#334

Report To
The Mississippi Legislature

A Review of the Financial Viability of the Mantachie Natural Gas District and the State's Relationship to the District

February 22, 1996

Although the Mantachie Natural Gas District may realize its first net income in FY 1996 and modest growth thereafter, the district's inability to generate revenues sufficient to make scheduled principal payments, pay day-to-day operating expenses, and pay off its high cumulative debt raises serious doubt regarding its ability to operate as a going concern. As of September 30, 1995, the district's total debt, including past due and future obligations, is $3,025,000.

PEER examined the district's enabling legislation, other statutory sources, general principles of bond law, and relevant case law, and determined that the State of Mississippi cannot be held liable for the default of the district on its bond obligations.

The PEER Committee

PEER: The Mississippi Legislature's Oversight Agency

The Mississippi Legislature created the Joint Legislative Committee on Performance Evaluation and Expenditure Review (PEER Committee) by statute in 1973. A standing joint committee, the PEER Committee is composed of five members of the House of Representatives appointed by the Speaker and five members of the Senate appointed by the Lieutenant Governor. Appointments are made for four-year terms with one Senator and one Representative appointed from each of the U. S. Congressional Districts. Committee officers are elected by the membership with officers alternating annually between the two houses. All Committee actions by statute require a majority vote of three Representatives and three Senators voting in the affirmative.

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PEER provides a variety of services to the Legislature, including program evaluations, economy and efficiency reviews, financial audits, limited scope evaluations, fiscal notes, special investigations, briefings to individual legislators, testimony, and other governmental research and assistance. The Committee identifies inefficiency or ineffectiveness or a failure to accomplish legislative objectives, and makes recommendations for redefinition, redirection, redistribution and/or restructuring of Mississippi government. As directed by and subject to the prior approval of the PEER Committee, the Committee's professional staff executes audit and evaluation projects obtaining information and developing options for consideration by the Committee. The PEER Committee releases reports to the Legislature, Governor, Lieutenant Governor, and the agency examined.

The Committee assigns top priority to written requests from individual legislators and legislative committees. The Committee also considers PEER staff proposals and written requests from state officials and others.

A Review of the Financial Viability of the Mantachie Natural Gas District and the State's Relationship to the District

February 22, 1996

The PEER Committee

Mississippi Legislature

The Mississippi Legislature

Joint Committee on Performance Evaluation and Expenditure Review

PEER Committee

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February 22, 1996

Honorable Kirk Fordice, Governor
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At its meeting of February 22, 1996, the PEER Committee authorized release of the report entitled A Review of the Financial Viability of the Mantachie Natural Gas District and the State's Relationship to the District.

Senator Bill Canon, Chairman

This report does not recommend increased funding or additional staff.

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February 22, 1996

Introduction

When the Legislature created the Mantachie Natural Gas District in northeast Mississippi in 1966, it declared the district to be a political subdivision of the state, with the authority to issue revenue bonds. Amendments to state law in 1982 placed a $3 million cap on the Mantachie Natural Gas District's revenue bonding authority. In February 1987, the district closed on $2.78 million in revenue bonds to begin construction on the natural gas system.

Since it became fully operational in 1988, the district's annual expenses have exceeded its revenues, and as of September 30, 1995, the district is in default on $360,000 of the principal of its bond issue. Also, the district has failed to pay over $300,000 in accrued interest on the outstanding bonds. The district's total debt, including past due and future obligations, is $3,025,000. In 1995, the Legislature denied the district's request for an increase in its bonding authority.

In response to a legislative request, PEER reviewed the financial viability of the district and the state's potential liability regarding the district's default on its bond indebtedness.

Overview

The major state issues relating to the Mantachie Natural Gas District involve whether the district is financially solvent and, if not, whether the state has any liability for the district's indebtedness.

Is Mantachie Natural Gas District generating sufficient revenues to continue its operations and pay its debts?

No. Based on PEER's projections, the district may generate annual net incomes of $58,783; $46,479; $64,900; $83,356; and $102,783 for fiscal years 1996 through 2000, respectively. However, the district's inability to generate revenues sufficient to make scheduled principal payments, pay day-to-day operating expenses, and pay off its high cumulative debt raises serious doubt regarding its ability to operate as a going concern. As of September 30, 1995, the district's total debt, including past due and future obligations, is $3,025,000.

The district's bondholders have had a legal right to place the district in receivership since 1991, when the district went into default. Although bondholders have shown considerable forbearance to date, they could exercise their right to dissolve the district and seize its assets at any time.

Does the state have any potential liability regarding the district's default on its bond indebtedness?

No. Based on an examination of the district's enabling legislation, other statutory sources, general principles of bond law, and relevant case law, the State of Mississippi cannot be held liable for the default of MNGD on its bond obligations.

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A Review of the Financial Viability of the Mantachie Natural Gas District and the State's Relationship to the District

Introduction

When the Legislature created the Mantachie Natural Gas District in northeast Mississippi in 1966, it declared the district to be a political subdivision of the state, with the authority to issue revenue bonds. Amendments to state law in 1982 placed a $3 million cap on the Mantachie Natural Gas District's revenue bonding authority. In February 1987, the district closed on $2.78 million in revenue bonds to begin construction on the natural gas system.

Since it became fully operational in 1988, the district's annual expenses have exceeded its revenues, and as of September 30, 1995, the district is in default on $360,000 of the principal of its bond issue. Also, the district has failed to pay over $300,000 in accrued interest on the outstanding bonds. The district's total debt, including past due and future obligations, is $3,025,000. In 1995, the Legislature denied the district's request for an increase in its bonding authority.

Authority

PEER reviewed the Mantachie Natural Gas District (MNGD) in accordance with MISS. CODE ANN. § 5-3-57 (1972).

Scope and Purpose

In conducting this review, PEER staff sought to develop:

- an overview of the legislative history, oversight, and governance of Mantachie Natural Gas District;

- a financial analysis of the district's operations, including its issuance and default in the payment on revenue bonds; and,

- a legal analysis of the question of the state's potential liability regarding the district's default on its bond indebtedness.

Method

During the course of the review, PEER:

- **interviewed the Chairman of the district's board of commissioners, the commission attorney, bond counsel, district staff, the district's former manager, and its contract engineer;**
- **reviewed board minutes;**
- **analyzed the district's financial audits and other relevant financial and administrative records;**
- **reviewed the district's engineering reports;**
- **researched relevant case law, statutory material, and other sources of information on bonds and bonding authority; and,**
- **interviewed Public Service Commission staff.**

Overview

The major state issues relating to the Mantachie Natural Gas District involve whether the district is financially solvent and, if not, whether the state has any liability for the district's indebtedness.

Is Mantachie Natural Gas District generating sufficient revenues to continue its operations and pay its debts?

No. Based on PEER's projections, the district may generate annual net incomes of $58,783; $46,479; $64,900; $83,356; and $102,783 for fiscal years 1996 through 2000, respectively. However, the district's inability to generate revenues sufficient to make scheduled principal payments, pay day-to-day operating expenses, and pay off its high cumulative debt raises serious doubt regarding its ability to operate as a going concern. As of September 30, 1995, the district's total debt, including past due and future obligations, is $3,025,000.

The district's bondholders have had a legal right to place the district in receivership since 1991, when the district went into default. Although bondholders have shown considerable forbearance to date, they could exercise their right to dissolve the district and seize its assets at any time.

Does the state have any potential liability regarding the district's default on its bond indebtedness?

No. Based on an examination of the district's enabling legislation, other statutory sources, general principles of bond law, and relevant case law, the State of Mississippi cannot be held liable for the default of Mantachie Natural Gas District on its bond obligations.

Background

Creation of Mantachie Natural Gas District

The Legislature created the Mantachie Natural Gas District in 1966 through Chapter 309, *Laws of 1966*. The district's territory encompasses:

- the portion of Itawamba County lying west of the Tombigbee River;
- the portion of Lee County lying one-half mile either side of Mississippi Highway 363 five miles west of the county line;
- the portion of Lee County one-half mile either side of U. S. Highway 78 extending five miles west from the county line and the unincorporated community of Mooreville in Lee County; and,
- the portion of Lee County one-half mile either side of Mississippi Highway 371 extending five miles southwest of the line dividing Lee and Itawamba counties.

(See Exhibit 1, page 5, for a map showing the location of the district.)

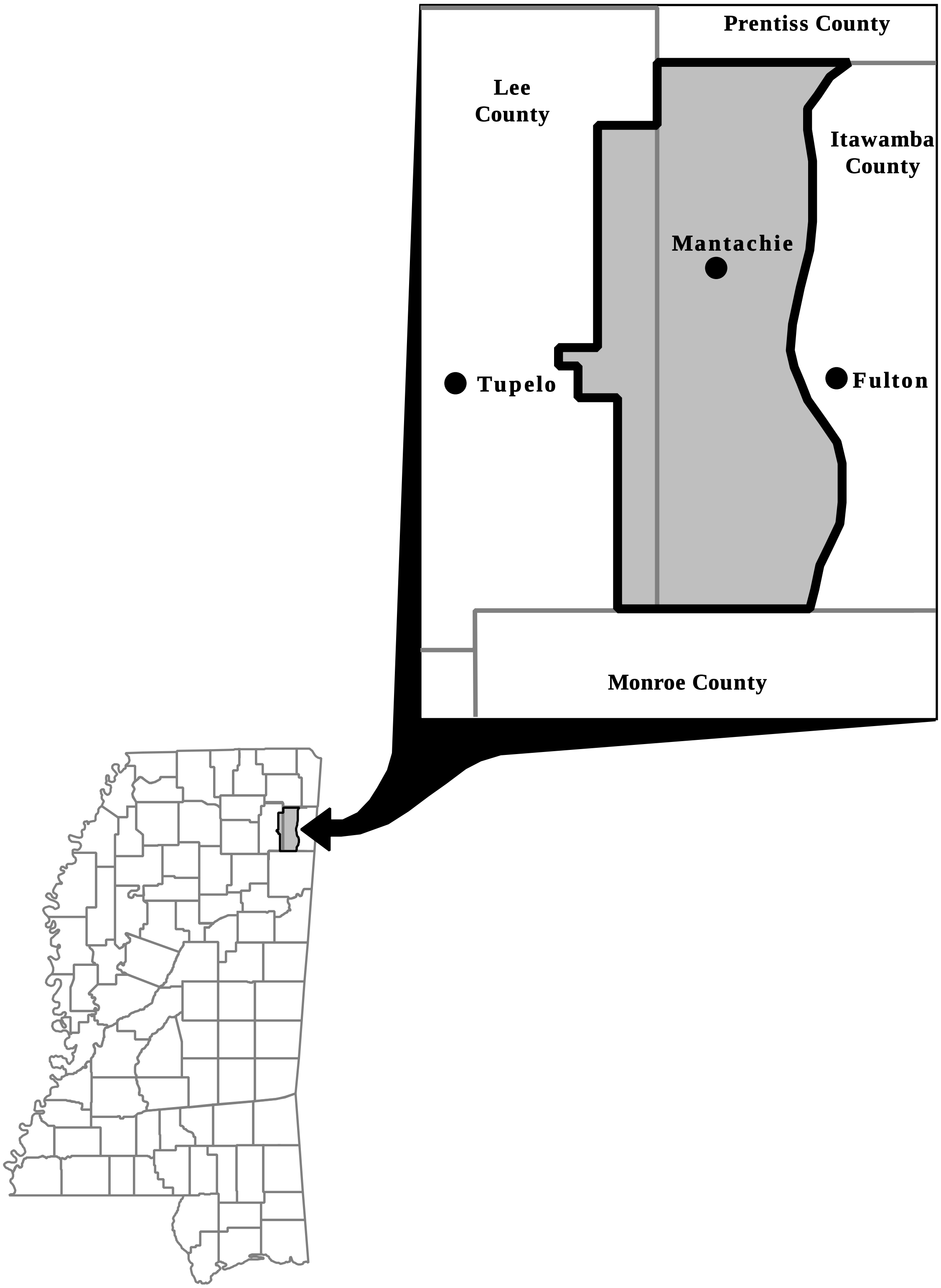
Chapter 309 declared the district to be a political subdivision of the state, with the authority to issue revenue bonds, with no cap provided in the original legislation. The law also specifically authorized the district to issue bonds to finance construction of a transmission system to service the district territory.

Although the Legislature created the Mantachie Natural Gas District in 1966, the district took no action toward construction of the necessary infrastructure to provide residents of the area with gas until the early 1980s, when the Legislature placed a $3 million cap on the district's revenue bonding authority and changed procedures for electing commissioners (Chapter 496, *Laws of 1982*).

Governance of Mantachie Natural Gas District

Prior to the amendments to the district's enabling legislation, the Governor appointed the three members of the district's Board of Commissioners. Amendments in Chapter 496, *Laws of 1982*, provided for election of the district's commissioners after the district had ten paying customers, with subsequent elections every year. The district conducts elections in accordance with rules and regulations promulgated by the commissioners.

Exhibit 1
Location of Mantachie Natural Gas District



SOURCE: PEER analysis of Mantachie Natural Gas District.

MISS. CODE ANN. § 21-27-17 requires the Board of Commissioners to employ a manager and employees as necessary to operate the gas system. As of November 1995, the board employed three full-time employees and a management consultant.

The Legislature charged the district's commissioners with creating the necessary bylaws and regulations for the safe, economic, and efficient management and protection of the system, including the power to:

-- fix employee salaries and direct them in the discharge of their duties;

-- make purchases for materials and supplies for the district and advertise for competitive bids in accordance with state law;

-- set and collect rates for services and facilities; and,

-- appropriate funds for the maintenance and improvements of the district.

Mantachie Natural Gas District operates outside the jurisdiction of federal and state utility regulatory agencies and is solely responsible for its management and operations. Unlike investor-owned utilities, which must receive the Public Service Commission's approval for various decisions, such as changes in rates, MNGD's board of commissioners is responsible for governing all practice, policy, and procedures relating to the district.

Financing and Construction of the Pipeline System

In 1985, the district's board of commissioners began planning to issue natural gas revenue bonds to finance the gas system's construction. In May of that year, the district contracted with Tumlinson & Associates, a West Point, Mississippi, engineering firm, to conduct a feasibility study projecting the number of customers who could be expected to use the system and the amount of gas sales per customer. Tumlinson assumed that industrial and commercial users and schools within the district would become customers of the district, and the firm projected significant growth in the number of customers and amount of gas sales during the ten-year bond period. The firm's 1986 feasibility study report concluded that the district would have adequate revenues to meet its debt service obligations and maintain operations through 1997.

Between June 1986 and February 1987, the district began to solicit participation from persons and businesses living in the district. In February 1987, the district closed on $2.78 million in revenue bonds. Construction on the system began in 1987, with the first customers hooking up to the system that year. The construction project resulted in the installation of ninety-eight miles of metal and plastic pipe to serve the 269-

square-mile area of the district. The district currently distributes natural gas received from the Texas Eastern Transmission Corporation pipeline. The district purchases gas supplies from Woodard Energy.

Exhibit 2, page 8, presents a chronology of events related to the history of Mantachie Natural Gas District.

Exhibit 2

Chronology of Mantachie Natural Gas District

1966 Mississippi Legislature creates the Mantachie Natural Gas District (MNGD)through its passage of Chapter 309, *Laws of 1966*. The Governor appoints three members to serve on the district's Board of Commissioners.

1982 Mississippi Legislature enacts Chapter 496, *Laws of 1982,* which amends Chapter 309, *Laws of 1966*, and provides a $3 million cap on the district's revenue bonding authority. The amendment also requires election of the three-member Board of Commissioners by the gas system's users.

1985 The commissioners begin plans for the construction of the gas distribution system. The district enters into a contract with Tumlinson & Associates in May to conduct a feasibility study.

1986 The commissioners adopt a resolution in October authorizing the issuance and sale of $2.78 million in revenue bonds for the construction of the natural gas system.

MNGD begins efforts in June to solicit user agreements to determine the level of participation from residents and businesses within the district.

1987 The district closes on $2.78 million in revenue bonds and construction begins on the system.

The commissioners hire a manager in October to oversee the day-to-day operations of the district.

1988 Construction of MNGD natural gas system ends in September.

1991 MNGD defaults on the scheduled principal of $60,000 and a portion of the interest portion of the bond issue.

1994 MNGD hires Foy Milton, a natural gas consulting engineer, to provide a report in August of financial projections for the district. The projection shows modest growth in the number of customers, natural gas usage, and revenues.

MNGD hires Allen and Hoshall Ltd., an engineering firm, to conduct a study of district expansion efforts which could serve approximately 713 customers at a cost of $1.1 million.

1995 MNGD requests increased bonding authority from the Mississippi Legislature to sell additional revenue bonds to Farmers' Home Administration for the construction of the distribution system extensions. The Legislature does not, however, approve an increase in the district's bonding authority.

The manager of the district resigns in July. The commissioners vote to retain him on a contractual basis as the district's certified manager.

SOURCE: Compiled by PEER.

Financial Analysis of Mantachie Natural Gas District's Operations

Is Mantachie Natural Gas District generating sufficient revenues to continue its operations and pay its debts?

No. Based on PEER's projections, the district may generate annual net incomes of $58,783; $46,479; $64,900; $83,356; and $102,783 for fiscal years 1996 through 2000, respectively. However, the district's inability to generate revenues sufficient to make scheduled principal payments, pay day-to-day operating expenses, and pay off its high cumulative debt raises serious doubt regarding its ability to operate as a going concern. As of September 30, 1995, the district's total debt, including past due and future obligations, is $3,025,000.

The district's bondholders have had a legal right to place the district in receivership since 1991, when the district went into default. Although bondholders have shown considerable forbearance to date, they could exercise their right to dissolve the district and seize its assets at any time.

The chief reasons for Mantachie Natural Gas District's financial instability, discussed in the following sections, are:

- The district's revenues have been insufficient, due to:
  - -- failure to enlist the number of customers projected;
  - -- failure to meet projected gas sales; and,
  - -- failure to collect all revenues due to the district;
- The district has made no immediate plans for retiring its defaulted debt.

The District's Issuance of and Default on Revenue Bonds

On February 1, 1987, Mantachie Natural Gas District issued bonds in the amount of $2,780,000 to raise money for the construction and acquisition of a natural gas transmission and distribution system. Interest rates on the natural gas system revenue bonds varied from 6.75% to 9.00% and were to be retired at varying amounts from 1990 through 2009. In 1990, the district used excess bond proceeds to make the first principal payment on the bonds in the amount of $55,000. In 1991, the district defaulted on the scheduled principal payment of $60,000 and payments for the interest portion of the bond issue also fell behind schedule.

As of September 30, 1995, the district has defaulted on $360,000 of the principal of the bond issue. This figure includes the $85,000 payment originally scheduled for February 1995 which has not been paid. Also, the district has failed to pay over $300,000 in accrued interest on the outstanding bonds. As of September 30, 1995, the district owed $660,000 in principal payments and accrued interest. The district's debt also includes $2,365,000 in future principal payments (excluding future interest payments). The district's total debt, including past due and future obligations, is $3,025,000.

Insufficient Revenues

- ***Since MNGD became fully operational in 1988, the district has not earned sufficient revenues to cover total operating and interest expenses for the district, and it has not made its full debt service obligations during the last five years.***

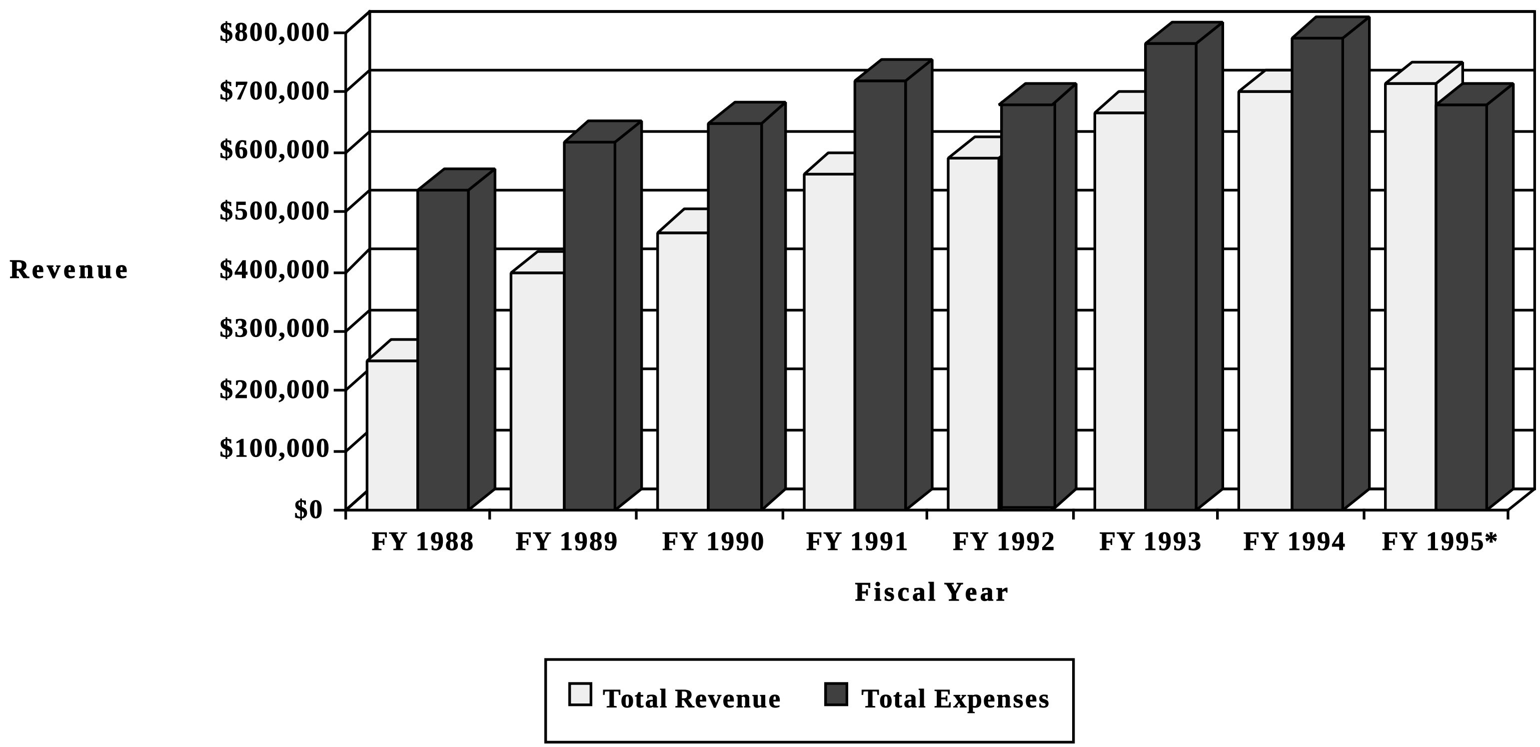
As shown in Exhibit 3, page 11, MNGD has not earned sufficient revenues from which to recover total district operating and interest expenses during its first seven years of operation. PEER reviewed audit reports for fiscal years FY 1988 through FY 1994 and unaudited financial statements for FY 1995. (The district's fiscal year begins on October 1 and ends on September 30.) Based on PEER's review of the district's FY 1995 unaudited financial statements, MNGD's total operating income of$453,632 could not offset expenses of $479,336, with a net loss of $25,704 for the year, the lowest annual net loss since FY 1988. As of September 1995, the district's unaudited financial statements showed a net capital deficit of $1,164,209, representing the district's cumulative net losses since FY 1988. Each year since FY 1989, the accounting firm which has conducted the district's annual audits (Watkins, Ward and Stafford of West Point), has included the following notation in its audit report:

> ***The district has suffered recurring losses from operations and has a net capital deficiency which raises substantial doubt about its ability to continue as a going concern.***

As with any ongoing concern, it is important for MNGD to have sufficient cash to pay operation and maintenance costs as well as its debt obligations. From FY 1988 through FY 1990, the district's cash flow was adequate to meet the district's required debt service payments. However, the district has been unable to meet its debt service payments during the last five years (see Exhibit 4, page 12.)

Exhibit 3

Mantachie Natural Gas District
Revenue Versus Total Expenses
FY 1988 - 1995



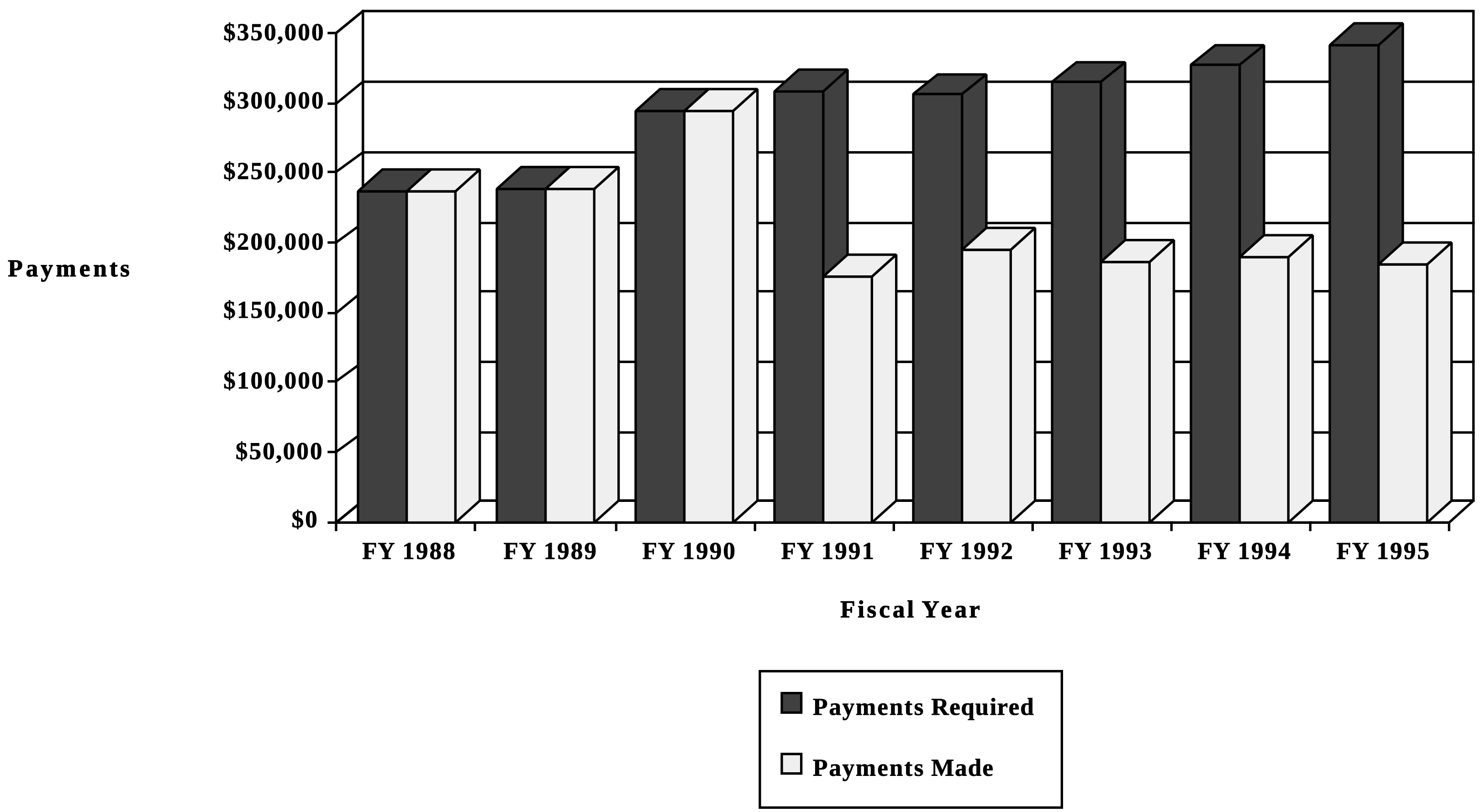
*** Fiscal Year 1995 figures are based on unaudited financial statements. PEER's analysis of financial statements and records shows a net loss of $25,704 for this year.**

Note: Total expenses include salary, professional services, operating, interest, and income expenses. Expenses does not include payment on the principal of the bond issue.

SOURCE: PEER analysis of Mantachie Natural Gas District financial records.

Exhibit 4

Mantachie Natural Gas District
Required versus Actual Debt Service Payments
FY 1988 - 1995



SOURCE: PEER analysis of Mantachie Natural Gas District financial records.

- ***MNGD has reached neither the projected number of customers nor the amount of gas sales necessary to yield sufficient revenues to pay both operating expenses and outstanding debts.***

The district must establish an adequate customer base and have an adequate level of sales per customer to operate as a profit-making enterprise. (See Exhibit 5, below, for projected and actual number of customers from FY 1988 to 1995.) In January 1995, the projected number of customers was 1,545; the district actually had 1,247 customers, 298 short of the number anticipated. Gas sales had been projected to increase during the district's eighth operating year to a total of $827,347. However, actual gas sales for the year amounted to $654,095. MNGD never planned for the shortfall in the number of customers and gas sales, nor did it have a contingency plan in place to adjust to these circumstances.

Exhibit 5

Comparison of Mantachie Natural Gas District Projected versus Actual Customers and Gas Sales FY 1988 to FY 1995

Fiscal Year	Projected Customers	Actual Customers	Projected Gas Sales	Actual Gas Sales
1987-88	300	600	$160,850	$180,914
1988-89	1,000	838	$553,500	$325,095
1989-90	1,400	934	$751,500	$409,677
1990-91	1,428	989	$764,694	$491,531
1991-92	1,456	992	$779,688	$544,004
1992-93	1,485	1,076	$795,217	$621,611
1993-94	1,515	1,204	$811,281	$654,537
1994-95	1,545	1,247	$827,347	$654,095

SOURCE: PEER analysis of unaudited Mantachie Natural Gas District records.

One of the factors contributing to MNGD's inability to reach its projected number of customers and sales revenues was the method its contract engineering firm used to estimate the number of customers who would become users of the district over a ten-year period. Instead of relying on the actual number of residents and businesses who had signed user agreement forms indicating they intended to use the natural gas system, Tumlinson & Associates based its projections on the assumption that industrial and commercial users and schools within the district would become customers of the district. In addition to using actual and assumption-based data, Tumlinson & Associates projected district growth in the number of customers and gas sales using the year-end number of

customers, rather than an average number of customers for the year, which would have resulted in more reasonable estimates of gas sales.

Tumlinson & Associates projected the average usage per customer to be 90 MCF (ninety thousand cubic feet). However, PEER's review of the district's historical data shows average customer usage has ranged from 65 to 75 MCF, significantly lower than Tumlinson's projection.

District personnel attribute MNGD's failure to achieve the projected levels of customers to three factors:

- **Many residents who initially signed commitments chose not to hook up to the system when it became operational.**
- **Residents of the district who were loyal customers to local dealers of butane gas chose not to convert to natural gas.**
- **The district's involvement in a lawsuit with Mississippi Valley Gas from 1987 until 1992 raised doubt concerning the district's right to serve one hundred potential customers in Lee County. The district ultimately won the right to serve residents in the area.**

MNGD's manager also attributed the district's failure to sell the projected amount of gas to the unseasonably warm winters Mississippi experienced in recent years.

- ***MNGD's failure to pursue aggressive collection of delinquent payments has resulted in a total of $52,943 in uncollected revenues due to the district.***

As of November 3, 1995, MNGD had 259 delinquent accounts (eighteen percent of all gas user accounts), representing $52,943 in unpaid bills. Exhibit 6, below, provides details of the delinquent accounts.

Exhibit 6

Summary of MNGD Delinquent Accounts
(as of November 3, 1995)

	30 days	60 days	90+ days
Number of accounts	73	22	164
Total uncollected dollars	$4,144	$2,179	$46,620

SOURCE: PEER analysis of Mantachie Natural Gas District records.

The district's unofficial policies do not allow customers to have a balance due which exceeds the deposit they paid. MNGD staff stated that the district requires customers to pay monthly gas bills within ten days after the bill becomes due. If the bill is not paid, the district mails a second notice one day after the due date, allowing customers fourteen days to pay before it assesses a late penalty (ten percent of the unpaid balance). Aside from the late notices mailed to customers, the district takes no aggressive measures to terminate services of delinquent users or to collect outstanding funds.

Of its 259 total delinquent customer accounts, (shown in Exhibit 6, page 14), the district's billing reports showed eighty-one disconnected customers as of November 1995. The district has apparently continued to provide service to the remaining 178 delinquent customers. PEER's analysis of MNGD computer billing reports shows that district managers have continued to report the district's disconnected accounts as users, giving commissioners, bondholders, and others a false impression of the actual number of users who receive gas services. Finally, the district has no formal written policy on delinquent accounts, nor does it have formal objective criteria with which to determine which users to disconnect. If the district had taken more aggressive actions to collect overdue accounts, funds collected could have been used to pay monthly operating expenses or debt obligations.

The District's Financial Outlook

- *MNGD has made no plans for retiring its defaulted debt.*

In August 1994, Foy Milton, a natural gas consulting engineer, made a report of financial projections for the district. The report shows detailed projections of the district for the years ending September 1994 through 1996, with less detailed projections for fiscal years 1997 through 2000. This report projects modest growth in the number of customers, natural gas usage, and revenue from operations. It also projects the district to generate a net profit beginning in fiscal year 1995 and continuing thereafter. (However, Milton's report does not address the district's repayment of cumulative debt and future bond principal obligations in its profitability analysis.)

The district also entered into a contract with Allen and Hoshall, Ltd., of Jackson to prepare an engineering study on the expansion of the district. The February 1995 engineering study shows that the district could serve up to 713 customers in the expanded area. However, the study failed to provide cost and revenue projections for this expansion and continued operation of the district, but notes that the revenues "could be adequate to repay loans needed to construct these proposed extensions." The study did not contain a plan for repayment of the district's cumulative debt and future bond principal obligations.

The district's proposed solution to its financial problems was to request approval from the Legislature to increase its bonding authority and obtain funds from the Farmers' Home Administration to:

- **-- pay off approximately $600,000 in principal and interest on bonds in default; and,**

- **-- carry out a $1.1 million expansion of the system.**

Representatives of MNGD failed in their efforts to gain legislative approval during the 1995 session to increase the $3 million cap on the district's bonding authority. The district has developed no other options to retire its defaulted debt.

- ***According to PEER's projections, the district will probably not be able to meet its continuing debt obligations or have sufficient cash to pay the amounts of principal and accrued interest now in default.***

To determine whether the district will be able to pay its expenses and continuing debt obligations, PEER prepared financial projections for FY 1996 through FY 2000 based on the following assumptions:

- **-- The district will hire a full-time manager in October 1996 at a salary of $36,000. PEER considers the hiring of a manager necessary for the district to become a going concern.**

- **-- Seventy new customers will sign up for services each year during the upcoming five-year period based on the average of new customers for the most recent five fiscal years.**

- **-- Average gas usage per customer over the next five-year period will be 69.4 MCF based on the average gas usage for the most recent five fiscal years.**

- **-- The district's non-interest expenses will increase by only four percent per year.**

According to PEER's projections, beginning with FY 1996 the district may realize its first annual net income ($58,783 for FY 1996). For fiscal years 1997 through 2000, PEER projects that the district will experience modest growth in net income of $46,479; $64,900; $83,356; and $102,783, respectively. However, PEER's projections show that even with this growth in net income, the district will not have sufficient resources to fulfill its original bond agreement in any year through 2009, the final year of the original bond agreement and pay amounts in default. By 2009, the cumulative effect of the district's long-term inability to generate sufficient income to meet its payment requirements will drive its required payments to pay off the bond issue that year to more than $1.3 million. (See Exhibit 7,

page 18). This is about $1 million more than the district's projected $345,000 income that year.

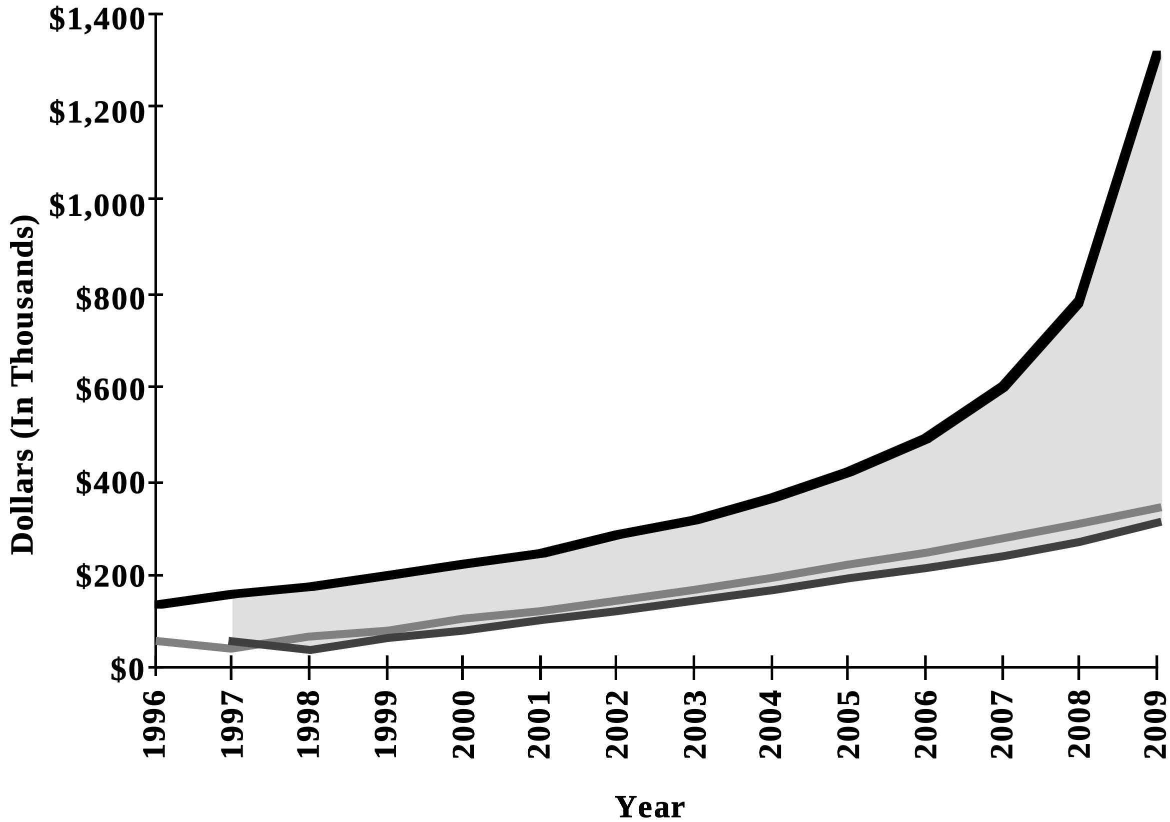
Conclusion

Based on PEER's projections, the district may generate annual net incomes of $58,783; $46,479; $64,900; $83,356; and $102,783 for fiscal years 1996 through 2000, respectively. However, the district's inability to generate revenues sufficient to make scheduled principal payments, pay day-to-day operating expenses, and pay off its high cumulative debt raises serious doubt regarding its ability to operate as a going concern. As of September 30, 1995, the district's total debt, including past due and future obligations, is $3,025,000.

The district's bondholders have had a legal right to place the district in receivership since 1991, when the district went into default. Although bondholders have shown considerable forbearance to date, they could exercise their right to dissolve the district and seize its assets at any time.

Exhibit 7

Projected Effect of MNGD's Inability to Make Annual Required Debt Retirement Payments



Required Payments: Projected bond principal and accrued interest funds needed to pay off debt by 2009 (the year by which MNGD is required to retire its bonded indebtedness)

Projected Income

Annual difference between projected payments and payments required to retire MNGD's debt by 2009

Projected Payments: Projected amounts MNGD will apply toward debt retirement

SOURCE: PEER analysis of Mantachie Natural Gas District financial records.

Legal Analysis of Potential Liability Regarding the District's Default on Bond Indebtedness

Does the state have any potential liabilityregardingthedistrict'sdefaulton its bond indebtedness?

No. Based on an examination of the district's enabling legislation, other statutory sources, general principles of bond law, and relevant case law, the State of Mississippi cannot be held liable for the default of MNGD on its bond obligations.

Enabling Legislation of the District and Other Statutory Remedies

Under the Mantachie Natural Gas District's amended enabling legislation, MNGD's Board of Commissioners is authorized to issue revenue bonds to finance and construct its natural gas transmission and distribution system. The legislation further provides that all powers with respect to natural gas transmission and distribution systems granted to municipalities under Sections 21-27-11 through -69 of the MISSISSIPPI CODE ANNOTATED are conferred upon the district.

CODE Section 21-27-23 (a) specifies that municipalities are authorized to issue revenue bonds. Section 21-27-47 further specifies that when a municipality (or MNGD, in this instance) issues revenue bonds, that the issuer's revenues are to be pledged for repayment of the bonds. Statutory remedies are also found at § 21-27-53 which address default on the bonds by the issuer. The remedies described in this CODE section were adopted as a remedy for bondholders in the Mantachie Natural Gas District's Bond Resolution. (See "The Bond Resolution and Official Statement" section, page 20.) No statutory provision obligates the full faith and credit of the State of Mississippi if a district defaults on its bonds.

Revenue versus General Obligation Bonds

As noted above, the bonds issued by Mantachie Natural Gas District, as authorized by statute, are revenue bonds, as opposed to general obligation bonds. This distinction is important because the two classes of bonds are viewed differently under general principles of bond law. General obligation bonds are backed by the full faith and credit of the state, county or municipality in which they are issued. Revenue bonds, by contrast, pledge only the revenues of the issuer. This view is also supported by case law from other states, which could be considered by Mississippi judges should a suit involving this particular question be filed.

> ***Revenue bonds and special obligation bonds share an essential distinction from general obligation bonds. The credit of the State is pledged for the payment of general obligation bonds. It is not for revenue bonds and special obligation bonds. . . .Revenue bonds are retired from the proceeds of the operation of the public structure or enterprise supporting their issuance.***

Schureman v. State Highway Commission **141 N.W.2d 62, 63 (Mich. 1966).**

Thus, the very nature of the bonds issued precludes any liability on the part of the State of Mississippi.

The Bond Resolution and Official Statement

The bond resolution is intended to reflect the contractual obligation on the part of the issuer (in this instance, Mantachie Natural Gas District) and the lender (the trustee who represents the bondholders). The official statement is prepared for the marketing of the bonds and "summarizes all the salient features of the underlying documents and agreements which support the offering." The official statement is similar in nature to a prospectus for corporate securities. (*See* R. Lamb and S. Rappaport, *Municipal Bonds* 287-291 [1980]). Both the bond resolution and the official statement specify legal remedies for the bondholders in the event of a default by the issuer.

In this instance, the provisions of the bond resolution and official statement in the event of default for the MNGD bond issue are identical. In the event of default, bondholders may by "suit, action, mandamus or other proceedings at law or in equity" compel performance by appropriate officials of the district of acts and duties specified in the resolution. If necessary, a receiver can be appointed to:

> ***. . .administer and operate the System with power to fix rates and collect charges sufficient to provide for the payment of all Bonds outstanding to the payment of which the Net Revenues of the System are pledged and to pay the expenses of operating and maintaining the System and to apply the Revenues of the System in conformity with the provisions of the Act and this Resolution.***

Article VIII, "Defaults and Remedies," Section 8.02, Bond Resolution; and "Default and Remedies," Official Statement, p.23.

Consistent with the discussion above of the distinctions between revenue and general obligation bonds, the Bond Resolution also provides that the Board of Commissioners for the district is authorized "to issue

natural gas system revenue bonds payable, as to both principal and interest, *solely* from the revenue derived from the operations of said system. (*See*, "Preamble," Bond Resolution, para. 6, p. 2. [emphasis added].)

Supporting Case Law

The general proposition that revenue bonds issued by a political subdivision such as the Mantachie Natural Gas District cannot become the obligations of the state may be summarized as follows:

> ***It may be stated as a general rule that insofar as the debt regulatory provisions of the Constitution are concerned, the state and its political subdivisions are regarded as separate entities rather than as a unit. Thus, it is held that bonds issued by a state officer or board payable solely out of proceeds of political subdivisions pledged as security are not state bonds. They are not part of the state debt within the debt limitation and are not within constitutional provisions requiring the consent of the electors of the state before state bonds or evidence of indebtedness pledging the faith and credit of the state or any of its revenues are issued.***

64 Am. Jur.2d *Public Securities Obligations*, § 45 (1972).

Cases from numerous jurisdictions also support this general proposition. Political subdivisions of the state are regarded as separate entities from the state in the area of debt obligations.

> ***[C]ounsel for the State Highway Commissioner argues earnestly that because the State created the Turnpike Authority, the State is as a matter of law, responsible for its debts. This view flies in the face of long established principles with respect to the status of public corporations in the field of government. Though created by the State and subject to dissolution by the State, they are in the eyes of the law independent entities and the State is not responsible for their debts and liabilities, whether they be municipal corporations or counties or such specialized bodies as the Port of New York Authority.***

***New Jersey Turnpike Authority v. Parsons*, 3 N.J. 235, 69 A.2d 875, 879 (1949).**

Case law likewise supports the proposition that revenue bonds issued by a political subdivision of the state do not constitute a general obligation of the state to pay so long as the bonds are to be paid solely from revenues of the issuing authority.

> ***The overwhelming weight of judicial opinion in this country is to the effect that bonds, . . .issued by states, cities, counties, . . .if such particular bonds or obligations are secured by and payable only from the revenues realized from a particular utility or property, acquired with the proceeds of the bonds or obligations, do not constitute debts of the particular state, . . . within definition of 'debts' as used in the constitutional provisions of states having limitations as to the incurring of indebtedness.***

***Schureman v. State Highway Commission*, 141 N.W.2d 62, 64 (Mich. 1966). *See also, California Toll Bridge Authority v. Wentworth*, 298 P. 485, 486 (Ca. 1931); *S.J. Groves & Sons Co. v. The Jersey Turnpike Authority*, 268 F. Supp. 568, 575 (N.J. 1967); *Murphy v. Epes*, 678 S.W.2d 352, 356 (Ark. 1984); *State v. Allen*, 158 Ohio St. 168, 107 N.E.2d 345, 349 (1952); *Wilmington Med. Center, Inc. v. Bradford*, 382 A.2d 1338, 1347 (Del. 1978).**

Finally, courts have addressed analogous situations to the one at hand where bonds are to be paid for out of proceeds or revenues of the pledged securities (i.e., MNGD's revenues), and where specific remedies for bondholders are provided in the bond resolution and by statute.

> ***There is no other method or provision for the repayment of such funds as may be borrowed upon these bonds. No holder of said bonds can in good faith, at any time, legally assert any claim against the state for their payment, upon default of the security pledged therefor. They are not, in fact, state bonds.***

***Davis v. Phipps*, 85 S.W.2d 1020, 1021-22 (Ark. 1935).**

Conclusion

Based on an examination of the district's enabling legislation, other statutory sources, general principles of bond law, and relevant case law, the State of Mississippi cannot be held liable for the default of MNGD on its bond obligations. The Legislature's choice of revenue bonds rather than general obligation bonds was appropriate because it did not obligate the state for the repayment of MNGD's financial indebtedness.

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