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July 30, 2001

KAREN D. WALKER  
850-425-5612

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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

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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 "B" 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 Word format has been provided.

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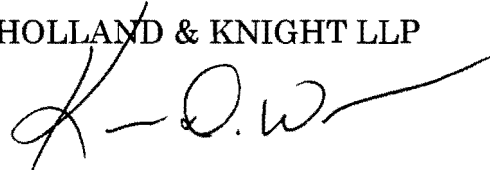
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Blanca Bayo  
July 30, 2001  
Page 2

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

A handwritten signature in black ink, appearing to read "K-D. Walker", with a long horizontal flourish extending to the right.

Karen D. Walker

KDW:kjg  
Enclosure

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

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Docket No. 011000-EI  
Filed: July 30, 2001

**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, 2002. 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, 2001, Southern Union had approximately \$3.2 billion in assets and five natural gas divisions which provide service to more than 1.5 million customers in Texas, Missouri, Pennsylvania, Massachusetts, Rhode Island and

DOCUMENT NUMBER-DATE

09288 JUL 30 2001

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Florida.<sup>1</sup> 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 Florida, Massachusetts, Missouri, 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  
Executive Vice President – Administration, General  
Counsel and Secretary  
Southern Union Company  
504 Lavaca Street, Suite 800  
Austin, Texas 78701  
(517) 370-8310

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<sup>1</sup> 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. The New England Division serves approximately 291,000 customers in Rhode Island and southeastern Massachusetts.

D. Bruce May  
Karen D. Walker  
HOLLAND & KNIGHT LLP  
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) 123,712 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, 2001, there were 50,981,547 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, 2001, 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.

Southern Union's funded debt is described in Exhibit "C" attached hereto, which includes: (a) a brief description of the funded debt, (b) the amounts authorized, (c) the amounts outstanding, (d) the amounts held as reacquired securities, (e) the amounts pledged, (f) the amounts owned by affiliated corporations, and (g) the amounts held in any funds.

## **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 ending July 31, 2002. In addition, Southern Union seeks authority to borrow up to \$500,000,000 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 July 27, 2001, a new issue of 10-year senior notes of Southern Union would have carried a yield to maturity of approximately 7.34%. The dividend rate for preferred securities is similarly affected by the terms of the offering. On July 27, 2001, a new issue of thirty-year tax deductible preferred securities of Southern Union would have carried a dividend yield of approximately 8.00%.

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 to convert the interim financing for its New England Mergers to a long-term financing;<sup>2</sup> to reacquire, by redemption, purchase, exchange or otherwise, any of its outstanding debt 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 maintains a continuous construction program, principally for gas distribution facilities. Southern Union estimates that construction

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<sup>2</sup> In Order No. PSC-00-1525-FOF-GU, the Commission recognized that Southern Union planned to enter into a 364 day credit facility, with an option to extend for an additional 364 days, to finance the mergers of Providence Energy Corporation, Valley Resources, Inc., and Fall River Gas Company into Southern Union. *See In re: Application by Atlantic Utilities, a Florida Division of Southern Union Company d/b/a South Florida Natural Gas for authority to issue and sell securities pursuant to Section 366.04, F.S., and Chapter 25-8, F.A.C.; and request for approval to borrow funds for short-term financing purposes*, 00 F.P.S.C. 8:313, Docket No. 000691-GU, Order No. PSC-00-1525-FOF-GU (Aug. 22, 2000). These mergers, which are now concluded, are commonly referred to as the New England Mergers. Up to \$100,000,000 of common equity, up to \$200,000,000 in preferred securities or preferred stock, and/or up to \$400,000,000 of debt securities will be used to refinance the interim debt incurred in connection with the New England Mergers.

expenditures under its fiscal year 2002 construction program will be approximately \$125,000,000.

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, simplification of Southern Union's capital structure, 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 \$500,000,000 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 \$500,000,000 will be priced based on LIBOR or the Euro rate and/or the prime rate of interest, and thus will fluctuate with market conditions.

**7. Lawful Object and Purpose**

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.

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

**FORM 10-K/A**  
**Amendment No. 1**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Fiscal Year Ended June 30, 2000

OR

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

Commission File No. 1-6407

**SOUTHERN UNION COMPANY**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**75-0571592**  
(I.R.S. Employer  
Identification No.)

**504 Lavaca Street, Eighth Floor**  
**Austin, Texas**  
(Address of principal executive offices)

**78701**  
(Zip Code)

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

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

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

Name of each exchange on which registered  
New York Stock Exchange

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

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

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

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

**DOCUMENTS INCORPORATED BY REFERENCE**

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

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

## PART I

### ITEM 1. *Business.*

#### Introduction

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

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

#### Pennsylvania Enterprises, Inc. Acquisition

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

#### Acquisitions Subsequent to Year-End

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

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

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

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

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

### **Company Operations**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

### **Company Investments**

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

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

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

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

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



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

### Competition

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

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

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

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

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

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

### Gas Supply

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

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

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

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

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

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

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

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

### **Utility Regulation and Rates**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

### **Environmental**

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

### **Investments in Real Estate**

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

### **Employees**

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

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

## Statistics of Principal Utility and Related Operations

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

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

- (a) "Degree days" are a measure of the coldness of the weather experienced. A degree day is equivalent to each degree that the daily mean temperature for a day falls below 65 degrees Fahrenheit.
- (b) Information with respect to weather conditions is provided by the National Oceanic and Atmospheric Administration. Percentages of 30-year measure are computed based on the weighted average volumes of gas sales billed.

Eight Months  
Ended June 30,  
2000(a)

**PG Energy:**

Average number of gas sales customers served:

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

Gas sales in MMcf:

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

Weather:

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

Gas transported in MMcf .....

	19,403
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(a) PG Energy was acquired on November 4, 1999. See *Pennsylvania Enterprises, Inc. Acquisition*.

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

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

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

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

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

**ITEM 2. Properties.**

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

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

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

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

**ITEM 3. Legal Proceedings.**

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

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

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



## PART II

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

#### Market Information

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

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

#### Holdings

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

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

#### Dividends

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

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

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

**ITEM 6. Selected Financial Data.**

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

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

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

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

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

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

### **Results of Operations**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

### Liquidity and Capital Resources

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

#### **Quantitative and Qualitative Disclosures About Market Risk**

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

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

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

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

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

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

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

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

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

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

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

## Other Matters

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

None.

**PART III**

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

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

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

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

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

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

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

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

**PART IV**

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

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

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

<b><u>Exhibit No.</u></b>	<b><u>Description</u></b>
2(a)	Agreement of Merger between Southern Union Company and Fall River Gas Company dated as of October 4, 1999. (Filed as Exhibit 2 to Southern Union's Current Report on Form 8-K filed on October 4, 1999 and incorporated herein by reference.)
2(b)	Agreement and Plan of Merger among Southern Union Company, GUS Acquisition Corporation and Providence Energy Corporation dated November 15, 1999. (Filed as Exhibit 2 to Southern Union's Current report on Form 8-K filed on November 19, 1999 and incorporated herein by reference.)



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

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

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

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\* Indicates Management Compensation Plan.

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<u>Exhibit No.</u>	<u>Description</u>
23	Consent of Independent Accountants.
24	Power of Attorney.
27	Financial Data Schedule.
(b)	<b>Reports on Form 8-K.</b> Southern Union's Current Report on Form 8-K dated June 5, 2000 providing certain historical financial statements and related notes thereto of Valley Resources, Inc. and Providence Energy Corporation.

## SIGNATURES

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

SOUTHERN UNION COMPANY

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

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

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**SOUTHERN UNION COMPANY AND SUBSIDIARIES  
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**SOUTHERN UNION COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF OPERATIONS**

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

See accompanying notes.

**SOUTHERN UNION COMPANY AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEET**

**ASSETS**

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

See accompanying notes.



**SOUTHERN UNION COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEET (Continued)**

**STOCKHOLDERS' EQUITY AND LIABILITIES**

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

See accompanying notes.

**SOUTHERN UNION COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**

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

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

See accompanying notes.

**SOUTHERN UNION COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**

	Common Stock, \$1 Par Value	Premium on Capital Stock	Treasury Stock, at Cost	Common Stock Held in Trust	Accumulated Other Comprehen- sive Income	Retained Earnings	Total
	(thousands of dollars)						
Balance July 1, 1997	\$ 17,171	\$ 225,252	\$ (794)	\$ --	\$ 664	\$ 25,169	\$ 267,462
Comprehensive income:							
Net earnings	--	--	--	--	--	12,229	12,229
Reclassification adjustment for gains included in net income	--	--	--	--	(664)	--	(664)
Comprehensive income							<u>11,565</u>
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	<u>28,252</u>	<u>252,638</u>	<u>(794)</u>	<u>--</u>	<u>--</u>	<u>16,738</u>	<u>296,834</u>
Comprehensive income:							
Net earnings	--	--	--	--	--	10,445	10,445
Minimum pension liability adjustment; net of tax	--	--	--	--	(436)	--	(436)
Comprehensive income							<u>10,009</u>
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	<u>31,240</u>	<u>276,610</u>	<u>(794)</u>	<u>(5,562)</u>	<u>(436)</u>	<u>--</u>	<u>301,058</u>
Comprehensive income:							
Net earnings (restated)	--	--	--	--	--	9,845	9,845
Unrealized gain in investment securities, net of tax	--	--	--	--	115,175	--	115,175
Minimum pension liability adjustment; net of tax	--	--	--	--	436	--	436
Comprehensive income							<u>125,456</u>
Common stock held in trust	--	--	--	(10,037)	--	--	(10,037)
5% stock dividend (restated)	2,359	7,452	--	--	--	(9,845)	(34)
Purchase of treasury stock	--	--	(14,425)	--	--	--	(14,425)
Issuance of stock for acquisition	16,714	315,235	--	--	--	--	331,949
Exercise of stock options	208	538	(335)	269	--	--	680
Balance June 30, 2000 (restated)	<u>\$ 50,521</u>	<u>\$ 599,835</u>	<u>\$ (15,554)</u>	<u>\$ (15,330)</u>	<u>\$ 115,175</u>	<u>\$ --</u>	<u>\$ 734,647</u>

See accompanying notes.

## SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### I Summary of Significant Accounting Policies

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

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

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

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

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

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

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

## SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

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

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

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

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

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

## SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

### II Restatement

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

### III Acquisitions

#### ***Pennsylvania Enterprises, Inc.***

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

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

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

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

**Pro Forma Financial Information**

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

	Year Ended June 30,	
	2000 (Restated)	1999
Operating revenues .....	\$ 880,190	\$ 838,836
Income before extraordinary item .....	2,079	5,782
Net earnings available for common stock .....	2,079	5,782
Net earnings per common stock:		
Basic .....	.05	.12
Diluted .....	.05	.11

**Other Acquisitions**

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

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

**Acquisitions Subsequent to Year-End**

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

## SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

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

#### IV Write-Off of Regulatory Assets

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



## SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

### V Other Income (Expense), Net

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

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

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

### VI Cash Flow Information

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

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

### VII Earnings Per Share

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

### VIII Property, Plant and Equipment

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

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

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

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

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

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

#### IX Investment Securities

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

## SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

### X Stockholders' Equity

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

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

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

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

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

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

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

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

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

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

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

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

**XI Preferred Securities of Subsidiary Trust**

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

**XII Debt and Capital Lease**

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

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

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

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

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

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

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

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

**SOUTHERN UNION COMPANY AND SUBSIDIARIES**  
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**XIII Employee Benefits**

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

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

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

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

**SOUTHERN UNION COMPANY AND SUBSIDIARIES  
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nil, respectively, and for those same plans were \$58,985,000; \$58,985,000; and \$42,181,000, respectively as of June 30, 1999.

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

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

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

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

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

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

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

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

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



## SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

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

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**XIV Taxes on Income**

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

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

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

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

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

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

**XV Utility Regulation and Rates**

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

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

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

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

## SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

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

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

### XVI Leases

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

### XVII Commitments and Contingencies

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

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

## SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

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

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

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

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

## SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

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

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

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

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

## SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

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

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

## SOUTHERN UNION COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

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

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

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

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



**SOUTHERN UNION COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

**XVIII Quarterly Operations (Unaudited)**

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

<u>Year Ended</u> <u>June 30, 1999</u>	<u>Quarter Ended</u>				<u>Total</u>
	<u>September 30</u>	<u>December 31</u>	<u>March 31</u>	<u>June 30</u>	
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 <sup>(2)</sup> .....	(.22)	.16	.51	(.17)	.31

(1) See Note II -- Restatement.

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

## REPORT OF INDEPENDENT ACCOUNTANTS

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

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

PricewaterhouseCoopers LLP

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

CONSENT OF INDEPENDENT ACCOUNTANTS

Exhibit 23

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

PricewaterhouseCoopers LLP

Austin, Texas  
April 25, 2001

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

**FORM 10-Q**

For the quarterly period ended

March 31, 2001

Commission File No. 1-6407

**SOUTHERN UNION COMPANY**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**75-0571592**  
(I.R.S. Employer  
Identification No.)

**504 Lavaca Street, Eighth Floor**  
**Austin, Texas**  
(Address of principal executive offices)

**78701**  
(Zip Code)

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

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

<u>Title of each class</u>	<u>Name of each exchange in which registered</u>
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 4, 2001 was 50,982,246.

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**SOUTHERN UNION COMPANY AND SUBSIDIARIES**  
**FORM 10-Q**  
**March 31, 2001**  
**Index**

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# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF OPERATIONS

	<u>Three Months Ended March 31,</u>	
	<u>2001</u>	<u>2000</u>
	(thousands of dollars, except shares and per share amounts)	
Operating revenues .....	\$ 914,653	\$ 344,789
Cost of gas and other energy .....	<u>685,404</u>	<u>217,793</u>
Operating margin .....	229,249	126,996
Revenue-related taxes .....	<u>33,664</u>	<u>14,195</u>
Net operating margin .....	195,585	112,801
Operating expenses:		
Operating, maintenance and general .....	69,766	39,189
Depreciation and amortization .....	24,615	15,191
Taxes, other than on income and revenues .....	<u>8,480</u>	<u>5,520</u>
Total operating expenses .....	<u>102,861</u>	<u>59,900</u>
Net operating revenues .....	<u>92,724</u>	<u>52,901</u>
Other income (expenses):		
Interest .....	(29,163)	(14,940)
Dividends on preferred securities of subsidiary trust .....	(2,370)	(2,370)
Other, net .....	<u>14,364</u>	<u>(1,034)</u>
Total other expenses, net .....	<u>(17,169)</u>	<u>(18,344)</u>
Earnings before income taxes .....	75,555	34,557
Federal and state income taxes .....	<u>34,749</u>	<u>15,042</u>
Net earnings available for common stock .....	<u>\$ 40,806</u>	<u>\$ 19,515</u>
Net earnings per share:		
Basic .....	<u>\$ .82</u>	<u>\$ .40</u>
Diluted .....	<u>\$ .77</u>	<u>\$ .38</u>
Weighted average shares outstanding:		
Basic .....	<u>49,933,878</u>	<u>49,265,244</u>
Diluted .....	<u>52,862,818</u>	<u>51,281,397</u>

See accompanying notes.

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF OPERATIONS

	Nine Months Ended March 31,	
	2001	2000
	(thousands of dollars, except shares and per share amounts)	
Operating revenues .....	\$ 1,664,461	\$ 669,170
Cost of gas and other energy .....	<u>1,203,862</u>	<u>402,182</u>
Operating margin .....	460,599	266,988
Revenue-related taxes .....	<u>62,597</u>	<u>29,416</u>
Net operating margin .....	398,002	237,572
Operating expenses:		
Operating, maintenance and general .....	168,935	98,647
Depreciation and amortization .....	64,319	39,539
Taxes, other than on income and revenues .....	<u>21,290</u>	<u>13,779</u>
Total operating expenses .....	<u>254,544</u>	<u>151,965</u>
Net operating revenues .....	<u>143,458</u>	<u>85,607</u>
Other income (expenses):		
Interest .....	(75,772)	(36,603)
Dividends on preferred securities of subsidiary trust .....	(7,110)	(7,110)
Other, net .....	<u>23,761</u>	<u>(5,527)</u>
Total other expenses, net .....	<u>(59,121)</u>	<u>(49,240)</u>
Earnings before income taxes and cumulative effect of change in accounting principle .....	84,337	36,367
Federal and state income taxes .....	<u>38,789</u>	<u>15,820</u>
Earnings before cumulative effect of change in accounting principle .....	45,548	20,547
Cumulative effect of change in accounting principle, net of tax .....	<u>602</u>	<u>--</u>
Net earnings available for common stock .....	<u>\$ 46,150</u>	<u>\$ 20,547</u>
Net earnings per share:		
Basic		
Before cumulative effect of change in accounting principle .....	\$ .92	\$ .49
Cumulative effect of change in accounting principle, net of tax .....	<u>.01</u>	<u>--</u>
	<u>\$ .93</u>	<u>\$ .49</u>
Diluted		
Before cumulative effect of change in accounting principle .....	\$ .87	\$ .47
Cumulative effect of change in accounting principle, net of tax .....	<u>.01</u>	<u>--</u>
	<u>\$ .88</u>	<u>\$ .47</u>
Weighted average shares outstanding:		
Basic .....	<u>49,479,253</u>	<u>41,690,742</u>
Diluted .....	<u>52,191,499</u>	<u>43,636,397</u>

See accompanying notes.

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF OPERATIONS

	Twelve Months Ended March 31,	
	2001	2000
	(thousands of dollars, except shares and per share amounts)	
Operating revenues .....	\$ 1,826,995	\$ 770,858
Cost of gas and other energy .....	<u>1,299,378</u>	<u>452,113</u>
Operating margin .....	527,617	318,745
Revenue-related taxes .....	<u>68,077</u>	<u>34,281</u>
Net operating margin .....	459,540	284,464
Operating expenses:		
Operating, maintenance and general .....	206,875	126,563
Depreciation and amortization .....	79,920	49,946
Taxes, other than on income and revenues .....	<u>24,780</u>	<u>17,506</u>
Total operating expenses .....	<u>311,575</u>	<u>194,015</u>
Net operating revenues .....	<u>147,965</u>	<u>90,449</u>
Other income (expenses):		
Interest .....	(90,661)	(45,759)
Dividends on preferred securities of subsidiary trust .....	(9,480)	(9,480)
Other, net .....	<u>19,580</u>	<u>(7,651)</u>
Total other expenses, net .....	<u>(80,561)</u>	<u>(62,890)</u>
Earnings before income taxes and cumulative effect of change in accounting principle .....	67,404	27,559
Federal and state income taxes .....	<u>32,558</u>	<u>12,516</u>
Earnings before cumulative effect of change in accounting principle .....	34,846	15,043
Cumulative effect of change in accounting principle, net of tax .....	<u>602</u>	<u>--</u>
Net earnings available for common stock .....	<u>\$ 35,448</u>	<u>\$ 15,043</u>
Net earnings per share:		
Basic		
Before cumulative effect of change in accounting principle .....	\$ .71	\$ .38
Cumulative effect of change in accounting principle, net of tax .....	<u>.01</u>	<u>--</u>
	<u>\$ .72</u>	<u>\$ .38</u>
Diluted		
Before cumulative effect of change in accounting principle .....	\$ .67	\$ .36
Cumulative effect of change in accounting principle, net of tax .....	<u>.01</u>	<u>--</u>
	<u>\$ .68</u>	<u>\$ .36</u>
Weighted average shares outstanding:		
Basic .....	<u>49,245,493</u>	<u>39,582,434</u>
Diluted .....	<u>51,838,262</u>	<u>41,320,632</u>

See accompanying notes.



# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEET

### ASSETS

	March 31,		June 30,
	2001	2000	2000
	(thousands of dollars)		
Property, plant and equipment:			
Plant in service .....	\$2,178,163	\$1,545,099	\$1,580,077
Construction work in progress .....	27,158	37,306	30,192
	2,205,321	1,582,405	1,610,269
Less accumulated depreciation and amortization .....	(758,717)	(497,227)	(509,947)
	1,446,604	1,085,178	1,100,322
Additional purchase cost assigned to utility plant, net .....	733,921	378,085	386,839
	2,180,525	1,463,263	1,487,161
Current assets:			
Cash and cash equivalents .....	8,166	52,327	27,829
Accounts receivable, billed and unbilled, net .....	462,279	129,650	74,959
Inventories, principally at average cost .....	41,639	26,698	60,259
Deferred gas purchase costs .....	99,415	--	--
Investment securities available for sale .....	92,241	--	187,817
Prepayments and other .....	14,730	7,854	877
	718,470	216,529	351,741
Deferred charges .....	212,711	139,313	145,006
Investment securities, at cost .....	20,081	15,587	10,489
Real estate .....	2,552	9,438	9,461
Other .....	36,552	20,841	17,602
	Total .....	Total .....	Total .....
	\$3,170,891	\$1,864,971	\$2,021,460

See accompanying notes.

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEET (Continued)

### STOCKHOLDERS' EQUITY AND LIABILITIES

	March 31,		June 30,
	2001	2000	2000
	(thousands of dollars)		
Common stockholders' equity:			
Common stock, \$1 par value; authorized 200,000,000 shares; issued 51,991,624 shares	\$ 51,992	\$ 48,135	\$ 50,521
Premium on capital stock	626,253	592,274	599,835
Less treasury stock, 1,010,077 shares at cost	(15,869)	(14,313)	(15,554)
Less common stock held in trust	(17,547)	(15,254)	(15,330)
Deferred compensation plans	7,499	763	808
Accumulated other comprehensive income (loss)	54,940	(436)	115,175
Retained earnings	46,150	20,547	--
<b>Total common stockholders' equity</b>	<b>753,418</b>	<b>631,716</b>	<b>735,455</b>
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	1,368,817	734,320	733,774
<b>Total capitalization</b>	<b>2,222,235</b>	<b>1,466,036</b>	<b>1,569,229</b>
Current liabilities:			
Long-term debt and capital lease obligation due within one year	5,219	2,169	2,193
Notes payable	211,600	3	3
Accounts payable	227,917	64,660	77,488
Federal, state and local taxes	66,069	22,526	7,359
Accrued interest	18,544	16,067	15,922
Accrued dividends on preferred securities of subsidiary trust	2,370	--	--
Customer deposits	20,584	17,805	17,255
Deferred gas purchase costs	--	21,674	11,708
Other	68,830	16,052	30,778
<b>Total current liabilities</b>	<b>621,133</b>	<b>160,956</b>	<b>162,706</b>
Deferred credits and other	131,726	111,818	106,015
Accumulated deferred income taxes	195,797	126,161	183,510
Commitments and contingencies	--	--	--
<b>Total</b>	<b>\$3,170,891</b>	<b>\$1,864,971</b>	<b>\$2,021,460</b>

See accompanying notes.

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock, \$1 Par Value	Premium on Capital Stock	Treasury Stock, at Cost	Common Stock Held in Trust	Accumulated Other Comprehen- sive Income	Retained Earnings/ (Deficit)	Total
	(thousands of dollars)						
Balance July 1, 1999 .....	\$ 31,240	\$ 276,610	\$ (794)	\$ (4,927)	\$ (436)	\$ --	\$ 301,693
Comprehensive income:							
Net earnings .....	--	--	--	--	--	9,845	9,845
Unrealized gain in investment securities, net of tax .....	--	--	--	--	115,175	--	115,175
Minimum pension liability adjustment; net of tax .....	--	--	--	--	436	--	436
Comprehensive income .....							<u>125,456</u>
Purchase of common stock							
held in trust .....	--	--	--	(9,864)	--	--	(9,864)
5% stock dividend .....	2,359	7,452	--	--	--	(9,845)	(34)
Purchase of treasury stock .....	--	--	(14,425)	--	--	--	(14,425)
Issuance of stock for acquisition	16,714	315,235	--	--	--	--	331,949
Exercise of stock options .....	<u>208</u>	<u>538</u>	<u>(335)</u>	<u>269</u>	--	--	<u>680</u>
Balance June 30, 2000 .....	50,521	599,835	(15,554)	(14,522)	115,175	--	735,455
Comprehensive income:							
Net earnings .....	--	--	--	--	--	46,150	46,150
Unrealized loss in investment securities, net of tax benefit	--	--	--	--	(58,605)	--	(58,605)
Cumulative effect of change in accounting principle .....	--	--	--	--	826	--	826
Unrealized loss on hedging activities .....	--	--	--	--	(2,456)	--	(2,456)
Comprehensive income (loss)							<u>(14,085)</u>
Payment on note receivable .....	--	290	--	--	--	--	290
Purchase of common stock							
held in trust .....	--	--	--	(2,360)	--	--	(2,360)
Benefit plan restructuring .....	--	--	--	6,560	--	--	6,560
Issuance of stock for acquisition .....	1,371	25,505	--	--	--	--	26,876
Exercise of stock options .....	<u>100</u>	<u>623</u>	<u>(315)</u>	<u>274</u>	--	--	<u>682</u>
Balance March 31, 2001 .....	<u>\$ 51,992</u>	<u>\$ 626,253</u>	<u>\$ (15,869)</u>	<u>\$ (10,048)</u>	<u>\$ 54,940</u>	<u>\$ 46,150</u>	<u>\$ 753,418</u>

See accompanying notes.

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF CASH FLOWS

	<u>Three Months Ended March 31,</u>	
	<u>2001</u>	<u>2000</u>
	(thousands of dollars)	
Cash flows from (used in) operating activities:		
Net earnings	\$ 40,806	\$ 19,515
Adjustments to reconcile net earnings to net cash flows (used in) from operating activities:		
Depreciation and amortization	24,615	15,191
Deferred income taxes	4,398	3,585
Non-cash compensation expense	(2,216)	--
Provision for bad debts	13,398	2,011
Financial derivative trading gains	(3,360)	--
Gain on sale of investment securities	(12,494)	--
Deferred interest expense	(406)	108
Other	865	428
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable, billed and unbilled	(65,258)	17,577
Accounts payable	(54,194)	(10,635)
Taxes and other liabilities	37,932	9,807
Customer deposits	(368)	(29)
Deferred gas purchase costs	(67,305)	2,382
Inventories	76,904	43,706
Other	(4,411)	(10,099)
Net cash flows (used in) from operating activities	<u>(11,094)</u>	<u>93,547</u>
Cash flows used in investing activities:		
Additions to property, plant and equipment	(25,469)	(26,608)
Acquisitions of operations, net of cash received	(1,646)	(2,252)
Proceeds from sale of subsidiary	--	12,150
Purchase of investment securities	--	(2,961)
Increase in customer advances	806	608
Deferred charges and credits	(12,105)	1,667
Proceeds from sale of investment securities	15,405	--
Other	4,691	1,538
Net cash flows used in investing activities	<u>(18,318)</u>	<u>(15,858)</u>
Cash flows from (used in) financing activities:		
Repayment of debt and capital lease obligation	(6,898)	(361)
Net borrowings (payments) under revolving credit facility	36,600	(12,900)
Purchase of treasury stock	--	(12,193)
Other	36	92
Net cash flows from (used in) financing activities	<u>29,738</u>	<u>(25,362)</u>
Change in cash and cash equivalents	326	52,327
Cash and cash equivalents at beginning of period	7,840	--
Cash and cash equivalents at end of period	<u>\$ 8,166</u>	<u>\$ 52,327</u>
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ 30,670	\$ 17,295
Income taxes	<u>\$ 1,000</u>	<u>\$ 1,711</u>

See accompanying notes.

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF CASH FLOWS

	Nine Months Ended March 31,	
	2001	2000
	(thousands of dollars)	
Cash flows (used in) from operating activities:		
Net earnings	\$ 46,150	\$ 20,547
Adjustments to reconcile net earnings to net cash flows (used in) from operating activities:		
Depreciation and amortization	64,319	39,539
Deferred income taxes	(1,562)	3,355
Non-cash compensation expense	239	-
Provision for bad debts	19,345	1,665
Financial derivative trading losses	5,684	-
Gain on sale of investment securities	(21,363)	-
Gain on sale of real estate	(13,532)	-
Deferred interest expense	(1,064)	187
Cumulative effect of change in accounting principle	(602)	-
Other	2,560	1,225
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable, billed and unbilled	(359,181)	(55,167)
Accounts payable	110,254	10,235
Taxes and other liabilities	56,410	9,719
Customer deposits	(852)	123
Deferred gas purchase costs	(102,120)	(5,149)
Inventories	33,316	33,652
Other	(16,015)	(10,090)
Net cash flows (used in) from operating activities	(178,014)	49,841
Cash flows used in investing activities:		
Additions to property, plant and equipment	(87,172)	(69,430)
Acquisition of operations, net of cash received	(406,949)	(38,083)
Proceeds from sale of subsidiary	-	12,150
Purchase of investment securities	(12,495)	(15,008)
Notes receivable	290	(4,000)
Increase (decrease) in customer advances	790	1,442
Deferred charges and credits	(3,630)	(241)
Proceeds from sale of investment securities	26,777	-
Proceeds from sale of real estate, net of closing costs	20,638	-
Other	4,116	1,959
Net cash flows used in investing activities	(457,635)	(111,211)
Cash flows from financing activities:		
Issuance of long-term debt	535,000	300,000
Issuance cost of debt	(2,538)	(6,643)
Repayment of debt and capital lease obligation	(14,607)	(138,269)
Premium on early extinguishment of acquired debt	-	(745)
Net borrowings (payments) under revolving credit facility	211,597	(21,000)
Purchase of treasury stock	-	(13,519)
Change in cash overdrafts	-	(6,655)
Payment of merger debt assumed	(114,171)	-
Other	705	528
Net cash flows from financing activities	615,986	113,697
Change in cash and cash equivalents	(19,663)	52,327
Cash and cash equivalents at beginning of period	27,829	-
Cash and cash equivalents at end of period	\$ 8,166	\$ 52,327
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ 78,092	\$ 40,512
Income taxes	\$ 1,052	\$ 1,711

See accompanying notes.

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF CASH FLOWS

	Twelve Months Ended March 31,	
	2001	2000
	(thousands of dollars)	
Cash flows (used in) from operating activities:		
Net earnings	\$ 35,448	\$ 15,043
Adjustments to reconcile net earnings to net cash flows from (used in) operating activities:		
Depreciation and amortization	79,920	49,946
Deferred income taxes	(4,482)	11,349
Provision for bad debts	22,678	2,573
Financial derivative trading losses	7,920	--
Deferred interest expense	(1,563)	289
Cumulative effect of change in accounting principle	(602)	--
Gain on sale of investment securities	(21,363)	--
Gain on sale of real estate	(13,532)	--
Other	3,138	1,160
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable, billed and unbilled	(307,844)	(5,216)
Accounts payable	122,621	(7,905)
Taxes and other liabilities	41,055	1,490
Customer deposits	(4,382)	(546)
Deferred gas purchase costs	(112,085)	2,839
Inventories	(245)	29,994
Other	(4,015)	(10,956)
Net cash flows (used in) from operating activities	(157,333)	90,060
Cash flows used in investing activities:		
Additions to property, plant and equipment	(118,188)	(92,179)
Acquisition of operations, net of cash received	(407,232)	(38,083)
Proceeds from sale of subsidiary	--	12,150
Purchase of investment securities	(18,488)	(17,008)
Note receivable	290	(4,000)
Customer advances	698	1,971
Deferred charges and credits	(7,046)	(4,398)
Proceeds from sale of investment securities	26,777	--
Proceeds from sale of real estate, net of closing costs	20,638	--
Other	1,604	1,326
Net cash flows used in investing activities	(500,947)	(140,221)
Cash flows from financing activities:		
Issuance of long-term debt	535,000	300,000
Issuance cost of debt	(3,187)	(6,643)
Repayment of debt and capital lease obligation	(15,129)	(157,590)
Premium on early extinguishment of acquired debt	26	(745)
Net borrowings (payments) under revolving credit facility	211,597	(18,600)
Purchase of treasury stock	(906)	(13,519)
Change in cash overdrafts	--	(603)
Payment of merger debt assumed	(114,171)	--
Other	889	188
Net cash flows from financing activities	614,119	102,488
Change in cash and cash equivalents	(44,161)	52,327
Cash and cash equivalents at beginning of period	52,327	--
Cash and cash equivalents at end of period	\$ 8,166	\$ 52,327
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ 95,315	\$ 52,117
Income taxes	\$ 3,652	\$ 3,617

See accompanying notes.

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### FINANCIAL STATEMENTS

These interim 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/A for the fiscal year ended June 30, 2000. 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. As further described below, the Company acquired Providence Energy Corporation and Fall River Gas Company on September 28, 2000, Valley Resources, Inc. on September 20, 2000 and Pennsylvania Enterprises, Inc. on November 4, 1999. Accordingly, the operating activities of the acquired operations are consolidated with the Company beginning on the respective acquisition dates. Thus, the results of operations of the Company for the periods subsequent to the acquisitions are not comparable to those periods prior to the acquisitions nor are the fiscal 2001 results of operations comparable with prior periods.

### ACQUISITION ACTIVITIES

On September 28, 2000, Southern Union completed the acquisition of Providence Energy Corporation (ProvEnergy) for approximately \$270,000,000 in cash plus the assumption of approximately \$90,000,000 in long-term debt. The ProvEnergy natural gas distribution operations are Providence Gas and North Attleboro Gas, which collectively serve approximately 176,000 natural gas customers. Providence Gas serves natural gas customers in Providence and Newport, Rhode Island, and 23 other cities and towns in Rhode Island. North Attleboro Gas serves customers in North Attleboro and Plainville, Massachusetts, towns adjacent to the northeastern Rhode Island border. Subsidiaries of the Company acquired in the ProvEnergy merger include ProvEnergy Oil Enterprises, Inc. ("ProvEnergy Oil"), and ProvEnergy Power Company, LLC. ProvEnergy Oil operates a fuel oil distribution business through its subsidiary, ProvEnergy Fuels, Inc. (ProvEnergy Fuels). ProvEnergy Fuels serves over 15,000 residential and commercial customers in Rhode Island and Massachusetts. ProvEnergy Power Company owns 50% of Capital Center Energy Company, LLC., a joint venture formed between ProvEnergy and ERI Services, Inc. to provide retail power.

On September 28, 2000, Southern Union completed the acquisition of Fall River Gas Company (Fall River Gas) for approximately 1,400,000 shares of Southern Union common stock and approximately \$27,000,000 in cash plus assumption of approximately \$20,000,000 in long-term debt. Fall River Gas serves approximately 49,000 customers in the city of Fall River and the towns of Somerset, Swansea and Westport, all located in southeastern Massachusetts. Also acquired in the Fall River Gas merger was Fall River Gas Appliance Company, Inc., which rents water heaters and conversion burners (primarily for residential use) in Fall River Gas' service area.

On September 20, 2000, Southern Union completed the acquisition of Valley Resources, Inc. (Valley Resources) for approximately \$125,000,000 in cash plus the assumption of approximately \$30,000,000 in long-term debt. Valley Resources natural gas distribution operations are Valley Gas Company and Bristol and Warren Gas Company, which collectively serve approximately 66,000 natural gas customers. Valley Resources' three non-utility subsidiaries acquired in the merger rent and sell appliances, offer service contract programs, sell liquid propane in Rhode Island and nearby Massachusetts, and distribute as a wholesaler franchised lines to plumbing and heating contractors. Also, acquired in the acquisition was Valley Resources' 90% interest in Alternate Energy Corporation, which sells, installs and designs natural gas conversion systems and facilities, is an authorized representative of the ONSI Corporation fuel cell, holds patents for a natural gas/diesel co-firing system and for a device to control the flow of fuel on dual-fuel equipment.

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company funded the cash portion of the above described acquisitions and any related refinancings of assumed debt with a bank note (the Term Note). See *Debt and Capital Lease*.

The assets of ProvEnergy, Fall River Gas and Valley Resources (hereafter referred to as the Company's "New England Operations") have been included in the consolidated balance sheet of the Company at March 31, 2001 and the results of operations from the New England Operations have been included in the statement of consolidated operations since their respective acquisition dates. The New England Operations' primary business is the distribution of natural gas through its public utility companies (collectively referred to as the "New England Division"). The acquisitions were accounted for using the purchase method. The additional purchase cost assigned to utility plant of approximately \$360,000,000 reflects the excess of the purchase price over the historical book carrying value of the utility plant. Amortization of the additional purchase cost assigned to utility plant is provided on a straight-line basis over forty years. The final allocation of the purchase price of the New England Operations acquisition is expected to be completed in the fourth quarter of fiscal year 2001. The Company plans to sell or dispose of certain non-core businesses acquired in the New England Operations.

Prior to the consummation of the acquisition of the New England Operations, the Company purchased shares of Providence Energy Corporation, Fall River Gas Company and Valley Resources, Inc. common stock for \$2,882,000. As all necessary approvals for the merger had not been obtained when these shares were purchased, these purchases were treated as investment securities prior to closing the mergers.

On November 4, 1999, the Company acquired Pennsylvania Enterprises, Inc. (hereafter referred to as the "Pennsylvania Operations") in a transaction valued at approximately \$500,000,000, including assumption of long-term debt of approximately \$115,000,000. The Company issued approximately 16,700,000 shares (before adjustment for any subsequent stock dividend) of common stock and paid approximately \$36,000,000 in cash to complete the transaction. The Company funded the cash portion of the acquisition of the Pennsylvania Operations and related refinancings with the sale of \$300,000,000 of 8.25% Senior Notes due 2029 completed on November 3, 1999 (8.25% Senior Notes). See *Debt and Capital Lease*.

The 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 156,000 gas customers in northeastern and central Pennsylvania. Subsidiaries of the Company included in the Pennsylvania Operations merger included PG Energy Services Inc., (Energy Services), Keystone Pipeline Services, Inc. (*Keystone*, a wholly-owned subsidiary of PG Energy Services Inc.), PEI Power Corporation, and Theta Land Corporation. Through Energy Services the Company markets a diversified range of energy-related products and services under the name of PG Energy PowerPlus and supplies propane under the name of PG Energy Propane. Keystone provides pipeline and fiber optic cable construction, installation, maintenance, and rehabilitation services. PEI Power Corporation operates a cogeneration plant that generates steam and electricity for resale. Theta Land Corporation, which owned and provided land management and development services for more than 44,000 acres of land, was sold for \$12,150,000 in January 2000. No gain or loss was recognized on this transaction. The Company plans to sell or dispose of both Keystone and the propane operations of Energy Services, which are not material to the Company. The Company has not yet sold these operations and there can be no assurance that a sale on terms satisfactory to the Company will be completed. A letter of intent has been entered into for certain of these operations with the sale expected to be completed during the fourth quarter of fiscal year 2001.

The assets of the Pennsylvania Operations are included in the consolidated balance sheet of the Company at March 31, 2001 and the results of operations from the Pennsylvania Operations have been included in the statement of consolidated operations since November 4, 1999. The acquisition was accounted for using the purchase method. The additional purchase cost assigned to utility plant of approximately \$261,000,000 reflects the excess of the



# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

### Pro Forma Financial Information

The following unaudited pro forma financial information for the nine-month periods ended March 31, 2001 and 2000 is presented as though the following events had occurred at the beginning of the earliest period presented: (i) acquisition of the New England Operations and the Pennsylvania Operations; (ii) the issuance of the Term Note and the sale of the 8.25% Senior Notes; and (iii) the refinancing of certain short-term and long-term debt at the time of the acquisitions. The pro forma financial information is not necessarily indicative of the results which would have actually been obtained had the acquisition of the New England Operations and Pennsylvania Operations, the issuance of the Term Note, 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.

	<u>Nine Months Ended March 31,</u>	
	<u>2001</u>	<u>2000</u>
Operating revenues . . . . .	\$ 1,708,121	\$ 1,013,239
Income (loss) before extraordinary item . . . . .	24,575	(2,339)
Net earnings (loss) available for common stock . . . . .	24,575	(2,339)
Net earnings (loss) per common stock:		
Basic . . . . .	.49	(.05)
Diluted . . . . .	.47	(.05)

### EARNINGS PER SHARE

Average shares outstanding, which excludes treasury stock, for basic earnings per share were 49,933,878 and 49,265,244 for the three-month period ended March 31, 2001 and 2000, respectively; 49,479,253 and 41,690,742 for the nine-month period ended March 31, 2001 and 2000, respectively; and 49,245,493 and 39,582,434 for the twelve-month period ended March 31, 2001 and 2000, respectively. Diluted earnings per share includes average shares outstanding as well as common stock equivalents from stock options and warrants. Common stock equivalents were 1,886,140 and 1,174,742 for the three-month period ended March 31, 2001 and 2000, respectively; 1,702,361 and 1,423,998 for the nine-month period ended March 31, 2001 and 2000, respectively; and 1,597,540 and 1,464,315 for the twelve-month period ended March 31, 2001 and 2000, respectively. At March 31, 2001, 1,015,528 shares of common stock were held by various rabbi trusts for certain of the Company's benefit plans and 185,947 shares were held in a rabbi trust for certain employees who deferred receipt of Company shares for stock options exercised.

### INVESTMENT SECURITIES

At March 31, 2001, the Company held securities of Capstone Turbine Corporation (Capstone). This investment is classified as "available for sale" under the Statement of Financial Accounting Standards Board (FASB) *Accounting for Certain Investments in Debt and Equity Securities*; accordingly, these securities are stated at fair value, with unrealized gains and losses recorded as a separate component of common stockholders' equity. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the Consolidated Statement of Operations when realized. During both the second and third quarters of the Company's fiscal year

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2001, the Company sold securities in Capstone, realizing a pre-tax gain of \$8,869,000 and \$12,494,000, respectively. As of March 31, 2001, the Company's remaining investment in Capstone had a fair value of \$92,241,000 and unrealized gain, net of tax, of \$56,569,000. From April 1, 2001 to May 4, 2001, additional securities were sold resulting in pre-tax gains of \$35,756,000. As of May 4, 2001, the fair value of the Company's remaining investment in Capstone was \$53,541,000. Subject to market conditions that are not detrimental to the Company, and as opportunities arise following the completion of the applicable lock-up periods to which it was subject, the Company expects to monetize its investment. The Company intends to use the proceeds from such sales to reduce outstanding debt.

All other securities owned by the Company are accounted for under the cost method. The Company's other investments in securities consist of common and/or preferred stock in non-public companies whose stock is not traded on a securities exchange. Realized gains and losses on sales of these investments, as determined on a specific identification basis, are included in the Consolidated Statement of Operations when incurred, and dividends are recognized as income when received.

### REAL ESTATE

On December 15, 2000, the Company sold its Austin, Texas headquarters building, Lavaca Plaza. The property, purchased by the Company in 1991, netted pre-tax cash proceeds of \$20,638,000, resulting in a pre-tax gain of approximately \$13,532,000.

### DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

**Accounting Policies of Derivatives and Hedging Activities** The Company recognizes derivatives on the consolidated balance sheet at their fair value. On the date of the derivative contract, the Company designates the derivative as: (i) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value" hedge); (ii) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow" hedge), or (iii) "held for trading" ("trading" instruments). Changes in the fair value of a derivative that qualifies as a fair-value hedge, along with the gain or loss on the hedged asset or liability that is attributable to the hedged risk (including gains or losses on firm commitments), are recorded in earnings. Changes in the fair value of a derivative that qualifies as a cash-flow hedge are recorded in other comprehensive income, until earnings are affected by the variability of cash flows. Lastly, changes in the fair value of derivative trading instruments are reported in current-period earnings.

**Adoption of Accounting Pronouncement** The Company adopted *Accounting for Derivative Instruments and Hedging Activities* on July 1, 2000. In accordance with that Statement, the Company recorded a net-of-tax cumulative-effect gain of \$602,000 in earnings to recognize the fair value of the gas derivative contracts at Energy Services that are not designated as hedges. The Company also recorded \$826,000 in accumulated other comprehensive income which recognizes the fair value of two interest rate swap derivatives that were designated as cash flow hedges.

**Derivative Activities** The Company manages certain business risks through the limited use of derivative instruments. Interest rate swaps are employed to hedge the effect of changes in interest rates related to certain debt instruments and commodity swaps and options to manage price risk associated with certain energy contracts, primarily heating oil. The Company was previously party to an interest rate swap designed to reduce exposure to changes in the fair value of a fixed rate lease commitment. This interest rate swap, designated as a fair value hedge, was terminated in October 2000 resulting in a pre-tax gain of \$182,000 which will be amortized into earnings through December 2004. The Company also continues to be obligated under three interest rate swaps created to hedge the exposure to potential volatility in interest payments on variable rate debt. At March 31, 2001 the fair value of these interest rate derivatives was a liability of \$3,018,000 and is offset by a matching adjustment to other comprehensive

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

income. For the three- and nine-month periods ended March 31, 2001 net settlement payments of \$362,000 and \$97,000, respectively, were made related to these derivatives and recorded to interest expense. The Company expects to reclassify as earnings during the next twelve months \$1,556,000 net-of-tax in derivative losses from accumulated other comprehensive income as the settlement of swap payments occur. The maximum term over which the Company is hedging exposures to the variability of cash flows is 31 months.

The Company was also previously committed under two gas derivative contracts related to certain non-regulated operations acquired in conjunction with the acquisition of the Pennsylvania Operations. These two contracts were not designated as hedging instruments and therefore did not qualify to receive hedge accounting treatment under the Statement. During the quarter ended December 31, 2000, these derivative contracts expired and the Company recognized a pre-tax loss of \$526,000 in recording the expiration of these derivative contracts. This loss was offset by a pre-tax gain of \$494,000 arising from the monthly settlement of the two derivative contracts that expired in November 2000.

In conjunction with the acquisition of Providence Energy Corporation, the Company also acquired ProvEnergy Oil, a distributor of fuel oil to retail and commercial customers. ProvEnergy Oil offers certain retail customers price caps for winter heating oil and purchases heating oil call options as a hedge against price fluctuations on the related anticipated commodity purchases. As of March 31, 2001, the Company owned options representing 294,000 gallons of fuel oil at an average strike price of \$.76 a gallon, and the fair value of the hedging options was nil. The maximum term over which the Company is hedging exposures to the variability of cash flows for forecasted purchases of home heating oil is ten months.

**Trading Contracts** The Company, through one of its non-regulated Pennsylvania subsidiaries, is also a party to certain energy trading contracts for the purchase and sale of energy commodities. These contracts are accounted for in accordance with Emerging Issues Task Force Issue *Accounting for Contracts Involved in Energy Trading and Risk Management Activities* which requires that energy trading contracts be recorded at fair value as of each balance sheet date with gains and losses included in earnings. During the third quarter ended March 31, 2001, the Company received settlements of \$340,000. At March 31, 2001 the trading asset was \$12,000, which represents the fair market value of the outstanding contracts.

In March 2001, the Company discovered unauthorized financial derivative energy trading activity by a non-regulated, wholly-owned subsidiary. During March 2001 and April 2001, all unauthorized trading activity was closed resulting in a cumulative cash expense of \$191,000, net of taxes. As a result of the unauthorized financial derivative energy trading activity, open contracts of a non-regulated, wholly-owned subsidiary were present at March 31, 2001 for: 10,000 MMBtu's of natural gas per day for the contract period of January 2001 to December 2001 at a fixed price of \$2.72 per MMBtu; 10,000 MMBtu's of natural gas per day for the contract period of January 2002 to August 2002 at a fixed price of \$3.41 per MMBtu; and 10,000 MMBtu's of natural gas per day for the contract period of May 2001 to December 2001 at a fixed price of \$4.81 per MMBtu. This unauthorized financial derivative energy trading activity resulted in a non-cash gain of \$1,814,000, net of taxes, for the three-month period ended March 31, 2001 and non-cash losses of \$3,069,000 and \$4,277,000, net of taxes, for the nine- and twelve-month periods ended March 31, 2001. These items are recorded in other, net on the Consolidated Statement of Operations. For the quarter ending March 31, 2001, the Company recorded a liability of \$7,921,000 representing the fair market value of the contracts and a pre-tax non-cash gain of \$3,360,000.

### 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

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

\$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, 2001 and 2000, 4,000,000 shares of Preferred Securities were outstanding.

### DEBT AND CAPITAL LEASE

	<u>March 31,</u> <u>2001</u>	<u>June 30,</u> <u>2000</u>
	(thousands of dollars)	
7.60% Senior Notes due 2024 .....	\$ 364,515	\$ 364,515
8.25% Senior Notes due 2029 .....	300,000	300,000
8.375% First Mortgage Bonds, due 2002 .....	30,000	30,000
5.62% First Mortgage Bonds, due 2003 .....	4,800	--
10.25% First Mortgage Bonds, due 2008 .....	2,182	--
6.82% First Mortgage Bonds, due 2018 .....	15,000	--
9.34% First Mortgage Bonds, due 2019 .....	15,000	15,000
9.63% First Mortgage Bonds, due 2020 .....	10,000	--
9.44% First Mortgage Bonds, due 2020 .....	6,500	--
8.09% First Mortgage Bonds, due 2022 .....	12,500	--
8.46% First Mortgage Bonds, due 2022 .....	12,500	--
7.50% First Mortgage Bonds, due 2025 .....	15,000	--
7.99% First Mortgage Bonds, due 2026 .....	7,000	--
7.24% First Mortgage Bonds, due 2027 .....	6,000	--
6.50% First Mortgage Bonds, due 2029 .....	14,428	--
7.70% Debentures, due 2022 .....	6,825	--
Term Note, due 2002 .....	523,000	--
Capital lease and other .....	<u>28,786</u>	<u>26,452</u>
Total debt and capital lease .....	1,374,036	735,967
Less current portion .....	<u>5,219</u>	<u>2,193</u>
Total long-term debt and capital lease .....	<u>\$ 1,368,817</u>	<u>\$ 733,774</u>

**Senior Notes** On November 3, 1999, the Company completed the sale of \$300,000,000 of 8.25% Senior Notes (8.25% Notes) due 2029. The net proceeds from the sale of these 8.25% Notes were used to: (i) fund the acquisition of Pennsylvania Enterprises, Inc.; (ii) repay approximately \$109,900,000 of borrowings under the revolving credit facility, and (iii) repay approximately \$136,000,000 of long- and short-term debt assumed in the acquisition.

**Assumed Debt** In connection with the acquisition of the Pennsylvania Operations, the Company assumed \$45,000,000 of First Mortgage Bonds bearing interest between 8.375% and 9.34%. In connection with the acquisition of ProvEnergy, the Company assumed \$86,916,000 of First Mortgage Bonds bearing interest between 5.62% and 10.25%. In connection with the acquisition of Fall River Gas, the Company assumed \$19,500,000 of First Mortgage

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Bonds bearing interest between 7.24% and 9.44%. In connection with the acquisition of Valley Resources, the Company assumed \$6,905,000 of 7.70% Debentures.

**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 March 31, 2001, the capital lease obligation outstanding was \$23,687,000 with a fixed rate of 5.79%. This system has significantly improved meter reading accuracy and timeliness and provided electronic accessibility to meters in residential customers' basements, thereby assisting in the reduction of the number of estimated bills.

**Credit Facilities** On May 31, 2000, the Company restated and amended its short-term and long-term credit facilities (together referred to as "Revolving Credit Facilities"). The Company has available \$90,000,000 under the short-term facility, which expires May 30, 2001, and \$135,000,000 under the long-term facility, which expires on May 31, 2003. The Company has additional availability under uncommitted line of credit facilities with various banks. Borrowings under the Revolving Credit Facilities are available for Southern Union's working capital, letter of credit requirements and other general corporate purposes. A balance of \$211,600,000 was outstanding under the Revolving Credit Facilities at March 31, 2001.

**Term Note** On August 28, 2000 the Company entered into the Term Note to fund (i) the cash portion of the consideration to be paid to the Fall River Gas' stockholders; (ii) the all cash consideration to be paid to the ProVenergy and Valley Resources stockholders, (iii) repayment of approximately \$50,000,000 of long- and short-term debt assumed in the mergers, and (iv) all related acquisition costs. As of March 31, 2001, a balance of \$523,000,000 was outstanding under this Term Note. The Term Note expires August 27, 2001 but may be extended at the Company's option through August 26, 2002 for a fee. No additional draws can be made on the Term Note.

### UTILITY REGULATION AND RATES

**Missouri** On November 7, 2000, Missouri Gas Energy filed a \$39,384,000 request for a rate increase with the Missouri Public Service Commission (MPSC). Statutes require that the MPSC reach a decision in the case within an eleven-month period.

On August 21, 1998, Missouri Gas Energy was notified by the MPSC of its decision to grant a \$13,300,000 annual increase to revenue effective on September 2, 1998, which is primarily earned volumetrically. The MPSC rate order reflected a 10.93% return on common equity. The rate order, however, disallowed certain previously recorded deferred costs requiring a non-cash write-off of \$2,221,000. The Company recorded this charge to earnings in its fiscal year ended June 30, 1998. On December 8, 1998, the MPSC denied rehearing requests made by all parties other than Missouri Gas Energy and granted a portion of Missouri Gas Energy's rehearing request. On October 10, 2000, the MPSC issued its decision on rehearing Missouri Gas Energy's request which served to reduce the \$13,300,000 annual revenue increase by \$70,000. 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.

**Rhode Island** Effective October 1, 2000, the Rhode Island Public Utilities Commission (RIPUC) approved a settlement agreement between Providence Gas, the Rhode Island Division of Public Utilities and Carriers, the Energy Council of Rhode Island, and The George Wiley Center. The settlement agreement recognizes the need for an increase in distribution system revenues of \$4,500,000, recovered through an adjustment to the throughput portion of the gas charge, and provides for a 21-month base rate freeze. In the settlement agreement, the RIPUC authorized system improvement programs. Additionally, higher levels of support for low income bill payment assistance was authorized as well as the continuation of the utility's demand side management and weatherization assistance programs.

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The settlement agreement also contains a weather mitigation clause and a non-firm margin incentive mechanism (non-firm margin is margin earned from interruptible customers with the ability to switch to alternative fuels). The weather mitigation clause is designed to mitigate the impact of weather volatility on customer billings, which will assist customers in paying bills and stabilize the revenue stream to Providence Gas. Providence Gas will defer the margin impact of weather that is greater than 2 percent colder-than-normal and will recover the margin impact of weather that is greater than 2 percent warmer-than-normal by making the corresponding adjustment to the deferred revenue account (DRA). The non-firm margin incentive mechanism is designed to encourage Providence Gas to promote the development of non-firm margins, which will reduce the cost of service to all customers. Providence Gas will retain 25 percent of all non-firm margins earned in excess of \$1,200,000.

Under the settlement agreement, Providence Gas may earn up to 10.7 percent but not less than 7.0 percent using the average return on equity for the two 12 month periods of October 2000 through September 2001 and July 2001 through June 2002.

**Pennsylvania** On April 3, 2000, PG Energy filed an application with the Pennsylvania Public Utility Commission (PPUC) seeking an increase in its base rates designed to produce \$17,900,000 in additional annual revenues. On December 7, 2000, the PPUC approved a settlement agreement that provides for a rate increase designed to produce \$10,800,000 of additional annual revenue. The new rates became effective on January 1, 2001.

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

### COMMITMENTS AND CONTINGENCIES

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

The Company is investigating the possibility that the Company or predecessor companies may have been associated with Manufactured Gas Plant (MGP) sites in its former service territories, principally in Arizona and New Mexico, and present service territories in Texas, Missouri and its newly acquired service territories in Pennsylvania, Massachusetts and Rhode Island. At the present time, the Company is aware of certain MGP sites in these areas and is investigating those and certain other locations. While the Company's evaluation of these Texas, Missouri, Arizona, New Mexico, Pennsylvania, Massachusetts and Rhode Island MGP sites is in its preliminary stages, it is likely that some compliance costs may be identified and become subject to reasonable quantification. Within the Company's service territories certain MGP sites are currently the subject of governmental actions. Certain of these sites are as follows:

**Kansas City, Missouri MGP Sites** In a letter dated May 10, 1999, the Missouri Department of Natural Resources (MDNR) sent notice of a planned Site Inspection/Removal Site Evaluation of the Kansas City Coal Gas Former MGP site. This site (comprised of two adjacent MGP operations previously owned by two separate companies and hereafter referred to as Station A and Station B) is located at East 1st Street and Campbell in Kansas City, Missouri and is owned by Missouri Gas Energy. A 1988 investigation of the site performed by an Environmental Protection Agency (EPA) contractor determined that further remedial assessment was not required under the Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA), as amended by the SUPERFUND Amendments and Reauthorization Act of 1986. The MDNR has stated that the reassessment of the Kansas City Coal Gas site is part of a statewide effort to identify, evaluate, and prioritize the potential hazards posed by all of Missouri's

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

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MGP 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 work plans for the environmental assessment of the sites. The final environment reports were sent to the state on March 6, 2000. In a letter dated June 21, 2000, MDNR responded to the Station A environmental report submitted by the Company. In that letter, MDNR stated that soil remediation will be necessary at the site (Station A) but that further exploration and delineation of site contamination should be performed before remedial methods can be determined. In response to MDNR's request, the Company submitted a work plan for further investigation of the site to the agency on September 18, 2000. Following MDNR's acceptance of the work plan, additional site assessment work was performed and completed on March 26, 2001. MDNR has not responded to the Station B environmental report submitted by the Company.

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

**Providence, Rhode Island Sites** During 1995, Providence Gas began an environmental evaluation at its primary gas distribution facility located at 642 Allens Avenue in Providence, Rhode Island. Environmental studies and a subsequent remediation work plan were completed at an approximate cost of \$4.5 million. Providence Gas also began a soil remediation project on a portion of the site in July 1999. As of March 31, 2001, approximately \$8,900,000 had been expended on soil remediation under the remediation work plan. Based on the results of the environmental investigation and the site information learned during the performance of work under the remediation work plan, the Company is now revising the remediation work plan. Although additional remediation work is planned for the site during calendar year 2001, assessment and remediation costs will not exceed \$1,000,000 during calendar year 2001. Because of the uncertainties associated with the revision of the remediation work plan and the development of a remedial solution for the entire site, the Company cannot offer any conclusions as to the total future cost of remediation of the property at this time.

In November 1998, Providence Gas received a letter of responsibility from the Department of Environmental Management (DEM) relating to possible contamination on previously owned property at 170 Allens Avenue in Providence. The current operator of the property has also received a letter of responsibility. A work plan has been created and approved by DEM. An investigation has begun to determine the extent of contamination, as well as the extent of the Company's responsibility. Providence Gas entered into a cost-sharing agreement with the current operator of the property, under which Providence Gas is responsible for approximately twenty percent (20%) of the costs related to the investigation. Costs of testing at this site as of March 31, 2001 were approximately \$300,000. Until the results of the investigation are known, the Company cannot offer any conclusions as to its responsibility.

**Tiverton, Rhode Island Site** Fall River Gas Company is a defendant in a civil action seeking to recover anticipated remediation costs associated with contamination found at property owned by the plaintiffs. This claim is based on alleged dumping of material by Fall River Gas Company trucks at the site in the 1930s and 1940s.

**Valley Resources Sites** Valley Resources is a party to an action in which Blackstone Valley Electric Company ("Blackstone") brought suit for contribution to its expenses of cleanup of a site on Mendon Road in Attleboro, Massachusetts, to which coal manufacturing waste was transported from a former MGP site in Pawtucket, Rhode Island (the "Blackstone Litigation"). Blackstone Valley Electric Company v. Stone & Webster, Inc., Stone & Webster

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Engineering Corporation, Stone & Webster Management Consultants, Inc. and Valley Gas Company, C. A. No. 94-10178JLT, United States District Court, District of Massachusetts. Valley Resources takes the position in that litigation that it is indemnified for any cleanup expenses by Blackstone pursuant to a 1961 agreement signed at the time of Valley Resources' creation. This suit was stayed in 1995 pending the issuance of rulemaking at the United States EPA (Commonwealth of Massachusetts v. Blackstone Valley Electric Company, 67 F.3d 981 (1995)). In January 2001, the EPA issued a Preliminary Administrative Decision on this issue and announced that, until March 21, 2001, it is soliciting comments on the Decision. The EPA subsequently announced that the current period would be extended for an additional three month period. While this suit has been stayed, Valley Resources and Blackstone (merged with Narragansett Electric Company in May 2000) have received letters of responsibility from the Rhode Island DEM with respect to releases from two MGP sites in Rhode Island. DEM issued letters of responsibility to Valley Resources and Blackstone in September 1995 for the Tidewater MGP in Pawtucket, Rhode Island, and in February 1997 for the Hamlet Avenue MGP in Woonsocket, Rhode Island. Valley Resources entered into an agreement with Blackstone (now Narragansett) in which Valley Resources and Blackstone agreed to share equally the expenses for the costs associated with the Tidewater site subject to reallocation upon final determination of the legal issues that exist between the companies with respect to responsibility for expenses for the Tidewater site and otherwise. No such agreement has been reached with respect to the Hamlet site.

To the extent that potential costs associated with former MGPs are quantified, the Company expects to provide any appropriate accruals and seek recovery for such remediation costs through all appropriate means, including in rates charged to customers, insurance and regulatory relief. At the time of the closing of the acquisition of the Company's Missouri service territories, the Company entered into an Environmental Liability Agreement that provides that Western Resources retains financial responsibility for certain liabilities under environmental laws that may exist or arise with respect to Missouri Gas Energy. In addition, at the time it was acquired, Providence Gas had in place a regulatory plan that created a mechanism for the recovery of environmental-related costs. This plan provided for recovery of environmental investigation and remediation costs incurred through September 30, 1997, as well as costs incurred during the three-year term of the plan, are to be amortized over a 10-year period, at a level authorized under the plan. A new plan, effective October 1, 2000 through June 30, 2002, establishes an environmental fund for the recovery of evaluation, remedial and clean-up costs arising out of the Company's MGPs and sites associated with the operation and disposal activities from MGPs.

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

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

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



# SOUTHERN UNION COMPANY AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

There are several lawsuits pending in the U. S. District Court for Arizona 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. The Company anticipates that a trial of the consolidated lawsuits in Arizona will begin in November 2001. 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. With the exception of ongoing legal fees associated with the aforementioned litigation, the Company believes that the results of the above-noted Southwest litigation will not have a materially adverse effect on the Company's financial condition, results of operations 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. 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 trial court's decision was appealed to the Thirteenth District of the Texas Court of Appeals (Court of Appeals). In December 2000, the Court of Appeals reversed and modified the trial court's judgment of approximately \$8,500,000 and awarded the City of Edinburg \$585,000, plus pre-judgment interest of \$190,000 against RGV and Valero for breach of contract. The Court of Appeals upheld the award for attorneys' fees of approximately \$3,500,000 against Valero, RGV and Southern Union. In April 2001, the Court of Appeals granted the release requested in Southern Union's motion for rehearing, and reformed its earlier opinion so as to exclude Southern Union from any remaining liability. The other parties in the case have contested this opinion. The Company will continue to monitor its position in this case. The Company believes 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. The Company also has entered into a settlement agreement to settle a related class action lawsuit with a majority of the cities served by the Company in Texas. The settlement will not have a material adverse impact on the Company's results of operations, financial position or cash flows.

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

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

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

**Overview** Southern Union Company's (the "Company") core business is the distribution of natural gas as a public utility through: Southern Union Gas, Missouri Gas Energy (MGE); Atlantic Utilities, doing business as South Florida Natural Gas (SFNG); PG Energy, acquired on November 4, 1999; and, effective with the September 2000 acquisitions of Providence Energy Corporation, Valley Resources, Inc. and Fall River Gas Company, collectively its New England Division. In addition, subsidiaries of Southern Union support and expand natural gas sales and capitalize on the Company's gas energy expertise. These subsidiaries operate natural gas pipeline systems, generate electricity, market natural gas and electricity to end-users and distribute propane and fuel oil. Certain subsidiaries also own or hold interests in real estate and other assets, which are primarily used in the Company's utility business.

Most of the Company's 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.

**Acquisitions** On September 28, 2000, Southern Union completed the acquisition of Providence Energy Corporation (ProvEnergy) for approximately \$270,000,000 in cash plus the assumption of \$90,000,000 in long-term debt. The ProvEnergy natural gas distribution operations are Providence Gas and North Attleboro Gas, which collectively serve approximately 176,000 natural gas customers. Providence Gas serves natural gas customers in Providence and Newport, Rhode Island, and 23 other cities and towns in Rhode Island. North Attleboro Gas serves customers in North Attleboro and Plainville, Massachusetts, towns adjacent to the northeastern Rhode Island border. Subsidiaries of the Company acquired in the ProvEnergy merger include ProvEnergy Oil Enterprises, Inc. (ProvEnergy Oil), and ProvEnergy Power Company, LLC. ProvEnergy Oil operates a fuel oil distribution business through its subsidiary, ProvEnergy Fuels, Inc. (ProvEnergy Fuels). ProvEnergy Fuels serves over 15,000 residential and commercial customers in Rhode Island and Massachusetts. ProvEnergy Power Company owns 50% of Capital Center Energy Company, LLC., a joint venture formed between ProvEnergy and ERI Services, Inc. to provide retail power.

On September 28, 2000, Southern Union also completed the acquisition of Fall River Gas Company (Fall River Gas) for approximately 1,400,000 shares of Southern Union common stock and approximately \$27,000,000 in cash plus assumption of \$20,000,000 in long-term debt. Fall River Gas serves approximately 49,000 customers in the city of Fall River and the towns of Somerset, Swansea and Westport, all located in southeastern Massachusetts. Also acquired in the Fall River Gas merger was Fall River Gas Appliance Company, Inc. which rents water heaters and conversion burners in Fall River Gas' service area.

On September 20, 2000, Southern Union completed the acquisition of Valley Resources, Inc. (Valley Resources) for approximately \$125,000,000 in cash plus the assumption of \$30,000,000 in long-term debt. Valley Resources natural gas distribution operations are Valley Gas Company and Bristol and Warren Gas Company, which collectively serve approximately 66,000 natural gas customers. Valley Resources' three non-utility subsidiaries acquired in the merger rent and sell appliances, offer service contract programs, sell liquid propane in Rhode Island and nearby Massachusetts, and distribute as a wholesaler franchised lines to plumbing and heating contractors. Also acquired in the acquisition was Valley Resources' 90% interest in Alternate Energy Corporation, which sells, installs and designs natural gas conversion systems and facilities, is an authorized representative of the ONSI Corporation fuel cell, holds patents for a natural gas/diesel co-firing system and for a device to control the flow of fuel on dual-fuel equipment.

Collectively, the operations from the above-mentioned acquisitions are referred to as the "New England Operations." The Company plans to sell or dispose of certain non-core businesses acquired in the New England Operations.

On November 4, 1999, the Company acquired Pennsylvania Enterprises, Inc. (hereafter referred to as the "Pennsylvania Operations") in a transaction valued at approximately \$500,000,000, including assumption of

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

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

long-term debt of approximately \$115,000,000. The Company issued approximately 16,700,000 shares (before adjustment for any subsequent stock dividend) of common stock and paid approximately \$36,000,000 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 156,000 gas customers in northeastern and central Pennsylvania. Subsidiaries of the Company included in the Pennsylvania Operations include PG Energy Services Inc., (Energy Services); Keystone Pipeline Services, Inc. (*Keystone*, a wholly-owned subsidiary of PG Energy Services Inc.); and PEI Power Corporation. Through Energy Services the Company markets a diversified range of energy-related products and services under the name of PG Energy PowerPlus and supplies propane under the name of PG Energy Propane. Keystone provides pipeline and fiber optic cable construction, installation, maintenance, and rehabilitation services. PEI Power Corporation operates a cogeneration plant that generates steam and electricity for resale. The Company plans to sell or dispose of both Keystone and the propane operations of Energy Services; these operations are not material to the Company. The Company has not yet sold these operations and there can be no assurance that a sale on terms satisfactory to the Company will be completed. A letter of intent has been entered into for certain of these operations with the sale expected to be completed during the fourth quarter of fiscal year 2001.

The operating activities of the acquired operations are consolidated with the Company beginning on their respective acquisition dates. Thus, the results of operations for the three-, nine- and twelve-month periods ended March 31, 2001 are not indicative of results that would necessarily be achieved for a full year since the majority of the Company's operating margin is earned during the winter heating season. For these reasons, the results of operations of the Company for the periods subsequent to the acquisitions are not comparable to those periods prior to the acquisitions nor are the fiscal 2001 results of operations comparable with prior periods.

### RESULTS OF OPERATIONS

#### *Three Months Ended March 31, 2001 and 2000*

The Company recorded net earnings available for common stock of \$40,806,000 for the three-month period ended March 31, 2001 compared with net earnings of \$19,515,000 for the same period in 2000. Earnings per diluted share were \$.77 in 2001, compared with \$.38 in 2000. Weighted average diluted shares outstanding increased 3% in 2001 due to the issuance of 1,370,629 shares of the Company's common stock on September 28, 2000 in connection with the acquisition of Fall River Gas.

Operating revenues were \$914,653,000 for the three-month period ended March 31, 2001, compared with \$344,789,000 in 2000. Gas purchase and other energy costs for the three-month period ended March 31, 2001 were \$685,404,000, compared with \$217,793,000 in 2000. 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 46% increase in gas sales volume to 77,671 MMcf in 2001 from 53,101 MMcf in 2000 and by a 123% increase in the average cost of gas from \$3.66 per MMcf in 2000 to \$8.17 per Mcf in 2001. Changes in the average cost of gas resulted from seasonal impacts on demands for natural gas. The New England Operations contributed \$210,500,000 to the overall increase in operating revenues, \$135,598,000 in gas purchase and other energy costs and 15,756 MMcf of the increase in gas sales volume. The remaining increases in both operating revenues and gas purchase and other energy costs was primarily due to the previously mentioned increase in the average cost of gas as well as an 8,814 MMcf increase in sales volume in the Texas, Missouri and Pennsylvania

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

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

service territories as a result of the colder-than-normal weather in these territories in 2001 as compared to the unusually mild temperatures in 2000.

Weather in MGE's service territories was 100% of a 30-year measure for the three-month period ended March 31, 2001, compared with 79% in 2000. Southern Union Gas service territories experienced weather which was 102% of a 30-year measure in 2001, compared with 62% in 2000. About half of the customers served by Southern Union Gas are weather normalized. Additionally, with the February 2000 revenue increase in El Paso, Texas, the new rate design collects a greater portion of the revenue stream from the monthly customer charge instead of being earned volumetrically. Weather for the PG Energy service territories was 98% of a 30-year measure for the three-month period ended March 31, 2001, compared with 92% in 2000. Weather in the New England division service territories was 100% of a 30-year measure for the three-month period ended March 31, 2001.

Net operating margin (operating margin less revenue-related taxes) increased \$82,784,000 for the three-month period ended March 31, 2001, compared with the same period in 2000. Growth in net operating margin is primarily due to the colder-than-normal weather, previously discussed, and the acquisition of the New England Operations which generated \$70,208,000 in net operating margin.

Operating expenses, which include operating, maintenance and general expenses, depreciation and amortization, and taxes other than on income and revenues, were \$102,861,000 for the three-month period ended March 31, 2001, an increase of \$42,961,000, compared with \$59,900,000 in 2000. An increase of \$36,109,000 was the result of the acquisition of the New England Operations. Also impacting operating expenses was an increase in bad debt expense in the Texas, Missouri and Pennsylvania service territories of \$9,326,000 due to an increase in customer receivables as a result of higher gas prices as previously discussed. This was partially offset by a \$2,216,000 reversal of non-cash compensation expense associated with shares of common stock held in a trust for one of the Company's benefit plans, resulting from a \$5.50 decrease in the Company's common stock price during the period from January 1, 2001 to March 22, 2001. The Company amended this plan effective March 22, 2001 to eliminate future expense, or income volatility, associated with the accounting treatment for such benefit plan.

Interest expense was \$29,163,000 for the three-month period ended March 31, 2001, compared with \$14,940,000 in 2000. Interest expense increased primarily due to a \$535,000,000 bank note (the Term Note) entered into by the Company on August 28, 2000 for the acquisition of the New England Operations. The Company entered into the Term Note to (i) fund the cash consideration paid to stockholders of Fall River Gas, ProvEnergy and Valley Resources, (ii) refinance and repay long- and short-term debt assumed in the New England Operations, and (iii) acquisition costs of the New England Operations. The Company also assumed \$113,321,000 in long-term debt of the New England Operations which was not refinanced or extinguished with the Term Note. As a result of the previously discussed high cost of gas, the Company incurred additional interest expense of \$2,547,000 under its short-term credit facilities during the three-month period ended March 31, 2001 compared with the same period in 2000. Southern Union is required to make payments to natural gas suppliers in advance of the receipt of cash payments from the Company's customers. See "Debt and Capital Lease" in the Notes to the Consolidated Financial Statements included herein.

Other income for the three-month period ended March 31, 2001 was \$14,364,000 compared with other expense of \$1,034,000 in 2000. Other income for the three-month period ended March 31, 2001, includes realized gains on the sale of investment securities of \$12,494,000, non-cash trading gains of \$3,360,000 and interest and dividend income of \$1,680,000. This was partially offset by \$3,568,000 of legal costs associated with ongoing litigation associated with the unsuccessful acquisition of Southwest Gas Corporation (Southwest). Other expense for the three-month period ended March 31, 2000 primarily consisted of \$1,400,000 of legal costs associated with the aforementioned ongoing litigation which was partially offset by \$663,000 in net rental income from Lavaca Realty Company ("Lavaca Realty").

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

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

The effective federal and state income tax rate is 46% and 43% for the three months ended March 31, 2001 and 2000, respectively. The increase in the effective federal and state income tax rate is a result of non-tax deductible amortization of additional purchase cost recorded at the acquisition of the New England Operations.

### ***Nine Months Ended March 31, 2001 and 2000***

The Company recorded net earnings available for common stock of \$46,150,000 for the nine-month period ended March 31, 2001, compared with net earnings of \$20,547,000 for the same period in 2000. Net earnings per diluted share were \$.88 in 2001 compared with \$.47 in 2000. Weighted average diluted shares outstanding increased 20% in 2001 due to the issuance of the Company's common stock in connection with the acquisition of Fall River Gas, previously discussed, and the issuance of 16,713,731 shares (before adjustment for any subsequent stock dividend) of the Company's common stock on November 4, 1999 in connection with the acquisition of the Pennsylvania Operations.

Operating revenues were \$1,664,461,000 for the nine-month period ended March 31, 2001, compared with \$669,170,000 in 2000. Gas purchase and other energy costs for the nine-month period ended March 31, 2001 were \$1,203,862,000, compared with \$402,182,000 in 2000. The increase in both operating revenues and gas purchase costs between periods was primarily due to a 53% increase in gas sales volume to 154,432 MMcf in 2001 from 101,225 MMcf in 2000 and by a 97% increase in the average cost of gas from \$3.59 per Mcf in 2000 to \$7.06 per Mcf in 2001 due to increases in average gas prices. The New England Operations contributed \$351,679,000 to the overall increase in operating revenues, \$224,708,000 in gas purchase and other energy costs and 26,655 MMcf of the increase in gas sales volume. The Pennsylvania Operations generated a net increase of \$136,886,000 in operating revenues, \$119,029,000 in gas purchase and other energy costs, and 5,501 MMcf of the increase in gas sales volume. The remaining increase in operating revenues, gas purchase and other energy costs, and gas sales volume resulted principally from the colder-than-normal weather in the Texas and Missouri service territories in 2001 as compared to the unusually mild temperatures in 2000.

MGE's service territories experienced weather which was 110% of a 30-year measure for the nine-month period ended March 31, 2001 compared with 79% in 2000. Weather for Southern Union Gas service territories was 113% of a 30-year measure in 2001, compared with 72% in 2000. About half of the customers served by Southern Union Gas are weather normalized. Additionally, with the February 2000 revenue increase in El Paso, Texas, the new rate design collects a greater portion of the revenue stream from the monthly customer charge instead of being earned volumetrically. Weather in the PG Energy service territories was 107% of a 30-year measure for the nine-month period ended March 31, 2001, compared with 91% of a 30-year measure for the five-month period ended March 31, 2000. Weather in the New England division service territories was 107% of a 30-year measure for the six-month period ended March 31, 2001.

Net operating margin increased \$160,430,000 for the nine-month period ended March 31, 2001 compared with the same period in 2000. Growth in net operating margin is primarily due to the acquisition of the New England Operations which generated \$118,921,000 in net operating margin and the Pennsylvania Operations which contributed a net increase of \$19,037,000. The remaining increase is due to the colder-than-normal weather in the Missouri and Texas service territories, previously discussed.

Operating expenses were \$254,544,000 for the nine-month period ended March 31, 2001, an increase of \$102,579,000, compared with \$151,965,000 in 2000. Increases of \$69,227,000 and \$16,850,000 were the result of the acquisitions of the New England Operations and the Pennsylvania Operations, respectively. Also contributing to the increase was an increase in bad debt expense in the Texas and Missouri service territories of \$9,929,000 due to an increase in customer receivables as a result of higher gas prices, previously discussed. Also impacting

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

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

operating expenses for the nine-month period ended March 31, 2001 were increases in employee payroll and benefit costs due to the colder-than-normal weather.

Interest expense was \$75,772,000 for the nine-month period ended March 31, 2001, compared with \$36,603,000 in 2000. Interest expense increased primarily due to the Term Note entered into by the Company for the acquisition of the New England Operations, previously discussed, and the issuance of \$300,000,000 of 8.25% Senior Notes on November 3, 1999 (8.25% Senior Notes) for the acquisition of the Pennsylvania Operations. The Company issued 8.25% Senior Notes to fund the acquisition of Pennsylvania Enterprises, Inc. and to extinguish \$136,000,000 in existing debt of the Pennsylvania Operations. The Company also assumed long-term debt of the New England Operations, previously discussed, and \$45,000,000 in long-term debt of the Pennsylvania Operations which was not refinanced or extinguished with the Term Note or the 8.25% Senior Notes. As a result of the previously discussed high cost of gas, the Company incurred additional interest expense of \$4,617,000 under its short-term credit facilities during the nine-month period ended March 31, 2001 compared with the same period in 2000. See "Debt and Capital Lease" in the Notes to the Financial Statements included herein.

Other income for the nine-month period ended March 31, 2001 was \$23,761,000, compared with other expense of \$5,527,000 in 2000. Other income for the nine-month period ended March 31, 2001 includes realized gains on the sale of investment securities of \$21,363,000, a \$13,532,000 gain on the sale of non-core real estate, and interest and dividend income of \$3,385,000. This was partially offset by \$8,466,000 of legal costs associated with ongoing litigation from the unsuccessful acquisition of Southwest and \$5,684,000 of non-cash trading losses. Other expense for the nine-month period ended March 31, 2000 primarily consisted of \$6,664,000 of legal costs associated with the aforementioned ongoing litigation which was partially offset by \$1,327,000 in rental income from Lavaca Realty.

The Company's consolidated federal and state effective income tax rate was 46% and 43% for the nine months ended March 31, 2001 and 2000, 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 acquisition of the New England Operations and Pennsylvania Operations.

The Company adopted the Statement of Financial Accounting Standards Board (FASB) *Accounting for Derivative Instruments and Hedging Activities* on July 1, 2000. In accordance with the transition provisions of the Statement, the Company recorded a net-of-tax cumulative-effect-type gain of \$602,000 in earnings to recognize the fair value of the derivative instruments that do not qualify for hedge accounting treatment under the Statement.

### **Twelve Months Ended March 31, 2001 and 2000**

The Company recorded net earnings available for common stock of \$35,448,000 for the twelve-month period ended March 31, 2001, compared with net earnings of \$15,043,000 in 2000. Earnings per diluted share were \$.68 in 2001 compared with earnings per diluted share of \$.36 in 2000. Weighted average diluted shares outstanding increased 25% due to the issuance of the Company's common stock in connection with the acquisition of Fall River Gas and the Pennsylvania Operations, previously discussed.

Operating revenues were \$1,826,995,000 for the twelve-month period ended March 31, 2001, compared with \$770,858,000 in 2000. Gas purchase and other energy costs for the twelve-month period ended March 31, 2001 were \$1,299,378,000, compared with \$452,113,000 in 2000. The increase in both operating revenues and gas purchase costs between periods was primarily due to a 47% increase in gas sales volume to 172,986 MMcf in 2001 from 117,777 MMcf in 2000 and by a 93% increase in the average cost of gas from \$3.50 per Mcf in 2000 to \$6.75 per Mcf in 2001 due to increases in average gas prices. The New England Operations contributed \$351,679,000 to the overall increase in operating revenues, \$224,708,000 in gas purchase and other energy costs and 26,655 MMcf of the increase in gas sales volume. The Pennsylvania Operations generated a net increase of \$182,376,000 in

# SOUTHERN UNION COMPANY AND SUBSIDIARIES

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

operating revenues, \$148,662,000 in gas purchase and other energy costs and 8,622 MMcf of the increase in gas sales volume. The remaining increases in operating revenues, gas purchase and other energy costs, and gas sales volume resulted principally from the colder weather in the Texas and Missouri Service territories in 2001 as compared to 2000.

MGE's service territories experienced weather which was 108% of the 30-year measure for the twelve-month period ended March 31, 2001 compared with 80% in 2000. Weather for Southern Union Gas service territories was 111% of a 30-year measure compared with 72% in 2000. About half of the customers served by Southern Union Gas are weather normalized. Weather in the PG Energy service territories was 106% of a 30-year measure for the twelve-month period ended March 31, 2001.

Net operating margin increased \$175,076,000 for the twelve-month period ended March 31, 2001, compared with the same period in 2000. Growth in net operating margin is primarily due to the acquisition of the New England Operations which generated \$118,921,000 and to the Pennsylvania Operations which contributed a net increase of \$34,345,000. The remaining increase is due to the colder weather in the Missouri and Texas service territories, previously discussed.

Operating expenses were \$311,575,000 for the twelve-month period ended March 31, 2001, an increase of \$117,560,000, compared with \$194,015,000 in 2000. Increases of \$69,227,000 and \$32,568,000 were the result of the acquisitions of the New England Operations and the Pennsylvania Operations, respectively. An increase in bad debt expense in the Texas and Missouri service territories of \$10,181,000 resulted from an increase in customer receivables as a result of higher gas prices, previously discussed. Also impacting operating expenses for the twelve-month period ended March 31, 2001 were increases in employee payroll and benefit costs due to the colder-than-normal weather and inventory write-downs associated with a propane operation.

Interest expense was \$90,661,000 for the twelve-month period ended March 31, 2001, compared with \$45,759,000 in 2000. Interest expense increased primarily due to the Term Note entered into by the Company for the acquisition of the New England Operations, the 8.25% Senior Notes issued by the Company for the acquisition of the Pennsylvania Operations and the assumption of debt by the Company from the New England Operations and Pennsylvania Operations, all previously discussed. As a result of the previously discussed high cost of gas, the Company incurred additional interest expense of \$4,558,000 under its short-term credit facilities during the twelve-month period ended March 31, 2001 compared with the same period in 2000. See "Debt and Capital Lease" in the Notes to the Consolidated Financial Statements included herein.

Other income for the twelve-month period ended March 31, 2001 was \$19,580,000 compared with other expense of \$7,651,000 in 2000. Other income for the twelve-month period ended March 31, 2001 includes realized gains on the sale of investment securities of \$21,363,000, a \$13,532,000 gain on the sale of non-core real estate, and \$5,002,000 of interest and dividend income. This was partially offset by \$12,165,000 of legal costs associated with ongoing litigation from the unsuccessful acquisition of Southwest and \$7,920,000 of non-cash trading losses. Other expense for the twelve-month period ended March 31, 2000 primarily consisted of \$10,503,000 of costs associated with unsuccessful acquisition activities and related litigation which was partially offset by \$1,841,000 in net rental income from Lavaca Realty.

The Company's consolidated federal and state effective income tax rate was 48% and 45% for the twelve-month period ended March 31, 2001 and 2000, 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 acquisition of the New England Operations and 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, 2001 and 2000:

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	2001	2000	2001	2000
Average number of gas sales customers served:				
Residential	1,341,714	1,062,100	1,195,591	965,954
Commercial	132,319	107,699	117,247	95,818
Industrial and irrigation	4,372	764	2,553	651
Pipeline and marketing	356	225	331	232
Public authorities and other	3,177	3,195	3,157	2,992
Total average customers served	<u>1,481,938</u>	<u>1,173,983</u>	<u>1,318,879</u>	<u>1,065,647</u>
Gas sales in millions of cubic feet (MMcf):				
Residential	56,833	36,566	102,539	67,166
Commercial	22,191	14,468	42,035	28,923
Industrial and irrigation	1,871	504	4,195	1,522
Pipeline and marketing	5,113	5,542	16,712	17,253
Public authorities and other	1,450	1,193	3,119	2,548
Gas sales billed	<u>87,458</u>	<u>58,273</u>	<u>168,600</u>	<u>117,412</u>
Net change in unbilled gas sales	(9,787)	(5,172)	4,386	365
Total gas sales	<u>77,671</u>	<u>53,101</u>	<u>172,986</u>	<u>117,777</u>
Gas sales revenues (thousands of dollars):				
Residential	\$ 596,129	\$ 225,712	\$ 1,009,451	\$ 450,861
Commercial	224,916	84,356	378,704	167,577
Industrial and irrigation	17,562	2,814	34,045	7,923
Pipeline and marketing	29,126	14,119	73,963	43,664
Public authorities and other	13,937	5,457	25,092	11,428
Gas sales revenues billed	<u>881,670</u>	<u>332,458</u>	<u>1,521,255</u>	<u>681,453</u>
Net change in unbilled gas sales revenues	(47,269)	(28,811)	76,772	3,660
Total gas sales revenues	<u>\$ 834,401</u>	<u>\$ 303,647</u>	<u>\$ 1,598,027</u>	<u>\$ 685,113</u>
Gas sales margin (thousands of dollars)	<u>\$ 166,236</u>	<u>\$ 95,223</u>	<u>\$ 363,136</u>	<u>\$ 238,484</u>
Gas sales revenue per thousand cubic feet (Mcf) billed:				
Residential	\$ 10.49	\$ 6.17	\$ 9.85	\$ 6.71
Commercial	10.14	5.83	9.01	5.79
Industrial and irrigation	9.39	5.59	8.12	5.21
Pipeline and marketing	5.70	2.55	4.43	2.53
Public authorities and other	9.61	4.57	8.04	4.49
Weather:				
Degree days:				
Southern Union Gas service territories	1,259	777	2,372	1,550
Missouri Gas Energy service territories	2,809	2,211	5,643	4,200
PG Energy service territories	3,120	2,929	6,651	4,524
New England service territories	2,980	--	5,174	--
Percent of normal, based on 30-year measure:				
Southern Union Gas service territories	102%	62%	111%	72%
Missouri Gas Energy service territories	100%	79%	108%	80%
PG Energy service territories	98%	92%	106%	91%
New England service territories	100%	--	107%	--
Gas transported in millions of cubic feet (MMcf)	26,822	25,738	91,264	70,093
Gas transportation revenues (thousands of dollars)	\$ 17,606	\$ 12,174	\$ 47,624	\$ 29,405

The above information does not include the Company's 43% equity ownership in a natural gas distribution company serving 25,000 customers in Piedras Negras, Mexico. Information for Fall River Gas and ProvEnergy, acquired September 28, 2000, and Valley Resources, acquired September 20, 2000, is included since October 1, 2000. The 30-year measure is used above for consistent external reporting purposes. Measures of normal weather used by the Company's regulatory authorities to set rates vary by jurisdiction. Periods used to measure normal weather for regulatory purposes range from 10 years to 30 years.



# 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.

On May 31, 2000, the Company restated and amended its short-term and long-term credit facilities (together referred to as "Revolving Credit Facilities"). The Company has available \$90,000,000 under the short-term facility, which expires May 30, 2001, and \$135,000,000 under the long-term facility, which expires on May 31, 2003. The Company has additional availability under uncommitted line of credit facilities with various banks. Borrowings under the Revolving Credit Facilities are available for Southern Union's working capital, letter of credit requirements and other general corporate purposes. A balance of \$211,600,000 was outstanding under the Revolving Credit Facilities at March 31, 2001.

On August 28, 2000 the Company entered into the Term Note to fund (i) the cash portion of the consideration to be paid to the Fall River Gas' stockholders; (ii) the all cash consideration to be paid to the ProvEnergy and Valley Resources stockholders, (iii) repayment of approximately \$50,000,000 of long- and short-term debt assumed in the New England mergers, and (iv) related acquisition costs. As of March 31, 2001, a balance of \$523,000,000 was outstanding on this Term Note. The Term Note expires August 27, 2001 but may be extended at the Company's option through August 26, 2002 for a 12.5 basis point fee. No additional draws can be made on the Term Note.

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 then existing various credit facilities. These senior notes are senior unsecured obligations and 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 sources of funds during the three-month period ended March 31, 2001 were \$36,600,000 borrowed under the Company's Revolving Credit Facilities and proceeds from the sale of investment securities of \$15,405,000. The principal uses of funds during this period included \$25,469,000 for on-going property, plant and equipment additions; \$6,898,000 for the retirement of long-term debt; as well as seasonal working capital needs of the Company.

The principal sources of funds during the nine-month period ended March 31, 2001 were \$535,000,000 borrowed under the Term Note, \$211,597,000 borrowed under the Company's Revolving Credit Facilities, proceeds from the sale of investment securities of \$26,777,000 and proceeds from the sale of real estate of \$20,638,000. This provided funds of \$406,949,000 for acquisition and related expenses of the New England Operations; \$114,171,000 for the retirement of merger debt assumed from the New England Operations; \$87,172,000 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 7.8% (including interest and the amortization of debt issuance costs and redemption premiums on refinanced debt).

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

# **SOUTHERN UNION COMPANY AND SUBSIDIARIES**

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

ongoing construction and maintenance programs and operational needs and may also be used periodically to reduce outstanding debt.

### **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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/A for the year ended June 30, 2000.

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/A for the year ended June 30, 2000, 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.

### **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; availability of cash flow; 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 May 12, 2001 Peter H. Kelley resigned from all of his current positions as an officer and director of Southern Union Company due to health reasons. The Board of Directors of Southern Union Company elected Thomas F. Karam as its new president and chief operating officer. Mr. Karam is currently the executive vice president of corporate development and president and chief executive officer of PG Energy, Southern Union Company's Pennsylvania division. Mr. Karam served as president and chief executive officer of Pennsylvania Enterprises, Inc. prior to its acquisition by Southern Union Company in 1999.

## 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, 2001

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

Date May 15, 2001

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

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**CONFIDENTIAL**

**SOUTHERN UNION COMPANY**  
**2 YEAR PROJECTIONS**  
**SOURCES AND USES OF FUNDS**  
*(thousands of dollars)*

**Exhibit B**

**Southern Union Company**  
**Funded Debt**

Exhibit C

(a) Description		(b) Terms of principal payout	(b) Original balance	(c) Balance Mar 31, 2001		(d) Amt held as reacq sec	(e) Amount pledged	(f) Amount owed by affiliates	(g) Amount held in any funds
			(in thousands)						
<b>Senior Notes</b>									
7.6% Senior notes due Feb 1, 2024 (paid Feb 1 and Aug 1)	7.600%	Balance @ maturity	475,000	364,515		none	unsecured	direct debt of SUCO	none
8.25% Senior notes due Nov 15, 2029 (paid May 15 and Nov 15)	8.250%	Balance @ maturity	300,000	300,000		none	unsecured	direct debt of SUCO	none
Term loan due August 26, 2002	Floating	Balance @ maturity	535,000	523,000	(1)	none	unsecured	direct debt of SUCO	none
AMR capital lease	Varies	Variable		23,687		none	all is secured	direct debt of SUCO	none
SUPro - various	Varies			1,150		none	all is secured	direct debt of subsid	none
Prov - various capital leases	Varies			1,604		none	all is secured	direct debt of SUCO	none
Valley - KSOP	Varies			2,344		none	all is secured	direct debt of SUCO	none
Total				<u>\$ 1,216,300</u>					
<b>Providence First Mortgage Bonds</b>									
Series M, due July 31, 2008 (paid July 31 and January 31)	10.250%	\$273k each July 31	10,000	2,182	(2)	none	all is secured	direct debt of SUCO	none
Series N, due May 30, 2020 (paid May 30 and Nov 30)	9.630%	\$10,000k @ term	10,000	10,000	(2)	none	all is secured	direct debt of SUCO	none
Series O, due September 30, 2022 (paid March 30 and Sept 30)	8.460%	\$12,500k @ term	12,500	12,500	(2)	none	all is secured	direct debt of SUCO	none
Series P, due September 30, 2022 (paid March 30 and Sept 30)	8.090%	\$625k each Sept 30 begin 2003	12,500	12,500	(2)	none	all is secured	direct debt of SUCO	none
Series Q, due November 30, 2003 (paid May 30 and Nov 30)	5.620%	\$1,600k each Nov 30	16,000	4,800	(2)	none	all is secured	direct debt of SUCO	none
Series R, due December 15, 2025 (paid Jun 15 and Dec 15)	7.500%	\$750k each Dec 15 begin 2006	15,000	15,000	(2)	none	all is secured	direct debt of SUCO	none
Series S, due April 1, 2018 (paid April 1 and Oct 1)	6.820%	\$15,000k @ term	15,000	15,000	(2)	none	all is secured	direct debt of SUCO	none
Series T, due February 1, 2029 (paid Feb 1, May 1, Aug 1 & Nov 1)	6.500%	Balance @ term	15,000	14,428	(2)	none	all is secured	direct debt of SUCO	none
Total				<u>86,410</u>					
<b>Valley Resources</b>									
Senior Notes due Sep 1, 2027 (paid Mar 1 and Sept 1)	7.700%	Balance @ term	7,000	6,825	(2)	none	unsecured	direct debt of SUCO	none
				<u>6,825</u>					
<b>Fall River Gas First Mortgage Bonds</b>									
9.44% due February 15, 2020 (paid Feb 15 and Aug 15)	9.440%	\$6,500 @ term	6,500	6,500	(2)	none	all is secured	direct debt of SUCO	none
7.99% due Sep 15, 2026 (paid Mar 15 and Sept 15)	7.990%	\$7,000 @ term	7,000	7,000	(2)	none	all is secured	direct debt of SUCO	none

**Southern Union Company**  
**Funded Debt**

**Exhibit C**

7.24% due Dec 15, 2027 (paid June 15 and Dec 15)	7.240%	\$6,000 @ term	6,000	6,000	(2)	none	all is secured	direct debt of SUCO	none
				<u>19,500</u>					
<b>PG Energy First Mortgage Bonds</b>									
9.34% due Sept 1, 2019 (paid Mar 1 and Sept 1)	9.340%	\$15,000 @ term	15,000	15,000		none	all is secured	direct debt of SUCO	none
8.375% due Dec 1, 2002 (paid Jun 1 and Dec 1)	8.375%	\$30,000 @ term	30,000	30,000		none	all is secured	direct debt of SUCO	none
				<u>45,000</u>					
<b>Grand total</b>				<u>1,374,035</u>					

(1) Note: term loan balance includes \$480,000,000 authorized to provide interim financing for the New England Mergers and \$43,000,000 authorized under the short term debt financing authorization.

(2) Assumed in conjunction with the Providence Gas, Valley Resources and Fall River Gas mergers in September 2000.