

MEMORANDUM

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MISSOURI
PUBLIC SERVICE COMMISSION

TO: Missouri Public Service Commission Official Case File
Case No. GO-97-301
Missouri Gas Energy

FROM: Chuck Hyneman
Accounting Department

Kenneth L. Rademan 4/11/97
Utility Services Division/Date

Lenny G. Baker 4/11/97
General Counsel's Office/Date

ELV
4/11/97

SUBJECT: Staff Recommendation for Conditional Approval of Accounting Authority Order for costs incurred in complying with the Commission's Gas Safety Rules

DATE: April 11, 1997

On February 4, 1997, 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 its gas safety program. MGE maintains the AAO is necessary because the expenditures associated with its gas safety program are significant, extraordinary, have not been reflected in the rates being charged for gas service, and are the result of the unusual event of the enactment of the revised gas safety rules by the Commission in 1989.

Paragraph 7 of MGE's Application states:

By this Application, MGE seeks permission and an AAO from the Commission to defer and book to Account 186.1, beginning February 1, 1997, and continuing through the effective date of the Commission's Report and Order in MGE's next general rate case, depreciation expense, property taxes, and carrying costs at the weighted average cost of capital the Commission found as appropriate for MGE in Case No. GR-96-285, that being 9.46%, on the costs incurred to remove and replace or repair facilities located in mobile home parks, to remove and replace Company-owned and customer-owned service and yard lines, to move and reset meters in connection therewith, to remove and replace cast iron mains, and to remove, replace and cathodically protect bare steel mains, with the deferred amounts to be computed on plant placed in service beginning on October 31, 1996.

In addition, MGE requests Commission confirmation "that the regulatory assets recorded by MGE under the AAO granted in Case No. GO-94-234 for the period of November 1, 1996 through

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January 31, 1997, which were not included in rates set by the Commission in Case No. GR-96-285 may continue to be recorded by MGE as regulatory assets in account 186.1 on its books and that MGE may request rate recovery of such assets in its next rate proceeding". In response to Staff Data Request No. 5 in this case, MGE stated that Federal Energy Regulatory Commission (FERC) Form 2 now allows for recording of regulatory assets in Account No. 182.3, Other Regulatory Assets, and MGE proposes to account for the gas safety program deferrals in Account No. 182.3. The Staff agrees that Account No. 182.3 is the correct account in which to book a regulatory asset created by safety program deferrals.

MGE's current rates reflect recovery of costs associated with two separate safety program deferrals. As a result of Case No. GO-92-185, MGE is receiving a return on \$6,371,127 included in rate base and recovering an annual amount of \$375,693. As a result of Case No. GO-94-234, MGE is receiving a return on \$11,496,937 included in rate base and recovering an annual amount of \$574,847.

In response to Staff Data Request No. 4 in this case, MGE estimated that it will invest approximately \$22 million in Mains and Services from February 1, 1997 through March 31, 1998. MGE estimates that the total deferral for carrying costs, property taxes and depreciation expense will be approximately \$1.9 million on this investment.

Staff believes there are four issues that need to be addressed in MGE's Application. These issues are:

1. Whether the costs are "extraordinary" and meet the Commission's standards for deferral;
2. Whether the Company's requested deferral period is appropriate;
3. The appropriate deferral rate; and
4. Whether the Commission should confirm that the regulatory assets deferred under the AAO granted in Case No. GO-94-234 may continue to be recorded as regulatory assets and that MGE may request rate recovery of these assets in its next rate proceeding.

Standards for Deferral

Requests for AAOs concerning gas safety-related costs have been granted by the Commission in the following cases:

<u>Case No.</u>	<u>Company</u>
GO-90-51	Kansas Power and Light Company
GO-90-115	Missouri Public Service
GO-90-215	United Cities Gas Company
GO-91-359	Missouri Public Service
GO-92-185	Kansas Power and Light Company
GO-94-133	Western Resources, Inc. d/b/a Gas Service
GO-94-234	Missouri Gas Energy

In its Report and Order for Case No. GO-91-359, the Commission stated "the only question before the Commission, therefore, is whether Company's gas operations expenses are 'extraordinary'. The Commission finds that said expenses are extraordinary inasmuch as they result from Company's compliance with the Commission's gas safety orders".

Given the Commission has historically treated costs incurred in compliance with the gas safety rules as extraordinary, and the language cited above from Case No. GO-91-359, Staff believes that MGE has met the standard for deferral in this Application.

Deferral Period

In this Application, MGE is requesting a deferral period beginning February 1, 1997, and continuing through the effective date of the Commission's Report and Order in MGE's next general rate case. In response to Staff Data Request No. 2 in this case, the Company stated that it "has not specified a date or month certain in which it would file its next rate case".

In its Report and Order in Case Nos. EO-91-358 and EO-91-360, Missouri Public Service, the Commission expressed its concern about the appropriate deferral period for an AAO. On page 8 of that Order the Commission stated:

The Commission finds that a time limitation on deferrals is reasonable since deferrals cannot be allowed to continue indefinitely. The Commission finds that a rate case must be filed within a reasonable time after the deferral period for recovery of the deferral to be considered.

In its Report and Order in Case No. GO-92-185, the Commission required that Kansas Power and Light Company file for a rate case within two years of the beginning of the deferral period if it desired to seek recovery of gas safety costs deferred under the authority of the AAO. Establishing a two year time limit for filing a rate case has become the Commission's traditional practice in AAO applications. Staff believes a similar condition should be placed on MGE in this Application requiring it to file a rate case within two years of the beginning of the deferral period, if it wishes to seek recovery of the regulatory asset created by this AAO.

In paragraph 7 of its Application, MGE requested that the deferral period extend through the effective date of the Commission's Report and Order in MGE's next general rate case. The Staff agrees that it is appropriate to clarify the end of the deferral period relative to the Company's next general rate case. However, Staff believes it would be more appropriate to cutoff the deferral period at the last date of the Commission's test year (including an update and/or true-up period). Staff's approach would allow for an appropriate matching of rate base, revenues and expenses in the test year of the next rate case. It will also eliminate the requirement or perceived requirement for a company to subsequently request authority to defer costs incurred after the end of the rate case test year, but prior to the end of the deferral period specified in the Commission's AAO.

Staff does not find any logical or practical reason for extending a deferral period up to the effective date of the Commission's Report and Order in a rate case. This approach only creates mechanical accounting problems as illustrated in MGE's Application in this proceeding. If a Company wishes to continue the deferral of costs, it can simply apply for another AAO starting on the day after the end of the Commission's test year in its last rate case. For the reasons described above, Staff recommends that the deferral period in this AAO be cutoff at the last day of the Commission's test year (including the update and/or true-up period) in MGE's next rate case. In addition, no recovery of deferred safety costs should be allowed in subsequent rate proceedings if MGE does not file a rate case within two years of the beginning of the deferral period authorized as a result of this Application.

Deferral (Carrying Cost) Rate

In its Application in this case, MGE is requesting a carrying cost rate of 9.46% to be applied to its investment in safety-related plant (services and mains). This rate is the weighted average cost of capital approved by the Commission in MGE's most recent rate case, Case No. GR-96-285. However, in response to Staff Data Request No. 3 in this case, MGE could not identify its specific cost of financing its safety program.

In Case No. GR-96-285, the Company argued that its deferrals resulting from previous gas safety AAOs should be included in rates based upon a deferral rate that equaled an overall rate of return ordered by the Commission in a previous rate proceeding. Staff opposed MGE's position on this issue and argued that the deferral rate for ratemaking purposes should be equal to MGE's current Allowance for Funds Used During Construction (AFUDC) rate.

On page 50 of its Report and Order in Case No. GR-96-285, (under the heading Safety Program Deferrals, Carrying Cost Rate), the Commission stated:

The Commission finds in favor of Staff on this issue because the Staff's proposal shows a carrying cost which is more reflective of the actual carrying cost associated with the gas safety line replacements.

The Commission has not always specified a carrying cost rate to be used when it has approved previous gas safety AAO applications. Staff believes that the language in the Commission's GR-96-285 Order provides sufficient guidance for MGE to select an appropriate carrying cost rate for its safety program deferrals. However, if the Commission determines that it should reference a specific rate in this order, it should specify that the carrying cost rate should be equal to the Company's current AFUDC rate, consistent with the Staff's position and the Commission's Order in Case No. GR-96-285.

Deferrals under GO-94-234

Staff addressed this issue in its Initial and Reply Briefs in Case No. GR-96-285. On page 103 of its Initial Brief in that case, Staff wrote "MGE is free to seek recovery of amounts it may defer from November 1996 forward in future rate cases". On page 49 of its Reply Brief Staff wrote "MGE can seek recovery in rates of any deferred amounts not included in this rate case in a future rate proceeding".

Staff is not convinced that additional language in the AAO issued in this case is necessary. However, Staff is not opposed to including language confirming MGE's request that it may continue to record and seek future rate recovery of the regulatory assets deferred under GO-94-234 for the period November 1, 1996 through January 31, 1997.

Recommendation

Based on the above analysis, and subject to the conditions described below, Staff recommends that the Commission approve MGE's request for an AAO for costs incurred in compliance with the Commission's gas safety rules. In addition, the Staff has no objections to inclusion in the Order of the language in Item No. 4 below, if the Commission so determines that inclusion of this language in the AAO is necessary and appropriate.

The Staff recommends that the Commission's Accounting Authority Order state:

1. That MGE is authorized to defer and book to Account 182.3, beginning February 1, 1997 and continuing through the last date of the Commission's test year, including any update on true-up period, in MGE's next rate case, depreciation expense, property taxes, and actual carrying costs incurred to remove and replace or repair facilities located in mobile home parks, to remove and replace Company-owned and customer owned service and yard lines, to move and reset meters in connection therewith, to remove and replace cast iron mains, and to remove, replace, and cathodically protect bare steel mains, with the deferred amounts to be computed on plant placed in service beginning on February 1, 1997. If no rate case is filed by MGE on or before January 31, 1999, no recovery of these costs shall be allowed in any subsequent rate case unless said costs were, in whole or part, incurred in the approved test year.
2. That nothing in this order shall be considered a finding by the Commission of the reasonableness of the costs and/or expenditures deferred in this proceeding, and the Commission reserves the right to consider the ratemaking treatment to be afforded all deferred costs and/or expenditures, including the resulting cost of capital incurred in financing the Company's gas safety program.
3. That MGE is directed hereby to maintain detailed supporting work papers relating to the monthly accruals of each item booked to Account No. 182.3 and any capital costs

booked to capital accounts in regard to the deferrals approved in ordered paragraph 1. In addition, MGE shall develop accounting records in sufficient detail to allow the calculation and subsequent audit of the actual carrying costs incurred in financing its gas safety program.

4. That MGE may continue to record as regulatory assets the deferrals of carrying costs, property taxes and depreciation expense under GO-94-234 for the period November 1, 1996 through January 31, 1997, and may request rate recovery of such assets in its next rate proceeding.

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