D.T.E. 00-26

Joint petition of North Attleboro Gas Company, Providence Energy Corporation, and Southern Union Company for approval of merger.

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I. INTRODUCTION 1

II. DESCRIPTION OF THE PROPOSAL 2

A. Structure of Merger 2

B. Costs Associated With Merger 3

C. Rate Plan 4

III. STANDARD OF REVIEW 4

IV. SPECIFIC CONSIDERATIONS OF THE MERGER 7

A. Rates and Resulting Net Savings 8

1. Effect on Rates 8

a. Petitioners Proposal 8

b. Analysis and Findings 8

2. Synergistic Savings 10

a. Petitioners Proposal 10

b. Analysis and Findings 10

3. Gas Savings 12

a. Petitioners Proposal 12

b. Analysis and Findings 12

B. Quality of Service 13

1. Petitioners Proposal 13

3. Analysis and Findings 14

C. Societal Costs 15

1. Petitioners Proposal 15

2. Analysis and Findings 15

D. Acquisition Premium 16

1. Petitioners Proposal 16

2. Analysis and Findings 16

E. Financial Integrity of Post-Merger Company 20

1. Petitioners Proposal 20

2. Analysis and Findings 21

F. Effect on Competition and Economic Development 21

1. Petitioners Proposal 21

2. Analysis and Findings 22

G. Cost Allocation Issues 22

1. Petitioners Proposal 22

2. Analysis and Findings 23

H. North Attleboro Operating as Division of Southern Union 24

1. Petitioners Proposal 24

2. Standard of Review 24

3. Analysis and Findings 26

a. Jurisdictional Issues 26

b. Corporate Name 27

V. STOCK ISSUANCE 28

A. Introduction 28

B. Analysis and Findings 28

VI. ORDER 29

I. INTRODUCTION

On January 27, 2000, North Attleboro Gas Company ("North Attleboro"), Providence Energy Corporation ("ProvEnergy"), and Southern Union Company ("Southern Union") (collectively, "Petitioners"), filed with the Department of Telecommunications and Energy ("Department") a petition for approval, pursuant to G.L. c. 164, § 96, of the mergers of North Attleboro with and into ProvEnergy, and ProvEnergy with and into Southern Union (Petition at 5). Moreover, the Petitioners requested that the Department confirm that Southern Union, as the surviving corporation of the mergers, would continue to have all of the franchise rights and obligations currently held by North Attleboro without having to secure approval by the Massachusetts General Court pursuant to G.L. c. 164, § 21 (id.). The Department docketed this matter as D.T.E. 00-26.[(1)]

Pursuant to notice duly issued, the Department conducted a public hearing in North Attleboro on April 10, 2000 to afford interested persons the opportunity to comment on the Petitioners' proposal. The Attorney General of the Commonwealth ("Attorney General") intervened as of right pursuant to G.L. c. 12, § 11E. The Department granted the Division of Energy Resources limited participant status in this proceeding.[(2)]

On June 2, 2000, the Department held an evidentiary hearing.[(3)] The Petitioners presented the testimony of three witnesses: (1) Peter H. Kelley, president and chief operating officer of Southern Union; (2) Ronald J. Endres, executive vice president and chief financial officer of Southern Union; and (3) James DeMetro, executive vice president of ProvEnergy. On June 20, 2000, the Petitioners submitted a brief reaffirming their positions. The evidentiary record consists of 64 exhibits and responses to seven record requests.

North Attleboro is a local distribution company ("LDC") supplying natural gas to approximately 3,800 customers in the towns of North Attleboro and Plainville; North Attleboro has been a wholly-owned subsidiary of ProvEnergy since 1987 (Exh. SUNA-1, at 2-3). ProvEnergy is a Rhode Island holding company which owns 100 percent of the issued and outstanding stock of North Attleboro and Providence Gas Company, an LDC that supplies gas to approximately 166,000 customers in Rhode Island (id.). Southern Union is an mulitstate LDC incorporated in Delaware with a principal place of business in Austin, Texas, supplying natural gas to approximately 1.2 million customers through four operating divisions in Florida, Missouri, Pennsylvania, and Texas (id.).

II. DESCRIPTION OF THE PROPOSAL

A. Structure of Merger

The Petitioners request Department approval of an Agreement and Plan of Merger ("Merger Agreement") that would reorganize North Attleboro as a Massachusetts operating division of Southern Union (Exh. SUNA-4, at § 2.1). Under the terms of the Merger Agreement, North Attleboro will merge with and into ProvEnergy, and ProvEnergy will merge with and into Southern Union; Southern Union as the surviving corporation will operate a North Attleboro division ("North Attleboro Division") as part of a "New England Business Unit" (Exhs. SUNA-1, at 10; SUNA-2, at 4; DTE 1-14).

As proposed, the merger would be effectuated in seven steps: (1) Southern Union would create GUS Acquisition Corporation ("GUS Acquisition") as a wholly-owned subsidiary of Southern Union for the purpose of effecting the merger with ProvEnergy and its wholly-owned subsidiaries; (2) GUS Acquisition would merge with and into ProvEnergy, with ProvEnergy as the surviving corporation; (3) ProvEnergy would adopt an agreement and plan of merger by which North Attleboro would merge into ProvEnergy, with ProvEnergy as the surviving corporation; (4) ProvEnergy would adopt an agreement by which Providence Gas Company, a wholly-owned subsidiary of ProvEnergy, would merge with and into ProvEnergy; and (5) Southern Union would adopt an agreement and a plan of merger by which ProvEnergy would merge with and into Southern Union, with Southern Union as the surviving corporation. At the time of the ProvEnergy-Southern Union merger, each outstanding share of ProvEnergy common stock, approximately 6,102,000 shares, would be automatically converted into the right to receive $42.50 in cash. Upon the completion of the stock conversion, North Attleboro will become a division of Southern Union, operating as part of Southern Union's New England Business Unit (Exhs. SUNA-1, at 10; SUNA-2, at 4; DTE 1-14). The Petitioners stated that the shareholders of ProvEnergy and Southern Union voted on the on the merger on August 28, 2000 (Exh. DTE 1-31; Tr. at 78-79; Company Letter, dated September 6, 2000).

B. Costs Associated With Merger

The Petitioners project that the total costs associated with the merger would be approximately $174.7 million. This projection includes: (1) $161.3 million in acquisition premiums associated with the difference between the price paid by Southern Union for

ProvEnergy and book value of the respective regulated utility assets acquired; and (2) approximately $13.4 million in transaction costs, including legal, accounting, financial expenses, and post-merger integration costs incurred to effect the consolidation of ProvEnergy's operations into those of Southern Union (Exh. SUNA-2, at 17). Based on 1998 operating data, the Petitioners estimated that North Attleboro would be allocated approximately seven percent of the total transaction costs, equal to approximately $12.3 million (Exh. SUNA-2, at 16-17). The precise amount would be determined at the time of the consummation of the merger (Exh. SUNA-2, at 17).

C. Rate Plan

After the proposed merger, North Attleboro's current base rates would remain in effect (Exh. SUNA-2, at 20; Tr. 1, at 46**)**. In lieu of proposing to recover merger-related costs in this proceeding, Southern Union requests the opportunity to develop, for filing in a future proceeding, a proposal to establish a Performance Base Rate ("PBR") approach for setting rates for the North Attleboro Division (Exhs. SUNA-2, at 18; DTE 2-23). In the event the Department does not approve the future filing of a PBR, the Petitioners request that the Department recognize Southern Union's right to seek recovery of merger-related costs, including the acquisition premium, in a future ratemaking proceeding to the extent that savings are demonstrated to have resulted from the merger (Exh. SUNA-2, at 18; Tr. at 10-11, 40-44).

III. STANDARD OF REVIEW

The Department's authority to review and approve mergers and acquisitions is found at G.L. c. 164, § 96, which, as a condition for approval, requires the Department to find that mergers and acquisitions are "consistent with the public interest". In Boston Edison

Company, D.P.U. 850, at 6-8 (1983), the Department construed § 96's standard of consistency with the public interest as requiring a balancing of the costs and benefits attendant on any proposed merger or acquisition. The Department stated that the core of the consistency standard was "avoidance of harm to the public." Boston Edison Company, D.P.U. 850, at 5. Therefore, under the terms of D.P.U. 850, a proposed merger or acquisition is allowed to go forward upon a finding by the Department that the public interest would be at least as well served by approval of a proposal as by its denial. Boston Edison Company, D.P.U. 850, at 5-8; NIPSCO-Bay State Acquisition at 9 (1998); Eastern-Essex Acquisition, D.T.E. 98-27, at 8 (1998). The Department has reaffirmed that it would consider the potential gains and losses of a proposed merger to determine whether the proposed transaction satisfies the § 96 standard. NIPSCO-Bay State Acquisition at 9 (1998); Eastern-Essex Acquisition at 8; Boston Edison Company, D.P.U./D.T.E. 97-63, at 7 (1998); Mergers and Acquisitions, D.P.U. 93-167-A at 6, 7, 9 (1994). The public interest standard, as elucidated in D.P.U. 850, must be understood as a "no net harm," rather than a "net benefit" test.[(4)] Eastern-Essex Acquisition at 8. The Department considers the special factors of an individual proposal to determine whether it is consistent with the public interest. Eastern-Essex Acquisition at 8; D.P.U./D.T.E. 97-63, at 7; Mergers and Acquisitions at 7-9. To meet this standard, costs or disadvantages

of a proposed merger must be accompanied by offsetting benefits that warrant their allowance. NIPSCO-Bay State Acquisition at 10; Eastern-Essex Acquisition at 8; D.P.U./D.T.E. 97-63, at 7; Mergers and Acquisitions at 18-19.

Various factors may be considered in determining whether a proposed merger or acquisition is consistent with the public interest pursuant to G.L. c. 164, § 96. These factors were set forth in Mergers and Acquisitions: (1) effect on rates; (2) effect on the quality of service; (3) resulting net savings; (4) effect on competition; (5) financial integrity of the post-merger entity; (6) fairness of the distribution of resulting benefits between shareholders and ratepayers; (7) societal costs, such as job loss; (8) effect on economic development; and (9) alternatives to the merger or acquisition. NIPSCO-Bay State Acquisition at 10; Eastern-Essex Acquisition at 8-9; D.P.U./D.T.E. 97-63, at 7-8; Mergers and Acquisitions at 7-9. This list is illustrative and not exhaustive, and the Department may consider other factors when evaluating a § 96 proposal. NIPSCO-Bay State Acquisition at 10; Eastern-Essex Acquisition at 9; Mergers and Acquisitions at 9.

With respect to the recovery of acquisition premiums, the Department has found that if a petitioner can demonstrate that denial of recovery of an acquisition premium would prevent the consummation of a particular merger that otherwise would satisfy G.L. c. 164, § 96, then the Department may be willing to consider recovery of an acquisition premium.[(5)] Eastern-Essex Acquisition at 9; Mergers and Acquisitions at 18-19. The Department will determine whether an acquisition premium should be allowed in a specific case by applying the general balancing of costs and benefits under the § 96 consistency standard. NIPSCO-Bay State Acquisition at 10-11; Eastern-Essex Acquisition at 9; Mergers and Acquisitions at 18-19. Thus, allowance or disallowance of an acquisition premium would be but one part of the cost/benefit analysis under the § 96 consistency inquiry. NIPSCO-Bay State Acquisition at 11; Eastern-Essex Acquisition at 9; Mergers and Acquisitions at 7.

The Department's determination whether the merger or acquisition meets the requirements of § 96 must rest on a record that quantifies costs and benefits to the extent that such quantification can be made. NIPSCO-Bay State Acquisition at 11; Eastern-Essex Acquisition at 10; Mergers and Acquisitions at 7. A § 96 petitioner who expects to avoid an adverse result cannot rest its case on generalities, but must instead demonstrate benefits that justify the costs, including the cost of any premium sought. NIPSCO-Bay State Acquisition at 11; Eastern-Essex at 10; Mergers and Acquisitions at 7. This admonition is particularly apt where allowance of an acquisition premium is sought. NIPSCO-Bay State Acquisition at 11; Eastern-Essex Acquisition at 10; Mergers and Acquisitions at 7.

IV. SPECIFIC CONSIDERATIONS OF THE MERGER

In considering the Petitioners' proposal, the Department's analysis focuses on the following: (1) effect on rates and resulting net savings; (2) effect on the quality of service; (3) societal costs; (4) acquisition premium; (5) financial integrity of the post-merger gas company (6) effect on competition and economic development; (7) cost

allocation issues; and (8) jurisdictional issues concerning Southern Union's operation of North Attleboro as a division of Southern Union.

A. Rates and Resulting Net Savings

1. Effect on Rates

a. Petitioners Proposal

The Petitioners propose to maintain North Attleboro's present base rates after the merger (Exh. SUNA-2, at 20). While they have not requested recovery of the acquisition premium or merger-related costs here, the Petitioners request permission to propose a PBR approach for setting rates for North Attleboro, as part of a future proceeding (Exh. SUNA-2, at 18; Tr. at 41-43).[(6)] Alternatively, the Petitioners request that the Department recognize Southern Union's right to seek recovery of merger-related costs, including the acquisition premium, in a future ratemaking proceeding to the extent that savings are demonstrated to have resulted from the merger (Exh. SUNA-2, at 18; Tr. at 10-11; 43-44). The Petitioners contend that the merger will not adversely impact the rates charged to customers, and that any future changes to base rates would remain subject to Department investigation and approval (Petitioners Brief at 14-15, citing Exh. SUNA-2, at 20).

b. Analysis and Findings

The Petitioners have represented that they are not seeking approval of a rate recovery mechanism as a component of their merger proposal. Rather, the Petitioners seek approval to file a rate recovery mechanism in a future rate proceeding, either in the form of a PBR or through a demonstration of merger-related savings. Section § 94 mandates the mechanism by which gas, electric, and water companies may petition the Department for a change in rates and the procedures for the Department to follow in reviewing any proposed rate change. Moreover, § 94 provides that the Department, on its own motion, may commence an investigation of a filed rate. The Department has broad discretion in exercising its authority to regulate rates under G.L. c. 164, § 94. See American Hoechest Corp. 379 Mass. 408, 411, 412, 413 (1980) (Department free to select or reject particular method of regulation as long as choice not confiscatory or otherwise illegal). The Department's actions under § 94 have been accorded deference in the realm of economic regulation. See, e.g., Massachusetts Oilheat Council, 418 Mass. at 802-807 (1994). Therefore, the Department concludes that there is no express or implied language in § 94 that would limit the Department to an particular regulatory scheme or its specific duration. Accordingly, we find that the Petitioners' proposal is consistent with the discretion afforded the Department under these statutory provisions. Eastern-Essex Acquisition at 15-16.

Nonetheless, in Incentive Regulation, D.P.U. 94-158, at 65-66 (1995), the Department directed utilities to submit PBR proposals in future base rate cases, and if they failed to do so, explain the reasons for such a failure and demonstrate, with full specificity, how they would be seeking to achieve more efficient operations, better cost controls, and lower rates. See also Fitchburg Gas and Electric Light Company, D.T.E. 98-51, at 5-7 (1998). Therefore, the Department directs Southern Union to submit an incentive-based proposal as part of its next base rate filing for its North Attleboro Division. Southern Union and its shareholders are placed on notice that they bear the burden to demonstrate the propriety of Southern Union's proposed PBR filing, and bear the risk as to whether incentive regulation will provide sufficient revenues to offset the acquisition premium and transaction costs arising from this merger.

2. Synergistic Savings

a. Petitioners Proposal

The Petitioners state that although Southern Union pursued a merger with ProvEnergy and its North Attleboro operating affiliate primarily for strategic purposes, cost savings for North Attleboro will be realized over the long term as a result of the merger (Exhs. SUNA-2, at 14; DTE-1-25; DTE-1-34; Tr. at 39, 60-61). The Petitioners estimate that there is a potential for annual merger-related savings of $12,917 consisting of: (1) $3,713 in directors' fees and expenses; (2) $3,110 in stock transfer and trustee fees; (3) $3,868 in financing fees as a result of lower commitment fee levels on its line of credit; (4) $1,394 in American Gas Association dues; and (5) $832 in rating agency fees (Exh. SUNA-2, exh. RJE-3).

According to the Petitioners, the merger of Southern Union with North Attleboro would expand the geographic diversity of Southern Union's operations by adding New England to its southwest, southeast, and mid-Atlantic regions, thereby reducing the effect of adverse economic or weather conditions in a particular part of the country on Southern Union's revenues, with resulting benefits to the North Attleboro Division (Exhs. SUNA-1, at 9-10; SUNA-2, at 14). Moreover, the Petitioners state that Southern Union and North Attleboro share similar business perspectives, thereby providing the opportunity for both to improve upon their present operations by drawing from each other's strengths (Petitioners Brief at 17-18).

b. Analysis and Findings

In order to recover merger-related costs, a petitioner must demonstrate the quantified costs and benefits to the extent that such quantification can be made, as well as demonstrate benefits that justify the costs; a petitioner cannot rest its case on generalities. Eastern-Colonial Acquisition at 7; NIPSCO-Bay State Acquisition at 11; Eastern-Essex Acquisition at 10; Mergers and Acquisitions at 7. While the Petitioners claim that cost savings will be available over the long term as a result of the merger, the Petitioners have provided no projected savings values to the Department (see, e.g., Exhs. DTE 3-2; DTE 3-2). Although they also claim that the merger of North Attleboro will expand Southern

Union's geographic diversity and thereby reduce the effect on Southern Union's revenues of adverse economic or weather conditions in a particular part of the country, the Petitioners provided no proven direct causal link with savings to North Attleboro's ratepayers. Stating that a merger is based on strategic considerations does not absolve a company from providing the quantitative evidence necessary to determine the propriety of a § 94 filing.

Although the Petitioners have stated annual savings of approximately $12,917 related to the reduction of duplicative processes between Southern Union and North Attleboro, they have failed to show sufficient savings to recover the merger-related costs of approximately $12.3 million. Accordingly, the Department finds that the Petitioners have failed to provide adequate evidence that savings would equal or exceed the costs to be recovered.

Despite the present lack of showing concerning acquisition premium recovery, the merger has been structured so that North Attleboro's ratepayers are not at risk for recovery of any acquisition premium or merger-related costs until Southern Union files a PBR proposal for its North Attleboro Division. The Petitioners have chosen to defer rate relief until a future date, and have repeatedly represented that Southern Union's shareholders would bear any risk that the benefits and cost savings resulting from the merger may be insufficient to offset the acquisition premium (Exh. SUNA-2, at 18-19; Tr. at 40-41, 43-44; Petitioners Brief at 10). The Petitioners have voluntarily undertaken the risk of deferring recovery of the acquisition premium and transaction costs, in the event they fail, in the future, to make the requisite showing of "countervailing advantages" required by Mergers and Acquisitions at 19. This feature of the merger proposal is of the Petitioners' own choosing and not at the Department's insistence. Thus, the Department finds that North Attleboro's ratepayers are likely to be better off, and certainly no worse off, than they would be absent the merger because the Petitioners are not seeking current recovery of any merger-related costs.

3. Gas Savings

a. Petitioners Proposal

The Petitioners submit that approval of the merger will likely yield two primary benefits relating to gas supply functions. First, the Petitioners assert that North Attleboro's overall system reliability will increase as a result of the ability to plan, contract, and dispatch gas supply resources on an integrated basis (Exhs. SUNA-3, at 8; DTE 2-9). Second, the Petitioners assert that gas-cost savings will occur as a result of the more efficient utilization of peak-shaving facilities and peaking supply contracts (Exh. SUNA-3, at 6-7). The Petitioners did not quantify the potential savings that could be achieved as a result of the coordination of the gas supply resources (Tr. at 97-98).

b. Analysis and Findings

In recently approved mergers and acquisitions, the Department has reaffirmed the importance of cost savings by utility companies and expected all utilities to explore any and all measures that provide the opportunity for these savings. Eastern-Essex Acquisition at 26; NIPSCO-Bay State Acquisition at 26, citing Mergers and Acquisitions at 18. The Department further stated that mergers and acquisitions are a useful and potentially beneficial mechanism for utility companies to consider in meeting their service obligations. Mergers and Acquisitions at 18. The Department here evaluates whether the opportunity exists for the petitioners to achieve the savings potential described in the proposal while maintaining the level of service and reliability North Attleboro customers have experienced.

The Department concurs with the Petitioners that the proposed merger has the potential to provide customers gas cost savings (albeit of indeterminate size) resulting from the joint management and procurement of Southern Union's and North Attleboro's gas supplies (Exhs. SUNA-3, at 8; DTE 1-2; DTE 1-5; DTE 1-6; DTE 1-7; Tr. 105-109, 116). Thus, with respect to gas costs, the Department finds that North Attleboro's ratepayers are likely to be better off, and certainly no worse off, than they would be absent the merger. NIPSCO-Bay State Acquisition at 27.

B. Quality of Service

1. Petitioners Proposal

The Petitioners propose to implement service quality measures to ensure that there is no degradation in service quality as a result of the merger (Exh. SUNA-3, at 10-12). The Petitioners propose to track service quality performance in the areas of: (1) emergency, billing and service telephone call answering time; (2) response to emergency calls; (3) lost-time accidents; (4) service appointments met on the day scheduled; and (5) actual meter reads (Exh. SUNA-3, at 10). Because adequate historical data exists only for responses to emergency calls and lost-time accidents, the Petitioners request 18 months to implement the necessary systems and processes which will be used to track the remaining measures (Exh. SUNA-3, at 10-12). At that time, the Petitioners propose to implement the systems and processes to track the necessary service quality data and to submit such data to the Department for its review, consistent with the Department's decision in Eastern-Essex Acquisition at 32-34 (Exh. SUNA-3, at 10-12). The Petitioners state that the proposed service quality measures and implementation period are consistent with those implemented in Eastern-Essex Acquisition (Petitioners Brief at 9).

3. Analysis and Findings

The Department retains oversight of a company's service quality pursuant to G.L. c. 164, § 76, and has stated that a service quality index is an important bulwark against deterioration in a company's service to its customers. Eastern-Essex Acquisition at 32-33; D.P.U./D.T.E. 97-63, at 15 (1998); Mergers and Acquisitions, D.P.U. 93-167-A at 8-10 (1994). The Petitioners have proposed to increase the number of service functions to be tracked and reported to the Department, as well as implement workforce automation

programs intended to provide customers with greater service convenience (Tr. at 28-31). The Department finds that this increased effort by Southern Union is likely to improve service quality for North Attleboro's customers. To ensure that there will be no reduction in the quality of service following consummation of the merger, the Department directs the Petitioners to implement their proposed service plan and to be prepared to submit for review by the Department an acceptable service quality plan 18 months after closing, or in accordance with any directives prescribed as a result of the Department's ongoing investigation into service quality, docketed as D.T.E. 99-84.

C. Societal Costs

1. Petitioners Proposal

The Petitioners represented that there will be no reduction in the labor force as a result of the merger (Exh. SUNA-1, at 23). In fact, the Petitioners expect the merger to have a positive impact on economic development in the North Attleboro area (Exh. SUNA-1, at 23). The Petitioners stated that they would maintain a local management presence in the North Attleboro division, for at least three years following consummation of the merger (Exhs. SUNA-2, at 4; SUNA-3, at 5; Tr. at 70-71).

2. Analysis and Findings

The impact of mergers on employment levels is an important matter for the Department's consideration and review. See Eastern-Essex Acquisition at 44. Although job redundancies in consolidated systems would impose avoidable costs and thus would be detrimental to ratepayers, the Department has noted that the elimination of these redundancies should be accomplished in a way that mitigates the effect on the utility's employees. Id. at 43. The Department has stated that proponents of mergers must demonstrate that they have a plan to minimize the effect of job displacement on employees. Id. at 44. The Petitioners anticipate no layoffs due to the impending merger. Further, Southern Union has committed itself to maintaining a local presence in North Attleboro (Tr. at 70-71). Accordingly, the Department finds that the proposed merger will have no negative effects on employment within the North Attleboro Division.

D. Acquisition Premium

1. Petitioners Proposal

The Petitioners estimate that the merger would result in an acquisition premium of approximately $161.3 million (Exhs. SUNA-2 at 15-16; DTE 1-30). The acquisition premium is primarily based on the purchase price of $42.50 per share, ProvEnergy's consolidated book value of $15.27 per share, and the number of ProvEnergy shares anticipated to be outstanding as of the consummation of the merger (Exhs. SUNA-2 at 15-16; DTE 1-30).[(7)] The Petitioners estimated that North Attleboro's share of the total acquisition premium would be equal to approximately seven percent of this total, or $11.29 million (Exh. SUNA-2, at 16). The Petitioners propose to amortize the acquisition

premium over a period not exceeding forty years, consistent with generally accepted accounting principles ("GAAP") requirements under purchase accounting (Tr. at 40-41, 45-46).

2. Analysis and Findings

The Department has stated that it will consider individual merger or acquisition proposals that seek recovery of an acquisition premium, as well as the recovery level of such premiums. NIPSCO-Bay State Acquisition at 39; Eastern-Essex Acquisition at 61, citing Mergers and Acquisitions at 18-19. Under the Department's standard, a company proposing a merger or acquisition must demonstrate that the costs or disadvantages of the transaction are accompanied by benefits that warrant their allowance. Thus, allowance or disallowance of an acquisition premium would be just one part (albeit an important one) of the cost/benefit analysis under the § 96 standard. Id.

With respect to the level of consideration paid by Southern for ProvEnergy, the record demonstrates that the purchase price was evaluated in light of a comparison with purchase prices associated with other recent mergers and acquisitions by LDCs, and an assessment of the potential long-term benefits of this merger (Exh. SUNA-2, at 5-6, exh. RJE-2; Tr. 51-52; RR-DTE-2). A purchase price at a multiple of book value expresses a buyer's expectations of the acquired company's future contributions to combined operations. NIPSCO-Bay State Acquisition at 39; Eastern-Essex Acquisition at 64. The particular exchange rate involved in merger or acquisition stock transactions expresses a number of matters of value to the buyer, including a premium for management control and long-term strategic and economic value perceived by the buyer as accruing from the transaction. Id. Between 1997 and 1999, acquisition prices in natural gas distribution company mergers have ranged between 2.2 times and 3.1 times the book value of the acquired company, with an average of 2.7 times book value (RR-DTE-2). Southern Union, as a knowledgeable and willing buyer, experienced in other acquisitions, was prepared to pay a premium over ProvEnergy's book value in exchange for long-term growth potential and to accept the risk associated with justifying, or not, the recovery of this premium at a later date (Exhs. SUNA-1 at 3-4).

The proposed purchase price for ProvEnergy's stock represents a premium of 2.8 times book value (Exhs. DTE-1-30; SUNA-2 at 5).[(8)] The price paid by Southern Union for ProvEnergy and North Attleboro in this case is within the range of what has been offered in other transactions involving natural gas distribution companies (RR-DTE-2).[(9)] The premium lies within the historic range and has been validated by the market at large. The Department finds that the proposed purchase price for North Attleboro's common stock and proposed exchange ratio is in line with other Department-approved gas acquisitions and, therefore, is reasonable and represents a valid expression of today's market conditions.

The Petitioners propose to amortize the acquisition premium over a period not exceeding 40 years using the purchase accounting method (Tr. at 84-85).[(10)] While mergers and transactions can also be accounted for using pooling-of-interests accounting, both GAAP

and the Securities and Exchange Commission ("SEC") require that a business combination satisfy 12 conditions before using the pooling-of-interests method. NIPSCO-Bay State Acquisition at 40. In view of the stringent requirements for the use of pooling-of-interests accounting and the SEC's preference for purchase accounting, the Department concludes that the use of purchase accounting for the proposed merger complies with GAAP. Accordingly, the Department finds that the Petitioners' proposed use of purchase accounting to record the merger is appropriate. Moreover, the Department finds that the merger has been structured so that North Attleboro's ratepayers are not at risk for recovery of any acquisition premium or merger-related costs. In fact, the Petitioners have represented that Southern Union's shareholders would bear any risk in the event that the benefits and cost savings resulting from the merger would be insufficient to offset the acquisition premium.

With respect to the amortization period of the acquisition premium, the Department has historically recognized that any acquisition premium would be, in general, amortized over the life of the acquired assets. Mergers and Acquisitions at 12, citing Bay State Gas Company, D.P.U. 17726, at 5-6 (1973); Boston Gas Company, D.P.U. 17574, at 11 (1973); Boston Gas Company, D.P.U. 17138, at 7-8 (1971). The evidence in this proceeding indicates that the Petitioners propose to use rules established by GAAP in calculating the amortization period for the acquisition premium (Tr. at 40-41). The Department concludes that the amortization period of 40 years complies with the rules established by GAAP and Department precedent.

Accordingly, the Department finds that the acquisition premium of $161.3 million as estimated by the Petitioners fairly represents the total acquisition premium that will result from the merger. Because the stock exchange of ProvEnergy by Southern Union would be based on the actual number of ProvEnergy shares outstanding on the consummation date, the amount of the acquisition premium cannot be precisely calculated until the consummation date or shortly thereafter -- although its range is determined through a formula.

Concerning the allocation of the acquisition premium, the Petitioners have indicated that North Attleboro's allocated share of the total acquisition premium would be based on its net assets relative to those of ProvEnergy. The Petitioners also represented that comparative cash flow analyses for ProvEnergy and North Attleboro would determine the allocation of the acquisition premium among ProvEnergy's regulated and nonregulated operations, including North Attleboro (Exh. SUNA-2, at 16; RR-DTE-6). The Petitioners are hereby directed to provide the Department with documentation that determines the actual acquisition premium. The Petitioners are further directed to provide the Department with a detailed listing of the final transaction costs. Both filings should be made within 90 days of consummation of the merger.

E. Financial Integrity of Post-Merger Company

1. Petitioners Proposal

The Petitioners contend that the proposed merger will have no adverse effects on the financial integrity of Southern Union's North Attleboro Division, and will provide the North Attleboro Division with greater access to capital than is now available to that company (Exh. SUNA-2, at 21). Specifically, the Petitioners explain that because North Attleboro will be joining a $2.5 billion company, which will serve approximately 1.6 million customers, North Attleboro's operations will enjoy greater financial stability and flexibility which will lead to cost savings over time, because, among other things, of the ability to obtain financing on more favorable terms and conditions (Exh. SUNA-2, at 21).

Additionally, the Petitioners maintain that the proposed merger will strengthen the financial integrity of Southern Union as a whole, because the merger will expand Southern Union's geographic diversity and minimize the effects of adverse economic or weather conditions in any one region (Exh. SUNA-1, at 9). This, according to the Petitioners, will have the effect of minimizing Southern Union's short-term risk and enhancing its long-term financial strength (Exh. SUNA-1, at 9; Tr. at 61-62).

2. Analysis and Findings

If the merger is implemented, North Attleboro (a gas company within the meaning of G.L. c. 164, sec. 1, and a Massachusetts corporation) would merge into Southern Union, an existing multistate gas distribution company incorporated in Delaware. The merger would thus extinguish North Attleboro's corporate existence under Massachusetts law, and convert North Attleboro into an operating division of Southern Union.

The Department has stated that the financial integrity of a company may be one of the factors considered in evaluating a merger petition. Mergers and Acquisitions at 8-9. A review of Southern Union's financial and operating data contained in its annual reports to both the Federal Energy Regulatory Commission and the SEC, annual returns and disclosure statements provided to its shareholders, demonstrates that Southern Union is financially viable (Exhs. SUNA-2, at 21; SUNA-5; SUNA-6; SUNA-7). Moreover, North Attleboro's post-merger financial position is likely to improve because of the additional sources of capital that would be available as a result of its affiliation with Southern Union. Such an improvement would result in benefits to ratepayers (Exh. SUNA-1, at 9; Tr. at 61-62). Accordingly, the Department finds that the merger will not adversely affect North Attleboro's or Southern Union's financial integrity.

F. Effect on Competition and Economic Development

1. Petitioners Proposal

The Petitioners contend that the proposed merger will not adversely affect competition in the gas industry (Exh. SUNA-2, at 22). The Petitioners state that Southern Union has a history of promoting customer choice and unbundling initiatives, which support competition in the gas industry (Exh. SUNA-2, at 22; Petitioners Brief at 19).

2. Analysis and Findings

The record indicates that Southern Union has participated in federal and state proceedings concerning the development of open-access gas transportation and unbundling (Exh. SUNA-2, at 22). Moreover, Southern Union has stated that its entry into Massachusetts, by virtue of the proposed merger, would require investment in additional technology and produce additional benefits to customers through increased choice and education (Exh. SUNA-2, at 22; Tr. at 28-32). Accordingly, the Department finds that the proposed merger will not adversely affect competition in the gas industry.

G. Cost Allocation Issues

1. Petitioners Proposal

The Petitioners state that they are not seeking approval of either a joint and common cost model or a specific allocation method as part of this merger (Tr. at 9). Instead, the Petitioners propose to submit for Department approval, in a future rate proceeding, a joint and common cost model outlining the underlying method and procedures for the assignment of joint and common costs among Southern Union's operating divisions and subsidiaries (Exh. DTE 2-19; Tr. at 25-27). Southern Union states that it will rely on its experience in developing and supporting cost allocations to its multiple regulators to create an allocation method in North Attleboro's next rate proceeding (Exhs. SUNA-2, at 11-13; DTE 2-19).[(11)]

2. Analysis and Findings

In determining whether rates are just and reasonable, the Department may examine affiliate transactions to ensure that dealings between affiliated companies provide direct benefits to ratepayers and that associated costs are reasonable and allocated in a nondiscriminatory manner. G.L. c. 164, § 76A; Cambridge Electric Light Company, D.P.U. 92-250, at 78 (1993); Bay State Gas Company, D.P.U. 92-111, at 134-135 (1992). The Department historically has exercised its obligation and authority to ensure that a company's affiliate costs passed on to the company's ratepayers are reasonable and that ratepayers pay no more than a fair portion of the costs. NIPSCO-Bay State Acquisition at 46; New England Telephone and Telegraph Company, D.P.U. 86-33-G at 113-211 (1989); Oxford Water Company, D.P.U. 1699, at 10-13 (1984).

The Department's standard for reviewing affiliate transactions was first articulated in D.P.U. 1699. In that case, the Department found that to recover costs incurred from an affiliate, a company must show that those costs: (1) are specifically beneficial to the individual company seeking rate relief (as opposed to other subsidiary members of the system as a whole); (2) reflect a reasonable and competitive price; and (3) are allocated by a formula that is cost-effective and nondiscriminatory. D.P.U. 1699, at 13. The Department previously has noted the desirability of direct assignment of costs where possible. Berkshire Gas Company, D.P.U. 90-121, at 58-59 (1990). In the case of indirect common costs, which are not amenable to direct assignment, the Department has required the use of cost allocations that are appropriate to the particular cost that is being allocated between companies. Id. at 64-70. See also Massachusetts-American Water Company,

D.P.U. 95-118, at 101 (1996); South Egremont Water Company, D.P.U. 94-161, at 3 n.3 (1995). More recently, the Department has elaborated on this policy, noting that services should be provided to an affiliate at fully allocated costs, which cost allocation method ensures that all direct costs and a portion of indirect costs are recovered from the affiliate. D.P.U./D.T.E. 97-96, at 7 (1998). Accordingly, the Petitioners are directed to develop a cost allocation system for transactions among Southern Union's respective divisions consistent with Department precedent.

H. North Attleboro Operating as Division of Southern Union

1. Petitioners Proposal

Southern Union is a natural gas local distribution company, incorporated under the laws of the State of Delaware in 1929, with a principal place of business in Austin, Texas (Exh. SUNA-1, at 2). After the merger, Southern Union will conduct North Attleboro's gas utility business as an operating division of Southern Union (Exhs. DTE 2-35, DTE 2-37). The Petitioners state that the North Attleboro-Southern Union proposal differs from other merger proposals considered by the Department in that Southern Union operates as a single utility in multiple jurisdictions (Exhs. SUNA-1, at 2-3, 10-11; SUNA-2, at 6-7; DTE 2-35; Tr. at 20-24). The Petitioners state that the North Attleboro Division would remain fully subject to the Department's regulatory jurisdiction under G.L. c. 164 (Exh. DTE 2-2).

2. Standard of Review

In pertinent part, G.L. c. 164, § 8A, requires the Department, after notice and public hearing, to certify to the secretary of state that the public convenience will be promoted, permitting Southern Union to operate as a gas company in Massachusetts. Because the statute does not define "public convenience," the Department relies on our precedents relating to "public convenience and necessity."

The Department has been accorded wide discretion in determining whether the "public convenience and necessity" would be promoted by some proposed action. Zacks v. Department of Public Utilities, 460 Mass. 217 (1985) Almeida Bus Lines, Inc. v. Department of Pub. Utils., 348 Mass 331 (1965); Holyoke St. Ry. v. Department of Pub.Utils., 347 Mass. 440 (1964); Newton v. Department of Pub. Utils., 339 Mass. 535 (1959). "Public convenience and necessity" is a term of art that the courts have equated with "public interest". Zacks v. Department of Public Utilities, 460 Mass. 217, 223 (1985). Therefore, to determine whether to authorize a gas company merger, the Department will consider whether the requested action is in the public interest. See, e.g., NIPSCO-Bay State Acquisition, D.T.E. 98-31, at 57.

Additionally, G.L. c. 164, § 5A requires a gas or electric corporation operating in Massachusetts to include the words "gas company" or "electric company," depending upon the particular company, in its name. The statute also prohibits any gas or electric corporation operating in Massachusetts from assuming the name or trade name of (1)

another corporation established under the laws of the Commonwealth, or (2) of a corporation wherever established, firm, association, or person carrying on business in the Commonwealth, or (3) any such name within three years prior thereto, or (4) any such name under reservation under the laws of the Commonwealth for another or proposed corporation wherever established, or (5) any name so similar to the existing corporation that as to be likely to be mistaken for it. Notwithstanding the foregoing, a name or trade name can be assumed with the written consent of the company previously filed with the secretary of state.

3. Analysis and Findings

a. Jurisdictional Issues

The entrance of foreign corporations in the Massachusetts gas and electric industries previously raised concerns over the legal status of foreign corporations operating gas and electric systems within Massachusetts; and foreign ownership was not favored. Third Annual Report of the Board of Gas and Electric Light Commissioners at 58 (1888). The enactment of the Electric Restructuring Act[(12)] ("Restructuring Act") revised the definition of a "gas company" or "electric company" set out in G.L. c. 164, § 1, to include non-Massachusetts corporations operating gas or electric utilities within Massachusetts.[(13)] The Act gives the Department the same jurisdiction over foreign utilities operating in Massachusetts as is currently applied to Massachusetts-chartered corporations. Therefore, there is no longer a bar on "foreign" corporations operating gas or electric systems within Massachusetts. The Department considers that approval of Southern Union's merger with North Attleboro and the request to conduct North Attleboro's gas utility business as an operating division of Southern Union to be consistent with the public interest (Exhs. DTE 2-35, DTE 2-37). Because the North Attleboro Division would remain fully subject to the Department's regulatory jurisdiction under G.L. c. 164, this proposal is consistent with the public interest. Because the Department has equated "public interest" with "public convenience," for the reasons described above, the Department finds that the public convenience would be promoted by authorizing Southern Union to operate as a gas company in Massachusetts. NIPSCO-Bay State Acquisition at 62.

Southern Union's current articles of incorporation authorize it to conduct business in any state or territory of the United States, as well as in foreign countries (Exh. DTE 2-39). Therefore, the Department concludes that Southern Union has complied with the requirements of G.L. c. 164, § 8A, and finds that approval may be granted. As a condition of this approval, the Petitioners are directed to submit to the Department written evidence that Southern Union has filed its articles of incorporation with the secretary of state. Southern Union shall not commence operations in Massachusetts until such a filing has been made in satisfactory form to the secretary of state. The Department places the Petitioners on notice that Southern Union's authorization to operate as a gas company in Massachusetts shall expire in 60 days from the date of this order, unless the merger is consummated on or before that date. NIPSCO-Bay State Acquisition at 62.

b. Corporate Name

Southern Union's present corporate name does not conform to the requirements of G.L. c. 164, § 11. The Petitioners indicated that, if the merger is ultimately implemented, Southern Union would operate in the North Attleboro Division under a d/b/a arrangement as "North Attleboro Gas Company" in order to maintain name identification with North Attleboro customers and thereby avoid customer confusion (Exh. DTE 1-29, at 4; Tr. at 22-23).[(14)]

General Laws c. 156B, § 11, in relevant part, permits corporations to assume any name that has not been used by a corporation in current operation or had been in operation during the prior three years, unless written consent of the preexisting corporation is filed with the state secretary. General Laws c. 164, § 5A imposes identical requirements on the assumption of a name by a gas or electric company, and makes additional provision for the use of trade names. Based on a review of G.L. c. 156B and c. 164, the Department concludes that there is no statutory bar against the use of an assumed name by Southern Union, and that an assumed name which conforms to the requirements of G.L. c. 164, § 5A would bring Southern Union into compliance with the requirements of that statute. Furthermore, the Department considers that the continued use of the North Attleboro corporate name by Southern Union for its North Attleboro operations would reduce the possibility of customer confusion resulting from the merger. Accordingly, the Department finds it appropriate for Southern Union to operate under North Attleboro's name, when the merger is consummated.

V. STOCK ISSUANCE

A. Introduction

The Petitioners have not requested that the Department authorize the issuance of any stock in this merger transaction (Tr. at 70).

B. Analysis and Findings

The common shares of North Attleboro, all of which are presently held by ProvEnergy, are to be cancelled out and not exchanged for those of ProvEnergy (Tr. at 69-70). Therefore, the Department finds that no approvals under G.L. c. 164, § 14 are necessary.

For a number of years, Southern Union has implemented a policy of distributing, in lieu of cash dividends, an annual common stock dividend of five percent to its common stockholders (Exh. SUNA-8 (1999 Annual Report), at 16). General Laws c. 164, § 11, prohibits a gas or electric company from declaring any stock dividend or dividing the proceeds of the sale of stock among its shareholders, and requires the payment of cash before any new stock may be issued. Thus, Southern Union's practice, if continued, would be in direct contravention of Massachusetts law. The Department expects Southern Union to comply with all Massachusetts general laws and directs Southern Union to cease its stock dividend policy immediately. We note that failure to comply with G.L. c.

164, § 11 and the Department's directives will result in the voiding of all common stock certificates issued by Southern Union for the purpose of issuing common stock dividends, and render Southern Union's directors and officers liable for penalties as provided in G.L. c. 164, §§ 12 and 17.

VI. ORDER

Accordingly, after due notice, hearing and consideration, it is

ORDERED: That pursuant to G.L. c. 164, § 96, the merger of North Attleboro Gas Company into Providence Energy Corporation, and the merger of Providence Energy Corporation into Southern Union Company is hereby approved; and it is

FURTHER ORDERED: That it is confirmed that, upon consummation of the merger of North Attleboro Gas Company and Providence Energy Corporation, and the merger of Providence Energy Corporation into Southern Union Company, Southern Union Company shall have all rights, powers, privileges, franchises, properties, real, personal or mixed, and immunities to engage in all activities in all the cities and towns in which North Attleboro Gas Company was engaged in immediately prior to the merger, and that further action pursuant to G.L. c. 164, § 21 is not required to consummate the merger of North Attleboro Gas Company and Southern Union; and it is

FURTHER ORDERED: That a copy of the journal entries, or a schedule summarizing such entries, recording the effect of the merger shall be filed with the Department upon consummation of the merger; and it is

FURTHER ORDERED: That the Secretary of the Commission shall transmit a certified copy of this Order to the Secretary of the Commonwealth within fourteen days; and it is

FURTHER ORDERED: That the Petitioners shall comply with all directives contained

in this Order.

By Order of the Department,

_____

James Connelly, Chairman

W. Robert Keating, Commissioner

Paul B. Vasington, Commissioner

Eugene J. Sullivan, Jr., Commissioner

Deirdre K. Manning, Commissioner

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

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

1. Southern Union has also petitioned for approval of a merger with Fall River Gas Company; that proceeding has been docketed as D.T.E. 00-25.

2. The Petitioners' request for approval of the merger is unopposed. On June 2, 2000, the Petitioners and the Attorney General notified the Department that the Attorney General had no objection to the Department granting the relief requested by the Petitioners (Tr. at 17-18).

3. The evidentiary hearing in this proceeding was conducted in conjunction with the evidentiary hearing in Southern Union-Fall River Merger, D.T.E. 00-25.

4. The Department notes that a finding that a proposed merger or acquisition would probably yield a net benefit does not mean that such a transaction must yield a net benefit to satisfy G.L. c. 164, § 96 and Boston Edison, D.P.U. 850.

5. Thus, Merger and Acquisitions removed the per se bar to recovery of acquisition premiums and treated them as just another kind of costs to be reckoned in the balancing

of costs and benefits required by G.L. c. 164, § 96 and Boston Edison Company, D.P.U. 850.

6. The Petitioners intend to recover the acquisition premium and other merger-related costs within the proposed PBR through operational savings and efficiencies (Exh. SU-NA-2, at 18).

7. The acquisition premium is a function of the purchase price of $42.50 per share, the book value as of December 31, 1999 of $15.27 per share, and the approximately 6,102,000 shares that the Petitioners estimate will be outstanding as of the consummation of the merger (Exh. SUNA-2, at 16). Subtracting the book value of approximately $98.0 million from the total purchase price of $259.3 million results in the $161.3 million acquisition premium.

8. In their pre-filed testimony the Petitioners calculated a price-to-book value multiple of 2.6. However, using the stated purchase price of $42.50 per share and a book value of $15.27 (as calculated in Exh. DTE-1-30) produces a premium of 2.8 times book value.

9. Southern Union stated that it did not engage the services of an investment banker in conjunction with negotiating the merger. Instead, Southern Union relied on its analysis of North Attleboro and its knowledge of the consideration involved in recent gas industry acquisitions in determining the price that Southern Union was willing to pay for the properties (Tr. 51-52).

10. The Petitioners indicated that if pooling of interest accounting was used for this transaction, Southern Union would be precluded in engaging in any material business combination for a period of two years (Tr. at 84-85). Further, Southern Union's decision not to use pooling of interests accounting to record the acquisition premium is based on its historical experience with past merger transactions (Tr. at 84-85).

11. [11] The Petitioners submitted a copy of Southern Union's corporate cost allocation report, Assignment and Allocation of Costs of Joint and Common Costs, Review of Use of Causal Pools. Southern Union states that it uses this method for allocating joint and common costs as a basis for developing a model each time it files a general rate case (Exh. DTE 2-19).

12. An Act Relative to Restructuring the Electric Utility Industry in the Commonwealth, Regulating the Provisions of Electricity and Other Services, and Promoting Enhanced Consumer Protection Therein. St. 1997, c. 164.

13. Section 189 of St. 1997, c. 164 changed the definition of "gas company" and "electric company" found in G.L. c. 164, § 1, so that a gas or electric company need not be a domestic Massachusetts corporation, provided such corporation is organized for the purpose of making and selling, or distributing and selling, gas and electricity within Massachusetts.

14. In addition to the North Attleboro Division, Southern Union would also be operating a Fall River division in Massachusetts resulting from the proposed merger of Fall River Gas Company with Southern Union. That proceeding has been docketed as D.T.E. 00-25. See Section I, above.