

**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 Approval)
to Change its Infrastructure System)
Replacement Surcharge.)

Case No. GO-2006-0201

STAFF MEMORANDUM

COMES NOW the Staff of the Missouri Public Service Commission, and for its Recommendation in this case states as follows:

1. On November 7, 2005, Missouri Gas Energy, a division of Southern Union Company, (MGE) filed its Application to change its infrastructure replacement system surcharge (ISRS) in accord with Sections 393.1009 to 393.1015 RSMo (Supp. 2004) and Commission rule 4 CSR 240-3.265.

2. In its November 17, 2005 Order Suspending Tariff And Directing Filing (Order), the Commission suspended MGE's tariff sheet, tariff number YG-2006-0348, and directed Staff to file a report no later than January 6, 2006.

3. Staff members from the Auditing and Energy Departments have reviewed MGE's Application and examined MGE's supporting documentation. In accord with the Commission's Order and consistent with Sections 393.1009 to 393.1015 RSMo (Supp. 2004), the Staff submits its Memorandum attached hereto as Appendix A with supporting Attachments A and B and incorporated by reference herein.

WHEREFORE, for the reasons stated in Staff's Memorandum with supporting Attachments A and B, the Staff recommends that the Commission issue an order that:

- (1) Rejects the tariff sheet filed by MGE on November 7, 2005, assigned tariff number YG-2006-0348;
- (2) Authorizes MGE to file a tariff to impose an Infrastructure System Replacement Surcharge that is sufficient to recover appropriate annual pre-tax revenues in the amount of \$2,388,348 (that includes \$1,223,622 from this Application and \$1,164,726 from Case No. GO-2005-0273); and,
- (3) Authorizes MGE to file an ISRS rate for each customer class as shown in Staff's attached Memorandum.

Respectfully submitted,

/s/ Robert S. Berlin
Robert S. Berlin
Associate General Counsel
Missouri Bar No. 51709

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 4th day of January, 2006.

/s/ Robert S. Berlin

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GO-2006-0201 – Missouri Gas Energy

FROM: William Harris, Auditing Department
Michael Ensrud, Tariffs/Rate Design - Energy

/s/ Tom Imhoff 01/04/06
Project Coordinator / Date

/s/ Bob Berlin 01/04/06
General Counsel's Office / Date

SUBJECT: Staff Report and Recommendation Regarding the Application Of Missouri Gas Energy Seeking The Missouri Public Service Commission's Approval To Change Its Infrastructure System Replacement Surcharge

DATE: January 4, 2006

BACKGROUND

On November 7, 2005, Missouri Gas Energy (MGE) a division of Southern Union Company filed an Application and Petition to Change Infrastructure System Replacement Surcharge (Application) with the Missouri Public Service Commission (Commission). For convenience the surcharge is referred to by the acronym ISRS. The Company submitted its Application based upon Missouri statutory sections 393.1009, 393.1012 and 393.1015, RSMo (Supp. 2004). These Statutory Sections provide eligible gas corporations with the ability to recover certain ISRS costs without a general rate case filing and prohibits a full Staff review of any increase in the gas company's revenues or decrease in other costs which may offset the ISRS revenue requirement. Commission Rule 4 CSR 240-3.265 was promulgated to comply with Sections 393.1009, 393.1012 and 393.1015.

Section 393.1015.2(2) RSMo states that the Staff may examine information of the gas corporation to confirm that the underlying costs are in accordance with the provisions of Sections 393.1009 to 393.1015 and to confirm the proper computation of the proposed charge. This Memorandum is being filed in accordance with the sixty (60) day provision of the statute.

STAFF'S INVESTIGATION

Staff members from the Auditing and Energy Departments participated in the Staff's examination of the Application. The Staff's examination included a review of the Application and the supporting documentation, a review of Sections 393.1009, 393.1012 and 393.1015, RSMo, discussions with MGE personnel, a review of selected ISRS work orders and a review of additional data provided by MGE.

THE APPLICATION

Specifically, MGE seeks approval of a surcharge designed to recover the pre-tax ISRS revenues necessary to produce net operating income equal to MGE's weighted cost of capital multiplied by the net original cost of the requested infrastructure replacements and facilities relocations. MGE also seeks recovery of all federal, state and local income and excise taxes applicable to such ISRS income and to recover all other ISRS-related costs, which include depreciation expense and property taxes on ISRS plant investments.

In paragraph 6 of its Application, MGE asserts that all of its proposed eligible infrastructure system replacements meet the following requirements stated in Section 393.1009:

1. They replace or extend the useful life of existing infrastructure;
2. They are in service and are used and useful;
3. They do not increase revenues by directly connecting the infrastructure replacement to new customers; and
4. They were not included in the Company's most recent general rate case, Case No. GR-2004-0209.

MGE also asserts that all of its proposed eligible infrastructure system replacements include the type of gas utility plant projects required by Section 393.1009, which are:

1. Mains, valves, service lines, regulator stations, vaults, and other pipeline system components installed to comply with state or federal safety requirements as replacements for existing facilities that have worn out or are in deteriorated condition;
2. Main relining projects, service line insertion projects, joint encapsulation projects, and other similar projects extending the useful life, or enhancing the integrity of pipeline system components undertaken to comply with state or federal safety requirements; and
3. Facilities relocations required due to construction or improvement of a highway, road, street, public way, or other public work by or on behalf of government entities having the power of eminent domain provided that the costs related to such projects have not been reimbursed to MGE.

In its Application, MGE requested an adjustment to its rates and charges through an increase to its ISRS rates. MGE's current ISRS rates were established effective May 13, 2005, as the result of the Commission's Order Approving Tariff in Compliance with Commission Order in Case No. GO-2005-0273. The current ISRS rates cover investments made for the period May 1, 2004 through December 31, 2004 and generate \$1,164,726 of revenues on an annual basis. The Company has continued to incur ISRS eligible costs for the period January 1, 2005 through October 31, 2005. These costs, reflected in this ISRS filing, are intended to generate an additional \$1,223,622 of annual revenues. The Company's proposed ISRS tariff in this application includes both revenue amounts

(totaling \$2,388,348) and would take effect no later than March 7, 2006 (120 days after MGE's Application was filed).

THE ISRS RATE SCHEDULES

As a basis for computing the monthly ISRS charge, MGE begins with the average customer numbers from each class from their filed 2004 annual report. Section 393.1015.5(1) allows that "each customer class maintains a proportional relationship equivalent to the proportional relationship of the monthly customer charge for each class." The Energy Staff has computed the ISRS surcharge based on the Auditing Department's Revenue Requirement mentioned above.

The Company is using a total customer count of 509,192 in this submission, which is consistent with MGE and Staff's prior ISRS filings in Case Nos. GO-2005-0273.

The Staff computed its ISRS rates in a manner consistent with all previous Staff computed ISRS recommendations. MGE has deviated from Staff's accepted methodology. MGE has added its rates computed from this filing to the rates computed in the previous GO-2005-0273 filing. MGE's procedure of adding the current effective ISRS rates to the separately computed ISRS rates from this case has resulted in slightly different "composite" rates than the "composite" rates that would be calculated under the Staff method. The Staff method computes the ISRS rates from the "composite" revenue requirement, and not, as MGE has done, by adding the separately computed ISRS rates that are derived from the GO-2005-0273 and GO-2006-0201 revenue requirements.

The differences between these methods are illustrated below:

Staff's Common Practice (Composite methodology)

Res	\$.36
Small Gen Ser	\$.48
Large Gen Vol	\$2.86
Large Vol Ser	\$14.74

MGEs "Add Old Rate to New"

Res	\$.35
Small Gen Ser	\$.49
Large Gen Vol	\$2.87
Large Vol Ser	\$14.74

STAFF'S CONCLUSIONS

Based on its examination and calculations, the Staff has determined that the Company's ISRS rates should be designed to recover annual revenues totaling \$2,388,348. This figure is comprised of \$1,223,622, from this application, and \$1,164,726 from Case No. GO-2005-0273. The Staff's determination of the \$1,223,622 in this application and the supporting calculations are shown in Attachment A to this Memorandum. These calculations reflect the cost of debt and

overall rate of return approved by the Commission's Order in MGE's most recently completed general rate proceeding, Case No. GR-2004-0209. The Staff believes that the projects proposed and included by MGE in this proceeding meet the requirements of Sections 393.1009, 393.1012 and 393.1015 RSMo.

Based on its examination and calculations, the Energy Staff has designed MGE's ISRS rates for each customer class based on the Auditing Department's ISRS revenue requirement of \$1,223,622 in this application and the ISRS revenue requirement of \$1,164,726 in Case No. GO-2005-0273. This proposal maintains the proportional relationship that is equivalent to the proportional relationship of the monthly customer charge for each customer class. The Staff's determination of these rates and the supporting calculations are shown in Attachment B to this Memorandum.

ASSESSMENTS, ANNUAL REPORTS AND OPEN CASES

The Staff has verified that the Company has filed its annual report and is not delinquent on any assessment. The Staff has reviewed this filing and is not aware of any issue currently pending before the Commission that affects, or is affected by, this filing. However, the following open cases involving this Company are before the Commission at this time:

Complaints	GC-2006-0066		
Application	GO-2006-0201		
PGA/ACA	GR-2003-0330	GR-2005-0104	GR-2005-0169
Rate Case	GR-2001-382		
Working Group	GW-2006-0110		
Rulemaking	GX-2006-0181		

STAFF'S RECOMMENDATIONS

Based upon the above, the Staff recommends that the Commission issue an order in this case that:

1. Rejects the tariff sheet filed by MGE on November 7, 2005, (assigned tariff number YG-2006-0348);
2. Authorizes MGE to file a tariff to impose an Infrastructure System Replacement Surcharge that is sufficient to recover appropriate annual pre-tax revenues in the amount of \$2,388,348 (\$1,223,622 from this application and \$1,164,726 from Case

- No. GO-2005-0273). This tariff sheet should use the traditional methodology of consolidating the two revenue requirements when computing the new ISRS rate.
3. Authorizes MGE to file an ISRS rate for each customer class that is reflected in Attachment B to this Memorandum.

Copies: Director - Utility Operations Division
Director - Utility Services Division
General Counsel
Manager - Procurement Analysis Department
Robert J. Hack – Vice President of Pricing & Regulatory Affairs (MGE)
Dean Cooper – Attorney with Brydon, Swearingen & England P.C.
Office of the Public Counsel

Missouri Gas Energy				
ISRS Calculation				
GO-2006-0201				
<u>ISRS Activity:</u>				
Gas Utility Plant Projects--Replacement Mains, Services and Associated Valves and Regulators (RM) RSMo 393.1012:				
SLRP		\$2,327,405		
Public Improvements		\$2,480,920		
Blanket Workorders - Service Line Peplacement		\$2,693,981		
Blanket Workorders - Encapsulation & Services		\$910,301		
Blanket Workorders - Meter & Regulator Settings		\$631,635		
Total Net 393.1012		\$9,044,242		
Deferred Taxes		(\$159,690)		
Accumulated Depreciation		(\$217,480)		
Total ISRS Rate Base		\$8,667,072		
Total ISRS Rate Base		\$8,667,072		
Rate of Return per Order in Case No. GR-2004-0209		8.36%		
<u>Revenue</u>		\$724,781		
Income Tax Conversion Factor		1.62308		
Revenue Requirement before Interest		\$1,176,377		
Total ISRS Rate Base		\$8,667,072		
Embedded Cost of Debt per Order in Case No. GR-2004-0209		4.72%		
Interest Expense Deduction		\$408,826		
Combined Federal and State Income Tax Rate per last Order		38.39%		
Total Revenue Requirement on Capital		\$156,955		
Income Tax Conversion Factor		1.62308		
Revenue Requirement Impact - Interest Deductability		\$254,750		
Total Revenue Requirement		\$921,627		
Amortization of Under-recovery of previous ISRS		\$0		
Depreciation Expense		\$206,311		
Property Taxes		\$95,684		
Total ISRS Revenues		\$1,223,622		

Missouri Gas Energy			
ISRS Calculation			
GO-2006-0201			
Property Tax Calculation			
ISRS Investment Subject to Property Taxes		\$9,044,242	
Less: Retirements		(\$465,691)	
Net Change in Property Base		\$8,578,550	
Current Property Tax Rate		1.12%	
Property Tax Expense		\$95,684	
Depreciation Expense Summary			
Service Line Replacements Depreciation Expense		\$52,914	
Public Improvements Depreciation Expense		\$56,422	
Blanket Workorders Depreciation Expense		\$107,702	
Retirements Depreciation Expense		(\$10,727)	
Total Depreciation Expense		\$206,311	

MISSOURI GAS ENERGY **Missouri Gas Energy**
GO-2006-0201

CASE NO. GO-2006-0201
FILE NO. YG-2006-0348
ISRS RATE DESIGN

Company's Total ISRS Revenues \$2,388,348
(See Staff's supporting calculation)

Customer Rate Class	Number of Customers	Customer Charges	Ratio To Res. Cust. Charge	Weighted Customer #	Customer Percentage	ISRS charge	ISRS Revenues
Residential	441747	\$11.65	1.0000	441747	79.5978%	\$0.36	\$1,901,073
Small General Service	66559	\$15.70	1.3476	89698	16.1625%	\$0.48	\$386,016
Large General Service	389	\$93.00	7.9828	3105	0.5595%	\$2.86	\$13,364
Large Volume Service	497	\$478.75	41.0944	20424	3.6802%	\$14.74	\$87,895
Whiteman Air Force Base	0	\$478.75	41.0944	0	0.0000%		\$0
Intrastate Transportation Service	0	\$478.75	41.0944	0	0.0000%		\$0
CNG - Fuel in vehicles	0	\$15.70	1.3476	0	0.0000%		\$0
TOTAL	509192			554974	100.0000%		\$2,388,348