BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Missouri Gas Energy, a Division of Southern Union Company, for an Accounting Authority Order Concerning Environmental Compliance Activities	)))))	**Case No. GU-2007-0480**

STAFF RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission (Staff) and for its Staff Recommendation, states as follows:

1. On June 20, 2007, the Commission issued its *Order Directing Filing* ordering the Staff to file, no later than July 20, 2007, either a recommendation or a status report informing the Commission of when Staff will file a recommendation. In its July 20th pleading, the Staff committed to filing its recommendation not later than September 7, 2007.

2. Accordingly, the Staff submits its recommendation regarding Missouri Gas Energy's (MGE or Company) request for an accounting authority order (AAO) concerning environmental compliance activities. Staff's recommendation is contained in its Memorandum, attached hereto as Appendix A, in both Non Proprietary (NP) and Highly Confidential (HC) versions, with supporting Schedule 1 "Environmental Liability Agreement" (ELA) marked HC in its entirety, and incorporated by reference herein.

3. Staff's HC version of its Memorandum, and the entire ELA are marked HC in accordance with Commission Rule 4CSR 240-2.135(1) and (2). The portion of Staff's Memorandum that includes references to information from the ELA, and the portion including calculations from information provided on data request responses which were marked HC by the Company, are marked HC. Information taken from the Southern Union Company's SEC Form 10K-A, which is a public document, is not marked as HC.

4. Based on its investigation, the Staff believes that MGE's Manufactured Gas Plant (MGP) costs are not extraordinary in nature, nor are its current level of incurred unreimbursed MGP costs material. For these reasons, and reasons more thoroughly explained in Staff's Memorandum, the Staff believes that this Application does not meet the Commission's standards for AAO approval. Therefore, the Staff recommends that the Commission not approve MGE's application for an AAO concerning environmental compliance activities.

WHEREFORE, based on the reasons stated above and in Staff's Memorandum, the Staff respectfully requests that the Commission not approve MGE's application for AAO in this case.

Respectfully submitted,

/s/ Robert S. Berlin

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or e-mailed to all counsel of record 7th day of September 2007.

/s/ Robert S. Berlin

M E M O R A N D U M

TO: Missouri Public Service Commission Official Case File
Case No. GU-2007-0480, Missouri Gas Energy

FROM: Paul R. Harrison, Auditing Department

/s/ Paul R. Harrison 9/06/2007
Utility Services Division/Date

/s/ Robert S. Berlin 9/06/2007
General Counsel's Office/Date

SUBJECT: Staff Recommendation to deny MGE's request for an Accounting Authority Order for costs related to its former manufactured gas plants.

DATE: September 6, 2007

On June 13, 2007, Missouri Gas Energy (MGE or Company), a division of Southern Union Company (Southern Union), filed an Application for an accounting authority order (AAO) authorizing the deferral of costs relating to environmental costs associated with its former manufactured gas plant (MGP) sites. MGE maintains that "an application for an AAO contains a single factual issue – whether the costs, which are asked to be deferred, are extraordinary in nature. *In the matter of the application of Missouri Public Service*, 1 Mo.P.S.C.3d 200, 300-204 (1991). 'By seeking a Commission decision [regarding the issuance of an AAO] the utility would be removing the issue of whether the item is extraordinary from the next rate case. All other issues would still remain, including, but not limited to, the prudency of any expenditures, the amount of recovery, if any, whether carrying costs should be recovered, and if there are any offsets to recovery.' *Id.*" [MGE Application, pages 2-3.]

In addition, in its Application the Company maintains that the Commission has in the past issued AAO's for costs "caused by unpredictable events, acts of government and other matters outside the control of the utility or the Commission.' *In the matter of St. Louis County Water Company's Tariff Designed to Increase Rates*, MoPSC Case No. WR-96-263, p. 13 (December 31, 1996) (emphasis added). The Commission has further stated that it 'has periodically granted AAOs and subsequent ratemaking treatment for various unusual occurrences such as flood-related costs, changes in accounting standards, and other matters which are unpredictable and cannot adequately or appropriately be addressed within normal budgeting parameters.' *Id.* at p. 14." [MGE Application, page 3.]

Finally, in its Application the Company maintains that there are many examples of AAOs based upon government actions and regulation. These instances include "compliance with environmental regulations such as the Clean Air Act (*In the matter of the application of Missouri Public Service*, 1 Mo.P.S.C.3d 200, 203-204 (1991)). In fact, the Commission has granted AAO's to natural gas companies in the past related to environmental activities. *See In the Matter of Laclede Gas Company*, Case No. GR-96-193, 5 Mo. P.S.C. 3d 108 (1996) (Laclede given authority to defer 'costs incurred to comply with Environmental Protection Agency regulations and orders in

connection with: (1) the investigation, assessment, removal, disposal, storage, remediation or other treatment of residues, substances, materials and/or property that are associated with former manufactured gas operations or located on former manufactured gas sites; (2) the dismantling and/or removal of facilities formerly utilized in manufactured gas operations; (3) efforts to recover such costs from potentially responsible third parties and insurance companies; and, (4) payments received by Laclede as a result of such efforts.); *In the Matter of the Application of United Cities Gas Company, a Division of Atmos Energy Corporation, for an Accounting Authority Order Related to Investigation and Response Actions Associated with Its Former Manufactured Gas Plant Site in Hannibal, Missouri*, Accounting Authority Order, Case GA-98-464 (1999).' " [MGE Application, pages 3-4.]

Specifically, by this Application, MGE requests an order which authorizes deferred accounting treatment for costs incurred in connection with environmental compliance activities primarily related to investigation, assessment and remediation of former MGP sites.

History

On January 31, 1994, Southern Union purchased the Missouri gas properties now being operated as MGE from Western Resources, Inc. (Western Resources) for $400,300,000. In its Amended Annual Report to the Securities and Exchange Commission (SEC), Form 10-K/A, filed on September 30, 1994, shortly after its purchase of the Western Resources property, Southern Union described the status of the newly acquired former manufactured gas plant sites:

> Missouri Gas Energy owns or is otherwise associated with a number of sites where manufactured gas plants were previously operated. These plants were commonly used to supply gas service in the late 19th and early 20th centuries, in certain cases by corporate predecessors to Western Resources. By-products and residues from manufactured gas could be located at these sites and at some time in the future may require remediation by the Environment Protection Agency (EPA) or delegated state regulatory authority.
>
> By virtue of notice under the Missouri Asset Purchase Agreement and its preliminary, non-invasive review, the Company became aware prior to closing of eleven such sites in the service territory of Missouri Gas Energy. Based on information reviewed, it appears that neither Western Resources nor any predecessor in interest ever owned or operated at least three of those sites.
>
> Subsequent to the closing of the Missouri Acquisition, as a result of an environmental audit, the Company has discovered the existence of possibly six additional sites in the service territory of Missouri Gas Energy. Southern Union has so informed Western Resources. The Company does not know if

> any of these additional sites were ever owned or operated by Western Resources or any of its predecessors in interest. Western Resources informed the Company that it was notified in 1991 by the EPA that it was evaluating one of the sites (in St. Joseph, Missouri) for any potential threat to human health and the environment. Western Resources also advised the Company on September 15, 1994 that as of that date the EPA had not notified it that any further action was required. Evaluation of the remainder of the sites by appropriate federal and state regulatory authorities may occur in the future. At that time and based upon information available to management, the Company believed that the costs of any remediation efforts that may be required for these sites for which it may ultimately have responsibility will not exceed the aggregate amount subject to substantial sharing by Western Resources.

As part of the purchase transaction, Southern Union and Western Resources entered into an Environmental Liability Agreement (ELA) with respect to future costs associated with the former manufactured gas plants being sold to Southern Union. The highly confidential ELA is attached, as Attachment 1, to this memorandum and describes a five-step tiered approach to the allocation of substantially all liabilities under environmental laws that may exist or arise with respect to the MGE's Missouri properties. The ELA is described as follows in Southern Union's September 30, 1994 SEC Form 10/K-A:

> Southern Union and Western Resources also entered into an Environmental Liability Agreement. Subject to the accuracy of certain representations made by Western Resources in the Missouri Asset Purchase Agreement, the agreement provides for a tiered approach to the allocation of substantially all liabilities under environmental laws that may exist or arise with respect to Missouri Gas Energy. The agreement contemplates Southern Union first seeking reimbursement from other potentially responsible parties or recovery of such costs under insurance or through rates charged to customers. To the extent certain environmental liabilities are discovered by Southern Union prior to January 1, 1996, and are not so reimbursed or recovered, Southern Union will be responsible for the first $3,000,000, if any, of out of pocket costs and expenses incurred to respond to and remediate any such environmental claim. Thereafter, Western Resources would share one-half of the next $15,000,000 of any such costs and expenses, and Southern Union would be solely liable for any such costs and expenses in excess of $18,000,000. The Company believes that it will be able to obtain substantial reimbursement or recovery for any such environmental liabilities from other potentially responsible third parties, under insurance or through rates charged to customers.

Specifically, the ELA established a five-tier approach for the recovery of all environmental costs for the MGE properties. The agreement contemplates Southern Union first seeking reimbursement from insurance carriers; second, through other potentially responsible parties (PRPs); third, through rates charged to customers; fourth, Southern Union would be responsible for the first $3,000,000 of the initial remaining liability; and, finally, Western Resources would share one-half of the next $15,000,000 of any such remaining costs and expenses. ** _____ _____ **

MGE's MGP Costs

Based on the documents received in response to data requests in this case, the Staff calculated that over the period 1994 through July 31, 2007, MGE has incurred a total of ** _____ ** in environmental costs, the bulk of which is specifically related to activities at its former MGP sites. Based also on data request responses, MGE recovered total MGP reimbursements of ** _____ ** through insurance claims and other payments from PRPs. In addition, Southern Union's initial liability for MGP costs as referenced in the ELA will cover an additional $3,000,000 in environmental costs. MGE has indicated to the Staff that it does not intend to charge customers for costs covered by the $3,000,000 liability amount, or to defer costs under this Application that would be covered by this ELA provision. In other words, as of July 31, 2007, taking into account both reimbursement from third parties and the portion of such costs that MGE has agreed not to charge to ratepayers, ** _____ ___ ** As of July 31, 2007, ** _____ _____ **

As shown above, MGE has received significant reimbursement of its MGP costs from insurance companies and other PRPs. In addition, MGE expects reimbursements of up to 50% of certain of its MGP costs from Western Resources as discussed above. In a discussing of its MGP costs in SEC Form 424B2 filed on January 10, 1994, Southern Union stated:

> The Company believes that it will be able to obtain substantial if not complete reimbursement or recovery for any such environmental liabilities from other potentially responsible third parties, under insurance or rates charged to customers.
>
> In addition, the Company is aware of the existence of other significant potentially responsible parties from whom contribution for remediation would be sought, and would expect to make claims upon its insurers, Western Resources; other potentially responsible parties (PRP) and would institute appropriate requests for rate relief.

NP

However, thirteen and one half years after it advised the SEC of the above, Southern Union has not sought recovery of any of these costs from Western Resources under the provisions of the ELA. In response to Staff Data Request No. 6, when asked why MGE and/or Southern Union has not attempted to enforce the ELA between Southern Union and Western Resources for the past thirteen and one half years, MGE responded that "To date, there have not been any costs which have not been covered by insurance, PRPs or the $3,000,000 referenced in the agreement." While Southern Union has not sought recovery of these costs from Western Resources, it has taken action to secure ratemaking recovery of these MGP costs from Missouri customers in their last two rate cases and through the filing of this AAO Application. MGE's current gas customers (who had no role in the creation of MGP costs and have no legal or contractual liability for them) are being asked to carry the future financial burden for the cleanup costs of these MGP sites.

Prior Treatment of MGP Costs in MGE Rate Cases

During MGE's last two rate cases (Case Nos. GR-2004-0209 and GR-2006-0422), MGE requested that the Commission establish an environmental response fund (ERF) of $750,000 and $500,000, respectively, to be included in annual rates for their MGP remediation costs. In their ERF proposals, the Company recommended that the ERF fund be treated as a "tracking mechanism" by which MGP costs (of unknown future quantity) would be collected from customers through a separate rate element, and later "trued up" by the Company by comparing the amount of the rate collections to the MGP expense actually incurred by MGE. Any over-recovery or under-recovery of MGP costs, as reflected by the tracking mechanism, would be refunded to/collected from customers at a later date. Also, as part of this proposal, the Company proposed that fifty percent (50%) of any applicable insurance proceeds and/or contributions obtained from Westar Energy (formerly Western Resources) and/or contributions obtained from PRPs, net of costs associated with obtaining such proceeds and/or contributions, should be credited to this fund. The remaining (50%) of these recoveries would be credited to the shareholders as a form of profit. The Company stated that under the terms of the proposed ERF, contributions to and/or proceeds obtained from other parties, net of the cost of obtaining such contributions and/or proceeds, shall be shared evenly between the Company's shareholders (as a form of profit) and customers (as a credit to the ERF). The fund would also be given credit for the accrued liability in the amount of $3,000,000 recorded on Southern Union's books following the acquisition of the Missouri property (which was to become MGE) from Western Resources.

In Case NO. GR-2004-0209, in regard to the ERF proposal, the Commission ruled that:

> In the future, at least until 2009, costs not covered by insurance will be paid, in part, by Western Resources under the Environmental Liability Agreement between those companies. In sum, MGE's proposal to include $750,000 per year in its cost of service for future environmental cleanup costs is based entirely on speculation regarding costs that the company may never incur. Furthermore, the creation of a pre-funded source for the payment of these cleanup costs would remove much of Southern Union's incentive to ensure

> that only prudently incurred and necessary costs are paid. If the money has already been recovered from ratepayers and is being held in the Fund, Southern Union would have little incentive to not pay it out to settle claims brought against it. The Fund would be subject to audit by Staff and Public Counsel and they could seek a prudence adjustment if necessary. But the need for a prudence adjustment is difficult to prove and is not a good substitute for the company's own desire to prudently minimize its costs to improve its bottom line. For these reasons, the Commission finds that MGE's proposal to create an Environmental Response Fund should be rejected. [Order, pages 35-39.]

In Case NO. GR-2006-0422, on the same issue, the Commission ruled that:

> MGE agrees that it is not possible to ascertain the costs of investigation and remediation. That the magnitude of the costs associated with this effort is impossible to know is again noted by MGE. Further, to date, MGE has not paid any costs associated with the environmental clean up. That these costs are not known and measurable precludes their inclusion in rates. Furthermore, the creation of a pre-funded source for the payment of these cleanup costs would remove much of Southern Union's incentive to ensure that only prudently incurred and necessary costs are paid. If the money has already been recovered from ratepayers and is being held in the Fund, Southern Union would have little incentive to not pay it out to settle claims brought against it. Although the Fund would be subject to audit by Staff and Public Counsel and they could seek a prudence adjustment, the need for a prudence adjustment is difficult to prove and is not a good substitute for the company's own desire to prudently minimize its costs to improve its bottom line. For these reasons, the Commission finds that MGE's proposal to create an Environmental Response Fund shall be rejected. [Order, pages 18-20.]

Prior Deferral Treatment of MGP Costs in Missouri

In Case No. GR-94-220, which concluded in a Stipulation and Agreement reached between the parties to the case, the Commission authorized Laclede Gas Company (Laclede) to establish an environmental cost deferral procedure. This deferral procedure became effective September 1, 1994. The authorization to begin deferring MGP related costs was only triggered to the extent that Laclede's costs exceeded the $250,000 of MGP costs reflected in the Laclede's rates. In the event the cumulative liability incurred by the Company for such costs during the deferral period was less than the cumulative amount of such annualized costs reflected in the rates approved in the settlement, Laclede was required to refund the difference. Laclede was also required to file a general rate case within approximately two years of the deferral authorization, or else the deferral authorization would become null and void.

This environmental cost deferral was continued as a result of stipulations and agreements in Laclede's next two rate cases. Laclede's deferral authority for its MGP costs ended on July 31, 1999 as part of the Stipulation and Agreement reached in Laclede's subsequent rate proceeding, Rate Case No. GR-99-315. Since that time, Laclede has not deferred any of its MGP expenses, and those costs have been treated as an ordinary expense in rate cases filed since 1999.

In an AAO issued by the Commission in Case No. GA-98-464, United Cities Gas Company (United Cities), a division of Atmos Energy Corporation, was authorized to defer costs related to its MGP site in Hannibal, Missouri. In this order, as in the Laclede authorization, the Commission imposed a time requirement for filing of a subsequent rate case following the AAO issuance. In the United Cities order, the Commission indicated that the AAO would become "null and void in the event that United Cities does not file tariff sheets proposing a general increase in rates within twenty-four (24) months from the effective date of this order." United Cities did not file a rate case within this period, and ultimately never sought ratemaking treatment of any of its deferred MGP costs, and its authority to defer MGP costs has since accordingly lapsed.

No Missouri utility is currently deferring its MGP or other environmental remediation costs pursuant to a Commission-authorized AAO.

Standards for Deferral

The Commission expressed its general position and standards for deferral of costs incurred outside a rate case test year in its Report and Order in Case Nos. EO-91-358 and EO-91-360, cases file by Missouri Public Service, a division of UtiliCorp United, Inc. (now Aquila, Inc.). In this Order, the Commission expressed its position that costs incurred outside of a rate case test year should be allowed only on a limited basis:

> The deferral of costs from one period to another period for the development of a revenue requirement violates the traditional method of setting rates…. Under historical test year ratemaking, costs are rarely considered from earlier than the test year to determine what is a reasonable revenue requirement for the future. Deferral of costs from one period to a subsequent rate case should be allowed only on a limited basis. [Order, pages 6-7.]

In the Standards for Deferral section of this Report and Order, the Commission described the following criteria for allowing utility companies to defer costs incurred outside of a rate case test year as a regulatory asset:

1. Events occurring during a period that are extraordinary, unusual and unique, and not recurring; and

2. The costs associated with the material event are material.

These criteria, as they apply to MGE's instant Application, will be addressed below. However, before concluding whether or not MGE's MGP costs and its Application in this case have met these criteria, a brief review of how the Federal Energy Regulatory Commission (FERC) Uniform System of Accounts (USOA) defines the term "extraordinary items" in General Instruction No. 7 may be helpful. The FERC USOA for natural gas utilities reads as follows:

> Extraordinary items. It is the intent that net income shall reflect all items of profit or loss during the period with the exception of prior period adjustments as described in paragraph 7.1 and long-term debt as described in paragraph 17 below. Those items related to the effects of events and transactions which have occurred during the current period and which are of unusual nature and infrequent occurrence shall be considered extraordinary items. Accordingly, they will be events and transactions of significant effect which are abnormal and significantly different from the ordinary and typical activities of the company, and which would not reasonably be expected to recur in the foreseeable future. (In determining significance, items should be considered individually and not be in the aggregate. However, the effects of a series of related transactions arising from a single specific and identifiable event or plan of action should be considered in the aggregate.) To be considered as extraordinary under the above guidelines, an item should be more than approximately 5 percent of income, computed before extraordinary items. Commission approval must be obtained to treat an item of less than 5 percent, as extraordinary.

The remainder of this recommendation memorandum will discuss the reasons the Staff believes that MGE's Application to defer environmental costs does not meet the Commission's traditional standard for deferral of costs. In the event the Commission chooses to grant MGE's deferral request, the Staff will also suggest conditions to be placed upon any such approval.

MGE's MGP Costs are not Unusual in Nature

As a natural gas distribution company, it should not be considered unusual for MGE to experience environmental remediation costs, such as costs to clean up former MGP sites. Many natural gas distribution and electric utilities throughout the United States are incurring MGP-related costs. In Missouri alone, MGP-related costs have been incurred by Laclede, United Cities and the Missouri Public Service division of Aquila, Inc., in addition to MGE.

MGE's MGP Costs are not Infrequent in Occurrence

Southern Union has been aware of the existence of potentially significant MGP costs associated with the Missouri gas properties it purchased from Western Resources since at least 1993. In fact, a review of the invoices from environmental contractors and consultants received in response to data requests in this proceeding show that MGE has been experiencing environmental costs each and every year since it came into existence in 1994. Based on the documents received in response to data requests in this case, the Staff calculated that over the period 1994 through July 31, 2007, MGE incurred approximately ** _____ ** in environmental costs, the bulk of which is related to its MGP operations. Therefore, the Staff concludes that MGE's MGP costs are not infrequent in occurrence.

Not only has MGE been incurring MGP-related costs for more than ten years, its own assertions in its Application show that it is likely that it will continue to incur these costs for the foreseeable future. Nor does MGE's Application explain why its future MGP costs will not continue to be largely reimbursable from third parties, as its past MGP costs have been. As such, these costs do not meet the Commission's nonrecurring or "infrequency of occurrence" criteria. Given the industry in which MGE operates, the Staff does not consider environmental costs, such as its MGP costs, to be unusual in nature for MGE.

The Staff agrees with the findings of the Accounting Principles Board in its APB Bulletin No. 30 where the Board stated that "An event or transaction of a type that occurs frequently in the environment in which the entity operates cannot, by definition, be considered as extraordinary, regardless of its financial effect."

MGE's Current MGP Costs Are Not Material

In MGE's last rate case, No. GR-2006-0422, the Staff's last calculation of MGE's net operating income on an adjusted basis was $36,123,186. For comparison purposes, during the same time period, MGE did not incur any MGP costs for which it was not reimbursed through insurance carriers or by other PRPs, or covered by its initial ELA liability of $3,000,000 . (The same point is true for the entire period of 1994 through July 2007.) Obviously, MGE's current and past levels of unreimbursed MGP costs do not meet the 5% net income materiality level used by the FERC, and MGE's past and current level of unreimbursed MGP costs certainly do not "significantly distort" MGE's current and past year's net income levels.

Even if MGE's environmental clean-up costs were to be considered extraordinary, deferral authority should not be granted unless the costs are actually material in nature as well. The Staff believes that materiality should not be judged based upon projected or budgeted future cost levels. It is only appropriate to grant deferral requests per AAO applications when the extraordinary event in question has actually occurred or is certain of occurring, and the financial impact on the utility can

be quantified with a high degree of accuracy. In its Application, MGE freely admits that it is "not possible to predict the timing and magnitude of MGP investigation at this time….there is uncertainty as to the ultimate costs of the remediation efforts" [MGE Application, p. 6.] Without an examination of actual incurred expenses by a utility, it is not possible to judge whether the costs of a particular event or series of events can be handled through normal accounting and rate practices, or whether treatment as an extraordinary item is justified.

The Commission itself has indicated that deferral treatment should not be granted to speculative expense amounts associated with events whose occurrence or timing is uncertain. In its Report and Order in Case Nos. EO-91-358 and EO-91-360, the Commission stated:

> The Commission agrees with Staff that whether the event has occurred or is certain to occur in the near future is a relevant factor. Utilities should not seek deferral of speculative events since it is hard to determine whether an event is extraordinary or material unless there is a high probability of its occurring within the near future. [Order, pages 8-9.]

MGE's Application does not provide any evidence that MGP clean-up costs are certain of occurring within the near future, nor does it assert that the financial impact of these events, when and if they incur, are capable of being accurately quantified at this time. Given the uncertain and speculative nature of MGE's future environmental cost levels at this time, MGE's instant Application is clearly premature.

Deferral Authority, If Granted, Should Only Apply to MGP Costs

MGE's request to defer costs in the instant Application is intended to apply to "costs incurred in connection with environmental compliance activities primarily related to investigation, assessment and remediation of former manufactured gas plant sites." However, MGE's discussions in its Application of these costs are solely concerned with MGP-related costs. Therefore, if the Commission were to grant MGE's requested deferral authority, the Staff recommends that such authority be limited to costs directly associated with investigation, assessment and remediation of former MGP sites.

MGE Should Continue to Seek Recovery of MGP Costs from Western Resources if Deferral Authority is Granted

As discussed above, MGE has the opportunity to seek recovery from Western Resources of a portion of its incurred MGP costs under the terms of the ELA. To date, MGE has not obtained any such recovery from Western Resources, ** _____ **

In reference to the ELA , the Staff is concerned with the impact upon the Agreement between Western Resources and Southern Union if this AAO is approved. Specifically, if MGE has recovered all costs from three of the four tiers (insurance, PRPs and the $3,000,000 initial liability, as

referenced in the Agreement) and is allowed by the Commission to defer all remaining MGP costs to the next rate case, can this action be interpreted as relieving Western Resources from its legal liability for its share of the remaining costs?

The Staff believes strongly that any deferral authorization or order allowing rate recovery of MGP costs should only be granted after MGE demonstrates that recovery of these costs is not possible from any other source, including insurance carriers, other PRPs and Western Resources under the ELA. Accordingly, the Staff recommends that, in the event the Commission grants MGE's deferral request in this Application, MGE only be allowed to defer 50% of its actual incurred MGP related expenses in order to recognize the portion of such costs potentially eligible for recovery from Western Resources under the terms of the ELA.

A Time Limit Should Be Placed Upon Any Allowed Deferrals if Deferral Authority is Granted

As has been discussed, the Commission's previous authorizations to defer environmental costs (Laclede, United Cities) both contained a time limit requiring the utilities to file a rate case within a period of time, or write-off the deferrals. In fact, most, if not all, deferrals allowed by the Commission through AAO applications have contained a similar rate case filing requirement. The Commission's rationale for such a limit was discussed in the Order for Case Nos. EO-91-358 and EO-91-360:

> The Commission finds that a time limitation on deferrals is reasonable since deferrals cannot be allowed to continue indefinitely. The Commission finds that a rate case must be filed within a reasonable time after the deferral period for recovery of the deferral to be considered… The limitation accomplishes two goals. First, it prevents the continued accumulation of deferred costs so that total disallowance would not affect the financial integrity of the company or the Commission's ability to make the disallowance; and secondly, it ensures the Commission a review of those costs within a reasonable time. If the costs are truly extraordinary, recovery in rates should not be delayed indefinitely. A utility should not be allowed to save deferrals to offset against excess earnings in some future period. [Pages 8-9.]

The Staff believes a requirement that MGE file a general rate case within two years or forfeit its ability to recover such deferrals in rates is reasonable in this instance, if the Commission chooses to allow MGE to defer its MGP costs through this Application.

Any Deferral Order Should Have No Ratemaking Effect

In all past AAOs granted by the Commission that the Staff is aware of, the Commission included language in its orders making clear that the authorization was not determinative in any way

on the question of future rate recovery of deferred costs. The Staff believes that similar language is appropriate in any Order in this Application allowing MGE to defer MGP costs.

Staff Recommendations

As described above, the Staff believes that MGE's MGP costs are not extraordinary in nature, nor are its current level of incurred unreimbursed MGP costs material. For these reasons, the Staff believes that this Application does not meet the Commission's standards for AAO approval. Therefore, the Staff recommends that the Commission reject MGE's AAO Application in this case.

If the Commission for any reason issues the requested AAO to MGE, the Staff recommends that the Commission include standard language in the Ordered section of the AAO. This language should include that the AAO would become null and void in the event that MGE does not file tariff sheets proposing a general increase in rates within twenty-four (24) months from the effective date of this order, and state that granting this AAO would have no effect on the subsequent ratemaking treatment of the deferred costs.

Any deferral authority granted to MGE should be limited to 50% of its incurred MGP costs otherwise eligible for sharing with Western Resources under the ELA.

If the Commission issues the requested AAO to MGE, the Staff recommends that the deferral authority be limited to MGE's incurred costs associated with former MGP sites.

In addition, Southern Union has in the past contracted with the same legal firms for Missouri MGP related activities, other types of legal work and MGP costs for other states. Because of this fact, and because legal fees has represented a substantial portion of Southern Union's MGP costs, the Staff requests that the Commission order MGE to require of its legal consultants to include a specific description of the type of work performed for each hour on each invoice presented for costs deferred under this AAO.

If the Commission does approve this AAO request, the Staff recommends the Commission include the following language in its Ordered section of the AAO:

> 1. That MGE is authorized to defer up to 50% of its MGP expenditures that it incurs eligible for potential sharing with Western Resources under the ELA, and 100% of its MGP expenditures not eligible for sharing under the ELA to Account 182.3, Other Regulatory Assets, beginning on October 1, 2007 and continuing through the earlier of September 30, 2009 or the end of the Commission-ordered test year as updated, or true-up period in MGE's next rate case. MGE should immediately reflect as a credit to the deferral any recoveries accrued on its or Southern Union's books and records or received from insurance carriers or other third parties relating to MGP costs previously deferred.

2. That nothing in this order shall be considered a finding by the Commission of the reasonableness of the costs and/or expenditures deferred, and the Commission reserves the right to consider the ratemaking treatment to be afforded all deferred costs and/or expenditures, including the recovery of carrying costs, if any.

3. That MGE is hereby directed to maintain detailed supporting records, work papers, invoices and other documents to support the amount of costs deferred under this AAO, including any related deferred taxes recorded as a result of the cost deferral. In addition, MGE shall provide detailed documentation, including a complete description of the type of work performed, specific MGP site and time spent for each invoice submitted for all legal expenses deferred under this AAO.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Application of Missouri Gas Energy, a division of Southern Union Company, for an Accounting Authority Order Concerning Environmental Compliance Activities	))))	Case No. GU-2007-0480

AFFIDAVIT OF PAUL R. HARRISON

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

PAUL R. HARRISON, of lawful age, on his oath states: that he 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 him; that he has knowledge of the matters set forth in such Staff Recommendation; and that such matters are true and correct to the best of his knowledge and belief.

Paul R. Harrison
PAUL R. HARRISON

Subscribed and sworn to before me this 6th day of September, 2007.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
County of Cole
My Commission Exp. 07/01/2008

D. Suzie Mankin
Notary Public

ATTACHMENT 1

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY