MGE MISSOURI GAS ENERGY
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FILED
MAY 9 1997
MISSOURI
PUBLIC SERVICE COMMISSION

ROBERT J. HACK
SENIOR ATTORNEY

May 8, 1997

Mr. Cecil I. Wright
Executive Secretary
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102

VIA FEDERAL EXPRESS

Re: Case No. GO-97-301, Missouri Gas Energy

Dear Mr. Wright:

Enclosed for filing in the above-referenced case are an original and fourteen (14) conformed copies of Missouri Gas Energy's Application for Rehearing. Please stamp as "filed" the extra copy that is enclosed and return it to my office in the enclosed self-addressed stamped envelope.

A copy of this filing has been mailed this date to the Office of the Public Counsel.

Thank you for your attention to this matter.

Sincerely,

Robert J Hack

CC: Roger W. Steiner
Douglas E. Micheel
Charles B. Hernandez

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MAY 9 1997

MISSOURI PUBLIC SERVICE COMMISSION

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 the issuance of an accounting order relating to gas safety projects.	)))))	Case No. GO-97-301

MISSOURI GAS ENERGY'S APPLICATION FOR REHEARING

Comes Now Missouri Gas Energy (MGE) pursuant to the provisions of Section 386.500 RSMo 1994 and 4 CSR 240-2.160 and in support of this Application for Rehearing respectfully states the following:

1. MGE filed this application for an accounting authority order on February 4, 1997. The Commission's Staff recommended conditional approval by memorandum dated April 11, 1997, and filed April 14, 1997. The recommendation of the Commission's Staff was not received by MGE in its offices until April 21, 1997. On May 2, 1997, the Commission issued its order granting the application subject to the conditions recommended by the Staff.

2. First, MGE seeks clarification of the Commission's order regarding the continued deferral of regulatory assets recorded pursuant to the Commission's order in Case No. GO-94-234 (at pages 5 and 7 of the order) which were not reflected in the rates fixed by the Commission in Case No. GR-96-285. Second, it is arbitrary, capricious, unreasonable, an abuse of discretion and unlawful for the Commission not to specify a carrying cost rate for MGE to use as it books these deferrals of costs associated with gas safety investment

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after the plant has been placed in service. Third, inasmuch as the Commission (at page 6 of its order) has authorized MGE to use "actual carrying costs incurred" as it books these deferrals of costs associated with gas safety investment after the plant has been placed in service, it is reasonable, appropriate and necessary for the Commission to specify that the rate to be used is 9.46%, the return on rate base (weighted average cost of capital) recently found reasonable and authorized by the Commission in Case No. GR-96-285.

Clarification Regarding Continued Deferral of Regulatory Assets Initially Authorized in Case No. GO-94-234

3. By its application, MGE seeks, among other things, authority to use a carrying cost rate of 9.46% in calculating the deferrals to be recorded pursuant to the authority granted in this case (i.e., the continued deferrals associated with gas safety plant placed in service before February 1, 1997, and the new deferrals associated with gas safety plant placed in service beginning February 1, 1997). In its application, MGE specifically raised the matter of the continued deferral of the regulatory assets authorized in Case No. GO-94-234 but not reflected in rates fixed by the Commission in Case No. GR-96-285 because MGE interpreted the authority under that order (Case No. GO-94-234) as ceasing once the deferrals of gas safety plant placed in service through January 31, 1997, had been recorded in February of 1997.

4. At page 7 of its order, in Ordered paragraph 4, the Commission stated

> [T]hat Missouri Gas Energy may continue to record as regulatory assets the deferrals of carrying costs, property taxes and depreciation expense under GO-94-234 for the period November 1, 1996 through January 31, 1997, and may request rate recovery of such assets in its next rate proceeding.

These deferrals relate both to plant placed in service before November 1, 1996, and to plant placed in service from November 1, 1996, through January 31, 1997. By its order in Case No. GO-94-234, the Commission specifically authorized MGE to use a 10.54% carrying cost rate. (Order, p. 4, Case No. GO-94-234, effective October 11, 1994). This rate was equivalent to the then-most recently authorized return on rate base (weighted average cost of capital) found reasonable by the Commission for The Kansas Power & Light Company. Re: Kansas Power & Light Company, 1 Mo.P.S.C. 3d 235, 252 (1992). As written, the instant order appears to require MGE to use a carrying cost rate of 10.54% for the continued deferrals associated with gas safety plant placed in service before February 1, 1997.

5. MGE seeks clarification that the Commission did not intend for MGE to use a carrying cost rate of 10.54% for the continued deferrals associated with gas safety plant placed in service before February 1, 1997. MGE asserts that the Commission should specifically authorize MGE to use a carrying cost rate of 9.46% (the most recently authorized return on rate base) for the continued deferrals associated with gas safety plant placed in service before February 1, 1997. At a minimum, the Commission should clearly indicate that MGE may book these continued deferrals using "actual carrying costs incurred."

The Commission Should Specify a Carrying Cost Rate of 9.46% in the Order

6. In its order, at page 6, the Commission authorized MGE to use "actual carrying costs incurred" in booking the new deferrals associated with gas safety plant placed in service beginning on February 1, 1997, instead of a specific rate of 9.46% as requested by MGE in its application. The Commission has in the past authorized the use of specific carrying cost rates for purposes of accounting authority orders. In the instant order the Commission has offered no explanation as to why it has not specified a carrying cost rate for MGE to use as it books the deferrals authorized by the Commission. Nor has the Commission offered any explanation as to why 9.46% is an inappropriate carrying cost rate for MGE to use as it books the deferrals authorized by the Commission.

7. Under generally accepted accounting principles (GAAP) as well as the Uniform System of Accounts (USOA), costs associated with gas safety plant (such as depreciation and property taxes) are booked to expense after the asset is placed in service, thereby exerting downward pressure on achieved returns and earnings, absent immediate rate relief. Also under GAAP and USOA, when assets, such as gas safety plant, are placed in service, overall plant investment levels increase, thereby exerting downward pressure on achieved returns and earnings, absent immediate rate relief. The negative earnings impact associated with MGE investing, in order to comply with a Commission-promulgated rule, approximately $20 million annually in gas safety assets that produce no incremental revenue has been recognized by the Commission as a

problem and has caused the Commission itself, as well as parties to proceedings before the Commission, to seek solutions. The Commission has settled on the accounting authority order as a viable solution to this problem.[1]

8. The recording of regulatory assets pursuant to an accounting authority order is accepted by GAAP and USOA, if properly authorized and structured by the Commission, and mitigates the substantial downward earnings effect of MGE's gas safety program by trapping the relevant costs (depreciation expense, ad valorem taxes and carrying costs or unrealized return on investment) and deferring them for recovery in subsequent periods. Without an accounting authority order, MGE must book these costs in the traditional manner and, absent timely rate relief (which is unavailable under current regulatory law, custom and practice in Missouri), suffer substantially reduced earnings as a result. MGE, therefore, needs clear, specific and complete instructions from the Commission in booking these deferrals in order for the accounting authority order to achieve its intended purpose.

9. Specifically, MGE needs direction as to what carrying cost rate it is to use as it books these deferrals after the gas safety assets have been placed in service. This guidance was requested by MGE in its application and is both appropriate and necessary in order for MGE to book the deferrals in accordance with the authority granted by the Commission. Provision of this guidance by the Commission is also necessary for MGE, the financial community (i.e., industry analysts, investors, stockholders, lenders etc.) and the Commission itself to be

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[1] See Re: Kansas Power & Light Company, 1 Mo.P.S.C. 3d 235, 238 (1992).

able to identify and understand with some degree of assurance the relative impacts of the gas safety program and the accounting authority order on MGE's achieved returns and earnings. By clearly defining the authority it grants now, the Commission can also appropriately avoid future disputes about what that authorization actually means and whether, on the basis of hindsight analysis, MGE construed the authorization appropriately.[2]

10. FASB Statement 71, issued by the Financial Accounting Standards Board, sets out the standards that must be met in order for independent auditors to recognize the creation of a valid regulatory asset which would allow the deferral of costs to a period other than the one in which such costs would traditionally be recognized. First, it must be probable that the capitalized costs will be allowable for ratemaking purposes and that future revenues will equal the capitalized cost. Second, based on the available evidence, it must be probable that rates set in the future will provide revenue sufficient to recover the previously incurred costs instead of being set to provide for recovery of expected levels of similar future costs. Unless the Commission specifies a carrying cost rate for MGE to use as it books these deferrals, the extent of the costs to be capitalized pursuant to this authority order cannot be known with any degree of certainty. As such, whether it is probable that the capitalized costs will be allowable for ratemaking purposes and that future revenues will equal the capitalized costs is also unknown. The Commission, therefore, must specify a

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[2] By granting clear and specific authority as requested in the application and herein, the Commission will not impair its ability to review the reasonableness of MGE's administration of and investment in the gas safety program during a subsequent rate proceeding.

carrying cost ratein the accounting authority order to meet the standards of FASB Statement 71 for the creation of a valid regulatory asset which will permit independent auditors to recognize the associated deferrals and not require the immediate recognition of such expenditures in the period incurred.

11. As used in the parlance of an accounting authority order, carrying costs equate to return on investment that is unrealized due to the inability to achieve timely rate relief. According to the Staff, the accounting authority order is designed to eliminate the effects of regulatory lag.[3] According to the Commission, the accounting authority order is a viable alternative to the inclusion of future plant in rate base to rectify the substantial negative earnings effects of regulatory lag and the gas safety program on MGE. Given these stated purposes, the only reasonable carrying cost for MGE to use is the most recently authorized return on rate base (weighted average cost of capital) found reasonable by the Commission for MGE which, for purposes of the accounting authority order sought in this application, is 9.46%.[4]

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[3] See Rebuttal Testimony of Mark L. Oligschlaeger, Case No. GR-96-285, pages 2-5 (attached hereto as Appendix A).

[4] The Staff recommended, at page 4 of its memorandum, that if the Commission elected to specify a carrying cost rate in the accounting authority order, it should direct the use of a rate equivalent to MGE's allowance for funds used during construction (AFUDC). An AFUDC-based rate is inappropriate for this particular circumstance. AFUDC is designed to compensate a utility for funds used during the construction of an asset. Accrual of AFUDC ceases when construction ends and the asset is placed in service. Under the accounting authority order sought by MGE, as well as other accounting authority orders previously granted by the Commission, the gas safety deferrals (depreciation, property taxes and carrying costs or unrealized return on investment) are not booked until after construction is complete and the asset is placed in service. If immediate rate relief was available, the gas safety plant would be placed in rate base at this point and begin earning a return on the investment, as well as accruing depreciation expense and property tax expense.

12. For all of the foregoing reasons, it is arbitrary, capricious, unreasonable, an abuse of discretion and unlawful for the Commission not to specify a carrying cost rate of 9.46% for MGE to use as it books the deferrals of costs associated with gas safety investment after the plant has been placed in service.

Wherefore MGE respectfully requests that the Commission issue its order granting this application for rehearing and specifying that MGE is to use a carrying cost rate of 9.46% in calculating the continued deferrals associated with gas safety plant placed in service before February 1, 1997, and in calculating the new deferrals associated with gas safety plant placed in service beginning on February 1, 1997. In so doing the Commission should also revise Ordered paragraph 2 to read as follows: [T]hat nothing in this order shall be considered a finding by the Commission of the reasonableness of the expenditures involved herein, or of the value for ratemaking purposes of the expenditures and property herein involved, or as an acquiescence in the value placed on these expenditures and property by Missouri Gas Energy, and the Commission reserves the right to consider the ratemaking treatment to be afforded these expenditures in any later proceeding.

Respectfully submitted,

Robert J. Hack #36496
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Kansas City, Missouri 64111
(816) 360-5755
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Attorney for Missouri Gas Energy

VERIFICATION

STATE OF MISSOURI)
)
COUNTY OF JACKSON)

On this 8th day of May, 1997, before me appeared Charles B. Hernandez, Director, Pricing and Regulatory Affairs for Missouri Gas Energy, to me personally known, who being by me first duly sworn, states that he has read the above and foregoing document and believes that the allegations therein are true and correct to the best of his information, knowledge and belief.

Subscribed and sworn to before me this 8th day of May, 1997.

Notary Public

My Commission expires: February 3, 2001

[illegible]
Notary Public-Notary Seal
State of Missouri
Jackson County
My Commission Expires Feb 3, 2001

CERTIFICATE OF SERVICE

The undersigned attorney hereby certifies that the foregoing was hand delivered or served via U.S. Postal Service this 8th day of May, 1997, upon:

Mr. Roger W. Steiner
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102

Mr. Douglas E. Micheel
Office of the Public Counsel
P.O. Box 7800
Jefferson City, MO 65102

Robert J. Hack

Attorney

Exhibit No.:
Issues: Riders and Savings Sharing Issue
Witness: Mark L. Oligschlaeger
Sponsoring Party: MoPSC Staff
Type of Exhibit: Rebuttal Testimony
Case No.: GR-96-285

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

MISSOURI GAS ENERGY DIVISION OF SOUTHERN UNION COMPANY

CASE NO. GR-96-285

Jefferson City, Missouri
September 1996

Appendix A

REBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

MISSOURI GAS ENERGY DIVISION OF SOUTHERN UNION COMPANY

CASE NO. GR-96-285

Q. Please state your name and business address.

A. Mark L. Oligschlaeger, P.O. Box 360, Jefferson City, MO 65102.

Q. By whom are you employed and in what capacity?

A. I am a Regulatory Auditor with the Missouri Public Service Commission (Commission).

Q. Please describe your educational background and work experience.

A. I attended Rockhurst College in Kansas City, MO, and received a Bachelor of Science degree in Business Administration with a major in Accounting in August 1981. I have been employed by the Commission since September 1981 within the Accounting Department. In November 1981, I passed the Uniform Certified Public Accountant (CPA) examination and, since February 1989, I have been licensed in the state of Missouri as a CPA.

Q. Have you previously filed testimony before this Commission?

A. Yes. A listing of cases in which I have previously filed testimony before this Commission is given in Schedule 1, attached to this rebuttal testimony.

Q. What is the purpose of this rebuttal testimony?

A. The purpose of this rebuttal testimony is to address the direct testimony of Missouri Gas Energy (MGE or Company) witness F. Jay Cummings concerning the

Company's proposal to institute use of a "gas safety rider" (GSR) and an "incentive regulation rider" (IRR) for rate purposes. I will also address the proposal of Company witness David N. Dittemore to share certain alleged acquisition-related savings between MGE's customers and shareholders.

GAS SAFETY RIDER

Q. Please describe MGE's current gas safety construction program.

A. In 1989, the Commission implemented new rules which required systematic upgrades to portions of Missouri utilities' natural gas distribution systems, particularly relating to replacement of certain service lines and yard lines and replacement and cathodic protection of mains. 4 CSR 240-40.030. Promulgation of these rules generally had an impact of substantially increasing gas utilities' construction expenditures, especially for MGE and prior to MGE, Western Resources, Inc. (WRI).

Q. Has the Commission allowed the use of any special regulatory mechanisms to aid utilities in recovering costs associated with their safety construction programs?

A. Yes. The Commission has set a policy of using accounting authority orders (AAOs) to allow gas utilities to defer the costs associated with safety construction programs for ultimate rate recovery. Use of AAOs eliminate the impact of "regulatory lag" on utilities' earnings related to safety construction.

Q. What is "regulatory lag"?

A. Regulatory lag is the lapse of time between a change in a utility's revenue requirement and reflection of that change in the utility's rates.

Q. What are AAOs?

A. AAOs are devices that are used to "capture" the financial impact of certain events that are normally reflected on the utility's income statement, and suspend the related dollars on the utility's balance sheet for future periods, when it will be eligible for inclusion in rates.

Q. How does the use of AAOs eliminate the impact of regulatory lag on the Company's safety investment?

A. Normal construction accounting for utilities allows the booking of a deferred return, known as the Allowance for Funds Used during Construction (AFUDC), during an asset's construction period to compensate for the carrying cost (financing cost) of the asset. After the asset is placed into service, accrual of AFUDC ceases, and the AFUDC booked during the construction period becomes part of the overall cost of the asset, to be recovered by the utility through depreciation charges over the life of the asset. However, once accrual of AFUDC on an asset ceases, the asset is placed in rate base for the purpose of calculating the utility's return, and depreciation on the asset begins to be recorded, even if the utility's rates have not changed to reflect the asset going into service. The increased required return attributable to the new asset, as well as the increased depreciation charges, means that the utility's earnings will decline as a result of the new asset being placed into service, all other things being equal. For a utility with a sizeable construction program, the impact of regulatory lag associated with new plant additions can be significant, unless the Company's other costs are declining or it is experiencing growth in revenues which would offset or mitigate this impact.

An AAO eliminates the impact of regulatory lag associated with plant additions by deferring the required carrying charges and depreciation expense in the utility's balance sheet, where the amounts will be held for future recovery in rate cases. Thus, an AAO can be used to protect a utility from earnings shortfalls associated with extraordinary construction programs. The amounts deferred through an AAO are usually given recovery in subsequent rate cases through an amortization and, depending on the nature of the item being deferred, the unamortized portion may be given rate base treatment. It should be noted, however, that granting of an AAO does not guarantee recovery of deferred amounts in subsequent rate proceedings, as the practice in Missouri is to reserve all ratemaking questions involving deferred amounts to the rate proceeding in which recovery is sought.

Q. Briefly explain how the AAO process works in the context of MGE's safety construction.

A. As service line, yard line and main replacements are made by the Company in the course of its safety program, the AAO allows MGE to defer carrying charges and the applicable depreciation expense and property tax on the replacements to Account 182.3, Other Regulatory Assets, instead of immediately reflecting those items in its net income. MGE would then seek recovery of the deferred amounts booked to Account 182.3 through an amortization in its next rate proceeding.

Q. Under what conditions have alternative ratemaking practices such as AAOs been granted by the Commission?

A. Generally, issuances of AAOs have been tied to the occurrence of "extraordinary items." Extraordinary items are events impacting a utility that are unusual in nature and infrequent in occurrence. The Commission has found that safety programs for gas utilities mandated by its rules constitute extraordinary items.

Q. Have AAOs been approved by the Commission for MGE and WRI in regard to their gas safety construction programs?

Q. Yes. Gas safety AAOs were ordered by the Commission for WRI in Case Nos. GO-92-185 and GO-94-133. Subsequent rate recovery of the gas safety costs deferred by WRI was allowed by the Commission in WRI's general rate increase case, No. GR-93-240. An AAO for gas safety costs was granted by the Commission to MGE in Case No. GO-94-234 after its purchase of WRI's Missouri gas properties in 1994. MGE is seeking rate recovery of those deferred amounts in this proceeding. Staff Accounting witnesses Charles R. Hyneman and V. William Harris address the Staff's position on rate recovery of past deferred safety costs in their testimony.

Q. What is the relationship between the current use of AAOs by MGE for treatment of gas safety costs and the proposed GSR?

A. MGE is proposing the GSR as a replacement for the current AAO deferral process, as noted by Mr. Cummings on page 9 of his direct testimony.

Q. Please describe your understanding of how MGE intends the GSR mechanism to work.

A. As described by Mr. Cummings, the GSR is intended to allow the Company to automatically increase rates on an annual basis to reflect the revenue requirement impact of safety plant additions made since the last general rate case or GSR filing. MGE's proposed tariff sheets for the GSR show that the annual increase will be based on gas safety projects