

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

In the Matter of the Application of Missouri Gas)
Energy, a division of Southern Union Company) Case No. GU-2005-0095
for an Accounting Authority Order Concerning the)
Kansas Property Tax for Gas in Storage.)

MGE’S REPLY BRIEF

COMES NOW Missouri Gas Energy, a division of Southern Union Company (MGE or Company), and, in reply to the initial briefs of the Staff (Staff) of the Missouri Public Service Commission (Commission) and the Office of the Public Counsel (Public Counsel), states as follows to the Commission:

INTRODUCTION

The initial briefs of the Staff and Public Counsel have confirmed the differences between the parties outlined in MGE’s Initial Brief.¹ The Staff supports the issuance of an accounting authority order (AAO), however, disagrees with the terms proposed by MGE. Public Counsel opposes the issuance of any AAO. MGE’s Initial Brief addressed practically all the issues raised in these briefs. Thus, MGE will not attempt to reply to everything anew in this brief and will instead emphasize what it believes to be a few important points.

MGE CAN’T JUST “FILE A RATE CASE”

Both the Staff and Public Counsel arguments ignore the practical realities of the situation presented to the Commission and MGE in this case. Their simple response to many of MGE’s arguments is that if MGE has difficulties it should just “file a rate case.” (Stf. Brf., p. 6-7, 7 (“MGE

¹ Except for Staff’s earlier position that MGE should not be allowed to defer expenses incurred after 2005. This proposal was not found in Staff’s Initial Brief and appears to have been abandoned.

may file a rate case and seek rate recovery if it finds that its current revenues are not sufficient to recover its total costs of providing service.”), 8-9, 10; Public Counsel Brf., p. 10-11).

The problem with the “file a rate case” approach is that at least some of the circumstances that led the Commission to deny recovery of these amounts when they were requested in the true-up proceeding in MGE’s last rate case, continue to exist. In its decision issued on September 21, 2004, effective October 2, 2004, the Commission found that this “potential tax liability is not currently known or measurable and on that basis it cannot be included in MGE’s cost of service.” *In the Matter of Missouri Gas Energy’s Tariffs*, Report and Order, Case No. GR-2004-0209, p. 79.

Because of the existence of the appeal, the Public Counsel continues to argue that while the Kansas gas storage taxes are now “measurable,” they are still not “known.” Tr. 215 (Bolin). The Staff witness also alleged that the Kansas gas storage taxes are not “known” at this time. Tr. 92 (Hyneman). In fact, the Public Counsel witness acknowledges that because of the existence of the appeal, even if MGE were trying a rate case now, the Public Counsel would still argue that these costs should not be included in MGE’s cost of service. Tr. 215 (Bolin).

Thus, as pointed out in MGE’s Initial Brief, it only has the ability to “file a rate case,” or at least to file a rate case that could include the Kansas gas storage tax, if it foregoes the appeal of the Kansas gas storage tax and makes payment of the taxes. This is something that is not in the best interest of MGE’s customers.

NOT NORMAL AND RECURRING COSTS

There is a similar problem with the Public Counsel’s arguments that the Kansas gas storage taxes are “normal, recurring costs” and “normal ongoing operating expenses.” (Public Counsel Brf., p. 3, 9). Of course, the Public Counsel acknowledges that “normal and recurring” expenses, if

reasonably incurred, would usually find a place in a utility's cost of service for rate making purposes. Tr. 214 (Bolin). However, as stated above, the Public Counsel would argue even today that the Kansas gas storage taxes should not be included in rates because they are not "known." Public Counsel appears to want to place MGE in a ratemaking "trick box" where the costs cannot be deferred because they are "normal" and yet cannot be recovered because they are not known.

Staff witness Hyneman believes that the taxes will not be "known" until the final legal determination of the legality of the tax, or in mid-2006. Tr. 92 (Hyneman). Testimony indicates that MGE likely could not make a rate case filing that would avoid the "known and measurable" issue until April of 2006. Tr. 81 (Noack). A ruling in such a rate case would not be required until March of 2007. Section 393.150, RSMo. Because of the nature of the rate case process, such a filing, without the issuance of an AAO, would require MGE to pay for three years of taxes before being able to start to recovery amounts for future taxes.

RATE CASE EXPENSE

The casual statement that MGE should "just file a rate case" also ignores the very real and significant expenses associated with a rate case, which are borne by the MGE shareholders in the first instance, and, ultimately, by MGE's customers. In MGE's last rate case, the authorized rate case expense was approximately \$900,000. Tr. 65 (Noack). The Public Counsel may not care about the inefficiency and wastefulness of MGE filing a rate case every 12-18 months. However, MGE is concerned about the use of resources required by such an approach and the Commission should be as well.

SHAREHOLDER AND CUSTOMER INTERESTS

The Kansas tax appeal is a situation where the interests of the MGE shareholders and its

customers are clearly aligned. It is unfortunate therefore that the Public Counsel has sought to belittle MGE's efforts to challenge the Kansas statute that attempts to impose the gas storage tax. The Public Counsel states that the "*only reason* MGE has to date not paid a property tax on gas held in storage is because it and other utilities have been successful in their legal challenges against the tax." (Public Counsel Brf. P. 6) (emphasis added). One would think that this effort would be worthy of commendation, not condemnation.

MGE has undertaken similar tax appeal efforts in the state of Oklahoma, which has also sought to impose a similar tax. The Public Counsel points this out as evidence that the gas storage tax is "typical and customary." Public Counsel Brf., p. 6. However, the situation in Oklahoma is similar to that in Kansas. MGE has sought to challenge a gas storage tax. MGE has not sought an AAO for the Oklahoma tax because it is substantially less in amount than the amount at issue in Kansas (approximately \$100,000 compared to the \$1.7 million in Kansas). Tr. 176-177 (Noack).

PROPERTY TAX FLUCTUATIONS

The Public Counsel argues that property tax is a fluctuating expense and alleges that MGE's property tax in calendar year 2004 was \$308,877 less than the amount used to determine MGE's current rates. (Public Counsel Brf., p. 5). This argument ignores several key points. First, the Public Counsel does not include in its calculation the \$1.7 million in 2004 property taxes represented by the Kansas gas storage property tax. Second, the rates referred to by the Public Counsel were only in effect for a little less than three months of 2004. Thus, the new rates were not applicable to the majority of the period identified by the Public Counsel (i.e. there is a lag).

This lag is part of the reason for the third point, which is that MGE has consistently under-recovered property taxes over the last several years. MGE compared the property taxes actually paid

by MGE beginning on August 6, 2001 (when rates went into effect from Case No. GR-2001-292) through December 31, 2004 (the end of the period identified by the Public Counsel) with the amount of property taxes that were included in the rates charged customers during that same time period. This comparison revealed that MGE under-collected property taxes during that time period by \$3,080,383. (Exh. 3 (Noack Sur.), p. 4-5). This result is supported by Staff's acknowledgment that MGE has consistently under-earned since the MGE properties were purchased in 1994. Tr. 72-73 (Noack).

TIME LIMITATION

MGE's proposal is attacked by both the Public Counsel and the Staff as being inconsistent with the Commission's earlier holding in the *Sibley* case (*In the Matter of Missouri Public Service*, 1 Mo.P.S.C. 3d 200, 206 (December 20, 1991)). The Public Counsel alleges that MGE has requested "an open-ended opportunity to seek recovery of deferred amounts." (Public Counsel Brf., p. 11).² The Staff alleges that the terms suggested by MGE "contravene the Commission's *Sibley* decision" because "MGE wants the property taxes to remain untouched on its balance sheet and not amortized to expense" until MGE's next rate case. (Stf. Brf., p. 8).

Both of these positions ignore a significant aspect of the proposal made by MGE. MGE very clearly proposed to time limit the deferrals. MGE suggested the following language to limit the deferral period to a clearly defined period of time:

In the event that MGE does not file a general rate case by May 31, 2008, MGE will commence amortization of these deferrals beginning June 1, 2008, over a five-year period, and will cease further deferrals unless the Commission grants a new

² The Public Counsel also alleges in a footnote that "an accounting authority order is normally one twelve-month period." Public Counsel Brf., p. 2, fn. 1. MGE is aware of no such limitation and Public Counsel identifies no authority for this position.

accounting authority order.

This approach would create neither an open-ended deferral nor an open-ended opportunity to seek recovery of deferred amounts. It would provide time limits that are consistent with statutory expectations regarding MGE's rate case frequency while still recognizing the importance of the appeal related to the Kansas gas storage tax, the uncertainty this challenge creates for the rate making process and the costs associated with an accelerated rate filing.

CONCLUSION

MGE has asked for an accounting authority order (AAO) allowing it to defer for consideration in its next general rate case taxes assessed by Kansas tax authorities on inventories of gas held on MGE's account for resale and stored in underground formations in the state of Kansas.

These taxes resulted from legislation passed by the Kansas legislature, effective in July of 2004, which created a new property tax associated with those inventories of gas. The legislation was made retroactive to inventories held as of January 1, 2004.

MGE has since received tax bills from various Kansas counties for the year 2004. These tax bills total \$1,721,830. No party denies that this expense is a material amount to MGE. (Stff. Brf., p. 5).

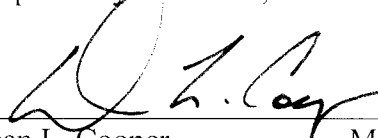
MGE initially requested that these new Kansas taxes be included in the cost of service in Commission Case No. GR-2004-0209. Those rates took effect on October 2, 2004. The Commission denied such treatment in part because the potential tax liability was not "known or measurable."

The subject of this application is a new tax, never before paid by the Company, that is being retroactively imposed on the Company by a governmental entity. MGE's management has no

control over this expense. The imposition of the Kansas gas storage tax is extraordinary, unusual and unique and not recurring and MGE's expenses related to this tax are appropriate for the issuance of an AAO.

WHEREFORE, MGE respectfully requests that the Commission consider this Reply Brief and, thereafter, grant MGE the requested accounting authority order.

Respectfully submitted,



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CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the foregoing document was sent by electronic mail, on May 10th 2005, to the following:

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