

**BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI**

In the Matter of the Application of Ozark)
Energy Partners, LLC for a Certificate of)
Convenience and Necessity to Construct)
and Operate an Intrastate Natural Gas)
Pipeline and Gas Utility to Serve Portions)
of the Missouri Counties of Christian,)
Stone and Taney, and for Establishment of)
Utility Rates.)

Case No. GA-2006-0561

STAFF'S BRIEF

COMES NOW the Staff of the Missouri Public Service Commission ("Staff"), and for its Brief states that Staff's recommendation in this case is: OEP be given a conditional Certificate of Convenience and Necessity (CCN), pending submission of completed financing arrangements. OEP has already committed to accept full responsibility for the financial viability of the system through an accounting methodology which Staff recommends as providing meaningful protection for consumers against the risk of financial failure of the proposed system.

I. Procedural History

On June 30, 2006, Ozark Energy Partners, LLC (OEP) filed an application for a certificate of convenience and necessity to construct and operate an intrastate natural gas pipeline and gas utility to serve portions of Christian, Stone and Taney counties. As permitted by the Commission's rule at 4 CSR 240-3.205 (2), OEP updated its Application with documents to comply with Commission rules including: (a) the legal description of the area to be certificated (4 CSR 240-3.205(1)(A) 3.); (b) a plat drawn to a scale of one-half inch (1/2") to the mile on maps comparable to county highway maps (4 CSR 240-3.205(1)(A) 4.); (c) a feasibility study containing plans and specifications for the utility system and estimated cost of the construction of the utility system during the first three (3) years of construction; plans for financing; proposed

rates and charges and an estimate of the number of customers, revenues and expenses during the first three (3) years of operations (4 CSR 240-3.205(1)(A) 5.); (d) The plans and specifications for the complete construction project and estimated cost of the construction project or a statement of the reasons the information is currently unavailable and a date when it will be furnished; (4 CSR 240-3.205(1)(B) 2.); and (e) plans for financing (4 CSR 240-3.205(1)(B) 3.). A hearing was held in this matter on November 29, 2007.

II. Discussion

Prior to hearing, Staff and OEP filed a Stipulation and Agreement (Stipulation) in this case. While that Stipulation was opposed by Southern Missouri Natural Gas, so it was not a Unanimous Stipulation, it, along with Staff's Memorandum in Support of Stipulation and Agreement, nonetheless represent the position of the Staff concerning the conditions the Commission should require of either OEP or SMNG when the Commission issues a CCN to either of the Applicants. At this point, it is Staff's recommendation that both Applicants, OEP and SMNG be granted conditional CCNs pending one or both filing financing that is satisfactory to Staff and to the Commission. (Tr.0168, p. 244, ls. 2-11; 245, ls 4-8.)

While Staff is recommending that SMNG and OEP both be granted conditional CCNs so both may pursue financing, (Tr.0168, p. 244, ls. 2-11; 245, ls 4-8.) Staff does not recommend that it is in the public interest for two companies to be given CCNs to serve this same area. (Tr.0168, p. 244, ls. 2-11; Tr. 0561 p. 55, ls. 7-11.)

Staff does not recommend it is in the public interest for the Commission to grant duplicate CCNs, because it is expensive to construct a natural gas system with duplicate facilities, which would likely lead to the financial failure of both companies. (Tr. 0561, p. 76, ln. 1 – p. 77, ln 5.)

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

Yes. Staff supports the Commission granting both Applicants for this general territory, Southern Missouri Natural Gas (SMNG) and Ozark Energy Partners (OEP), conditional certificates of convenience and necessity (CCN) to serve the requested areas, conditioned on the Company (s) ability to obtain reasonable financing on reasonable terms. (Tr.0168, p. 244, ls. 2-11; Tr.0168, p. 256, ls. 12-23.) Staff recommends that both Companies be required to meet certain conditions before a final CCN is granted to either. (Tr.0168, p. 244, ls 23-25).

The ability of a company to obtain financing is the basis for Staff's recommendation to grant dual conditional CCNs. To increase the chances that at least one of the Applicants will succeed, Staff is recommending that, rather than grant one company a CCN at this time, the Commission grant both companies conditional CCNs. (Tr.0168 p. 244, ls. 2-11.) Staff recommends that whichever company 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 begin construction and has fulfilled all appropriate and necessary authorizations for the purpose of providing natural gas service in its requested Commission-authorized service territory be granted the final CCN. (Tr.0168, p. 245, ln. 9 – Tr. 247, ln. 10)

If the Commission were to determine it should grant a CCN to only one of the Applicants, since OEP has accepted conditions Staff feels are necessary to protect the public from the financial failure of the system, Staff recommends the Commission find it in the public interest and grant OEP a CCN to construct and operate a natural gas utility to serve portions of the Missouri counties of Christian, Stone and Taney, including the following Missouri cities and

their environs: Highlandville: Hollister, Kimberling City, Reeds Spring, and upon receipt of a local franchise, Branson and Branson West. The CCN would need to be conditioned on OEP's presentation of a financing plan acceptable to the Commission.

With regard to the City of Branson West, if the Commission were to approve only one application Staff recommends that the Commission approve a certificate to OEP, as requested, that includes Branson West, contingent upon OEP obtaining a municipal franchise from the City of Branson West. To date, OEP has not been granted a municipal franchise for the provision of gas to the City of Branson.

At this point, however, it remains Staff's recommendation that the Commission grant both Applicants conditional CCNs, because as Mr. Straub explained: [t]here 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. (Exh 24., Straub Dir. HC. P. 3-4.)

Staff's recommendation is that the Commission ultimately grant only one of the Applicants a final CCN because competition between two natural gas companies in this area would indeed be destructive. (Tr. 0561, p. 76, ln. 1 – p. 77, ln 5.) Staff's recommendation to permit both to try to obtain financing by granting both conditional CCNs ** “_____

_____.” ** (Tr. 0168 HC Vol. 3, p. 62.)

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

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.*

Granting a Certificate of Convenience and Necessity (CCN) to OEP to construct gas plant, requires the Commission to determine whether OEP has obtained the necessary franchises, and whether the project is necessary and convenient for the public interest. § 393.170 RSMo. (2000). This statutory section also permits the Commission to impose 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. 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.” The public interest is not served if the utility is unable to deliver service due to its inability to generate sufficient revenue. “Additionally, what is necessary and convenient encompasses regulation of monopoly for destructive competition, prevention of undesirable competition, and prevention of duplication of service.” *State ex rel. Public Water Supply Dist . No. 8 v. Public Serv. Comm'n*, 600 S.W.2d 147, 154 (Mo .App .1980). “The determination of what is necessary and convenient has long been, and continues to be, a matter of debate. From analysis of court decisions on this subject, the general purpose of what is necessary and convenient encompasses regulated monopoly for destructive competition, prevention of undesirable competition and prevention of duplication of service. The **underlying public interest** is and remains the controlling concern, because cut-throat competition is destructive and the public is the ultimate party which pays for such destructive competition.” *Id* (emphasis added).

b. Is OEP qualified to provide the proposed service and is OEP financially able to provide the proposed service?

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. (*Id.*)

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. (Exh. 24, Straub Dir. HC, p. 6-7.)

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_____. ** (Exh.. 24, Straub Dir., p. 6-7.) ** _____

OEP is willing to accept responsibility for the financial success of the system. Staff recommends and OEP has agreed that the following conditions may and should be part of any final CCN granted to OEP:

1. OEP 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.

2. The parties recommend that the Commission make no finding as to the prudence or ratemaking treatment to be given any costs or expenses incurred as a result of the granting of this certificate of convenience and necessity, except as otherwise addressed in this Stipulation and Agreement.

3. OEP agrees that if, at any time, it sells or otherwise disposes of its assets 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 OEP's books at its purchase price or the fair value of the assets, rather than at the net original cost of the assets. OEP also acknowledges that it is the intention of the Parties that the provisions of this paragraph shall apply to any successors or assigns of OEP.

Staff's goal in recommending this provision is to ensure that the continuing risk of the financial viability of the system not be shifted to customers 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 section places the responsibility for the economic success or failure of its certificated gas operations on OEP, and not its customers and sets forth an expectation by the parties that any future owners of OEP properties through a purchase or acquisition from OEP will book its acquired net plant in service at the purchase price value of the properties, not the net original cost to OEP. (*Id.*)

This approach is one of two alternatives which lead to the same goal of assuring that an Applicant for a CCN accept the risk of financial failure. (Tr.0168, p. 295, ls. 12-25). One approach is to impute a certain level of revenues and this other approach involves valuation of assets at sale. (Tr.0168, p. 294, ls. 2-13.) While the rate base evaluation approach may be more effective in protecting consumers, it is not more onerous for owners and is a reasonable and fair approach because it uses an objective measurement to value the company's assets. (Tr.0168, p. 295, ln. 19-25.)

The "net original cost concept" has been the policy of this Commission for many years; i.e., the concept that a utility's plant in service should be valued at its net original cost to the initial owner for rate purposes, even if the plant is subsequently purchased at a cost either above or below the net original cost by a subsequent owner. The Staff fully supports this concept. However, in the limited circumstances that a utility is unable to charge cost based rates (due to competitive pressures), the net original cost concept no longer can be or should be applicable to a utility's recovery of its plant investment in rates. (Tr.0168, p. 270.)

Additionally, OEP has agreed to meet several service quality conditions: "the Company agrees to respond to inquiries from the Consumer Services Department within three (3) business days, except for the interruption of service issues, to which it will respond within one (1) business day. OEP also agreed to adhere to all Commission rules and regulations including those relating to service and agreed to abide by provisions of the Cold Weather Rule." (Exh 24, Straub Dir. HC, p. 12.)

c. Is OEP financially able to provide this service?

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. (Tr. 0561, p. 61, ls 6-19; Tr. 0561 p. 70, ls 1-18; Tr.0561, p. 72, ln.2 – p. 74, ln. 3.) If OEP is able to obtain financing, Staff believes it will be able to provide natural gas service in this area (Tr.0561, p. 75, ln 22- p. 76, ln 6.)

d. When should construction begin?

Prior to beginning construction of any facilities, plant, works or system for the transmission or distribution of natural gas, either Applicant should be required to submit a financial plan to the Commission for Staff's review and the Commission's approval and should:

- a. Include no bank or loan restrictions on the Company's ability to hedge with fixed price physical contracts; and
- b. Not include any financing agreement with restrictions on the Company's ability to get fixed price contracts for natural gas.
- c. Submit to the Staff, ten (10) days subsequent to closing of any loan or other financing arrangements, all documents finally executed to obtain financing for construction of the proposed systems.

(Exh. 24, Straub Dir. HC p. 13)

These conditions define the type of financing arrangement Staff expects the Company to obtain so that it can operate the system efficiently and to hedge and purchase sufficient natural gas to serve its customers. Provision of these documents to Staff will demonstrate the company has obtained financing to begin construction which does not restrict the Company's ability to manage its gas supply efficiently. (*Id.*)

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

_____ ** are designed, constructed, and tested in compliance with the standards, codes, and regulations referenced by the Company and all parts of the system are operated by personnel that are trained and qualified in this specific type of delivery system, then the Gas Safety/Engineering Staff believes the system can be operated in a safe manner. (Exh 24. Straub Dir. HC, p. 18-19.)

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?

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 conditions Staff recommends the Commission impose are the conditions in the Stipulation and Agreement OEP signed in Case No. GA-2006-0561, which is incorporated herein by reference.

WHEREFORE, Staff recommends the Commission issue OEP a conditional CCN to serve its requested service area, with the exact same conditions agreed to in Exh. 24.

Respectfully submitted,

/s/ Lera L. Shemwell

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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 7th day of January, 2008.

/s/ Lera L. Shemwell