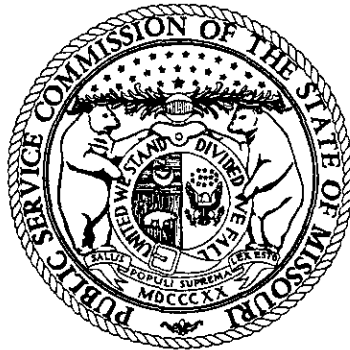


**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**



In the Matter of the Application of Missouri)
Gas Energy, a Division of Southern Union Company,) Case No. GO-99-258
for the Issuance of an Accounting Authority Order)
Relating to Year 2000 Compliance Projects.)

REPORT AND ORDER

Issue Date: March 2, 2000

Effective Date: March 14, 2000

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Gas Energy, a Division of Southern Union Company,) Case No. GO-99-258
for the Issuance of an Accounting Authority Order)
Relating to Year 2000 Compliance Projects.)

APPEARANCES

Robert J. Hack, Attorney, 3420 Broadway, Kansas City, Missouri 64111, for Missouri Gas Energy.

Douglas E. Micheel, Senior Public Counsel, Office of the Public Counsel, Post Office Box 7800, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

Bruce H. Bates, Assistant General Counsel, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE:

Lewis R. Mills, Jr.

REPORT AND ORDER

Procedural History

On December 8, 1998, Missouri Gas Energy, a division of Southern Union Company (MGE), filed an application for an accounting authority order relating to its Year 2000 (Y2K) compliance projects. On March 3, 1999, the Staff of the Commission (Staff) filed its memorandum in which it recommended that the Commission require MGE to submit to certain conditions. On April 19, MGE filed its response in which it objected to these conditions. On May 5, the Office of the Public Counsel (Public

Counsel) filed a motion to dismiss, or in the alternative, to establish a procedural schedule. On May 11, 1999, the Commission set this matter for a prehearing conference. On May 17, 1999, MGE requested rehearing and reconsideration of the order establishing a prehearing conference. On June 6, 1999, the Commission denied Public Counsel's motion to dismiss and MGE's request for rehearing and reconsideration. The parties filed testimony, and a hearing was held on October 20, 1999.

Findings of Fact

The parties have identified six issues. The Commission will address them in the order they are listed in the List of Issues filed on October 13, 1999. The Commission will also address the Nonunanimous Stipulation and Agreement filed on October 5, 1999, by MGE and Staff.

The Commission has reviewed and considered all of the evidence and arguments presented by the various parties. Some evidence and positions of parties on the issue may not be addressed by the Commission.

The failure of the Commission to mention a piece of evidence or a position of a party indicates that, while the evidence or position was considered, it was not found relevant or necessary to the resolution of the particular issue. In particular, since the position of the Staff was, through the Nonunanimous Stipulation and Agreement, resolved in support of MGE, its testimony will not be specifically discussed.

Issues Presented for Hearing

1. Are MGE's Y2K expenditures material?

This issue arose early in the case when Public Counsel moved to dismiss MGE's application partially based on Public Counsel's allegation that MGE's Y2K expenditures were not material. In discussing Public Counsel's motion, the Commission stated: "materiality is an issue that may be considered when determining whether to allow deferral of expenses. However, a finding of materiality is not necessary to allow deferral. . . ." Inasmuch as the Commission finds that both the event causing the expenditures and the expenditures themselves are extraordinary, the Commission need not find that the expenditures are material to allow deferral.

2. Are MGE's Y2K expenditures to upgrade or replace computer equipment recurring?

Public Counsel argues that MGE's Y2K expenditures are similar to routine computer hardware and software upgrades, and similar to "activities that MGE has taken to correct other problems it has had with its computer systems and operating processes." Public Counsel states that because MGE regularly replaces hardware and software, its efforts to ensure Y2K compliance are not extraordinary. Public Counsel asserts that these Y2K efforts are in essence the same activities that MGE takes nearly every day to operate and maintain its computer systems. Public Counsel also argues that MGE's Y2K efforts are similar to other project teams that MGE constitutes from time to time.

MGE points out that its Y2K Project will not recur with any reasonable frequency. MGE testified that its Y2K compliance efforts included:

identifying all critical business systems in which a failure could lead to service interruptions, to a degradation of the quality of customer service, or to problems in business management;

assessing the criticality of these systems;

collecting vendor-provided Y2K compliance documentation for all applicable systems;

testing critical systems and interfaces in a simulated Y2K environment;

modifying existing systems and validating modifications to meet Y2K readiness requirements;

investigating critical supplier Y2K compliance; and

developing contingency and recovery plans.

The Commission finds that MGE's expenditures to ensure its systems are Y2K compliant are not recurring. Although businesses regularly upgrade computer systems to ensure that they do not become obsolete, the comprehensive scope of MGE's Y2K project, and the fact that it was a response to a non-recurring event, supports MGE's arguments that these costs are non-recurring.

3. Are MGE's Y2K expenditures extraordinary?

Public Counsel's arguments that MGE's Y2K costs are not extraordinary are similar to those it advances on the question of whether these costs are recurring. That is, Public Counsel argues that MGE's Y2K efforts are not extraordinary because they are similar to ongoing

computer upgrades, similar to other project teams, and planned for and budgeted.

MGE points out that assessing the Y2K compliance of all software and hardware that might contain microchips, in a relatively short period of time, is an extraordinary undertaking. Furthermore, assessing the Y2K readiness of all MGE's vendors and suppliers, and developing contingency plans are not activities similar to those undertaken in MGE's normal course of business.

The Commission finds that MGE's Y2K expenditures are extraordinary. As noted above, MGE's Y2K project required examination of a large number of separate areas to ensure Y2K compliance and prepare for contingencies. The comprehensive nature of this examination, coupled with the fact that the event necessitating the examination happens only once every 100 years, makes the expenditures extraordinary. The Commission largely agrees with MGE's position that expenditures caused by the turn of the century are extraordinary.

4. Is MGE seeking to defer costs that are already built into its current tariffed rates?

This question is moot because the Commission is herein approving the Nonunanimous Stipulation and Agreement between Staff and MGE which will allow MGE to only defer incremental operating expenses incurred for Y2K compliance projects. By definition, incremental operating expenses cannot be included in current rates.

5. Does MGE require an AAO for Y2K expenditures to prevent irreparable harm to its financial integrity?

There is no evidence that MGE will suffer irreparable harm to its financial integrity if an AAO is not granted, and no party argues that such harm will occur. In granting an AAO, the Commission need not, and does not here, find that irreparable harm will occur if the AAO is not granted.

6. Were MGE's Y2K expenditures unforeseen or unpredictable?

Public Counsel argues that MGE's Y2K compliance costs were neither unforeseen nor unpredictable. Both MGE and Staff argue that whether they were unforeseen or unpredictable is immaterial to the question of whether an AAO should be granted. The Commission agrees with MGE and Staff. Although a finding that an event was unpredictable might support the conclusion that the event was extraordinary, an event can be extraordinary even though it was predictable and foreseeable. Public Counsel points out that MGE has known that it might face Y2K issues since at least 1993. Nevertheless, the sheer breadth of the examination undertaken in MGE's Y2K project and the fact that it was necessitated by an unrelated industry's failure to program computer systems to accommodate the passage of time to a new century make the associated costs extraordinary, even though they may have been predictable.

The Commission concludes that the costs associated with MGE's Y2K compliance efforts are extraordinary and meet the Commission's criteria for deferral. The Commission will allow MGE to defer them.

The Nonunanimous Stipulation and Agreement

Having found that Public Counsel's arguments in opposition to the granting of the AAO are not well taken, and having concluded that the AAO will be granted, the Commission will turn to the provisions of the Nonunanimous Stipulation and Agreement filed on October 5, 1999, by MGE and Staff. The Nonunanimous Stipulation and Agreement resolved all issues between those two parties, and recommended that the Commission grant MGE an AAO subject to certain conditions. The signatories stipulated that:

The Commission should grant MGE an AAO for the incremental operating expenses incurred for Y2K compliance projects between July 1, 1998, and February 28, 2000.

MGE shall begin to expense the deferred costs beginning on January 1, 2000, subject to restatement for expenditures through February 28, 2000, using a ten-year amortization period.

Rate base treatment of the unamortized balance, and materiality of the deferred costs, will be addressed in the general rate case in which the recovery of the deferred costs is addressed.

MGE will not seek recovery of deferred costs unless it initiates a general rate case by February 28, 2002.

The Commission finds that these conditions are reasonable, and will adopt them.

Conclusions of Law

MGE is a public utility engaged in the provision of natural gas service to the general public in the state of Missouri and, as such, is subject to the general jurisdiction of the Missouri Public Service Commission pursuant to Chapters 386 and 393, RSMo 1994.

Pursuant to Section 536.060, RSMo 1994, the Commission may accept the Stipulation and Agreement as a resolution of some of the issues in this case.

IT IS THEREFORE ORDERED:

1. That the application for an accounting Authority Order for the incremental operating expenses incurred for Y2K compliance projects filed on December 8, 1998, by Missouri Gas Energy, a Division of Southern Union Company, as modified by the Nonunanimous Stipulation and Agreement filed on October 5, 1999, is granted.

2. That the Nonunanimous Stipulation and Agreement filed on October 5, 1999, by the Staff of the Commission and Missouri Gas Energy, a Division of Southern Union Company, is approved.

3. That the motion to dismiss filed by the Office of the Public Counsel on May 5, 1999 is denied.

4. That nothing in this order shall be considered a finding by the Commission of the value for ratemaking purposes of the expenditures herein involved.

5. That the Commission reserves the right to consider any ratemaking treatment to be afforded the expenditures herein involved in a later proceeding.

6. That this order shall become effective on March 14, 2000.

7. That this case may be closed on March 15, 2000.

BY THE COMMISSION

A handwritten signature in black ink, reading "Dale Hardy Roberts". The signature is written in a cursive style with a large, stylized "D" and "R".

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

(S E A L)

Lumpe, Ch., Crumpton, Murray,
Schemenauer, and Drainer, CC., concur
and certify compliance with the provisions
of Section 536.080, RSMo 1994.

Dated at Jefferson City, Missouri,
on this 2nd day of March, 2000.