BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Tariff Sheets Designed to Increase Rates for Gas Service in the Company's Missouri Service Area.	)))	**Case No. GR-98-140**
In the Matter of Missouri Gas Energy's Proposed Modifications to Its Facilities Extension Policy.	))	**Case No. GT-99-237**

REPORT AND ORDER ON REHEARING

Issue Date: October 10, 2000

Effective Date: October 10, 2000

269

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TABLE OF CONTENTS

Appearances 1

Procedural History 2

Rehearing Issues 3

Findings of Fact 4
Inclusion in Rate Base of Accumulated Deferred Income Taxes from SLRP Deferrals 5
Gross-up/Gross-down 8

Conclusions of Law 8

Ordered Paragraphs 10

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Thomas R. Schwarz, Jr., Deputy General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: **Nancy Dippell, Senior.**

REPORT AND ORDER ON REHEARING

Procedural History

The Missouri Public Service Commission (Commission) issued a Report and Order in these consolidated cases on August 21, 1998. The Report and Order was corrected by order issued August 26, 1998. The Report and Order authorized Missouri Gas Energy, a division of Southern Union Company (MGE) to file tariff sheets to provide for a general rate increase of $13,297,499. A number of parties filed motions for rehearing, including MGE which filed its Application for Rehearing and Motion for Reconsideration on September 1, 1998.

The Commission granted rehearing to MGE on two issues: (A) whether a rate base offset for accumulated deferred income taxes, attributable to MGE's service line replacement program (SLRP) deferrals, is appropriate in light of the Commission's exclusion of the SLRP deferrals from rate base; and, (B) an appropriate adjustment for the gross-up of revenues for uncollectibles and gross-down of revenues for late payment charge revenues.

On December 11, 1998, MGE filed a motion for clarification of the Commission's order granting rehearing. The case was then stayed pending circuit and appellate court appeal. A hearing was scheduled twice but as a result of actions taken by the Cole County Circuit Court and the Western District of the Missouri Court of Appeals, both scheduled hearing dates were canceled. On April 25, 2000, the Missouri Supreme Court denied the application to transfer Case Nos. WD57089 and WD57147 from the Western District of Missouri Court of Appeals and as a result, the Commission regained jurisdiction to proceed with the hearing. On April 27, 2000, MGE notified the Commission that judicial review was final and renewed its motion for clarification.

An order granting the motion for clarification and motions to strike certain rehearing testimony was issued on June 15, 2000. The order

clarified that the only two issues for rehearing were those cited in the order granting rehearing. The order also struck portions of the Direct Rehearing Testimony and the Rehearing Rebuttal Testimony of MGE's witness, Charles B. Hernandez. In addition, the order struck portions of the Rehearing Rebuttal Testimony of the Staff of the Missouri Public Service Commission's (Staff) witness, Phillip K. Williams.

Rehearing on the two issues was held on July 5, 2000. The parties appearing at the rehearing were MGE, Public Counsel, Staff, Midwest Gas Users' Association (MGUA), and the City of Kansas City. At the hearing the City of Kansas City asked to be excused from attending the hearing and Riverside Pipeline Company, L.P., and Mid-Kansas Partnership had previously filed written requests to be excused. The parties were not excused from the hearing and forfeited their rights to participate in the hearing by not being present.

During the evidentiary hearing, the Commission requested that MGE provide as a late-filed exhibit, Internal Revenue Service Letter Ruling No. 945008, and the parties were given until July 24, 2000, to file written objections to the exhibit. The letter ruling was received and marked for identification as Exhibit No. 241.

On July 24, 2000, objections to late-filed Exhibit No. 241 were filed by MGUA and the Public Counsel. An order sustaining the objections to Exhibit No. 241 was issued on August 10, 2000.

Initial briefs were filed by interested parties on August 17, 2000, and reply briefs were filed on September 11, 2000.

Rehearing Issues

The Commission granted rehearing on two issues. The issue of the gross-up and gross-down factors and how they apply to the corrected revenue

requirement was stipulated to at the hearing by all the parties present. The remaining issue was contested.

MGE argued that the rate base should not be reduced for deferred income taxes associated with the unamortized balance of the Safety Line Replacement Program (SLRP) deferrals. These deferrals were excluded from rate base in the original Report and Order. Public Counsel and Staff proposed to include as an offset to rate base the deferred income taxes associated with the unamortized balance of SLRP deferrals that have been excluded from rate base. MGUA agreed with Staff and Public Counsel. Public Counsel further argued that this item was included in its original calculations and was not an issue that was "omitted" by the parties as MGE contended.

MGE also argued that because the entire unamortized balance of the SLRP deferrals was excluded from rate base, none of the associated deferred income taxes should have been used to reduce rate base. MGE argued that to do otherwise would be a violation of the United States Internal Revenue Code (IRC).

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

Inclusion in Rate Base of Accumulated Deferred Income Taxes from SLRP Deferrals

MGE is involved in an accelerated program to replace customer service lines as ordered by the Commission. While implementing the SLRP, MGE has been granted a series of accounting authority orders that permit MGE to accumulate expenditures that would normally be expensed in the period in which they were incurred. These items are depreciation expense, property tax expense, and carrying costs associated with the installed SLRP plant after the actual SLRP plant was placed in service, but prior to these related expenses being directly reflected in rates.

In Case No. GR-96-285, the Commission permitted MGE to include these expensed deferrals in rate base as well as to amortize the deferrals over a 20-year period. By including the expense deferrals in rate base, MGE earned a return on the unamortized deferred amounts. In the present case, the Commission excluded those deferrals from rate base, but accelerated MGE's total recovery of the costs from 20 to ten years.

MGE argues that since the shareholders are financing the investment that gave rise to deferred income taxes, the benefit of those deferred income taxes should flow to the shareholders (in other words, the deferred income taxes should not be an offset to rate base). The Commission was not persuaded by MGE's arguments or the testimony of its witnesses and determines that the use of the SLRP accumulated deferred income taxes, as an offset to rate base, is appropriate as explained below.

Deferred income taxes, including MGE's accumulated deferred income taxes for SLRP deferrals, result from the timing difference between when a company currently deducts an expense on its income tax return and when it later deducts the expense on its financial statement records. This is also known as a book-tax timing difference. MGE's accumulated deferred income taxes for SLRP deferrals are created by a book-tax timing difference.

The purpose of including an offset to rate base for accumulated deferred income taxes is to recognize that ratepayers have provided money through rates for the payment of taxes that the utility has deferred paying until a later period. The utility may use the ratepayers' money until the payment of the deferred income taxes is made.

MGE's witness, June Dively, testified to the fact that MGE was "enjoying" the benefits of those deferred taxes. Therefore, MGE's deferred income tax reserve represents a prepayment of income taxes by the ratepayers from which MGE "enjoys" a financial benefit.

MGE's witness Dively further admitted that MGE's taxes would not be affected by whether or not the item was included or excluded from rate base. Because it is the book-tax timing difference which gives rise to the benefit that MGE receives, and not the SLRP deferrals that have been excluded from rate base, the Commission finds that the SLRP accumulated deferred income taxes are not related to the actual SLRP expense deferrals for purposes of inclusion in rate base. Therefore, the SLRP accumulated deferred income taxes should continue to be included as an offset to MGE's rate base.

MGE also claims that the Commission's treatment of the deferred taxes would violate the IRC. MGE's SLRP facilities are depreciated at an accelerated rate for income tax purposes under the provisions of the IRC. Sections 168(f)(2), (1)(9) and (i)(10) of the IRC provide that normalization requirements must be met in order for an owner of public utility property to use accelerated depreciation for income tax purposes.

MGE argued that violating the normalization rules of the IRC would disqualify MGE from making use of accelerated depreciation for income tax purposes, thus eventually causing MGE's customer rates to increase because no further deferred income taxes would arise to reduce MGE's rate base. However, MGE did not present any evidence which would support its claim

that the Commission's decision in this matter would be a violation of the IRC. In fact, MGE's witness Dively testified that no ruling had been made by the Internal Revenue Service specifically related to MGE that would support its theory regarding IRC violation.

Public Counsel argued that there is no IRC violation. MGE's witness Dively testified that although the Commission's Report and Order had not treated its SLRP expenditures in a manner MGE thought was appropriate, MGE's SLRP was still in progress, and MGE was currently recording deferred taxes related to the current amortization of SLRP deferrals in accordance with the normalization rules of the IRC.

Public Counsel also argued that MGE should not be allowed to raise the potential IRC violation argument in the rehearing because that theory was not specifically mentioned in MGE's application for rehearing as required by the Commission's rule 4 CSR 240-2.160.[1] Public Counsel is correct that MGE did not specifically set forth a potential violation of the IRC as a ground for which MGE considered the Commission's order unlawful. Furthermore, even if MGE had included that argument in its application for rehearing, there was not sufficient evidence nor convincing arguments presented for the Commission to find that an IRC violation will occur.

Therefore, the Commission finds that the question of an IRC violation is not an appropriate issue for rehearing because it was not an issue preserved for rehearing under Section 386.500, RSMo 1994, and the Commission's rule 4 CSR 240-2.160.

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[1] The Commission's rule 4 CSR 240-2.160 was rescinded and readopted effective April 30, 2000. However, former section (1) of that rule restates Section 386.500, RSMo 1994, which says that applications for rehearing "shall set forth specifically the ground(s) on which the applicant considers the order to be unlawful, unjust, or unreasonable." Current section (1) of 4 CSR 240-2.160 merely states that applications for rehearing shall be made in compliance with the statute.

Gross-up/Gross-down

This issue was brought before the Commission on rehearing to correct an inadvertent error regarding the valuation of the revenue requirement. MGE's witness Hernandez explained the error in his prefiled Direct Rehearing Testimony marked as Exhibit 237. At the evidentiary hearing the parties participating presented an oral stipulation that the mathematical calculations as presented in Schedule CBH1 and CBH8 to Exhibit 237 are accurate.

Those numbers represent that a factor of 1.100306 should be used to gross up revenue to account for uncollectibles and that a factor of .997761 should be used to gross down revenues for late payment revenue. Those factors when properly applied to the Commission's corrected revenue requirement of $13,297,499 result in a revenue requirement of $13,228,311. No party has objected to these calculations. The Commission previously found that the revenue requirement was in the public interest and now finds that the revenue requirement should be corrected using the factors as stipulated to by the parties at the rehearing.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law.

Missouri Gas Energy, a division of the Southern Union company, 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.

The Commission has authority under Chapter 393, RSMo 1994, to set just and reasonable rates for the provision of service by regulated gas utilities.

The orders of the Commission must be based on substantial and competent evidence, taken on the record as a whole, and must be reasonable and not arbitrary, capricious, or contrary to law. In that regard, and in setting rates which are just and reasonable, the Commission has considered all relevant evidence and determines, as set out in the findings of fact, that the stipulation of the parties at the hearing as to the gross-up and gross-down factors applied to the corrected revenue requirement which results in a revenue requirement of $13,228,311 is in the public interest and is approved.

Section 386.500, RSMo 1994, provides in part:

> 1. After an order or decision has been made by the commission, the public counsel or any corporation or person or public utility interested therein shall have the right to apply for a rehearing in respect to any matter determined therein, and the commission shall grant and hold such rehearing, if in its judgment sufficient reason therefor be made to appear; if a rehearing shall be granted the same shall be determined by the commission within thirty days after the same shall be finally submitted.
>
> 2. No cause or action arising out of any order or decision of the commission shall accrue in any court to any corporation or the public counsel or person or public utility unless that party shall have made, before the effective date of such order or decision, application to the commission for a rehearing. Such application shall set forth specifically the ground or grounds on which the applicant considers said order or decision to be unlawful, unjust or unreasonable. . . .

Current Commission rule 4 CSR 240-2.160, effective April 30, 2000, provides in part that "[a]pplications for rehearing may be filed pursuant to statute." The Commission rule 4 CSR 240-2.160 in effect at the time MGE filed its application restated the requirements in Section 386.500, RSMo 1994.

26 U.S.C. Section 168 provides that normalization requirements must be met in order for an owner of public utility property to use accelerated depreciation for income tax purposes.

IT IS THEREFORE ORDERED:

1. That the stipulation of the parties to the gross-up factor of 1.100306 and the gross-down factor of .997761 is approved.

2. That the accumulated deferred income taxes related to the Safety Line Replacement Program deferral continues to be included as an offset to Missouri Gas Energy's rate base.

3. That no later than November 10, 2000, Missouri Gas Energy, a division of Southern Union Company, shall file revised tariff sheets with a thirty day effective date which are consistent with the previous orders in this case and with the final revenue requirement of $13,228,311.

4. That all objections not specifically ruled upon are overruled and all motions not specifically ruled upon are denied.

5. That this Report and Order on Rehearing shall become effective on October 10, 2000.

BY THE COMMISSION

Dale Hardy Roberts

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

(S E A L)

Lumpe, Ch., Schemenauer, and
Simmons, CC., concur;
Murray, C., dissents;
and certify compliance with the
provisions of Section 536.080,
RSMo 1994.
Drainer, C., absent.

Dated at Jefferson City, Missouri,
on this 10th day of October, 2000.

ALJ/Sec'y: Dippell / Payne

10-4
Date Circulated

GR-99-140 and
CASE NOS: GT-99-237

Lumpe, Chair

absent
Drainer, Vice Chair

Murray, Commissioner

Schemenauer, Commissioner

Simmons, Commissioner

10-10
Agenda Date

Action taken: 3-1 AS

Must Vote Not Later Than _____

STATE OF MISSOURI

OFFICE OF THE PUBLIC SERVICE COMMISSION

I have compared the preceding copy with the original on file in this office and I do hereby certify the same to be a true copy therefrom and the whole thereof.

WITNESS my hand and seal of the Public Service Commission, at Jefferson City, Missouri, this 10th day of Oct. 2000.

Dale Hardy Roberts

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION
JEFFERSON CITY
October 10, 2000

CASE NOS: GR-98-140

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Enclosed find certified copy of ORDER in the above-numbered case(s).

Sincerely,

Dale Hardy Roberts

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge