

MEMORANDUM

TO: Missouri Public Service Commission Official Case File, Case Nos. GA-2006-0561, Ozark Energy Partners, LLC; GA-2007-0168, Tariff No. YG-2008-0725, Southern Missouri Gas Company, L.P. d/b/a Southern Missouri Natural Gas

FROM: Thomas M. Imhoff, Energy Department - Tariffs/Rate Design
Mike Straub, Procurement Analysis Department
David Murray, Financial Analysis Department

/s/ Thomas M. Imhoff 6/18/2008 /s/ Lera L. Shemwell 6/18/2008
Energy Department/Date General Counsel's Office/Date

SUBJECT: Staff's Compliance Recommendation On Southern Missouri Gas Company d/b/a Southern Missouri Natural Gas' Application For A Certificate Of Convenience And Necessity, in Case No. GA-2007-0168, Tariff No. YG-2008-0561 and Ozark Energy Partners Application in Case No. GA-2006-0561

DATE: June 18, 2008

Introduction

This memorandum contains Missouri Public Service Commission (Commission) Staff's (Staff) recommendations for the two interrelated cases listed above and will be filed in both cases.

On June 30, 2006, Ozark Energy Partners (OEP) filed its Application for a Certificate of Convenience and Necessity (CCN) to serve the Branson area. On October 26, 2006, Alliance Gas Energy (AGE) also filed its Application for a CCN to serve a similar area around Branson. On June 29, 2007, Southern Missouri Gas Company, L.P. d/b/a Southern Missouri Natural Gas Company (SMNG) and AGE filed a Motion to substitute SMNG for AGE as the party requesting the CCN in Case No. GA-2007-0168. On July 11, 2007, the Commission granted that Motion. On July 20, 2007, SMNG advised the Commission that they would "step in the shoes" of AGE and become the applicant to serve the Branson area.

SMNG also filed an Application for a CCN to serve additional areas. In Case No. GA-2007-0212, SMNG applied for a CCN to expand its service area to include Lebanon, Houston, and Licking. The Staff recommendation on that Application will be made separately. On December 12, 2006, in Case No. GF-2007-0215, SMNG applied for approval of financing for "...working capital, capital expenditures and other lawful corporate purposes, including the proposed expansion of its service area to include Lebanon, Missouri, and other communities within Applicant's existing service area." On September 24, 2007, SMNG filed its First Amended Application to state the intended use of funds are for "...working capital, capital expenditures and other lawful corporate purposes,

including the proposed expansion of its service area to include Lebanon, Houston, Licking, Branson, Hollister and Branson West..." On April 17, 2008, the Commission issued an Order Approving Financing in Case No. GF-2007-0215 which provides for the financing of SMNG's expansion into the requested service areas in addition to other purposes identified in the finance case.

Recommendations

Financing:

In Case No. GF-2007-0215, Staff recommended the Commission approve SMNG's financing application subject to several conditions. Condition No. 2 of Staff's recommendation required SMNG to file all final terms and conditions of the proposed financing. On June 12, 2008, SMNG filed the final terms and conditions of the proposed financing of its planned expansion into both Lebanon and Branson. Staff has reviewed the final terms and conditions and finds them to be consistent with the summary of the proposed terms and conditions Staff reviewed before recommending conditional approval of SMNG's finance application. The proposed structure of the financing is also consistent with Staff's required Condition Nos. 5 and 6, which required that the debt and equity investor shall be the entity identified in the Second Amended Financing Application and that as long as this entity was the noteholder of the proposed debt instrument, it would also continue to hold the majority equity interest.

Staff notes that, although the filed terms and conditions appear to be final, SMNG has notified Staff it has not closed on the proposed financing. According to Condition 13.d. of Case No. GA-2006-0561, which was incorporated into the Report and Order in Case No. GA-2007-0168, "[SMNG] shall 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." Consequently, after the closing and final execution of the financing proposed in Case No. GF-2007-0215, to satisfy the requirement in the GA-2007-0168 case, SMNG should provide the final executed loan documents to Staff. If any of these documents contain material changes, Staff will notify the Commission.

Reporting Requirements:

In accordance with the Commission Report & Order in Case No GA-2007-0168, SMNG accepted the non-disposition accounting-related conditions similar to those recommended in the Stipulation and Agreement between OEP and Staff in Case No. GA-2006-0561. Those items listed in Section III. M, Reliability and Natural Gas Planning, and Section III. N, Hedging, are due to Staff and Public Counsel no later than 60 days prior to SMNG flowing any natural gas in the expanded service area. Subsequent reporting requirements are also contained in Sections M and N of the above referenced Stipulation and Agreement.

Feasibility:

Staff has reviewed the Feasibility Study filed by SMNG to provide natural gas service in the requested service area and is of the opinion the proposal is economically feasible if key assumptions like the future costs of natural gas, the future costs of propane, the construction of the distribution

system, and the conversion rate for existing propane customers are correct. Staff also is of the opinion, however, that expansion to the Branson area contains significant economic risks due to the feasibility study's key assumptions. All utilities, even well established utilities, face economic risks so the existence of economic risks should not be the sole criterion on which to determine economic feasibility. Staff maintains that SMNG's ability to obtain financing to proceed with the project is a reasonable criterion for assessing economical feasibility and, therefore, Staff is able to recommend the Commission make a finding that the Company's request to provide natural gas service in the requested service area is economically feasible.

Additionally, SMNG has testified that SMNG is willing to bear the financial risk of the viability and the feasibility of this project. In its agreement to accept the conditions (except the disposition accounting condition) in the Non-Unanimous Stipulation and Agreement between OEP and Staff, filed in Case No. GA-2006-0561, SMNG has accepted the risk in future rate cases of the economic consequences of any failure of this system to achieve forecasted conversion rates and/or its inability to successfully compete with propane.

Tariffs:

On June 5, 2008, SMNG filed revised tariff sheets with a proposed effective date of July 5, 2008, for the purpose of complying with the Commission's Report and Order issued on February 5, 2008. These tariff sheets contain maps showing the Commission approved service area, metes and bounds descriptions, and other applicable tariff provisions necessary to provide natural gas service by SMNG in the expanded service area. The Staff has reviewed each of the tariff sheets, as filed by SMNG on June 5, 2008, and is of the opinion that these sheets are in compliance with the Commission's Order. However, Staff notes that SMNG has not submitted any franchise agreement for the city of Branson West. Staff recommends that the Commission may not issue SMNG a CCN to serve Branson West until SMNG has secured a franchise agreement from Branson West and filed it with the Commission.

OEP's CCN:

Case No. GA-2006-0561 was OEP's CCN request to serve natural gas in the Branson area. OEP was also granted a conditional CCN by the Commission. OEP is no longer requesting a CCN. Therefore, Staff recommends the Commission cancel the conditional CCN granted to OEP and reject its pending application in GA-2006-0561.

Miscellaneous:

The Staff has verified that SMNG has filed its annual report and is not delinquent on any assessment. Other than the cases referenced in this recommendation, Staff is not aware of any other matters before the Commission other than those indicated in this filing that are affected by this filing.

Summary

Staff recommends the Commission find the following:

1. The final terms and conditions of SMNG's financing proposal are consistent with the summary of the proposed terms and conditions Staff reviewed before recommending conditional approval of SMNG's finance application;
2. After the closing and final execution of the financing proposed in Case No. GF-2007-0215, to satisfy the requirement in the GA-2007-0168 case, SMNG shall provide the final executed loan documents to Staff;
3. SMNG accepted and shall comply with all conditions recommended in the Stipulation and Agreement between OEP and Staff in Case No. GA-2006-0561 except the disposition-related accounting item (III.A.3). Those items listed in Section III. M, Reliability and Natural Gas Planning, and Section III. N, Hedging, shall be provided to Staff and Public Counsel no later than 60 days prior to SMNG flowing any natural gas in the expanded service area;
4. The Company's request to provide natural gas service in the requested service area is economically feasible;
5. The conditional CCN granted to OEP is canceled and its pending application in GA-2006-0561 is rejected;
6. Deny SMNG a CCN to serve Branson West because SMNG has not secured a franchise agreement from Branson West;
7. SMNG has accepted and shall bear the economic consequences of any failure of this system to achieve forecasted conversion rates and/or its inability to successfully compete with propane;
8. Grant SMNG a full CCN to serve its requested service area as modified in Case No. GA-2007-0168, and;
9. Approve the following tariff sheets filed on June 5, 2008, to become effective on July 5, 2008:

P.S.C. MO No. 1

Original Sheet No. xi

Original Sheet No. xii

Original Sheet No. v.1

Original Sheet No. v.2

Original Sheet No. v.3

1st revised Sheet No. 4 Cancelling Original Sheet No. 4

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE 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-2006-0561
GA-2007-0168

AFFIDAVIT OF THOMAS M. IMHOFF

STATE OF MISSOURI)
) ss:
COUNTY OF COLE)

Thomas M. Imhoff, employee of the Missouri Public Service Commission, being of lawful age and after being duly sworn, states that he has participated in preparing the accompanying Staff Memorandum, and that the facts therein are true and correct to the best of his knowledge and belief.




THOMAS M. IMHOFF

Subscribed and affirmed before me this 18th day of June, 2008.



DAWN L. HAKE
My Commission Expires
March 16, 2009
Cole County
Commission #05407843



NOTARY PUBLIC

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

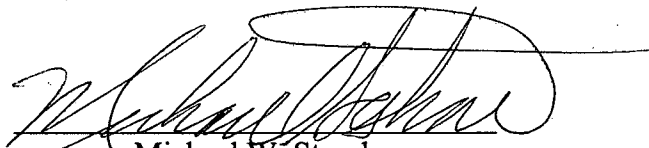
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Case No. GA-2006-0561
GA-2007-0168

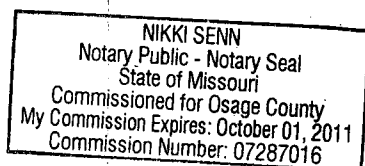
AFFIDAVIT OF MICHAEL W. STRAUB

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

Michael W. Straub, employee of the Missouri Public Service Commission, being of lawful age, and after being duly sworn, states that he has participated in the preparation of the foregoing Staff Recommendation and that the facts therein are true and correct to the best of his knowledge and belief.


Michael W. Straub

Subscribed and sworn to before me this 18th day of June, 2008.




Notary Public

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE 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)
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Missouri.)

Case No. GA-2006-0561
GA-2007-0168

AFFIDAVIT OF DAVID MURRAY

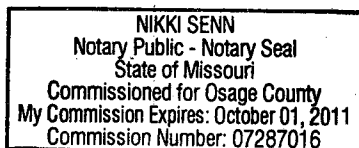
STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

David Murray, employee of the Missouri Public Service Commission, being of lawful age, and after being duly sworn, states that he has participated in the preparation of the foregoing Financing section of the Staff Recommendation and that the facts therein are true and correct to the best of his knowledge and belief.



David Murray

Subscribed and sworn to before me this 18th day of June, 2008.





Notary Public