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September 15, 2000

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Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

RE: Case No. GO-2000-624

FILED³

SEP 15 2000

Missouri Public
Service Commission

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of a **STAFF RECOMMENDATION**.

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

Dennis L. Frey
Assistant General Counsel
(573) 751-8700
(573) 751-9285 (Fax)

Enclosure

cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

FILED³
SEP 15 2000

Missouri Public
Service Commission

In the Matter of the Application of)
Missouri Gas Energy, a Division of)
Southern Union Company, for the)
Issuance of an Accounting Authority)
Order Relating to Environmental)
Activities.)

Case No. GO-2000-624

STAFF RECOMMENDATION

COMES NOW the Staff ("Staff") of the Missouri Public Service Commission ("Commission") and for its Recommendation, respectfully states as follows:

1. On April 5, 2000, Missouri Gas Energy ("MGE" or "Company"), a division of Southern Union Company, filed with the Commission, pursuant to Sections 386.250 and 393.140 RSMo 1994, an Application for an accounting authority order ("AAO") authorizing the deferral of costs related to former manufactured gas plant ("MGP") sites located in the Company's service territory.

2. On June 12, 2000, the Company filed a motion for issuance of the Commission's standard protective order, and the Commission granted the motion on June 27, 2000.

3. The Commission's jurisdiction of this issue is established under Section 393.140(4) RSMo. 1994. Pursuant to that authority, the Commission adopted the Federal Energy Regulatory Commission's Uniform System of Accounts ("USOA") in 4 CSR 240-40.040. The USOA permits deferral of "extraordinary" items and, in the general instructions thereof, provides greater detail as to how an expenditure item can be found "extraordinary". In its Report and Order in consolidated Case Numbers EO-91-358 and EO-91-360, *In re Missouri Public Service, Mo.*

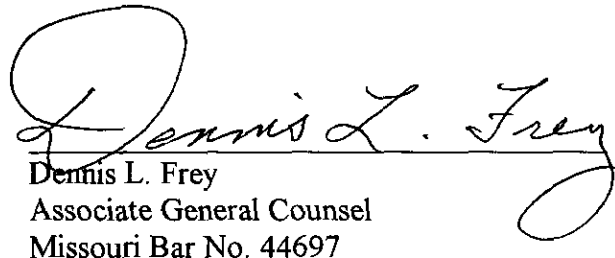
P.S.C.3d, 200 (1991), the Commission stated that such deferrals "should be allowed only on a limited basis." *Id.* at 205. The Commission continued, stating that a limited basis obtains "when events occur during a period which are extraordinary, unusual and unique, and not recurring." *Id.*¹ Based on its review of the subject Application, and its analysis as set forth in the Memorandum attached hereto as Appendix A, Staff is of the opinion that the expenditures for which MGE seeks an AAO in this case fail to qualify for the requested deferral. Therefore, the Staff recommends that MGE's request be denied. In the event, however, that the Commission decides, notwithstanding Staff's recommendation, to approve the Company's request for an AAO, Staff recommends that the "ordered" section of the Commission's Order include language as set forth in its Memorandum.

WHEREFORE, for the reasons stated in its attached Memorandum, the Staff recommends that the Commission issue an Order denying MGE's request for an AAO authorizing the deferral of costs related to former MGP sites located in the Company's Missouri service territory. In the event that the Commission decides to grant MGE's request for an AAO in this case, Staff recommends that the Commission include in the "ordered" section of its Order, language as set forth in the Memorandum attached hereto.

¹ The Commission's Report and Order in this consolidated case was affirmed in *State of Missouri, ex rel. Office of the Public Counsel v. Public Service Commission of Missouri, et al.*, 858 S.W.2d 806 (Mo. App. W.D. 1993).

Respectfully submitted,

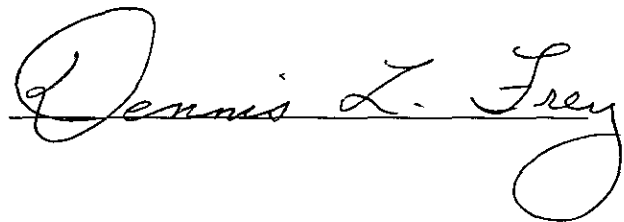
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Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 15th day of September 2000.



MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GO-2000-624, Missouri Gas Energy

FROM: Chuck Hyneman, Utility Services Division/Accounting Department

Charles R. Hyneman
Project Coordinator/Date 9/12/00

Thomas R. Schwanz Jr. 9/13/00
General Counsel's Office/Date 9-12-00

SUBJECT: Staff Recommendation that the Commission deny MGE's request for an Accounting Authority Order for costs related to former manufactured gas plants

DATE: September 12, 2000

On April 5, 2000, Missouri Gas Energy (MGE or Company), a division of Southern Union Company (Southern Union), filed an Application for an accounting authority order (AAO) authorizing the deferral of costs related to former manufactured gas plant sites (MGP) located in its service territory. MGE maintains the AAO is necessary because the expenditures associated with these former MGP sites are significant and extraordinary, and have not been reflected in the rates being charged for gas service. Also, MGE asserts that these costs are the result of the unusual event of Missouri Department of Natural Resources' (MDNR) Site Inspection/Removal Site Evaluation and are necessary for MGE to strive to meet MDNR's requirements.

Specifically, by this Application, MGE seeks permission and an AAO from the Commission to defer and book to Account 182.3, beginning July 1, 1999, and continuing through the end of the test year in MGE's next general rate case, all costs incurred or payments received by MGE during the deferral period (including, but not limited to, all legal and consulting fees) in connection with:

- 1) the investigation, assessment, removal, disposal, storage, remediation or other treatment of residues, substances, materials, and/or property that are associated with former manufactured gas operations or located on former manufactured gas plant sites;
- 2) the dismantling and/or removal of facilities formerly utilized in manufactured gas operations;
- 3) efforts to recover such costs from potentially responsible third parties and insurance companies; and
- 4) reimbursement and recoveries of costs from third parties and insurance companies.

Manufactured gas is a type of fuel that was used from the late 1800s until the 1930s, when natural gas became available. It was produced by the incomplete combustion of coal and sometimes oil to produce a synthetic combustible gas that was piped from the plant site to customers for use in heating, cooking, and lighting. The manufacturing process produced residual products, including coal tar, that were frequently deposited in on-site lagoons or underground wells or pits--a method of disposal considered safe at the time. In the early 1980s the Environmental Protection Agency declared this coal tar waste a hazardous substance and began requiring current and former owners of the sites to clean up the contamination.

History

On January 31, 1994, Southern Union purchased the Missouri gas properties now being operated as MGE from Western Resources, Inc. (WRI) for \$401,600,000. Southern Union recorded an acquisition adjustment (the excess of the purchase price over the net book value of the acquired assets) of \$54,000,000 as a result of this purchase. The amount of the acquisition adjustment also included various accounting entries to record certain pre-acquisition contingencies, presumably including future MGP costs.

In its Amended Annual Report to the Securities and Exchange Commission (SEC), Form 10-K/A, filed on September 30, 1994, Southern Union described the status of the newly acquired former manufactured gas plants:

Missouri Gas Energy owns or is otherwise associated with a number of sites where manufactured gas plants were previously operated. These plants were commonly used to supply gas service in the late 19th and early 20th centuries, in certain cases by corporate predecessors to Western Resources. By-products and residues from manufactured gas could be located at these sites and at some time in the future may require remediation by the EPA or delegated state regulatory authority.

By virtue of notice under the Missouri Asset Purchase Agreement and its preliminary, non-invasive review, the Company became aware prior to closing of 11 such sites in the service territory of Missouri Gas Energy. Based on information reviewed thus far, it appears that neither Western Resources nor any predecessor in interest ever owned or operated at least three of those sites.

Subsequent to the closing of the Missouri Acquisition, as a result of an environmental audit, the Company has discovered the existence of possibly six additional sites in the service territory of Missouri Gas Energy. Southern Union has so informed Western Resources. The Company does not know if any of these additional sites were ever owned or operated by Western Resources or any of its predecessors in interest. Western Resources has informed the Company that it was notified in 1991 by the EPA that it was evaluating one of the sites (in St. Joseph, Missouri) for any potential threat to human health and the environment. Western Resources has also advised the Company on September 15, 1994 that as of that date the EPA had not notified it that any further action may be required. Evaluation of the remainder of the sites by appropriate federal and state regulatory authorities may occur in the future. At the present time and based upon information available to management, the Company believes that the costs of any remediation efforts that may be required for these sites for which it may ultimately have responsibility will not exceed the aggregate amount subject to substantial sharing by Western Resources.

As part of the purchase, Southern Union and WRI entered into an Environmental Liability Agreement with respect to future costs associated with the former manufactured gas plants being sold to Southern Union. The Environmental Liability Agreement is described in Southern Union's 1993 Annual Report to the SEC (Form 10-K) filed on March 29, 1994:

Southern Union and Western Resources also entered into an Environmental Liability Agreement at closing. Subject to the accuracy of certain representations made by Western Resources in the Missouri Asset Purchase Agreement, the agreement provides for a tiered approach to the allocation of substantially all liabilities under environmental laws that may exist or arise with respect to the Missouri Business. The agreement contemplates Southern Union first seeking reimbursement from other potentially responsible parties, or recovery of such costs under insurance or through rates charged to customers. To the extent certain environmental liabilities are discovered by Southern Union prior to July 9, 1995, and are not so reimbursed or recovered, Southern Union will be responsible for the first \$3,000,000, if any, of out of pocket costs and expenses incurred to respond to and remediate any such environmental claim. Thereafter, Western Resources would share one-half of the next \$15,000,000 of any such costs and expenses, and Southern Union would be solely liable for any such costs and expenses in excess of \$18,000,000.

Prior Treatment of MGP Costs in Missouri

In Case No. GR-94-40, which concluded in a settlement agreement reached among the parties to the case, the Commission authorized Laclede Gas Company (Laclede) to establish an environmental cost deferral procedure, which became effective September 1, 1994. The authorization to begin deferring MGP-related costs was triggered only to the extent that Laclede's costs exceeded the \$250,000 of MGP costs reflected in the Laclede's rates. In the event the cumulative liability incurred by the Company for such costs during the deferral period was less than the cumulative amount of such annualized costs reflected in the rates approved in the settlement, Laclede was required to refund the difference to the ratepayers. The Commission found in its Report and Order in Case No. GR-94-240 that:

Ordinarily the granting of authority to defer expenses is allowed only for extraordinary expenses since it violates the matching principle. Although the issue of whether the expenses granted deferral by the Stipulation and Agreement in this case was not litigated, the Commission finds that these expenses are extraordinary and that deferral is appropriate under the terms of the Stipulation and Agreement.

The settlement agreement reached among the parties to this case included the standard language found in a Stipulation and Agreement to a rate case. The Stipulation and Agreement in Case No. GR-94-40 states that except to the extent specified in the Stipulation and Agreement, no party to the case has approved or acquiesced in any ratemaking principle or method of cost determination or cost allocation underlying, or allegedly underlying, the Stipulation and Agreement.

This environmental cost deferral procedure was extended as a result of stipulations and agreements in Laclede's next two rate cases. Laclede's deferral authority for its MGP costs ended on July 31, 1999 as part of the Stipulation and Agreement reached in Laclede's most recent rate proceeding, Case No. GR-99-315. Current MGP costs incurred by Laclede are not being deferred as a regulatory asset on its balance sheet, but are being charged to expense on its income statement in the period the costs are

incurred.

Also, in an AAO issued by the Commission in Case No. GA-98-464, United Cities Gas Company, a division of Atmos Energy Corporation, was authorized to defer costs related to its MGP in Hannibal Missouri. United Cities Gas Company has not sought ratemaking treatment of any deferred MGP costs.

MGE's MGP Costs

In response to Staff Data Requests, Southern Union stated that it has incurred \$273,365 in MGP costs for the twelve-month period from June 1999 through May 2000. Included in this amount is approximately \$92,600 of outside legal costs and employee expenses, the bulk of which is related to research on certain insurance companies' legal liability for MGE's MGP costs.

It appears that in addition to recovering MGP costs from its ratepayers, MGE expects to receive reimbursement of these costs from insurance companies and other potentially responsible parties. In a section discussing its MGP costs in SEC Form 424B2 filed on January 10, 1994, Southern Union stated:

The Company believes that it will be able to obtain substantial if not complete reimbursement or recovery for any such environmental liabilities from other potentially responsible third parties, under insurance or rates charged to customers.

In addition, the Company is aware of the existence of other significant potentially responsible parties from whom contribution for remediation would be sought, and would expect to make claims upon its insurers (Western Resources has already done so on its own behalf) and institute appropriate requests for rate relief.

However, more than six years have elapsed since Southern Union advised the SEC that it expects to make claims on insurance companies and other responsible third parties, and it has not done so. In response to Staff Data Request No. 2, when asked for information about other responsible third parties and responsible insurance companies, Southern Union stated that "no amount has been sought from these parties or these parties' insurance companies at this time." While Southern Union has not sought recovery from insurance companies and potentially responsible third parties, it has taken action to secure ratemaking recovery of these MGP costs through the filing of this AAO Application. MGE's current gas customers (who had no role in the creation of MGP costs) are the only group from whom cost recovery or reimbursement is currently being sought.

Standards for Deferral

As a basis for its determination whether or not a particular cost is extraordinary and appropriate for deferral, the Commission uses the Federal Energy Regulatory Commission's (FERC) definition of Extraordinary items as reflected in the general instructions of the FERC's *Uniform System of Accounts* (USOA).

The FERC defines extraordinary items as those items related to the effects of events and transactions which have occurred during the current period and which are of unusual nature and infrequent occurrence.

In General Instruction No. 7, the FERC describes the three criteria which must be present before an item (revenue or expense) can be determined to be extraordinary. The item must be:

- (1) Of Significant Effect - would significantly distort the current year's income (more than approximately 5 percent of current net income)
- (2) Unusual - related to an event which is abnormal and significantly different from the ordinary and typical activities of the company; and
- (3) Infrequent - related to an event which is not reasonably be expected to recur in the foreseeable future.

General Instruction No. 7 provides a threshold for when the FERC considers a cost to be "of significant effect", or material. This materiality level is reached when a revenue or expense has an impact of "more than approximately 5 percent of income, computed before extraordinary items." Included in the FERC's definition of extraordinary items is a reference to Account 435, Extraordinary Deductions. The description of this account states that it should include "losses of unusual nature and infrequent occurrence, which would significantly distort the current year's income..."

The Commission expressed its general position and standards for deferral of costs incurred outside a rate case test year in its Report and Order in Case Nos. EO-91-358 and EO-91-360. These AAO Applications were filed by Missouri Public Service, a division of UtiliCorp United, Inc. In its Report and Order, the Commission expressed its position that costs incurred outside of a rate case test year should be allowed only on a limited basis:

The deferral of costs from one period to another period for the development of a revenue requirement violates the traditional method of setting rates.

Under historical test year ratemaking, costs are rarely considered from earlier than the test year to determine what is a reasonable revenue requirement for the future. Deferral of costs from one period to a subsequent rate case should be allowed only on a limited basis.

In the *Standards for Deferral* section of this Report and Order, the Commission described the limited basis on which it will allow AAO cost deferrals:

1. When events occur during a period that are extraordinary, unusual and unique, and not recurring;
2. Although not case-dispositive, materiality of the cost is relevant to whether the event is extraordinary;

3. The determination of whether or not a cost is extraordinary will be made on a case-by-case basis.

The Commission also determined that a time limitation on deferrals should be made since deferrals cannot be allowed to continue indefinitely. The Commission found that a rate case must be filed within a reasonable time after the deferral period begins for recovery of the deferral to be considered. In Case Nos. EO-91-358 and EO-91-360, the Commission determined that twelve months was a reasonable period. In other cases, the Commission has found two years to be a reasonable deferral period prior to filing a rate case.

The Staff is aware that the Commission has granted AAOs for at least twenty years. Although the FERC USOA applies extraordinary treatment equally to revenue and expenses and gains and losses, the Staff does not know of a single instance when a Missouri utility requested an AAO to defer extraordinary revenues or extraordinary gains. The Commission noted this fact in its Report and Order in Case Nos. EO-91-358 and EO-91-360 where it stated "companies do not propose to defer profits to subsequent rate cases to lessen the effect of regulatory lag, but insist it is a benefit to defer costs." This fact alone indicates that there is an "inherent inequity" and potential for abuse in the AAO process. While AAOs can and do serve a useful purpose, they should be issued on a very limited basis and only when the specific criteria as outlined by the Commission are met. These restrictions are important to protect both the Commission and Missouri utility ratepayers.

While the issuance of an AAO does not authorize rate recovery of the deferred costs, it does allow a utility to defer expenses that are normally charged to current earnings. This expense deferral causes a higher level of net income to be reported in a company's financial statements than would be reported without the AAO. Corporate financial statements are relied on heavily by ordinary as well as professional investors. As such, it is important that these financial statements reflect the true financial operations of a company for that given time period. Accounting mechanisms, such as an AAO, can be used inappropriately to distort or misrepresent the true earnings during a period. One way an AAO can be used inappropriately is as a means to "manage" reported earnings. For example, if a company does not believe that its earnings level will reach financial analysts' expectations, it may seek to defer an expense to increase reported income. Strict limitations on the ability to defer costs serve to protect the Commission from being party to such earnings management.

Restrictions on AAOs are also important to protect Missouri ratepayers from paying unnecessarily higher utility rates. As described above, AAO deferrals increase current earnings. While this increase in earnings is a benefit to a utility's shareholders, it is potentially detrimental to its customers. This potential detriment lies in the fact that an AAO cost deferral increases the likelihood that the cost deferred will be included in the utility's future cost of service, leading to higher utility rates. Increasing future rates as a result of past costs (costs incurred prior to a rate case test year) is contrary to the fundamental principles of utility rate regulation and should be permitted to occur on a very limited basis.

Staff's Findings

An event or transaction is presumed to be an ordinary and usual activity unless the evidence clearly supports its classification as an extraordinary item. In other words, there is a general presumption that all items of profit and loss recognized during the period are to be used in determining the figure reported as net income. The only possible exception to this presumption is with respect to items (both revenues and expenses) which are materially significant in relation to the company's net income and are clearly not identifiable with or do not result from usual or typical business operations, taking into account the environment in which the utility operates.

Given the industry in which MGE operates, the Staff does not consider environmental costs, such as its MGP costs to be unusual in nature. In addition, MGE has been incurring MGP-related costs for several years and it is likely that it will continue to incur these costs for the foreseeable future. As such, these costs do not meet the Commission's nonrecurring or "infrequency of occurrence" criterion. Finally, MGE's MGP costs incurred in the fiscal year ended June 30, 2000 were not material to Southern Union's net income for this period and do not meet the FERC's "of significant effect" test.

MGE's MGP Costs are not Unusual in Nature

As a natural gas distribution company, should it be considered unusual for MGE to experience environmental remediation costs, such as costs to cleanup former manufactured gas plants? The answer is "No." Many natural gas distribution companies throughout the United States are incurring MGP-related costs. In Missouri alone, MGP-related costs are being incurred by, in addition to MGE, Laclede Gas Company, United Cities Gas Company and Missouri Public Service division of UtiliCorp United, Inc. While it might be unusual for a regulated telephone utility to experience significant environmental costs, it is not unusual for these costs to be incurred by electric and natural gas utilities.

At paragraph 7 of its Application, MGE mischaracterizes MDNR's Site Inspection/Removal Site Evaluation as an extraordinary (MGE uses the word "unusual") event. The MDNR is responsible for environmental safety in Missouri, so it should not be considered "unusual" or extraordinary for this agency to take enforcement actions to ensure a safe environment. The underlying event, or the event that caused MGE to incur MGP costs, is the contamination of the soil. This contamination was made by the owners of the MGP sites many years before these sites were acquired by MGE. This event is not unusual as it occurred hundreds of times in the United States in the late 1800s and early 1900s.

MGE's MGP Costs are not Infrequent in Occurrence

Southern Union has been aware of the existence of potentially significant MGP costs related to the Missouri gas properties it purchased from WRI since at least 1993. The fact that Southern Union and WRI entered into a Environmental Liability Agreement for MGP costs with no expiration date indicates the expectation that these costs will be incurred well into the future.

A review of the invoices from environmental contractors and consultants received in response to data requests in this proceeding shows that MGE has been experiencing environmental costs since it came into existence in 1994. Based on the invoices received in response to data requests in this case, the Staff calculated that over the period 1995 through 1998 MGE incurred a minimum of \$160,000 in environmental costs, the bulk of which is related to its MGP operations. This period included the test years of both MGE's rate cases, Case Nos. GR-96-285 and GR-98-140. The Staff did not make any adjustment to MGE's test year cost of service that removed any MGP related cost in either of these two cases. Therefore, it is likely that MGE has been in the past, and is currently recovering at least a portion of its ongoing MGP costs in rates. Deferral of a type of cost for future rate recovery that has previously been included in the determination of a utility's revenue requirement would be inappropriate.

Considering that MGE now owns several MGP sites, it is likely that MGE will be incurring MGP costs for many years into the foreseeable future. For example, NUI Corporation, a natural gas distribution company headquartered in New Jersey, owns 16 MGP sites, as compared to 17 MGP sites in MGE's service territory. In its 1998 Annual Report to the SEC, NUI advised that MGP costs could "be incurred during a future period of time that may range up to fifty years."

An argument might be made that the underlying event, the contamination of the land that is causing the MGP costs, could be considered an event that occurred infrequently. However, this argument would be misplaced. This event did not occur infrequently while the MGP sites were in production, the actual event (soil contamination) occurred continuously over many years. The problem today is not the underlying event, but the effects of the underlying event – MGP costs. Given that these costs could be incurred by MGE for possibly up to fifty years means that MGP costs should be considered as normal recurring costs. The appropriate accounting for this recurring cost, and whether this cost should be borne by insurance companies, former owners of the MGP sites, MGE's (Southern Union) shareholders, or MGE's natural gas customers is a question that is appropriately addressed in MGE's next general rate case.

MGE's Current MGP Costs Are Not Material

On August 2, 2000, Southern Union announced that its net income for its fiscal year ended June 30, 2000 was \$11,052,000. In comparison, the after-tax impact of the \$273,365 in MGP costs incurred by MGE over the twelve months ended May 2000 represents only 1.26 percent of net income. This is significantly less than the 5 percent materiality level used by the FERC, and including this amount as a current period expense certainly does not "significantly distort" Southern Union's current year's income of over \$11 million. While it is possible MGE may experience significant MGP costs in the future (absent significant insurance recovery), it hasn't shown in this AAO Application that these costs are material to current operations.

The press release announcing Southern Union's net income for the year ended June 30, 2000 also stated that during this period, Southern Union incurred \$5,700,000 in after-tax litigation costs on unsuccessful acquisition activity. Assuming all of these costs were tax deductible, this indicates approximately \$9,500,000 in actual expenses paid. Excluding the unsuccessful merger litigation

expenses and certain community relations consultant costs (discussed below) from the materiality calculation, the net income impact on a more normalized level of earnings drops from 1.26 percent to .84 percent. Clearly this is not a significant cost during this period.

During the course of review of this AAO Application, the Staff discovered approximately \$13,000 in community relations consultant costs classified by MGE as MGP-related, which initially appear to be unnecessary, and in part, unreasonable. While the Staff has not conducted a comprehensive analysis of these costs, to the extent some of these costs are determined to be inappropriate for recovery as reasonable and necessary costs, the materiality impact of MGE's MGP costs on Southern Union's current net income would be even less.

AAOs Issues on a Case-by-Case Basis

The Commission's third standard for AAO cost deferrals is that the determination of whether or not a cost is extraordinary will be made on a case-by-case basis. The Staff interprets this to mean that just because an AAO is granted for one company at a particular point in time does not mean that a similar or even the same cost should be deferred under an AAO by a different utility. Specifically, just because the Commission determines a certain cost to be extraordinary at a certain point in time does not mean that it will make the same determination years later. This is especially true in today's dynamic regulatory environment.

An AAO should be issued based on the facts and circumstances of each case. The Staff has determined that the AAO Application filed by MGE in this case has not met the Commission's standards for the issuance of an AAO authorizing the extraordinary accounting treatment of deferring expenses outside of a rate case test year.

Recommendation

As described above, the Staff finds that MGE's MGP costs are neither extraordinary nor material and therefore, do not meet the Commission's criteria for AAO approval. The Staff recommends that the Commission reject MGE's AAO Application in this case.

If, on the other hand, the Commission for any reason approves MGE's Application in this case, the Staff recommends that the Commission include the standard ratemaking disclaimer language and conditions in the Ordered section of the AAO. The Staff's recommended AAO language and conditions listed below are consistent with prior Commission AAOs with the exception of condition Nos. 4 and 6.

The Staff's recommended AAO condition No. 4 includes language which reflects the uncertainty as to who should be responsible for paying these MGP costs. This uncertainty is related to the terms and conditions of Southern Union's acquisition of the Missouri gas properties now being operated as MGE, including the Environmental Liability Agreement discussed above. Because it is a ratemaking consideration, the Staff decided not to include a discussion of this issue in this proceeding, but reserve the discussion for MGE's next rate case.

Because Southern Union contracts with the same legal firms for various types of legal work and because legal fees represent a substantial portion of Southern Union's MGP costs, there is a need for an increased level of expense documentation. In condition No.6, the Staff requests that the Commission order MGE to require its legal consultants to include a specific description of the type of work performed for each hour billed on each invoice presented in connection with costs deferred under this AAO.

If the Commission does approve this AAO request, the Staff recommends the Commission include the following language in its Ordered section of the AAO:

1. That MGE is authorized to defer and book to Account 182.3, beginning on July 1, 1999 and continuing through the earlier of June 30, 2001 or the end of the Commission-ordered test year as updated, or true-up period in MGE's next rate case, incremental costs reasonably incurred and directly related to its former manufactured gas plant operations in the MGE service territory. Any MGP-related payments received by Southern Union Company and the amount of any MGP-related costs in current rates shall be credited to Account 182.3.
2. That MGE shall amortize any deferred MGP-costs over a five-year period. The amortization to expense will occur on a monthly basis beginning the month after the costs are deferred on MGE's financial records.
3. That this AAO shall become null and void in the event Missouri Gas Energy does not file tariff sheets proposing a general increase in rates within twenty-four (24) months from the effective date of the order granting authorization of the AAO.
4. That nothing in this order shall be considered a finding by the Commission of the reasonableness or the appropriateness of the costs and/or expenditures deferred, and that the Commission reserves the right to consider the ratemaking treatment to be afforded all deferred costs and/or expenditures, including the recovery of carrying costs, if any. In addition, the issuance of this AAO should not be interpreted as an indication that the Commission has determined that the deferred MGP costs are appropriately assigned to MGE's natural gas customers.
5. That the Commission reserves the right to determine whether the ultimate amount of MGP costs approved for recovery is significant and material and therefore qualifies for recovery as an extraordinary cost.
6. That in order to allow for a determination of the reasonableness and appropriateness of the costs deferred, MGE is hereby directed to maintain all detailed supporting records, work papers, invoices and other documents to support the amount of costs deferred under this AAO, including any related deferred taxes recorded as a result of the cost deferral. In addition, MGE shall provide detailed documentation, including a complete description of the type of work performed, specific MGP site, and time spent, for each invoice submitted for all legal expenses deferred under this AAO.

MO PSC CASE NO. GO-2000-624
OFFICIAL CASE FILE MEMORANDUM, PAGE 11 OF 11

Copies: Director - Utility Operations Division
 Director - Policy and Planning Division
 Director - Utility Services Division
 General Counsel
 Manager of Accounting - Utility Services Division
 Office of the Public Counsel
 Robert J. Hack - Missouri Gas Energy

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Case No. GO-2000-624
September 15, 2000

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