance of any other securities in respect of, or in substitution for, shares of capital stock or the capital stock of any Subsidiary; or (iii) redeem, repurchase or

otherwise acquire any shares of its capital stock or the capital stock of any Subsidiary other than (A) redemptions, repurchases and other acquisitions of shares of capital stock in connection with the administration of employee benefit and dividend reinvestment and customer stock purchase plans as in effect on the date hereof in the ordinary course of the operation of such plans consistent with past practice, (B) intercompany acquisitions of capital stock, (C) the redemption of the ProvGas Preferred Stock as contemplated herein or (D) as set forth in Section 6.1(k) of this Agreement.

(f) Issuance of Securities. PVY shall not, nor shall it permit any of its Subsidiaries to, issue, agree to issue, deliver, sell, award, pledge, dispose of or otherwise encumber or authorize or propose the issuance, delivery, sale, award, pledge, disposal or other encumbrance of, any shares of its or their capital stock of any class or any securities convertible into or exchangeable for, or any rights, warrants or options to acquire, any such shares or convertible or exchangeable securities, other than the issuance of shares of PVY Common Stock pursuant to (i) outstanding grants or awards made prior to the date of this Agreement under the PVY Benefit Plans and Acquired Company Option Plans and (ii) any dividend reinvestment plan of PVY in effect as of the date hereof.

(g) Accounting. PVY shall not, nor shall it permit any of its Subsidiaries to, make any changes in their accounting methods, principles or practices except as required by law, rule, regulation or GAAP. Prior to the Closing, PVY shall comply with the then current accounting rules for costs deferred for Y2K.

(h) No Shopping.

(1) PVY shall not, and shall not authorize or permit any of its (or any of its Subsidiaries') officers, directors, agents, financial advisors, attorneys, accountants or other Representatives to, directly or indirectly, solicit, initiate or encourage submission of proposals or offers from any Person relating to, or that could reasonably be expected to lead to, a Business Combination or participate in any negotiations or substantive discussions regarding, or furnish to any other Person any information with respect to, or otherwise cooperate in any way with, or assist or participate in, facilitate or encourage, any effort or attempt by any other Person to do or seek a Business Combination; provided, however, that, prior to the PVY Shareholders' Approval, PVY may, in response to an unsolicited written proposal from a third party with respect to a Business Combination that PVY's Board of Directors determines, in its good faith judgment, after consultation with and the receipt of the advice of its financial advisor and outside counsel with customary qualifications, is a Superior Proposal, (i) furnish information to, and negotiate, explore or otherwise engage in substantive discussions with such third party, only if PVY's Board of Directors determines, in its good faith judgment after consultation with its financial advisors and outside legal counsel, that it is reasonably necessary in order to comply with its fiduciary duties under applicable law and (ii) take and disclose to PVY's shareholders a position with respect to another Business Combination proposal, or amend or withdraw such position,

pursuant to Rule 14d-9 and 14e-2 under the Exchange Act, or make such disclosure to PVY's shareholders which in the good faith judgment of PVY's Board of Directors, based on the advice of its outside counsel, is required by applicable law. Prior to furnishing any non-public information to, entering into negotiations with or accepting a Superior Proposal from such third party, PVY will (i) provide written notice to SUG to the effect that it is furnishing information to or entering into discussions or negotiations with such third party and (ii) receive from such third party an executed confidentiality agreement containing substantially the same terms and conditions as the Confidentiality Agreement. PVY will immediately cease and cause to be terminated any existing solicitation, initiation, encouragement, activity, discussion or negotiations with any parties conducted heretofore by PVY or any of its representatives with respect to any Business Combination.

(2) Except as expressly permitted by this Section 6.1(h), neither the PVY Board of Directors nor any committee thereof may, (i) withdraw or modify, or propose publicly to withdraw or modify, in a manner adverse to SUG, the approval or recommendation by such Board of Directors or such committee of the Merger or this Agreement, (ii) approve or recommend, or propose publicly to approve or recommend, a Business Combination or (iii) cause PVY to enter into any letter of intent, agreement in principle, acquisition agreement or other similar agreement related to any Business Combination. Notwithstanding the foregoing, prior to the time at which the PVY Shareholders' Approval has been obtained, in response to an unsolicited Business Combination proposal from a third party, if PVY's Board of Directors determines, in its good faith judgment, after consultation with and the receipt of the advice of its financial advisor and outside counsel with customary qualifications, that such proposal is a Superior Proposal and that failure to do any of the actions set forth in clauses (i), (ii) or (iii) above would create a reasonable possibility of a breach of the fiduciary duties of PVY's Board of Directors under applicable law, PVY's Board of Directors may withdraw or modify its approval or recommendation of the Merger or this Agreement, approve or recommend a Business Combination or cause PVY to enter into a Business Combination or an agreement related to a Business Combination and, subject to PVY having paid to SUG the fees described in Section 8.3(a) hereof and having entered into a definitive agreement with respect to such Business Combination proposal, terminate this Agreement; provided, however, that prior to entering into a definitive agreement with respect to a Business Combination proposal, PVY shall give SUG at least two (2) business days' notice thereof, and shall cause its Representatives to, negotiate with SUG to make such adjustments in the terms and conditions of this Agreement as would enable PVY to proceed with the transactions contemplated herein on such adjusted terms; provided, further, that if PVY and SUG are unable to reach an agreement on such adjustments within two (2) business days after such notice from PVY, PVY may enter into such definitive agreement, subject to the provisions of Article VIII.

(3) PVY shall notify SUG orally and in writing of any such inquiries, offers or proposals (including the material terms and conditions of any such offer or proposal and the identity of the Person making it), within two business days of the receipt thereof, shall use all reasonable efforts to keep SUG informed of the status and revised material terms and conditions of any such inquiry, offer or proposal and shall give SUG one (1) day's advance notice of the first delivery of non-public information to such Person. If any such inquiry, offer or proposal is in writing, PVY shall promptly deliver to SUG a copy of such inquiry, offer or proposal.

(4) For purposes of this Agreement, (i) "Business Combination" means (other than the transactions contemplated or permitted by this Agreement) (A) a merger, consolidation or other business combination, share exchange, sale of a minimum of 2% of the outstanding shares of capital stock, tender offer or exchange offer or similar transaction involving PVY or any of its Subsidiaries, (B) acquisition in any manner, directly or indirectly, of a material interest in any capital stock of, or a material equity interest in a substantial portion of the assets of, PVY or any of its Subsidiaries, including any single or multi-step transaction or series of related transactions that is structured to permit a third party to acquire beneficial ownership of a majority or greater equity interest in PVY or any of its Subsidiaries, or (C) the acquisition in any manner, directly or indirectly, of any material portion of the business or assets (other than inventory in the Ordinary Course of Business) of PVY or any of its Subsidiaries and (ii) "Superior Proposal" means a proposed Business Combination involving at least 50% of the shares of capital stock or a material portion of the assets of PVY that PVY's Board of Directors determines, after consulting with PVY's financial advisors and outside counsel, is financially superior to the transactions contemplated hereby and it appears that the party making the proposal is reasonably likely to have the funds necessary to consummate the Business Combination.

(i) Solicitation of Proxies. Subject to Section 6.1(h), PVY shall use its reasonable best efforts to solicit from its shareholders proxies in favor of the Merger and shall take all other action necessary to secure the PVY Shareholders' Approval. PVY shall cause ProvGas and Attleboro to approve the ProvGas Merger and the Attleboro Merger.

(j) PVY Shareholders' Approval.

(1) Subject to the provisions of Section 6.1(h) and Section 6.1(j)(2), PVY shall, as soon as reasonably practicable after the date hereof (i) take all steps necessary to duly call, give notice of, convene and hold a meeting of its shareholders (including all adjournments thereof, the "PVY Meeting") for the purpose of securing the PVY Shareholders' Approval, (ii) distribute to its shareholders the Proxy Statement in accordance with applicable federal and state law and with its Organizational Documents, (iii) subject to the fiduciary duties of its Board of Directors, recommend to its shareholders the approval of this

Agreement and the transactions contemplated hereby and (iv) cooperate and consult with SUG with respect to each of the foregoing matters.

(2) The PVY Meeting for the purpose of securing the PVY Shareholders' Approval, including any adjournments thereof, will be held on such date or dates as PVY and SUG mutually determine.

(k) Financing Activities. PVY shall, and shall cause its Subsidiaries to, cooperate, to the fullest extent commercially reasonable and practicable, with SUG's requests with respect to refinancing by the Acquired Companies of the current maturities of any of their indebtedness, and any repurchase, redemption or prepayment by any of the Acquired Companies of any of its indebtedness or preferred stock that may be required because of the Mergers or that SUG may request that the Acquired Companies effect, so as to permit SUG to have the maximum opportunity to refinance, on or promptly after the Closing Date without any penalty except as may be due pursuant to the terms of the Acquired Companies' indebtedness and preferred stock as in effect on the date of this Agreement, any of the Acquired Companies' indebtedness or preferred stock outstanding on the Closing Date; provided, however, that, except as provided in Section 6.1(m), no Acquired Company shall be required to consummate prior to the Effective Time any such refinancing, repurchase, redemption or repayment requested by SUG.

(l) PVY Disclosure Schedule. On the date hereof, PVY has delivered to SUG the PVY Disclosure Schedule, accompanied by a certificate signed by an executive officer of PVY stating the PVY Disclosure Schedule is being delivered pursuant to this Section 6.1(l). The PVY Disclosure Schedule constitutes an integral part of this Agreement and modifies the representations, warranties, covenants or agreements of PVY contained herein to the extent that such representations, warranties, covenants or agreements expressly refer to the PVY Disclosure Schedule; provided that (i) terms used in the PVY Disclosure Schedule, unless otherwise defined, shall have the meanings, if any, ascribed to them in this Agreement, (ii) information provided in one section of the PVY Disclosure Schedule shall suffice, without repetition or cross-reference, as a disclosure of such information in any other relevant section of the PVY Disclosure Schedule if the disclosure in the first section is sufficient on its face without further inquiry to reasonably inform SUG of the information required to be disclosed in such other sections of the PVY Disclosure Schedule in order to avoid a breach under the counterpart sections of this Agreement and (iii) the inclusion of any item in the PVY Disclosure Schedule shall not establish any threshold of materiality.

(m) Redemption of ProvGas Preferred Stock. PVY shall cause ProvGas (i) to redeem 16,000 shares of ProvGas Preferred Stock on February 15, 2000 pursuant to Section 4 of the Certificate of Authorization for the ProvGas Preferred Stock, and (ii) to redeem the remaining 16,000 shares of ProvGas Preferred Stock on March 1, 2000 pursuant to Section 4 of such Certificate of Authorization.

(n) Amendment of ProvGas Indenture. PVY shall cause ProvGas to use its good faith commercially reasonable efforts to obtain prior to the Effective Time the consent of

holders of at least 80% in aggregate principal amount of all First Mortgage Bonds outstanding under the ProvGas Indenture to each of the amendments to the ProvGas Indenture described on Schedule 6.1(n) hereto; provided, however, that PVY and its Subsidiaries shall not be required to make any payment to any holder of First Mortgage Bonds prior to the Effective Time, other than such payments that are required to be made under the ProvGas Indenture, which payments ProvGas shall make as required under the ProvGas Indenture. If this Agreement is terminated and the Mergers do not occur, (i) within 30 days after the termination of this Agreement, PVY shall provide SUG with a schedule showing the reasonable out-of-pocket fees and reasonable out-of-pocket expenses, including fees and expenses of a solicitation agent, an information agent, and legal fees and expenses, incurred by or on behalf of PVY and ProvGas in connection with complying with the covenant set forth in the preceding sentence (excluding payments made to holders of the First Mortgage Bonds), (ii) within 30 days after the termination of this Agreement, SUG shall provide PVY with a schedule showing the reasonable out-of-pocket fees and reasonable out-of-pocket expenses, including legal fees and expenses, incurred by or on behalf of SUG in connection with the solicitation of consents described in the preceding sentence (excluding payments made to holders of the First Mortgage Bonds), (iii) if PVY's fees and expenses, as set forth on the schedule provided by PVY pursuant hereto, exceed SUG's fees and expenses, as set forth on the schedule provided by SUG pursuant hereto, SUG shall pay PVY 50% of such excess within 60 days after the termination of this Agreement, and (iv) if SUG's fees and expenses, as set forth on the schedule provided by SUG pursuant hereto, exceed PVY's fees and expenses, as set forth on the schedule provided by PVY pursuant hereto, PVY shall pay SUG 50% of such excess within 60 days after the termination of this Agreement; provided, however, that if this Agreement is terminated based on the breach by any party of its obligations under this Agreement, such breaching party shall bear its own such fees and expenses and shall pay the non-breaching party the fees and expenses, as set forth on the applicable schedule provided in accordance with this section by the non-breaching party, within 60 days after the termination of this Agreement.

Section 6.2 Covenants of SUG. SUG agrees to observe and perform the following covenants and agreements:

(a) Governmental Approvals; Third Party Consents. SUG will use its commercially reasonable best efforts at SUG's sole expense to obtain all necessary consents, approvals and waivers from any Person required in connection with the transactions contemplated hereby under any license, lease, permit, Contract or agreement applicable to SUG, including, without limitation, the approvals of those Governmental Bodies listed in Section 4.3 of the SUG Disclosure Schedule and as required by the HSR Act.

(b) Employees; Benefits. With respect to the employees of the Acquired Companies (excluding unionized employees) (the "Employees"), except as otherwise specified herein, SUG agrees as follows:

(1) To assume and maintain for their term all employment and change in control agreements of PVY in effect as of the Effective Time;

(2) During the 24 months immediately following the Closing Date, to maintain for the Employees who continue their service with SUG or any Subsidiary of SUG base salary levels, bonus opportunity levels and overall employee benefits (other than the 1989 Stock Option Plan, the 1989 Non-Employee Director Stock Option Plan, the Non-Employee Director Stock Plan, the 1998 Performance Share Plan, the Restricted Stock Incentive Plan and the Employee Stock Purchase Plan, all of which shall be terminated as of the Closing Date) that are no less favorable in the aggregate than those currently provided to Employees generally, except for any changes made to comply with applicable law or tax qualification nondiscrimination rules; provided, however, that (i) during such 24-month period, all PVY qualified and non-qualified defined benefit pension plans shall be maintained without adverse amendment or modification, except for any changes made to comply with applicable law or, in the case of the PVY tax-qualified defined benefit plan, tax qualification nondiscrimination rules; and (ii), with respect to any severance from employment occurring during such 24-month period, to provide severance benefits to such Employees on a basis no less favorable than would otherwise be provided to such Employees under the applicable severance pay plans of PVY as in effect on the date of this Agreement. After the 24 months immediately following the Closing Date, SUG agrees to maintain during the next 24-month period, for Employees who continue their service with SUG or any Subsidiary of SUG, base salary levels, bonus opportunity and overall employee benefits that are appropriate for the market given SUG's financial circumstances, the industry in which it operates, and regulatory considerations. Nothing in this Agreement shall restrict, limit or interfere with the ability (after the Closing Date) of SUG to terminate, amend or replace any particular agreement, plan or program, or terminate the employment of any person, provided that the requirements of this Section 6.2(b)(2) are otherwise satisfied.

(3) For purposes of eligibility, vesting and benefit accrual under all benefit plans provided to the Employees after the Closing Date, SUG will recognize the tenure of employment, as recognized by the Acquired Companies as of the Closing Date.

(4) All vacation time earned by the Employees prior to the Closing Date must be taken by the end of the calendar year in which the Closing Date occurs, except where the Employee is requested by PVY or SUG to forego their vacation for business-related reasons. For purposes of awarding vacation time at the beginning of each calendar year following the Closing Date, SUG will recognize the tenure of employment, as recognized by the Acquired Company as of the Closing Date.

(5) SUG will permit each of the Employees to carry forward all days of sick leave accrued prior to the Closing Date.

(6) Effective immediately following the Closing Date, each Employee who satisfies the eligibility criteria used by SUG for similarly situated employees of SUG shall be eligible for awards under SUG's Long-Term Incentive Stock Option Plan. SUG represents that, as of the date of this Agreement, such plan is the only plan in which SUG employees actively participate which provides benefits in the form of SUG capital stock, other than the SUG Employee Stock Purchase Plan or SUG tax-qualified or supplemental retirement plans.

(7) For a five (5) year period from the Closing Date, SUG agrees to provide retiree medical plan coverage which is substantially comparable to the coverage under the PVY retiree medical plan as of the date hereof, subject to SUG's right to adjust copayment and cost sharing provisions (which may be continued in the same proportions to the PVY-provided portions of cost) to any former Employee (and his or her eligible dependents) who is currently receiving such benefits thereunder, or any active Employee (and his or her eligible dependents) who would be eligible for such benefits if he or she retired on the Closing Date (or who, within five (5) years of the Closing Date, retires and is eligible to receive benefits thereunder).

(c) WARN. Neither SUG nor any Acquired Company shall, at any time prior to 90 days after the Effective Time, effectuate a "plant closing" or "mass layoff," as those terms are defined in the Worker Adjustment and Retraining Notification Act of 1988, as amended ("WARN"), affecting in whole or in part any site of employment, facility, operating unit or employee without complying with the notice requirements and other provisions of WARN.

(d) Directors. Immediately after the Effective Time on the Closing Date, the Chief Executive Officer of PVY immediately prior to the Effective Time shall be elected to the Board of Directors of SUG, and thereafter nominated and recommended for reelection if necessary such that such individual shall have a term of at least three years from the Closing Date, and such individual shall hold office in accordance with the Certificate of Incorporation and Bylaws of SUG; provided, however, that if such individual is also an officer or employee of SUG, such individual shall be required to resign as a director of SUG if he resigns or is terminated as an officer or employee of SUG.

(e) Officers of PVY Division of SUG.

(1) From the Effective Time until the earlier of their resignation or removal by the President of SUG, (i) Mr. James Dodge shall serve as Chief Executive Officer and President and (ii) James DeMetro shall serve as Executive Vice President, Energy Services, in each case, of the PVY Division of SUG and all other energy-related businesses of SUG conducted in New England.

(2) From the Effective Time until the earlier of their resignation or removal by SUG, the following individuals shall serve the PVY Division of SUG in the following capacities:

Kenneth Hogan as Vice President, Chief Financial Officer and Treasurer
Susann G. Mark as Vice President and General Counsel
James A. Grasso as Vice President, Public Government Affairs
Gerald A. Yurkevicz as Vice President, Business Development and Marketing
Royalynne Hourihan as Vice President, Human Resources
Timothy S. Lyons as Vice President, Marketing and Regulatory Affairs
Robert W. Owens as Senior Vice President, Gas Distribution
Peter J. Gill as Vice President, Information Technology
James M. Stephens as President of Providence Energy Services
Paul E. O'Keefe as General Manager of Providence Energy Oil
George Mason as Vice President of Providence Energy Oil

The provisions of this Section 6.2(e) are subject to the specific terms of the employment contracts referred to in Section 6.2(b)(1), and the duties and responsibilities attributable to the positions referred to in Section 6.2(e) shall be as set forth in such contracts.

(f) Charitable Contributions. SUG will maintain PVY's charitable contributions for at least the calendar year in which the Effective Time occurs and the next two calendar years thereafter at no less than $175,000, which PVY represents is the current year budget for the fiscal year ending September 30, 2000.

(g) Corporate Offices. For at least three years after the Effective Time, SUG will operate the Acquired Companies' operations in Rhode Island and Massachusetts as a separate division of SUG. For at least three years after the Effective Time, SUG will maintain the principal executive offices of the Acquired Companies in Rhode Island and, for at least three years after the Effective Time, SUG will maintain such Rhode Island offices as the principal executive offices for all of SUG's energy-related businesses conducted in New England; provided, however, that SUG will not be required to maintain such Rhode Island offices as the principal executive offices for all of SUG's energy-related businesses conducted in New England if Mr. James Dodge ceases to be the Chief Executive Officer of the PVY Division of SUG.

(h) Collective Bargaining Agreements. At the Effective Time, SUG agrees to assume all collective bargaining agreements covering employees of any Acquired Company, and shall discharge when due any and all liabilities of any Acquired Company under such collective bargaining agreements relating to periods after the Effective Time.

(i) SUG Disclosure Schedule. On the date hereof, SUG has delivered to PVY the SUG Disclosure Schedule, accompanied by a certificate signed by an executive officer of SUG stating that the SUG Disclosure Schedule is being delivered pursuant to this Section 6.2(i). The SUG Disclosure Schedule constitutes an integral part of this Agreement and modifies the representations, warranties, covenants or agreements of SUG contained herein to the extent that such representations, warranties, covenants or agreements expressly refer to the SUG Disclosure Schedule; provided that (i) terms used in the SUG Disclosure Schedule, unless otherwise

defined, shall have the meanings, if any, ascribed to them in this Agreement, (ii) information provided in one section of the SUG Disclosure Schedule shall suffice, without repetition or cross-reference, as a disclosure of such information in any other relevant section of the SUG Disclosure Schedule if the disclosure in the first section is sufficient on its face without further inquiry to reasonably inform PVY of the information required to be disclosed in such other sections of the SUG Disclosure Schedule in order to avoid a breach under the counterpart sections of this Agreement and (iii) the inclusion of any item in the SUG Disclosure Schedule shall not establish any threshold of materiality.

Section 6.3 Additional Agreements.

(a) The Proxy Statement. As soon as practicable after the date hereof, PVY shall take such reasonable steps as are necessary for the prompt preparation and filing with the SEC of a proxy statement relating to the PVY Meeting (together with any amendments thereto or supplements thereto, the "Proxy Statement"). Each of SUG and PVY shall furnish all information concerning it, its officers and directors, and the holders of its capital stock as the other may reasonably request in connection with the preparation and filing of the Proxy Statement. PVY will use all commercially reasonable efforts to cause the Proxy Statement to be cleared by the SEC as promptly as practicable after filing and as promptly as practicable after such clearance, PVY shall mail the Proxy Statement to its stockholders entitled to notice of and to vote at the PVY Meeting. As promptly as practical after consultation between SUG and PVY, PVY shall respond to any comments made by the SEC with respect to the Proxy Statement.

(ii) The information supplied by PVY for inclusion or incorporation by reference in the Proxy Statement shall not, at the date of the mailing of the Proxy Statement (or any supplement thereto) and at the time of the PVY Meeting, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading. If at any time prior to PVY Meeting any event or circumstance relating to PVY or any of its Subsidiaries, or its or their respective officers or directors, should be discovered by PVY that should be set forth in a supplement to the Proxy Statement, PVY shall promptly inform SUG. All documents that PVY is responsible for filing with the SEC in connection with the transactions contemplated herein shall comply as to form in all material respects with the applicable requirements of the Securities Act and the regulations thereunder and the Exchange Act and the regulations thereunder.

(iii) The information supplied by SUG for inclusion or incorporation by reference in the Proxy Statement shall not, at the date of the mailing of the Proxy Statement (or any supplement thereto), at the time of the PVY Meeting, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they are made, not misleading. If at any time prior to the PVY Meeting any event or circumstance relating to SUG or any of its Subsidiaries, or to their respective officers or directors, should be discovered by SUG that should be set forth in a supplement to the Proxy Statement, SUG shall promptly inform PVY.

(iv) No representation, warranty, covenant or agreement is made by or on behalf of PVY with respect to information supplied by any other Person for inclusion in the Proxy Statement. No representation, warranty, covenant or agreement is made by or on behalf of SUG with respect to information supplied by any other Person for inclusion in the Proxy Statement. No filing of, or amendment or supplement to, the Proxy Statement shall be made by PVY without providing SUG with the opportunity to review and comment thereon (except for any ongoing SEC reporting required of PVY or ProvGas that will be incorporated by reference). If at any time prior to the PVY Meeting any information relating to any party hereto or any of their respective officers, directors, shareholders or Subsidiaries, should be discovered by any party hereto which should be set forth in an amendment or supplement to the Proxy Statement so that the Proxy Statement would not include any untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, the party which discovers such information shall promptly notify the other party hereto and an appropriate amendment or supplement describing such information shall be promptly prepared, filed with the SEC and, to the extent required by law, disseminated to the shareholders of PVY.

(b) Further Assurances. Each of SUG and PVY agrees, and PVY agrees to cause its Subsidiaries, to take all such reasonable and lawful action as may be necessary or appropriate in order to effectuate the Mergers in accordance with this Agreement as promptly as possible. If, at any time after the Effective Time, any such further action is necessary or desirable to carry out the purpose of this Agreement and to vest SUG with full right, title and possession to all assets, property, rights, privileges, powers and franchises of the Acquired Companies, the officers and directors of SUG will be fully authorized to take, and will take, all such lawful and necessary action.

(c) Financial Statements to be Provided. Upon SUG's request, PVY shall (i) provide to SUG audited and unaudited financial statements required to be included in the proxy statements and the registration statement contemplated by the Agreement of Merger, dated as of October 4, 1999, by and between SUG and Fall River Gas Company and (ii) cause its independent accountants to deliver to SUG and Fall River Gas Company the required consents in connection therewith.

ARTICLE VII
CONDITIONS

Section 7.1 Conditions to SUG's Obligation to Effect the Merger. The obligations of SUG and Newco to effect the transactions contemplated by this Agreement shall be subject to fulfillment at or prior to the Closing of the following conditions:

(a) Representations and Warranties True as of the Closing Date. PVY's representations and warranties in this Agreement shall have been accurate in all respects as of the date of this Agreement and shall be accurate in all respects as of the Closing Date as if made on the Closing Date, except for such inaccuracies (without regard to any materiality qualifications

contained therein) which, individually and in the aggregate, would not be reasonably likely to result in a PVY Material Adverse Effect.

(b) Compliance with Agreements. The covenants, agreements and conditions required by this Agreement to be performed and complied with by any of the Acquired Companies shall have been performed and complied with in all material respects prior to or at the Closing Date.

(c) Certificate. PVY shall execute and deliver to SUG a certificate of an authorized officer of PVY, dated the Closing Date, stating that the conditions specified in Sections 7.1(a) and 7.1(b) of this Agreement have been satisfied.

(d) Governmental Approvals. All approvals, consents, opinions or rulings of all Governmental Bodies required in order to consummate the transactions contemplated hereby shall have been obtained by Final Order in such form as are not, and with no conditions that are, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect or a material adverse effect on the business, financial condition or results of operations of SUG, or which would otherwise, in the reasonable determination of SUG, be unduly burdensome to SUG in a manner that would be, individually or in the aggregate, reasonably likely to have a PVY Material Adverse Effect or a material adverse effect on the business, financial condition or results of operations of SUG. The applicable waiting period under the HSR Act with respect to the transactions contemplated hereby shall have expired or have been terminated.

(e) Third Party Consents. Each of the consents required under Section 5.4 of this Agreement shall have been obtained to the reasonable satisfaction of SUG, other than any such consents which, if not obtained, are not, individually or in the aggregate, reasonably likely to result in a PVY Material Adverse Effect after the Closing. In addition, the consent of the holders of at least 80% in aggregate principal amount of all First Mortgage Bonds outstanding under the ProvGas Indenture to each of the amendments to the ProvGas Indenture described on Schedule 6.1(n) hereto shall have been obtained.

(f) Injunctions. On the Closing Date, there shall be no Orders which operate to restrain, enjoin or otherwise prevent the consummation of this Agreement or the Mergers.

(g) Resignations. Each director of each Acquired Company shall, if requested by SUG, resign any position as a director of an Acquired Company effective as of the Closing Date in accordance with such Acquired Company's Organizational Documents and applicable provisions of the RIBCA or MBCL, as the case may be; provided, however, that such resignations shall not cause the termination of any such Person's employment as an employee of an Acquired Company or reduce any such employee's then current level of compensation.

(h) Shareholder Approvals. The PVY Shareholders' Approval shall have been obtained, and all of the outstanding shares of the ProvGas Preferred Stock shall have been redeemed in accordance with the Organizational Documents of ProvGas.

(i) Tax Good Standing. Letters of Tax Good Standing shall have been obtained for PVY and ProvGas from the Rhode Island Department of Taxation.

(j) Conversion of Options. All directors who have options outstanding under the 1989 Non-Employee Director Stock Option Plan shall have consented to the conversion of such options into a right to receive in respect thereof a cash payment on the basis set forth in Section 3.3.

Section 7.2 Conditions to PVY's Obligations to Effect the Mergers. The obligation of PVY to effect the transactions contemplated by this Agreement shall be subject to fulfillment at or prior to the Closing of the following conditions:

(a) Representations and Warranties True as of the Closing Date. SUG's representations and warranties in this Agreement shall have been accurate in all respects as of the date of this Agreement and shall be accurate in all respects as of the Closing Date as if made on the Closing Date, except for such inaccuracies (without regard to any materiality qualifications contained herein) which, individually and in the aggregate, would not be reasonably likely to result in a SUG Material Adverse Effect.

(b) Compliance with Agreements. The covenants, agreements and conditions required by this Agreement to be performed and complied with by SUG shall have been performed and complied with in all material respects prior to or at the Closing Date.

(c) Certificate. SUG shall execute and deliver to PVY a certificate of an authorized officer of SUG, dated the Closing Date, stating that the conditions specified in Sections 7.2(a) and 7.2(b) of this Agreement have been satisfied.

(d) Governmental Approvals. All approvals, consents, opinions or rulings of all Governmental Bodies required in order to consummate the transactions contemplated hereby shall have been obtained by Final Order. The applicable waiting period under the HSR Act with respect to the transactions contemplated hereby shall have expired or have been terminated.

(e) Injunctions. On the Closing Date, there shall be no Orders which operate to restrain, enjoin or otherwise prevent the consummation of this Agreement or the Mergers.

(f) Shareholder Approvals. The PVY Shareholders' Approval shall have been obtained.

ARTICLE VIII
TERMINATION

Section 8.1 Termination Rights. This Agreement may be terminated in its entirety at any time prior to the Closing:

(a) By the mutual written consent of SUG and PVY;

(b) By PVY, on the one hand, or SUG, on the other hand, in writing if there shall be in effect a non-appealable order of a court of competent jurisdiction prohibiting the consummation of the Mergers in accordance with this Agreement;

(c) By PVY, by written notice to SUG, if there is a breach of any representation or warranty of SUG, which breach cannot be cured and would cause the conditions set forth in Section 7.2(a) to be incapable of being satisfied;

(d) By SUG, by written notice to PVY, if there is a breach of any representation or warranty of PVY, which breach cannot be cured and would cause the conditions set forth in Section 7.1(a) to be incapable of being satisfied;

(e) By PVY, by written notice to SUG in accordance with Section 6.1(h)(2); provided, however, that the termination described in this clause (e) shall not be effective unless and until PVY shall have paid SUG the fee described in Section 8.3(a) and PVY has substantially contemporaneously entered into a definitive agreement with respect to the proposed Business Combination;

(f) By PVY, by written notice to SUG, if the PVY Shareholders' Approval is not obtained at the PVY Meeting upon the taking of such vote including all adjournments, or by SUG, by written notice to PVY, if the PVY Shareholders' Approval is not obtained at the PVY Meeting upon the taking of such vote including all adjournments;

(g) By SUG, by written notice to PVY, if the Board of Directors of PVY or any committee thereof (i) withdraws or modifies, or proposes publicly to withdraw or modify, in a manner adverse to SUG, the approval or recommendation by the Board of Directors or such committee of the Merger or this Agreement, (ii) approves or recommends, or proposes publicly to approve or recommend, a Business Combination, (iii) causes PVY to enter into a definitive agreement related to any Business Combination, (iv) resolves to take any of the actions specified in clause (i), (ii) and (iii) above or (v) fails to cause ProvGas to redeem all of the outstanding shares of ProvGas Preferred Stock as provided in Section 6.1(m);

(h) By SUG, by written notice to PVY, if a third party, including a group (as defined under the Exchange Act), acquires securities representing greater than 50% of the voting power of the outstanding voting securities of PVY; or

(i) By either party in writing at any time after 5:00 p.m., Eastern Time on November 15, 2000 (the "Initial Termination Date"), if the Closing has not occurred prior thereto; provided, however, that the right to terminate this Agreement under this Section 8.1(i) will not be available to any party that is in material breach of its representations, warranties, covenants or agreements contained herein; and provided, further, that if on the Initial Termination Date (i) the conditions to closing set forth in Sections 7.1(d) and 7.2(d) shall not have been fulfilled or (ii) any approval or authorization of any Governmental Body required in connection with the consummation of the Mergers shall have not been obtained and such approval or authorizations shall not have become a Final Order, but all other conditions to

Closing shall be fulfilled or shall be capable of being fulfilled, then the Initial Termination Date will be extended to April 1, 2001.

Section 8.2 Effect of Termination. If this Agreement is terminated pursuant to Section 8.1, this Agreement shall be of no further force and effect and there shall be no further liability hereunder on the part of any party or its Affiliates, directors, officers, shareholders, agents or other Representatives; provided, however, that (i) any fee payable under Section 8.3(a) is paid to SUG and (ii) no such termination shall relieve any party of liability for any claims, damages or losses suffered by the other party as a result of the negligent or willful failure of a party to perform any obligations required to be performed by it hereunder on or prior to the date of termination. Notwithstanding anything to the contrary contained herein, the provisions of Section 8.2, Sections 10.1 through 10.6 and Sections 10.8 through 10.11 of this Agreement shall survive any termination of this Agreement.

Section 8.3 Termination Fee; Expenses.

(a) Termination Fee. If this Agreement is terminated pursuant to Section 8.1(e), 8.1(g) or 8.1(h), then PVY shall pay to SUG promptly (but not later than five business days after notice is received from PVY) an amount equal to $7.5 million in cash.

(b) Expenses. The parties agree that the agreements contained in this Section 8.3 are an integral part of the transactions contemplated by this Agreement and constitute liquidated damages and not a penalty. Notwithstanding anything to the contrary contained in this Section 8.3, if PVY fails to pay promptly to SUG the fee due under Section 8.3(a), in addition to any amounts paid or payable pursuant to Section 8.3(a), PVY shall pay the costs and expenses (including legal fees and expenses) in connection with any action, including the filing of any lawsuit or other legal action, taken to collect payment, together with interest on the amount of any unpaid fee calculated using an annual percentage rate of interest equal to the prime rate published in *The Wall Street Journal* on the date (or preceding business day if such date is not a business day) such fee was required to be paid, compounded on a daily basis using a 360-day year.

ARTICLE IX
INDEMNIFICATION; REMEDIES

Section 9.1 Directors' and Officer's Indemnification.

(a) Indemnification and Insurance. For a period of six years after the Effective Time, SUG will indemnify and hold harmless the present and former officers and directors of PVY and its Subsidiaries (the "Indemnified Parties") in respect of acts or omissions occurring prior to the Effective Time to the extent provided under PVY's articles of incorporation and bylaws in effect on the date hereof; provided, however, that if any claim or claims are asserted or made within such six-year period, all rights to indemnification in respect of such claims shall continue until the final disposition of any and all such claims. For six years after the Effective Time, SUG will use its reasonable best efforts to provide officers' and directors' liability insurance in respect of acts or omissions occurring prior to the Effective Time

covering each such person currently covered by PVY's officers' and directors' liability insurance policy on terms with respect to coverage and amount no less favorable than those of such policy in effect on the date hereof; provided, however, that in satisfying its obligation under this Section, if the annual premiums of such insurance coverage exceed 200% of the previous year's premiums, SUG will be obligated to obtain a policy with the best coverage available, in the reasonable judgment of the Board of Directors of SUG, for a cost not exceeding such amount.

(b) Successors. In the event SUG or any of its successors or assigns (i) consolidates with or merges into any other Person and is not the continuing or surviving corporation or entity of such consolidation or merger or (ii) transfers all or substantially all of its properties and assets to any Person, then and in either such case, proper provisions must be made so that the successors and assigns of SUG will assume the obligations set forth in this Section 9.1.

(c) Survival of Indemnification. To the fullest extent permitted by law, from and after the Effective Time, all rights to indemnification as of the date hereof in favor of the employees, agents, directors and officers of any Acquired Company with respect to their activities as such prior to the Effective Time, as provided in their respective Organizational Documents in effect on the date hereof, or otherwise in effect on the date hereof, will survive the Mergers and will continue in full force and effect except for amendments to make changes permitted by law that would enhance the rights of past or present officers and directors to indemnification or advancement of expenses in respect of acts or omissions occurring prior to the Effective Time. for a period of not less than six years from the Effective Time (or, in the case of matters occurring prior to the Effective Time which have not been resolved prior to the sixth anniversary of the Effective Time, until such matters are finally resolved).

Section 9.2 Representations and Warranties. Each and every representation and warranty of either party shall expire at, and be terminated and extinguished with, the Effective Time.

ARTICLE X
GENERAL PROVISIONS

Section 10.1 Expenses. Each of the parties will pay all costs and expenses of its performance of and compliance with this Agreement, except (i) as provided in the last sentence of Section 6.1(n) or Section 8.3 and as expressly provided otherwise herein, (ii) PVY shall pay all fees and expenses of counsel for PVY, (iii) SUG shall pay all fees and expenses of counsel for SUG and Newco, (iv) SUG will pay all real estate transfer taxes and real estate recording fees, if any, including expenses of counsel associated with real estate title, transfer and recording issues in connection with the Mergers, and all filing and application fees paid to Governmental Bodies in connection with the Mergers and (v) PVY will pay all of the costs of printing and mailing the Proxy Statement to the PVY stockholders.

Section 10.2 Notices. All notices, requests and other communications hereunder shall be in writing and shall be deemed to have been given upon receipt if either (a) personally

delivered, (b) sent by prepaid first class mail, and registered or certified and a return receipt requested or (c) by facsimile telecopier with completed transmission acknowledged:

if to SUG or to Newco, to:

Southern Union Company
504 Lavaca Street, Suite 800
Austin, Texas 78701
Attention: Peter H. Kelley
President and Chief Operating Officer
Telecopier: (512) 477-3879

with a copy to:

Hughes Hubbard & Reed LLP
One Battery Park Plaza
New York, New York 10004
Attention: Garett J. Albert
Telecopier: (212) 422-4726

if to PVY, to:

Providence Energy Corporation
100 Weybosset Street
Providence, Rhode Island 02903
Attention: James H. Dodge
Chairman, President and CEO
Telecopier: (401) 421-4887

with a copy to:

Simpson Thacher & Bartlett
425 Lexington Avenue
New York, New York 10017
Attention: Peter J. Gordon
Telecopier: (212) 455-2502

or at such other address or number as shall be given in writing by a party to the other parties.

Section 10.3 Assignment. This Agreement may not be assigned by any party hereto without the prior written consent of the other parties hereto. Any assignment in violation of the terms of this Agreement shall be null and void *ab initio*.

Section 10.4 Successor Bound. Subject to the provisions of Section 10.3, this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns.

Section 10.5 Governing Law; Forum; Consent to Jurisdiction. This Agreement shall be construed in accordance with and governed by the laws of the State of New York except to the extent that the terms and consummation of the Mergers are subject to the DGCL, the RIBCA or the MBCL, in which case such laws shall govern. Each party to this Agreement hereby irrevocably and unconditionally (i) consents to submit to the exclusive jurisdiction of the federal courts of the Southern District of New York in the county of New York and the borough of Manhattan for any proceeding arising in connection with this Agreement (and each such party agrees not to commence any such proceeding, except in such courts), (ii) to the extent such party is not a resident of the State of New York, agrees to appoint an agent in the State of New York as such party's agent for acceptance of legal process in any such proceeding against such party with the same legal force and validity as if served upon such party personally within the State of New York, and to notify promptly each other party hereto of the name and address of such agent, (iii) waives any objection to the laying of venue of any such proceeding in the federal courts of the Southern District of New York in the county of New York and the borough of Manhattan, and (iv) waives, and agrees not to plead or to make, any claim that any such proceeding brought in any federal court of the Southern District of New York has been brought in an improper or otherwise inconvenient forum.

Section 10.6 Waiver of Trial By Jury. EACH PARTY TO THIS AGREEMENT HEREBY WAIVES TRIAL BY JURY IN ANY ACTION OR PROCEEDING TO WHICH ANY SUCH PARTY MAY BE A PARTY ARISING OUT OF OR IN ANY WAY PERTAINING TO (i) THIS AGREEMENT, (ii) THE MERGERS, (iii) THE CONFIDENTIALITY AGREEMENT OR (iv) ANY RELATED DOCUMENTS. IT IS AGREED AND UNDERSTOOD THAT THIS WAIVER CONSTITUTES A WAIVER OF TRIAL BY JURY OF ALL CLAIMS AGAINST ALL PARTIES WHO ARE PARTIES TO THIS AGREEMENT. THIS WAIVER IS KNOWINGLY, WILLINGLY AND VOLUNTARILY MADE BY EACH PARTY HERETO, AND EACH SUCH PARTY HEREBY REPRESENTS AND WARRANTS THAT NO REPRESENTATIONS OF FACT OR OPINION HAVE BEEN MADE BY ANY PERSON TO INDUCE THIS WAIVER OR TRIAL BY JURY OR TO IN ANY WAY MODIFY OR NULLIFY ITS EFFECT. EACH PARTY TO THIS AGREEMENT FURTHER REPRESENTS AND WARRANTS THAT EACH SUCH PARTY HAS BEEN REPRESENTED IN THE SIGNING OF THIS AGREEMENT AND IN THE MAKING OF THIS WAIVER BY INDEPENDENT LEGAL COUNSEL, SELECTED OF EACH SUCH PARTY'S OWN FREE WILL, AND THAT EACH SUCH PARTY HAS HAD THE OPPORTUNITY TO DISCUSS THIS WAIVER WITH COUNSEL.

Section 10.7 Cooperation; Further Documents.

(a) Each of the parties hereto agrees to use its reasonable best efforts to take or cause to be taken all action, and to do or cause to be done all things necessary, proper or advisable under applicable laws, regulations or otherwise, to consummate and to make effective the transactions contemplated by this Agreement, including, without limitation, the timely performance of all actions and things contemplated by this Agreement to be taken or done by each of the parties hereto.

(b) Each party shall cooperate with the other party in such other party's discharge of the obligations hereunder, which shall include making reasonably available to the other party such of its books and records as contain, and such of its personnel as have, relevant information, with respect thereto.

Section 10.8 Construction of Agreement. The terms and provisions of this Agreement represent the results of negotiations between the parties and their Representatives, each of which has been represented by counsel of its own choosing, and neither of which has acted under duress or compulsion, whether legal, economic or otherwise. Accordingly, the terms and provisions of this Agreement shall be interpreted and construed in accordance with their usual and customary meanings, and each of the parties hereto hereby waives the application in connection with the interpretation and construction of this Agreement of any rule of law to the effect that ambiguous or conflicting terms or provisions contained in this Agreement shall be interpreted or construed against the party whose attorney prepared the executed draft or any earlier draft of this Agreement.

Section 10.9 Publicity; Organizational and Operational Announcements. No party hereto shall issue, make or cause the publication of any press release or other announcement with respect to this Agreement or the transactions contemplated hereby, or otherwise make any disclosures relating thereto, without the consent of the other parties, such consent not to be unreasonably withheld or delayed; provided, however, that such consent shall not be required where such release or announcement is required by applicable law or the rules or regulations of a securities exchange, in which event the party so required to issue such release or announcement shall endeavor, wherever possible, to furnish an advance copy of the proposed release to the other parties.

Section 10.10 Waiver. Except as otherwise expressly provided in this Agreement, neither the failure nor any delay on the part of any party to exercise any right, power or privilege hereunder shall operate as a waiver thereof, nor shall any single or partial exercise or waiver of any such right, power or privilege preclude any other or further exercise thereof, or the exercise of any other right, power or privilege available to each party at law or in equity.

Section 10.11 Parties in Interest. This Agreement (including the documents and instruments referred to herein) is not intended to confer upon any Person, other than the parties hereto and their successors and permitted assigns, any rights or remedies hereunder, except that the parties hereto agree and acknowledge that the agreements and covenants contained in Section 6.2(d) are intended for the direct and irrevocable benefit of the director of PVY specified therein, and that the agreements and covenants contained in Section 9.1 are intended for the direct and irrevocable benefit of the Indemnified Parties described therein and their respective heirs or legal representatives (such director or Indemnified Party, a "Third Party Beneficiary"), and that each such Third Party Beneficiary, although not a party to this Agreement, shall be and is a direct and irrevocable third party beneficiary of such agreements and covenants and shall have the right to enforce such agreements and covenants against SUG in all respects fully and to the same extent as if such Third Party Beneficiary were a party hereto.

Section 10.12 Specific Performance. The parties hereto agree that irreparable damage would occur to a party in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that any party shall be entitled to an injunction or injunctions to prevent breaches of this agreement by any other party and to enforce specifically, to the fullest extent available, the terms and provisions hereof, including each party's obligation to close, in any court of the United States or any state having jurisdiction, this being in addition to any other right or remedy to which any party is entitled at law or in equity.

Section 10.13 Section and Paragraph Headings. The section and paragraph headings in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

Section 10.14 Amendment. This Agreement may be amended only by an instrument in writing executed by the parties hereto.

Section 10.15 Entire Agreement. This Agreement, the exhibits, annexes and schedules hereto and the documents specifically referred to herein and the Confidentiality Agreement constitute the entire agreement, understanding, representations and warranties of the parties hereto with respect to the subject matter hereof and supersede all prior agreements with respect thereto.

Section 10.16 Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

[SIGNATURES APPEAR ON FOLLOWING PAGE]

IN WITNESS WHEREOF, the parties have executed and delivered this Agreement as of the date first written above.

SOUTHERN UNION COMPANY

By: Peter H. Kelley
Name: Peter H. Kelley
Title: President and Chief Operating Officer

GUS ACQUISITION CORPORATION

By: Peter H. Kelley
Name: Peter H. Kelley
Title: President

PROVIDENCE ENERGY CORPORATION

By:
Name:
Title:

AGREEMENT AND PLAN OF MERGER

BY AND AMONG

VALLEY RESOURCES, INC.,

SOUTHERN UNION COMPANY

AND

SUG ACQUISITION CORPORATION

DATED AS OF NOVEMBER 30, 1999

TABLE OF CONTENTS

INDEX OF DEFINED TERMS

AGREEMENT AND PLAN OF MERGER, dated as of November 30, 1999 (this "Agreement"), by and among Valley Resources, Inc., a Rhode Island corporation (the "Company"), Southern Union Company, a Delaware corporation ("Parent"), and SUG Acquisition Corporation, a Rhode Island corporation and a wholly-owned subsidiary of Parent ("Merger Sub").

WHEREAS, the Company and Parent have determined to engage in a business combination transaction on the terms stated herein; and

WHEREAS, the respective Boards of Directors of the Company, Parent and Merger Sub have approved and deemed it advisable and in the best interests of their respective shareholders to consummate the transactions contemplated herein under which the businesses of the Company and Parent would be combined by means of the merger of Merger Sub with and into the Company and the subsequent mergers of the Company and its regulated subsidiaries into Parent;

NOW, THEREFORE, in consideration of the premises and the representations, warranties, covenants and agreements contained herein, the parties hereto, intending to be legally bound hereby, agree as follows:

ARTICLE I
THE MERGER

Section 1.1 *The Merger.* Upon the terms and subject to the conditions of this Agreement, at the Effective Time (as defined in Section 1.3), Merger Sub shall be merged with and into the Company (the "Merger") in accordance with the laws of the State of Rhode Island. As a result of the Merger, the separate corporate existence of Merger Sub shall cease and the Company shall be the surviving corporation in the Merger and shall continue its corporate existence under the laws of the State of Rhode Island. The effects and the consequences of the Merger shall be as set forth in Section 1.2. Throughout this Agreement, the term the "Company" shall refer to the Company prior to the Merger and the term "Surviving Corporation" shall refer to the Company in its capacity as the surviving corporation in the Merger.

Section 1.2 *Effects of the Merger.* Pursuant to the Merger, (i) the Articles of Incorporation of the Surviving Corporation shall be amended and restated at and as of the Effective Time to be identical to the Articles of Incorporation of Merger Sub, as in effect immediately prior to the Effective Time, until thereafter amended as provided by law, except that Article 1 of the Articles of Incorporation shall be changed so that the name of the Surviving Corporation shall be "Valley Resources, Inc." and (ii) the By-laws of the Surviving Corporation shall be amended and restated at and as of the Effective Time to be identical to the By-laws of Merger Sub, as in effect immediately prior to the Effective Time, until thereafter amended as provided by law, except that the By-laws shall be changed so that the name of the Surviving Corporation shall be "Valley Resources, Inc." Subject to the foregoing, the additional effects of the Merger shall be as provided in Section 7-1.1-69 of the Rhode Island Business Corporation Act (the "RIBCA").

Section 1.3 *Effective Time of the Merger.* On the Closing Date (as defined in Section 3.1), with respect to the Merger, a duly executed Articles of Merger complying with Section 7-1.1-65 of the RIBCA shall be filed with the Secretary of the State of Rhode Island. The Merger shall become effective upon the issuance of a Certificate of Merger by the Secretary of State of the State of Rhode Island (the "Effective Time").

Section 1.4 *Directors and Officers.* The directors and officers of Merger Sub immediately prior to the Effective Time shall be the directors and officers of the Surviving Corporation and shall hold office from the Effective Time until their respective successors are duly elected or appointed and qualified in the manner provided in the Articles of Incorporation and By-laws of the Surviving Corporation, or as otherwise provided by the RIBCA.

Section 1.5 *Other Transactions.* Immediately after the Effective Time, the Surviving Corporation shall adopt an agreement and plan of merger pursuant to which Valley Gas Company ("Valley"), a wholly-owned Subsidiary (as defined in Section 4.1) of the Company, shall merge with and into the Surviving Corporation on the Closing Date, with the Surviving Corporation being the surviving corporation, by complying with the requirements of the RIBCA (the "Valley Merger"). Immediately following the consummation of the Valley Merger, the Surviving Corporation shall adopt an agreement and plan of merger pursuant to which Bristol and Warren Gas Company ("Bristol"), a wholly-owned Subsidiary of the Company, shall merge with and into the Surviving Corporation on the Closing Date, with the Surviving Corporation being the surviving corporation, by complying with the requirements of the RIBCA (the "Bristol Merger"). Immediately following the consummation of the Bristol Merger, Parent shall adopt an agreement and plan of merger pursuant to which the Surviving Corporation shall merge with and into Parent on the Closing Date, with Parent being the surviving corporation by complying with the requirements of the RIBCA and the Delaware General Corporation Law (the "Company Merger"). The Merger, the Bristol Merger, the Valley Merger and the Company Merger shall hereinafter be referred to collectively as the "Mergers."

Section 1.6 *Certificate of Incorporation; By-laws.* Pursuant to the Company Merger, the Restated Certificate of Incorporation of Parent, as in effect immediately prior to the Effective Time, shall be the Certificate of Incorporation of Parent until thereafter amended as provided by law and (ii) the By-laws of Parent, as in effect immediately prior to the Effective Time, shall be the By-laws of Parent until thereafter amended as provided by law.

Section 1.7 *Directors and Officers.* The directors and officers of Parent immediately prior to the Effective Time will be the directors and officers of Parent after consummation of the Company Merger, each to hold office in accordance with Restated Certificate of Incorporation and By-laws of Parent.

ARTICLE II
TREATMENT OF SHARES

Section 2.1 *Effect of the Merger on Capital Stock.* At the Effective Time, by virtue of the Merger and without any action on the part of any holder of any capital stock of the Company or Merger Sub:

(a) Shares of Merger Sub Stock. Each share of common stock, $1.00 par value, of Merger Sub that is issued and outstanding immediately prior to the Effective Time shall be converted into and become one fully paid and nonassessable share of common stock, $1.00 par value, of the Surviving Corporation.

(b) Cancellation of Certain Company Common Stock. Each share of common stock, $1.00 par value, of the Company (the "Company Common Stock") that is owned by the Company as treasury stock and all shares of Company Common Stock that are owned by Parent shall be canceled and shall cease to exist, and no stock of Parent or other consideration shall be delivered in exchange therefor.

(c) Conversion of Company Common Stock. Subject to the provisions of this Section 2.1, each share of Company Common Stock (which shall be deemed to include without limitation each related associated preferred stock purchase right (collectively, the "Rights") issued pursuant to the Rights Agreement, dated as of June 18, 1991, between the Company and State Street Bank and Trust Company, as Rights Agent (the "Company Rights Agreement"), which will be terminated at the Effective Time (any reference in this Agreement to Company Common Stock will be deemed to include without limitation the associated Rights)), other than shares canceled pursuant to Section 2.1(b), issued and outstanding immediately prior to the Effective Time shall by virtue of the Merger and without any action on the part of the holder thereof, be converted into the right of each holder thereof to receive $25.00 in cash (the "Merger Consideration").

Section 2.2 *Exchange of Certificates.*

(a) Deposit with Exchange Agent. As soon as practicable after the Effective Time, Parent shall deposit with a bank or trust company as may be selected by Parent and be reasonably acceptable to the Company (the "Exchange Agent"), pursuant to an agreement in form and substance reasonably acceptable to Parent and the Company, an amount of cash representing the aggregate Merger Consideration.

(b) Exchange and Payment Procedures. As soon as practicable after the Effective Time, Parent shall cause Parent's transfer agent and registrar, as paying agent (the "Paying Agent"), to mail to each holder of record as of the Effective Time of a certificate or certificates representing the shares of Company Common Stock ("Company Certificates") that have been converted pursuant to Section 2.1(c): (i) a letter of transmittal (which shall specify that delivery shall be effected, and risk of loss and title to the Company Certificates shall pass, only upon actual delivery of the Company Certificates to the Paying Agent and shall be in such form and have such other provisions as Parent may reasonably specify) and (ii) instructions for effecting the surrender of the Company Certificates and receiving the Merger Consideration to which such

holder shall be entitled therefor pursuant to Section 2.1. Upon surrender of a Company Certificate for cancellation to the Paying Agent or to such other agent or agents as may be appointed by Parent, together with a duly executed letter of transmittal and such other documents as the Paying Agent may require, the holder of such Company Certificate shall be entitled to receive in exchange therefor the Merger Consideration to which such holder is entitled in accordance with Section 2.1(c), and the Company Certificate so surrendered shall forthwith be canceled. If payment of the Merger Consideration is to be made to any person other than the person in whose name the surrendered Company Certificate is registered, it shall be a condition of payment that the Company Certificate so surrendered shall be properly endorsed or shall be otherwise in proper form for transfer and that the person requesting such payment shall have paid any transfer and other Taxes (as defined in Section 4.8) required by reason of the payment of the Merger Consideration to a person other than the registered holder of the Company Certificate surrendered or shall have established to the satisfaction of Parent that such Tax either has been paid or is not applicable. Until surrendered as contemplated by this Section 2.2, each Company Certificate (other than a certificate representing shares of Company Common Stock to be canceled in accordance with Section 2.1(b)) shall be deemed at any time after the Effective Time to represent only the right to receive upon such surrender the Merger Consideration contemplated by Section 2.1. No interest will be paid or will accrue on any cash payable to holders of Company Certificates pursuant to the provisions of this Article II.

(c) Investment of Funds. The Exchange Agent shall invest the funds representing the aggregate Merger Consideration, as directed by the Parent, in (i) direct obligations of the United States of America, (ii) obligations for which the full faith and credit of the United States of America is pledged to provide for the payment of principal and interest or (iii) commercial paper rated the highest quality by either Moody's Investors Service, Inc. or Standard and Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc.; provided, however, that, notwithstanding anything to the contrary in this Agreement, if the Exchange Agent is not able or refuses to so invest such funds, the Parent may deposit such funds in trust with another bank or trust company which has a net capital of not less than $100,000,000, as may be selected by Parent, so long as the Exchange Agent is allowed to draw on such funds to the extent required to pay the Merger Consideration. Any net earnings with respect to such funds shall be the property of and paid over to Parent as and when requested by Parent.

(d) Lost, Stolen or Destroyed Certificates. In the event any Company Certificate shall have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the person claiming such Company Certificate to be lost, stolen or destroyed, the Exchange Agent will issue in exchange for such lost, stolen or destroyed Company Certificate the Merger Consideration deliverable in respect thereof as determined in accordance with this Article II; provided, however, that the person to whom the Merger Consideration is paid shall, if required by Parent, as a condition precedent to the payment thereof, give the Exchange Agent a bond in such sum as it may ordinarily require and indemnify Parent in a manner satisfactory to it against any claim that may be made against Parent with respect to the Company Certificate claimed to have been lost, stolen or destroyed.

(e) Closing of Transfer Books. After the Effective Time, the stock transfer books of the Company shall be closed and there shall be no transfers on the stock transfer books of the

Surviving Corporation of shares of Company Common Stock that were outstanding immediately prior to the Effective Time. If, after the Effective Time, Company Certificates are presented to Parent, they shall be canceled and exchanged for the appropriate amount of Merger Consideration as provided in Section 2.1 and in this Section 2.2.

(f) Termination of Exchange Agent. All funds held by the Exchange Agent for payment to the holders of unsurrendered Company Certificates and unclaimed at the end of one year from the Effective Time shall be returned to Parent, after which time any holder of unsurrendered Company Certificates shall look as a general creditor only to Parent for payment of such funds to which such holder may be due, subject to applicable law.

(g) Escheat. Neither the Surviving Corporation nor Parent shall be liable to any holder of Company Common Stock for Merger Consideration delivered to a public official pursuant to any applicable abandoned property, escheat or similar law. Any amounts remaining unclaimed by holders of any such shares of Company Common Stock five years after the Effective Time (or such earlier date immediately prior to the time at which such amounts would otherwise escheat to or become property of any Governmental Authority (as defined in Section 4.4(c)) shall, to the extent permitted by applicable law, become the property of Parent, free and clear of any claims or interest of any such holders or their successors, assigns or personal representatives previously entitled thereto.

ARTICLE III
THE CLOSING

Section 3.1 *Closing.* The closing of the Merger (the "Closing") shall take place at the offices of Hughes Hubbard & Reed LLP, New York, New York, at 10:00 a.m., Eastern time, on a date selected by Parent and reasonably satisfactory to the Company which is no more than five business days following the date on which the last of the conditions set forth in Article VIII hereof is fulfilled or, if permissible, waived (other than conditions that by their nature are required to be performed on the Closing Date, but subject to satisfaction of such conditions), or at such other time and date and place as the Company and Parent shall mutually agree (the "Closing Date").

ARTICLE IV
REPRESENTATIONS AND WARRANTIES OF THE COMPANY

The Company represents and warrants to Parent as follows:

Section 4.1 *Organization And Qualification.* The Company and each of its Subsidiaries (as defined below) is a corporation duly organized, validly existing and in good standing under the laws of its jurisdiction of incorporation or organization, has all requisite corporate power and authority, and has been duly authorized by all necessary approvals and orders of the Rhode Island and all other regulatory authorities, in each such case, to own, lease and operate its assets and properties to the extent owned, leased and operated and to carry on its business as it is now being conducted and is duly qualified and in good standing to do business in

each jurisdiction in which the nature of its business or the ownership or leasing of its assets and properties makes such qualification necessary, other than in such jurisdictions where the failure to be so qualified and in good standing will not, when taken together with all other such failures, have a material adverse effect (i) on the business, properties, financial condition or results of operations of the Company and its Subsidiaries taken as a whole or (ii) on the ability of the Company and its Subsidiaries to consummate the Mergers in accordance with this Agreement and the Related Documents (as defined in Section 4.4(a)) (any such material adverse effect being hereafter referred to as a "Company Material Adverse Effect"). As used in this Agreement, the term "Subsidiary" of a person shall mean any corporation or other entity (including partnerships and other business associations) of which a majority of the outstanding capital stock or other voting securities having the power under ordinary circumstances to elect directors or similar members of the governing body of such corporation or entity (or otherwise having the power to direct the business and policies of that other corporation or other entity) shall at the time be held, directly or indirectly, by such person.

Section 4.2 *Subsidiaries.* Section 4.2(i) of the Company Disclosure Schedule (as defined in Section 7.6) sets forth a description of all Subsidiaries and Joint Ventures (as defined below) of the Company and its Subsidiaries, including the name of each such entity, the state or jurisdiction of its incorporation or organization, the Company's or its Subsidiary's interest therein and a brief description of the principal line or lines of business conducted by each such entity. Except as set forth in Section 4.2(ii) of the Company Disclosure Schedule, none of the Company's Subsidiaries is a "public utility company," a "holding company," a "subsidiary company" or an "affiliate" of any "public utility company" or of any "holding company" within the meaning of Section 2(a)(5), 2(a)(7), 2(a)(8) or 2(a)(11) of the Public Utility Holding Company Act of 1935, as amended (the "1935 Act"). Except as set forth in Section 4.2(i) of the Company Disclosure Schedule, all of the issued and outstanding shares of capital stock owned, directly or indirectly, by the Company of each Subsidiary or Joint Venture of the Company are validly issued, fully paid, nonassessable and free of preemptive rights, and are owned, directly or indirectly, by the Company free and clear of any liens, claims, encumbrances, security interests, equities, charges and options of any nature whatsoever (collectively, "Liens"), and there are no outstanding subscriptions, options, calls, contracts, voting trusts, proxies or other commitments, understandings, restrictions, arrangements, rights or warrants, including any right of conversion or exchange under any outstanding security, instrument or other agreement, obligating the Company or any Subsidiary of the Company to issue, deliver or sell, or cause to be issued, delivered or sold, additional shares of its capital stock or obligating it to grant, extend or enter into any such agreement or commitment. As used in this Agreement, the term "Joint Venture" of a person shall mean any corporation or other entity (including partnerships and other business associations) that is not a Subsidiary of such person, in which such person or one or more of its Subsidiaries owns an equity interest, other than equity interests held for passive investment purposes which are less than 2% of any class of the outstanding voting securities or equity of any such entity.

Section 4.3 *Capitalization.* The authorized capital stock of the Company consists of (i) 20,000,000 shares of Company Common Stock and (ii) 500,000 shares of preferred stock, $100 par value (the "Company Preferred Stock"). As of the close of business on November 29, 1999, there were issued and outstanding 4,991,264 shares of Company Common Stock. No

shares of Company Preferred Stock are issued or outstanding. There are no shares of Company Common Stock or Company Preferred Stock reserved for issuance upon exercise of outstanding Company stock options or stock appreciation rights. All of the issued and outstanding shares of the capital stock of the Company are validly issued, fully paid, nonassessable and free of preemptive rights. Except as set forth in Section 4.3 of the Company Disclosure Schedule, there are no outstanding subscriptions, options, stock appreciation rights, calls, contracts, voting trusts, proxies or other commitments, understandings, restrictions, arrangements, rights or warrants, including any right of conversion or exchange under any outstanding security, instrument or other agreement, obligating the Company or any Subsidiary of the Company to issue, deliver or sell, or cause to be issued, delivered or sold, additional shares of the capital stock of the Company or any Subsidiary of the Company, or obligating the Company or any of its Subsidiaries to grant, extend or enter into any such agreement or commitment.

Section 4.4 *Authority; Non-contravention; Statutory Approvals; Compliance.*

(a) Authority. The Company and each applicable Subsidiary of the Company has all requisite corporate power and authority to enter into this Agreement and the Related Documents and, subject to obtaining the Company Shareholders' Approval (as defined in Section 4.12), the Company Required Statutory Approvals (as defined in Section 4.4(c)) and the Legislative Actions (as defined in Section 6.1(y)), to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and the Related Documents and the consummation by the Company and its Subsidiaries of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action on the part of the Company and its Subsidiaries, subject to obtaining the Company Shareholders' Approval. This Agreement has been, and as of the Closing the Related Documents to be executed by the Company and its applicable Subsidiaries will be, duly and validly executed and delivered by the Company or its applicable Subsidiary, as the case may be, and, assuming the due authorization, execution and delivery by the other signatories hereto and thereto, constitutes or will constitute, as the case may be, the valid and binding obligations of the Company or its applicable Subsidiary, as the case may be, enforceable against it in accordance with its terms, except to the extent that enforceability may be limited by applicable bankruptcy, insolvency or other laws affecting the enforcement of creditors' rights generally and subject to the general principles of equity (regardless of whether enforcement is sought in a court of law or equity). As used in this Agreement, the term (i) "Related Documents" shall mean any Contract provided for in this Agreement to be entered into by one or more of the parties hereto or their respective Subsidiaries in connection with the Mergers, and (ii) "Contract" shall mean any agreement, contract, document, instrument, obligation, promise, commitment or undertaking (whether written or oral) to which any person is a party or by which any person or its assets may be bound.

(b) Non-Contravention. The execution and delivery of this Agreement and the Related Documents by the Company and its Subsidiaries do not, and the consummation of the transactions contemplated hereby and thereby will not, violate, conflict with, or result in a breach of any provision of, or constitute a default (with notice or lapse of time) under, or result in the termination or modification of, or accelerate the performance required by, or result in a right of termination, cancellation, or acceleration of any obligation or the loss of a benefit under, or result in the creation of any Lien upon any of the properties or assets of the Company or any of its

Subsidiaries or any of its Joint Ventures (any such violation, conflict, breach, default, right of termination, modification, cancellation or acceleration, loss or creation, a "Violation" with respect to the Company, its Subsidiaries and Joint Ventures) pursuant to any provisions of (i) the articles of incorporation, by-laws or similar governing documents of the Company, subject to Section 4.4(b)(i) of the Company Disclosure Schedule, any of its Subsidiaries or any of its Joint Ventures, (ii) subject to obtaining the Company Required Statutory Approvals and the receipt of the Company Shareholders' Approval, any statute, law, ordinance, rule, regulation, judgment, decree, order, injunction, writ, permit or license of any Governmental Authority applicable to the Company, any of its Subsidiaries or any of its Joint Ventures, or any of their respective properties or assets or (iii) subject to obtaining the third-party consents or other approvals set forth in Section 4.4(b)(iii) of the Company Disclosure Schedule (the "Company Required Consents"), any note, bond, mortgage, indenture, deed of trust, license, franchise, permit, concession, contract, lease, commitment, security agreement, loan agreement, or other instrument, obligation, agreement or other Contract of any kind to which the Company, any of its Subsidiaries or any of its Joint Ventures is a party or by which any of such persons or any of their properties or assets may be bound or affected, excluding from the foregoing clauses (ii) and (iii) such Violations as would not have, individually or in the aggregate, a Company Material Adverse Effect.

(c) Statutory Approvals. Except as described in Section 4.4(c) of the Company Disclosure Schedule (the "Company Required Statutory Approvals"), no declaration, filing or registration with, or notice to or authorization, consent or approval of, any court, federal, state, local or foreign governmental or regulatory body (including a stock exchange or other self-regulatory body) or authority (each, a "Governmental Authority") is necessary for the execution and delivery of this Agreement and the Related Documents by the Company and its Subsidiaries or Joint Ventures or the consummation by the Company and its Subsidiaries or Joint Ventures of the transactions contemplated hereby and thereby, the failure to obtain, make or give which are, individually or in the aggregate, reasonably likely to have a Company Material Adverse Effect, it being understood that references in this Agreement to "obtaining" such Company Required Statutory Approvals shall mean making such declarations, filings or registrations, giving such notices, obtaining such authorizations, consents or approvals and having such waiting periods expire as are necessary to avoid a violation of law.

(d) Compliance; Contracts. Except as set forth in Section 4.10 of the Company Disclosure Schedule, or as disclosed in the Company SEC Reports (as defined in Section 4.5) delivered to Parent prior to the date of this Agreement, neither the Company nor any of its Subsidiaries nor any of its Joint Ventures is in violation of, is under investigation with respect to any violation of, or has been given notice of, or been charged with any violation of, or failure to comply with, any law, statute, order, rule, regulation, tariff, franchise agreement, principle of common law, ordinance or judgment (including, without limitation, any applicable Environmental Law, as defined in Section 4.10(i)(ii)) of any Governmental Authority except for violations that, individually and in the aggregate, do not have a Company Material Adverse Effect. The Company and its Subsidiaries and Joint Ventures have all permits, licenses, franchises and other governmental authorizations, consents and approvals necessary to conduct their respective businesses and to own, operate and vote all of their respective assets as currently conducted in all respects, except those which the failure to obtain would not, individually or in the aggregate, have a Company Material Adverse Effect. Neither the Company nor any of its

Subsidiaries nor any of its Joint Ventures nor to the Knowledge (as defined below) of any of the foregoing, any other party thereto, is in breach or violation of or in default in the performance or observance of any term or provision of, and no event has occurred or is occurring which, with lapse of time or action by a third party, could result in a default by any party thereto under, (i) its articles of incorporation or by-laws or similar governing document or (ii) any commitment, deed of trust, franchise, permit, concession, security agreement, obligation, agreement, indenture, mortgage, loan agreement, note, lease, bond, or other Contract, license, approval or other instrument to which it is a party or by which it is bound or to which any of its property is subject, except for breaches, violations or defaults that, individually and in the aggregate, do not have a Company Material Adverse Effect. Set forth in Section 4.4(d) of the Company Disclosure Schedule is a list as the date hereof of all Contracts to which any of the Company or any of its Subsidiaries is a party involving a total commitment by or to any party thereto of more than $125,000 on an annual basis or more than $500,000 on its remaining term which cannot be terminated on no more than sixty (60) days' notice without penalty or additional cost to the Company or its applicable Subsidiary as the terminating party. Except as disclosed in the Company SEC Reports delivered to Parent prior to the date of this Agreement, and with such exceptions as are not, individually or in the aggregate, reasonably likely to have a Company Material Adverse Effect, each Contract to which the Company or any of its Subsidiaries is a party is in full force and effect and constitutes the valid and binding obligation of the parties thereto, enforceable against such party in accordance with its terms, except to the extent that enforceability may be limited by applicable bankruptcy, insolvency or other laws affecting the enforcement of creditors' rights generally and subject to the general principles of equity (regardless of whether enforcement is sought in a court of law or equity). For purposes of this Agreement, (i) an individual will be deemed to have "Knowledge" of a particular fact or other matter if such individual is actually aware of such fact or other matter and (ii) a person (other than an individual) will be deemed to have "Knowledge" of a particular fact or other matter if any individual who is serving as a director or officer of such person or any Subsidiary of it has actual knowledge after reasonable inquiry of such fact or other matter.

(e) Except as set forth in Section 4.4(e) of the Company Disclosure Schedule, there is no "non-competition" or other similar Contract that restricts the ability of the Company or any of its Affiliates to conduct business in any geographic area or that would reasonably be likely to restrict Parent or any of its Affiliates to conduct business in any geographic area. As used in this Agreement, the term "Affiliate" shall mean, with respect to any person, any other person that directly, or through one or more intermediaries, controls or is controlled by or is under common control with such first person. As used in this definition, "control" (including with correlative meanings, "controlled by" and "under common control with") shall mean possession, directly or indirectly, or power to direct or cause the direction of management or policies (whether through ownership of securities or partnership or other ownership interests, by contract or otherwise).

Section 4.5 *Reports and Financial Statements.* The filings required to be made by the Company and its Subsidiaries and Joint Ventures since January 1, 1996 under the Securities Act of 1933, as amended (the "Securities Act"), the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the 1935 Act and applicable state public utility laws and regulations have been filed with the Securities and Exchange Commission (the "SEC") or the appropriate state public utilities commission, as the case may be, including all forms, statements, financial

statements, reports, agreements (oral or written) and all documents, exhibits, schedules, amendments and supplements appertaining thereto, were duly made and complied (or, with respect to such documents to be filed after the date of this Agreement, will be duly made and will comply), as of their respective dates, in all material respects with all applicable requirements of the appropriate statute and the rules and regulations thereunder. The Company has made available to Parent a true and complete copy of each report, schedule, registration statement and definitive proxy statement filed by the Company with the SEC since January 1, 1997 (as such documents, including those filed after the date of this Agreement, have since the time of their filing been amended, the "Company SEC Reports"). As of their respective dates, the Company SEC Reports did (or will) not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. The audited consolidated financial statements and unaudited interim financial statements of the Company included in the Company SEC Reports (collectively, the "Company Financial Statements") have been (or will be) prepared in accordance with U.S. generally accepted accounting principles applied on a consistent basis ("GAAP") (except as may be indicated therein or in the notes thereto and except with respect to unaudited statements as permitted by Form 10-Q of the SEC) and fairly present (or will fairly present) the consolidated financial position of the Company and its Subsidiaries as of the dates thereof and the consolidated results of operations and cash flows for the periods then ended. True, accurate and complete copies of the articles of incorporation and by-laws of the Company, each of its Subsidiaries and each of its Joint Ventures have been made available to Parent. The Company SEC Reports delivered to Parent prior to the date of this Agreement accurately disclose all material regulation of the Company and each of its Subsidiaries and Joint Ventures that relates to the utility business of any of the Company and each of its Subsidiaries and Joint Ventures.

Section 4.6 *Absence of Certain Changes or Events.* Except as disclosed in the Company SEC Reports delivered to Parent prior to the date of this Agreement, from August 31, 1999, the Company and each of its Subsidiaries have conducted their businesses only in the ordinary course of business consistent with past practice, and there has not been, and no fact or condition exists which, individually or in the aggregate, would have or, insofar as reasonably can be foreseen, could have, a Company Material Adverse Effect.

Section 4.7 *Litigation.* Except as disclosed in the Company SEC Reports delivered to Parent prior to the date of this Agreement or as set forth in Section 4.8(g) or Section 4.10 of the Company Disclosure Schedule, (a) there are no claims, suits, actions or proceedings pending or, to the Knowledge of the Company and its Subsidiaries, threatened, nor are there any investigations, requests for information, or reviews pending or, to the Knowledge of the Company and its Subsidiaries, threatened against, relating to or affecting the Company or any of its Subsidiaries, and (b) there are no judgments, decrees, injunctions, rules or orders of any court, governmental department, commission, agency, instrumentality or authority or any arbitrator applicable to the Company or any of its Subsidiaries, except for any of the foregoing under clauses (a) and (b) that, individually and in the aggregate, would not reasonably be expected to have a Company Material Adverse Effect. There is no claim, suit, action or proceeding pending that challenges, or that may have the effect of preventing, delaying, making illegal, or otherwise interfering with, the Mergers or any of the transactions contemplated hereby.

Section 4.8 *Tax Matters.* "Taxes," as used in this Agreement, means any federal, state, county, local or foreign taxes, charges, fees, levies or other assessments, including, without limitation, all net income, gross income, sales and use, ad valorem, transfer, gains, profits, excise, franchise, real and personal property, gross receipts, capital stock, production, business and occupation, disability, employment, payroll, license, estimated, stamp, custom duties, severance or withholding taxes or charges imposed by any governmental entity, and includes any interest and penalties (civil or criminal) on or additions to any such taxes. "Tax Return," as used in this Agreement, means a report, return or other written information required to be supplied to a governmental entity with respect to Taxes.

(a) Filing of Timely Tax Returns. Except as set forth in Section 4.8(a) of the Company Disclosure Schedule, the Company and each of its Subsidiaries have duly filed (or there has been filed on its behalf) within the time prescribed by law all material Tax Returns (including withholding Tax Returns) required to be filed by each of them under applicable law. Any such Tax Returns were and are in all material respects true, complete and correct.

(b) Payment of Taxes. Except as set forth in Section 4.8(a) of the Company Disclosure Schedule, the Company and each of its Subsidiaries have, within the time and in the manner prescribed by law, paid all Taxes (including withholding Taxes) required to have been paid except for those contested in good faith and for which adequate reserves have been taken.

(c) Tax Reserves. All material Taxes payable by the Company and its Subsidiaries for all taxable periods and portions thereof through the date of the most recent financial statements contained in the Company Financial Statements delivered to Parent prior to the date of this Agreement are properly reflected in such financial statements in accordance with GAAP, and the unpaid Taxes of the Company and its Subsidiaries do not exceed the amount shown therefor on such financial statements, adjusted for the Taxes incurred in the ordinary course of business through the Effective Time.

(d) Extensions of Time for Filing Tax Returns. Except as set forth in Section 4.8(d) of the Company Disclosure Schedule, neither the Company nor any of its Subsidiaries have requested any extension of time within which to file any material Tax Return, which Tax Return has not since been filed.

(e) Waivers of Statute of Limitations. Neither the Company nor any of its Subsidiaries has executed any outstanding waivers or comparable consents regarding the application of the statute of limitations with respect to any Taxes or Tax Returns.

(f) Expiration of Statute of Limitations. The statute of limitations for the assessment of all material Taxes has expired for all applicable material Tax Returns of the Company and each of its Subsidiaries, or those material Tax Returns have been examined by the appropriate taxing authorities for all periods through the date hereof, and no deficiency for any material Taxes has been proposed, asserted or assessed against the Company or any of its Subsidiaries that has not been resolved and paid in full.

(g) Audit, Administrative and Court Proceedings. Except as set forth in Section 4.8(g) of the Company Disclosure Schedule, no material claims, audits, disputes, controversies, examinations, investigations or other proceedings are presently pending, or, to the Knowledge of the Company and its Subsidiaries, threatened, with regard to any Taxes or Tax Returns of the Company or any of its Subsidiaries.

(h) Tax Rulings. Neither the Company nor any of its Subsidiaries has received a Tax Ruling (as defined below) or entered into a Closing Agreement (as defined below) with any taxing authority that would have a continuing effect after the Closing Date. "Tax Ruling," as used in this Agreement, shall mean a written ruling of a taxing authority relating to Taxes. "Closing Agreement," as used in this Agreement, shall mean a written and legally binding agreement with a taxing authority relating to Taxes.

(i) Availability of Tax Returns. The Company has provided or made available to Parent complete and accurate copies of (i) all Tax Returns, and any amendments thereto, filed by the Company or any of its Subsidiaries (or any predecessors thereto) for all open years, (ii) all audit reports received from any taxing authority relating to any Tax Return filed by the Company or any of its Subsidiaries and (iii) any Closing Agreements entered into by the Company or any of its Subsidiaries with any taxing authority.

(j) Tax Sharing Agreements. Except as set forth in Section 4.8(j) of the Company Disclosure Schedule, neither the Company nor any of its Subsidiaries is a party to any agreement, understanding or arrangement relating to allocating or sharing of Taxes.

(k) Liability for Others. Neither the Company nor any of its Subsidiaries has any liability for any material Taxes of any person other than the Company and its Subsidiaries (i) under Treasury Regulation Section 1.1502-6 (or any similar provision of state, local or foreign law), (ii) as a transferee or successor, (iii) by contract or (iv) otherwise.

(l) Code Section 897. To the Knowledge of the Company and its Subsidiaries after due inquiry, no foreign person owns or has owned beneficially more than five percent of the total fair market value of Company Common Stock during the applicable period specified in Section 897(c)(1)(A)(ii) of the Internal Revenue Code of 1986, as amended (the "Code").

(m) Code Section 280G. Neither the Company nor any of its Subsidiaries is a party to any agreement that could result in a non-deductible expense under Section 280G of the Code.

(n) Code Section 481. Neither the Company nor any of its Subsidiaries has agreed to or is required to make any adjustment pursuant to Section 481 of the Code.

(o) Code Section 341(f). Neither the Company nor any of its Subsidiaries has made an election under Section 341(f) of the Code.

(p) Code Section 355. Neither the Company nor any of its Subsidiaries has made a distribution or has been the subject of a distribution intended to qualify under Section 355 of the Code.

Section 4.9 *Employee Matters; ERISA.*

(a) For purposes of this Section 4.9, the following terms have the definitions set forth below:

(i) "Controlled Group Liability" means any and all liabilities (a) under Title IV of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), (b) as a result of a failure to comply with the minimum funding requirements of Section 302 of ERISA or Section 412 of the Code, (c) under Section 4971 of the Code, and (d) as a result of a failure to comply with the continuation coverage requirements of Section 601 et seq. of ERISA and Section 4980B of the Code, other than such liabilities that arise solely out of, or relate solely to, the Employee Benefit Plans.

(ii) "ERISA Affiliate" means, with respect to any entity, trade or business, any other entity, trade or business that is a member of a group described in Section 414(b), (c), (m) or (o) of the Code or Section 4001(b)(1) of ERISA that includes the first entity, trade or business, or that is a member of the same "controlled group" as the first entity, trade or business pursuant to Section 4001(a)(14) of ERISA.

(iii) An "Employee Benefit Plan" means any employee benefit plan, program, policy, practice, agreement or other arrangement providing benefits to any current or former employee, officer or director of the Company or any of its Subsidiaries or any beneficiary or dependent thereof that is sponsored or maintained by the Company or any of its Subsidiaries or to which the Company or any of its Subsidiaries contributes or is obligated to contribute, whether or not written, including without limitation any employee welfare benefit plan within the meaning of Section 3(1) of ERISA, any employee pension benefit plan within the meaning of Section 3(2) of ERISA (whether or not such plan is subject to ERISA) and any bonus, incentive, deferred compensation, vacation, sick leave, disability, stock purchase, stock option, stock award, phantom stock, stock appreciation right, severance, employment, change of control or fringe benefit plan, program or agreement.

(iv) A "Plan" means any Employee Benefit Plan other than a Multiemployer Plan.

(v) A "Multiemployer Plan" means any "multiemployer plan" within the meaning of Section 4001(a)(3) or 3(37) of ERISA.

(vi) "Withdrawal Liability" means liability to a Multiemployer Plan as a result of a complete or partial withdrawal from such Multiemployer Plan, as those terms are defined in Part I of Subtitle E of Title IV of ERISA or under the terms of the Multiemployer Plan.

(b) Section 4.9(b) of the Company Disclosure Schedule includes a complete list of all Employee Benefit Plans and, with respect to executive welfare benefit plans and nonqualified pension, savings and deferred compensation plans, states the number of employees participating in or covered by such plans. Such list identifies all Plans which are funded with or provide benefits in the form of Company Common Stock or other securities of the Company or its Subsidiaries.

(c) With respect to each Plan, the Company has delivered to Parent a true, correct and complete copy of: (i) each writing constituting a part of such Plan, including without limitation all plan documents, trust agreements, and insurance contracts and other funding vehicles, and a description of each unwritten plan; (ii) the three most recent Annual Reports (Form 5500 Series) and accompanying schedules, if any; (iii) the current summary plan description and any material modifications thereto, if required to be furnished under ERISA; (iv) the most recent annual financial report, if any; (v) the three most recent actuarial reports, if any; (vi) the most recent determination letter from the Internal Revenue Service (the "IRS"), if any; (vii) the three most recent Pension Benefit Guaranty Corporation ("PBGC") Forms 1; and (viii) loan documents in connection with loans by the Plan. Prior to the date of this Agreement, the Company has delivered to Parent a true, correct and complete copy of each current employee handbook relating to employees of the Company or any of its Subsidiaries. Except as specifically provided in the foregoing documents delivered to Parent, there are no amendments to any Plan that have been adopted or approved nor has the Company or any of its Subsidiaries undertaken to make any such amendments or to adopt or approve any new Plan.

(d) Section 4.9(b) of the Company Disclosure Schedule identifies each Plan that is intended to be a "qualified plan" within the meaning of Section 401(a) of the Code ("Qualified Plans"). The IRS has issued a favorable determination letter with respect to each Qualified Plan and the related trust that has not been revoked, and, to the Knowledge of the Company and its Subsidiaries, nothing has occurred since the date of such determination letter which cannot be remedied by timely amendment and which would adversely affect the qualified status of such plan. Section 4.9(b) of the Company Disclosure Schedule identifies each Plan or related trust which is intended to meet the requirements of Code Section 501(c)(9) (a "VEBA"), and except as disclosed in Section 4.9(d) of the Company Disclosure Schedule, each such VEBA meets such requirements, has received a favorable determination letter from the IRS, and provides no disqualified benefits (as such term is defined in Code Section 4976(b)).

(e) All contributions required to be made to any Plan by applicable law or regulation or by any Plan document or other contractual undertaking, and all premiums due or payable with respect to insurance policies funding any Plan, have been timely made or paid in full. Each Plan that is an employee welfare benefit plan under Section 3(l) of ERISA (i) is funded through an insurance company contract or a contract with a health maintenance organization, (ii) is, or is funded through, a VEBA identified as such in Section 4.9(b) of the Company Disclosure Schedule, or (iii) is unfunded.

(f) With respect to each Employee Benefit Plan, the Company and its Subsidiaries have substantially complied, and are now in substantial compliance, with all provisions of ERISA, the Code and all laws and regulations applicable to such Employee Benefit Plans and

each Plan has been administered in all material respects in accordance with its terms and the terms of any applicable collective bargaining agreement. There is not now, nor do any circumstances now exist that could reasonably be expected to give rise to, any requirement for the posting of security with respect to a Plan or the imposition of any Lien on the assets of the Company or any of its Subsidiaries under ERISA or the Code. To the Knowledge of the Company and its Subsidiaries, no non-exempt prohibited transaction (as defined in Section 406 of ERISA or Section 4975 of the Code) or breach of fiduciary duty has occurred with respect to any Plan, and no event has occurred which would subject the Company or Parent to any material liability for any excise tax, tax on unrelated business taxable income, penalty, or fine under ERISA or the Code.

(g) With respect to each Plan that is subject to Title IV of ERISA, the minimum funding requirements of Section 302 of ERISA or Section 412 of the Code, or Section 4971 of the Code: (i) there does not exist any accumulated funding deficiency within the meaning of Section 412 of the Code or Section 302 of ERISA, whether or not waived; (ii) as of August 31, 1999, the fair market value of the assets of each such Plan that is a defined benefit plan equals or exceeds the "projected benefit obligation" (within the meaning of Financial Accounting Standard No. 87) under such Plan, based upon the actuarial assumptions set forth in the most recent actuarial report for such Plan; (iii) no reportable event within the meaning of Section 4043(c) of ERISA for which the 30-day notice requirement has not been waived has occurred since December 31, 1994 in respect of any such Plan which is a defined benefit Plan; (iv) all premiums to the PBGC have been timely paid in full; (v) no liability (other than for premiums to the PBGC not yet due and for the payment of benefits and contributions in the ordinary course) under Title IV of ERISA has been incurred by the Company or any of its Subsidiaries; (vi) to the Knowledge of the Company and its Subsidiaries, the PBGC has not instituted proceedings to terminate any such Plan and no condition exists that presents a material risk that such proceedings will be instituted or which would constitute grounds under Section 4042 of ERISA for the termination of, or the appointment of a trustee to administer, any such Plan; and (vii) neither the Company nor any of its Subsidiaries has taken any action to terminate such Plan.

(h) No Employee Benefit Plan is a Multiemployer Plan or a plan that has two or more contributing sponsors at least two of which are not under common control, within the meaning of Section 4063 of ERISA (a "Multiple Employer Plan"). None of the Company and its Subsidiaries nor any of their respective ERISA Affiliates has, at any time during the last six years, contributed to or been obligated to contribute to any Multiemployer Plan or Multiple Employer Plan. None of the Company and its Subsidiaries nor any of their respective ERISA Affiliates has incurred any Withdrawal Liability or other liability that has not been satisfied in full.

(i) There does not now exist, nor do any circumstances exist that could reasonably be expected to result in, any Controlled Group Liability to the Company, any of its Subsidiaries, or Parent with respect to any employee benefit plan of any ERISA Affiliate of the Company or any its Subsidiaries. Without limiting the generality of the foregoing, neither the Company nor any of its Subsidiaries, nor any of their respective ERISA Affiliates, has engaged in any transaction described in Section 4069 or Section 4204 or 4212(c) of ERISA since December 31, 1993.

(j) Except as set forth in Section 4.9(j) of the Company Disclosure Schedule and except for health continuation coverage as required by Section 4980B of the Code or Part 6 of Title I of ERISA or applicable state law, the Company and its Subsidiaries have no material liability for life, health, medical or other welfare benefits to former employees or beneficiaries or dependents of former employees.

(k) Neither the execution and delivery of this Agreement nor the consummation of any of the transactions contemplated hereby will (either alone or in conjunction with any other event) cause any amount to be payable, cause the accelerated funding, vesting, exercisability, payment or delivery of, or increase the amount or value of, any payment or benefit to any current or former employee, officer or director of the Company or any of its Subsidiaries.

(l) Section 4.9(l)(i) of the Company Disclosure Schedule sets forth a list as of no more than thirty (30) days prior to the date of this Agreement, of all the present officers and employees of the Company and its Subsidiaries. indicating each employee's base salary or wage rate and identifying those who are union employees and those who are part-time employees. Except as set forth in Section 4.9(l)(ii) of the Company Disclosure Schedule, as of the date of this Agreement, no labor union or other collective bargaining unit has been certified or recognized by the Company or any of its Subsidiaries. The Company has provided to Parent a true, complete and correct copy of each collective bargaining agreement covering employees of the Company and its Subsidiaries. No labor organization or group of employees of the Company or any of its Subsidiaries has made a pending demand for recognition or certification, and there are no representation or certification proceedings or petitions seeking a representation proceeding presently pending or, to the Knowledge of the Company or any of its Subsidiaries, threatened to be brought or filed with the National Labor Relations Board or any other labor relations tribunal or authority. There are no organizing activities. strikes, work stoppages, slowdowns, lockouts, arbitrations or material grievances, or other material labor disputes pending or, to the Knowledge of the Company or any of its Subsidiaries. threatened against or involving the Company or any of its Subsidiaries. Each of the Company and its Subsidiaries is in compliance in all material respects with all applicable laws and collective bargaining agreements respecting employment and employment practices, terms and conditions of employment, wages and hours and occupational safety and health.

(m) There are no pending or, to the Knowledge of the Company and its Subsidiaries, threatened claims (other than claims for benefits in the ordinary course), lawsuits or arbitrations, and, to the Knowledge of the Company and its Subsidiaries, there is no set of circumstances which may reasonably give rise to a claim or lawsuit, against the Plans, any fiduciaries thereof with respect to their duties to the Plans, or the assets of any of the trusts under any of the Plans which could reasonably be expected to result in a material liability. No Plan is the subject of any pending, or, to the Knowledge of the Company and its Subsidiaries, threatened, governmental audit or investigation.

(n) Except as set forth in Section 4.9(n) of the Company Disclosure Schedule, the Company and its Subsidiaries, as applicable. have reserved the right to unilaterally amend and terminate each Plan which is an "employee welfare benefit plan," as such term is defined in

Section 3(1) of ERISA, which provides health or life insurance benefits after termination of employment.

(o) Except as set forth in Section 4.9(o) of the Company Disclosure Schedule, as of the date of this Agreement, none of the Company and its Subsidiaries is a party to any employment agreement with any employee pertaining to any of the Company and its Subsidiaries.

Section 4.10 *Environmental Protection.* Except as set forth in Section 4.10 of the Company Disclosure Schedule or as disclosed in the Company SEC Reports delivered to Parent prior to the date of this Agreement:

(a) Compliance. Except where the failure to be in such compliance would not, individually or in the aggregate, have a Company Material Adverse Effect, (i) the Company and each of its Subsidiaries are in compliance with all applicable Environmental Laws (as defined in Section 4.10(i)(ii)) and (ii) neither the Company nor any of its Subsidiaries has received any communication from any Governmental Authority or any written communication from any other person that alleges that the Company or any of its Subsidiaries is not in compliance with applicable Environmental Laws.

(b) Environmental Permits. The Company and each of its Subsidiaries has obtained or has applied for all environmental, health and safety permits and governmental authorizations (collectively, the "Environmental Permits") necessary for the construction of its facilities or the conduct of its operations, and all such Environmental Permits are in good standing or, where applicable, a renewal application has been timely filed and is pending agency approval, and the Company and its Subsidiaries are in compliance with all terms and conditions of the Environmental Permits, and the Company reasonably believes that any transfer, renewal or reapplication for any Environmental Permit required as a result of the Mergers can be accomplished in the ordinary course of business, except where the failure to obtain or to be in such compliance would not, individually or in the aggregate, have a Company Material Adverse Effect.

(c) Environmental Claims. There are no Environmental Claims (as defined in Section 4.10(i)(i)) pending or, to the Knowledge of the Company and its Subsidiaries, threatened (i) against the Company or any of its Subsidiaries or Joint Ventures, or (ii) against any real or personal property or operations that the Company or any of its Subsidiaries owns, leases or manages, in whole or in part, that, if adversely determined, would have, individually or in the aggregate, a Company Material Adverse Effect.

(d) Releases. Except for Releases of Hazardous Materials the aggregate liability for which would not have a Company Material Adverse Effect, there have been no Releases (as defined in Section 4.10(i)(iv)) of any Hazardous Material (as defined in Section 4.10(i)(iii)) that would be reasonably likely to (i) form the basis of any Environmental Claim against the Company or any of its Subsidiaries or Joint Ventures, or (ii) to the Knowledge of the Company and its Subsidiaries, cause damage or diminution of value to any of the operations or real

properties owned, leased or managed, in whole or in part, by the Company or any of its Subsidiaries or Joint Ventures.

(e) Predecessors. The Company and its Subsidiaries have no Knowledge of any Environmental Claim pending or threatened, or of any Release of Hazardous Materials that would be reasonably likely to form the basis of any Environmental Claim, in each case against any person or entity (including, without limitation, any predecessor of the Company or any of its Subsidiaries) whose liability the Company or any of its Subsidiaries or Joint Ventures retained, succeeded to, acquired, or assumed, either contractually or by operation of law, or against any real or personal property which the Company or any of its Subsidiaries or Joint Ventures formerly owned, leased or managed, in whole or in part, except for Releases of Hazardous Materials the liability for which would not have, individually or in the aggregate, a Company Material Adverse Effect.

(f) Listed Sites. There have been no Hazardous Materials generated by the Company or any of its Subsidiaries or Joint Ventures (or predecessors of any of them) that have been disposed of or come to rest at any site that has been included in any published federal, state, or local priority list of hazardous or toxic waste sites.

(g) Environmental Reports. A copy of all environmental investigations, studies, audits, tests, reviews or analyses relating to the Company or any of its Subsidiaries or Joint Ventures conducted by any of them or any consultant engaged by any of them within the last three years have been provided to Parent prior to the date of this Agreement.

(h) Liens. The real property owned, operated or leased by the Company and its Subsidiaries is not subject to any Lien, securing the costs of environmental remediation, arising under Environmental Laws.

(i) As used in this Agreement:

(i) "Environmental Claim" means any and all administrative, regulatory or judicial actions, suits, demands, demand letters, directives, claims, liens, investigations, requests for information, proceedings or notices of noncompliance or violation by any person or entity (including any Governmental Authority) alleging potential liability (including, without limitation, potential responsibility for or liability for enforcement costs, investigatory costs, cleanup costs, governmental response costs, removal costs, remedial costs, natural-resources damages, property damages, personal injuries, fines or penalties) arising out of, based on or resulting from (A) the presence, or Release or threatened Release into the environment, of any Hazardous Materials at any location, whether or not owned, operated, leased or managed by the Company, Parent or any of their respective Subsidiaries or Joint Ventures; or (B) circumstances forming the basis of any violation, alleged violation of, or failure to comply with any Environmental Law; or (C) any and all claims by any third party seeking damages, contribution, indemnification, cost recovery, compensation or injunctive relief resulting from the presence or Release of any Hazardous Materials.

(ii) "Environmental Laws" means all federal, state, local laws, rules, ordinances and regulations relating to pollution, the environment (including, without limitation, ambient air, surface water, groundwater, land surface or subsurface strata), protection of human health as it relates to the environment, or occupational health and safety, including, without limitation, laws and regulations relating to Releases or threatened Releases of Hazardous Materials, damage to the environment, resource extraction or other activities that could have impact on the Environment, or the manufacture, processing, distribution, use, treatment, storage, disposal, transport or handling of Hazardous Materials.

(iii) "Hazardous Materials" means (A) any petroleum or petroleum products, radioactive materials, asbestos in any form that is or could become friable, urea formaldehyde foam insulation, coal tar residue, and transformers or other equipment that contain dielectric fluid containing polychlorinated biphenyls ("PCBs") in regulated concentrations; and (B) any chemicals, materials or substances which are now defined as or included in the definition of "hazardous substances," "hazardous wastes," "hazardous materials," "extremely hazardous wastes," "restricted hazardous wastes," "toxic substances," "toxic pollutants," "hazardous constituents" or words of similar import, under any Environmental Law; and (C) any other chemical, material, substance or waste, exposure to which is now prohibited, limited or regulated under any Environmental Law in a jurisdiction in which the Parent, the Company or any of their Subsidiaries or Joint Ventures operates or has stored, treated or disposed of Hazardous Materials.

(iv) "Release" means any release, spill, emission, leaking, injection, deposit, disposal, discharge, dispersal, leaching or migration into the atmosphere, soil, surface water, groundwater or property.

Section 4.11 *Regulation as a Utility.* Except as set forth in Section 4.11 of the Company Disclosure Schedule, neither the Company nor any "associate company," "subsidiary company" or "affiliate" (as such terms are defined in the 1935 Act) of the Company is subject to regulation as (a) a "holding company," a "public-utility company," a "subsidiary company" or an "affiliate" of a "holding company," within the meaning of Sections 2(a)(7), 2(a)(5), 2(a)(8) and 2(a)(11), respectively, of the 1935 Act, (b) a "public utility" under the Power Act, (c) a "natural-gas company" under the Natural Gas Act or (d) a public utility or public service company (or similar designation) by any state in the United States other than Rhode Island or by any foreign country.

Section 4.12 *Vote Required.* The approval of the Merger by a majority of the shares entitled to be voted by the holders of Company Common Stock (the "Company Shareholders' Approval") is the only vote of the holders of any class or series of the capital stock of the Company or any of its Subsidiaries required to approve this Agreement, the Mergers and the other transactions contemplated hereby.

Section 4.13 *Opinion of Financial Advisor.* The Company has received the opinion of PaineWebber Incorporated, dated as of the date of this Agreement, to the effect that the Merger

Consideration is fair from a financial point of view to the holders of Company Common Stock, and a copy of such opinion will be provided to Parent promptly after the execution of this Agreement.

Section 4.14 *Ownership of Parent Common Stock.* The Company does not "beneficially own" (as such term is defined for purposes of Section 13(d) of the Exchange Act) any shares of common stock of Parent.

Section 4.15 *Intellectual Property.* Neither the Company nor any of its Subsidiaries has any Knowledge of (i) any infringement or claimed infringement by the Company or any of its Subsidiaries of any patent or patent license rights, trademarks or copyrights of others or (ii) any infringement of the patent or patent license rights, trademarks or copyrights owned by or under license to the Company or any of its Subsidiaries, except for any such infringements of the type described in clause (i) or (ii) that are not, individually or in the aggregate, reasonably likely to have a Company Material Adverse Effect.

Section 4.16 *Title to Assets.* Except as disclosed in the Company SEC Reports delivered to Parent prior to the date of this Agreement, none of the assets of the Company or any of its Subsidiaries are subject to any Lien.

Section 4.17 *Indebtedness.* All outstanding principal amounts of indebtedness for borrowed money of the Company and its Subsidiaries as of November 23, 1999 are set forth in Section 4.17 of the Company Disclosure Schedule.

Section 4.18 *Machinery and Equipment.* Except for normal wear and tear, and with such other exceptions as are not, individually or in the aggregate, reasonably likely to have a Company Material Adverse Effect, the machinery and equipment of the Company and its Subsidiaries are in good operating condition and in a state of reasonable maintenance and repair.

Section 4.19 *Insurance.* Section 4.19 of the Company Disclosure Schedule sets forth a list of all policies of insurance held by the Company and its Subsidiaries as of the date of this Agreement. Since September 30, 1997, the assets and the business of the Company and its Subsidiaries have been continuously insured with what the Company reasonably believes are reputable insurers against all risks and in such amounts normally insured against by companies of the same type and in the same line of business as the Company and its Subsidiaries. No notice of cancellation, non-renewal or material increase in premiums has been received by any of the Company and its Subsidiaries with respect to such policies, and none of the Company and its Subsidiaries has Knowledge of any fact or circumstance that could reasonably be expected to form the basis for any cancellation, non-renewal or material increase in premiums, except for such cancellations, non-renewals and increases which are not, individually or in the aggregate, reasonably likely to have a Company Material Adverse Effect. None of the Company and its Subsidiaries is in default with respect to any provision contained in any such policy or binder nor has there been any failure to give notice or to present any claim relating to the business or the assets of the Company and its Subsidiaries under any such policy or binder in a timely fashion or in the manner or detail required by the policy or binder, except for such defaults or failures which are not, individually or in the aggregate, reasonably likely to have a Company Material Adverse

Effect. There are no outstanding unpaid premiums (except premiums not yet due and payable), and no notice of cancellation or renewal with respect to, or disallowance of any claim under, any such policy or binder has been received by the Company and its Subsidiaries, except for such non-payments of premiums, cancellations, renewals or disallowances which are not, individually or in the aggregate, reasonably likely to have a Company Material Adverse Effect.

Section 4.20 *Regulatory Proceedings*. Except as disclosed in the Company SEC Reports delivered to Parent prior to the date of this Agreement, other than purchase gas adjustment provisions, none of the Company or its Subsidiaries all or part of whose rates or services are regulated by a Governmental Authority (a) has rates that have been or are being collected subject to refund, pending final resolution of any rate proceeding pending before a Governmental Authority or on appeal to the courts, or (b) is a party to any rate proceedings before a Governmental Authority that are, individually or in the aggregate, reasonably likely to result in any orders having a Company Material Adverse Effect.

Section 4.21 *The Company Rights Agreement*. Prior to the date of this Agreement, the Company has delivered to Parent a true and complete copy of the Company Rights Agreement. The consummation of the transactions contemplated by this Agreement will not result in the triggering of any right or entitlement of the holders of the Company Common Stock or other Company securities under the Company Rights Agreement. Neither the Company nor any of its Subsidiaries is a party to any agreement similar to the Company Rights Agreement.

ARTICLE V
REPRESENTATIONS AND WARRANTIES OF PARENT

Parent represents and warrants to the Company as follows:

Section 5.1 *Organization and Qualification*. Each of Parent and Merger Sub is a corporation duly organized, validly existing and in good standing under the laws of its jurisdiction of incorporation, has all requisite corporate power and authority, and Parent has been duly authorized by all necessary approvals and orders of the Florida, Missouri, Pennsylvania and Texas regulatory authorities and the Federal Energy Regulatory Commission (the "FERC"), to own, lease and operate its assets and properties to the extent owned, leased and operated and to carry on its business as it is now being conducted.

Section 5.2 *Authority; Statutory Approvals*.

(a) *Authority*. Each of Parent and Merger Sub has all requisite corporate power and authority to enter into this Agreement and, subject to the applicable Parent Required Statutory Approvals (as defined in Section 5.2(b)), to consummate the transactions contemplated hereby. The execution and delivery of this Agreement, and the consummation by Parent and Merger Sub of the transactions contemplated hereby have been duly authorized by all necessary corporate action on the part of Parent and Merger Sub. This Agreement has been duly and validly executed and delivered by Parent and Merger Sub and, assuming the due authorization, execution and delivery by the other signatories hereto, constitutes a valid and binding obligation of Parent and

Merger Sub enforceable against them in accordance with its terms, except to the extent that enforceability may be limited by applicable bankruptcy, insolvency or similar laws affecting the enforcement of creditors' rights generally and subject to the general principles of equity (regardless of whether enforcement is sought in a court of law or equity).

(b) Statutory Approval. Except as described in Section 5.2(b) of the Parent Disclosure Schedule (as defined in Section 7.6) (the "Parent Required Statutory Approvals"), no declaration, filing or registration with, or notice to or authorization, consent or approval of, any Governmental Authority is necessary for the execution and delivery of this Agreement by Parent or Merger Sub or the consummation by Parent or Merger Sub of the transactions contemplated hereby, the failure to obtain, make or give which would have, individually or in the aggregate, a material adverse effect on the ability of Parent and Merger Sub to consummate the Mergers in accordance with this Agreement (any such material adverse effect being hereafter referred to as a "Parent Material Adverse Effect"), it being understood that references in this Agreement to "obtaining" such Parent Required Statutory Approvals shall mean making such declarations, filings or registrations; giving such notices: obtaining such authorizations, consents or approvals; and having such waiting periods expire as are necessary to avoid a violation of law.

ARTICLE VI
CONDUCT OF BUSINESS PENDING THE MERGER

Section 6.1 *Covenants of the Company.* From the date hereof until the Effective Time or earlier termination of this Agreement, the Company agrees as follows, as to itself and to each of its Subsidiaries, except as expressly consented to in writing by Parent:

(a) Ordinary Course of Business. The Company shall, and shall cause its Subsidiaries to, carry on their respective businesses in the usual, regular and ordinary course in substantially the same manner as heretofore conducted and use all commercially reasonable efforts to (i) not make or permit any material change in the general nature of its business, (ii) preserve intact their present business organizations and goodwill, preserve the goodwill and relationships with customers, suppliers and others having business dealings with them, (iii) subject to prudent management of workforce needs and ongoing programs currently in force, keep available the services of their present officers and employees as a group, (iv) maintain and keep material properties and assets in as good repair and condition as at present, subject to ordinary wear and tear, and maintain supplies and inventories in quantities consistent with past practice, and (v) preserve all franchises, tariffs. certificates of public convenience and necessity, licenses, authorizations and other governmental rights and permits.

(b) Dividends. The Company shall not, nor shall it permit any of its Subsidiaries to: (i) declare or pay any dividends on or make other distributions in respect of any capital stock other than (A) dividends by a wholly-owned Subsidiary of the Company to the Company or another wholly-owned Subsidiary of the Company, and (B) regular dividends on Company Common Stock with usual record and payment dates that do not exceed the current rate of $0.75 per share of Company Common Stock per year. (ii) split, combine or reclassify any of its capital stock or the capital stock of any of its Subsidiaries or issue or authorize or propose the issuance

of any other securities in respect of, in lieu of, or in substitution for, shares of its capital stock or the capital stock of any of its Subsidiaries, or (iii) redeem, repurchase or otherwise acquire any shares of its capital stock or the capital stock of any of its Subsidiaries, other than redemptions, repurchases and other acquisitions of shares of capital stock in connection with the administration of employee benefit and dividend reinvestment plans as in effect on the date hereof in the ordinary course of the operation of such plans consistent with past practice.

(c) Issuance of Securities. Except as set forth in Section 6.1(c) of the Company Disclosure Schedule, the Company shall not, nor shall it permit any of its Subsidiaries to, issue, agree to issue, deliver, sell, award, pledge, dispose of or otherwise encumber or authorize or propose the issuance, delivery, sale, award, pledge, disposal or other encumbrance of, any shares of their capital stock of any class or any securities convertible into or exchangeable for, or any rights, warrants or options to acquire, any such shares or convertible or exchangeable securities.

(d) Compliance With Law. The Company shall, and shall cause its Subsidiaries to, comply in all material respects with all applicable legal requirements and permits, including without limitation those relating to the filing of reports and the payment of Taxes due to be paid prior to the Closing, other than those contested in good faith with adequate reserves set forth in the Company Financial Statements delivered to Parent prior to the date of this Agreement.

(e) Charter Documents; Other Actions. The Company shall not, nor shall it permit any of its Subsidiaries to, (i) amend or propose to amend its respective articles of incorporation, by-laws or regulations, or similar organizational documents or (ii) take or fail to take any other action, which in any such case would reasonably be expected to prevent or materially impede or interfere with the Mergers.

(f) Acquisitions. Except as disclosed in Section 6.1(f) of the Company Disclosure Schedule, the Company shall not, nor shall it permit any of its Subsidiaries to, acquire or agree to acquire, by merging or consolidating with, or by purchasing an equity interest in or a portion of the assets of, or by any other manner, any business or any corporation, partnership, association or business organization or division thereof, or otherwise acquire or agree to acquire any material amount of assets.

(g) Contracts. The Company and its Subsidiaries shall not enter into any transaction or any Contract involving a total commitment by or to any party thereto of more than $125,000 on a yearly basis or more than $500,000 on its remaining term which cannot be terminated on no more than 60 days' notice without penalty or cost to the Company or any of its Subsidiaries as a terminating party. Without limiting the prior sentence, the Company shall not, except in the ordinary course of business consistent with past practice, modify, amend, terminate, renew or fail to use reasonable business efforts to renew any material Contract to which the Company or any of its Subsidiaries is a party or waive, release or assign any material rights or claims with respect thereto.

(h) Capital Expenditures. The Company shall not, nor shall it permit any of its Subsidiaries to, make capital expenditures in an aggregate amount in excess of the amount

budgeted by the Company or its Subsidiaries for capital expenditures as set forth in Section 6.1(h) of the Company Disclosure Schedule.

(i) No Dispositions. The Company shall not, nor shall it permit any of its Subsidiaries to, sell, lease, license, encumber or otherwise dispose of, any of its respective assets, other than encumbrances or dispositions in the ordinary course of business consistent with past practice.

(j) Indebtedness. The Company shall not, nor shall it permit any of its Subsidiaries to, incur or guarantee any indebtedness (including any debt borrowed or guaranteed or otherwise assumed including, without limitation, the issuance of debt securities or warrants or rights to acquire debt) or enter into any "keep well" or other agreement to maintain any financial statement condition of another person or enter into any arrangement having the economic effect of any of the foregoing other than (i) short-term indebtedness in the ordinary course of business consistent with past practice which is subject to redemption or prepayment at any time at the option of the Company or its applicable Subsidiary on no more than 30 days' notice without any penalty or premium or (ii) arrangements between the Company and its wholly-owned Subsidiaries or among its wholly-owned Subsidiaries.

(k) Compensation, Benefits; Employees. Except as may be required by applicable law or under existing Employee Benefit Plans or collective bargaining agreements, as may be required to facilitate or obtain a determination letter from the IRS that a plan is a Qualified Plan, or as expressly contemplated by this Agreement, the Company shall not, nor shall it permit any of its Subsidiaries to, (i) enter into, adopt or amend or increase the amount or accelerate the payment or vesting of any benefit or amount payable under any Employee Benefit Plan, or otherwise increase the compensation or benefits of any director, officer or other employee of the Company or any of its Subsidiaries, except for normal increases in compensation and benefits (including incentive compensation) or actions in the ordinary course of business, that are consistent with the Company's past practice of adjusting compensation and benefits to reflect the average compensation and benefits as determined by general industry or market surveys; provided that prior to implementing any such increases on the basis of such surveys the Company shall advise Parent of its intention so to increase compensation or benefits and of the basis therefor and shall otherwise consult with Parent concerning such proposed increases, or (ii) enter into or amend any employment, severance or special pay arrangement with respect to the termination of employment or other similar contract, agreement or arrangement with any director or officer or other employee. This subsection (k) is not intended to (A) restrict the Company or its Subsidiaries from granting promotions to officers or employees based upon job performance or workplace requirements in the ordinary course of business consistent with past practice or (B) restrict the Company's ability to make available to employees the plans, benefits and arrangements that have customarily and consistent with past practices been available to officers and employees in the context of such merit-based promotion. The Company and its Subsidiaries shall not hire any new employee unless such employee is a bona fide replacement for a presently-filled position with the Company or a Subsidiary as of the date hereof.

(l) 1935 Act. The Company shall not, nor shall it permit any of its Subsidiaries to, engage in any activities which would cause a change in its status, or that of its Subsidiaries, under the 1935 Act.

(m) Accounting. The Company shall not, nor shall it permit any of its Subsidiaries to, make any changes in their accounting methods, principles and practices, except as required by law, rule, regulation or GAAP.

(n) Cooperation, Notification. The Company shall, and shall cause its Subsidiaries to, (i) confer on a regular and frequent basis with one or more representatives of Parent to discuss, subject to applicable law, material operational matters and the general status of its ongoing operations, (ii) promptly notify Parent of any significant changes in its business, properties, assets, condition (financial or other), results of operations or prospects, (iii) advise Parent of any change or event which has had or, insofar as reasonably can be foreseen, is reasonably likely to result in a Company Material Adverse Effect, and (iv) without limiting the Company's and its Subsidiaries' obligations under Section 6.1(u)(i), promptly provide Parent with copies of all filings made by the Company or any of its Subsidiaries with any state or federal court, administrative agency, commission or other Governmental Authority in connection with this Agreement and the transactions contemplated hereby.

(o) Third-Party Consents. The Company shall, and shall cause its Subsidiaries to, use all commercially reasonable efforts to obtain all the Company Required Consents and other consents required to consummate the transactions contemplated hereby. The Company shall promptly notify Parent of any failure or prospective failure to obtain any such consents and, if requested by Parent, shall provide copies of all the Company Required Consents obtained by the Company to Parent.

(p) Discharge of Liabilities. The Company shall not, nor shall it permit any of its Subsidiaries to, pay, discharge or satisfy any material claims, liabilities or obligations (absolute, accrued, asserted or unasserted, contingent or otherwise), other than the payment, discharge or satisfaction, in the ordinary course of business consistent with past practice (which includes the payment of final and unappealable judgments) or in accordance with their terms, of liabilities reflected or reserved against in, or contemplated by, the most recent consolidated financial statements (or the notes thereto) of the Company included in the Company SEC Reports delivered to Parent prior to the date of this Agreement, or incurred in the ordinary course of business consistent with past practice.

(q) Insurance. The Company shall, and shall cause its Subsidiaries to, maintain with financially responsible insurance companies insurance in such amounts and against such risks and losses as are customary for companies engaged in the electric and gas utility industry.

(r) Permits. The Company shall, and shall cause its Subsidiaries to, use reasonable efforts to maintain in effect all existing governmental permits pursuant to which the Company or any of its Subsidiaries operate.

(s) No Rights Triggered. The Company shall ensure that the entering into of this Agreement and the Related Documents and the consummation of the transactions contemplated hereby and thereby and any other action or combination of actions, or any other transactions contemplated hereby and thereby, do not and will not result, directly or indirectly, in the grant of any rights to any person under any Contract (other than the employment agreements disclosed in Section 6.1(s) of the Company Disclosure Schedule) to which it or any of its Subsidiaries is a party or otherwise. In addition, the Company shall not amend or waive any rights in a manner that would adversely affect any party's ability to consummate the Mergers or the economic benefits of the Mergers to Parent.

(t) Taxes. The Company shall not, and shall cause its Subsidiaries not to, (i) make or rescind any express or deemed material election relating to Taxes, (ii) settle or compromise any material claim, audit, dispute, controversy, examination, investigation or other proceeding relating to Taxes, (iii) materially change any of its methods of reporting income or deductions for federal income Tax purposes, except as may be required by applicable law, or (iv) file any material Tax Return other than in a manner consistent with past custom and practice.

(u) The Company and its Subsidiaries shall:

(i) Not file any material application, petition, motion, order, brief, settlement or agreement in any material proceeding before any Governmental Authority which involves the Company or any of its Subsidiaries, and appeals related thereto without, to the extent reasonably practicable, consulting Parent; provided, however, that if such proceeding is reasonably likely to have a Company Material Adverse Effect, the Company shall not make any such filing without the consent of Parent, which consent shall not be unreasonably withheld or delayed;

(ii) Not engage in or modify, except in the ordinary course of business, any material intercompany transactions involving any other Subsidiary of the Company;

(iii) Not make any changes in financial policies or practices, or strategic or operating policies or practices;

(iv) Not make any loan or advance to any officer, director, shareholder, employee or any other person other than advances for business purposes to employees in the ordinary course of business;

(v) Not purchase, sell, lease, dispose of or otherwise transfer or make any Contract for the purchase, sale, lease, disposition or transfer of, or subject to Lien, any of the assets of the Company or its Subsidiaries other than in the ordinary course of business; and

(vi) Not terminate any existing gas purchase, exchange or transportation contract necessary to supply firm gas at all city gate delivery points

or enter into any new contract for the supply, transportation, storage or exchange of gas with respect to the Company's or its Subsidiaries' regulated gas distribution operations or renew or extend or negotiate any existing contract providing for the same where such contract is not terminable within sixty (60) days without penalty without obtaining Parent's prior written consent; provided, however, that if the Company provides Parent with a copy of any such proposed new Contract, Parent shall be deemed to have consented to the entering into of such Contract if Parent does not notify the Company of its disapproval of such Contract by the end of the second business day after receipt by Parent of such copy of such proposed new Contract.

(v) Customer Notifications. At any time and from time to time as reasonably requested by Parent prior to the Closing Date, each of the Company and its Subsidiaries will permit Parent at Parent's expense to insert preprinted single-page customer education materials into billing documentation to be delivered to customers affected by this Agreement; provided, however, that the Company has reviewed in advance and consented to the content of such materials, which consent shall not be unreasonably withheld or delayed. Other means of notifying customers may be employed by either the Company or Parent, at the expense of the initiating party, but in no event shall any notification be initiated without the prior consent of the other party (which consent shall not be unreasonably withheld or delayed).

(w) Company Bondholders' Consent. The Company shall use its reasonable best efforts to obtain consents from all holders of each series of First Mortgage Bonds issued under the Indenture of First Mortgage dated as of December 15, 1992 between Valley, the Company, as Guarantor, and State Street Bank and Trust Company, as Trustee, and from all holders of each series of debentures issued under the Indenture between the Company and Mellon Bank, N.A., dated as of September 1, 1997, each as amended or supplemented from time to time, to such amendments to such Indentures as requested by Parent.

(x) Financing Activities. The Company shall, and shall cause its Subsidiaries to, cooperate, to the fullest extent commercially reasonable and practicable, with Parent's requests with respect to refinancing by the Company and its Subsidiaries of the current maturities of any of their indebtedness, and any repurchase, redemption or prepayment by the Company or any of its Subsidiaries of any of their indebtedness that may be required prior to or because of the Mergers or that Parent may request that the Company or any of its Subsidiaries effect prior to the Mergers, so as to permit Parent to have the maximum opportunity to refinance, on or promptly after the Closing Date without any penalty except as may be due pursuant to the terms of the Company's or its Subsidiaries' indebtedness as in effect on the date of this Agreement, any of the Company's or its Subsidiaries' indebtedness outstanding on the Closing Date; provided, however, that neither the Company nor any of its Subsidiaries shall be required to consummate prior to the Effective Time any such refinancing, repurchase, redemption or repayment requested by Parent.

(y) Legislative Action. The Company shall, and shall cause its Subsidiaries to, use commercially reasonable efforts to cause the Rhode Island Legislature to: (i) unconditionally amend the legislative charter of Valley to expressly and unconditionally approve and authorize

the Valley Merger, (ii) unconditionally amend the legislative charter of Bristol to expressly and unconditionally approve and authorize the Bristol Merger, (iii) expressly and unconditionally approve and authorize the Company Merger, and (iv) expressly and unconditionally permit Parent to qualify to do business in Rhode Island in accordance with the RIBCA, notwithstanding contrary provisions of §7-1.1-3 and §7-1.1-99 (collectively, the "Legislative Actions"). All Legislative Actions shall be in form and substance reasonably acceptable to Parent. The Company shall, and shall cause its Subsidiaries to, cooperate with Parent to effect the Legislative Actions as soon as practicable after the date of this Agreement.

Section 6.2 *Covenant of the Company: Alternative Proposals.* (a) From and after the date hereof, the Company agrees (i) that it will not, its Subsidiaries will not, and it will not authorize or permit any of its or its Subsidiaries' officers, directors, employees, agents and representatives (including, without limitation, any investment banker, financial advisor, attorney or accountant retained by it or any of its Subsidiaries or any of the foregoing) to, directly or indirectly, encourage, initiate or solicit (including by way of furnishing information) or take any other action designed or which could be reasonably expected to facilitate any inquiries or the making of any proposal or offer (including, without limitation, any proposal or offer to its shareholders) which constitutes or may reasonably be expected to lead to an Alternative Proposal (as defined below) from any person or engage in any discussion or negotiations concerning, or provide any non-public information or data to make or implement or otherwise in any way cooperate or facilitate the making of an Alternative Proposal; (ii) that it will immediately cease and cause to be terminated any existing solicitation, initiation, encouragement, activity, discussions or negotiations with any parties conducted heretofore with a view of formulating an Alternative Proposal; and (iii) that it will notify Parent orally and in writing of any such inquiry, offer or proposals, within one business day of the receipt thereof, and that it shall keep Parent informed of the status of any such inquiry, offer or proposal; provided, however, that notwithstanding any other provision hereof, the Company may (1) at any time prior to the time at which the Company Shareholders' Approval shall have been obtained, engage in discussions or negotiations with a third party who (without solicitation in violation of the terms of this Agreement) seeks to initiate such discussions or negotiations and may furnish such third party information concerning the Company and its business, properties and assets if, and only to the extent that, (A) (x) the third party has first made an Alternative Proposal that, in the good faith judgment of the Company's Board of Directors (after consulting with its financial and legal advisors) is financially superior to the Company's shareholders than the Merger and has demonstrated that it will have adequate sources of financing to consummate such Alternative Proposal, and (y) the Board of Directors of the Company shall conclude in good faith, based upon the advice of outside counsel and such other matters as the Board of Directors of the Company deems relevant, that such actions are necessary for the Company's Board of Directors to act in a manner consistent with its fiduciary duties to shareholders under applicable law, and (B) prior to furnishing such information to, or entering into discussions or negotiations with, such person or entity, the Company (x) provides at least two business days' prior written notice to Parent to the effect that it intends to furnish information to, or intends to enter into discussions or negotiations with, such person or entity, and of the identity of the person or group making the Alternative Proposal and the material terms thereof, including a copy of any offer or proposal submitted in writing, and (y) receives from such person an executed confidentiality agreement

containing the same terms and conditions as the Confidentiality Agreement (as defined in Section 7.1) except that such confidentiality agreement shall not prohibit such person from making an unsolicited Alternative Proposal, and (2) comply with Rule 14e-2 promulgated under the Exchange Act with regard to a tender or exchange offer. "Alternative Proposal" shall mean any merger, acquisition, consolidation, reorganization, business combination, share exchange, tender offer, exchange offer or similar transaction involving the Company or any of the Company's Subsidiaries, or any proposal or offer to acquire in any manner, directly or indirectly, a material equity interest in or a material portion of the assets of the Company or any of the Company's Subsidiaries, including any single or multi-step transaction or series of related transactions.

(b) Neither the Board of Directors of the Company nor any committee thereof may, (i) withdraw or modify, or propose publicly to withdraw or modify, in a manner adverse to Parent, the approval or recommendation by the Board of Directors of the Company or such committee of the Merger or this Agreement, (ii) approve or recommend or propose publicly to approve or recommend an Alternative Proposal or (iii) cause the Company or any of its Subsidiaries to enter into any letter of intent, agreement in principle, acquisition agreement or other similar agreement related to any Alternative Proposal. Notwithstanding the foregoing, prior to the time at which the Company Shareholders' Approval has been obtained, in response to an Alternative Proposal (without solicitation in violation of the terms of this Agreement) from a third party, if the Board of Directors of the Company determines, in its good faith judgment, after consultation with and the receipt of the advice of its financial advisor and outside counsel, that such proposal is financially superior to the Company's shareholders than the Merger and that failure to do any of the actions set forth in clauses (i), (ii) or (iii) above of this Section 6.2(b) would create a reasonable possibility of a breach of the fiduciary duties of the Company's Board of Directors under applicable law, the Board of Directors of the Company may (i) withdraw or modify its approval or recommendation of the Merger or this Agreement, approve or recommend an Alternative Proposal or cause the Company to enter into an Alternative Proposal and (ii) negotiate with a third party with respect to such Alternative Proposal, and subject to the Company having paid to Parent the fees described in Section 9.3 hereof and having entered into a definitive agreement with respect to such Alternative Proposal, terminate this Agreement; provided, however, that prior to entering into a definitive agreement with respect to an Alternative Proposal, the Company shall give Parent at least five (5) days' notice thereof, and shall cause its representatives to negotiate with Parent to make such adjustments in the terms and conditions of this Agreement as would enable the Company to proceed with the transactions contemplated herein on such adjusted terms; provided, further, that if the Company and Parent are unable to reach an agreement on such adjustments within five (5) days after such notice from the Company, the Company may enter into such definitive agreement, subject to the provisions of Article IX.

Section 6.3 *Employment Agreement.* Parent and Mr. Alfred P. Degen have entered into an employment agreement in the form attached hereto as Exhibit A (the "Employment Agreement"), which will become effective upon consummation of the Merger.

ARTICLE VII
ADDITIONAL AGREEMENTS

Section 7.1 *Access to Information.*

(a) Upon reasonable notice and during normal business hours, the Company shall, and shall cause its Subsidiaries to, afford to the officers, directors, employees, accountants, counsel, investment bankers, financial advisors and other representatives of Parent reasonable access, throughout the period prior to the Effective Time, to all of its and its Subsidiaries' properties, books, contracts, commitments and records (including, but not limited to, Tax Returns) and during such period, the Company shall, and shall cause its Subsidiaries to, furnish promptly to Parent access to each report, schedule and other document filed or received by it or any of its Subsidiaries pursuant to the requirements of federal or state securities laws or filed with or sent to the SEC, the Department of Justice, the Federal Trade Commission or any other federal or state regulatory agency or commission. Each party shall, and shall cause its Subsidiaries to, afford to the officers, directors, employees, accountants, counsel, investment bankers and other representatives of the other reasonable access to all information concerning themselves, their subsidiaries, directors, officers and shareholders and such other matters as may be reasonably requested by the other party in connection with any filings, applications or approvals required or contemplated by this Agreement. Each party shall, and shall cause its Subsidiaries and representatives to, hold in strict confidence all Information (as defined in the Confidentiality Agreement) concerning the other parties furnished to it in connection with the transactions contemplated by this Agreement in accordance with Confidentiality Agreement dated November 1, 1999 between the Company and Parent, as it may be amended from time to time (the "Confidentiality Agreement").

(b) As promptly as practicable after Parent's request, the Company will furnish such financial and operating data and other information pertaining to the Company or its Subsidiaries and their businesses and assets as Parent may reasonably request; provided, however, that nothing herein will obligate the Company or any of its Subsidiaries to take actions that would unreasonably disrupt its ordinary course of business or violate the terms of any legal requirement or Contract to which the Company or its Subsidiary is a party or to which any of its assets is subject in providing such information, or to incur any costs with respect to Parent's external auditors (or the Company's or its Subsidiaries' external auditors in the event a report by such auditors is requested by Parent) providing accounting services with respect to issuing an auditor's report required by or for Parent.

Section 7.2 *Proxy Statement.*

(a) (i) As soon as practicable after the date hereof, the Company shall take such reasonable steps as are necessary for the prompt preparation and filing with the SEC of a proxy statement relating to the Company Special Meeting (as defined in Section 7.4(a)) (together with any amendments thereto or supplements thereto, the "Proxy Statement"). Each of Parent and the

Company shall furnish all information concerning it, its officers and directors, and the holders of its capital stock as the other may reasonably request in connection with the preparation and filing of the Proxy Statement. The Company will use all commercially reasonable efforts to cause the Proxy Statement to be cleared by the SEC as promptly as practicable after filing and as promptly as practicable after such clearance, the Company shall mail the Proxy Statement to its shareholders entitled to notice of and to vote at the Company Special Meeting. As promptly as practical after consultation between Parent and the Company, the Company shall respond to any comments made by the SEC with respect to the Proxy Statement.

(ii) The Company agrees that information supplied by the Company for inclusion or incorporation by reference in the Proxy Statement shall not, at the date of the mailing of the Proxy Statement (or any supplement thereto) and at the time of the Company Special Meeting, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading. If at any time prior to the Company Special Meeting any event or circumstance relating to the Company or any of its Subsidiaries, or its or their respective officers or directors, should be discovered by the Company that should be set forth in a supplement to the Proxy Statement, the Company shall promptly inform Parent. All documents that the Company is responsible for filing with the SEC in connection with the transactions contemplated hereby shall comply as to form in all material respects with the applicable requirements of the Securities Act and the regulations thereunder and the Exchange Act and the regulations thereunder.

(iii) Parent agrees that information supplied by Parent for inclusion or incorporation by reference in the Proxy Statement shall not, at the date of the mailing of the Proxy Statement (or any supplement thereto) or at the time of the Company Special Meeting, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they are made, not misleading. If at any time prior to the Company Special Meeting any event or circumstance relating to Parent or any of its Subsidiaries, or to their respective officers or directors, should be discovered by Parent that should be set forth in a supplement to the Proxy Statement, Parent shall promptly inform the Company.

(iv) No representation, warranty, covenant or agreement is made by or on behalf of the Company with respect to information supplied by any other person other than its Subsidiaries for inclusion in the Proxy Statement. No representation, warranty, covenant or agreement is made by or on behalf of Parent with respect to information supplied by any other person for inclusion in the Proxy Statement. No filing of, or amendment or supplement to, the Proxy Statement shall be made by the Company without providing Parent with the opportunity to review and comment thereon; provided, however, that no such filing, amendment or supplement (i) that relates to Parent or any of its

Subsidiaries or (ii) that is reasonably likely to have a material adverse effect on Parent or any of its Subsidiaries, shall be made without Parent's prior written approval. If at any time prior to the Company Special Meeting any information relating to any party hereto or any of their respective officers, directors, shareholders or Subsidiaries, should be discovered by any party hereto which should be set forth in an amendment or supplement to the Proxy Statement so that the Proxy Statement would not include any untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, the party which discovers such information shall promptly notify the other party hereto and an appropriate amendment or supplement describing such information shall be promptly prepared, filed with the SEC and, to the extent required by law, disseminated to the shareholders of the Company.

(b) Letter of the Company's Accountant. Following receipt by Grant Thornton LLP, the Company's independent auditor, of an appropriate request from the Company pursuant to SAS No. 72, the Company shall use its best efforts to cause to be delivered to Parent a letter of Grant Thornton LLP dated a date within two business days before the date of the Proxy Statement, and addressed to Parent, in form and substance reasonably satisfactory to Parent and customary in scope and substance for the "cold comfort" letters delivered by independent public accountants in connection with proxy statements similar to the Proxy Statement.

Section 7.3 *Regulatory Matters.* Each party hereto shall cooperate and use its commercially reasonable efforts to promptly prepare and file all necessary documentation, to effect all necessary applications, notices, petitions, filings and other documents, and to use all commercially reasonable efforts to obtain no later than the Initial Termination Date (as defined in Section 9.1(b)), as such date may be extended pursuant to Section 9.1(b), all necessary permits, consents, approvals and authorizations of all Governmental Authorities necessary or advisable to consummate the transactions contemplated by this Agreement, including, without limitation, the Company Required Statutory Approvals, the Parent Required Statutory Approvals and the Legislative Actions. Notwithstanding anything to the contrary contained in this Agreement, including this Section 7.3, neither Parent, nor any of Parent's Affiliates shall be required to divest themselves of any of their respective assets or properties or agree to limit the ownership or operation by Parent or any of Parent's Affiliates of any assets including any of the assets of the Company and its Subsidiaries and Joint Ventures.

Section 7.4 *Company Shareholders' Approval.*

(a) Company Special Meeting. Subject to the provisions of Section 7.4(b), the Company shall, as soon as reasonably practicable after the date hereof (i) take all steps necessary to duly call, give notice of, convene and hold a meeting of its shareholders (the "Company Special Meeting") for the purpose of securing the Company Shareholders' Approval, (ii) distribute to its shareholders the Proxy Statement in accordance with applicable federal and state law and with its articles of incorporation and by-laws, (iii) subject to the fiduciary duties of its Board of Directors, recommend to its shareholders the approval of this Agreement and the transactions contemplated hereby, (iv) solicit from its shareholders proxies in favor of the Merger

and take all other action reasonably necessary, or, in the reasonable opinion of Parent, advisable to secure the Company Shareholders' Approval, and (v) cooperate and consult with Parent with respect to each of the foregoing matters.

(b) Meeting Date. The Company Special Meeting for the purpose of securing the Company Shareholders' Approval shall be held on such date as the Company and Parent shall mutually determine.

Section 7.5 *Directors' and Officers' Indemnification.*

(a) Indemnification and Insurance. For a period of six years after the Effective Time, Parent will indemnify and hold harmless the present and former officers and directors of the Company and its Subsidiaries (the "Indemnified Parties") in respect of acts or omissions occurring prior to the Effective Time to the extent provided under the Company's articles of incorporation and by-laws in effect on the date hereof; provided, however, that if any claim or claims are asserted or made within such six-year period, all rights to indemnification in respect of such claims shall continue until the final disposition of any and all such claims. For six years after the Effective Time, Parent will use its reasonable best efforts to provide officers' and directors' liability insurance in respect of acts or omissions occurring prior to the Effective Time covering each such person currently covered by the Company's officers' and directors' liability insurance policy on terms with respect to coverage and amount no less favorable than those of such policy in effect on the date hereof; provided, however, that in satisfying its obligation under this Section, if the annual premiums of such insurance coverage exceed 200% of the previous year's premiums, Parent will be obligated to obtain a policy with the best coverage available, in the reasonable judgment of the Board of Directors of Parent, for a cost not exceeding such amount.

(b) Successors. In the event Parent or any of its successors or assigns (i) consolidates with or merges into any other person and is not the continuing or surviving corporation or entity of such consolidation or merger or (ii) transfers all or substantially all of its properties and assets to any person, then and in either such case, proper provisions must be made so that the successors and assigns of Parent will assume the obligations set forth in this Section 7.5.

(c) Survival of Indemnification. To the fullest extent permitted by law, from and after the Effective Time, all rights to indemnification as of the date hereof in favor of the employees, agents, directors and officers of the Company and its Subsidiaries with respect to their activities as such prior to the Effective Time, as provided in its respective articles of incorporation and by-laws in effect on the date hereof, or otherwise in effect on the date hereof, shall survive the Merger and shall continue in full force and effect for a period of not less than six years from the Effective Time (or in the event any relevant claim is asserted or made within such six-year period, until final disposition of such claim).

(d) Benefit. The provisions of this Section 7.5 are intended to be for the benefit of, and shall be enforceable by, each Indemnified Party, his or her heirs and his or her representatives.

Section 7.6 *Disclosure Schedules.* On the date hereof, (a) Parent has delivered to the Company a schedule (the "Parent Disclosure Schedule"), accompanied by a certificate signed by an authorized officer of Parent stating the Parent Disclosure Schedule is being delivered pursuant to this Section 7.6(a), and (b) the Company has delivered to Parent a schedule (the "Company Disclosure Schedule"), accompanied by a certificate signed by an authorized officer of the Company stating the Company Disclosure Schedule is being delivered pursuant to this Section 7.6(b). The Company Disclosure Schedule and the Parent Disclosure Schedule are collectively referred to herein as the "Disclosure Schedules." The Disclosure Schedules constitute an integral part of this Agreement and modify the respective representations, warranties, covenants or agreements of the parties hereto contained herein to the extent that such representations, warranties, covenants or agreements expressly refer to the Disclosure Schedules. Anything to the contrary contained herein or in the Disclosure Schedules notwithstanding, any and all statements, representations, warranties or disclosures set forth in the Disclosure Schedules shall be deemed to have been made on and as of the date hereof.

Section 7.7 *Public Announcements.* Subject to each party's disclosure obligations imposed by law or the applicable regulations of any securities exchange upon which such party's securities are listed, the Company and Parent will cooperate with each other in the development and distribution of all news releases and other public information disclosures with respect to this Agreement or any of the transactions contemplated hereby and shall not issue any public announcement or statement with respect hereto without the consent of the other party (which consent shall not be unreasonably withheld).

Section 7.8 *Certain Employee Agreements.* Subject to Section 7.9, Parent shall assume all contracts, agreements and collective bargaining agreements of the Company and its Subsidiaries which apply to any current or former employee or current or former director of the Company or any of its Subsidiaries; provided, however, that the foregoing shall not prevent Parent from enforcing such contracts, agreements and collective bargaining agreements in accordance with their terms, including, without limitation, any reserved right to amend, modify, suspend, revoke or terminate any such contract, agreement or collective bargaining agreement. It is the present intention of Parent and the Company that following the Effective Time there will be no involuntary reductions in force at the Company or its Subsidiaries, but that Parent will achieve workforce reductions through attrition; however, Parent reserves the right to respond as it deems appropriate based on business conditions and regulatory environments. If reductions in workforce in respect of employees of the Company and its Subsidiaries become necessary, they shall be made on a fair and equitable basis, in light of the circumstances and the objectives to be achieved, giving consideration to previous work history, job experience, qualifications, and business needs, and any employees whose employment is terminated or jobs are eliminated by Parent shall be entitled to participate on a fair and equitable basis in the job posting programs offered by Parent. Any workforce reductions carried out following the Effective Time by Parent shall be done in accordance with all applicable collective bargaining agreements, and all applicable laws and regulations governing the employment relationship and termination thereof including, without limitation, the Worker Adjustment and Retraining Notification Act and regulations promulgated thereunder, and any comparable state or local law.

Section 7.9 *Employee Benefit Plans.*

(a) Except as may be required by applicable law, each Plan in effect on the date hereof (or as amended or established in accordance with or as permitted by this Agreement) shall be maintained in effect with respect to the employees, former employees, directors or former directors of the Company and any of its Subsidiaries who are covered by such plans, programs, agreements or arrangements immediately prior to the Effective Time until Parent determines otherwise on or after the Effective Time, and Parent shall assume as of the Effective Time each Plan maintained by the Company immediately prior to the Effective Time and perform such plan, program, agreement or arrangement in the same manner and to the same extent that the Company would be required to perform thereunder; provided, however, that nothing herein contained shall limit any reserved right contained in any such Plan to amend, modify, suspend, revoke or terminate any such plan, program, agreement or arrangement; provided, further, that, except as may be required by applicable law, Parent or its Subsidiaries shall provide to the employees of the Company and its Subsidiaries who are employed immediately prior to the Effective Time and who are not covered by a collective bargaining agreement ("Covered Company Employees") for a period of no less than 24 months following the Effective Time, base salary levels, bonus opportunity levels and employer-provided benefits under Qualified Plans, supplemental retirement benefit plans which are not Qualified Plans and welfare plans that are comparable in the aggregate to those provided immediately prior to the Effective Time. Without limiting the foregoing, each Covered Company Employee who is a participant in any Plan shall receive credit for purposes of eligibility to participate, vesting and eligibility to receive benefits (but specifically excluding for benefit accrual purposes) under any replacement benefit plan of Parent or any of its Subsidiaries or Affiliates in which such employee becomes a participant for service credited for the corresponding purpose under any such Plan, unless such crediting of service would operate to cause any such plan or agreement to fail to comply with the applicable provisions of the Code and ERISA or other applicable law. Notwithstanding the foregoing, but subject to Section 7.9(b), Parent acknowledges that each Covered Company Employee who is a participant in the Valley Gas Company Supplemental Retirement Plan (the "SERP") as of the date hereof shall continue to accrue benefits for 24 months after the Effective Time under terms at least as favorable as the terms of the SERP in effect on the date of this Agreement, taking into account service and compensation earned while employed by Parent and its Subsidiaries after the Effective Time. After the 24 months immediately following the Effective Time, Parent agrees to maintain during the next 24-month period, for Covered Company Employees who continue their service with Parent, base salary levels, bonus opportunity and employer-provided benefits under Qualified Plans, supplemental retirement benefit plans which are not Qualified Plans and welfare plans that are appropriate for the market given Parent's financial circumstances, the industry in which it operates, and regulatory considerations. No provision contained in this Section 7.9 shall be deemed to constitute an employment contract between Parent or any of its Subsidiaries and any individual, or a waiver of Parent's or any of its Subsidiaries' right to discharge any employee at any time, with or without cause.

(b) The Company shall take all necessary actions so that, effective no later than immediately before the date the Company Shareholders' Approval is obtained, (i) each of the SERP, the Morris Merchants, Inc. Executive Deferred Compensation Plan and all other executive benefit plans and programs of the Company and its Subsidiaries shall be amended to the extent

necessary so that any provisions therein that prohibit or limit the amendment or termination thereof following a change of control do not apply to individuals who are not participants therein as of the date of this Agreement and (ii) subject to applicable law and the provisions of any applicable collective bargaining agreement, each Qualified Plan shall be amended to the extent necessary so that any provisions therein that call for the waiver or elimination of vesting requirements upon or following a change in control shall apply only to individuals who are participants therein immediately before the Effective Time. Section 7.9(b) of the Company Disclosure Schedule sets forth a list of all Plans which contain provisions that either (x) prohibit or limit the amendment or termination thereof following a change of control, or (y) call for the waiver or elimination of vesting requirements upon a change of control.

(c) Parent will permit each of the Covered Company Employees to carry forward all days of sick leave accrued prior to the Effective Time.

(d) For a 5-year period from the Effective Time, Parent agrees to provide retiree medical plan coverage which is substantially comparable to the coverage under the Company retiree medical plan as of the date hereof, subject to Parent's right to adjust copayment and cost sharing provisions (which may be continued in the same proportions to the Company-provided portions of cost) to any former Covered Company Employee (and his or her eligible dependents) who is currently receiving such benefits thereunder, or any active Covered Company Employee (and his or her eligible dependents) who would be eligible for such benefits if he or she retired on the Effective Time (or who, within 5 years of the Effective Time, retires and is eligible to receive benefits thereunder).

Section 7.10 *Company Stock Plans.* With respect to each Plan that provides for benefits in the form of Company Common Stock ("Company Stock Plans"), the Company and Parent shall take all corporate action necessary or appropriate to (i) provide for the issuance or purchase in the open market of common stock of Parent rather than Company Common Stock, pursuant thereto, and otherwise to amend such Company Stock Plans to reflect this Agreement and the Merger, (ii) obtain shareholder or board of director approval with respect to such Company Stock Plans to the extent such approval is required for purposes of the Code or other applicable law, or to enable such Company Stock Plans to comply with Rule 16b-3 promulgated under the Exchange Act, (iii) reserve for issuance under such Company Stock Plans or otherwise provide a sufficient number of shares of Parent Common Stock for delivery upon payment of benefits, grant of awards or exercise of options under such Company Stock Plans and (iv) as soon as practicable after the Effective Time, file registration statements on Form S-8 (or any successor or other appropriate forms), with respect to the shares of Parent Common Stock subject to such Company Stock Plans to the extent such registration statement is required under applicable law, and Parent shall use its best efforts to maintain the effectiveness of such registration statements (and maintain the current status of the prospectuses contained therein) for so long as such benefits and grants remain payable and such options remain outstanding. With respect to those individuals who subsequent to the Merger will be subject to the reporting requirements under Section 16(a) of the Exchange Act, the Company shall administer the Company Stock Plans, where applicable, in a manner that complies with Rule 16b-3 promulgated under the Exchange Act. This Section 7.10 shall not limit any reserved right contained in any Plan to amend, modify, suspend, revoke or terminate any such plan, program, agreement or arrangement.

Section 7.11 *Expenses.* Subject to Section 9.3, all costs and expenses incurred in connection with this Agreement and the transactions contemplated hereby shall be paid by the party incurring such expenses.

Section 7.12 *Further Assurances.* Each party will, and will cause its Subsidiaries to, execute such further documents and instruments and, subject to the last sentence of Section 7.3 take such further actions as may reasonably be requested by any other party in order to consummate the Mergers in accordance with the terms hereof.

Section 7.13 *Community Involvement.* For two years after the Effective Time, Parent will make at least $60,000 per year in charitable contributions to the communities served by the Company prior to the Merger and otherwise maintain a substantial level of involvement in community activities in the State of Rhode Island that is similar to, or greater than, the level of community development and related activities carried on by the Company.

Section 7.14 *Financial Statements to be Provided.* Upon Parent's request, the Company shall (i) provide to Parent audited and unaudited financial statements required to be included in (a) the proxy statements and the registration statement contemplated by the Agreement of Merger, dated as of October 4, 1999, by and between Parent and Fall River Gas Company and (b) the proxy statement contemplated by the Agreement and Plan of Merger, dated as of November 15, 1999, by and between Parent, GUS Acquisition Corporation and Providence Energy Corporation, and (ii) cause its independent accountants to deliver to Parent, Fall River Gas Company and Providence Energy Corporation the required consents in connection therewith.

Section 7.15 *Officers of Valley Division.* From the Effective Time until the earlier of their resignation, removal by Parent, or reassignment by Parent in the event of a restructuring of the Valley Division, the following individuals shall serve the Valley Division of the New England Business Unit of Parent in the following capacities:

Alfred P. Degen as President and Chief Executive Officer
Charles K. Meunier as Vice President, Operations
Richard G. Drolet as Vice President, Information Systems and Corporate Planning
Sharon Partridge as Vice President, Chief Financial Officer and Treasurer
Jeffrey P. Polucha as Vice President, Marketing and Development
James P. Carney as Assistant Vice President, Human Resources
William D. Mullin as Assistant Vice President, Operations
Alan H. Roy as Assistant Vice President, Gas Supply
Robert A. Young as Assistant Vice President and Chief Engineer

Parent expressly reserves the right to restructure the operations of the Valley Division or the New England Business Unit at any time and from time to time in any manner that it deems appropriate in its sole discretion.

ARTICLE VIII
CONDITIONS

Section 8.1 *Conditions to Each Party's Obligation to Effect the Mergers.* The respective obligations of each party to effect the Mergers shall be subject to the satisfaction at or prior to the Closing of the following conditions, except, to the extent permitted by applicable law, that such conditions may be waived in writing pursuant to Section 9.5 by the joint action of the parties hereto:

(a) Shareholder Approval. The Company Shareholders' Approval shall have been obtained.

(b) No Injunction. No temporary restraining order or preliminary or permanent injunction or other order by any federal or state court preventing consummation of the Mergers shall have been issued and be continuing in effect, and the Mergers and the other transactions contemplated hereby shall not have been prohibited under any applicable federal or state law or regulation.

Section 8.2 *Conditions to Obligation of Parent to Effect the Mergers.* The obligation of Parent to effect the Mergers shall be further subject to the satisfaction, at or prior to the Closing, of the following conditions, except as may be waived by Parent in writing pursuant to Section 9.5:

(a) Performance of Obligations of the Company. The Company (and its appropriate Subsidiaries) shall have performed in all material respects its agreements and covenants contained in or contemplated by this Agreement to be performed by it at or prior to the Effective Time.

(b) Representations and Warranties. The representations and warranties of the Company set forth in this Agreement shall be true and correct (i) on and as of the date hereof and (ii) on and as of the Closing Date with the same effect as though such representations and warranties had been made on and as of the Closing Date (except for representations and warranties that expressly speak only as of a specific date or time other than the date hereof or the Closing Date, which need only be true and correct as of such date or time) except in the case of clauses (i) and (ii) for such failures of representations or warranties to be true and correct (without regard to any materiality qualifications contained in any of such representations or warranties) which, individually and in the aggregate, would not be reasonably likely to result in a Company Material Adverse Effect.

(c) Closing Certificates. Parent shall have received a certificate signed by an authorized officer of the Company, dated the Closing Date, to the effect that the conditions set forth in Section 8.2(a) and Section 8.2(b) of this Agreement have been satisfied.

(d) Statutory Approvals. The Company Required Statutory Approvals, the Parent Required Statutory Approvals and all other approvals, consents, opinions or rulings of Governmental Authorities required in order to consummate the transactions contemplated

hereby, shall have been obtained, such approvals shall have become Final Orders (as defined below) and such Final Orders shall not impose terms or conditions which, individually or in the aggregate, would be reasonably likely to have a Company Material Adverse Effect or a material adverse effect on the business, operations, properties, financial condition or results of operation of Parent, or which would otherwise, in the reasonable determination of Parent, be unduly burdensome to Parent in a manner that would be, individually or in the aggregate, reasonably likely to have, a Company Material Adverse Effect or a material adverse effect on the business, operations, properties, financial condition or results of operation of Parent. A "Final Order" means an action by a Governmental Authority as to which: (a) no request for stay of the action is pending, no such stay is in effect and if any time period is permitted by statute or regulation for filing any request for such stay, such time period has passed; (b) no petition for rehearing, reconsideration or application for review of the action is pending and the time for filing any such petition or application has passed; (c) such Governmental Authority does not have the action under reconsideration on its own motion and the time in which such reconsideration is permitted has passed; and (d) no appeal to a court, or a request for stay by a court of the Governmental Authority's action is pending or in effect and the deadline for filing any such appeal or request has passed. The applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, with respect to the transactions contemplated hereby, shall have expired or been terminated.

(e) No Company Material Adverse Effect. No Company Material Adverse Effect shall have occurred, and there shall exist no fact or circumstance other than facts and circumstances disclosed in the Company SEC Reports delivered to Parent prior to the date of this Agreement which is reasonably likely to have a Company Material Adverse Effect.

(f) Company Required Consents. Each of the Company Required Consents shall have been obtained to the reasonable satisfaction of Parent, other than any such consents which, if not obtained, are not, individually or in the aggregate, reasonably likely to result in a Company Material Adverse Effect after the Closing. In addition, all consents and approvals required under the terms of any note, bond or indenture listed in Section 4.4(b) of the Company Disclosure Schedule to which the Company or any of its Subsidiaries is a party, shall have been obtained.

(g) Resignations. Each director of the Company, and each director of the Subsidiaries of the Company, shall resign or retire as a director of the applicable entity effective as of the Effective Time in accordance with such entity's organizational documents and applicable provisions of the RIBCA or other applicable state law, as the case may be; provided, however, that such resignations (but not retirements) shall not cause the termination of any such person's employment as an employee of the Company or its Subsidiaries.

(h) Tax Good Standing. Letters of Tax Good Standing shall have been obtained for the Company and its Subsidiaries from the Rhode Island Department of Taxation.

(i) Company Bondholders' Consent. All holders of each series of First Mortgage Bonds issued and outstanding under the Indenture of First Mortgage, dated as of December 15, 1992, between Valley, the Company, as Guarantor, and State Street Bank and Trust Company, as Trustee, and all holders of each series of debentures issued and outstanding under the Indenture

between the Company and Mellon Bank, N.A., dated as of September 1, 1997, each as amended or supplemented from time to time, shall have consented to such amendments to such Indentures as requested by Parent.

(j) Legislative Actions. The Legislative Actions shall have been completed.

Section 8.3 *Conditions to Obligation of the Company to Effect the Mergers.* The obligation of the Company to effect the Mergers shall be further subject to the satisfaction, on or prior to the Closing Date, of the following conditions, except as may be waived by the Company in writing pursuant to Section 9.5:

(a) Performance of Obligations of Parent. Parent shall have performed in all material respects its agreements and covenants contained in or contemplated by this Agreement to be performed by it at or prior to the Effective Time.

(b) Representations and Warranties. The representations and warranties of Parent set forth in this Agreement shall be true and correct (i) on and as of the date hereof and (ii) on and as of the Closing Date with the same effect as though such representations and warranties had been made on and as of the Closing Date (except for representations and warranties that expressly speak only as of a specific date or time other than the date hereof or the Closing Date, which need only be true and correct as of such date or time) except in the case of clauses (i) and (ii) for such failures of representations or warranties to be true and correct (without regard to any materiality qualifications contained in any of such representations and warranties) which, in the aggregate, would not be reasonably likely to result in a Parent Material Adverse Effect.

(c) Statutory Approvals. The Company Required Statutory Approvals and the Parent Required Statutory Approvals shall have been obtained. The applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, with respect to the transactions contemplated hereby, shall have expired or been terminated.

(d) Closing Certificates. The Company shall have received a certificate signed by an authorized officer of Parent, dated the Closing Date, to the effect that the conditions set forth in Section 8.3(a) and Section 8.3(b) of this Agreement have been satisfied.

ARTICLE IX
TERMINATION, AMENDMENT AND WAIVER

Section 9.1 *Termination.* This Agreement may be terminated at any time prior to the Closing Date, whether before or after approval by the shareholders of the Company contemplated by this Agreement:

(a) by mutual written consent of the Company and Parent;

(b) by any party hereto, by written notice to the other parties, if the Effective Time shall not have occurred on or before the date that is 15 months from the date hereof (the "Initial Termination Date"); provided,

however, that if on the Initial Termination Date the conditions to the Closing set forth in Section 8.2(d), 8.3(c) or 8.2(j) shall not have been fulfilled but all other conditions to the Closing shall be fulfilled or shall be capable of being fulfilled, then the Initial Termination Date shall be extended to the 18-month anniversary of the date hereof; and provided, further, that the right to terminate this Agreement under this Section 9.1(b) shall not be available to any party whose failure to fulfill any obligation under this Agreement or whose breach of any agreement or covenant has been the cause of, or resulted directly or indirectly in, the failure of the Effective Time to occur on or before the Initial Termination Date or as it may be so extended;

(c) by any party hereto, by written notice to the other parties, if the Company Shareholders' Approval shall not have been obtained at a duly held Company Special Meeting, including any adjournments thereof, by the Initial Termination Date;

(d) by any party hereto, by written notice to the other parties if any state or federal law, order, rule or regulation is adopted or issued, which has the effect of prohibiting the Mergers, or by any party hereto if any court of competent jurisdiction in the United States or any State shall have issued an order, judgment or decree permanently restraining, enjoining or otherwise prohibiting the Mergers, and such order, judgment or decree shall have become final and nonappealable;

(e) by the Company prior to the time at which the Company Shareholders' Approval shall have been obtained, upon five days' prior written notice to Parent, if the Board of Directors of the Company determines in good faith that termination of this Agreement is necessary for the Board of Directors of the Company to act in a manner consistent with its fiduciary duties to shareholders under applicable law by reason of an Alternative Proposal meeting the requirements of Section 6.2 having been made; provided that

(A) the Board of Directors of the Company shall determine based on advice of outside counsel with respect to the Board of Directors' fiduciary duties that notwithstanding a binding commitment to consummate an agreement of the nature of this Agreement entered into in the proper exercise of its applicable fiduciary duties, and notwithstanding all concessions which may be offered by Parent in negotiation entered into pursuant to Section 6.2(b), it is necessary pursuant to such fiduciary duties that the directors reconsider such commitment as a result of such Alternative Proposal;

(B) the other provisions of Section 6.2(b) have been complied with by the Company; and

(C) the Company's ability to terminate this Agreement pursuant to Section 9.1(e) is conditioned upon the payment by the Company to Parent of the amounts owed by it pursuant to Section 9.3;

(f) by the Company, by written notice to Parent, if (i) there exist breaches of the representations and warranties of Parent made herein as of the date hereof which breaches, individually or in the aggregate, would or would be reasonably likely to result in a Parent Material Adverse Effect, and such breaches shall not have been remedied within 20 days after receipt by Parent of notice in writing from the Company, specifying the nature of such breaches and requesting that they be remedied, or (ii) Parent shall have failed to perform and comply with, in all material respects, its agreements and covenants hereunder, and such failure to perform or comply shall not have been remedied within 20 days after receipt by Parent of notice in writing from the Company, specifying the nature of such failure and requesting that it be remedied;

(g) by Parent, by written notice to the Company, if (i) there exist breaches of the representations and warranties of the Company made herein as of the date hereof which breaches, individually or in the aggregate, would or would be reasonably likely to result in a Company Material Adverse Effect, and such breaches shall not have been remedied within 20 days after receipt by the Company of notice in writing from Parent, specifying the nature of such breaches and requesting that they be remedied, (ii) the Company (or its appropriate Subsidiaries) shall not have performed and complied with its agreements and covenants contained in Sections 6.1(b) and 6.1(c) or shall have failed to perform and comply with, in all material respects, its other agreements and covenants hereunder, and such failure to perform or comply shall not have been remedied within 20 days after receipt by the Company of notice in writing from Parent, specifying the nature of such failure and requesting that it be remedied, or (iii) the Board of Directors of the Company or any committee thereof (A) shall withdraw or modify or proposes to withdraw or modify in any manner adverse to Parent its approval or recommendation of this Agreement or the transactions contemplated hereby, (B) shall fail to reaffirm such approval or recommendation upon Parent's request within two days of such request, (C) shall approve or recommend any acquisition of the Company or any of its Subsidiaries or a material portion of their respective assets or any tender offer for the shares of capital stock of the Company or any of its Subsidiaries or any other Alternative Proposal, in each case by a party other than Parent or any of its Affiliates, (D) causes the Company or any of its Subsidiaries to enter into a definitive agreement related to the Alternative Proposal or (E) shall resolve to take any of the actions specified in clause (A), (B), (C) or (D); or

(h) by Parent, by written notice to Company, if a third party, including a group (as defined under the Exchange Act), acquires securities representing greater than 50% of the voting power of the outstanding voting securities of Company.

Section 9.2 *Effect of Termination.* In the event of termination of this Agreement by either the Company or Parent pursuant to Section 9.1, there shall be no liability on the part of any party or its Affiliates, shareholders, officers or directors, agents or other representatives hereunder; provided, however, that (i) any fee payable under Section 9.3 is paid to Parent and (ii) no such termination shall relieve any party of liability for any claims, damages or losses suffered by the other party as a result of the negligent or willful failure of a party to perform any obligations required to be performed by it hereunder on or prior to the date of termination and (iii) the agreement contained in the last sentence of Section 7.1(a) and Sections 7.11, 9.3, 10.3, 10.4, 10.5, 10.6, 10.7, 10.8, 10.9 and 10.10 shall survive any termination of this Agreement.

Section 9.3 *Termination Fee; Expenses.*

(a) The Company shall pay Parent a fee of $5.0 million in cash ("Termination Fee") upon the termination of this Agreement by the Company pursuant to Section 9.1(e) or by Parent pursuant to Section 9.1(g)(iii) or 9.1(h).

(b) Liquidated Damages; Prompt Payment. The parties agree that the agreements contained in this Section 9.3 are an integral part of the transactions contemplated by the Agreement and constitute liquidated damages and not a penalty. If the Company fails to pay promptly to Parent the fee due under Section 9.3, in addition to any amounts paid or payable pursuant to Section 9.3, the Company shall pay the costs and expenses (including legal fees and expenses) in connection with any action, including the filing of any lawsuit or other legal action, taken to collect payment, together with interest on the amount of any unpaid fee at the prime rate published in *The Wall Street Journal* on the date (or preceding business day if such date is not a business day) such fee was required to be paid, compounded on a daily basis using a 360-day year.

Section 9.4 *Amendment.* This Agreement may be amended by the Boards of Directors of the parties hereto, at any time before or after approval hereof by the shareholders of the Company and prior to the Effective Time, but after such approvals, no such amendment shall (a) alter or change the amount of the Merger Consideration, or (b) alter or change any of the terms and conditions of this Agreement if any of the alterations or changes, alone or in the aggregate, would materially adversely affect the rights of holders of Company capital stock, except for alterations or changes that could otherwise be adopted by the Board of Directors of the Company, without the further approval of such shareholders. This Agreement may not be amended except by an instrument in writing signed on behalf of each of the parties hereto.

Section 9.5 *Waiver.* At any time prior to the Effective Time, the parties hereto may (a) extend the time for the performance of any of the obligations or other acts of the other parties hereto, (b) waive any inaccuracies in the representations and warranties contained herein or in any document delivered pursuant hereto and (c) waive compliance with any of the agreements or

conditions contained herein, to the extent permitted by applicable law. Any agreement on the part of a party hereto to any such extension or waiver shall be valid if set forth in an instrument in writing signed on behalf of such party. Except as otherwise expressly provided in this Agreement, neither the failure nor any delay on the part of any party to exercise any right, power or privilege hereunder shall operate as a waiver thereof, nor shall any single or partial exercise or waiver of any such right, power or privilege preclude any other or further exercise thereof, or the exercise of any other right, power or privilege available to each party at law or in equity.

ARTICLE X
GENERAL PROVISIONS

Section 10.1 *Non-survival.* All representations, warranties and agreements in this Agreement shall not survive the Merger, except as otherwise provided in this Agreement and except for the agreements contained in this Section 10.1, in Articles I and II and in Sections 7.5, 7.11, 9.3, 10.3, 10.4, 10.5, 10.6, 10.7, 10.8, 10.9 and 10.10.

Section 10.2 *Brokers.* The Company represents and warrants that, except for PaineWebber Incorporated whose fees have been disclosed to Parent prior to the date hereof, no broker, finder or investment banker is entitled to any brokerage, finder's or other fee or commission in connection with the Mergers or the transactions contemplated by this Agreement based upon arrangements made by or on behalf of the Company or any of its Subsidiaries. Parent represents and warrants that no broker, finder or investment banker is entitled to any brokerage, finder's or other fee or commission in connection with the Mergers or the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Parent.

Section 10.3 *Notices.* All notices and other communications hereunder shall be in writing and shall be deemed given if (a) delivered personally, (b) sent by reputable overnight courier service on the business day after mailing, (c) telecopied (which is confirmed) (if confirmed during business hours) at the time of such confirmation or (if confirmed outside of business hours) the next business day or (d) mailed by registered or certified mail (return receipt requested) five days after being so mailed, in each case to the parties at the following addresses (or at such other address for a party as shall be specified by like notice):

(i) If to the Company, to:

Valley Resources, Inc.
1595 Mendon Road
P.O. Box 7900
Cumberland, Rhode Island 06144
Attention: Sharon Partridge
Vice President, Chief Financial Officer, Secretary and Treasurer
Telephone: (401) 334-1188
Telecopy: (401) 334-9135

with a copy to:

Edwards and Angell, LLP
51 John F. Kennedy Parkway
Short Hills, New Jersey 07078
Attention: Christine M. Marx, Esq.
Telephone: (973) 921-5219
Telecopy: (973) 376-3380

(ii) If to Parent or Merger Sub, to:

Southern Union Company
504 Lavaca Street, Suite 800
Austin, Texas 78701
Attention: Peter H. Kelley
President and Chief Operating Officer
Telephone: (512) 370-8307
Telecopy: (512) 477-3879

with a copy to:

Hughes Hubbard & Reed LLP
One Battery Park Plaza
New York, New York 10004
Attention: Kenneth A. Lefkowitz, Esq.
Telephone: (212) 837-6557
Telecopy: (212) 422-4726

Section 10.4 *Miscellaneous.* This Agreement (including the documents and instruments referred to herein) (a) constitutes the entire agreement and supersedes all other prior agreements and understandings, both written and oral, among the parties, or any of them, with respect to the subject matter hereof other than the Confidentiality Agreement; and (b) shall not be assigned by operation of law or otherwise without the prior written consent of the other parties hereto. Any assignment in violation of the terms of this Agreement shall be null and void *ab initio*. This Agreement shall be construed in accordance with and governed by the laws of the State of New York (without regard to its principles of conflicts of law other than Sections 5-1401 and 5-1402 of the New York General Obligations Law), including all matters of construction, validity and performance, except to the extent that the terms and consummation of the Mergers are subject to the Delaware General Corporation Law or the RIBCA, in which case such laws shall govern.

Section 10.5 *Interpretation.* When a reference is made in this Agreement to Sections or Exhibits, such reference shall be to a Section or Exhibit of this Agreement, respectively, unless otherwise indicated. The table of contents and headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this

Agreement. Whenever the words "include," "includes" or "including" are used in this Agreement, they shall be deemed to be followed by the words "without limitation."

Section 10.6 *Counterparts; Effect.* This Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original, but all of which shall constitute one and the same agreement.

Section 10.7 *Parties in Interest.* This Agreement shall be binding upon and inure solely to the benefit of each party hereto and their respective successors and permitted assigns, and, except for rights of Indemnified Parties as set forth in Section 7.5, nothing in this Agreement, express or implied, is intended to confer upon any other person any rights or remedies of any nature whatsoever under or by reason of this Agreement.

Section 10.8 *Waiver of Jury Trial.* Each party to this Agreement waives, to the fullest extent permitted by applicable law, any right it may have to a trial by jury in respect of any action, suit or proceeding arising out of this Agreement.

Section 10.9 *Enforcement.* The parties agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that the parties shall be entitled to an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement in any court of the United States located in the State of Rhode Island or in the Southern District of New York in the county of New York and the borough of Manhattan, or in Rhode Island state court or in New York state court in the county of New York and the borough of Manhattan, this being in addition to any other remedy to which they are entitled at law or in equity. In addition, each of the parties hereto (a) consents to submit itself to the personal jurisdiction of any federal court located in the State of Rhode Island or in the Southern District of New York in the county of New York and the borough of Manhattan, or any Rhode Island state court or in any New York state court in the county of New York and the borough of Manhattan in the event any dispute arises out of this Agreement or any of the transactions contemplated by this Agreement, (b) agrees that it will not attempt to deny such personal jurisdiction by motion or other request for leave from any such court and (c) agrees that it will not bring any action relating to this Agreement or any of the transactions contemplated by this Agreement in any court other than a federal or state court sitting in the State of Rhode Island or in the county of New York and the borough of Manhattan.

Section 10.10 *Construction of Agreement.* The terms and provisions of this Agreement represent the results of negotiations between the parties and their representatives, each of which has been represented by counsel of its own choosing, and neither of which has acted under duress or compulsion, whether legal, economic or otherwise. Accordingly, the terms and provisions of this Agreement shall be interpreted and construed in accordance with their usual and customary meanings, and each of the parties hereto hereby waives the application in connection with the interpretation and construction of this Agreement of any rule of law to the effect that ambiguous or conflicting terms or provisions contained in this Agreement shall be interpreted or construed against the party whose attorney prepared the executed draft or any earlier draft of this Agreement.

[Signature Page Follows]

IN WITNESS WHEREOF, the Company, Parent and Merger Sub have caused this Agreement to be signed by their respective officers thereunto duly authorized as of the date first written above.

VALLEY RESOURCES, INC.

By:_____
Name: Alfred P. Degen
Title: President and Chief Executive Officer

SOUTHERN UNION COMPANY

By:_____
Name: Peter H. Kelley
Title: President and Chief Operating Officer

SUG ACQUISITION CORPORATION

By:_____
Name: Peter H. Kelley
Title: President

IN WITNESS WHEREOF, the Company, Parent and Merger Sub have caused this Agreement to be signed by their respective officers thereunto duly authorized as of the date first written above.

VALLEY RESOURCES, INC.

By:_____
Name: Alfred P. Degen
Title: President and Chief Executive Officer

SOUTHERN UNION COMPANY

By: Peter H. Kelley
Name: Peter H. Kelley
Title: President and Chief Operating Officer

SUG ACQUISITION CORPORATION

By: Peter H. Kelley
Name: Peter H. Kelley
Title: President

LEGAL APPROVAL

AGREEMENT OF MERGER

between

SOUTHERN UNION COMPANY

and

FALL RIVER GAS COMPANY

Dated as of October 4, 1999

MERGER OF

FALL RIVER GAS COMPANY

WITH AND INTO

SOUTHERN UNION COMPANY

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AGREEMENT OF MERGER

This AGREEMENT OF MERGER (this "Agreement") is made as of the 4th day of October, 1999, by and between SOUTHERN UNION COMPANY, a Delaware corporation ("SUG"), and FALL RIVER GAS COMPANY, a Massachusetts corporation ("FAL").

RECITALS

WHEREAS, the Board of Directors of each of SUG and FAL has approved and deems it advisable and in the best interests of their respective stockholders to consummate the merger of FAL with and into SUG upon the terms and subject to the conditions set forth herein; and

WHEREAS, in furtherance thereof, the Board of Directors of each of SUG and FAL has approved this Agreement and the merger of FAL with and into SUG, with SUG being the surviving corporation (the "Merger");

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants and agreements herein contained, and intending to be legally bound hereby, SUG and FAL hereby agree as follows:

ARTICLE I
DEFINITIONS

Section 1.1 Certain Defined Terms. For purposes of this Agreement, the following terms have the meanings specified or referred to in this Article I (such definitions to be equally applicable to both the singular and plural forms of the terms defined):

"*Acquired Companies*"--FAL and its Subsidiaries, collectively, and each, an "Acquired Company."

"*Affiliate*"--with respect to any Person, any other Person that directly, or through one or more intermediaries, controls or is controlled by or is under common control with such first Person. As used in this definition, "control" (including with correlative meanings, "controlled by" and "under common control with") shall mean possession, directly or indirectly, of power to direct or cause the direction of management or policies (whether through ownership of securities or partnership or other ownership interests, by contract or otherwise).

"*Applicable Contract*"--any Contract (a) under which any Acquired Company has any rights, (b) under which any Acquired Company has any obligation or liability, or (c) by which any Acquired Company or any of the assets owned or used by it is bound.

"*Average Trading Price*"--of SUG Common Stock, as of any date, will equal the average of the reported closing market prices of such stock for the ten consecutive trading days ending on the third trading day prior to such date (counting from and including the trading day immediately preceding such date). The closing market price for each day in question will be the last sale price, regular way or, if no such sale takes place on such day, the average of the closing bid and

asked prices, regular way, in either case as reported in the principal consolidated transaction reporting system of the principal national securities exchange on which SUG Common Stock is listed or admitted to trading.

"*CERCLA*"--the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended.

"*Closing Date*"--the date on which the Closing actually takes place.

"*Contract*"--any agreement, contract, document, instrument, obligation, promise or undertaking (whether written or oral) that is legally binding.

"*DGCL*"--the Delaware General Corporation Law.

"*Encumbrance*"--any charge, adverse claim, lien, mortgage, pledge, security interest or other encumbrance.

"*Environment*"--soil, land surface or subsurface strata, surface waters (including navigable waters, ocean waters, streams, ponds, drainage basins, and wetlands), groundwaters, drinking water supply, stream sediments, ambient air (including indoor air), plant and animal life, and any other environmental medium or natural resource.

"*Environmental Law*"--any Legal Requirement that requires or relates to:

(a) advising appropriate authorities, employees, and the public of intended or actual releases of pollutants or hazardous substances or materials, violations of discharge limits, or other prohibitions and of the commencements of activities, such as resource extraction or construction, that could have significant impact on the Environment;

(b) preventing or reducing to acceptable levels the release of pollutants or hazardous substances or materials into the Environment;

(c) reducing the quantities, preventing the release, or minimizing the hazardous characteristics of wastes that are generated;

(d) reducing to acceptable levels the risks inherent in the transportation of hazardous substances, pollutants, oil, or other potentially harmful; or

(e) making responsible parties pay private parties, or groups of them, for damages done to their health or the Environment, or permitting self-appointed representatives of the public interest to recover for injuries done to public assets or for damages to natural resources.

"*ERISA*"--the Employee Retirement Income Security Act of 1974, as amended, or any successor law, and regulations and rules issued pursuant to that act or any successor law.

"*Exchange Act*"--the Securities Exchange Act of 1934, as amended, or any successor law, and regulations and rules issued by the SEC pursuant to that act or any successor law.

"*Facilities*"--any real property, leaseholds, or other interests currently or formerly owned or operated by any Acquired Company and any buildings, plants, structures, or equipment (including motor vehicles, tank cars, and rolling stock) currently or formerly owned or operated by any Acquired Company.

"*FAL Balance Sheet*"--the audited consolidated balance sheet of the Acquired Companies at September 30, 1998 (including the notes thereto), provided by FAL to SUG as part of the FAL Financial Statements.

"*FAL Common Stock*"--the common stock, par value $.83^{1}/_{3}$ per share, of FAL.

"*FAL Disclosure Schedule*"--the disclosure schedule delivered by FAL to SUG concurrently with the execution and delivery of this Agreement.

"*FAL Material Adverse Effect*"--a material adverse effect (i) on the business, operations, financial condition or results of operations of FAL and its Subsidiaries, taken as a whole, or (ii) on the ability of FAL and its Subsidiaries to consummate the Merger in accordance with this Agreement.

"*FAL Permitted Liens*"--Encumbrances securing Taxes, assessments, governmental charges or levies, or the claims of materialmen, mechanics, carriers and like persons, all of which are not yet due and payable or which are being contested in good faith; Encumbrances (other than any Encumbrance imposed by ERISA) incurred on deposits made in the Ordinary Course of Business in connection with worker's compensation, unemployment insurance or other types of social security; the Encumbrances created by the Indenture of First Mortgage, dated as of December 1, 1952, between FAL and State Street Bank and Trust Company, successor in interest to the First National Bank of Boston, successor by merger to Old Colony Trust Company, as Trustee, as amended or supplemented from time to time; in the case of leased real property, Encumbrances (not attributable to an Acquired Company as lessee) affecting the landlord's (and any underlying landlord's) interest in any leased real property; and such other Encumbrances which are not, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect.

"*Final Order*"--an action by a Governmental Body as to which: (a) no request for stay of the action is pending, no such stay is in effect and if any time period is permitted by statute or regulation for filing any request for such stay, such time period has passed; (b) no petition for rehearing, reconsideration or application for review of the action is pending and the time for filing any such petition or application has passed; (c) such Governmental Body does not have the action under reconsideration on its own motion and the time in which such reconsideration is permitted has passed; and (d) no appeal to a court, or a request for stay by a court of the Governmental Body's action is pending or in effect and the deadline for filing any such appeal or request has passed.

"*GAAP*"--generally accepted United States accounting principles, applied on a consistent basis.

"*Governmental Authorization*"--any approval, consent, license, franchise, certificate of public convenience and necessity, permit, waiver or other authorization issued, granted, given, or otherwise made available by or under the authority of any Governmental Body or pursuant to any Legal Requirement.

"*Governmental Body*"--any:

(a) nation, state, county, city, town, village, district or other jurisdiction of any nature;

(b) federal, state, county, local, municipal or other government;

(c) governmental or quasi-governmental authority of any nature (including any governmental agency, branch, department, official or entity and any court or other tribunal); or

(d) body exercising, or entitled to exercise, any administrative, executive, judicial, legislative, police, regulatory or taxing authority or power of any nature.

"*Hazardous Activity*"--the distribution, generation, handling, importing, management, manufacturing, processing, production, refinement, Release, storage, transfer, transportation, treatment, or use (including any withdrawal or other use of groundwater) of Hazardous Materials in, on, under, about, or from the Facilities or any part thereof into the Environment, any other act, business, operation, or thing that increases the danger, or risk of danger, or poses an unreasonable risk of harm to persons or property on or off the Facilities, or that may affect the value of the Facilities or the Acquired Companies.

"*Hazardous Materials*"--any waste or other substance that is listed, defined, designated, or classified as, or otherwise determined to be, hazardous, radioactive, or toxic or a pollutant or a contaminant under or pursuant to any Environmental Law, including any admixture or solution thereof, and specifically including petroleum and all derivatives thereof or synthetic substitutes therefor and asbestos or asbestos-containing materials.

"*HSR Act*"--the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, or any successor law, and regulations and rules issued by the U.S. Department of Justice or the Federal Trade Commission pursuant to that act or any successor law.

"*IRC*"--the Internal Revenue Code of 1986, as amended.

"*IRS*"--the Internal Revenue Service or any successor agency.

"*Knowledge*"--an individual will be deemed to have "Knowledge" of a particular fact or other matter if such individual is actually aware of such fact or other matter. A Person (other

than an individual) will be deemed to have "Knowledge" of a particular fact or other matter if any individual who is serving as a director or officer of such Person or any material Subsidiary of it or other management employee with direct responsibility for such particular fact or other matter of such Person or any material Subsidiary of it (or in any similar capacity) has actual knowledge of such fact or other matter.

"*Legal Requirement*"--any federal, state, county, local, municipal, foreign, international, multinational, or other administrative order, constitution, law, ordinance, principle of common law, regulation, rule, tariff, franchise agreement, statute or treaty.

"*Material Contract*"--a Contract involving a total commitment by or to any party thereto of at least $65,000 on an annual basis or at least $250,000 on its remaining term which cannot be terminated on no more than sixty (60) days' notice without penalty or additional cost to the Acquired Company as the terminating party.

"*MBCL*"--the Massachusetts Business Corporation Law.

"*Order*"--any award, decision, decree, injunction, judgment, order, writ, ruling, subpoena, or verdict entered, issued, made, or rendered by any court, administrative agency, or other Governmental Body or by any arbitrator.

"*Ordinary Course of Business*"--an action taken by a Person will be deemed to have been taken in the "Ordinary Course of Business" only if:

(a) such action and authorization therefor is consistent with the past practices of such Person and is taken in the ordinary course of the normal day-to-day operations of such Person; and

(b) such action is not required by law to be authorized by the board of directors (or similar authority) of such Person or of such Person's parent company (if any).

"*Organizational Documents*"--(a) the articles or certificate of incorporation or organization and the bylaws of a corporation; (b) the partnership agreement and any statement of partnership of a general partnership; (c) the limited partnership agreement and the certificate of limited partnership of a limited partnership; (d) the certificate of formation and the members, operating or similar agreement of a limited liability company; (e) any charter or similar document adopted or filed in connection with the creation, formation or organization of a Person; and (f) any amendment to any of the foregoing.

"*Person*"--any individual, corporation (including any non-profit corporation), general or limited partnership, limited liability company, joint venture, estate, trust, association, organization, labor union, organized group of persons, entity of any other type, or Governmental Body.

"*Proceeding*"--any action, arbitration, hearing, litigation or suit (whether civil, criminal, administrative, investigative, or informal) commenced, brought, conducted, or heard by or before, or otherwise involving, any Governmental Body or arbitrator.

"*PUHCA*"--the Public Utility Holding Company Act of 1935, as amended, or any successor law, and regulations and rules issued by the SEC pursuant to that act or any successor law.

"*Related Documents*"--any Contract provided for in this Agreement to be entered into by one or more of the parties hereto or their respective Subsidiaries in connection with the Merger.

"*Release*"--any spilling, leaking, emitting, discharging, depositing, escaping, leaching, dumping, or other releasing into the Environment, whether intentional or unintentional.

"*Representative*"--with respect to a particular Person, any director, officer, employee, agent, consultant, advisor, or other representative of such Person, including legal counsel, accountants, and financial advisors.

"*SEC*"--the United States Securities and Exchange Commission or any successor agency.

"*Securities Act*"--the Securities Act of 1933, as amended, or any successor law, and regulations and rules issued by the SEC pursuant to that act or any successor law.

"*Subsidiary*"--with respect to any Person (the "Owner"), any Person of which securities or other interests having the power to elect a majority of that other Person's board of directors or similar governing body, or otherwise having the power to direct the business and policies of that corporation or other Person (other than securities or other interests having such power only upon the happening of a contingency that has not occurred) are held by the Owner or one or more of its Subsidiaries; when used without reference to a particular Person, "Subsidiary" means a Subsidiary of FAL.

"*SUG Balance Sheet*"--the audited consolidated balance sheet of SUG at June 30, 1999 (including the notes thereto), provided by SUG to FAL as part of the SUG Financial Statements.

"*SUG Common Stock*"--the common stock, par value $1.00 per share, of SUG.

"*SUG Disclosure Schedule*"--the disclosure schedule delivered by SUG to FAL concurrently with the execution and delivery of this Agreement.

"*SUG Material Adverse Effect*"--a material adverse effect (i) on the business, operations, financial condition or results of operations of SUG and its Subsidiaries, taken as a whole, or (ii) on the ability of SUG to consummate the Merger in accordance with this Agreement.

"*Tax*"--any tax (including any income tax, capital gains tax, value-added tax, sales and use tax, franchise tax, payroll tax, withholding tax or property tax), levy, assessment, tariff, duty (including any customs duty), deficiency, franchise fee or payment, payroll tax, utility tax, gross

receipts tax or other fee or payment, and any related charge or amount (including any fine, penalty, interest or addition to tax), imposed, assessed or collected by or under the authority of any Governmental Body or payable pursuant to any tax-sharing agreement or any other Contract relating to the sharing or payment of any such tax, levy, assessment, tariff, duty, deficiency or fee.

"*Tax Return*"--any return (including any information return), report, statement, schedule, notice, form, or other document or information filed with or submitted to, or required to be filed with or submitted to, any Governmental Body in connection with the determination, assessment, collection, or payment of any Tax or in connection with the administration, implementation, or enforcement of or compliance with any Legal Requirement relating to any Tax.

"*Threatened*"--a claim, Proceeding, dispute, action, or other matter will be deemed to have been "Threatened" if any demand or statement has been made (orally or in writing) or any notice has been given (orally or in writing), or if any other event has occurred or any other circumstance exists, that would lead a director, officer or management employee of a comparable gas distribution company to conclude that such a claim, Proceeding, dispute, action, or other matter is likely to be asserted, commenced, taken or otherwise pursued in the future.

Section 1.2 Other Defined Terms. In addition to the terms defined in Section 1.1, certain other terms are defined elsewhere in this Agreement as indicated below and, whenever such terms are used in this Agreement, they shall have their respective defined meanings.

Term	Section
Agreement	Introductory Paragraph
Business Combination	6.1(h)(4)
Cash Consideration	3.1(a)
Cash Election	3.1(b)
Cash Election Number	3.1(b)
Cash Election Shares	3.1(c)
Cash Fraction	3.1(c)
Certificates	3.2(c)
Closing	2.3
Confidentiality Agreement	6.1(c)(1)
Dissenting Shares	3.3
Effective Time	2.2
Election Deadline	3.2(b)

Employees	6.2(b)
Exchange Ratio	3.1(a)
FAL	Introductory Paragraph
FAL Benefit Plans	5.18(a)
FAL Commonly Controlled Entity	5.18(e)
FAL Financial Statements	5.9
FAL Meeting	6.1(j)(1)
FAL Proxy Statement	4.18
FAL SEC Documents	5.9
FAL Stockholders' Approval	5.24
Form of Election	3.2(b)
Indemnified Parties	9.1(a)
Initial Termination Date	8.1(k)
Maximum Value	3.1(a)
Merger	Recitals
Merger Consideration	3.1(a)
Minimum Value	3.1(a)
NYSE	3.1(e)
Paying Agent	3.2(a)
PBGC	4.14(b)
PEI	4.2
PEI Merger Agreement	4.2
Registration Statement	4.18
Rule 145 Affiliates	6.1(k)
Rule 145 Letters	6.1(k)
Stock Consideration	3.1(a)
SUG	Introductory Paragraph
SUG Benefit Plans	4.14(a)
SUG Commonly Controlled Entity	4.14(d)

SUG Financial Statements	4.9
SUG SEC Documents	4.9
Superior Proposal	6.1(h)(4)
Surviving Corporation	2.1
Third Party Beneficiary	10.11
Total Consideration	3.1(e)

ARTICLE II
THE MERGER; OTHER TRANSACTIONS

Section 2.1 The Merger. Upon the terms and subject to the conditions of this Agreement, at the Effective Time, FAL will be merged with and into SUG in accordance with the laws of the State of Delaware and the Commonwealth of Massachusetts. SUG will be the surviving corporation in the Merger (the "Surviving Corporation") and will continue its corporate existence under the laws of the State of Delaware. The Merger will have the effect as provided in the applicable provisions of the DGCL and the MBCL. Without limiting the generality of the foregoing, upon the Merger, all the rights, privileges, immunities, powers and franchises of FAL and SUG will vest in the Surviving Corporation and all obligations, duties, debts and liabilities of FAL and SUG will be the obligations, duties, debts and liabilities of the Surviving Corporation.

Section 2.2 Effective Time of the Merger. On the Closing Date, with respect to the Merger, (i) a duly executed certificate of merger complying with the requirements of the DGCL will be executed and filed with the Secretary of State of the State of Delaware and (ii) duly executed articles of merger complying with the requirements of the MBCL will be filed with the Secretary of State of the Commonwealth of Massachusetts. The Merger will become effective upon filing the certificate of merger with the Secretary of State of the State of Delaware and the articles of merger with the Secretary of State of the Commonwealth of Massachusetts (the "Effective Time").

Section 2.3 Closing. Unless this Agreement has been terminated and the transactions contemplated herein have been abandoned pursuant to Article VIII hereof, the closing of the transactions contemplated by this Agreement (the "Closing") will take place at 10:00 a.m., Eastern Time, on the Closing Date to be specified by the parties, which shall be no later than the tenth business day after satisfaction or waiver of all of the conditions set forth in Article VII hereof (other than Sections 7.1(a), 7.1(b), 7.1(c), 7.1(f), 7.1(g), 7.1(h), 7.1(k), 7.1(l), 7.2(a), 7.2(b), 7.2(c), 7.2(e), 7.2(f) and 7.2(h), which shall be satisfied or waived on the Closing Date) at the offices of Hughes Hubbard & Reed LLP, New York, counsel to SUG, unless another date or place is agreed to in writing by the parties hereto.

Section 2.4 Certificate of Incorporation; Bylaws. Pursuant to the Merger, the Restated Certificate of Incorporation of SUG, as in effect immediately prior to the Effective Time, shall be the Certificate of Incorporation of the Surviving Corporation until thereafter amended as provided by law and (ii) the bylaws of SUG as in effect immediately prior to the Effective Time, shall be the bylaws of the Surviving Corporation until thereafter amended as provided by law.

Section 2.5 Directors and Officers. The directors and officers of SUG immediately prior to the Effective Time will be the directors and officers of the Surviving Corporation, each to hold office in accordance with the Certificate of Incorporation and bylaws of the Surviving Corporation.

ARTICLE III
CONVERSION OF SHARES

Section 3.1 Effect of the Merger. As of the Effective Time, by virtue of the Merger and without any action on the part of the holders of any shares of FAL Common Stock:

(a) Each issued and outstanding share of FAL Common Stock (other than Dissenting Shares) will be converted into the right of each holder thereof to receive (i) that number of fully paid and nonassessable shares of SUG Common Stock (the "Stock Consideration") equal to $23.50 divided by the Exchange Ratio rounded to the nearest hundred-thousandth or (ii) upon a valid Cash Election as provided in Section 3.1(b), $23.50 in cash (the "Cash Consideration"), subject to the limitations set forth in Section 3.1(b), 3.1(c), and 3.1(e). In the case of the consideration to be received by the holders of FAL Common Stock in the aggregate, "Merger Consideration" shall mean the Cash Consideration together with the Stock Consideration. In the case of the consideration to be received by an individual holder of FAL Common Stock, "Merger Consideration" shall mean the Cash Consideration and/or the Stock Consideration to be received by such holder, as the case may be.

"Exchange Ratio" shall mean the Average Trading Price of SUG Common Stock as of the Closing Date. Notwithstanding the foregoing, if the Exchange Ratio as calculated pursuant to the preceding sentence and without regard to this sentence (i) is less than the Minimum Value, then the Exchange Ratio will be equal to the "Minimum Value," or (ii) is greater than the "Maximum Value," then the Exchange Ratio will be equal to the "Maximum Value." "Minimum Value" will be $16.875 and "Maximum Value" will be $19.6875.

(b) Subject to the immediately following sentence and to Section 3.1(c) and 3.1(e), each record holder of shares of FAL Common Stock immediately prior to the Effective Time shall be entitled to elect to receive cash for all or any part of such shares of FAL Common Stock (a "Cash Election"). Notwithstanding the foregoing, the aggregate number of shares of FAL Common Stock that may be converted into the right to receive cash consideration shall not exceed the Cash Election Number. To the extent not covered by a properly given Cash Election, all shares of FAL Common Stock issued and outstanding immediately prior to the Effective

Time shall, except as provided in Section 3.1(g), be converted solely into shares of SUG Common Stock.

"Cash Election Number" shall equal, subject to reduction pursuant to Section 3.1(e), the amount by which (i) 50% of the number of shares of FAL Common Stock outstanding immediately prior to the Effective Time, exceeds (ii) the sum of (a) the number of shares of FAL Common Stock to be exchanged for cash in lieu of fractional shares pursuant to Section 3.1(g), and (b) the number of Dissenting Shares.

(c) If the aggregate number of shares of FAL Common Stock covered by Cash Elections (the "Cash Election Shares") exceeds the Cash Election Number, each Cash Election Share shall be converted into (i) the right to receive an amount in cash, without interest, equal to the product of (a) $23.50 and (b) a fraction (the "Cash Fraction"), the numerator of which shall be the Cash Election Number and the denominator of which shall be the total number of Cash Election Shares, and (ii) a number of shares of SUG Common Stock equal to the product of (a) $23.50 divided by the Exchange Ratio and (b) a fraction equal to one minus the Cash Fraction.

(d) SUG will make all computations to give effect to this Section 3.1.

(e) If, after having made the calculation under Section 3.1(b), the value of the SUG Common Stock (excluding fractional shares to be paid in cash) to be issued in the Merger, valued at the lesser of the Average Trading Price as of the Closing Date and the closing price of SUG Common Stock on the last trading day before the Closing Date (or, if determined to be more appropriate to ensure the status of the Merger as a reorganization under Section 368(a)(1)(A) of the IRC, the trading price as of the time of the Closing), as reported on the New York Stock Exchange ("NYSE"), is less than 50% of the total consideration to be paid in exchange for the shares of FAL Common Stock (including, without limitation, the amount of cash to be paid in lieu of fractional shares and treating any Dissenting Shares as having been exchanged for the Cash Consideration) (the "Total Consideration"), then the Cash Election Number shall be reduced to the extent necessary so that the value of the SUG Common Stock to be issued in the Merger (as determined above) is 50% of the Total Consideration.

(f) Each holder of FAL Common Stock shall surrender all such holder's certificates formerly representing ownership of FAL Common Stock in the manner provided in Section 3.2. All such shares of FAL Common Stock, when so converted, shall no longer be outstanding and shall be canceled and automatically converted into the right to receive the Merger Consideration (and cash in lieu of fractional shares) therefor upon the surrender of such certificate in accordance with Section 3.2. Any payment made pursuant to this Section 3.1 shall be made net of applicable withholding taxes to the extent such withholding is required by law.

(g) No fractional share of SUG Common Stock shall be issued in connection with the Merger. Each holder of shares of FAL Common Stock shall be entitled to receive in lieu of any fractional share of SUG Common Stock to which such holder otherwise would have been entitled pursuant to this Section 3.1 (after taking into account all shares of FAL Common Stock then held of record by such holder) a cash payment in an amount equal to the product of

(i) the fractional interest of a share of SUG Common Stock to which such holder otherwise would have been entitled and (ii) the closing price of a share of SUG Common Stock on the NYSE on the trading day immediately prior to the Effective Time. Payment of such amounts shall be made by SUG.

Section 3.2 Exchange of FAL Common Stock Certificates.

(a) SUG's registrar and transfer agent, or such other bank or trust company as may be selected by SUG and be reasonably acceptable to FAL, will act as paying agent ("Paying Agent") for the holders of FAL Common Stock in connection with the Merger, pursuant to an agreement providing for the matters set forth in this Section 3.2 and such other matters as may be appropriate and the terms of which shall be reasonably satisfactory to SUG and FAL.

(b) (i) Not fewer than 15 business days prior to the Closing Date, SUG will cause the Paying Agent to mail a form of election (the "Form of Election") to holders of record of shares of FAL Common Stock (as of a record date as close as practicable to the date of mailing). In addition, the Paying Agent will use its reasonable efforts to make the Form of Election available to the Persons who become stockholders of FAL during the period between such record date and the Election Deadline. Any election to receive Cash Consideration contemplated by Section 3.1(b) will have been properly made only if the Paying Agent shall have received at its designated office or offices, by 4:00 p.m., Eastern Time, on the third business day prior to the Closing Date (the "Election Deadline"), a Form of Election properly completed, as set forth in such Form of Election. An election may be revoked only by written notice received by the Paying Agent prior to the Election Deadline. In addition, all elections shall automatically be revoked if the Paying Agent is notified by SUG and FAL that the Merger has been abandoned. SUG shall have the discretion, which it may delegate in whole or in part to the Paying Agent, to determine whether Forms of Election have been properly completed, signed and submitted or revoked pursuant to this Section 3.2(b), and to disregard immaterial defects in Forms of Election. The decision of SUG (or the Paying Agent, as the case may be) in such matters shall be conclusive and binding.

(c) At the Effective Time of the Merger, SUG will instruct the Paying Agent to promptly, and in any event not later than three (3) business days following the Effective Time, mail (and to make available for collection by hand) to each holder of record of a certificate or certificates, which immediately prior to the Effective Time represented outstanding shares of FAL Common Stock (the "Certificates"), whose shares of FAL Common Stock were converted pursuant to Section 3.1(a) into the right to receive the Merger Consideration (and cash in lieu of fractional shares) (i) a letter of transmittal (which shall specify that delivery shall be effected, and risk of loss and title to the Certificates shall pass, only upon delivery of the Certificates to the Paying Agent and shall be in such form and have such other provisions as SUG may reasonably specify) and (ii) instructions (which shall provide that at the election of the surrendering holder Certificates may be surrendered, and payment therefor collected, by hand delivery) for use in effecting the surrender of the Certificates in exchange for payment of the Merger Consideration (and cash in lieu of fractional shares). Upon surrender of a Certificate for cancellation to the

Paying Agent or to such other agent or agents as may be appointed by SUG, together with such letter of transmittal, duly executed, the holder of such Certificate shall be entitled to receive in exchange therefor the Merger Consideration for each share of FAL Common Stock formerly represented by such Certificate (and cash in lieu of fractional shares), to be mailed (or made available for collection by hand if so elected by the surrendering holder) within three (3) business days of receipt thereof, and the Certificate so surrendered shall forthwith be canceled. If payment of the Merger Consideration (and cash in lieu of fractional shares) is to be made to a Person other than the Person in whose name the surrendered Certificate is registered, it shall be a condition of payment that the Certificate so surrendered shall be properly endorsed or shall be otherwise in proper form for transfer and that the Person requesting such payment shall have paid any transfer and other Taxes required by reason of the payment of the Merger Consideration (and cash in lieu of fractional shares) to a Person other than the registered holder of the Certificate surrendered or shall have established to the satisfaction of the Surviving Corporation that such Tax either has been paid or is not applicable. Until surrendered as contemplated by this Section 3.2, each Certificate (other than Certificates representing FAL Common Stock held by SUG or Dissenting Shares) shall be deemed at any time after the Effective Time to represent only the right to receive the Merger Consideration (and cash in lieu of fractional shares) as contemplated by this Section 3.2.

(d) In the event any Certificate shall have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the Person claiming such Certificate to be lost, stolen or destroyed, the Paying Agent will issue in exchange for such lost, stolen or destroyed Certificate the Merger Consideration (and cash in lieu of fractional shares) deliverable in respect thereof as determined in accordance with this Article III, provided that the Person to whom the Merger Consideration (and cash in lieu of fractional shares) is paid shall, as a condition precedent to the payment thereof, give the Paying Agent a bond in such sum as it may ordinarily require and indemnify the Surviving Corporation in a manner satisfactory to it against any claim that may be made against the Surviving Corporation with respect to the Certificate claimed to have been lost, stolen or destroyed.

(e) After the Effective Time, the stock transfer books of FAL shall be closed and there shall be no transfers on the stock transfer books of the Surviving Corporation of shares of FAL Common Stock that were outstanding immediately prior to the Effective Time. If, after the Effective Time, Certificates are presented to the Surviving Corporation, they shall be canceled and exchanged for the Merger Consideration (and cash in lieu of fractional shares) as provided in this Article III.

(f) The Surviving Corporation shall not be liable to any holder of FAL Common Stock for Merger Consideration (and cash in lieu of fractional shares) delivered to a public official pursuant to any applicable abandonment, escheat or similar law. Any amounts remaining unclaimed by holders of any such shares of FAL Common Stock seven years after the Effective Time (or such earlier date immediately prior to the time at which such amounts would otherwise escheat to or become property of any Governmental Body) shall, to the extent permitted by applicable law, become the property of the Surviving Corporation, free and clear of

any claims or interest of any such holders or their successors, assigns or personal representatives previously entitled thereto.

Section 3.3 Dissenting Shares. Notwithstanding any provision of this Agreement to the contrary, the shares of any holder of FAL Common Stock who has demanded and perfected appraisal rights for such shares in accordance with the MBCL and who, as of the Effective Time, has not effectively withdrawn or lost such appraisal rights ("Dissenting Shares"), shall not be converted into or represent a right to receive the Merger Consideration (and cash in lieu of fractional shares) pursuant to Section 3.1, but the holder thereof shall only be entitled to such rights as are granted by the MBCL. Notwithstanding the foregoing, if any holder of shares of FAL Common Stock who demands appraisal of such shares under the MBCL shall effectively withdraw the request for appraisal or lose the right to appraisal, then, as of the later of the Effective Time and the occurrence of such event, such holder's shares shall automatically be converted into and represent only the right to receive the Merger Consideration and cash in lieu of fractional shares, without interest thereon, upon surrender of the certificate representing such shares. FAL shall give SUG prompt notice of any demands received by FAL for appraisal of FAL Common Stock, and, prior to the Effective Time, SUG shall have the right to participate in all negotiations and proceedings with respect to such demands. Prior to the Effective Time, FAL shall not, except with the prior written consent of SUG, make any payment with respect to or offer to settle, any such demands.

ARTICLE IV
REPRESENTATIONS AND WARRANTIES OF SUG

SUG, as to SUG and its Subsidiaries, represents and warrants to FAL that:

Section 4.1 Organization, Existence and Qualification. SUG is a corporation duly incorporated, validly existing, and in good standing under the laws of the State of Delaware, with full corporate power and authority to conduct its business as it is now being conducted, to own or use the properties and assets that it purports to own or use, to perform its obligations under all Contracts to which it is a party, and to execute and deliver this Agreement. SUG is duly qualified to do business as a foreign corporation and is in good standing under the laws of each state or other jurisdiction in which either the ownership or use of the properties owned or used by it, or the nature of the business conducted by it, requires such qualification as a foreign corporation except for such failures to be so qualified or in good standing as are not, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect.

Section 4.2 Capitalization. As of the date of this Agreement, the authorized capital stock of SUG consists of (i) 50,000,000 shares of SUG Common Stock, of which 31,288,321 shares were issued and 31,236,696 were outstanding on September 30, 1999, and (ii) 1,500,000 shares of Cumulative Preferred Stock, no par value, none of which are issued or outstanding. The issued and outstanding shares of SUG Common Stock have been validly issued and are fully paid and nonassessable. The shares of SUG Common Stock to be issued as the Merger Consideration have been duly authorized and when issued and delivered in accordance with the terms of this Agreement, will have been validly issued and will be fully paid and nonassessable

and the issuance thereof is not subject to any preemptive or other similar right. Except as specifically described in the SUG SEC Documents delivered to FAL prior to the date of this Agreement, as of the date of this Agreement, no shares of SUG Common Stock are held, in treasury or otherwise, by SUG or any of its Subsidiaries and except as set forth in Section 4.2 of the SUG Disclosure Schedule, as of the date of this Agreement, there are no outstanding (i) securities convertible into SUG Common Stock or other capital stock of SUG or any of its material Subsidiaries, (ii) warrants or options to purchase SUG Common Stock or other securities of SUG or any of its material Subsidiaries or (iii) commitments to issue shares of SUG Common Stock (other than pursuant to the Merger and other than pursuant to the Agreement of Merger, dated as of June 7, 1999 (the "PEI Merger Agreement"), by and between SUG and Pennsylvania Enterprises, Inc. ("PEI")) or other securities of SUG or any of its material Subsidiaries.

Section 4.3 Subsidiaries; Investments. Except as set forth in Section 4.3 of the SUG Disclosure Schedule, as of the date of this Agreement, SUG has no Subsidiaries or investments in any Person except for marketable securities reflected in the SUG SEC Documents delivered to FAL prior to the date of this Agreement, and SUG is the registered owner and holder of all of the issued and outstanding shares of capital stock of its Subsidiaries and has good title to such shares. The outstanding capital stock of each material Subsidiary of SUG has been validly issued and is fully paid and nonassessable.

Section 4.4 Authority Relative to this Agreement and Binding Effect. The execution, delivery and performance of this Agreement and the Related Documents by SUG have been duly authorized by all requisite corporate action. The execution, delivery and performance of this Agreement and the Related Documents by SUG will not result in a violation or breach of any term or provision of, constitute a default, or require a consent, approval or notification, or accelerate the performance required under, the Organizational Documents of SUG, any indenture, mortgage, deed of trust, security agreement, loan agreement, or other Contract to which SUG is a party or by which its assets are bound, or violate any Order, with such exceptions as are not, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect. This Agreement constitutes and the Related Documents to be executed by SUG when executed and delivered will constitute valid and binding obligations of SUG, enforceable against SUG in accordance with their terms, except as enforceability may be limited by (i) bankruptcy or similar laws from time to time in effect affecting the enforcement of creditors' rights generally or (ii) the availability of equitable remedies generally.

Section 4.5 Governmental Approvals. Except as set forth in Section 4.5 of the SUG Disclosure Schedule and as required by the HSR Act, no approval or authorization of any Governmental Body with respect to performance under this Agreement or the Related Documents by SUG is required to be obtained by SUG in connection with the execution and delivery by SUG of this Agreement or the Related Documents or the consummation by SUG of the transactions contemplated hereby or thereby, the failure to obtain which are, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect.

Section 4.6 Public Utility Holding Company Status; Regulation as a Public Utility. SUG is a "gas utility company" (as such term is defined in PUHCA). SUG indirectly owns a minority interest in a "foreign utility company" (as such term is defined in PUHCA) that is exempt from, and is deemed not to be a public utility company for purposes of, PUHCA pursuant to Section 33 thereof with respect to which SUG has filed with the SEC a Form U-57 notification of foreign utility company status. Except as stated above in this Section 4.6, neither SUG nor any of its Subsidiaries is a "holding company," a "subsidiary company," a "public utility company" or an "affiliate" of a "public utility company," or a "holding company" within the meaning of such terms in PUHCA.

Section 4.7 Compliance with Legal Requirements; Governmental Authorizations.

(a) Except as set forth in Section 4.7 of the SUG Disclosure Schedule or specifically described in the SUG SEC Documents delivered to FAL prior to the date of this Agreement, and subject to Section 4.15 of this Agreement, to the Knowledge of SUG, SUG is not in violation of any Legal Requirement that is applicable to it, to the conduct or operation of its business, or to the ownership or use of any of its assets, other than such violations, if any, which are not, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect.

(b) The SUG SEC Documents delivered to FAL prior to the date of this Agreement accurately describe all material regulation of SUG that relates to the utility business of SUG as of the date of this Agreement. Except as set forth in Section 4.7 of the SUG Disclosure Schedule, SUG has, and is in material compliance with, all material Governmental Authorizations necessary to conduct its business and to own, operate and use all of its assets as currently conducted.

Section 4.8 Legal Proceedings; Orders. Except as set forth in Section 4.8 of the SUG Disclosure Schedule or as specifically described in the SUG SEC Documents delivered to FAL prior to the date of this Agreement, there is no pending Proceeding:

(1) that has been commenced by or against, or that otherwise relates to, SUG or, if the merger with PEI is consummated, PEI, that is reasonably likely to have a SUG Material Adverse Effect; or

(2) as of the date of this Agreement, that challenges, or that may have the effect of preventing, delaying, making illegal, or otherwise interfering with, the Merger or any of the transactions contemplated hereby.

To the Knowledge of SUG, no such Proceedings, audits or investigations have been Threatened that are, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect. As of the date of this Agreement, SUG is not subject to any Orders that are, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect.

Section 4.9 SEC Documents. SUG has made (and, with respect to such documents filed after the date hereof through the Closing Date, will make) available to FAL a true and complete copy of each report, schedule, registration statement (other than on Form S-8), and definitive proxy statement filed by SUG with the SEC since September 16, 1999 and through the Closing Date in substantially the form filed with the SEC (the "SUG SEC Documents"). As of their respective dates, the SUG SEC Documents, including without limitation any financial statements or schedules included therein, complied (or will comply), in all material respects with the requirements of the Securities Act or the Exchange Act, as the case may be, and the rules and regulations of the SEC thereunder applicable to such SUG SEC Documents, and did not (or will not) contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. The audited consolidated financial statements and unaudited interim financial statements of SUG included in the SUG SEC Documents (collectively, the "SUG Financial Statements") were (or will be) prepared in accordance with GAAP applied on a consistent basis (except as may be indicated therein or in the notes thereto and except with respect to unaudited statements as permitted by Form 10-Q) and fairly present (or will fairly present) in all material respects the financial position of SUG as of the respective dates thereof or the results of operations and cash flows for the respective periods then ended, as the case may be, subject, in the case of unaudited interim financial statements, to normal, recurring adjustments which are not material in the aggregate.

Section 4.10 Taxes. Except as set forth in Section 4.10 of the SUG Disclosure Schedule:

(a) SUG and its Subsidiaries have timely filed all United States federal, state and local income Tax Returns required to be filed by or with respect to them or requests for extensions to file such Tax Returns have been timely filed, granted and have not expired, and SUG and its Subsidiaries have timely paid and discharged all Taxes due in connection with or with respect to the periods or transactions covered by such Tax Returns and have paid all other Taxes as are due or made adequate provision therefor in accordance with GAAP except where the failures to so file, pay or discharge are not, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect. As of the date of this Agreement, there are no pending audits or other examinations relating to any Tax matters. There are no Tax liens on any assets of SUG or its Subsidiaries. As of the date of this Agreement, SUG and its Subsidiaries have not granted any waiver of any statute of limitations with respect to, or any extension of a period for the assessment of, any Tax. The accruals and reserves (including deferred taxes) reflected in the SUG Balance Sheet are in all material respects adequate to cover all material Taxes accruable through the date thereof (including interest and penalties, if any, thereon and Taxes being contested) in accordance with GAAP.

(b) Neither SUG nor any of its Subsidiaries is obligated under any Contract with respect to industrial development bonds or other obligations with respect to which the excludability from gross income of the holder for federal or state income tax purposes could be affected by the Merger or any of the transactions contemplated by this Agreement.

(c) SUG has no present plan or intention after the Merger to (i) sell or otherwise dispose of any of the assets of the Surviving Corporation, including the assets of FAL acquired pursuant to the Merger, except for dispositions made in the ordinary course of business or to a corporation controlled by the Surviving Corporation within the meaning of Section 368(a)(2)(C) of the IRC, or (ii) reacquire any of the SUG Common Stock included in the Merger Consideration, other than repurchases in the open market pursuant to stock repurchase plans undertaken for reasons unrelated to the transactions contemplated by this Agreement.

Section 4.11 Intellectual Property. SUG has no Knowledge of (i) any infringement or claimed infringement by it of any patent rights or copyrights of others or (ii) any infringement of the patent or patent license rights, trademarks or copyrights owned by or under license to it, except for any such infringements of the type described in clause (i) or (ii) that are not, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect.

Section 4.12 Contracts. Except as described in Section 4.12 of the SUG Disclosure Schedule or as specifically described in the SUG SEC Documents delivered to FAL prior to the date of this Agreement, and with such exceptions as are not, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect, all of SUG's Contracts are in full force and effect and neither SUG nor, to the Knowledge of SUG, any other party thereto is in default thereunder nor has any event occurred or is any event occurring that, with notice or the passage of time or otherwise, is reasonably likely to give rise to an event of default thereunder by any party thereto.

Section 4.13 Indebtedness. All outstanding principal amounts of indebtedness for borrowed money of SUG as of October 1, 1999 are set forth in Section 4.13 of the SUG Disclosure Schedule.

Section 4.14 Employee Benefit Plans.

(a) Except as set forth in Section 4.14 of the SUG Disclosure Schedule, each of the SUG Benefit Plans has been operated and administered in all material respects in accordance with its governing documents and applicable federal and state laws (including, but not limited to, ERISA and the IRC). For purposes of this Agreement, "SUG Benefit Plans" shall mean all employee retirement, welfare, stock option, stock ownership, deferred compensation, bonus or other benefit plans, agreements, practices, policies, programs, or arrangements that are applicable to any employee, director or consultant of SUG or its Subsidiaries or maintained by or contributed to by SUG or its Subsidiaries.

(b) Except as set forth in Section 4.14 of the SUG Disclosure Schedule, as to any SUG Benefit Plan subject to Title IV of ERISA, there is no event or condition which presents the material risk of plan termination, no accumulated funding deficiency, whether or not waived, within the meaning of Section 302 of ERISA or Section 412 of the IRC has been incurred for which any liability is outstanding, no reportable event within the meaning of Section 4043 of ERISA (for which the notice requirements of Regulation §4043 promulgated by the Pension Benefit Guaranty Corporation ("PBGC") have not been waived) has occurred within the

last six years, no notice of intent to terminate the SUG Benefit Plan has been given under Section 4041 of ERISA, no proceeding has been instituted under Section 4042 of ERISA to terminate the SUG Benefit Plan, there has been no termination or partial termination of the SUG Benefit Plan within the meaning of Section 411(d)(3) of the IRC within the last six years, except with respect to the conversion of the retirement income plan to a cash balance plan for which full vesting was granted with respect to affected employees, no event described in Sections 4062 or 4063 of ERISA has occurred, all PBGC premiums have been timely paid and no liability to the PBGC has been incurred, except for PBGC premiums not yet due.

(c) Except as set forth in Section 4.14 of the SUG Disclosure Schedule, each trust funding a SUG Benefit Plan, which trust is intended to be exempt from federal income taxation pursuant to Section 501(c)(9) of the IRC, satisfies the requirements of such section and has, whenever required by law, received a favorable determination letter from the IRS regarding such exempt status, and to the Knowledge of SUG has not, since receipt of the most recent favorable determination letter, been amended or operated in any way which would adversely affect such exempt status.

(d) Except as set forth in Section 4.14 of the SUG Disclosure Schedule, with respect to any SUG Benefit Plan or any other "employee benefit plan" as defined in Section 3(3) of ERISA which is established, sponsored, maintained or contributed to, or has been established, sponsored, maintained or contributed to or, to the Knowledge of SUG, with respect to any such plan which has been established, sponsored, maintained or contributed to within six years prior to the Closing Date, by SUG or its Subsidiaries or any corporation, trade, business or entity under common control or being a part of an affiliated service group with SUG, within the meaning of Section 414(b), (c) or (m) of the IRC or Section 4001 of ERISA ("SUG Commonly Controlled Entity"), (i) no withdrawal liability, within the meaning of Section 4201 of ERISA, has been incurred, which withdrawal liability has not been satisfied and no such withdrawal liability is reasonably expected to be incurred, (ii) no liability under Title IV of ERISA (including, but not limited to, liability to the PBGC) has been incurred by SUG or any SUG Commonly Controlled Entity, which liability has not been satisfied (other than for PBGC premiums not yet due), (iii) no accumulated funding deficiency, whether or not waived, within the meaning of Section 302 of ERISA or Section 412 of the IRC has been incurred for which any liability is outstanding, (iv) there has been no failure to make any contribution (including installments) to such plan required by Section 302 of ERISA and Section 412 of the IRC which has resulted in a lien under Section 302 of ERISA or Section 412 of the IRC and for which any liability is currently outstanding, (v) to the Knowledge of SUG, no action, omission or transaction has occurred with respect to any such plan or any other SUG Benefit Plan which could subject SUG or the plan or trust forming a part thereof to a material civil liability or penalty under ERISA or other applicable laws, or a material Tax under the IRC, (vi) any such plan which is a Group Health Plan has complied in all material respects with the provisions of Sections 601-608 of ERISA and Section 4980B of the IRC, (vii) there are no pending or, to the Knowledge of SUG, Threatened claims by or on behalf of any such plan or any other SUG Benefit Plan, by any employees, former employees or plan beneficiaries covered by such plan or otherwise by or on behalf of any person involving any such plan (other than routine non-

contested claims for benefits) which could result in a material liability to SUG and its Subsidiaries, taken as a whole, and (viii) neither SUG nor any SUG Commonly Controlled Entity has engaged in, or is a successor or parent corporation to any entity or person that has engaged in, a transaction described in Section 4069 of ERISA.

(e) The execution and delivery of this Agreement and the consummation of the transactions contemplated hereby will not (i) increase the amount of benefits otherwise payable under any SUG Benefit Plan, (ii) result in the acceleration of the time of eligibility to participate in any SUG Benefit Plan, or of any payment, exercisability, funding or vesting of any benefit under any SUG Benefit Plan, (iii) result in payment becoming due or with respect to any current or former employee, director or consultant, or (iv) result in any payment becoming due in the event of a termination of employment or service of any employee, director or consultant.

(f) SUG is not a party to any Contract nor has it established any policy or practice, which would require SUG to make a payment or provide any other form of compensation or benefit to any Person performing (or who within the past twelve months performed) services for SUG during or upon termination of such services which would not be payable or provided in the absence of the consummation of the transactions contemplated by this Agreement.

(g) Except as would affect unionized employees and/or retirees who are covered by bargaining agreements, if any, and as otherwise set forth in Section 4.14 of the SUG Disclosure Schedule, each SUG Benefit Plan which is an "employee welfare benefit plan," as such term is defined in Section 3(1) of ERISA, may be unilaterally amended or terminated in its entirety without any liability being incurred by SUG or any Affiliate of SUG, except as to benefits accrued thereunder prior to such amendment or termination.

(h) As of the date of this Agreement, SUG has not contributed nor been obligated to contribute to any "multi-employer plan" within the meaning of Section 3(37) of ERISA within the last six years and has no outstanding liability with respect to any such plan.

Section 4.15 Environmental Matters. Except as set forth in Section 4.15 of the SUG Disclosure Schedule or as specifically described in the SUG SEC Documents delivered to FAL prior to the date of this Agreement, and with such other exceptions as are not, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect:

(a) To the Knowledge of SUG, SUG and any Person for whose conduct SUG is reasonably likely to be held responsible, is currently and at all times has been, in material compliance with any Environmental Law. SUG has not received any Order, notice, or other communication from (i) any Governmental Body or private citizen acting in the public interest, or (ii) the current or prior owner or operator of any Facilities, of any violation or failure to comply with any Environmental Law, or of any obligation to undertake or bear the cost of any environmental cleanup, or with respect to any property or Facility at which Hazardous Materials generated by SUG or any other Person for whose conduct SUG may be held responsible were transported for disposal; and

(b) There are no pending or, to the Knowledge of SUG, Threatened claims or Encumbrances arising under or pursuant to any Environmental Law with respect to or affecting any of the Facilities or any other properties and assets (whether real, personal, or mixed) in which SUG has or had a direct or indirect interest (including by ownership or use).

Section 4.16 No Material Adverse Change. Except as described in the SUG SEC Documents that have been provided to FAL prior to the date of this Agreement, since the date of the SUG Balance Sheet, there has not been any SUG Material Adverse Effect, and no events have occurred or circumstances exist that are, individually or in the aggregate, reasonably likely to have a SUG Material Adverse Effect, except that any SUG Material Adverse Effect that results from or relates to (a) general business or economic conditions, (b) conditions generally affecting the industries in which SUG competes or (c) the announcement of the transactions contemplated by this Agreement shall be disregarded.

Section 4.17 Brokers. SUG is not a party to, or in any way obligated under any Contract, and there are no outstanding claims against SUG, for the payment of any broker's or finder's fees in connection with the origin, negotiation, execution or performance of this Agreement.

Section 4.18 Proxy Statement; Registration Statement. None of the information supplied or to be supplied to FAL by or on behalf of SUG for inclusion in the proxy statement, in definitive form, relating to the FAL Meeting to be held in connection with the Merger (the "FAL Proxy Statement"), or supplied by or on behalf of SUG in the Registration Statement on Form S-4 (and any amendments thereto) to be filed by SUG with the SEC pursuant to the Securities Act to register the shares of SUG Common Stock constituting the Stock Consideration (the "Registration Statement") will, in the case of the Registration Statement, at the effective time of the Registration Statement, at any time the Registration Statement is amended or supplemented, at the date the FAL Proxy Statement is first mailed to FAL's stockholders, at any time the FAL Proxy Statement is amended or supplemented, at the time of the FAL Meeting and at the Effective Time, and in the case of the FAL Proxy Statement, at the date the FAL Proxy Statement is first mailed to FAL's stockholders, at any time the FAL Proxy Statement is amended or supplemented and at the time of the FAL Meeting (giving effect to any documents incorporated by reference therein), contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading. The Registration Statement will comply as to form and in substance in all material respects with the applicable provisions of the Securities Act and the rules and regulations thereunder.

Section 4.19 No Vote Required. No vote of the holders of any class or series of the capital stock of SUG is required to approve this Agreement and the Merger.

Section 4.20 Disclaimer of Representations and Warranties. EXCEPT FOR THE REPRESENTATIONS AND WARRANTIES CONTAINED IN THIS ARTICLE IV, SUG MAKES NO OTHER REPRESENTATIONS OR WARRANTIES, EXPRESS OR IMPLIED, AND SUG HEREBY DISCLAIMS ANY SUCH OTHER REPRESENTATIONS OR

WARRANTIES, WHETHER BY SUG, ANY SUBSIDIARY OF SUG, OR ANY OF THEIR RESPECTIVE OFFICERS, DIRECTORS, EMPLOYEES, AGENTS OR REPRESENTATIVES, OR ANY OTHER PERSON, WITH RESPECT TO THIS AGREEMENT AND THE TRANSACTIONS CONTEMPLATED HEREBY, NOTWITHSTANDING THE DELIVERY OR DISCLOSURE TO FAL OR ANY OF ITS DIRECTORS, OFFICERS, EMPLOYEES, AGENTS OR REPRESENTATIVES, OR ANY OTHER PERSON, OF ANY DOCUMENTATION OR OTHER INFORMATION BY SUG, ANY SUBSIDIARY OF SUG, OR ANY OF THEIR RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES, AGENTS OR REPRESENTATIVES, OR ANY OTHER PERSON, WITH RESPECT TO ANY OF THE FOREGOING.

ARTICLE V
REPRESENTATIONS AND WARRANTIES OF FAL

FAL, as to the Acquired Companies, represents and warrants to SUG as follows:

Section 5.1 Organization, Existence and Qualification.

(a) Each Acquired Company is a corporation duly incorporated, validly existing, and in good standing under the laws of its state of incorporation or organization, with full corporate power and authority to conduct its business as it is now being conducted, to own or use the properties and assets that it purports to own or use, and to perform all its obligations under all Applicable Contracts. Section 5.1(a) of the FAL Disclosure Schedule sets forth the name of each Acquired Company, the state or jurisdiction of its incorporation or organization, and each state or jurisdiction where such Acquired Company is duly qualified as a foreign corporation. Each Acquired Company is duly qualified to do business as a foreign corporation and is in good standing under the laws of each state or other jurisdiction in which either the ownership or use of the properties owned or used by it, or the nature of the business conducted by it, requires such qualification as a foreign corporation except for such failures to be so qualified or in good standing as are not, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect.

(b) FAL has delivered to SUG copies of the Organizational Documents, as currently in effect, of each Acquired Company.

Section 5.2 Capitalization. The capital stock of FAL consists of 2,951,334 shares of FAL Common Stock, of which 2,220,086 shares are issued and outstanding. The issued and outstanding shares of FAL Common Stock have been validly issued and are fully paid and nonassessable. Except as specifically described in the FAL SEC Documents delivered to SUG prior to the date of this Agreement, no shares of FAL Common Stock are held, in treasury or otherwise, by FAL or any of its Subsidiaries and there are no outstanding (i) securities convertible into FAL Common Stock or other capital stock of FAL or any of its Subsidiaries, (ii) warrants or options to purchase FAL Common Stock or other securities of FAL or any of its Subsidiaries or (iii) other commitments to issue shares of FAL Common Stock or other securities of FAL or any of its Subsidiaries.

Section 5.3 Subsidiaries; Investments. Except as set forth in Section 5.3 of the FAL Disclosure Schedule, FAL has no Subsidiaries or investments in any Person (except for marketable securities disclosed to SUG prior to the date of this Agreement) and FAL is the registered owner and holder of all of the issued and outstanding shares of capital stock of its Subsidiaries and has good title to such shares. The outstanding capital stock of each Subsidiary has been validly issued and is fully paid and nonassessable. All such capital stock owned by any Acquired Company is free and clear of any Encumbrance (except for any Encumbrance disclosed in the FAL SEC Documents delivered to SUG prior to the date of this Agreement, or created or incurred by this Agreement in favor of SUG, or imposed by federal or state securities laws).

Section 5.4 Authority Relative to this Agreement and Binding Effect. The execution, delivery and performance of this Agreement and the Related Documents by FAL have been duly authorized by all requisite corporate action, except, as of the date of this Agreement, for the FAL Stockholders' Approval. Except as set forth in Section 5.4 of the FAL Disclosure Schedule, the execution, delivery and performance of this Agreement and the Related Documents by FAL will not result in a violation or breach of any term or provision of, or constitute a default, require a consent, approval or notification, or accelerate the performance required under, the Organizational Documents of any of the Acquired Companies, any indenture, mortgage, deed of trust, security agreement, loan agreement, or other Applicable Contract to which any of the Acquired Companies is a party or by which its assets are bound, or violate any Order, with such exceptions as are not, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect. This Agreement constitutes and the Related Documents to be executed by any of the Acquired Companies when executed and delivered will constitute valid and binding obligations of such Acquired Company, enforceable against such Acquired Company in accordance with their terms, except as enforceability may be limited by (i) bankruptcy or similar laws from time to time in effect affecting the enforcement of creditors' rights generally or (ii) the availability of equitable remedies generally.

Section 5.5 Governmental Approvals. Except as set forth in Section 5.5 of the FAL Disclosure Schedule and as required by the HSR Act, no approval or authorization of any Governmental Body with respect to performance under this Agreement or the Related Documents by any Acquired Company is required to be obtained by FAL in connection with the execution and delivery by FAL of this Agreement or the Related Documents or the consummation by the Acquired Companies of the transactions contemplated hereby or thereby, the failure to obtain which are, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect.

Section 5.6 Public Utility Holding Company Status; Regulation as a Public Utility. None of the Acquired Companies is a "holding company," a "subsidiary company," a "public utility company," or an "affiliate" of a "public utility company" or a "holding company" within the meaning of such terms in PUHCA.

Section 5.7 Compliance with Legal Requirements; Governmental Authorizations.

(a) Except as set forth in Section 5.7(a) of the FAL Disclosure Schedule or as specifically described in the FAL SEC Documents delivered to SUG prior to the date of this Agreement, and subject to Section 5.19 of this Agreement, to the Knowledge of any Acquired Company, no Acquired Company is in violation of any Legal Requirement that is applicable to it, to the conduct or operation of its business, or to the ownership or use of any of its assets, other than such violations, if any, which are not, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect.

(b) The FAL SEC Documents delivered to SUG prior to the date of this Agreement accurately describe all material regulation of each Acquired Company that relates to the utility business of any Acquired Company. Except as set forth on Section 5.7(a) of the FAL Disclosure Schedule, each Acquired Company has, and is in material compliance with, all material Governmental Authorizations necessary to conduct its business and to own, operate and use all of its assets as currently conducted.

Section 5.8 Legal Proceedings; Orders. Except as set forth in Section 5.8 of the FAL Disclosure Schedule or as specifically described in the FAL SEC Documents delivered to SUG prior to the date of this Agreement, there is no pending Proceeding:

(1) that has been commenced by or against, or that otherwise relates to, any Acquired Company that is reasonably likely to have a FAL Material Adverse Effect; or

(2) as of the date of this Agreement, that challenges, or that may have the effect of preventing, delaying, making illegal, or otherwise interfering with, the Merger or any of the transactions contemplated hereby.

To the Knowledge of FAL, except as set forth in Section 5.8 of the FAL Disclosure Schedule, as of the date of this Agreement, no such Proceedings, audits or investigations have been Threatened that are, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect. As of the date of this Agreement, none of the Acquired Companies is subject to any Orders that are, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect.

Section 5.9 SEC Documents. FAL has made (and, with respect to such documents filed after the date hereof through the Closing Date, will make) available to SUG a true and complete copy of each report, schedule, registration statement (other than on Form S-8), and definitive proxy statement filed by FAL with the SEC since September 30, 1998 through the Closing Date in substantially the form filed with the SEC (the "FAL SEC Documents"). As of their respective dates, the FAL SEC Documents, including without limitation any financial statements or schedules included therein, complied (or will comply), in all material respects with the requirements of the Securities Act or the Exchange Act, as the case may be, and the rules and regulations of the SEC thereunder applicable to such FAL SEC Documents, and did not (or will

not) contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. The audited consolidated financial statements and unaudited interim financial statements of FAL included in the FAL SEC Documents (collectively, the "FAL Financial Statements") were (or will be) prepared in accordance with GAAP (except as may be indicated therein or in the notes thereto and except with respect to unaudited statements as permitted by Form 10-Q) and fairly present (or will fairly present) in all material respects the financial position of FAL and its Subsidiaries, as of the respective dates thereof or the results of operations and cash flows for the respective periods then ended, as the case may be, subject, in the case of unaudited interim financial statements, to normal, recurring adjustments which are not material in the aggregate.

Section 5.10 Taxes. Except as set forth in Section 5.10 of the FAL Disclosure Schedule:

(a) The Acquired Companies have timely filed all United States federal, state and local income Tax Returns required to be filed by or with respect to them or requests for extensions to file such Tax Returns have been timely filed, granted and have not expired, and the Acquired Companies have timely paid and discharged all Taxes due in connection with or with respect to the periods or transactions covered by such Tax Returns and have paid all other Taxes as are due or made adequate provision therefor in accordance with GAAP except where failures to so file, pay or discharge are not, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect. There are no pending audits or other examinations relating to any Tax matters. There are no Tax liens on any assets of the Acquired Companies. As of the date of this Agreement, none of the Acquired Companies has granted any waiver of any statute of limitations with respect to, or any extension of a period for the assessment of, any Tax. The accruals and reserves (including deferred taxes) reflected in the FAL Balance Sheet are in all material respects adequate to cover all material Taxes accruable through the date thereof (including interest and penalties, if any, thereon and Taxes being contested) in accordance with GAAP.

(b) None of the Acquired Companies is obligated under any Applicable Contract with respect to industrial development bonds or other obligations with respect to which the excludability from gross income of the holder for federal or state income tax purposes could be affected by the Merger or any of the transactions contemplated by this Agreement.

Section 5.11 Intellectual Property. No Acquired Company has any Knowledge of (i) any infringement or claimed infringement by any Acquired Company of any patent rights or copyrights of others or (ii) any infringement of the patent or patent license rights, trademarks or copyrights owned by or under license to any Acquired Company, except for any such infringements of the type described in clause (i) or (ii) that are not, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect.

Section 5.12 Title to Assets. Except (i) as set forth in Section 5.12 of the FAL Disclosure Schedule, (ii) as specifically described in the FAL SEC Documents delivered to SUG

prior to the date of this Agreement, (iii) as set forth in Section 5.19 of this Agreement or (iv) as set forth in Section 5.19 of the FAL Disclosure Schedule, none of the Acquired Companies' assets are subject to any Encumbrance other than FAL Permitted Liens.

Section 5.13 Indebtedness. All outstanding principal amounts of indebtedness for borrowed money of the Acquired Companies as of October 4, 1999 are set forth in Section 5.13 of the FAL Disclosure Schedule.

Section 5.14 Machinery and Equipment. Except for normal wear and tear, and with such exceptions as are not, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect, the machinery and equipment of the Acquired Companies necessary for the conduct by the Acquired Companies of their respective businesses as presently conducted are in good operating condition and in a state of reasonable maintenance and repair.

Section 5.15 Applicable Contracts. Set forth in Section 5.15(a) of the FAL Disclosure Schedule is a list as the date hereof of all Applicable Contracts to which any Acquired Company is a party involving a total commitment by or to any party thereto of more than $65,000 on an annual basis or more than $250,000 on its remaining term which cannot be terminated on no more than sixty (60) days' notice without penalty or additional cost to the Acquired Company as the terminating party. Except as specifically described in the FAL SEC Documents delivered to SUG prior to the date of this Agreement, and with such exceptions as are not, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect, all Applicable Contracts of the Acquired Companies are in full force and effect and no Acquired Company nor, to the Knowledge of FAL, any other party thereto is in default thereunder nor has any event occurred or is any event occurring that with notice or the passage of time or otherwise, is reasonably likely to give rise to an event of default thereunder by any party thereto.

Section 5.16 Insurance. Section 5.16(a) of the FAL Disclosure Schedule sets forth a list of all policies of insurance held by the Acquired Companies as of the date of this Agreement. Since June 30, 1994, the assets and the business of the Acquired Companies have been continuously insured with what FAL believes are reputable insurers against all risks and in such amounts normally insured against by companies of the same type and in the same line of business as any of the Acquired Companies. As of the date of this Agreement, no notice of cancellation, non-renewal or material increase in premiums has been received by any of the Acquired Companies with respect to such policies, and no Acquired Company has Knowledge of any fact or circumstance that could reasonably be expected to form the basis for any cancellation, non-renewal or material increase in premiums, except for such cancellations, non-renewals and increases which are not, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect. None of the Acquired Companies is in default with respect to any provision contained in any such policy or binder nor has there been any failure to give notice or to present any claim relating to the business or the assets of the Acquired Companies under any such policy or binder in a timely fashion or in the manner or detail required by the policy or binder, except for such defaults or failures which are not, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect. As of the date of this Agreement,

there are no outstanding unpaid premiums (except premiums not yet due and payable), and no notice of cancellation or renewal with respect to, or disallowance of any claim under, any such policy or binder has been received by the Acquired Companies as of the date hereof, except for such non-payments of premiums, cancellations, renewals or disallowances which are not, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect.

Section 5.17 Employees. Section 5.17(a) of the FAL Disclosure Schedule sets forth a list as of no more than thirty (30) days prior to the date of this Agreement of all the present officers and employees of the Acquired Companies, indicating each employee's base salary or wage rate and identifying those who are union employees and those who are part-time employees. Except as set forth in Section 5.17(b) of the FAL Disclosure Schedule, as of the date of this Agreement, no labor union or other collective bargaining unit has been certified or recognized by any of the Acquired Companies, and, to the Knowledge of the Acquired Companies, as of the date of this Agreement, there are no elections, organizing drives or material controversies pending or Threatened between any of the Acquired Companies and any labor union or other collective bargaining unit representing any of the Acquired Companies' employees. There is no pending or, to the Knowledge of FAL, Threatened labor practice complaint, arbitration, labor strike or other material labor dispute (excluding grievances) involving any of the Acquired Companies which are, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect. Except for collective bargaining agreements or as set forth in Section 5.17(c) of the FAL Disclosure Schedule, none of the Acquired Companies is a party to any employment agreement with any employee pertaining to any of the Acquired Companies.

Section 5.18 Employee Benefit Plans.

(a) Each of the FAL Benefit Plans has been operated and administered in all material respects in accordance with its governing documents and applicable federal and state laws (including, but not limited to, ERISA and the IRC). For purposes of this Agreement, "FAL Benefit Plans" shall mean all employee retirement, welfare, stock option, stock ownership, deferred compensation, bonus or other benefit plans, agreements, practices, policies, programs, or arrangements, that are applicable to any employee, director or consultant of the Acquired Companies or maintained by or contributed to by any of the Acquired Companies.

(b) As to any FAL Benefit Plan subject to Title IV of ERISA, there is no event or condition which presents the material risk of plan termination, no accumulated funding deficiency, whether or not waived, within the meaning of Section 302 of ERISA or Section 412 of the IRC has been incurred for which any liability is outstanding, no reportable event within the meaning of Section 4043 of ERISA (for which the notice requirements of Regulation §4043 promulgated by the PBGC have not been waived) has occurred within the last six years, no notice of intent to terminate the FAL Benefit Plan has been given under Section 4041 of ERISA, no proceeding has been instituted under Section 4042 of ERISA to terminate the FAL Benefit Plan, there has been no termination or partial termination of the FAL Benefit Plan within the meaning of Section 411(d)(3) of the IRC within the last six years, no event described in Sections

4062 or 4063 of ERISA has occurred, all PBGC premiums have been timely paid and no liability to the PBGC has been incurred, except for PBGC premiums not yet due.

(c) There is no matter pending (other than qualification determination applications and filings and other required periodic filings) with respect to any of the FAL Benefit Plans before the IRS, the Department of Labor, the PBGC or in or before any other governmental authority.

(d) Each trust funding a FAL Benefit Plan, which trust is intended to be exempt from federal income taxation pursuant to Section 501(c)(9) of the IRC, satisfies the requirements of such section and has received a favorable determination letter from the IRS regarding such exempt status and to the Knowledge of any Acquired Company has not, since receipt of the most recent favorable determination letter, been amended or operated in any way which would adversely affect such exempt status.

(e) With respect to any FAL Benefit Plan or any other "employee benefit plan" as defined in Section 3(3) of ERISA which is established, sponsored, maintained or contributed to, or to the Knowledge of the Acquired Companies, with respect to any such plan which has been established, sponsored, maintained or contributed to within six years prior to the Closing Date, by the Acquired Companies or any corporation, trade, business or entity under common control or being a part of an affiliated service group with any of the Acquired Companies, within the meaning of Section 414(b), (c) or (m) of the IRC or Section 4001 of ERISA ("FAL Commonly Controlled Entity"), (i) no withdrawal liability, within the meaning of Section 4201 of ERISA, has been incurred, which withdrawal liability has not been satisfied and no such withdrawal liability is reasonably expected to be incurred, (ii) no liability under Title IV of ERISA (including, but not limited to, liability to the PBGC) has been incurred by the Acquired Companies or any FAL Commonly Controlled Entity, which liability has not been satisfied (other than for PBGC premiums not yet due), (iii) no accumulated funding deficiency, whether or not waived, within the meaning of Section 302 of ERISA or Section 412 of the IRC has been incurred for which any liability is outstanding, (iv) there has been no failure to make any contribution (including installments) to such plan required by Section 302 of ERISA and Section 412 of the IRC which has resulted in a lien under Section 302 of ERISA or Section 412 of the IRC and for which any liability is currently outstanding, (v) to the Knowledge of any Acquired Company, no action, omission or transaction has occurred with respect to any such plan or any other FAL Benefit Plan which could subject any of the Acquired Companies, the plan or trust forming a part thereof, or SUG to a material civil liability or penalty under ERISA or other applicable laws, or a material Tax under the IRC, (vi) any such plan which is a Group Health Plan has complied in all material respects with the provisions of Sections 601-608 of ERISA and Section 4980B of the IRC, (vii) there are no pending or, to the Knowledge of any Acquired Company, Threatened claims by or on behalf of any such plan or any other FAL Benefit Plan, by any employees, former employees or plan beneficiaries covered by such plan or otherwise by or on behalf of any person involving any such plan (other than routine non-contested claims for benefits) which could result in a material liability to the Acquired Companies taken as a whole, and (viii) neither the Acquired Companies nor any FAL Commonly

Controlled Entity has engaged in, or is a successor or parent corporation to any entity or person that has engaged in, a transaction described in Section 4069 of ERISA.

(f) The execution and delivery of this Agreement and the consummation of the transactions contemplated hereby will not (i) increase the amount of benefits otherwise payable under any FAL Benefit Plan, (ii) result in the acceleration of the time of eligibility to participate in any FAL Benefit Plan, or any payment, exercisability, funding or vesting of any benefit under any FAL Benefit Plan, (iii) result in any payment becoming due to or with respect to any current or former employee, director or consultant, or (iv) result in any payment becoming due in the event of a termination of employment or service of any employee, director or consultant.

(g) None of the Acquired Companies is a party to any Applicable Contract nor has it established any policy or practice, which would require it or SUG to make a payment or provide any other form of compensation or benefit to any Person performing (or who within the past twelve months performed) services for any of the Acquired Companies during or upon termination of such services which would not be payable or provided in the absence of the consummation of the transactions contemplated by this Agreement.

(h) Except as would affect unionized employees and/or retirees who had been unionized employees, each FAL Benefit Plan which is an "employee welfare benefit plan," as such term is defined in Section 3(1) of ERISA, may be unilaterally amended or terminated in its entirety without any liability being incurred by any of the Acquired Companies, SUG or any Affiliate of SUG, except as to benefits accrued thereunder prior to such amendment or termination.

(i) None of the Acquired Companies has contributed nor been obligated to contribute to any "multi-employer plan" within the meaning of Section 3(37) of ERISA within the last six years, and none of the Acquired Companies has any outstanding liability with respect to any such plan.

(j) Section 5.18(j) of the FAL Disclosure Schedule contains a true and complete list of each FAL Benefit Plan, and any management, employment, deferred compensation, severance (including any payment, right or benefit resulting from a change in control), bonus, or other contract for personal services with any current or former officer, director or employee, any consulting contract with any person who prior to entering this such contract was a director or officer or owner of 5% or more of the stock of any Acquired Company or family member of any such director, officer or stockholder, or any plan, agreement, arrangement or understanding similar to any of the foregoing. There are no outstanding options to purchase FAL capital stock or other securities. FAL has provided to SUG a complete and correct copy of each FAL Benefit Plan (or written summary of any unwritten FAL Benefit Plan), and with respect to each FAL Benefit Plan, the current summary plan description, related trust agreements, related insurance contracts, the latest IRS determination letter, the last three annual reports on Form 5500 series (including all required schedules), and the most recent actuarial report and annual financial statements.

Section 5.19 Environmental Matters. Except as set forth in Section 5.19 of the FAL Disclosure Schedule or as specifically described in the FAL SEC Documents delivered to SUG prior to the date of this Agreement, and with such other exceptions as are not, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect:

(a) To the Knowledge of any Acquired Company, no Facility owned or operated by any Acquired Company is currently, or was at any time, listed on the National Priorities List promulgated under CERCLA, or on any comparable state list, and no Acquired Company has received any written notification of potential or actual liability or a written request for information from any Person under or relating to CERCLA or any comparable Legal Requirement with respect to any Acquired Company or the Facilities;

(b) To the Knowledge of any Acquired Company, each Acquired Company and any Person for whose conduct any Acquired Company is reasonably likely to be held responsible, is currently and at all times has been, in material compliance with any Environmental Law. No Acquired Company has received any Order, notice, or other communication from (i) any Governmental Body or private citizen acting in the public interest, or (ii) the current or prior owner or operator of any Facilities, of any violation or failure to comply with any Environmental Law, or of any obligation to undertake or bear the cost of any environmental cleanup, or with respect to any property or Facility at which Hazardous Materials generated by any Acquired Company were transported for disposal;

(c) There are no pending or, to the Knowledge of any Acquired Company, Threatened claims arising under or pursuant to any Environmental Law with respect to or affecting any of the Facilities or any other properties and assets (whether real, personal, or mixed) in which any Acquired Company has or had a direct or indirect interest (including by ownership or use); and

(d) FAL has delivered or made available to SUG true and complete copies and results of any environmental site assessments, studies, analyses, tests or monitoring possessed by any Acquired Company of which any Acquired Company has Knowledge pertaining to Hazardous Materials or Hazardous Activities in, on or under the Facilities, or concerning compliance by any Acquired Company or any other Person for whose conduct any Acquired Company is reasonably likely to be held responsible, with Environmental Laws.

Section 5.20 No Material Adverse Change. Since the date of the FAL Balance Sheet, except as specifically described in the FAL SEC Documents delivered to SUG prior to the date of this Agreement, there has not been any FAL Material Adverse Effect, and no events have occurred or circumstances exist that are, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect, except that any FAL Material Adverse Effect that results from or relates to (a) general business or economic conditions, (b) conditions generally affecting the industries in which the Acquired Companies compete or (c) the announcement of the transactions contemplated by this Agreement shall be disregarded.

Section 5.21 Brokers. No Acquired Company is a party to, or in any way obligated under any Applicable Contract, and there are no outstanding claims against any Acquired Company, for the payment of any broker's or finder's fees in connection with the origin, negotiation, execution or performance of this Agreement.

Section 5.22 Regulatory Proceedings. Except as set forth in Section 5.22 of the FAL Disclosure Schedule, other than purchase gas adjustment provisions, none of FAL or its Subsidiaries all or part of whose rates or services are regulated by a Governmental Body (a) has rates that have been or are being collected subject to refund, pending final resolution of any rate proceeding pending before a Governmental Body or on appeal to the courts, or (b) is a party to any rate proceeding before a Governmental Body that are, individually or in the aggregate, reasonably likely to result in any Orders having a FAL Material Adverse Effect.

Section 5.23 Proxy Statement; Registration Statement. None of the information supplied or to be supplied by or on behalf of the Acquired Companies in either the FAL Proxy Statement or supplied or to be supplied by the Acquired Companies to SUG for inclusion in the Registration Statement, will, in the case of the Registration Statement, at the effective time of the Registration Statement, at any time the Registration Statement is amended or supplemented, at the date the FAL Proxy Statement is first mailed to FAL's stockholders, at any time the FAL Proxy Statement is amended or supplemented, at the time of the FAL Meeting and at the Effective Time, and in the case of the FAL Proxy Statement, at the date the FAL Proxy Statement is first mailed to FAL's stockholders, at any time the FAL Proxy Statement is amended or supplemented and at the time of the FAL Meeting (giving effect to any documents incorporated by reference therein), contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading. The FAL Proxy Statement will comply as to form and in substance in all material respects with the applicable provisions of the Exchange Act and the rules and regulations thereunder.

Section 5.24 Vote Required. Other than the approval of the Merger by the holders of two thirds of the outstanding shares of FAL Common Stock entitled to vote on the question (the "FAL Stockholders' Approval"), no vote of the holders of any class or series of the capital stock of any Acquired Company is required to approve this Agreement and the Merger.

Section 5.25 Opinion of Financial Advisor. FAL has provided SUG a copy of the opinion of Legg Mason Wood Walker, Incorporated, dated as of the date hereof, with respect to the Merger Consideration to be received by the holders of FAL Common Stock pursuant to the transactions contemplated by this Agreement.

Section 5.26 Disclaimer of Representations and Warranties. EXCEPT FOR THE REPRESENTATIONS AND WARRANTIES CONTAINED IN THIS ARTICLE V, FAL MAKES NO OTHER REPRESENTATIONS OR WARRANTIES, EXPRESS OR IMPLIED, AND FAL HEREBY DISCLAIMS ANY SUCH OTHER REPRESENTATIONS OR WARRANTIES, WHETHER BY FAL, ANY SUBSIDIARY OF FAL, OR ANY OF THEIR RESPECTIVE OFFICERS, DIRECTORS, EMPLOYEES, AGENTS OR

REPRESENTATIVES, OR ANY OTHER PERSON, WITH RESPECT TO THIS AGREEMENT AND THE TRANSACTIONS CONTEMPLATED HEREBY, NOTWITHSTANDING THE DELIVERY OR DISCLOSURE TO SUG OR ANY OF ITS DIRECTORS, OFFICERS, EMPLOYEES, AGENTS OR REPRESENTATIVES, OR ANY OTHER PERSON, OF ANY DOCUMENTATION OR OTHER INFORMATION BY FAL, ANY SUBSIDIARY OF FAL, OR ANY OF THEIR RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES, AGENTS OR REPRESENTATIVES, OR ANY OTHER PERSON, WITH RESPECT TO ANY OF THE FOREGOING.

ARTICLE VI
COVENANTS

Section 6.1 Covenants of FAL. FAL agrees to observe and perform the following covenants and agreements:

(a) Conduct of the Business Prior to the Closing Date. With respect to the Acquired Companies, except (i) as contemplated in this Agreement, (ii) as required by law or regulation, or (iii) as otherwise expressly consented to in writing by SUG which consent shall not be unreasonably withheld or delayed, prior to the Closing, FAL will cause each Acquired Company to:

(1) Not make or permit any material change in the general nature of its business;

(2) Maintain its Ordinary Course of Business in accordance with prudent business judgment and consistent with past practice and policy, and maintain its assets in good operating repair, order and condition, reasonable wear and tear excepted, subject to retirements in the Ordinary Course of Business;

(3) Preserve the Acquired Company as an ongoing business and use reasonable efforts to maintain the goodwill associated with the Acquired Company;

(4) Preserve all of the Acquired Companies' franchises, tariffs, certificates of public convenience and necessity, licenses, authorizations and other governmental rights and permits;

(5) Not enter into any material transaction or Material Contract;

(6) Not purchase, sell, lease, dispose of or otherwise transfer or make any contract for the purchase, sale, lease, disposition or transfer of, or subject to lien, any of the assets of the Acquired Company other than in the Ordinary Course of Business;

(7) Not hire any new employee unless such employee is a bona fide replacement for a presently-filled position with the Acquired Company as of the date hereof;

(8) Not file any material applications, petitions, motions, orders, briefs, settlement or agreements in any material Proceeding before any Governmental Body which involves any Acquired Company, and appeals related thereto;

(9) Not engage in or modify, except in the Ordinary Course of Business, any material intercompany transactions involving any other Acquired Company;

(10) Not voluntarily change in any material respect or terminate any insurance policies disclosed on Section 5.16(a) of the FAL Disclosure Schedule that presently are in effect unless equivalent coverage is obtained;

(11) Except as disclosed or specifically contemplated in this Agreement or in Section 6.1(a)(11) of the FAL Disclosure Schedule, and with respect to budgeted expenditures known and specifically disclosed in writing to SUG, subject to adjustments in the Ordinary Course of Business and other deviations (which in the aggregate shall not exceed 5% on an annualized basis during the period from the date of this Agreement until the Closing Date), not make any capital expenditure or capital expenditure commitment;

(12) Not make any changes in financial policies or practices, or strategic or operating policies or practices, in each case which involve any Acquired Company;

(13) Comply in all material respects with all applicable material Legal Requirements and permits, including without limitation those relating to the filing of reports and the payment of Taxes due to be paid prior to the Closing, other than those contested in good faith;

(14) Not adopt, amend (other than amendments that reduce the amounts payable by SUG or any of its Subsidiaries or amendments required by law) or assume an obligation to contribute to any FAL Benefit Plan or collective bargaining agreement or enter into any employment, consulting, severance or similar Contract with any Person (including without limitation, contracts with management of any Acquired Company or any of its Affiliates that might require payments be made upon consummation of the transactions contemplated hereby) or amend any such existing contracts;

(15) Except in the Ordinary Course of Business or as required by the terms of any existing Contract, FAL Benefit Plan or collective bargaining

agreement, not grant any increase or change in total compensation, benefits or pay any bonus to any employee, director or consultant;

(16) Not grant or enter into or extend the term of any Contract with respect to continued employment or service for any employee, officer, director or consultant;

(17) Not make any loan or advance to any Person other than to any officer, director, stockholder or employee in the Ordinary Course of Business;

(18) Not terminate any existing gas purchase, exchange or transportation contract necessary to supply firm gas at all city gate delivery points or enter into any new contract for the supply, transportation, storage or exchange of gas with respect to the Acquired Companies' regulated gas distribution operations or renew or extend or negotiate any existing contract providing for the same where such contract is not terminable within sixty (60) days without penalty;

(19) Not amend any of its Organizational Documents; and

(20) Subject to Section 6.1(l), not issue or assume any note, debenture or other evidence of indebtedness which by its terms does not mature within one year from the date of execution or issuance thereof, unless otherwise redeemable or subject to prepayment at any time at the option of the Acquired Company on not more than thirty (30) days notice without penalty for such redemption or prepayment.

(b) Customer Notifications. At any time and from time to time reasonably requested by SUG prior to the Closing Date, each Acquired Company will permit SUG at FAL's expense to insert preprinted single-page customer education materials into billing documentation to be delivered to customers affected by this Agreement; provided, however, that FAL has reviewed in advance and consented to the content of such materials, which consent shall not be unreasonably withheld or delayed. Other means of notifying customers may be employed by either party, at the expense of the initiating party, but in no event shall any notification be initiated without the prior consent of the other party (which consent shall not be unreasonably withheld or delayed).

(c) Access to the Acquired Companies' Offices, Properties and Records; Updating Information.

(1) From and after the date hereof and until the Closing Date, the Acquired Companies shall permit SUG and its Representatives to have, on reasonable notice and at reasonable times, reasonable access to such of the offices, properties and employees of the Acquired Companies, and shall disclose, and make available to SUG and its Representatives all books, papers and records to

the extent that they relate to the ownership, operation, obligations and liabilities of or pertaining to the Acquired Companies, their businesses, assets and liabilities. Without limiting the application of the Confidentiality Agreement dated October 4, 1999 between FAL and SUG (the "Confidentiality Agreement"), all documents or information furnished by the Acquired Companies hereunder shall be subject to the Confidentiality Agreement.

(2) FAL will notify SUG as promptly as practicable of any significant change in the Ordinary Course of Business or operation of any of the Acquired Companies and of any material complaints, investigations or hearings (or communications indicating that the same may be contemplated) by any Governmental Body, or the institution or overt threat or settlement of any material Proceeding involving or affecting any of the Acquired Companies or the transactions contemplated by this Agreement, and shall use reasonable efforts to keep SUG fully informed of such events and permit SUG's Representatives access to all materials prepared in connection therewith, consistent with any applicable Legal Requirement or Contract.

(3) As promptly as practicable after SUG's request, FAL will furnish such financial and operating data and other information pertaining to the Acquired Companies and their businesses and assets as SUG may reasonably request; provided, however, that nothing herein will obligate any of the Acquired Companies to take actions that would unreasonably disrupt its Ordinary Course of Business or violate the terms of any Legal Requirement or Contract to which the Acquired Company is a party or to which any of its assets is subject in providing such information, or to incur any costs with respect to SUG's external auditors (or the Acquired Companies' external auditors in the event a report by such auditors is requested by SUG) providing accounting services with respect to issuing an auditor's report required by or for SUG.

(d) Governmental Approvals; Third Party Consents. FAL will use its reasonable best efforts to obtain all necessary consents, approvals and waivers from any Person required in connection with the transactions contemplated hereby under any license, lease, permit or Contract applicable to the Acquired Companies, including, without limitation, the approvals of those Governmental Bodies and the consents of those third parties listed in Section 5.4 and Section 5.5 of the FAL Disclosure Schedule and as required by the HSR Act.

(e) Dividends. FAL shall not, nor shall it permit any of its Subsidiaries to: (i) declare or pay any dividends on or make other distributions in respect of any of its or their capital stock other than (A) dividends by a wholly-owned Subsidiary to FAL or another wholly-owned Subsidiary, or (B) regular quarterly dividends on FAL Common Stock with usual record and payment dates that do not exceed the current rate of $0.96 per fiscal year; (ii) split, combine or reclassify any of its capital stock or the capital stock of any Subsidiary or issue or authorize or propose the issuance of any other securities in respect of, or in substitution for, shares of its

capital stock or the capital stock of any Subsidiary; or (iii) redeem, repurchase or otherwise acquire any shares of its capital stock or the capital stock of any Subsidiary other than redemptions, repurchases and other acquisitions of shares of capital stock in connection with the administration of employee benefit and dividend reinvestment and customer stock purchase plans as in effect on the date hereof in the ordinary course of the operation of such plans consistent with past practice.

(f) Issuance of Securities. FAL shall not, nor shall it permit any of its Subsidiaries to, issue, agree to issue, deliver, sell, award, pledge, dispose of or otherwise encumber or authorize or propose the issuance, delivery, sale, award, pledge, disposal or other encumbrance of, any shares of its or their capital stock of any class or any securities convertible into or exchangeable for, or any rights, warrants or options to acquire, any such shares or convertible or exchangeable securities, other than as provided for in the FAL Benefit Plans, and its dividend reinvestment plan in effect as of the date hereof.

(g) Accounting. FAL shall not, nor shall it permit any of its Subsidiaries to, make any changes in their accounting methods, principles or practices except as required by law, rule, regulation or GAAP.

(h) No Shopping.

(1) FAL shall not, and shall not authorize or permit any of its (or any of its Subsidiaries') officers, directors, agents, financial advisors, attorneys, accountants or other Representatives to, directly or indirectly, solicit, initiate or encourage submission of proposals or offers from any Person relating to, or that could reasonably be expected to lead to, a Business Combination or participate in any negotiations or discussions regarding, or furnish to any other Person any information with respect to, or otherwise cooperate in any way with, or assist or participate in, facilitate or encourage, any effort or attempt by any other Person to do or seek a Business Combination; provided, however, that, prior to the FAL Stockholders' Approval, FAL may, in response to an unsolicited written proposal from a third party with respect to a Business Combination that FAL's Board of Directors determines, in its good faith judgment, after consultation with and the receipt of the advice of its financial advisor and outside counsel with customary qualifications, is a Superior Proposal, (i) furnish information to, and negotiate, explore or otherwise engage in substantive discussions with such third party, only if FAL's Board of Directors determines, in its good faith judgment after consultation with its financial advisors and outside legal counsel, that it is reasonably necessary in order to comply with its fiduciary duties under applicable law and (ii) take and disclose to FAL's stockholders a position with respect to another Business Combination proposal, or amend or withdraw such position, pursuant to Rule 14d-9 and 14e-2 under the Exchange Act, or make such disclosure to FAL's stockholders which in the good faith judgment of FAL's Board of Directors is required by applicable law, based on the advice of its

outside counsel. Prior to furnishing any non-public information to, entering into negotiations with or accepting a Superior Proposal from such third party, FAL will (i) provide written notice to SUG to the effect that it is furnishing information to or entering into discussions or negotiations with such third party and (ii) receive from such third party an executed confidentiality agreement containing substantially the same terms and conditions as the Confidentiality Agreement. FAL will immediately cease and cause to be terminated any existing solicitation, initiation, encouragement, activity, discussion or negotiations with any parties conducted heretofore by FAL or any of its representatives with respect to any Business Combination.

(2) Except as expressly permitted by this Section 6.1(h), neither the FAL Board of Directors nor any committee thereof may, (i) withdraw or modify, or propose publicly to withdraw or modify, in a manner adverse to SUG, the approval or recommendation by such Board of Directors or such committee of the Merger or this Agreement, (ii) approve or recommend, or propose publicly to approve or recommend, a Business Combination or (iii) cause FAL to enter into any letter of intent, agreement in principle, acquisition agreement or other similar agreement related to any Business Combination. Notwithstanding the foregoing, prior to the time at which the FAL Stockholders' Approval has been obtained, in response to an unsolicited Business Combination proposal from a third party, if FAL's Board of Directors determines, in its good faith judgment, after consultation with and the receipt of the advice of its financial advisor and outside counsel with customary qualifications, that such proposal is a Superior Proposal and that failure to do any of the actions set forth in clauses (i), (ii) or (iii) above would create a reasonable possibility of a breach of the fiduciary duties of FAL's Board of Directors under applicable law, FAL's Board of Directors may (i) withdraw or modify its approval or recommendation of the Merger or this Agreement, approve or recommend a Business Combination or cause FAL to enter into a Business Combination and (ii) negotiate with a third party with respect to such Business Combination proposal and, subject to FAL having paid to SUG the fees described in Section 8.3(a) hereof and having entered into a definitive agreement with respect to such Business Combination proposal, terminate this Agreement; provided, however, that prior to entering into a definitive agreement with respect to a Business Combination proposal, FAL shall give SUG at least five (5) day's notice thereof, and shall cause its Representatives to, negotiate with SUG to make such adjustments in the terms and conditions of this Agreement as would enable FAL to proceed with the transactions contemplated herein on such adjusted terms; provided, further, that if FAL and SUG are unable to reach an agreement on such adjustments within five (5) days after such notice from FAL, FAL may enter into such definitive agreement, subject to the provisions of Article VIII.

(3) FAL shall notify SUG orally and in writing of any such inquiries, offers or proposals (including, without limitation, the material terms and conditions of any such offer or proposal and the identity of the Person making it), within one business day of the receipt thereof, shall use all reasonable efforts to keep SUG informed of the status and details of any such inquiry, offer or proposal and shall give SUG two (2) days advance notice of the first delivery of non-public information to such Person. If any such inquiry, offer or proposal is in writing, FAL shall promptly deliver to SUG a copy of such inquiry, offer or proposal.

(4) For purposes of this Agreement, (i) "Business Combination" means (other than the transactions contemplated or permitted by this Agreement) (A) a merger, consolidation or other business combination, share exchange, sale of shares of capital stock, tender offer or exchange offer or similar transaction involving FAL or any of its Subsidiaries, (B) acquisition in any manner, directly or indirectly, of a material interest in any capital stock of, or a material equity interest in a substantial portion of the assets of, FAL or any of its Subsidiaries, including any single or multi-step transaction or series of related transactions that is structured to permit a third party to acquire beneficial ownership of a majority or greater equity interest in FAL or any of its Subsidiaries, or (C) the acquisition in any manner, directly or indirectly, of any material portion of the business or assets (other than immaterial or insubstantial assets or inventory in the Ordinary Course of Business) of FAL or any of its Subsidiaries and (ii) "Superior Proposal" means a proposed Business Combination involving at least 50% of the shares of capital stock or a material portion of the assets of FAL that FAL's Board of Directors determines, after consulting with FAL's financial advisors and outside counsel, is financially superior to the transactions contemplated hereby and it appears that the party making the proposal is reasonably likely to have the funds necessary to consummate the Business Combination.

(i) Solicitation of Proxies; FAL Proxy Statement. Subject to Section 6.1(h), FAL shall use its reasonable best efforts to solicit from its stockholders proxies in favor of the Merger and shall take all other action necessary or, in the reasonable opinion of SUG, advisable to secure the FAL Stockholders' Approval.

(j) FAL Stockholders' Approval.

(1) Subject to the provisions of Section 6.1(h) and Section 6.1(j)(2), FAL shall, as soon as reasonably practicable after the date hereof (i) take all steps necessary to duly call, give notice of, convene and hold a meeting of its stockholders (including all adjournments thereof, the "FAL Meeting") for the purpose of securing the FAL Stockholders' Approval, (ii) distribute to its stockholders the FAL Proxy Statement in accordance with applicable federal and state law and with its Organizational Documents, (iii) subject to the fiduciary duties of its Board of Directors, recommend to its stockholders the approval and

adoption of this Agreement and the transactions contemplated hereby and (iv) cooperate and consult with SUG with respect to each of the foregoing matters.

(2) The FAL Meeting for the purpose of securing the FAL Stockholders' Approval, including any adjournments thereof, will be held on such date or dates as FAL and SUG mutually determine.

(k) Rule 145 Letters. FAL shall promptly identify to SUG all officers and directors of any Acquired Company and any other persons who are "affiliates" within the meaning of such term as used in Rule 145 under the Securities Act ("Rule 145 Affiliates"), and FAL shall use its reasonable efforts to provide to SUG undertakings from such persons ("Rule 145 Letters") to the effect that no disposition of shares of SUG Common Stock received in the Merger will be made by such persons except within the limits and in accordance with the applicable provisions of said Rule 145, as amended from time to time, or except in a transaction which, in the opinion of legal counsel satisfactory to SUG, is exempt from registration under the Securities Act.

(l) Financing Activities. FAL shall, and shall cause its Subsidiaries to, cooperate, to the fullest extent commercially reasonable and practicable, with SUG's requests with respect to refinancing by the Acquired Companies of the current maturities of any of their indebtedness, and any repurchase, redemption or prepayment by any of the Acquired Companies of any of its indebtedness that may be required prior to or because of the Merger or that SUG may request that the Acquired Companies effect prior to the Merger, so as to permit SUG to have the maximum opportunity to refinance, on or promptly after the Closing Date without any penalty except as may be due pursuant to the terms of the Acquired Companies' indebtedness as in effect on the date of this Agreement, any of the Acquired Companies' indebtedness outstanding on the Closing Date; provided, however, that no Acquired Company shall be required to consummate prior to the Effective Time any such refinancing, repurchase, redemption or repayment requested by SUG.

(m) FAL Disclosure Schedule. On the date hereof, FAL has delivered to SUG the FAL Disclosure Schedule, accompanied by a certificate signed by an executive officer of FAL stating the FAL Disclosure Schedule is being delivered pursuant to this Section 6.1(m). The FAL Disclosure Schedule constitutes an integral part of this Agreement and modifies the representations, warranties, covenants or agreements of FAL contained herein to the extent that such representations, warranties, covenants or agreements expressly refer to the FAL Disclosure Schedule.

(n) FAL Bondholders' Consent. FAL shall use its reasonable best efforts to obtain consents from all holders of each series of First Mortgage Bonds issued and outstanding under the Indenture of First Mortgage, dated as of December 1, 1952, between FAL and State Street Bank and Trust Company, successor in interest to the First National Bank of Boston, successor by merger to Old Colony Trust Company, as Trustee, as amended or supplemented from time to time, to such amendments to such Indenture as requested by SUG.

Section 6.2 Covenants of SUG. SUG agrees to observe and perform the following covenants and agreements:

(a) Governmental Approvals; Third Party Consents. SUG will use its reasonable best efforts at SUG's sole expense to obtain all necessary consents, approvals and waivers from any Person required in connection with the transactions contemplated hereby under any license, lease, permit, Contract or agreement applicable to SUG, including, without limitation, the approvals of those Governmental Bodies and the consents of those third parties listed in Section 4.5 of the SUG Disclosure Schedule and as required by the HSR Act.

(b) Employees; Benefits. With respect to the employees (excluding unionized employees) listed in Section 5.17(a) of the FAL Disclosure Schedule (or their successors employed pursuant to Section 6.1(a)(7) above) (the "Employees"), except as otherwise specified herein, SUG agrees as follows:

(1) During the 12 months immediately following the Closing Date, to make available to the Employees who continue their service with the Surviving Corporation or any Subsidiary of the Surviving Corporation employee benefit plans or arrangements that are no less favorable, in the aggregate, than the FAL Benefit Plans listed in Section 5.18(j) of the FAL Disclosure Schedule offered to the Employees immediately prior to the date of this Agreement.

(2) For purposes of eligibility, vesting and benefit accrual under all benefit plans provided to the Employees after the Closing Date, SUG will recognize the tenure of employment, as recognized by the Acquired Companies as of the Closing Date.

(3) All vacation time earned by the Employees prior to the Closing Date must be taken by the end of the calendar year in which the Closing Date occurs, except where the Employee is requested by FAL or SUG to forego their vacation for business-related reasons. For purposes of awarding vacation time at the beginning of each calendar year following the Closing Date, SUG will recognize the tenure of employment, as recognized by the Acquired Company as of the Closing Date.

(c) Blue Sky Permits. SUG shall use its reasonable best efforts to obtain, prior to the effective date of the Registration Statement, all necessary state securities laws or "blue sky" permits and approvals required to carry out the transactions contemplated by the Agreement, and will pay all expenses incident thereto.

(d) Listing Application. Prior to the Closing, SUG shall cause the shares of SUG Common Stock constituting the Stock Consideration to be listed on the NYSE, subject to official notice of issuance thereof.

(e) Collective Bargaining Agreements. At the Effective Time, SUG agrees to assume all collective bargaining agreements covering employees of any Acquired Company, and shall discharge when due any and all liabilities of any Acquired Company under such collective bargaining agreements relating to periods after the Effective Time.

(f) SUG Disclosure Schedule. On the date hereof, SUG has delivered to FAL the SUG Disclosure Schedule, accompanied by a certificate signed by an executive officer of SUG stating that the SUG Disclosure Schedule is being delivered pursuant to this Section 6.2(f). The SUG Disclosure Schedule constitutes an integral part of this Agreement and modifies the representations, warranties, covenants or agreements of SUG contained herein to the extent that such representations, warranties, covenants or agreements expressly refer to the SUG Disclosure Schedule.

(g) Conduct of the Business Prior to the Closing Date. Except (i) as contemplated in this Agreement, (ii) in connection with the transactions contemplated by the PEI Merger Agreement, (iii) as required by law or regulation or (iv) as otherwise expressly consented to in writing by FAL which consent will not be unreasonably withheld or delayed, prior to the Closing, SUG will:

(1) Not make or permit any material change in the general nature of its business;

(2) Maintain its present operations in the Ordinary Course of Business in accordance with prudent business judgment and consistent with past practice and policy, and maintain its assets in good repair, order and condition, reasonable wear and tear excepted, subject to retirements in the Ordinary Course of Business;

(3) Preserve SUG as an ongoing business and use reasonable efforts to maintain the goodwill associated with SUG; and

(4) Preserve all of SUG's franchises, tariffs, certificates of public convenience and necessity, licenses, authorizations and other governmental rights and permits.

(h) Access to SUG's Offices, Properties and Records; Updating Information.

(1) From and after the date hereof and until the Closing Date, SUG and its Subsidiaries shall permit FAL and its Representatives to have, on reasonable notice and at reasonable times, reasonable access to such of the offices, properties and employees of SUG and its Subsidiaries, and shall disclose, and make available to FAL and its Representatives all books, papers and records to the extent that they relate to the ownership, operation, obligations and liabilities of or pertaining to SUG, its Subsidiaries and their respective businesses and assets. Without limiting the application of the Confidentiality Agreement, all documents

or information furnished by SUG and its Subsidiaries hereunder shall be subject to the Confidentiality Agreement.

(2) SUG will notify FAL as promptly as practicable of any significant change in the Ordinary Course of Business or operation of SUG or any of its Subsidiaries and of any material complaints, investigations or hearings (or communications indicating that the same may be contemplated) by any Governmental Body, or the institution or overt threat or settlement of any material Proceeding involving or affecting SUG or any of its Subsidiaries or the transactions contemplated by this Agreement, and shall use reasonable efforts to keep FAL fully informed of such events and permit FAL's Representatives access to all materials prepared in connection therewith consistent with any applicable Legal Requirement or Contract.

Section 6.3 Additional Agreements.

(a) The Registration Statement and the FAL Proxy Statement. As soon as practicable after the date hereof, FAL and SUG shall take such reasonable steps as are necessary for the prompt preparation and filing with the SEC of (i) the FAL Proxy Statement by FAL and (ii) the Registration Statement, which will include certain information contained in the FAL Proxy Statement, by SUG. The foregoing shall include without limitation: (i) obtaining and furnishing the information required to be included therein, (ii) after consultation between FAL and SUG, responding promptly to any comments made by the SEC with respect to the FAL Proxy Statement and the Registration Statement and any amendments and preliminary version thereof and (iii) causing the Registration Statement to become effective, and the FAL Proxy Statement to be mailed to FAL's stockholders at the earliest practicable date. FAL agrees, as to information with respect to FAL, its officers, directors, stockholders and Subsidiaries contained in the Registration Statement and the FAL Proxy Statement, and SUG agrees, as to information with respect to SUG, its officers, directors, stockholders and Subsidiaries contained in the Registration Statement and the FAL Proxy Statement, that such information, in the case of the FAL Proxy Statement at the time of the mailing of the FAL Proxy Statement and (as then amended or supplemented) at the time of the FAL Meeting, or in the case of the Registration Statement at the time of the mailing of the FAL Proxy Statement (as then amended or supplemented), at the time of the FAL Meeting and at the effective time of the Registration Statement, will not contain any untrue statement of material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading. No representation, warranty, covenant or agreement is made by or on behalf of FAL with respect to information supplied by any other Person for inclusion in the FAL Proxy Statement or the Registration Statement. No representation, warranty, covenant or agreement is made by or on behalf of SUG with respect to information supplied by any other Person for inclusion in the FAL Proxy Statement or the Registration Statement. No filing of, or amendment or supplement to, the FAL Proxy Statement or the Registration Statement shall be made by any party hereto without providing the other party with the opportunity to review and comment thereon (except for any ongoing SEC reporting required of SUG or FAL that will be

incorporated by reference). If at any time prior to the Effective Time any information relating to any party hereto or any of their respective officers, directors, stockholders or Subsidiaries, should be discovered by any party hereto which should be set forth in an amendment or supplement to the FAL Proxy Statement or the Registration Statement so that the FAL Proxy Statement or the Registration Statement would not include any untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, the party which discovers such information shall promptly notify the other party hereto and an appropriate amendment or supplement describing such information shall be promptly prepared, filed with the SEC and, to the extent required by law, disseminated to the stockholders of FAL, as may be necessary.

(b) Further Assurances. Each of SUG and FAL agrees, and FAL agrees to cause its Subsidiaries, to take all such reasonable and lawful action as may be necessary or appropriate in order to effectuate the Merger in accordance with this Agreement as promptly as possible. If, at any time after the Effective Time, any such further action is necessary or desirable to carry out the purpose of this Agreement and to vest the Surviving Corporation with full right, title and possession to all assets, property, rights, privileges, powers and franchises of the Acquired Companies, the officers and directors of the Surviving Corporation will be fully authorized to take, and will take, all such lawful and necessary action.

(c) Financial Statements to be Provided. Upon SUG's request, FAL shall (i) provide to SUG audited and unaudited financial statements required to be included in the proxy statements and the registration statement contemplated by the PEI Merger Agreement and (ii) cause its independent accountants to deliver to SUG and PEI the required consents in connection therewith.

ARTICLE VII
CONDITIONS

Section 7.1 Conditions to SUG's Obligation to Effect the Merger. The obligation of SUG to effect the transactions contemplated by this Agreement shall be subject to fulfillment at or prior to the Closing of the following conditions:

(a) Representations and Warranties True as of the Closing Date. FAL's representations and warranties in this Agreement shall have been accurate in all material respects as of the date of this Agreement and shall be accurate in all material respects as of the Closing Date as if made on the Closing Date; provided, however, that any such representation or warranty that is qualified by any standard of materiality (including, but not limited to, FAL Material Adverse Effect) shall have then been, and shall then be, accurate in all respects.

(b) Compliance with Agreements. The covenants, agreements and conditions required by this Agreement to be performed and complied with by any of the Acquired Companies shall have been performed and complied with in all material respects prior to or at the Closing Date.

(c) Certificate. FAL shall execute and deliver to SUG a certificate of an authorized officer of FAL, dated the Closing Date, stating that the conditions specified in Sections 7.1(a) and 7.1(b) of this Agreement applicable to the Acquired Companies have been satisfied.

(d) Governmental Approvals. All approvals, consents, opinions or rulings of all Governmental Bodies required in order to consummate the transactions contemplated hereby shall have been obtained by Final Order in such form as is, and with no conditions that are, individually or in the aggregate, reasonably likely to have a FAL Material Adverse Effect or a material adverse effect on the business, operations, properties, financial condition or results of operations of the Surviving Corporation, or which would otherwise, in the reasonable determination of SUG, be unduly burdensome to the Surviving Corporation or any of its Affiliates. In addition, and without limitation of the condition set forth in the immediately preceding sentence, the Massachusetts Department of Telecommunications and Energy shall have resolved, by means of a Final Order, the manner in which the Surviving Corporation as a whole and its operating division in Massachusetts will be regulated under Chapter 164 of the Massachusetts General Laws, and such resolution shall be acceptable to SUG in its sole discretion. The applicable waiting period under the HSR Act with respect to the transactions contemplated hereby shall have expired or have been terminated.

(e) Third Party Consents. Each of the consents required under Section 5.4 of this Agreement shall have been obtained to the reasonable satisfaction of SUG, other than any such consents which, if not obtained, are not, individually or in the aggregate, reasonably likely to result in a FAL Material Adverse Effect after the Closing. In addition, all consents and approvals required, under the terms of any note, bond or indenture listed in Section 5.4 of the FAL Disclosure Schedule to which any of the Acquired Companies is a party, shall have been obtained.

(f) Injunctions. On the Closing Date, there shall be no Orders which operate to restrain, enjoin or otherwise prevent the consummation of this Agreement or the Merger.

(g) Resignations. Each director of each Acquired Company shall resign any position as a director of an Acquired Company effective as of the Closing Date in accordance with such Acquired Company's Organizational Documents and applicable provisions of the MBCL; provided, however, that such resignations shall not cause the termination of any such Person's employment as an employee of an Acquired Company or reduce any such employee's then current level of compensation.

(h) Opinion of Tax Counsel. On the Closing Date, SUG shall have received from Hughes Hubbard & Reed LLP, counsel to SUG, an opinion to the effect that the Merger will constitute a "reorganization" within the meaning of IRC Section 368(a)(1)(A), and that no gain or loss will be recognized by SUG or FAL with respect to the Merger.

(i) FAL Stockholders' Approval. The FAL Stockholders' Approval shall have been obtained.

(j) Appraisal Rights. Demand for payment for shares and appraisal thereof by stockholders of FAL in accordance with the MBCL with respect to the Merger shall not equal or exceed 5 percent of the shares of FAL Common Stock entitled to vote on the Merger.

(k) Rule 145 Letters. Each Rule 145 Affiliate shall have executed and delivered to SUG a Rule 145 Letter, in form and substance reasonably satisfactory to SUG and its counsel.

(l) Registration Statement. The Registration Statement shall have become effective, no stop order suspending the effectiveness of the Registration Statement shall have been issued and no proceedings for that purpose shall have been initiated or threatened by the SEC.

(m) Listing of SUG Common Stock. The shares of SUG Common Stock constituting the Stock Consideration shall have been authorized for listing, upon official notice of issuance, on the NYSE.

(n) FAL Bondholders' Consent. All holders of each series of First Mortgage Bonds issued and outstanding under the Indenture of First Mortgage, dated as of December 1, 1952, between FAL and State Street Bank and Trust Company, successor in interest to the First National Bank of Boston, successor by merger to Old Colony Trust Company, as Trustee, as amended or supplemented from time to time, shall have consented to such amendments to such Indenture as requested by SUG.

Section 7.2 *Conditions to FAL's Obligations to Effect the Merger.* The obligation of FAL to effect the transactions contemplated by this Agreement shall be subject to fulfillment at or prior to the Closing of the following conditions:

(a) Representations and Warranties True as of the Closing Date. SUG's representations and warranties in this Agreement shall have been accurate in all material respects as of the date of this Agreement and shall be accurate in all material respects as of the Closing Date as if made on the Closing Date; provided, however, that any such representation or warranty that is qualified by any standard of materiality (including, but not limited to, SUG Material Adverse Effect) shall have then been, and shall then be, accurate in all respects.

(b) Compliance with Agreements. The covenants, agreements and conditions required by this Agreement to be performed and complied with by SUG shall have been performed and complied with in all material respects prior to or at the Closing Date.

(c) Certificate. SUG shall execute and deliver to FAL a certificate of an authorized officer of SUG, dated the Closing Date, stating that the conditions specified in Sections 7.2(a) and 7.2(b) of this Agreement applicable to SUG have been satisfied.

(d) Governmental Approvals. All approvals, consents, opinions or rulings of all Governmental Bodies required in order to consummate the transactions contemplated hereby

shall have been obtained by Final Order in such form as is, and with no conditions that are, individually or in the aggregate, reasonably likely to have a material adverse effect on the business, operations, properties, financial condition or results of operations of the Surviving Corporation. The applicable waiting period under the HSR Act with respect to the transactions contemplated hereby shall have expired or have been terminated.

(e) Injunctions. On the Closing Date, there shall be no Orders which operate to restrain, enjoin or otherwise prevent the consummation of this Agreement or the Merger.

(f) Opinion of Counsel. On the Closing Date, FAL shall have received from Rich, May, Bilodeau & Flaherty, P.C., counsel to FAL, an opinion to the effect that the Merger will be treated for federal income tax purposes as a "reorganization" within the meaning of IRC Section 368(a), and that no gain or loss will be recognized for federal income tax purposes by the stockholders of FAL who receive SUG Common Stock in the Merger upon their receipt of the Merger Consideration, except that any realized gain will be recognized to the extent of the amount of cash received (including cash in lieu of the fractional shares).

(g) FAL Stockholders' Approval. The FAL Stockholders' Approval shall have been obtained.

(h) Registration Statement. The Registration Statement shall have become effective, no stop order suspending the effectiveness of the Registration Statement shall have been issued and no proceedings for that purpose shall have been initiated or threatened by the SEC.

(i) Listing of SUG Common Stock. The shares of SUG Common Stock constituting the Stock Consideration shall have been authorized for listing, upon official notice of issuance, on the NYSE.

ARTICLE VIII
TERMINATION

Section 8.1 Termination Rights. This Agreement may be terminated in its entirety at any time prior to the Closing:

(a) By the mutual written consent of SUG and FAL;

(b) By FAL, on the one hand, or SUG, on the other hand, in writing if there shall be in effect a non-appealable order of a court of competent jurisdiction prohibiting the consummation of the Merger in accordance with this Agreement;

(c) By FAL, by written notice to SUG, if there is a breach of any representation, warranty, covenant or agreement of SUG, which breach cannot be cured and would cause the conditions set forth in Section 7.2(a) or (b) to be incapable of being satisfied;

(d) By SUG, by written notice to FAL, if there is a breach of any representation, warranty, covenant or agreement of FAL, which breach cannot be cured and would cause the conditions set forth in Section 7.1(a) or (b) to be incapable of being satisfied;

(e) By FAL, by written notice to SUG in accordance with Section 6.1(h)(2); provided, however, that the termination described in this clause (e) shall not be effective unless and until FAL shall have paid SUG the fee described in Section 8.3(a) and FAL has substantially contemporaneously entered into a definitive agreement with respect to the proposed Business Combination;

(f) By FAL, by written notice to SUG, if the FAL Stockholders' Approval is not obtained at the FAL Meeting or by SUG, by written notice to FAL, if the FAL Stockholders' Approval is not obtained at the FAL Meeting; provided, however, that there has not been a material misrepresentation or a material breach of covenant, warranty or agreement contained herein on the part of the party asserting its right to terminate pursuant to this Section 8.1(f);

(g) By SUG, by written notice to FAL, if the Board of Directors of FAL or any committee thereof (i) withdraws or modifies, or proposes publicly to withdraw or modify, in a manner adverse to SUG, the approval or recommendation by the Board of Directors or such committee of the Merger or this Agreement, (ii) approves or recommends, or proposes publicly to approve or recommend, a Business Combination, (iii) causes FAL to enter into a definitive agreement related to any Business Combination or (iv) resolves to take any of the actions specified in clause (i), (ii) and (iii) above;

(h) By SUG, by written notice to FAL, if a third party, including a group (as defined under the Exchange Act) acquires securities representing greater than 50% of the voting power of the outstanding voting securities of FAL; or

(i) By FAL, by written notice to SUG, if the Average Trading Price of the SUG Common Stock as of the Closing is lower than $15.00.

(j) By either party in writing at any time after 5:00 p.m., Eastern Time, on October 15, 2000 (the "Initial Termination Date"), if the Closing has not occurred prior thereto; provided, however, that the right to terminate this Agreement under this Section 8.1(j) will not be available to any party that is in material breach of its representations, warranties, covenants or agreements contained herein; and provided, further, that if on the Initial Termination Date (i) the conditions to closing set forth in Sections 7.1(d) and 7.2(d) shall not have been fulfilled or (ii) any approval or authorization of any Governmental Body required in connection with the consummation of the Merger shall have not been obtained and such approval or authorizations shall not have become a Final Order, but all other conditions to Closing shall be fulfilled or shall be capable of being fulfilled, then the Initial Termination Date will be extended to February 28, 2001.

Section 8.2 Effect of Termination. If this Agreement is terminated pursuant to Section 8.1, this Agreement shall be of no further force and effect and there shall be no further

liability hereunder on the part of any party or its Affiliates, directors, officers, stockholders, agents or other Representatives; provided, however, that (i) any fee payable under Section 8.3(a) is paid to SUG and (ii) no such termination shall relieve any party of liability for any claims, damages or losses suffered by the other party as a result of the negligent or willful failure of a party to perform any obligations required to be performed by it hereunder on or prior to the date of termination. Notwithstanding anything to the contrary contained herein, the provisions of Section 8.2, Sections 10.1 through 10.6 and Sections 10.8 through 10.11 of this Agreement shall survive any termination of this Agreement.

Section 8.3 Termination Fee; Expenses.

(a) Termination Fee. If this Agreement is terminated pursuant to Section 8.1(e), 8.1(g) or 8.1(h), then FAL shall pay to SUG promptly (but not later than five business days after notice is received from FAL) an amount equal to $1.5 million in cash.

(b) Expenses. The parties agree that the agreements contained in this Section 8.3 are an integral part of the transactions contemplated by this Agreement and constitute liquidated damages and not a penalty. Notwithstanding anything to the contrary contained in this Section 8.3, if FAL fails to pay promptly to SUG the fee due under Section 8.3(a), in addition to any amounts paid or payable pursuant to Section 8.3(a), FAL shall pay the costs and expenses (including legal fees and expenses) in connection with any action, including the filing of any lawsuit or other legal action, taken to collect payment, together with interest on the amount of any unpaid fee calculated using an annual percentage rate of interest equal to the prime rate published in the *Wall Street Journal* on the date (or preceding business day if such date is not a business day) such fee was required to be paid, compounded on a daily basis using a 360-day year.

ARTICLE IX
INDEMNIFICATION; REMEDIES

Section 9.1 Directors' and Officers' Indemnification.

(a) Indemnification and Insurance. For a period of six years after the Effective Time, the Surviving Corporation will indemnify and hold harmless the present and former officers and directors of FAL and its Subsidiaries (the "Indemnified Parties") in respect of acts or omissions occurring prior to the Effective Time to the extent provided under FAL's articles of organization and bylaws in effect on the date hereof; provided, however, that if any claim or claims are asserted or made within such six-year period, all rights to indemnification in respect of such claims shall continue until the final disposition of any and all such claims. For six years after the Effective Time, the Surviving Corporation will use its reasonable best efforts to provide officers' and directors' liability insurance in respect of acts or omissions occurring prior to the Effective Time covering each such person currently covered by FAL's officers' and directors' liability insurance policy on terms with respect to coverage and amount no less favorable than those of such policy in effect on the date hereof; provided, however, that in satisfying its obligation under this Section, if the annual premiums of such insurance coverage

exceed 200% of the previous year's premiums, the Surviving Corporation will be obligated to obtain a policy with the best coverage available, in the reasonable judgment of the Board of Directors of the Surviving Corporation for a cost not exceeding such amount.

(b) Successors. In the event the Surviving Corporation or any of its successors or assigns (i) consolidates with or merges into any other Person and is not the continuing or surviving corporation or entity of such consolidation or merger or (ii) transfers all or substantially all of its properties and assets to any Person, then and in either such case, proper provisions must be made so that the successors and assigns of the Surviving Corporation will assume the obligations set forth in this Section 9.1.

(c) Survival of Indemnification. To the fullest extent permitted by law, from and after the Effective Time, all rights to indemnification as of the date hereof in favor of the employees, agents, directors and officers of any Acquired Company with respect to their activities as such prior to the Effective Time, as provided in their respective Organizational Documents in effect on the date hereof, or otherwise in effect on the date hereof, will survive the Merger and will continue in full force and effect except for amendments to make changes permitted by law that would enhance the rights of past or present officers and directors to indemnification or advancement of expenses in respect of acts or omissions occurring prior to the Effective Time for a period of not less than six years from the Effective Time (or, in the case of matters occurring prior to the Effective Time which have not been resolved prior to the sixth anniversary of the Effective Time, until such matters are finally resolved).

Section 9.2 Representations and Warranties. Each and every representation and warranty of either party shall expire at, and be terminated and extinguished with, the Effective Time.

ARTICLE X
GENERAL PROVISIONS

Section 10.1 Expenses. Each of the parties will pay all costs and expenses of its performance of and compliance with this Agreement, except (i) as provided in Section 8.3 and as expressly provided otherwise herein, (ii) FAL shall pay all fees and expenses of counsel for FAL, (iii) SUG will pay all real estate transfer taxes and real estate recording fees, if any, including expenses of counsel associated with real estate title, transfer and recording issues in connection with the Merger, and all filing and application fees paid to Governmental Bodies in connection with the Merger and (iv) SUG and FAL will each pay half of the combined costs of printing and mailing to the FAL stockholders the prospectus that is a part of the Registration Statement and the FAL Proxy Statement.

Section 10.2 Notices. All notices, requests and other communications hereunder shall be in writing and shall be deemed to have been given upon receipt if either (a) personally delivered, (b) sent by prepaid first class mail, and registered or certified and a return receipt requested or (c) by facsimile telecopier with completed transmission acknowledged:

if to SUG, to:

Southern Union Company
504 Lavaca Street, Suite 800
Austin, Texas 78701
Attention: Peter H. Kelley
President and Chief Operating Officer
Telecopier: (512) 477-3879

with a copy to:

Pennsylvania Enterprises, Inc.
One PEI Center
Wilkes-Barre, Pennsylvania 18711-0601
Attention: Thomas F. Karam
President and Chief Executive Officer
Telecopier: (570) 829-8900

and

Hughes Hubbard & Reed LLP
One Battery Park Plaza
New York, New York 10004
Attention: Garett J. Albert
Telecopier: (212) 422-4726

if to FAL, to:

Fall River Gas Company
155 North Main Street
Fall River, Massachusetts 02722
Attention: Bradford J. Faxon
President and Chief Executive Officer
Telecopier: (508) 675-7811

with a copy to:

Rich, May, Bilodeau & Flaherty, P.C.
176 Federal Street
Boston, Massachusetts 02110
Attention: Eric J. Krathwohl
Telecopier: (617) 556-3889

or at such other address or number as shall be given in writing by a party to the other parties.

Section 10.3 Assignment. This Agreement may not be assigned by any party hereto without the prior written consent of the other parties hereto. Any assignment in violation of the terms of this Agreement shall be null and void *ab initio*.

Section 10.4 Successor Bound. Subject to the provisions of Section 10.3, this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns.

Section 10.5 Governing Law; Forum; Consent to Jurisdiction. This Agreement shall be construed in accordance with and governed by the laws of the State of New York except to the extent that the terms and consummation of the Merger are subject to the DGCL or the MBCL in which case such laws shall govern. Each party to this Agreement hereby irrevocably and unconditionally (i) consents to submit to the exclusive jurisdiction of the federal courts of the Southern District of New York in the county of New York and the borough of Manhattan and the jurisdiction of the federal courts of the District of Massachusetts in the county of Suffolk and the city of Boston for any proceeding arising in connection with this Agreement (and each such party agrees not to commence any such proceeding, except in such courts), (ii) to the extent such party is not a resident of the State of New York or the Commonwealth of Massachusetts, agrees to appoint agents in the State of New York and the Commonwealth of Massachusetts as such party's agents for acceptance of legal process in any such proceeding against such party with the same legal force and validity as if served upon such party personally within the State of New York or the Commonwealth of Massachusetts, respectively, and to notify promptly each other party hereto of the name and address of each such agent, (iii) waives any objection to the laying of venue of any such proceeding in the federal courts of the Southern District of New York in the county of New York and the borough of Manhattan or the federal courts of the District of Massachusetts in the county of Suffolk and the city of Boston, and (iv) waives, and agrees not to plead or to make, any claim that any such proceeding brought in any federal court of the Southern District of New York or the District of Massachusetts has been brought in an improper or otherwise inconvenient forum.

Section 10.6 Waiver of Trial By Jury. EACH PARTY TO THIS AGREEMENT HEREBY WAIVES TRIAL BY JURY IN ANY ACTION OR PROCEEDING TO WHICH ANY SUCH PARTY MAY BE A PARTY ARISING OUT OF OR IN ANY WAY PERTAINING TO (i) THIS AGREEMENT, (ii) THE MERGER, (iii) THE CONFIDENTIALITY AGREEMENT OR (iv) ANY RELATED DOCUMENTS. IT IS AGREED AND UNDERSTOOD THAT THIS WAIVER CONSTITUTES A WAIVER OF TRIAL BY JURY OF ALL CLAIMS AGAINST ALL PARTIES WHO ARE PARTIES TO THIS AGREEMENT. THIS WAIVER IS KNOWINGLY, WILLINGLY AND VOLUNTARILY MADE BY EACH PARTY HERETO, AND EACH SUCH PARTY HEREBY REPRESENTS AND WARRANTS THAT NO REPRESENTATIONS OF FACT OR OPINION HAVE BEEN MADE BY ANY PERSON TO INDUCE THIS WAIVER OR TRIAL BY JURY OR TO IN ANY WAY MODIFY OR NULLIFY ITS EFFECT. EACH PARTY TO THIS AGREEMENT FURTHER REPRESENTS AND WARRANTS THAT EACH SUCH PARTY HAS BEEN REPRESENTED IN THE

SIGNING OF THIS AGREEMENT AND IN THE MAKING OF THIS WAIVER BY INDEPENDENT LEGAL COUNSEL, SELECTED OF EACH SUCH PARTY'S OWN FREE WILL, AND THAT EACH SUCH PARTY HAS HAD THE OPPORTUNITY TO DISCUSS THIS WAIVER WITH COUNSEL.

Section 10.7 Cooperation; Further Documents.

(a) Each of the parties hereto agrees to use its reasonable best efforts to take or cause to be taken all action, and to do or cause to be done all things necessary, proper or advisable under applicable laws, regulations or otherwise, to consummate and to make effective the transactions contemplated by this Agreement, including, without limitation, the timely performance of all actions and things contemplated by this Agreement to be taken or done by each of the parties hereto.

(b) Each party shall cooperate with the other party in such other party's discharge of the obligations hereunder, which shall include making reasonably available to the other party such of its personnel as have relevant information, with respect thereto.

Section 10.8 Construction of Agreement. The terms and provisions of this Agreement represent the results of negotiations between the parties hereto and their Representatives, each of which has been represented by counsel of its own choosing, and neither of which has acted under duress or compulsion, whether legal, economic or otherwise. Accordingly, the terms and provisions of this Agreement shall be interpreted and construed in accordance with their usual and customary meanings, and FAL and SUG hereby waive the application in connection with the interpretation and construction of this Agreement of any rule of law to the effect that ambiguous or conflicting terms or provisions contained in this Agreement shall be interpreted or construed against the party whose attorney prepared the executed draft or any earlier draft of this Agreement.

Section 10.9 Publicity; Organizational and Operational Announcements. No party hereto shall issue, make or cause the publication of any press release or other announcement with respect to this Agreement or the transactions contemplated hereby, or otherwise make any disclosures relating thereto, without the consent of the other party, such consent not to be unreasonably withheld or delayed; provided, however, that such consent shall not be required where such release or announcement is required by applicable law or the rules or regulations of a securities exchange, in which event the party so required to issue such release or announcement shall endeavor, wherever possible, to furnish an advance copy of the proposed release to the other party.

Section 10.10 Waiver. Except as otherwise expressly provided in this Agreement, neither the failure nor any delay on the part of any party to exercise any right, power or privilege hereunder shall operate as a waiver thereof, nor shall any single or partial exercise or waiver of any such right, power or privilege preclude any other or further exercise thereof, or the exercise of any other right, power or privilege available to each party at law or in equity.

Section 10.11 Parties in Interest. This Agreement (including the documents and instruments referred to herein) is not intended to confer upon any Person, other than the parties hereto and their successors and permitted assigns, any rights or remedies hereunder, except that the parties hereto agree and acknowledge that the agreements and covenants contained in Section 9.1 are intended for the direct and irrevocable benefit of the Indemnified Parties described therein and their respective heirs or legal representatives (each such director or Indemnified Party, a "Third Party Beneficiary"), and that each such Third Party Beneficiary, although not a party to this Agreement, shall be and is a direct and irrevocable third party beneficiary of such agreements and covenants and shall have the right to enforce such agreements and covenants against the Surviving Corporation in all respects fully and to the same extent as if such Third Party Beneficiary were a party hereto.

Section 10.12 Specific Performance. The parties hereto agree that irreparable damage would occur to a party in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that any party shall be entitled to an injunction or injunctions to prevent breaches of this agreement by any other party and to enforce specifically, to the fullest extent available, the terms and provisions hereof, including each party's obligation to close, in any court of the United States or any state having jurisdiction, this being in addition to any other right or remedy to which any party is entitled at law or in equity.

Section 10.13 Section and Paragraph Headings. The section and paragraph headings in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

Section 10.14 Amendment. This Agreement may be amended only by an instrument in writing executed by the parties hereto.

Section 10.15 Entire Agreement. This Agreement, the exhibits, annexes and schedules hereto and the documents specifically referred to herein and the Confidentiality Agreement constitute the entire agreement, understanding, representations and warranties of the parties hereto with respect to the subject matter hereof.

Section 10.16 Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

[SIGNATURES APPEAR ON FOLLOWING PAGE]

IN WITNESS WHEREOF, the parties have executed and delivered this Agreement as of the date first written above.

SOUTHERN UNION COMPANY

By: _____
Name: Ronald J. Endres
Title: Executive Vice President

FALL RIVER GAS COMPANY

By: _____
Name: Bradford J. Faxon
Title: President and Chief Executive Officer

By: _____
Name: Peter H. Thanas
Title: Senior Vice President and Treasurer

[SEAL]

IN WITNESS WHEREOF, the parties have executed and delivered this Agreement as of the date first written above.

SOUTHERN UNION COMPANY

By:
Name: Peter H. Kelley
Title: President and Chief Operating

FALL RIVER GAS COMPANY

By:
Name: Bradford J. Faxon
Title: President and Chief Executive

By:
Name: Peter H. Thanas
Title: Senior Vice President and Treasurer

(SEAL)