

**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,)	Case No. GA-2007-0168
Install, Own, Operate, Control, Manage)	
and Maintain a Natural Gas Distribution)	
System to Provide Gas Service in)	
Branson, Branson West, Reeds Spring,)	
and Hollister, Missouri.)	

BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

A. Introduction and Summary

The Office of the Public Counsel does not support approval of the Southern Missouri Gas Company, L.P. d/b/a Southern Missouri Natural Gas (SMNG) application for a certificate of public convenience and necessity (CCN), primarily because SMNG refuses to accept a condition that would protect ratepayers should SMNG's expansion prove to be economically unfeasible. SMNG has also not satisfied its burden of proof showing that the expansion is economically feasible. Lastly, the proposed \$0.20 per Ccf surcharge to recover the cost of the lateral pipeline is not a lawful rate increase.

The communities of Branson, Branson West, and Hollister (collectively "Branson area") could potentially benefit from the expansion of natural gas. However, the analysis does not end at the benefit to that area alone. Utility companies wishing to expand their service territory into a new community must first prove the granting of a CCN is "necessary and convenient for the public service" as required by §393.170 RSMo 2000. In SMNG's recent CCN request for the cities of Lebanon, Houston and Licking, the

Commission reiterated that “necessary” means the expansion “would be an improvement that justifies its costs.”¹ SMNG has not met its burden of proving that the plan to serve the Branson area would justify its costs because evidence received during the hearing shows that SMNG’s feasibility study that SMNG contains unreliable cost estimates. More importantly, consumers could be harmed because SMNG refused to accept Staff’s condition that requires SMNG to pay for any economic harm due to system overbuild. SMNG’s refusal to agree to this important condition should be considered when answering the question of whether this proposal is an improvement justified by the costs to consumers. An unreliable study based on unreliable cost estimates is not competent and substantial evidence on which to base a determination that it is “necessary.”

SMNG has also not met its burden of proof showing that the proposed \$0.20 per Ccf surcharge to recover the cost of the lateral pipeline is a lawful rate increase. Rates must be just, reasonable, and lawful; the courts review PSC decisions to determine if the decisions are reasonable and lawful. § 386.510 RSMo. The addition of the surcharge does not consider all relevant factors, and, therefore, would constitute single issue ratemaking. No evidence or explanation on the record shows why this surcharge would not constitute single-issue ratemaking. SMNG’s surcharge is proposed outside of a rate increase case wherein the Commission considers all relevant factors. The Commission may not authorize a rate that results from a single issue rate-making.

If the Commission determines that SMNG should be granted a CCN to serve the Branson area, the customers should be insulated from the harm of overbuilding. The

¹ 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

most meaningful public protection is for the Commission to require SMNG to hold customers harmless from any negative economical consequences of SMNG's feasibility estimates. This can be accomplished in part by ensuring that ratepayers do not pay the cost of overbuilding the system. (Tr. 293). The only proposal to accomplish this goal is the Staff's proposed condition to require any below cost acquisitions of SMNG's system to be reflected at the purchase price rather than at the net original cost of the assets. Public Counsel urges the Commission to order this condition as part of any CCN the Commission grants.

B. Argument

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?

SMNG should not be awarded a CCN to serve the Branson area. The Commission outlined the requirements for determining whether to grant a certificate of convenience and necessity in Case No. GA-2007-0212.² The Commission stated that a CCN requires: 1) a need for public natural gas service; 2) a qualified applicant; 3) a financially able applicant; 4) an economically feasible proposal; and 5) that the proposed service is in the public interest. Sub issues (a) through (e) below address each requirement and explain why SMNG has not met its burden of proof that all requirements have been met.

a. Is there a public need for natural gas service?

The Mayor of the City of Branson, Ms. Reanne Presley, testified that natural gas service in Branson would benefit citizens and developers alike by offering a new choice

provide gas service in Lebanon, Missouri, Case No. GA-2007-0212, *Report and Order*, August 16, 2007.

in utility service. (Tr. 136). Ms. Presley also testified that natural gas could encourage more industry to locate in the Branson area. (Tr. 139). The “public need” analysis, however, must also determine whether expansion into Branson “would be an improvement that justifies its costs.” State ex rel. Intercon Gas, Inc. v. P.S.C., 848 S.W.2d 593, 597 (Mo. App., W.D. 1993); State ex rel. Beaufort Transfer Co. v. Clark, 504 S.W.2d 216, 219 (Mo. App. 1973). The feasibility study submitted by SMNG does not provide a reliable estimate of the costs of the project and, therefore, fails to satisfy SMNG’s burden of proof that the natural gas expansion project justifies its costs. The evidence discussed below shows that many of SMNG’s estimates do not accurately reflect a reliable feasibility analysis. If true, the costs required to build this risky system in bedrock will far exceed SMNG’s understated cost estimates. SMNG has not adduced competent and substantial evidence that shows that the study is true, accurate and correct and worthy of reliability. § 536.070(11). It has not come forward with evidence that satisfies its burden of proof to show that the improvement will justify its costs. Therefore, it has not proven the proposal is necessary

b. Is SMNG qualified to provide the proposed service?

SMNG generally appears technically qualified to provide natural gas services, but SMNG is a relatively new utility company with little history. Public Counsel and the Staff raised recent concerns with SMNG’s qualifications to provide gas services involving SMNG’s ability to effectively hedge gas purchases.³ These hedging concerns have hopefully been resolved through Commission-approved stipulations with SMNG.

² *Report and Order*, Case No. GA-2007-0212, August 16, 2007.

³ *See* Case No. GC-2006-0180, Office of the Public Counsel v. Southern Missouri Gas Company, L.P.; and Case No. GR-2006-0352, In the Matter of Southern Missouri Natural Gas Company,

The Commission's Staff also filed a complaint against SMNG after the company failed to hire an experienced general manager to operate SMNG's distribution system.⁴ These prior cases should persuade the Commission to proceed with caution when evaluating the applicant's qualifications and deciding whether SMNG is qualified to effectively operate the proposed natural gas distribution system.

Public Counsel's main concern with SMNG's qualifications to serve the Branson area is whether SMNG has the experience to successfully expand at the rapid rate SMNG proposes. MGE, which has a foothold in areas near the Branson area, has for whatever reason chosen not to attempt an expansion into the Branson area. The Staff raised concerns about the ability of such a start-up expansion to succeed. Public Counsel concurs with that concern and adds that those concerns should be factored into the decision of whether SMNG's decision-makers have the necessary qualifications

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

SMNG has a pending application for financing in Case No. GF-2007-0215.⁵ Obviously, if the Commission denies SMNG's financing, SMNG will not satisfy this requirement. At this time, Public Counsel has not had a sufficient opportunity to analyze SMNG's Second Amended Financing Application that was recently filed on December 17, 2007 in Case No. GF-2007-0215. However, without reliable feasibility estimates, it is premature to determine whether SMNG has the financial ability to provide the proposed service.

L.P.'s Purchased Gas Adjustment (PGA) Factors to be Reviewed in Its 2005-2006 Actual Cost Adjustment.

⁴ See Case No. GC-2006-0182.

⁵ In the Matter of the Application of Southern Missouri Gas Company, L.P., d/b/a Southern Missouri Natural Gas, for Authority to Issue approximately \$10 Million in Equity Capital and Approximately \$50 Million In Notes and Other Forms of Indebtedness.

d. Is SMNG's proposed service economically feasible?

Public Counsel questions whether SMNG has adduced sufficient competent and substantial evidence to meet its burden of proof that its proposal to serve these communities is economically feasible. Since SMNG is a fairly new utility, the Commission should give heightened scrutiny to the company's rapid expansion proposal. SMNG runs a serious risk of overextending its distribution system in a short period of time, which could prove to be harmful to SMNG's new and existing customers. These inherent risks require a careful analysis of SMNG's feasibility study. Because the feasibility study does not provide reliable data, SMNG has not introduced proper evidence on the "necessity" requirement and, therefore, has failed to carry its burden of proof.

The most extensive criticism of SMNG's feasibility study came from Ozark Energy's witness Mr. Steven Cattron, former President and CEO of Missouri Gas Energy, and former Vice President of Kansas City Power & Light. (Tr. 314). In his positions with MGE and KCPL, Mr. Cattron was involved with strategic business planning, strategic acquisitions, and evaluating economic feasibility. (Tr. 315). Mr. Cattron testified that SMNG's historical average cost for the period of 2002 through 2006 as reported in SMNG's annual reports filed with the Commission is significantly different than the average cost SMNG used in its feasibility study. (Exhibit 14 (HC), Tr. 338). This results in an unreliable capital requirement in SMNG's feasibility study. (Tr. 342). Mr. Cattron also testified that the electric conversion estimates used by SMNG in its feasibility study are "completely unreasonable." (Tr. 351). Converting a consumer is difficult once they make the capital decision to invest in a particular type of heating

equipment, and SMNG's feasibility study relies heavily on these conversions. (Tr. 351). Lastly, Mr. Cattron testified that SMNG's gross margin estimates from its feasibility study are "significantly out of line" with typical gross margin rates. (Exhibit 21(HC), Tr. 357-360). Mr. Cattron's testimony raises questions that remain unanswered as to the reasonableness of SMNG's feasibility estimates.

For additional questions about SMNG's proposal, the Commission should look to Commissioner Clayton's dissenting comments in the Lebanon CCN case, Case No. GA-2007-0212:

[T]he size and market position of [SMNG] do not suggest it is the most appropriate company for this type of expansion. The company only recently entered certain markets of southwest Missouri including the counties of Wright, Texas, Howell, Webster, and Greene and the communities of Willow Springs by purchasing Tartan Energy Company L.L.C. It is among the smallest utilities in the state. It does not have large economies of scale to offer its customers, and its systems are spread over 130 miles, among twelve communities. **This project is not simply an expansion of an existing plant but a venture into new, uncharted territory.**⁶ [emphasis added].

These same concerns should heighten the Commission's scrutiny in considering SMNG's application for Branson and whether SMNG has demonstrated that the expansion proposal is feasible. Commissioner Clayton's dissent further commented on SMNG:

[T]his Commission is faced with a question of allowing a utility to expand into a new service territory with significant capital requirements and risk. In the short time period the company has been doing business in Missouri, Office of Public Counsel has filed a complaint against the company for improper or imprudent gas purchasing practices, the Commission has demanded improvements to protect its customers from improperly paying higher rates and, now, Staff allegedly has found new problems in the PGA/ACA review for further company-threatening adjustments. **The company is requesting a leap of faith from the Commission for a potentially risky investment, and it has simply not carried its burden.**⁷ [emphasis added].

⁶ The Dissenting Opinion of Commissioner Robert M. Clayton III, Case No. GA-2007-0212, October 3, 2007, pp. 2-3.

⁷ *Id.* at pp. 4-5.

In the present case, SMNG is requesting a larger leap of faith from the Commission when it requests an order which would essentially endorse the feasibility study submitted by SMNG. Since the overwhelming weight of the evidence shows that the feasibility study is highly suspect and not based on accurate data according to Mr. Cattron's expert testimony, SMNG has not carried its burden of proof that its proposal is feasible.

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

As the Commission is well aware, the Commission's foremost responsibility is to protect the public. The protection given the utility is incidental. State ex rel. Crown Coach Company v. P.S.C., 179 S.W.2d 123 (Mo.App. 1944); State ex rel. Electric Company of Missouri v. Atkinson, 204 S.W. 897 (Mo. 1918). It is not in the public interest to allow a utility company to expand into a new area until the utility can prove that its proposal is necessary, is economically feasible, and that the utility has the qualifications and financial ability to provide the service. SMNG has not produced competent and substantial evidence that satisfies these requirements. And without the conditional language proposed by the Staff to protect consumers from the high economic failure risk, the public interest will not be served by granting the CCN application.

i. SMNG's Proposed \$0.20 per Ccf Surcharge

SMNG's request also includes a proposal to levy a \$0.20 per Ccf surcharge on Branson area customers to pay the cost of the lateral gas pipeline. SMNG proposes this surcharge on top of SMNG's existing approved rates and regulations for natural gas service. The rates in SMNG's current tariff were based on an analysis of the expenses and revenues of SMNG. The addition of the surcharge does not consider all relevant factors, and, therefore, would constitute single issue ratemaking. "The rationale behind

the single-issue ratemaking prohibition is to prevent the Commission from allowing a utility to raise rates to cover increased costs in one area without realizing there were counterbalancing savings in another area." State ex rel. Sprint Spectrum L.P. v. PSC, 112 S.W.3d 20 (Mo.App W.D. 2003). Staff testimony shows that the Staff does not know if SMNG's existing rates are cost-based; the Staff has not done a full review of SMNG's rates since 2000. (Tr. 297-298).

SMNG's proposed \$0.20 per Ccf surcharge also raises unanswered questions of district-specific pricing. District-specific pricing is addressed by §393.130.3 RSMo 2000, which states:

No gas corporation, electrical corporation, water corporation or sewer corporation shall make or grant any undue or unreasonable preference or advantage to any person, corporation or locality, or to any particular description of service in any respect whatsoever, or subject any particular person, corporation or locality or any particular description of service to any undue or unreasonable prejudice or disadvantage in any respect whatsoever.

There has been no evidence or analysis provided to explain whether the circumstances of this case warrant district-specific prices.

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?

Public Counsel asks the Commission to outright reject the Application. However, if the Commission determines that it will grant SMNG a CCN, Public Counsel asks the Commission to protect consumers by mandating the following conditions for approval of the CCN.

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.

The Staff proposed this condition to protect consumers in the event SMNG's feasibility estimates are incorrect. It places the risk of SMNG's proposal being uneconomical and unfeasible squarely on the shoulders of the investors. This condition is to "provide meaningful protection of customer interests" and "meaningful assumption of all economic risk by the shareholders." (Tr. 269-270). Staff witness Mr. Mark Oligschlaeger explained that "new gas systems may be overbuilt and reflect uneconomic levels of plant." In these situations, the net original cost concept of ratemaking is no longer applicable and "should not be used in the rate process." (Tr. 270). Instead, "when ownership passes to a new owner...the presumed rate valuation of the assets should be based on the new purchase price." (Tr. 270). This would simply put the burden on the owner to propose adjustments to that purchase price if the new owner wanted the plant assets valued in a different manner for rate purposes. (Tr. 271).

Mr. Oligschlaeger testified that using net original cost is appropriate for plant assets in a normal ratemaking environment. (Tr. 275). However, past history and the Staff's experience is that a normal regulatory environment cannot exist in this situation because cost based rates may not be possible. (Tr. 275). The Staff testified that their experience with startup gas companies is that they struggle economically, largely because

the initial level of customers was overestimated, or their predicted ability to compete with propane or electric was overestimated. (Tr. 276). In these situations the plant systems were “overbuilt and uneconomic as a result.” (Tr. 276). Mr. Oligschlaeger testified that often these systems are overbuilt in relation to the actual number of customers served. (Tr. 293). In SMNG’s case, SMNG is tackling a huge endeavor with huge capital expenditures, and the consequences of failure deserve greater protections. (Tr. 280). And considering the problems with the accuracy of SMNG’s customer predictions and conversion estimates, there are legitimate concerns that SMNG’s predictions are overestimated. Adding to this concern is Mr. Oligschlaeger’s testimony that the rates for the properties *now operated* by SMNG are also not sufficient to fully recover their net original cost. (Tr. 298).

The Commission has approved similar customer protection conditions in the past. (Tr. 272-273) AmerenUE has recorded the acquisition purchase price rather than net original cost, and Missouri Gas Utility has recorded the acquisition price of purchasing municipal systems instead of the cost reflected in the municipality’s books. (Tr. 274). Staff witness Mr. Oligschlaeger testified that the Commission should have added this condition to the CCN for Lebanon, Houston and Licking. (Tr. 296). Perhaps due to the lower level of risk associated with the Lebanon expansion, the Staff did not specifically propose this condition to the CCN. Regardless, it is the Staff’s “intent to make this a consistent recommendation in gas CCN startup cases.” (Tr. 296). Mr. Oligschlaeger testified that the Staff is not changing a policy, but is simply changing a methodology that the Staff intends to recommend when there is a risk of failure in a company’s ability to charge cost-based rates. (Tr. 296, 302).

This condition “would apply only if Southern Missouri is not in a position to charge cost-based rates.” (Tr. 286). In that situation, “there is no reason for the normal presumption that the net original cost should be the basis for either accounting or for rate purposes, and this condition reflects that belief.” (Tr. 289). The condition would also notify future buyers of SMNG’s system that the “economic risk is being assumed by the company.” (Tr. 286)

SMNG’s witness Mr. Maffett testified that SMNG’s shareholders should bear the financial risk if the expansion proposal does not succeed. (Tr. 87). Despite Mr. Maffett’s testimony, there is no meaningful “agreement on how that concept should be practically applied in future situations.” (Tr. 276). The Staff’s recommended condition provides that practical application and ensures consumers will be partly protected from the economic failure of SMNG’s expansion plans, beyond just a simple statement by SMNG that it should assume responsibility. SMNG contradicts itself when it agrees to assume the financial risk of a failed expansion plan, yet balks at the only proposal to execute that agreement.

The Commission expressed its concern for the ratepayer impacts of unsound feasibility estimates in SMNG’s Lebanon, Houston and Licking application, Case No. GA-2007-0212. The Commission stated in its Report and Order:

The Commission further determines that if acceptable financing can be obtained without excessive risk to the current ratepayers, the grant of certificates is in the public interest. Thus, the Commission determines it is reasonable and necessary to place certain conditions on the grant of the requested certificate. As proposed by Staff and Public Counsel, the certificates of convenience and necessity will be conditioned on Southern Missouri Gas obtaining financing which is approved by the Commission, and on the shareholders, rather than the ratepayers, being deemed responsible for the detrimental effects of a loss resulting from inaccurate estimations of customer conversion or usage rates.

Unfortunately, the parties in the Lebanon expansion case did not explain to the Commission exactly *how* SMNG's shareholders, rather than ratepayers, are to be held responsible for the detrimental effects of a loss resulting from inaccurate estimations of customer conversion or usage rates. The proposed condition in the present case clarifies how that will be accomplished by helping to ensure consumers will not be left holding the bag for the poor investment decisions of SMNG. If SMNG's feasibility estimates prove to be inaccurate and SMNG executes its exit strategy to sell the company's assets, consumers would be protected against paying for the overbuild costs.

b. Should the Commission adopt similar conditions to those recommended in the Stipulation and Agreement between OEP and Staff filed in Case No. GA-2006-0561 on November 8, 2007?

There are many conditions in the Stipulation and Agreement between Ozark Energy and Staff. For the reasons discussed earlier in this brief, along with the caveats discussed, Public Counsel supports the following financial conditions from the GA-2006-0561 Stipulation:

- 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.
- 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.
- 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.

Public Counsel does not support the condition that would allow SMNG to serve the Branson area once the listed conditions are met, because those conditions do not include the submission and approval of a more reliable feasibility study.

3. Conclusion

Bringing natural gas to new areas of the state can provide public benefits where the plan for such an expansion is economically feasible. The utility proposing expansion has the burden to prove the plan's feasibility, and if expansion is not supported by competent and substantial evidence, the requested CCN must be denied. Public Counsel would like to see the Branson area benefit from natural gas service, but the evidence in this case does not support the grant of a CCN. Branson area consumers deserve a reliable plan and appropriate economic protections. For the reasons stated in this brief, Public Counsel requests that the Commission deny SMNG a CCN to serve the Branson area.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

By: /s/ Marc D. Poston

Marc D. Poston (#45722)

Senior Public Counsel

P. O. Box 2230

Jefferson City MO 65102

(573) 751-5558

(573) 751-5562 FAX

marc.poston@ded.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to the following this 4th day of January, 2008:

General Counsel Office
Missouri Public Service
Commission
200 Madison Street, Suite 800
P.O. Box 360
Jefferson City, MO 65102
GenCounsel@psc.mo.gov

Mills Lewis
Office Of Public Counsel
200 Madison Street, Suite 650
P.O. Box 2230
Jefferson City, MO 65102
opcservice@ded.mo.gov

Shemwell Lera
Missouri Public Service
Commission
200 Madison Street, Suite 800
P.O. Box 360
Jefferson City, MO 65102
Lera.Shemwell@psc.mo.gov

Cooper L Dean
Missouri Gas Energy
312 East Capitol
P.O. Box 456
Jefferson City, MO 65102
dcooper@brydonlaw.com

Duffy W Gary
Missouri Gas Energy
312 East Capitol
P.O. Box 456
Jefferson City, MO 65102
duffy@brydonlaw.com

Young Mary Ann
Ozark Energy Partners, LLC
2031 Tower Drive
P.O. Box 104595
Jefferson City, MO 65110-4595
myoung@wdspsc.com

Steinmeier D William
Ozark Energy Partners, LLC
2031 Tower Drive
P.O. Box 104595
Jefferson City, MO 65110-4595
wds@wdspsc.com

Fischer M James
Southern Missouri Natural Gas
101 Madison Street--Suite 400
Jefferson City, MO 65101
jfischerpc@aol.com

Davenport Aimee
Southern Star Central Gas
Pipeline
314 East High Street
Jefferson City, MO 65101
adavenport@lathropgage.com

DeFord S Paul
Southern Star Central Gas
Pipeline
2345 Grand Blvd
Suite 2800
Kansas City, MO 64108-2684
pdeford@lathropgage.com

/s/ Marc Poston
