BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the matter of the Application of Southern Missouri Gas Company, L. P. d/b/a Southern Missouri Natural Gas for a certificate of public convenience and necessity authorizing it to construct, install, own, operate, control, manage and maintain a natural gas distribution system to provide gas service in Branson, Branson West, Reed's Spring and Hollister, Missouri.	)	Case No. GA-2007-0168

STAFF'S POSITION ON THE ISSUES

Comes now the Staff of the Missouri Public Service Commission ("Staff"), and for its Position on the Issues states:

ISSUES

1. **Should SMNG be granted a conditional certificate of convenience and necessity to serve Branson, Hollister, and Branson West, Missouri, and surrounding environs, as requested by SMNG in this proceeding?**

Staff's position: Staff supports the Commission granting both Applicants conditional certificates of convenience and necessity with the same conditions as accepted by OEP in Case No. GA-2006-0561. If the Commission grants either or both Applicants a CCN the CCN should be conditioned on the Company (s) ability to obtain reasonable financing on reasonable terms. Staff attempted to negotiate similar Stipulations with both entities which have applied for CCNs for this area. Staff has been able to reach agreement with OEP and therefore, recommends approval of its Application with the conditions set out in the Stipulation.

If the Commission were to grant both companies conditional CCNs, Staff recommends that the company which can make a showing that it has secured financing for the proposed service territories, which includes providing to Staff the final executed financing document(s), is able to immediately begin construction and has fulfilled all appropriate and necessary authorizations for the purpose of providing natural gas service in its requested and Commission authorized service territory.

a. Is there a public need for the proposed service?

Staff Position: Staff views this as the same question as whether natural gas service is necessary or convenient for the public. In terms of public need or the necessity of natural gas service in Branson, in construing the term “necessary or convenient,” the Court has stated that “the term ‘necessity’ does not mean ‘essential’ or ‘absolutely indispensable,’ but that [the] service would be an improvement justifying its cost.” In the *Intercon Gas* case, the Court of Appeals further construed this statutory section and noted several criteria for evaluation of the necessity and convenience of the proposed project:

“Public convenience and necessity is not proven merely by the desire for other facilities. It must be clearly shown there is failure, breakdown, incompleteness or inadequacy in the existing regulated facilities in order to prove the public convenience and necessity requiring the issuance of another certificate. The fact that one does not desire to use present available service does not warrant placing in the field a competing utility.” *State ex rel. Intercon Gas, Inc. v. Public Serv. Comm'n*. 848 S.W.2d 593, 597(Mo.App. 1993)(*citing State ex rel. Beaufort Transfer Co. v. Clark*, 504 S.W.2d 216,219 (Mo. App. 1973). After defining and interpreting the meaning of the phrase "necessary or convenient," the Court of Appeals indicated that it is up to the Commission to decide “when the evidence indicates the public interest would be served.” *Id*. The public interest is not served if the utility is unable to deliver service due to its inability to generate sufficient revenue.

b. Is SMNG qualified to provide the proposed service?

Yes. SMNG is an existing utility company.

c. Does SMNG have the financial ability to provide the service?

There are several factors that have contributed to the financial difficulties of bringing natural gas service to the Branson area, including: (a) the cost to excavate in rock, (b) the competition from propane and, in some areas, electric cooperatives and (c) the lack of infrastructure to deliver natural gas from an interstate pipeline. Staff recommends the following condition be placed on SMNG: "SMNG shall be responsible in future rate cases for the economic consequences of any failure of this system to achieve forecasted conversion rates and/or its inability to successfully compete against propane."

Staff recommends this condition to ensure that the continuing risk of the financial viability of the system not be shifted to customers either in a rate case or upon sale of the system. It is the experience of Staff that small systems have struggled financially and, if a system becomes financially viable, it is usually through the sale of the system and the write-down of the value of system assets to a level that may be supported by rates. This proposed condition places the responsibility for the economic success or failure of its certificated gas operations on SMNG, and not its customers.

Within the last 15-20 years, there has been a distinct pattern to new gas operation start-ups in Missouri. These start-up companies have generally failed to achieve their forecasts for converting existing customers from propane service or for serving new customers in their service territories. As a result, these start-ups have been saddled with "over-built" systems, and accordingly have not been able to charge rates that are fully compensatory of its cost of service.

It has been a standard condition in certificate cases for new gas utilities that the utilities are explicitly required to fully assume the risk of failing to achieve their estimated conversion rates from existing propane customers (i.e., failure to successfully compete against propane.) Trying to remedy inadequate earnings as a result of any such failure by increasing customer rates would constitute an unacceptable shifting of risk from the utility to its customers, and would in all likelihood be counter-productive in any effort by the utility to become more competitive with propane in its pursuit of additional customers.

To avoid shifting to customers, in a subsequent rate case, the risk of economic viability, Staff will actively oppose any increase in rates, including increases to rate base values that are not fully supported. Staff's concern with sale of the system at less than fair value is addressed in paragraph 3 of this section. Staff will resist any future attempt to shift the risk to customers by claiming that the rate base has a higher value than can be justified.

d. Is SMNG's proposed service economically feasible?

Staff's position: This depends largely on SMNG's ability to obtain reasonable financing on reasonable terms. The ability of a company to actually obtain financing indicates that a lender has found the project to meet some objective criteria for economic feasibility. Neither company should be permitted to exercise its Commission granted CCN until and unless it provides to Staff evidence that it has actually obtained financing for the project.

e. Is SMNG's proposed service in the public interest?

Staff's position: It is unusual that two companies are competing for generally the same territory. Staff does not recommend that it is in the public interest for two companies to be given CCNs to serve this area. It is Staff's position that if the Commission grants both SMNG and Ozark Energy Partners conditional CCN's, whichever company is able to obtain financing and begin construction immediately to build a natural gas system should be granted the final and only CCN for this area. Both will need to have obtained the statutorily required local franchise prior to beginning construction in any municipality it seeks to serve. Hollister is the only city in which both companies have franchises. If both Applicants were to be granted conditional CCNs, both should be required to meet the conditions set out in the Stipulation and Agreement filed in Case No. GA-2006-0561.

2. What conditions, if any, should the Commission impose upon the grant of certificate of convenience and necessity to serve Branson, Branson West, and Hollister, Missouri, and surrounding environs?

Staff's position: Section § 393.170 RSMo. (2000) permits the Commission to issue a Certificate of Convenience and necessity to an Applicant and to impose any necessary conditions on the grant of authority:

> The commission shall have the power to grant the permission and approval herein specified whenever it shall after due hearing determine that such construction or such exercise of the right, privilege or franchise is necessary or convenient for the public service. The commission may by its order impose such condition or conditions as it may deem reasonable and necessary . . .

In accord with this sub-section, the Commission may grant Applicant's request if, after hearing, it determines that the certificate is necessary or convenient for the public interest.

The Commission should impose the same conditions on SMNG as would be imposed on OEP when the Commission approves the Stipulation and Agreement in Case No. GA-2006-0561.

a. Should the Commission specifically condition the certificate upon the following agreement by SMNG:

"SMNG agrees that if, at any time, it sells or otherwise disposes of its assets before SMNG has cost based rates in a sale, merger, consolidation or liquidation transaction at a fair value less than its net original cost for those assets, the purchaser/new owner shall be expected to reflect those assets on its books at its purchase price or the fair value of the assets, rather than at the net

> original cost of the assets. This provision is intended to define SMNG's responsibility relative to the exercise of this certificate relative to SMNG's risk, not SMNG's customers, to absorb the costs in the event serving of this area is found to be uneconomic under original cost of service regulation. SMNG also acknowledges that it is the intention of the Parties that the provisions of this paragraph shall apply to any successors or assigns of SMNG**.** Nothing in this paragraph is intended to increase or diminish the existing rights or obligations of the parties with respect to ratemaking treatment of SMNG's existing assets outside the properties related to this certificate**."**

Staff's position: Yes. Another consequence of the inability of new start-up gas utilities in Missouri to become fully competitive with propane has been the subsequent sale of many of these companies to new owners, with a purchase price for the utility and/or its assets sharply discounted from the net original cost of the properties. Again, the subsequent sale of these utilities at a large discount reflects the fact that these systems have been over-built. The Staff believes the subsequent purchase price for these types of properties is a much more accurate estimate of their true economic value than the net original cost of the properties to the initial owners. Any effort by the new owners to charge customers the net original cost of the gas properties in this situation would simply be another attempt to shift the risk of the economic viability of these properties from the owners to its gas customers. For this reason, Staff recommends the Commission express its expectation that the shareholders or investors bear the risk of economic disappointment, be clearly communicated to any new or prospective owners of these properties, that any new owners will account for the properties on their books and records at its purchase price of the assets, and not the net original cost to SMNG. This treatment would clearly place the burden on the new ownership in any subsequent rate proceedings to justify any attempt to increase rate base by seeking to reflect the net original cost of the properties in customer rates.

b. Should the Commission adopt similar conditions to those recommended in the Stipulation And Agreement between OEP and Staff filed in Case No. GA-2007-0561 on November 8, 2007?

Staff's position: Yes. If the Commission determines that both Companies should be granted conditional CCN's the Commission should, in every way possible, impose identical conditions on both companies.

Neither company should begin any construction for provision of service in its requested service territory or in any area that may be necessary to serve the requested service territory until after the Commission issues its Order approving the Applicant's financing and grants a full CCN. Such order should deny the request of the competing Applicant. The Applicant receiving the exclusive CCN should be required to commence construction within one year of the Commission's final approval for its full CCN.

For purposes of this proposed condition, Staff would recommend defining "construction" as "the systematic building of the local distribution company."

Above are the Staff's positions on the issues in this case.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record this 27th day of November 2007.

/s/ Lera L. Shemwell