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Wednesday, January 8, 2003

To: Enforcement Division, Securities and Exchange Commission
U.S. Attorneys (Tulsa, Oklahoma City, Dallas, Phoenix, Kansas)
Oklahoma Corporation Commissioners
Kansas Corporation Commissioners
Texas Railroad Commissioners
Maricopa County Attorney

Via Facsimile

Re: ONEOK, Inc. --- Possible Balance-Sheet and Regulated-Rate Manipulation

Mesdames/Sirs:

The attached letter to ONEOK general counsel John A. Gabarino briefly summarizes the publicly reported facts of certain recent transactions of ONEOK, Inc., which raise the possibility of balance-sheet and regulated-utility-rate manipulation by the company.

Because certain of these manipulations, were they to be established, would fall within the purview of your offices, I provide copies of this letter to you.

In the interest of full disclosure, I would note that my interest in this matter originated from my service as an expert witness for the applicants (ratepayers) in Cause PUD No. 98000188 before the Oklahoma Corporation Commission, settled by ONEOK in May 2002 with proclaimed benefits to ratepayers of \$48 million, in which evidence was presented that ONEOK had improperly camouflaged the costs of a legal settlement (not recoverable from ratepayers) as purchased-gas costs (passed through directly to ratepayers).¹

Should you have questions or desire to pursue this matter further, I stand ready to assist in any appropriate manner.

Sincerely,

Stephen P. Dresch, Ph.D.

¹ For further information on the referenced litigation before the Oklahoma Corporation Commission, see my prefiled testimony and related documents (links at www.forensic-intelligence.org).



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Wednesday, January 8, 2003

John A. Gabarino, Jr., General Counsel
ONEOK, Inc.
Tulsa, Oklahoma

Via Facsimile 918-588-7960

**Re: ONEOK, Inc. [OKE], Southwest Gas Corp. [SWX] & Southern Union Co. [SUG] –
Recent Events**

Dear Mr. Gabarino:

Having developed a certain interest in ONEOK's affairs over the last several years, I found rather intriguing the juxtaposition of recent events involving the above-referenced companies (to which I will generally refer by ticker symbol):

- SWX paid SUG \$17.5 million to settle litigation arising from the competing (and ultimately failed) efforts of SUG and OKE to acquire SWX.
- OKE paid SWX \$3 million to settle related litigation.
- A federal district court jury awarded SUG \$0.975 million in compensatory damages and \$60 million in punitive damages against Arizona Corporation Commissioner James Irvin, while Irvin's associate, Jack Rose, reached a preverdict settlement under which he will pay SUG \$75,000. The jury verdict appears to have hinged on SUG's allegation that Irvin and Rose acted in concert with OKE to induce SWX to accept an offer from OKE which was inferior to SUG's offer.
- OKE paid SUG \$5 million to settle related litigation. The terms of this settlement have been characterized as "confidential" and "under court seal."
- OKE has agreed to acquire certain assets and liabilities from SUG for \$420 million; these assets are primarily associated with state-regulated natural gas distribution. With reference to this transaction, SUG's most recent 10-Q reports: "As of September 30, 2002, the aggregate carrying amounts of assets and liabilities to be sold [to ONEOK] were approximately \$410,000,000 and \$121,000,000, respectively." Thus, as a result of the sale (for \$420 million) of assets with a net book value of \$289 million, SUG will realize a premium of \$131 million (or 45.3 percent).

Reviewing the various SUG/OKE/SWX charges and countercharges, it certainly appears that SUG viewed OKE as the principal tortfeasor. Yet, OKE's reported settlement with SUG is less than 30 percent of the settlement which SUG successfully demanded of SWX and less than 10 percent of the damages awarded to SUG by the jury in the suit against Commissioner Irvin.

Especially in light of the large premium over book value which SUG will realize on its asset sale to OKE, the question arises: Was SUG's pending litigation against OKE a factor in the determination of the price of the SUG assets acquired by OKE, i.e., was some part of the nominal price of this transaction in fact a component of OKE's legal settlement with SUG (in addition to OKE's reported \$5 million settlement payment)?

This question is significant for the following reason: Assume that, of the \$420 million nominally paid by OKE for the SUG assets, \$x (presumably less than \$131 million) represents an implicit legal-settlement payment. \$x openly paid by OKE to SUG to settle litigation would appear on OKE's books as a current expense, reducing net income. However, \$x paid as part of a nominal asset acquisition would appear as an exchange of assets (cash for real assets), with no immediate implications for net income. Thus, were OKE to camouflage (i.e., "launder") an \$x legal-settlement payment as part of an asset acquisition, OKE's net income would be overstated by \$x.¹

Also of possible significance are the implications for state-regulated utility rates and tariffs (in Texas and elsewhere, notably Oklahoma and Kansas) of the possible overvaluation of the SUG assets acquired by OKE, if OKE attempts successfully to secure a target rate of return on these assets as valued at OKE's nominal acquisition cost.

There questions arise because of the required disclosure, by OKE and SUG, of the legal settlement and the asset transaction. But, this observation raises a further question: Are there additional, undisclosed, transactions between SUG and OKE (e.g., gas-purchase or gas-transportation contracts), the terms of which may incorporate further litigation-related payments by OKE to SUG?

I would note that, while the timing of the referenced events would raise questions in any event, these questions are rendered more compelling by ONEOK's established history of laundering legal-settlement expenses. I refer specifically to ONEOK's May 2002 settlement of Cause PUD No. 98000188 before the Oklahoma Corporation Commission, in which evidence was presented that ONEOK, through a sweetheart contract with Dynamic Energy Resources, transformed the cost of its settlement of a suit brought by Gage Corporation (Creek Systems) into what appeared to be purchased-gas costs.² While the cost of a legal settlement would not have been recoverable from natural-gas ratepayers, the inflated cost of gas under the Dynamic contract was passed through directly to ratepayers. Under the settlement resolving this ratepayer action, ONEOK agreed to provide credits and related benefits with a proclaimed value to ratepayers of \$48 million.

I will appreciate any comments you may have on these issues.

Sincerely,



Stephen P. Dresch, Ph.D.

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| ec: | SEC Enforcement Division (202-942-9570) | U.S. Attorneys Tulsa (918-581-7769) |
| | Texas Railroad Commission (512-463-7161) | OK City (405-553-8888) |
| | Oklahoma Corporation Commission (405-521-4532) | Phoenix (602-514-7693) |
| | Kansas Corporation Commission (785-271-3354) | Dallas (214-767-2898) |
| | Maricopa County Attorney (602-506-8102) | Kansas (316-269-6484) |

¹ Note that the implications of the alternatives are less significant for SUG. The \$x paid by OKE would appear as a nonrecurring component of net income whether it were cast as (a) an OKE legal-settlement payment or (b) a primum over book value on assets sold.

² See my prefiled testimony and related documents (links at www.forensic-intelligence.org).