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 Lebanon, Missouri.	))))))))	**Case No. GA-2007-0212**

STAFF'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

COMES NOW the Staff of the Missouri Public Service Commission, by and through the General Counsel, and for its Proposed Findings of Fact and Conclusions of Law, states as follows:

Findings of Fact

1. Southern Missouri Natural Gas Company, L.P., doing business as Southern Missouri Natural Gas ("SMNG"), is a Missouri limited partnership with its principal place of business at 301 East 17th Street, Mountain Grove, Missouri. SMNG owns and operates a natural gas transmission and distribution system in southern Missouri serving approximately 7,500 residential, commercial and industrial customers. SMNG currently serves the communities of Rogersville, Marshfield, Ava, Norwood, Mountain Grove, West Plains, Willow Springs, Cabool, and Mansfield in six Missouri counties. About 6,800 of SMNG's current customers are residential customers. Some 600 to 700 residential customers disconnect every spring and reconnect every fall in order to avoid the customer charge in the months outside the winter heating season.

2. SMNG currently has an ACA balance between $220,453 and $378,470, that Staff has recommended be disallowed. SMNG has represented to the Commission that a disallowance of this scale would be detrimental to the Company's ability to continue to provide safe and adequate service throughout its Missouri service areas.

3. SMNG is owned by Sendero SMGC GP Acquisition Company, LLC (2%), and Sendero SMGC Limited Acquisition Company, LLC (98%). SMNG is the only asset owned by these two entities. Sendero SMGC GP Acquisition Company, LLC, and Sendero SMGC Limited Acquisition Company, LLC, in turn, are owned by Sendero Capital Partners Missouri, LLC (4.5590%), CHx Capital Missouri, Inc. (93.0639%), and Michael J. Lewis (2.3771%). SMNG has a management agreement with Sendero Asset Management, LLC ("SAM"), for which SMNG compensates SAM about $200,000 annually. Randy Maffett owns Sendero Capital Partners Missouri, LLC, and Alex Cranberg owns CHx Capital Missouri, Inc.

4. On December 6, 2006, SMNG filed its application for a certificate of convenience and necessity ("CCN") for a local distribution system serving Lebanon, Missouri, Case No. GA-2007-0212. SMNG stated in its application that it was "in the process of obtaining a franchise from the City of Lebanon, Missouri, to provide natural gas service to customers in Lebanon, Missouri, and various unincorporated environs." SMNG further stated that Lebanon does not now have natural gas service and that SMNG proposed to provide service in Lebanon under its existing tariff.

5. On December 12, 2006, SMNG filed its application for authority to issue $10 million in additional equity capital and $50 million in notes and other forms of indebtedness, Case No. GF-2007-0215. Among the stated purposes for the additional capital was to finance the proposed expansion in Lebanon and elsewhere.

6. SMNG supplemented its application in Case No. GA-2007-0212 with an ordinance of the City of Lebanon granting it a franchise to operate a natural gas distribution system on February 8, 2007.

7. On February 15, 2007, SMNG filed its application for a CCN for a local distribution system serving Houston, Licking and Mountain View, Missouri, Case No. GA-2007-0310. SMNG later withdrew its application as to Mountain View.

8. This Commission previously granted a CCN to SMNG to serve Houston and Licking on April 14, 1995; however, SMNG has not yet extended service to, or commenced offering service in, those communities.

9. The Commission consolidated the three cases into Case GA-2007-0212 on March 8, 2007.

10. Two parties intervened, the Missouri Propane Gas Association ("MPGA") in order to "protect the interests of its members and of propane gas consumers in the proposed area of service," and Southern Star Central Gas Pipeline, Inc., an interstate natural gas pipeline operator that provides wholesale transportation services to SMNG. MPGA opposed SMNG's application.

11. On May 16, 2007, MPGA moved to dismiss or stay these proceedings on the ground that the franchise obtained by SMNG from the City of Lebanon

was invalid because not ratified by a vote of the people. The Commission denied this motion. Nonetheless, under threat of litigation by MPGA, the City of Lebanon set a ratification election on August 7, 2007. The election was held as scheduled and the ordinance was duly ratified.

12. The franchise granted to SMNG by the City of Lebanon is not exclusive.

13. On June 13, 2007, Staff filed its Memorandum and Recommendation, advising the Commission that the two CCNs sought by SMNG should be granted but that action on the financing application should be deferred for the time being. With respect to Lebanon, the Staff recommended that the CCN be conditioned on a favorable result in the ratification election.

14. The Commission convened an evidentiary hearing on SMNG's applications at its offices in Jefferson City, Missouri, on July 27, 2007. All parties appeared except Southern Star Central Pipeline, Inc. The Commission heard testimony from five witnesses and received 16 exhibits.

15. Staff analyzed the feasibility study submitted by SMNG in support of its applications. Staff substituted more conservative estimates in place of some of the Company's inputs. Staff made the following adjustments to the Company's model : growth rates were replaced by the Company's actual growth experienced on the existing system from 1995 to 2000; Staff removed all gas sales revenue and expense; added inflation during 2007 for the current SMNG system; tripled the distribution cost per customer from $500 to $1,500; added an allowance for interest on working capital; and doubled the estimated pipeline cost from

$9,750,000 to $19,500,000. Feasibility was evaluated by looking at the internal rate of return (“IRR”) for the project over the twenty years covered by the model plus a terminal value. A hurdle rate of ten percent was considered to be the break point for feasibility. The IRR produced in the model, as adjusted by Staff, is thirteen percent. Therefore, Staff concluded that the project was financially feasible. SMNG expects a residential conversion rate of 50%.

16. Staff believes that the Company will face embedded, entrenched competition from propane dealers, whose prices and business practices are unregulated. Staff performed a sensitivity analysis of the feasibility study submitted by SMNG, substituting more conservative figures for some of those used by SMNG. Using information from the Energy Information Administration, the residential price per gallon of propane on March 12, 2007, was $1.68, which equates to an equivalent price per Ccf of natural gas of $1.83. SMNG's PGA rate for natural gas in March was $0.95 per Ccf. Since the price of propane is a delivered price, Staff calculated the delivered price of 1,000 Ccf of natural gas to compare with the equivalent of 1,000 Ccf of propane by adding to the price per Ccf of natural gas the commodity charge of $0.357 and the customer charge equivalent by dividing the $120.00 customer charge for 12 months by 1,000, or $0.12. The cost of 1,000 Ccf of natural gas, calculated this way, would be $1,427, whereas the price of the equivalent of 1,000 Ccf of propane would be $1,834. The price of propane would have to drop to approximately $1.307 per gallon to be competitive with natural gas. However, the wholesale price of

propane on March 12, 2007, in Missouri was $1.055, suggesting that propane dealers may be able to cut their retail prices in an effort to stay competitive.

17. Staff does not presently recommend approval of SMNG's financing application because the final terms and conditions are as yet unknown. SMNG has informed Staff that the equity investors will be one or two large, accredited, institutional investors with specific industry knowledge and experience relevant to the proposed investment and financing of SMNG as well as projected ranges of terms and conditions it expects to transact. SMNG is currently still engaged in negotiations with potential investors and, once its negotiations are complete, will file an amendment to its Application with supporting documentation. After SMNG has filed this information, Staff will issue its final recommendation on SMNG's financing application.

18. One aspect of the financing application is an increase of SMNG's working capital credit line to $25 million.

19. SMNG's applications for CCNs were supported by financing plans as required by Commission rules.

20. The equity investors that are considering investing in SMNG's expansion are waiting to see whether the Commission will grant the necessary CCNs.

21. SMNG will not be able to complete the proposed expansion to Lebanon, Houston and Licking if it is not able to obtain financing.

22. SMNG's applications for CCNs to serve Lebanon, Houston and Licking include all attachments and information required by the Commission's rules.

23. Natural gas is not presently available in Lebanon, Houston or Licking. The availability of natural gas would allow energy consumers in Lebanon, Houston and Licking to reduce their energy costs. Natural gas is cheaper for heating than propane, electricity and fuel oil. Per MMBTU, SMNG can deliver natural gas for about $13.00 compared to about $20.00 per MMBTU for propane. However, because propane is not regulated, propane dealers have much more flexibility in setting prices. If businesses reduce their energy costs, they may reduce their retail costs or add employees.

24. Joe Knapp, City Administrator for Lebanon, testified that there is a need for natural gas service in that community. Knapp testified that creation of a competitive energy market in Lebanon would result in the creation of jobs in the community. Knapp also testified that he expects the cost of municipally-supplied electricity in Lebanon to increase by 30% to 40% in the future. Knapp testified that Lebanon is a manufacturing community, with approximately 6,000 manufacturing jobs. The manufacturers in Lebanon include Emerson, Durham, Carr Industries, DTE Metal Products, Precision, Carmeco, Bass Tracker, Landau Boats, and G3 Boats. Knapp testified that the availability of natural gas would help Lebanon attract new industry. Existing industrial customers in Lebanon are also interested in natural gas. Lebanon issued RFPs to 20 natural gas suppliers and received only two bids. SMNG was the winning bidder.

25. There are approximately 6,000 households in Lebanon and approximately 1,000 each in Houston and Licking.

26. SMNG's experience is that about 52% of propane-using households will convert to natural gas over a five-year period after it becomes available. About 20% to 30% of all-electric households will convert to natural gas. In the event that the expected conversion rate is not achieved, SMNG's shareholders will absorb the loss. After the first five years, SMNG expects growth of 1.5% to 2.0% annually.

27. SMNG will obtain the necessary gas from the Southern Star pipeline, Station 142 near Rogersville. SMNG has already contracted for the necessary gas to serve Lebanon, Houston and Licking, plus a reserve margin of 20%. Station 142 is the end of the Southern Star pipeline and the beginning of the SMNG system.

28. The availability of natural gas in Lebanon, Houston and Licking would create competition with other energy providers that could drive energy prices down for all customers.

29. If the requested CCNs are granted, SMNG estimates that service will be available in Lebanon by December 2007 or January 2008. SMNG expects to spend about $11 million to build transmission lines to Lebanon, Houston and Licking, and another $1.7 million to build distribution lines in those communities.

30. SMNG would not build a distribution line to a neighborhood to serve a single customer.

31. SMNG would bear the total cost of laying a 2-inch distribution main along a street. The cost of the service lines and meters would be shared by SMNG and the customer. SMNG estimates that conversion will cost about

$1,500 per residential customer, including the cost of the main. Each meter costs $300 to $400. SMNG's tariff allows it to pay $250 of the conversion cost per residential customer.

32. The propane market is very competitive in Lebanon. There are seven dealers in the city and five or six others in the surrounding area.

33. Peak-shaving plants and stand-by plants are propane-based facilities used in areas where natural gas pressure is inadequate in peak usage periods. Such facilities are used in Springfield, Waynesville and Fort Leonard Wood. The use of such facilities has the effect of causing propane prices to rise.

34. The effect of the introduction of natural gas into a propane market is to substantially reduce the demand for propane. This necessarily raises costs for those propane customers that do not, or cannot, convert to natural gas. The effect on propane dealers is catastrophic.

35. Propane is heavier than natural gas and is more dangerous because it tends to pool in low areas.

36. Staff recommends that the requested CCNs be granted, conditioned upon obtaining financing on acceptable terms.

Conclusions of Law

Jurisdiction:

SMNG is a "gas corporation" and a "public utility" within the intendments of § 386.020, RSMo Supp. 2006, and it is thus subject to the regulatory jurisdiction of this Commission pursuant to Chapters 386 and 393, RSMo.

Controlling Law:

Section 393.170 provides:

> 1. No gas corporation, electrical corporation, water corporation or sewer corporation shall begin construction of a gas plant, electric plant, water system or sewer system without first having obtained the permission and approval of the commission.
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> 2. No such corporation shall exercise any right or privilege under any franchise hereafter granted, or under any franchise heretofore granted but not heretofore actually exercised, or the exercise of which shall have been suspended for more than one year, without first having obtained the permission and approval of the commission. Before such certificate shall be issued a certified copy of the charter of such corporation shall be filed in the office of the commission, together with a verified statement of the president and secretary of the corporation, showing that it has received the required consent of the proper municipal authorities.
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> 3. 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. Unless exercised within a period of two years from the grant thereof, authority conferred by such certificate of convenience and necessity issued by the commission shall be null and void.

Section 393.170.3, set out above, authorizes this Commission to grant CCNs when it determines, after due hearing, that the proposed project is "necessary or convenient for the public service." It has been held that the term "necessity" does not mean "essential" or "absolutely indispensable," but rather that the proposed project "would be an improvement justifying its cost," *St. ex rel. Intercon Gas, Inc. v. Public Service Commission,* 848 S.W.2d 593, 597 (Mo. App., W.D. 1993); *St. ex rel. Beaufort Transfer Co. v. Clark,* 504 S.W.2d 216, 219 (Mo. App. 1973), and that the inconvenience to the public occasioned by lack of the proposed service is great enough to amount to a necessity. *Beaufort Transfer Co., supra; St. ex rel. Transport Delivery Service v. Burton,* 317 S.W.2d 661 (Mo. App. 1958). The phrase "necessary or convenient" extends to the regulation of monopoly to prevent destructive competition, undesirable competition and duplication of service. *Intercon Gas, supra; St. ex rel. Public Water Supply Dist. No. 8 v. Public Service Commission,* 600 S.W.2d 147, 154 (Mo. App. 1980). "The safety and adequacy of facilities are proper criteria in evaluating necessity and convenience as are the relative experience and reliability of competing suppliers." *Intercon Gas, supra, quoting St. ex rel. Ozark Electric Coop. v. Public Service Commission,* 527 S.W.2d 390, 394 (Mo. App. 1975). It is within the Commission's discretion to determine when the evidence indicates the public interest would be served by the award of the certificate. *Intercon Gas, supra; Ozark Electric Coop.,* 527 S.W.2d at 392. However, the Commission may not grant a CCN unless the applicant has already obtained a local franchise, an "absolute prerequisite." *St. ex inf. Shartel ex rel. City of Sikeston v. Missouri Utilities Co.,* 331 Mo. 337, 350, 53 S.W.2d 394, 399 (Mo. banc 1932).

Based on a review of prior Commission decisions, MPGA suggests that there are five criteria that must be satisfied in order for the Commission to grant a CCN, as follows:

1. The proposed service must be needed.
2. The applicant must be qualified to provide the proposed service.

3. The applicant must have the financial ability to provide the proposed service.

4. The proposed project must be economically feasible.

5. The proposal must promote the public interest.

Contrary to MPGA's position, the standard governing this matter is set by statute: as noted above, the Commission may grant the CCNs if it determines, after hearing, that they are "necessary or convenient for the public service." Section 393.170.3. Some of MPGA's five criteria – 1 and 5 – restate the statutory standard, albeit in a somewhat garbled manner. The others are factors that the Commission has properly considered in other, similar cases. *See Intercon Gas, supra.* In particular, Staff points out that SMNG need not have its financing in hand in order to qualify for the CCNs.

If the Commission grants the requested CCNs to SMNG, the Company will have an obligation to serve the public in its allotted service areas. *State ex rel. Harline v. Public Service Commission*, 343 S.W.2d 177, 181 (Mo. App. 1960). *Harline* provides as follows regarding a public utility's obligation to serve in its certificated service territory:

> The certificate of convenience and necessity is a mandate to serve the area covered by it, because it is the utility's duty, within reasonable limitations, to serve all persons in an area it has undertaken to serve. *State ex rel. Ozark Power & Water Co. v. Public Service Commission,* 287 Mo. 522, 229 S.W. 782; *State ex rel. Kansas City Power & Light Co. v. Public Service Commission of Missouri et al.,* 335 Mo. 1248, 76 S.W.2d 343; *State ex rel. Federal Reserve Bank of Kansas City v. Public Service Commission,* 239 Mo.App. 531, 191 S.W.2d 307; and *May Department Stores Co. v. Union Electric Light & Power Co.,* 341 Mo. 299, 107 S.W.2d 41.

Discussion:

The evidence adduced shows that the proposed expansion of SMNG's service to Lebanon, Houston and Licking is economically feasible, will meet a definite need in those communities, and will confer tangible economic benefits upon them. The evidence also shows that the expansion will have a catastrophic impact upon propane dealers in those communities and may have an adverse effect on propane prices in those communities. On balance, the benefits that the expansion will confer can be seen to outweigh the negative impacts and the Commission, therefore, concludes that the grant of the proposed CCNs is both necessary and convenient for the public interest.

As proposed by Staff, the CCNs will be conditioned upon SMNG's obtaining acceptable financing.

IT IS THEREFORE ORDERED:

1. That Southern Missouri Natural Gas Company, L.P., doing business as Southern Missouri Natural Gas, is hereby granted a Certificate of Convenience and Necessity to serve the communities of Lebanon, Houston and Licking, Missouri.

2. That the certificates granted in Ordered Paragraph No. 1, above, are conditioned upon the Company's obtaining financing acceptable to the Commission.

WHEREFORE, Staff prays that the Commission will adopt its Proposed Findings of Fact, Conclusions of Law and Ordered Paragraphs, and grant such other and further relief as would be just in the circumstances.

Respectfully submitted,

s/ Kevin A. Thompson
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Certificate of Service

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by First Class United States Mail, postage prepaid, on this **13th day of August, 2007,** to the parties of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case, a copy of which is attached hereto and incorporated herein by reference.

s/ Kevin A. Thompson