MEMORANDUM

TO: Missouri Public Service Commission
Official Case File Case No. GF-2010-0334
Missouri Gas Utility, Inc.

FROM: Shana Atkinson, Financial Analysis Department

/s/ Shana Atkinson 08/31/10	/s/ Jennifer Hernandez 8/31/10
Project Coordinator / Date	General Counsel's Office / Date

SUBJECT: Staff Recommendation to conditionally approve the Application of Missouri Gas Utility, Inc. for authority to issue up to and including an aggregate of $26.4 million in some combination of (1) revenue bonds under the terms of a Loan Agreement with Summit Utilities, Inc., and related debt instruments and (2) a term loan from CoBank, ACB, all such indebtedness to be secured by a mortgage, lien and encumbrance.

DATE: August 31, 2010

1. (a) **Type of Issue:** (i) one or more loan agreements by and between Missouri Gas Utility, Inc. (MGU or Company), Summit Utilities, Inc., (Summit), UMB Bank, N.A., (UMB) and/or CoBank ACB, (CoBank); (ii) one or more reimbursement agreements, which includes an $2,000,000 line of credit to be made available to MGU by UMB Bank-Colorado, N.A.(UMB-Colorado); (iii) one or more notes, loan agreements and a mortgage or deed of trust from MGU to UMB, UMB-Colorado and/or CoBank; (iv) a trust agreement by and between Summit, MGU and The Bank of New York, Mellon, N.A; and (v) and one or more general security agreements by and between MGU and UMB; UMB-Colorado and CoBank.

   (b) **Amount:** Up to $26.4 million.

   (c) **Rate:** * * The interest rate on the revenue bonds will be variable based on a margin over LIBOR.

2. **Proposed Date of Transaction:** During the course of calendar years 2010 through 2012.

3. (a) **Statement of Purpose of the Transaction:** The Applicant proposes to use the proceeds obtained through its loan agreements with Summit and/or CoBank to provide financing for its ongoing Construction Program and other corporate purposes in Missouri. The Construction Program includes expenditures made, or being made, in recent Commission authorized certificated areas in Benton, Morgan, Camden and Miller counties, including the communities of Camdenton,

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Osage Beach and Lake Ozark (Case No. GA-2010-0012) and Greene, Polk and Dallas counties, including the communities of Bolivar and Buffalo (Case No. GA-2010-0189).

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

Yes _X_ No ___

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

___ (a) If such instruments have been previously filed with the Commission, a reference to the Case Number in which the instruments were furnished.

_X_ (b) If such instruments have not been executed at the time of filing, a statement of the general terms and conditions to be contained in the instruments, which are proposed to be executed.

___ (c) If no such instruments are either executed or to be executed, a statement of how the securities are to be sold.

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

Yes _X_ No ____

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

Yes _X_ No ____

7. **Capital expenditure schedule reviewed:**

Yes _X__ No ____

8. **Journal entries required to be filed by the Company to allow for the Fee Schedule to be applied:**

Yes ____No __X_

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9. **Recommendation of the Staff:**

_____ Grant by session order (see Comments)

__X__ Conditional Approval granted pending receipt of definite terms of issuance (see Comments)

____ Require additional and/or revised data before approval can be granted (see Comments)

____ Formal hearing required (see Comments)

____ Recommend dismissal (see Comments)

COMMENTS:

Background: MGU 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. MGU provides natural gas service in the Missouri counties of Harrison, Daviess, Caldwell, Pettis and Benton. Also, MGU has recently been granted certification to expand franchise operations into Morgan, Camden, and Miller counties in central Missouri. On December 18, 2004, the Commission authorized MGU to acquire the natural gas systems in the towns of Gallatin and Hamilton in Case No. GO-2005-0120. MGU is a wholly-owned subsidiary of Summit Utilities, Inc. (f/k/a CNG Holdings, Inc.), a Colorado corporation. To Staff's knowledge, MGU's operations are limited to regulated natural gas distribution operations in Missouri. Summit is a private corporation with many private shareholders. However, one private shareholder, **______________________________ ** of the common equity as of March 31, 2010. ** ______________________________ ** Summit has four wholly-owned subsidiaries: Colorado Natural Gas, Inc. ("CNG"), MGU, 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, and 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.

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MGU's Application requests Commission authority to put a lien on or encumber its Missouri utility assets as part of a transaction which will ultimately involve the issuance of revenue bonds by its parent company, and a term loan from CoBank. Because MGU is not a Missouri corporation, it is not requesting authority to directly issue debt pursuant to Section 393.200, RSMo and 4 CSR 240-3.220 and consequently was not required to file the documents consistent with this law and regulation. 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.

Transaction: MGU is requesting Commission authority to create a lien or encumbrance on its Missouri properties in order to secure payment of up to $26.4 million of possible debt proceeds. $19.2 million of this amount is expected to be used for the Lake of the Ozarks project and the balance, $7.2 million, is expected to be utilized in connection with MGU's expansion of operations into Dallas, Greene and Polk counties. Staff verified that the amounts estimated for purposes of MGU's certificate cases, Case Nos. GA-2010-0189 and GA-2010-0012, in which the Commission authorized certificates of convenience and necessity for these projects, are consistent with the amount of financing requested in this case. Because the amount of financing requested in this case is consistent with the estimated capital needs in the certificate cases, Staff considers the requested amount of financing to be reasonably required and acceptable considering that its use is for the construction of additional natural gas distribution plant in the requested service territories. The financing will be accomplished through the following methods: (1) Summit issues its Revenue Bonds on behalf of MGU and/or (2) MGU enters directly into a Term Loan from CoBank.

The Revenue Bonds will be of the same general type, and issued in the same manner, as was authorized by the Commission in Case Nos. GF-2009-0057 and GF-2009-0331. Staff has attached the diagrams from these cases to its recommendation in order to show how this debt transaction will be structured (Attachment 1).

Revenue Bonds: The Revenue Bonds would be issued by Summit on behalf of MGU and the bond proceeds loaned to MGU pursuant to the terms of an internal loan agreement between Summit and MGU. Each new series of Revenue Bonds shall be issued and sold to investors either by private placement or through an offering exempt from registration. The Revenue Bonds will be secured by a Letter of Credit ("LOC") by a commercial bank having an investment grade rating (the "LOC Bank"). This structure will allow the Revenue Bonds to have the same credit rating as the LOC Bank, which should result in a lower rate of interest than MGU could obtain without the LOC.

Term Loan: MGU may also borrow up to and including $15,000,000 through a long-term, secured credit facility from CoBank. In such an event, MGU would enter into a senior secured term loan facility.

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In MGU's previous finance case, Case No. GF-2009-0331, Staff was concerned about the Company's variable interest rate risk exposure. The variable interest rate volatility creates cash flow risk to MGU and Summit. The variable interest rates were based on a spread over the 30-day LIBOR rate. The average 30-day LIBOR rate as of the seven months ending July 2010 was 0.35 percent, which is very low compared to the 2008 average 30-day LIBOR rate of 2.89 percent. The average 30-day LIBOR rate as of July 2010 is the same rate as the 2009 average 30-day LIBOR rate of 0.35 percent. *

*

(Proprietary) In the past, Summit has been able to mitigate risk due to the interest rate volatility for $29.6 million of bonds issued for its CNG operations by entering into an interest rate collar that effectively limits the high end of the LIBOR rate to 6 percent and the low end to 4.725 percent. The interest rate collar on these bonds expires on March 31, 2011. None of the current MGU debt is subject to the interest rate collar arrangement.

MGU indicated in response to Staff Data Request No. 0003 that the only variable interest rate debt that is hedged by Summit and its subsidiaries is $29.6 million at CNG. Such debt is hedged under an interest rate collar arrangement which will expire in March 31, 2011. CNG is currently pursuing fixed rate financing on its new and existing debt and in so doing, has no plan to renew the existing hedge arrangement. *

* In response to Staff Data Request No. 0005, MGU indicated that the Company has not hedged any debt pursuant to the debt authorized in MGU's most recent finance case, Case No. GF-2009-0331. *

* Summit intends to manage its variable interest rate debt exposure by migrating toward a targeted 50 percent fixed rate component of total debt during 2010, and increasing the percentage of fixed-rate debt thereafter as their variable rate band-backed Letter of Credit arrangements expire.

An advantage of MGU being a part of a holding company is the diversification of risk that may be incurred at any one subsidiary because of market conditions at the time capital is needed. For this reason, Staff believes its analysis of the proposed transaction, and the risks associated with it, should not assume MGU acts as a stand-alone entity because this would ignore the reality of MGU's affiliation with Summit. Unfortunately, due to regulatory issues in connection with financing applications, utility companies usually only provide information on the stand-alone entity as if it existed independently. However, when it comes to investors' evaluation of the risk of investing in a business, these affiliations are of extreme importance to their evaluation. Therefore, if the Staff is to evaluate whether the proposed transaction may be detrimental to the public, it would be irresponsible to ignore these circumstances. Besides, this is how Standard and Poor's (S&P) usually evaluates the creditworthiness of parent companies and their subsidiaries, i.e. on a consolidated basis.

The proposed amount of fixed interest rate debt for MGU should account for about 18 percent of the total consolidated Summit debt ($15 million divided by $83.40 million ($57,002,559 fiscal year end March 31, 2010 Summit debt + $26,400,000 requested)). Summit's consolidated financials would have 67.15 percent of its debt as fixed or hedged, with the proposed fixed interest rate debt at MGU and the hedged CNG debt until the hedge expires March 31, 2011 ($26.4 million plus $29.6 million, divided by $83.4 million). Therefore, when the hedge expires, the majority of Summit's outstanding debt will have variable interest rates. MGU's proposed fixed-rate financing helps mitigate the cash flow risk at MGU. MGU indicated to Staff that Summit does not currently plan on renewing the interest rate collar hedge arrangement because CNG is currently pursuing fixed rate financing on its new and existing debt. If CNG obtains fixed rate financing on its new and existing debt, then this would limit Summit's exposure to cash flow risk due to fluctuations in short-term interest rates. However, if Summit does not fix the interest rate on the CNG debt, then this will expose Summit to significant cash flow risk, which may impact MGU's credit quality.

In the instant case, Staff currently believes MGU's affiliation with Summit is advantageous to its ability to incur the additional leverage associated with the proposed transaction. In fact, Summit is providing a guarantee for debt issued directly by MGU. However, it is also possible that financial and business risk incurred by Summit at its other operations may become detrimental to MGU's ability to attract capital, such as an instance in which Summit decides to no longer hedge its interest rate risk at CNG. Currently, it appears that Summit's current business and financial risk is fairly consistent with that of MGU. Staff confirmed this by reviewing Summit's most recent audited financial statements that provide a description of its operations. However, as is apparent from the Commission's experience with other Missouri utilities, unaffiliated risks incurred by the holding company and/or its other subsidiaries may impact the credit quality being impacted by risks that are not affiliated with the Missouri regulated utilities, this situation can change due to risks incurred by the holding company and its other subsidiaries. Summit's cash flow risk could increase after March 31, 2011, if they choose not to renew the interest rate collar hedge arrangement on the $29.6 million associated with Summit's CNG subsidiary, or if CNG does not obtain direct fixed rate financing.

<u>Pro Forma Financial Impact of Proposed Debt:</u> Schedules 1 and 2 attached to this recommendation show Staff's analysis of the possible impact the proposed financing may have on MGU's and Summit's ability to meet its debt service obligations. The assumptions made for the pro forma impacts are of critical importance in determining the possible impact of the proposed financing on MGU's and Summit's financial condition. For purposes of assessing the possible impact of the proposed transaction, Staff evaluated Summit's and MGU's financial ratios based on the Company projected *

* Based on S&P's benchmarks, Summit has highly leveraged financial risk based on the FFO/Debt and Debt/EBITDA ratios and an aggressive financial risk based on the Debt/Capital ratio for years 2010-2015. MGU has an aggressive financial risk based on the Debt/Capital ratio for years 2010-2015 and FFO/Debt for years 2013 and 2015, a highly leveraged financial risk based on the FFO/Debt ratio for years 2010-2012 and 2014, and Debt/EBITDA ratio for years 2010-2015. Using S&P's matrix as of May 27, 2009, as a guide to credit rating evaluation, Summit's and MGU's credit metrics are consistent with a credit rating in the BB- to BB+ range based on a "Strong" business risk profile. Staff chose a "Strong" business risk profile due to the fact that the company competes in service areas that have ready availability to alternative energy sources.

However, considering that the Company may receive a loan at a rate of * *, it appears that CoBank may be viewing the credit risk of MGU as being fairly low. Staff approximated a 20-year public utility bond yield average for the last three months by taking an average of 10 and 30 year bonds:

BB-	7.39
BB	6.69
BB+	6.14
BBB-	5.57
BBB	5.45

(Reuters Corporate Spreads for Utilities from BondsOnline)

Therefore, the fixed interest rate that the Company is receiving on the term loan seems consistent with that of a BBB rated utility bond.

In the Company's most recent finance case, Case No. GF-2009-0331, Staff's Recommendation was conditioned upon MGU continuing the agreement with Summit whereby Summit commits to be capitalized with no more debt capital as a percentage of total capital, as compared to how it capitalizes MGU. Summit complies with this condition and is expected to continue to do so, based on the debt to capital ratios of the current financial statements and the pro-forma financial statements. Additionally, Staff conditioned its recommended approval on Summit's business risk remaining consistent with its current operations. MGU filed with the Commission both Summit's and MGU's fiscal-year end annual audited financial statements to ensure compliance with this condition. Staff has evaluated this information and believes MGU is in compliance with these conditions.

The recommendation was also conditioned on the Company filing with the Commission a plan for managing its variable interest rate risk exposure in association with the application for financing with the Commission in association with its planned filing for a Certificate of Convenience and Necessity for the Lake of the Ozarks area. if it was filed before January 31, 2011. Therefore, the Company is conditioned to file a plan for managing its variable interest rate risk exposure in this case. The Company provided its plan for managing its variable interest rate risk exposure in response to Staff Data Request 0009:

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Staff believes the Company's plan for managing its variable interest rate risk exposure is reasonable. Summit is actively working towards achieving a 50/50 variable/fixed interest rate split by entering into a fixed interest rate term loan for MGU and * * Staff conditions its recommendation in this case on the Company filing Summit's finalized plans for managing the consolidated variable interest rate risk exposure no later than March 31, 2011, the date CNG's hedge on its debt expires. MGU's pro-forma financial statements show the amount of anticipated equity contributions to MGU. Stockholder's equity for 2010 is $11,446,067, ** **

OTHER ISSUES:

The Staff has verified that the Company has filed its annual report and is not delinquent on any assessment. The Staff's Budget and Fiscal Services Department has reviewed the circumstances in this finance case and because the Company is not a Missouri corporation, the fee schedule, as set forth in Section 386.300 RSMo, 2000, in accordance with 4 CSR 240-3.615(1)(F), does not apply.

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 any information concerning communication with credit rating agencies concerning the proposed financing.

3. That the Company file with the Commission all final terms and conditions of the proposed financing subject to this case, including, but not limited to, the aggregate proceeds received, price information, and estimated expenses.

4. That MGU continue the agreement with Summit Utilities, Inc. whereby Summit commits to :

    (a) be capitalized with no more debt capital as a percentage of total capital, as compared to how it capitalizes MGU and,

    (b) Summit Utilities, Inc.'s business risk shall remain consistent with its current operations.

   The debt to capital ratio shall be as defined in the Reimbursement and Pledge Agreement by and among MGU, Summit and U.S. Bank National Association. MGU shall file with the Commission both Summit's and MGU's fiscal-year end annual audited financial statements to ensure compliance with this condition.

5. That all future funds acquired through issuance of securities under this application shall be used exclusively for the benefit of Missouri Gas Utility, Inc's Missouri regulated operations.

6. That the amount authorized for purposes of the requested lien or encumbrance shall be limited to $26,400,000.

7. That the Company file with the Commission Summit Utilities, Inc.'s finalized plans for managing the consolidated variable interest rate risk exposure no later than March 31, 2011.

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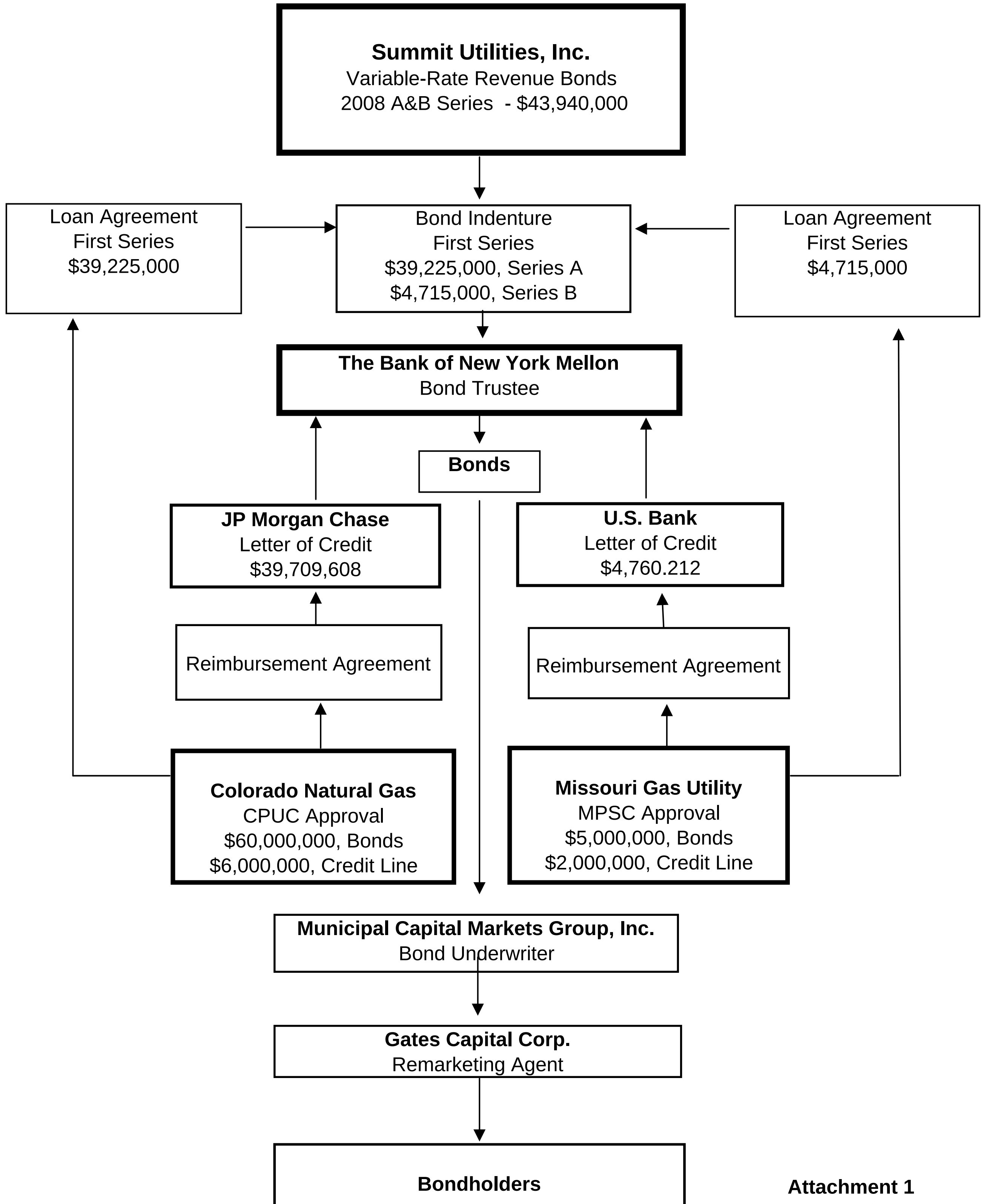

Attachment 1
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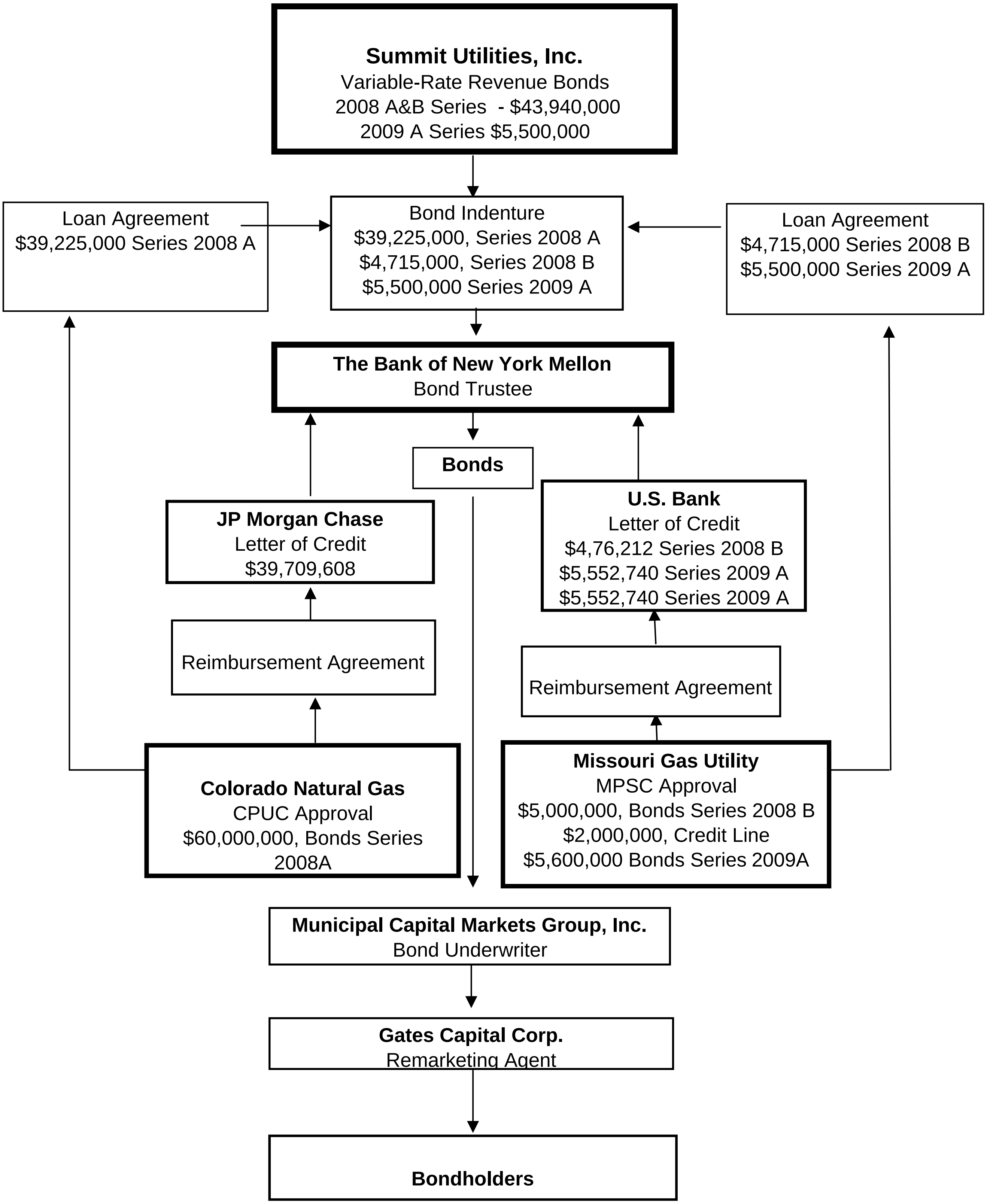
Summit Utilities, Inc.
Variable-Rate Revenue Bonds
2008 A&B Series - $43,940,000
2009 A Series $5,500,000
Loan Agreement
$39,225,000 Series 2008 A
Bond Indenture
$39,225,000, Series 2008 A
$4,715,000, Series 2008 B
$5,500,000 Series 2009 A
Loan Agreement
$4,715,000 Series 2008 B
$5,500,000 Series 2009 A
The Bank of New York Mellon
Bond Trustee
Bonds
JP Morgan Chase
Letter of Credit
$39,709,608
U.S. Bank
Letter of Credit
$4,76,212 Series 2008 B
$5,552,740 Series 2009 A
$5,552,740 Series 2009 A
Reimbursement Agreement
Reimbursement Agreement
Colorado Natural Gas
CPUC Approval
$60,000,000, Bonds Series 2008A
Missouri Gas Utility
MPSC Approval
$5,000,000, Bonds Series 2008 B
$2,000,000, Credit Line
$5,600,000 Bonds Series 2009A
Municipal Capital Markets Group, Inc.
Bond Underwriter
Gates Capital Corp.
Remarketing Agent
Bondholders

SCHEDULE 1

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY

SCHEDULE 2

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Application of Missouri Gas Utility, Inc., for Authority to Enter into certain Debt Instruments and to Issue up to and including $26,400,000 of Long-Term Indebtedness, in one or more Transactions, and to, among other things, Execute and Deliver a Mortgage and Security Agreement to Secure said Indebtedness.	)))))))	Case No. GF-2010-0334

AFFIDAVIT OF SHANA ATKINSON

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Shana Atkinson, of lawful age, on her oath states: that she 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 her; that she has knowledge of the matters set forth in such Staff Recommendation; and that such matters are true and correct to the best of her knowledge and belief.

Shana Atkinson

Shana Atkinson

Subscribed and sworn to before me this 31st day of August, 2010.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 08, 2012
Commission Number: 08412071

D Suzie Mankin

Notary Public