MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GF-2009-0331, Missouri Gas Utility, Inc.

FROM: Shana Atkinson, Financial Analysis Department

/s/ Shana Atkinson 05/13/09	/s/ Bob Berlin 5/13/09
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 $5.5 million of indebtedness through the indirect issuance of variable-interest-rate revenue bonds ("Bonds"), to be secured by a mortgage, lien and encumbrance for up to $5.65 million that includes accrued interest on the Bonds.

DATE: May 13, 2009

1. (a) **Type of Issue:** (i) $5.5 million loan agreement by and between Missouri Gas Utility, Inc. ("MGU") and Summit Utilities, Inc. ("Summit"); (ii) a note and mortgage from MGU to US Bank; (iii) a trust agreement by and between Summit, MGU and The Bank of New York Mellon, N.A.; and (iv) a general security agreement by and between MGU and US Bank.

   (b) **Amount:** Up to $5.5 million.

   (c) **Rate:** The interest rate on the loan shall be variable based on a margin of approximately 100 basis points over 30-day Libor (London interbank offered rate), an additional 12.5 basis points for remarketing of the bonds and an additional 125 basis points for a letter of credit from US Bank.

2. **Proposed Date of Transaction:** During the course of calendar year 2009.

3. (a) **Statement of Purpose of the Transaction:** The Applicant proposes to use the long-term loan proceeds for its ongoing construction program and other corporate purposes. The construction program includes expenditures made, or being made, in recent Commission authorized certificated areas in the communities of Green Ridge, Cole Camp, Lincoln and Warsaw (Case No. GA-2009-0264).

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

   Yes _X_ No

Appendix 1

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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_

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 and Caldwell. 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 (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, 2009. Summit has five wholly-owned subsidiaries: Colorado Natural Gas, Inc. ("CNG"), MGU, Colorado Water Utility, Inc. ("CWU"), Deer Creek Water, LLC ("DCW") and Wolf Creek Energy, LLC ("WCE"). 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. CWU was formed in 2005 and operates a local water distribution system near Parker, Colorado and is currently subject to the jurisdiction of the CPUC. DCW was formed in April 2005 and hold the rights to water sold to CWU. 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.

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 variable-interest-rate revenue bonds by its parent company, Summit. 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

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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 $5.5 million of possible debt proceeds. The request is for a letter of credit (LOC) that will be provided by US Bank in conjunction with variable-interest rate revenue bonds. This letter of credit is a contract between US Bank, MGU and Summit that requires MGU to reimburse US Bank for payments it makes to the bondholders and for Summit to guarantee these payments. This type of arrangement allows the debt to be rated at the same level as the bank, which lowers the cost. In the proposed transaction, US Bank charges an annual fee of 1.25 percent for the letter of credit.

Appendix 1, attached to MGU's Application, provides a diagram of how the transaction will be structured and the role of Summit in the proposed debt transaction.

$5.5 million LOC: The Application states that $5.5 million in bonds will be issued directly by Summit with The Bank of New York Mellon serving as the Bond Trustee. Although the Application requests authority to issue up to $5.5 million in bonds, the lien on MGU's Missouri operating properties for the LOC is for up to $5.65 million due to accrued interest on the Bonds and the LOC fees and costs. The proceeds will then be loaned to MGU by means of the Series 2009A Loan Agreement between Summit and MGU. Interest payments to the bondholders will be made by US Bank which is providing the LOC. This LOC allows Summit the ability to issue the bonds at a cost based on the credit quality of US Bank. It is Staff's understanding that these bonds will be rated by a credit rating agency. Staff will condition its recommended approval of the proposed financing on MGU submitting this rating when it is available. Based on the Reimbursement and Pledge Agreement between MGU, US Bank and Summit, MGU will reimburse US Bank for the payments it makes to the bondholders and also pay an additional fee of 1.25 percent for the LOC. The interest rate charged on the bonds is anticipated to be 100 basis points (1 percent) over the 30-day Libor rate. However, this margin has been variable in the past based on the level of the 30-day Libor rate and concerns about the credit markets. This margin may increase or decrease based on changes in these conditions. The interest rate spreads over Libor that have been incurred on the debt authorized in Case No. GF-2009-0057 have consistently held at approximately 1 percent above Libor during 2009 for both MGU and Summit. The average 30-day Libor rate as of the four months ended April 2009 was .46 percent, which is low compared to the 2008 average 30-day Libor rate of 2.89 percent. Additionally, the margin charged over Libor was volatile at the end of 2008. This interest rate volatility creates cash flow risk to MGU and more importantly to Summit. In the past, Summit has been able to mitigate risk due to the volatility of Libor 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. 0005 that Summit does not plan to hedge the variable interest rates on the debt financing proposed in the instant application. If MGU were a stand-alone company, Staff believes that MGU not hedging its interest rate exposure would be of much greater risk to MGU's ability to attract capital for future capital expenditure needs. However, 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 seem foolhardy to ignore these circumstances. Besides, this is how Standard and Poor's (S&P) evaluates the creditworthiness of the parent company.

If Summit does not hedge the MGU debt, because the proposed amount of debt at MGU only accounts for 11.04 percent of the total consolidated Summit debt ($5.5 million divided by $49.82 million), this should not have a large impact on Summit's consolidated financials. In response to Staff Data Request No. 0012, MGU stated that approximately 98 percent of Summit's debt is issued at variable interest rates. 67 percent of Summit's total debt is hedged with an interest rate collar arrangement at its CNG subsidiary. This interest rate collar expires on March 31, 2011. After the issuance of the MGU debt, Summit would be hedged on 60 percent of Summit's variable-interest rate debt. Consequently, the incremental impact on Summit's overall risk exposure should be minimal.

However, MGU indicated to Staff that Summit does not currently plan on renewing the interest rate collar hedge arrangement, although renewal remains as an option subject to Board determination. If Summit chooses not to continue to hedge its variable interest rate debt, then, beginning March 31, 2011, this would expose Summit and all of its properties to an extreme amount of cash flow risk due to fluctuations in short-term interest rates. Consequently, Staff believes it is appropriate to condition the approval of the proposed Application on MGU being required to file with the Commission a plan on how the Company plans to manage its variable interest rate risk exposure no later than January 31, 2011. However, if the Company files an 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 before January 31, 2011, then the Company will address its plan for managing its variable interest rate risk exposure in the context of that financing case.

In the instant case, Staff currently believes MGU's affiliation with Summit is advantageous to its ability to incur the financial risk associated with the proposed transaction. 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. However, as is apparent from the Commission's experience with other Missouri utilities' 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 financial 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. For this reason, Staff believes its aforementioned proposed condition is appropriate.

Pro Forma Financial Impact of Proposed Debt: 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. However, with the recent tightening and volatility of the credit markets, it is much more difficult to make reliable assumptions, at least in regard to the cost of the debt to MGU and Summit. For example, the 30-day Libor rate has decreased by approximately 140 basis points since December 2008. While these yields are quite attractive, because of the volatility in short-term rates, this rate could very well increase back to normal or higher than normal levels in the near future. For purposes of assessing the possible impact of the proposed transaction, Staff believed it was important to assume that the 30-day Libor rate would return to more normal levels, if not reach the higher levels achieved in 2007 during a Fed induced credit tightening cycle. Consequently, Staff's assumed interest rate for the variable rate date that has not been hedged was approximately 0.50 percent higher than that assumed by MGU.

The Company communicated to Staff that the Pro Forma financials they submitted represent 100% of the expected April 2011 through March 2012 fiscal year earnings period, which represents full anticipated penetration in the service territories derived from the new construction in 2009. The Pro Forma Financials are not simply the next 12 months of operations since that would only capture a partial year of earnings and not be a true reflection of the earnings streams generated by the business expansion. However, Staff found it prudent to use its estimated 2009 earnings in its analysis. In communication with the Company, Staff was informed that in the year of construction (2009) the Company expects to achieve an earnings stream of approximately 65% of the 2011 levels. Therefore, since cash flows for the new construction will not be received until October 2009, Staff took the percentage that the third and fourth quarter represented for the Company's earnings last year and applied that percentage to the 2011 levels. This found the level that would be realized in October 2011 through March 2012. Because the Company will receive approximately 65% of those levels, we applied the estimated number to this percentage to get the estimated earnings number for October 2009 through March 2010. Staff also applied the same estimation approach to the Company's operating expenses. Even with Staff's more conservative estimates of earnings the

Company was above the S&P benchmarks for an investment grade credit rating for all four ratios. (See Schedules 1 and 2)

Because of the small relative impact the proposed transaction will have on Summit's consolidated financial condition, Staff does not believe the proposed transaction would be detrimental.

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 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, 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) keep 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 regulated operations.

6. That the amount authorized for purposes of the requested lien or encumbrance shall be limited to $5,650,000.

7. That the Company file with the Commission a plan for managing its variable interest rate risk exposure no later than January 31, 2011. However, if the Company files an 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 before January 31, 2011, then the Company will address its plan for managing its variable interest rate risk exposure in the context of that financing case.

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 $5,500,000 of Bonded 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-2009-0331

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 13th day of May, 2009.

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

Selected Financial Ratios
for Missouri Gas Utility, Inc.

RATIO ANALYSIS	Fiscal Year Ending 3/31/2009 estimate	Pro Forma	S&P Benchmark Bounds for Investment Grade Credit Rating[1]	Loan Covenant Minimum
Funds From Operations Interest Coverage:	4.50 x	3.09 x	2.0 x	
Funds from Operations to Total Debt:	14.91%	11.61%	10 %	
Total Debt to Total Capital:	58.37%	58.54%	60 %	
EBITDA/Interest Coverage	5.00 x	3.15 x	NA x	2.25 x

Notes:
1. Source: Standard & Poor's RatingsDirect, "U.S. Utilities Ratings Analysis Now Portrayed In The S&P Corporate Ratings Matrix", November 30, 2007.

Schedule 1

Selected Financial Ratios
for Summit Utilities, Inc.

RATIO ANALYSIS	Final Pro-forma	Fiscal Year Ending 3/31/2009 estimate	S&P Benchmark Bounds for Investment Grade Credit Rating[1]	Loan Covenant Minimum
Funds From Operations Interest Coverage:	2.56 x	3.09 x	2.0 x	
Funds from Operations to Total Debt:	11.14%	12.59%	10 %	
Total Debt to Total Capital:	56.66%	56.33%	60 %	
EBITDA/Interest Coverage	2.68 x	3.32 x	NA x	2.25 x

Notes:
1. Source: Standard & Poor's RatingsDirect, "U.S. Utilities Ratings Analysis Now Portrayed In The S&P Corporate Ratings Matrix", November 30, 2007

Schedule 2