

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Application of)	
Missouri Gas Energy for the)	
Issuance of an Accounting Authority)	
Order Relating to its Natural Gas)	Case No. GU-2011-0392
Operations and for a Contingent)	
Waiver of the Notice Requirement)	
Of 4 CSR 240-4.020(2))	

MGE’S REPLY TO STAFF’S RECOMMENDATIONS

COMES NOW, Southern Union Company d/b/a Missouri Gas Energy (“MGE” or “Company”), by and through counsel, and, for its *Reply to Staff’s Recommendation to Approve MGE’s Application in Part and Deny in Part* (“*Staff’s Recommendation*”), states as follows to the Missouri Public Service Commission (“Commission”):

1. On June 6, 2011, MGE filed its *Application* in which it requested that the Commission grant it an Accounting Authority Order (“AAO”) permitting MGE to defer those extraordinary costs associated with the devastation caused by the May 22, 2011 tornado in Joplin, Missouri.

2. *Staff’s Recommendation*, which was filed on August 19, 2011, supports MGE’s *Application* and position in this matter in several key respects:

- a. Staff concluded that the May 22, 2011 tornado was an extraordinary event which met one prong of a two-prong standard cited by Staff for the deferral of costs.¹
- b. Staff concluded that expenditures and costs associated with the tornado “have had and will have material impact on MGE’s financial position,”² which met the other prong of Staff’s application of the standard for the deferral of costs.
- c. Indicating that since the “extraordinary event” and “material impact” criteria required for an AAO were met, Staff recommended to the

¹ *Staff Recommendation*, Official Case File Memorandum, p. 4.

² *Id.*

Commission that MGE be allowed to “defer O&M expenses and related capital-related costs”³ associated with the tornado, subject to other conditions in Staff’s Recommendation.

- d. Staff noted that the Commission has adopted FERC’s Uniform System of Accounts (“USOA”) and therefore uses definitions from the USOA, along with prior Commission orders, as its legal standard.⁴

3. MGE also agrees with several of the conclusions that Staff reaches in its

Staff Recommendation:

- a. MGE agrees with Staff that an AAO is not determinative in any way on the question of future rate recovery of deferred costs.⁵
- b. MGE agrees with Staff that any insurance or government proceeds applicable to deferred costs should be used to offset the total amount of deferred expense.⁶
- c. MGE agrees that it will not seek to recover costs associated with the tornado through its Infrastructure System Replacement Surcharge (ISRS) mechanism.⁷
- d. MGE agrees to maintain detailed supporting records, work papers, invoices, and other documents to support the amount of costs deferred under an AAO, including any related deferred taxes recorded as a result of the cost deferral that would be made available for review by the Staff, Office of Public Counsel, and other intervenors in accordance with Commission rules.⁸

4. MGE appreciates Staff’s engagement on its *AAO Application* and the seriousness with which it has taken its responsibilities to address the financial impact of the Joplin tornado on MGE. As noted above, MGE agrees with and supports much of Staff’s analysis. In this *Reply*, MGE wishes to focus the Commission on the key area of disagreement that it has with Staff’s analysis, as well as make clear that if the Commission accepts *Staff’s Recommendations* as written, granting an AAO which

³ *Id.*

⁴ *Id.*, p. 3, FN 1.

⁵ *Id.*, p. 5.

⁶ *Id.*, p. 5. MGE noted in its *Application* that it would only defer and record costs “net of any insurance proceeds.” (MGE Application, p. 5, para. 9)

⁷ *Id.*, p. 6.

⁸ *Id.*

excludes fixed cost recovery provided through MGE's distribution rates will provide little assistance to MGE from the impact of this natural disaster. It is MGE's belief, based on ongoing discussions with insurers, that potential insurance payments may cover facilities replacement costs, lost gas costs, and incident response costs incurred by MGE due to the tornado. While MGE believes that it has a good faith basis to seek to deferral authority for such costs resulting from the tornado, and that deferral treatment is necessary and appropriate until such time that insurance payments are determined (as MGE argued in its *Application* and as Staff agrees), the primary (and growing) impact to MGE relates to the lost recovery of fixed costs.

5. The main point of disagreement that MGE has with *Staff's Recommendation* is Staff's unexplained departure from the accounting standard that it relies on elsewhere in its analysis - an accounting standard that expressly includes revenues as being eligible for deferral treatment. As described more fully below, Staff's argument that lost revenues and fixed cost recovery should not be included in an AAO is directly contradicted by the USOA. These losses have, and will, materially impact MGE financially and should be deferred for later consideration in a rate case.

6. In its *Application*, MGE seeks authorization to defer and record as a regulatory asset the incremental costs (which Staff recommends for deferral approval) and the loss of the fixed cost recovery provided by the Company's distribution rates⁹ (which Staff recommends be denied deferral approval). MGE noted in its *Application* that its margin revenues have been, and will continue to be, significantly reduced due to the number of customers impacted by the tornado.¹⁰ The Staff does not dispute that

⁹ MGE *Application*, p. 5, para. 9.

¹⁰ *Id.*, p. 4, paragraph 7.

MGE's margin revenues (i.e. its distribution rates as opposed to its PGA rates) recover the fixed cost of providing distribution service. The Commission, in its Report and Order in Case No. GR-2009-0355, specifically noted that "SFV rates are intended to recover fixed costs through fixed charges and variable costs (i.e., the cost of the gas commodity) through variable charges."¹¹ Huge sections of Joplin are gone – houses and business that MGE served simply no longer exist. Thousands of structures – which include MGE residential, commercial, and industrial customers - have been damaged or completely destroyed. A significant percentage of those structures will not be ready for service in the foreseeable future.¹² Given MGE's rate structure, the loss of these customers means the loss of fixed charges that recover fixed costs that cannot be eliminated or reduced.¹³ This lost revenue, estimated at \$83,615 per month (with an annual impact of \$1,003,384) has and will continue to have a materially adverse financial impact on MGE. This event is of a magnitude that could not be foreseen in the ratemaking process or in any risk determination accounted for in rates.

7. Staff agrees that the Commission has adopted the FERC USOA¹⁴ and that MGE's request for deferral authority is derived from standards found in the USOA.¹⁵ Staff recommends authorization for MGE to defer costs associated with the tornado to Account 182.3, Other Regulatory Assets,¹⁶ as defined in the USOA.

¹¹ *Id.*, citing Report and Order, In the Matter of MGE and its Tariff Filing to Implement a General Rate Increase for Natural Gas Service, GR-2009-0355, p. 42.

¹² *Id.*, p. 4, paragraph 7.

¹³ MGE disputes Staff's assertion that "information provided to Staff in this proceeding indicates that MGE has billed revenues sufficient to fully recover its fixed costs even after the tornado occurred." *See Staff's Recommendation*, p. 7.

¹⁴ *Staff Recommendation*, p. 3, FN 1.

¹⁵ *Id.*, p. 1.

¹⁶ *Id.*, p. 8.

8. While Staff characterizes MGE's request to recover its fixed costs as "unprecedented" and states that utilities should not recover lost revenues even if they otherwise meet the standard for deferral, the Commission need look no further than the USOA itself for precedent. Staff recommends that MGE's costs associated with the tornado (apart from revenues) should be deferred and recorded as a "regulatory asset." The definition of "regulatory assets and liabilities," in the USOA are those items that "arise from specific **revenues**, expenses, gains, or losses..."¹⁷ The Commission has noted previously that "in Missouri, 'words and phrases shall be taken in their plain or ordinary and usual sense...'"¹⁸ Here, the Staff's unsupported assertion that "deferral of lost revenues is not appropriate,"¹⁹ is directly contradicted by the very standard that Staff uses elsewhere to support MGE's Application. The USOA clearly permits "revenues, gains, or losses" as well as "expenses" to be included as a regulatory asset, just as MGE requests here.

9. Further, Staff's attempt to draw a distinction between the appropriateness of deferral for losses associated with system repairs as opposed to deferral for lost revenues²⁰ is also unsupported by the accounting standard it relies upon. The USOA's description of "Account 182.3, Other Regulatory Assets," states that "this account shall include the amounts of regulatory-created assets..." (as noted above, regulatory assets include "revenues") and include amounts "established by those charges which would have been included in **net income, or accumulated other comprehensive**

¹⁷ USOA Code of Federal Regulations, Title 18, Part 201 Subchapter F – Accounts, Natural Gas, General Instruction – Definitions No. 31, definition of Regulatory Assets and Liabilities (emphasis added).

¹⁸ Re Missouri Gas Energy, 2008 WL 5351369, *5 (Dec. 17, 2008), quoting Section 1.090 RSMo 2000. As noted in Section 1.090, the technical use word should be also understood according to its technical import.

¹⁹ *Staff Recommendation*, p. 7.

²⁰ *Id.*, p. 6.

income....”²¹ Again, the USOA permits the inclusion of revenues and income in regulatory asset accounts. Staff offers no support for its position to exclude lost revenues from an AAO, other than noting that it found no case law that previously addressed the issue. Notably, Staff provides no mention of case law in opposition. It should be dispositive here that the USOA expressly allows revenues for deferral treatment. While Staff agrees that MGE’s other costs associated with the tornado are material and extraordinary, its position that MGE should not be permitted to defer lost revenue runs contrary to the plain language of the USOA.

10. It is important to note that granting an AAO for costs associated with the tornado will not automatically grant MGE rate recovery for those costs. An AAO only allows MGE to defer items for *later consideration* in a subsequent general rate case.²² An AAO is not an assurance of recovery,²³ only the temporary accounting recognition of a significant, unexpected, and material event. It is up to MGE to argue - and the Commission to determine - whether those deferred costs should be included in rates. MGE alone runs the risk that those costs will not be included in rates. MGE has met the threshold for the deferral and accounting recognition for the costs and lost revenues associated with this tornado. It has shown that its costs and lost revenues are material and extraordinary and that they meet the standards and definitions in the USOA.²⁴

²¹ USOA, 182.3 “Other Regulatory Assets” (emphasis added).

²² State ex rel. Office of Public Counsel v. Public Service Commission, 858 S.W.2nd 806, 812-13 (Mo. App. W.D. 1993).

²³ In the Matter of the Application of Missouri Gas Energy, Report and Order, 2008 WL 5351369, at *2 (Dec. 17, 2008).

²⁴ Because ratemaking treatment is not assured, Staff’s arguments as to which costs are appropriate and whether lost revenue should be included in rates is premature. MGE ultimately will have the burden to show that the costs, expenses, and revenues that are included in an AAO should be later included in rates. The threshold question here is whether the costs are extraordinary and material. Staff concedes that this threshold has been met. Staff’s argument that approval an order allowing deferral of lost revenue would in some way provide a “financial guarantee” for “normal customer usage or sales” a) ignores the fact that MGE has an SFV residential rate design

MGE's request for the authority to defer those costs and lost revenues should be granted.

11. The Commission should determine that it may issue an opinion based on the pleadings and MGE respectfully requests that the Commission issue an order that includes the following language:

- a. MGE is authorized to defer and record to the USOA Account 182.3, Other Regulatory Assets, the incremental costs (net of any insurance proceeds), loss of the fixed cost recovery provided by the Company's distribution rates, and depreciation and carrying charges equal to its ongoing AFUDC rates²⁵ associated with the events surrounding the May 22 tornado.
- b. Nothing in the Commission's 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.
- c. Any and all offsets, including but not limited to insurance claim proceeds or government payments or credits applicable to incremental costs and loss of fixed cost recovery provided by the Company's distribution rates shall be used to offset the total amount of costs to be deferred.
- d. MGE shall not seek to recover any tornado-related capital costs for which it is deferring depreciation and carrying charges pursuant to this AAO through its Infrastructure System Replacement Surcharge rate mechanism.
- e. MGE shall begin amortization of and recovery of the involved expenses and losses, which are deferred and recorded in Account 182.3, over a five-year period, commencing with the effective date

that does not rely on customer natural gas usage and b) incorrectly presumes that rate recovery is forthcoming. MGE only seeks permission to defer the costs and lost revenues from this event. Ratemaking determinations will be made by the Commission at a later date.

²⁵ Should this matter move to a procedural schedule, MGE reserves the right to argue for a different carrying charge and rate and does not concede that the AFUDC rate is appropriate. MGE notes that higher carrying charges and rates have been used by Staff and MGE in other contexts.

of rates approved by the Commission in the first rate case following Case No. GR-2009-0355 or no later than January 1, 2013.²⁶

- f. MGE shall maintain detailed supporting records, work papers, invoices, and other supporting documents to support the amount of costs deferred under this AAO, including any related deferred taxes recorded as a result of the cost deferral. Such records shall be made available for review by the Commission Staff, the Office of Public Counsel and other intervenors, pursuant to 4 CSR 240-2.085 and Section 386.480.

12. Should the Commission determine that it cannot grant MGE's request for an order consistent with paragraph 9, *supra*, MGE respectfully requests that the Commission set a prehearing conference for the purpose of discussing a procedural schedule in this matter.

WHEREFORE, MGE respectfully requests that the Commission issue an Accounting Authority Order authorizing MGE to account for and record on its books as a regulatory asset the incremental May 22, 2011 tornado and severe weather related expenses and the lost fixed cost components of its rates, all as more specifically described in paragraph 9, *supra*; or that the Commission set a prehearing conference for the purpose of discussing a procedural schedule in this matter.

²⁶ This amortization period was proposed by MGE in its Application. MGE does not agree with the amortization period proposed by Staff in its *Recommendation*. Staff states that "it has consistently recommended that amortizations to expense for deferred costs should begin shortly after the incremental costs associated with the extraordinary item have been incurred." (Staff Recommendation, p. 5). Accordingly, Staff recommended that deferral begin in January 2012. Given the extent of the devastation in Joplin, the true extent of MGE's losses – while generally defined – will not be precisely known by January 1, 2012. Rebuilding, restoration of infrastructure, insurance recovery, and customer loss determinations are ongoing. A more flexible approach, but one that still has a generally defined start date, is warranted in this case.

Respectfully submitted

/s/

Todd J. Jacobs, MBE # 52366
Senior Attorney
Missouri Gas Energy
3420 Broadway
Kansas City, MO 64111
(816) 360-5976
(816) 360-2903 (fax)
todd.jacobs@sug.com

Jim Swearengen, MBE #2150
Dean Cooper, MBE #36592
Brydon, Swearengen, and England P.C.
P.O. Box 456
Jefferson City, MO 65102
(573) 635-7166
(573) 634-7431 (fax)
lrackers@brydonlaw.com

ATTORNEYS FOR MISSOURI GAS ENERGY

CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the foregoing document was sent by electronic mail to the following counsel this 16th day of September, 2011:

Lera Shemwell
Missouri Public Service Commission
Governor's Office Building
Jefferson City, Missouri 65102
lera.shemwell@psc.mo.gov
gencounsel@psc.mo.gov

Marc Poston
Governor's Office Building
200 Madison Street
Jefferson City, Missouri 65102
marc.poston@ded.mo.gov
opcservice@ded.mo.gov

/s/

Todd J. Jacobs