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.	))))	**<u>Case No. GO-2009-0009</u>** YG-2009-0008

<u>STAFF REPLY TO MGE'S RESPONSE</u>

COMES NOW the Staff of the Missouri Public Service Commission, in reply to the Commission's September 8, 2008 Order Directing Reply to MGE Response, and states:

1. Nowhere in its recommendation does the Staff offer any rationale as to why a mismatch between ISRS eligible plant balances (as of May 31, 2008) and depreciation and the deferred tax reserve (as of October 30, 2008) is reasonable and appropriate.

<u>Staff Reply</u>: In its Memo, the Staff did in fact provide a specific explanation why it used the October 30, 2008 depreciation reserve date. The Staff explained that this date more closely reflects MGE's net investment in ISRS plant near the date the surcharge will go into effect. The following quote is from page 4 of the Staff's Memo:

> *This would make the effective date of the customer surcharge from this case about October 30, 2008. <u>The Staff used the October 30, 2008 date for the depreciation reserve and deferred tax reserve in its calculation of ISRS revenues, as that more closely reflects MGE's net investment in ISRS plant near the date the surcharge will go into effect.(emphasis added)</u>*

The issue in question relates the appropriate date on which to value MGE's net investment in ISRS plant. The Commission needs to decide if the net investment in ISRS plant should be valued at a date as close as possible to the date the ISRS will go into effect, which is October 30, 2008 (Staff's position) or should the surcharge be based on the net investment value on or about the date MGE filed its Application, June 30, 2008 (MGE's position).

2. MGE has requested, both informally and formally, the Staff to explain its rationale for this proposed mismatch, but as of the date of this filing, the Staff has not yet provided MGE with any rationale.

Staff Reply: Staff received data request no. 7 from MGE on Tuesday September 2, 2008 asking the Staff to explain why it believes that a "mismatch" between ISRS eligible plant balances (as of May 31, 2008) and depreciation and the deferred tax reserve (as of October 30, 2008) is reasonable and appropriate.

On the same day, the Staff contacted MGE and asked MGE to explain what it meant by the term "mismatch" in this specific data request. MGE responded to this email and stated that it meant "matching up the plant and reserve just like a normal rate base would." The Staff has had no further discussion with MGE on this topic and is in the process of responding to MGE's data requests.

3. MGE believes that depreciation and the deferred tax reserve should be calculated as of the same date as the ISRS eligible plant.

Staff Reply: MGE's proposal to calculate the amount of the ISRS that will go into effect in October 2008 based on the net investment of the ISRS plant at June 30, 2008 is deficient. It is deficient not only because it lacks a significant theoretical basis, it is deficient primarily because it does not reflect reality. It does not reflect the reality that its net ISRS investment has been updated since it filed its Application through the recognition of depreciation expense on this specific vintage of ISRS plant. MGE's proposal also ignores the reality that the net ISRS plant that the Staff is using in its ISRS calculation is the same net plant amount that is or will be reflected on MGE's books and records when the ISRS goes into effect on October 30, 2008.

For each month that passes since the ISRS plant was placed in service MGE recorded depreciation expense on this plant. This accounting recognition was made in MGE's books and records. The amount of the depreciation expense on the ISRS plant is charged to the depreciation reserve, which increases the amount of the reserve and reduces the value of the plant to a net plant amount (plant less depreciation reserve). As each month passes, the net investment in ISRS plant is continually reduced.

Similarly, as time passes, the deferred tax reserve associated with this plant increases which decreases the net investment in ISRS plant.

MGE calculates the surcharge on a net investment amount at June 30, 2008, a date that has no relevance. The correct valuation of the ISRS plant is the net investment amount that will be in effect as close as possible to the date the ISRS goes into effect. This is MGE's actual net original cost of the ISRS plant that is addressed in the Commission's ISRS Rules. The net original cost of the ISRS plant back on June 30, 2008 no longer exists.

Commission Rule 4 CSR 240-3.265 (1) *Natural Gas Utility Petitions for Infrastructure System Replacement Surcharges* defines ISRS revenues as the appropriate pretax revenues necessary to:

> Produce net operating income equal to the natural gas utility's weighted cost of capital multiplied by the <u>net original cost of eligible infrastructure system replacements,</u> including recognition of accumulated deferred income taxes and accumulated depreciation associated with eligible infrastructure system replacements that are included in a currently effective infrastructure system replacement surcharge (ISRS); (emphasis added)
>
> 2. Recover state, federal, and local income or excise taxes applicable to such income; and
>
> 3. Recover all other ISRS costs;

The "<u>net original cost of eligible infrastructure system replacements</u>", simply means the ISRS plant less the amount of depreciation expense that MGE has recognized on its books and records related to that plant (ISRS plant placed in service during the period October 2007 through May 2008).

As of July 2, 2008, when it filed its case, MGE had only recognized $96,495 of depreciation expense on this specific plant. However, each month, MGE will recognize on its books $21,024 in depreciation expense related to this $10,715,787 of ISRS plant. When this ISRS becomes effective on October 30, 2008, the depreciation reserve will have grown from $96,495, to $180,591 on MGE's books and records.

While it continues to record the accrual of depreciation expense for this specific vintage of ISRS plant on its books and records, and while it continues to reflect an updated net investment in ISRS plant on its balance sheet each month, MGE is asking the Commission to allow it to calculate its ISRS based on what the net ISRS investment was when it decided to file its ISRS Application, June 2008

The Staff does not believe that updating the depreciation and deferred income tax reserves through October 2008 on ISRS on ISRS plant placed in service through June 2008 ISRS plant results in any mismatch. The Staff has calculated the specific depreciation reserve and deferred income tax reserve on the specific ISRS plant that MGE included in its Application. Time does not stand still. During the pendency of this ISRS case, the depreciation and deferred tax reserves on this vintage ISRS plant keeps growing and growing, and MGE net investment in this ISRS plant keeps decreasing over this time period. The Staff recommends that it reject MGE's method of using an outdated net ISRS investment amount in the calculation of the ISRS and adopt the Staff's method of calculation which reflects the use of MGE actual net ISRS investment when the ISRS will be passed on to MGE's ratepayers.

WHEREFORE Staff submits its Reply to MGE's Response as directed by the Commission.

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 electronically mailed to all counsel of record this 10th day of September 2008.

/s/ Robert S. Berlin______________