

Will Energy Transfer Act with Integrity?

As regular readers know, the proposed merger between Energy Transfer Equity (ETE) and Williams Companies (WMB) has been a rich source of material. Last week a judge's ruling enabled ETE to cancel the deal since a needed tax opinion was not forthcoming. WMB found it convenient to say the least that ETE's tax counsel Latham Watkins, having originally provided informal guidance that no adverse tax outcome was likely, later changed their minds coincident with their client souring on the deal. However, Judge Sam Glasscock III found no coincidence and absent a tax opinion that the deal was tax-free, ETE had its escape hatch.

We didn't think the deal would get done, but we remain interested in the fate of the convertible preferred securities ETE issued in March. As we wrote before (see *Is Energy Transfer Quietly Fleecing Its Investors?*), a select group of ETE insiders representing 31% of the common units outstanding was given the opportunity to swap their units for preferred securities with a guaranteed dividend which could be reinvested in more common units at \$6.56 per share (ETE closed Friday at \$13.80). Ostensibly this was to shore up ETE's balance sheet given the \$6BN cash payout they had agreed to under the merger. But it had the additional result of devaluing ETE units for all the other holders, including WMB investors who would be receiving new securities linked in value to ETE. WMB naturally sued. This looked like a very aggressive, almost scorched earth negotiating strategy by ETE in their efforts to force a renegotiation on WMB. However, as we noted in May, ETE CEO Kelcy Warren indicated that these securities would remain outstanding even if the merger was cancelled.

WMB's lawsuit of these securities didn't receive a ruling from

Judge Glasscock. He recognized his ruling on the tax opinion was likely to scupper the deal anyway, rendering WMB no longer an injured party. However, the same judge is hearing a lawsuit on this issue from other plaintiffs.

Without doubt, the abovementioned securities represent fraud by ETE's management. Every ETE investor would welcome the opportunity to swap their common units for the ones Kelcy and his friends own. He has a fiduciary obligation to other ETE investors which this action clearly violates, transferring substantial value (we estimated \$1.3BN) from investors in the same class of units to the insiders. Since ETE no longer faces the prospect of finding \$6BN, the apparent need for the securities themselves has disappeared and we await their cancellation.

So we're watching to see if ETE acts with integrity and voluntarily cancels the convertible preferreds. Or will they seek to retain this wealth transfer with a different justification? It's going to be hard for ETE to negotiate future deals credibly following the WMB experience, but especially so if they choose wrong on this issue. One can forgive the second thoughts on the merger, because the market moved sharply against MLPs last year. This was an issue of judgment. But a CEO who openly defrauds his public partners has lost his reputation for good. What use to the world is a dishonest billionaire, beyond donating his money to have a couple of buildings named after him? In future dealings with Kelcy and the other insiders, including John McReynolds (President of ETE's General Partner), Matthew Ramsey (President of Energy Transfer Partners), Marshall McCrea III (Group Chief Operating Officer) and Ray Davis (retired, co-founder), you'd always have to assume that they could once again fail to act in good faith having done so before. Based on the data we analyze about our blog subscribers, we know senior managers at ETE are reading this.

It may surprise, but we remain invested in ETE. We believe

Kelcy Warren will cancel these securities. He and his team have built a fantastic business. They are enormously talented. They can avoid any loss of face by simply saying the securities are no longer needed. This is the right thing to do. You won't find any sell-side analysts asking tough questions on this issue out of fear of causing offense. At SL Advisors we are free to say what many other analysts are merely thinking, because our only interest in ETE is that its value appreciate and its stock price rise. In this way, we are completely aligned with our clients and free to call it as we see it.

Kelcy, do the right thing.

We are invested in ETE and WMB