

## MEMORANDUM

**TO:** Missouri Public Service Commission  
Official Case No. GF-2013-0261  
Summit Natural Gas of Missouri, Inc.

**FROM:** David Murray, Financial Analysis, Utility Services Department

/s/ David Murray 12/18/12

Project Coordinator / Date

/s/ Bob Berlin 12/18/12

Staff Counsel's Office / Date

**SUBJECT:** Staff Recommendation to conditionally approve the Application of Summit Natural Gas of Missouri, Inc. ("SNGMO") for authority to encumber its Missouri regulated natural gas distribution assets in an amount not to exceed \$100,000,000 in order to secure a three-year term loan.

**DATE:** December 18, 2012

1. (a) **Type of Issue:** 3-Year Senior Secured Term Loan

(b) **Amount:** \$100 million

(c) **Rate:** The interest rate will be \*\* \_\_\_\_\_  
\_\_\_\_\_ \*\* as defined in the loan agreement.

2. **Proposed Date of Transaction:** By December 31, 2012.

3. (a) **Statement of Purpose of the Transaction:** The Applicant proposes to use the proceeds to: (1) refinance \$43 million of SNGMO outstanding indebtedness owed to CoBank and UMB Bank of Colorado; (2) finance capital needs related to the expansion around the Lake of the Ozarks ("the Lake") as authorized in Case No. GA-2012-0285; (3) finance "fill-in" capital needs associated with the existing SNGMO system; and (4) finance a one-time cash distribution to the private equity investor, JP Morgan Infrastructure Investment Fund ("IIF"). (In an email from SMNG sent to Staff dated December 17, 2012, the Company advised it is no longer requesting to finance a one-time cash distribution to IIF. Staff addresses this change in the body of its recommendation).

(b) **From a financial perspective, does Staff deem this Statement of Purpose of the Issue reasonable?:**

Yes, to the extent the Company has decided to withdraw its request for a one-time cash distribution.

**\*\* Denotes Highly Confidential Information \*\***

**NP**

4. **Copies of executed instruments defining terms of the proposed securities:**

Such instruments have not been executed, but a term sheet providing the principal terms and conditions to be contained in the instruments were attached to the Application.

5. **Certified copy of resolution of the directors of applicant, or other legal documents authorizing the issuance of the securities reviewed:**

Yes

6. **Pro-forma Balance Sheet and Income Statement reviewed:**

Yes

7. **Capital expenditure schedule reviewed:**

No

8. **Recommendation of the Staff:**

Conditional Approval granted pending receipt of definite terms of issuance (see Comments below, Recommended Conditions section )

**COMMENTS:**

**Background:** SNGMO is a corporation duly incorporated under the laws of the State of Colorado with its principal office located at 7810 Shaffer Parkway, Suite 120, Littleton, Colorado 80127. SNGMO provides natural gas service or plans to provide natural gas service in the Missouri counties of Benton, Caldwell, Camden, Daviess, Douglas, Greene, Harrison, Howell, Laclede, Miller, Morgan, Pettis, Stone, Taney, Texas, Webster and Wright. SNGMO is a wholly-owned subsidiary of Summit Utilities, Inc., also a Colorado corporation. To Staff's knowledge, SNGMO's operations are limited to regulated natural gas distribution operations in Missouri. SNGMO is a private corporation with one private shareholder, IIF. Summit has four wholly-owned subsidiaries: Colorado Natural Gas, Inc. ("CNG"), SNGMO, Wolf Creek Energy, LLC ("WCE") and Summit Utilities Management Services, LLC ("SUMS"). CNG is an operating natural gas distribution company subject to the jurisdiction of the Public Utilities Commission of the State of Colorado ("CPUC") with respect to its retail gas operations. WCE purchases natural gas, then contracts to transport the gas across the Colorado Interstate Gas Company system and another utility's system. The gas is sold to three customers at the point of transfer between the other utility and CNG. SUMS was formed in December 2009 to provide

construction project consulting and business advisory consulting services for unaffiliated natural gas industry companies.

SNGMO's Application requests Commission authority to put a lien on or encumber its Missouri utility assets for purposes of securing a three-year term loan in the amount of \$100 million. Though SNGMO is not a Missouri corporation, the Commission exercises its right to regulatory oversight pursuant to Section 393.180 which states, in pertinent part, "The power of gas corporations ....to create liens upon their property situated in this state is a special privilege, the right of supervision, regulation, restriction and control of which is and shall continue to be vested in the state, and such power shall be exercised as provided by law and under such rules and regulations as the commission may prescribe." Although there is no explicit specification of the standard to be used in such cases, Staff has historically applied the standard of "not detrimental to the public interest" in such instances and will do so in this case.

**Company's Verbal Amendment to Application Regarding One-time Cash Distribution:**

After Staff had further discussions with the Company regarding its planned uses of the funds raised through the requested encumbrance, the Company no longer plans to make a one-time \$20 million distribution to IIF. The Company represents to Staff that instead of making this distribution, the Company will retain the proceeds for purposes of investment in the system. This new representation appears logical to Staff because SNGMO is expected to expend additional capital in the next several months well in excess of the originally requested \$20 million distribution for purposes of the Lake project. Although this is technically an amendment to the Application supported by an email from the Company to Staff, the redirection of the proposed one-time \$20 million distribution to IIF to the support of the Lake project is adequately addressed in Staff's recommendation. Also, because the Company has expressed an interest in receiving Commission approval by December 31, 2012, Staff decided to inform the Commission of this amendment on behalf of the Company through the Staff recommendation.

**Transaction:** SNGMO is requesting Commission authority to create a lien/encumbrance on its Missouri properties in order to secure payment of up to \$100 million of possible debt proceeds. Pro forma financial statements attached to the Application indicated that \*\*\_\_\_\_ \*\* banks planned to equally participate in loaning funds to SNGMO. \*\*\_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

\*\*

Of the total proposed \$100 million, \$43 million will be used to refinance a previous "bridge loan" issued to facilitate the merger of the previous Missouri Gas Utility, Inc. ("MGU") and the Southern Missouri Natural Gas ("SMNG") companies. SNGMO's original intent was to

NP

The primary difference between the terms and conditions of the financing requiring encumbrance in this Application, other than the requested amount, is that SNGMO is not extending the term of any of its debt to 20 years as it had initially contemplated. Under the current proposed scenario, SNGMO's \$100 million of debt will have a term of three years, maturing on December 31, 2015. It is Staff's understanding that the inclusion of financing for the Lake project is one of the primary reasons SNGMO changed the financing plan it presented in its encumbrance Application in File No. GO-2012-0102. However, based on SNGMO's response to Staff Data Request No. 1,

**Request to Encumber:** Although Staff acknowledges that the encumbrance request in this Application is associated with a project that will likely add as much to the Company's asset base as it encumbers, Staff is concerned about the Company's inability to meet certain financial targets it had indicated it could achieve in its last encumbrance case, File No. GO-2012-0102. If the Company has not been able to achieve its targeted growth for supporting its existing system, then now may not be the time to embark on additional expansion. Regardless, the Company has already been granted Commission Authority to proceed with the Lake project (Case No. GA-2012-0285) \*\* \_\_\_\_\_

NP

\_\_\_\_\_. \*\*. The issue before the Commission in this Application is not whether the Company should continue expansion. The issue here is whether it is appropriate to allow the Company to encumber its Missouri utility assets in the amount of \$100 million to secure debt financing. While Staff has concerns about SNGMO's exposure to significant refinancing risk based on the short-term nature of the underlying financing instrument, Staff notes that but for SNGMO's need to encumber its Missouri assets, it could issue unsecured debt without Commission Authority. Consequently, Staff's focus in this Application is on whether the funds raised through the collateralization request is not detrimental to the public interest.

Staff is guided by the interpretation of "a detriment to the public interest" is subjective. In a past collateralization case, *In the Matter of the Application of Aquila, Inc. for Authority to Assign, Transfer, Mortgage or Encumber Its Utility Franchise, Works or System in Order to Secure Revised Bank Financing Arrangements*, Case No. EF-2003-0465, in its February 24, 2004 Report and Order the Commission concluded that "a detriment to the public interest" includes a "risk of harm to ratepayers." The Commission went on to state that "the Commission cannot know whether the encumbrances will result in rate increases. But the Commission should look at the reasonableness of the risk of the increases." The Commission indicated that granting Aquila's application would be detrimental to the public interest because of the "unreasonable risk of harm to Missouri ratepayers compared to the minimal benefit Aquila would receive." The Commission explicitly expressed its concern that "Missouri ratepayers would suffer a detriment if Aquila used its Missouri regulated assets to support the debt for its riskier, unregulated operations."

After considering SNGMO's Application and the amendment to the Application discussed above, the \$100 million of funds to be collateralized with SNGMO's Missouri regulated utility assets can be directly tied to investment in SNGMO's Missouri utility operations. The Company represents that the funds will be used as follows: \*\* \_\_\_\_\_

\_\_\_\_\_. \*\*.

**IIF's Past and Future Planned Capital Commitments:** Schedule 1 attached to this recommendation provides Staff's estimate of the capital IIF has invested in the SNGMO system since it acquired ownership interest in both SMNG and MGU (merged to form SNGMO). At year end December 31, 2011, SNGMO owed IIF \*\* \_\_\_\_\_

\_\_\_\_\_. \*\*. The total equity cash infusions made by the owner into the SMNG system for the period 2009 through 2011 was approximately \*\* \_\_\_\_\_. \*\*. IIF's total equity cash infusions into MGU for the same period was approximately \*\* \_\_\_\_\_. \*\*. Additionally, in response to Staff Data Request No. 5, SNGMO indicated that it had invested \*\* \_\_\_\_\_

\_\_\_\_\_. \*\*. Staff is not aware of IIF receiving any cash distributions from the Missouri systems during the period in which it made these investments. Consequently, IIF has invested approximately \*\* \_\_\_\_\_ \*\* of additional capital in both the MGU and SMNG system

NP

since it acquired ownership of both entities. Based on projected financial statements SNGMO filed with its Application, IIF plans to invest additional equity capital of approximately \*\*\_\_\_\_\_\*\* through 2016, largely due to construction associated with the Lake project.

It is clear that IIF's financial support has been the primary catalyst allowing the possibility for Missourians to now have the option to take natural gas if they choose to do so. Although this is clearly a benefit to the Missouri public interest, it does not come without risks. The primary risk is that these expansion projects do not generate enough cash flow to support debt service payments required for any debt SNGMO incurs. It is possible the Company could issue additional unsecured debt that the Company is not required to come before the Commission for approval. If the Company were to do that, it would introduce additional financial risk, increasing the potential for bankruptcy. As stated above, Staff's primary focus in its review of the Application's requested relief to use SNGMO's Missouri utility assets was to determine whether the funds raised from the lien are for the benefit of the Missouri utility assets subject to such lien. Staff confirmed this to be the case.

The encumbrance request in SNGMO's Application applies to all of SNGMO's assets, not just specific parts of its system. In this case Staff must consider whether SNGMO's current in-service natural gas distribution assets will be unduly burdened with a lien used to raise proceeds for SNGMO's expansion into the Lake area. As discussed above, SNGMO plans to use approximately \*\*\_\_\_\_\_\*\* of the \$100 million of proceeds for expansion into the Lake area. Because the Lake project is expected to result in an additional book value asset base of approximately \*\*\_\_\_\_\_\*\*, Staff does not consider this amount to be disproportionately in favor of the Lake project over SNGMO's current system. After the Lake project is completed, the book value of the Lake assets is expected to be approximately \*\*\_\_\_\_\_\*\* of SNGMO's net plant in service. The \$100 million of collateralized debt would represent approximately \*\*\_\_\_\_\_\*\* of SNGMO's net plant in service after the Lake project is completed.

### **RECOMMENDED CONDITIONS:**

Staff recommends that this Application be approved with the following conditions:

1. That nothing in this Memorandum or the Commission's order shall be considered a finding by the Commission of the value of this transaction for rate making purposes, which includes, but is not limited to the capital structure, and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions and their effect on cost of capital, in any later proceeding.
2. That the Company file with the Commission all final terms and conditions of the proposed secured debt.

**NP**

3. That all future funds acquired through the collateralization of Summit Natural Gas of Missouri's utility properties shall be used exclusively for the benefit of its Missouri utility properties, which shall not include a distribution to IIF.
4. That the amount authorized for purposes of the requested lien or encumbrance shall be limited to \$100,000,000.

**SCHEDULE 1**

**HAS BEEN DEEMED**

**HIGHLY CONFIDENTIAL**

**IN ITS ENTIRETY**



**BEFORE THE PUBLIC SERVICE COMMISSION**

In the Matter of the Application of Summit )  
 Natural Gas of Missouri Inc., for Authority ) Case No. GF-2013-0261  
 to Issue up to and including \$100,000,000 of )  
 long-term indebtedness. )

## AFFIDAVIT OF DAVID MURRAY

STATE OF MISSOURI                    )  
  )                    SS.  
COUNTY OF COLE                    )

David Murray, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Recommendation in memorandum form, to be presented in the above case; that the information in the Staff Recommendation was developed by him; that he has knowledge of the matters set forth in such Staff Recommendation; and that such matters are true and correct to the best of his knowledge and belief.

  
David Murray

Subscribed and sworn to before me this 18th day of December, 2012.

Dianna L. Vaughn  
Notary Public

