M E M O R A N D U M

TO: Missouri Public Service Commission Official Case File
Case No. GO-2005-0273 – Missouri Gas Energy

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

/s/ Charles Hyneman 04/13/05	/s/ Lera Shemwell 04/13/05
Project Coordinator / Date	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 Establish an Infrastructure System Replacement Surcharge

DATE: April 13, 2005

BACKGROUND

On February 14, 2005, Missouri Gas Energy (MGE) a division of Southern Union Company (Southern Union) filed an Application and Petition for Establishment of an 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 (2003), which became effective on August 28, 2003. These statutory sections provide eligible gas corporations with the ability to recover certain ISRS costs without a general rate case filing and prohibit a 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 proper calculation of the proposed charge. The Staff may submit a report regarding its examination to the Commission not later than sixty days after the petition is filed. This Memorandum is being filed in accordance with this provision.

STAFF'S INVESTIGATION

Staff members from the Auditing and Energy Departments participated in the Staff's examination of the Application. The Auditing Department'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. Additionally, information regarding the status of MGE's assessment payment histories and annual report filing histories are set out below.

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 addition to ISRS-related costs, MGE's Application includes the cost to remove the non-ISRS gas plant prior to the installation of new ISRS plant (cost of removal).

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 the implementation of an ISRS rate schedule intended to generate $1,364,610 of additional revenues on an annual basis. The Company's proposed ISRS tariff would take effect no later than June 14, 2005 (120 days after MGE's Application was filed).

Section 393.1012.1 contains a ISRS materiality requirement that prevents the Commission from approving MGE's ISRS if it would produce annual ISRS revenues below the lesser of one million dollars or one-half of one percent of MGE's base revenue level approved by the Commission in MGE's most recent general rate proceeding. Both MGE's proposed and the Staff's recommended level of annual ISRS revenues exceed one million dollars.

ADJUSTMENTS TO MGE'S REVENUE CALCULATION

MGE's proposed ISRS surcharge consists of the following cost components:

1.	Return on ISRS Plant	$751,854
2.	Depreciation Expense	$197,974
3.	Property Taxes	$ 93,425
4.	Cost of Removal	$199,884
5.	Underrecovery of MGE's previous ISRS charge	$121,474
	Total ISRS	$1,364,611

MGE incorrectly included cost of removal expense in the amount of $199,884 as a component of total ISRS revenues. Section 393.1009(7) defines ISRS costs as depreciation expense and property taxes. Cost of removal is not included in this definition. The Staff is removing this expense because it is not an ISRS cost permitted by statute to be considered in the ISRS calculation. Section 393.1015.2(2) specifically prohibits any examination of other revenue requirement or ratemaking issues in consideration of ISRS filings made pursuant to the provisions of Sections 393.1009 to 393.1015.

During its review of MGE's ISRS work orders, the Staff noted four work orders where MGE failed to obtain the required contribution or reimbursement from the government entity requiring a main relocation. The work order numbers and the amount included as ISRS plant by MGE in its Application are:

1. 98-6514 $100,000
2. 03-5048 $55,469
3. 03-5258 $1,072,764
4. 03-5980 $123,685

The determination of whether or not the costs related to these work orders (return, depreciation and property taxes) are valid ISRS costs involves a determination of the prudency of MGE's management actions and the reasonableness of the costs charged to these work orders. This determination is beyond the audit scope that is allowed for the Staff review under the ISRS legislation and, therefore, is not addressed in the Memorandum. However, the Staff will review the prudency of these costs in MGE's next rate case and propose any adjustment or refund of the ISRS charge allowed in this case in MGE's next ISRS Application.

THE ISRS RATE SCHEDULES

To compute the monthly ISRS charge, MGE has recommended using the customer numbers from their filed 2003 annual report and the provision from Section 393.1015.5(1) which 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 computes the ISRS surcharge based on the Auditing Department's ISRS revenue requirement and the same provision mentioned above. The Energy Department Staff is using the customer numbers to be filed in MGE's 2004 annual report with the Auditing Staff's revenue requirement in the derivation of MGE's ISRS rates. The methodology is consistent with MGE's previous ISRS filings in Case No. GO-2004-0242.

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 of $1,164,726. This amount reflects MGE's proposed ISRS of $1,364,611 less the Staff's adjustment to remove the cost of removal component of $199,884. The Staff's determination of this amount and the supporting calculations are shown in Attachment A to this Memorandum. These calculations reflect the cost of debt and overall rate of return ordered by the Commission in MGE's most recently completed general rate proceeding, Case No. GR-2004-0209.

With the possible exception of the work orders noted above, based on a "spot-check" of the project work orders included for recovery in the Company's proposed ISRS, the Staff believes that the projects included meet the requirements of Sections 393.1009, 393.1012 and 393.1015 RSMo.

The underecovery of MGE's previous ISRS in the amount of $121,474 that is included in this ISRS should be fully recovered after 12 months of this ISRS being in effect. If this is the case, this component will be removed in the 12-month ISRS reconciliation required by Section 393.1015.5(2). Assuming no other differences in the approved ISRS and actual ISRS dollars recovered, MGE ISRS will be adjusted from $1,164,726 to $1,043,252 after the initial 12-month period.

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 $1,164,726. 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 AND ANNUAL REPORTS

In accordance with established practice regarding the submission of Staff recommendations to the Commission, the Staff has reviewed the status of the Applicant's assessment payments and annual report filings. In this regard, the Staff reviewed electronic information maintained by the Commission's Budget and Fiscal Services Department and Data Center, and information in the Commission's Electronic Filing and Information System. Based on its review of this information, the Staff notes that MGE has no delinquent assessments and no past due annual reports.

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 file by MGE on February 14, 2005, (assigned tariff number YG-2005-0615);
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 $1,164,726.
3. Authorizes MGE to file an ISRS rate for each customer class that is reflected in Attachment B to this Memorandum.

Missouri Gas Energy
Staff ISRS Calculation
GO-2005-0273

ISRS Activity:

Gas Utility Plant Projects--Replacement Mains, Services and Associated Valves and Regulators (RM) RSMo 393.1012:

SLRP	$1,977,889
Public Improvements	$3,476,362
Blanket Workorders - Encapsulation & Services	$3,318,306
Blanket Workorders - Meter & Regulator Settings	$84,634
Total Net 393.1012	$8,857,191
Deferred Taxes	($1,725,963)
Accumulated Depreciation	($60,722)
Total ISRS Rate Base	$7,070,506
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Rate of Return per Order in Case No. GR-2004-0209	8.36%
Revenue	$591,268
Income Tax Conversion Factor	1.62308
Revenue Requirement before Interest	$959,676
Total ISRS Rate Base	$7,070,506
Embedded Cost of Debt per Order in Case No. GR-2004-0209	4.72%
Interest Expense Deduction	$333,516
Combined Federal and State Income Tax Rate per last Order	38.39%
Total Revenue Requirement on Capital	$128,042
Income Tax Conversion Factor	1.62308
Revenue Requirement Impact - Interest Deductability	$207,822
Total Revenue Requirement	$751,853
Under-recovery of previous ISRS	$121,474
Depreciation Expense	$197,974
Property Taxes	$93,425
Total ISRS Revenue Rrequirement	$1,164,726

Attachment A

MISSOURI GAS ENERGY
CASE NO. GO-2005-0273
FILE NO. YG-2005-0615
ISRS RATE DESIGN
ISRS RATE FILING NO.3

Company's Total ISRS Revenues $1,164,726
(See company 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%	$0.17	$927,096
Small General Service	66559	$15.70	1.3476	89698	16.1625%	$0.24	$188,249
Large General Service	389	$93.00	7.9828	3105	0.5595%	$1.40	$6,517
Large Volume Service	497	$478.75	41.0944	20424	3.6802%	$7.19	$42,864
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%		$1,164,726

* Due to rounding to the nearest penny, the designed ISRS rates will under collect by $22,456. However, it should be noted that the total amount collected will be trued-up at a later date.

Attachment B