

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. GO-2009-0302 / File No. YG-2009-0604 – Missouri Gas Energy

FROM: Keith Foster, Auditing Department
Michael Ensrud, Tariffs/Rate Design – Energy

/s/ Mark Oligschlaeger 04/20/09

/s/ Tom Imhoff 04/20/09

Project Coordinator / Date

/s/ Robert S. Berlin 04/20/09

General Counsel's Office / Date

SUBJECT: Staff Report and Recommendation Regarding the Application of Missouri Gas Energy
Seeking the Missouri Public Service Commission's Approval to Increase an Infrastructure
System Replacement Surcharge

DATE: April 20, 2009

BACKGROUND

On February 19, 2009, Missouri Gas Energy (MGE), a division of Southern Union Company, filed an Application and Petition (Application) to implement a change in MGE's Infrastructure System Replacement Surcharge (ISRS) with the Missouri Public Service Commission (Commission) with a proposed effective date of March 21, 2009. The Commission's Rule 4 CSR 240-3.265; Natural Gas Utility Petitions for Infrastructure System Replacement Surcharges allows Gas corporations to recover certain infrastructure system replacement costs outside of a formal rate case filing through a surcharge on customers' bills. MGE filed this tariff sheet to reflect a total revenue requirement of \$4,128,940.

On February 24, 2009, the Commission issued its order that suspended the proposed ISRS tariff until June 19, 2009, directing notice and setting an intervention date of March 16, 2009. The Commission indicated that it must issue its order regarding this application effective no later than June 19, 2009.

On March 17, 2009 the Commission set a filing date of April 20, 2009 for Staff's Recommendation. This Memorandum is in response to that Order.

STAFF'S INVESTIGATION

Staff members from the Auditing and Energy Tariffs/Rate Design Departments participated in the Staff's investigation of the Application. The Staff's investigation included a review of the Application, the supporting documentation, Missouri statutory sections 393.1009, 393.1012 and 393.1015 RSMo and all additional data provided by MGE.

THE APPLICATION

In Case Number GO-2008-0113, the first portion of MGE's current ISRS revenues was calculated on ISRS plant that was placed in service during the period November 1, 2006 through September 30, 2007. In Case Number GO-2009-0009, the second portion of MGE's current ISRS revenues was calculated on ISRS plant that was placed in service during the period October 1, 2007 through May 31, 2008. In MGE's current ISRS Application, Case Number GO-2009-0302, MGE seeks to recover costs of ISRS-qualifying plant placed in service from June 1, 2008 through January 31, 2009. The chart below presents a quantification of MGE's revenue requirement request in its current Application:

	MGE as Filed
ISRS Plant in Service June 2008 - January 2009	\$8,772,859
Deferred Taxes GO-2008-0113 at 1/31/2009	(\$185,922)
Deferred Taxes GO-2009-0009 at 1/31/2009	(\$135,311)
Deferred Taxes GO-2009-0302 at 1/31/2009	(\$61,081)
Accumulated Depreciation GO-2008-0113 at 1/31/2009	(\$173,545)
Accumulated Depreciation GO-2009-0009 at 1/31/2009	(\$168,193)
Accumulated Depreciation GO-2009-0302 at 1/31/2009	(\$75,648)
Total ISRS Rate Base	\$7,973,159
Total Grossed Up Rate of Return per GR-2006-0422	11.19%
Return on ISRS Rate Base	\$892,215
Annual Depreciation Expense ISRS Plant Additions	\$207,637
Annual Depreciation Expense Plant Retirements	(\$7,645)
Property Taxes on 2008 Plant from GO-2009-0009 due 12/31/2009	\$44,559
Property Taxes on 2008 Plant from GO-2009-0302 due 12/31/2009	\$62,792
2008 Revenue Undercollection	\$143,741
Total ISRS Revenues	\$1,343,299

STAFF REVIEW

The Staff's review consisted of a review of MGE's Application, a review of selected plant work orders at MGE's headquarters in Kansas City, Missouri, responses to Staff data requests, and discussions with MGE personnel. Based on the Staff's review of MGE's ISRS plant work orders and discussions with MGE personnel, MGE agreed that \$21,627 in plant costs should be removed. These were for costs associated with a project that was revenue producing and thus did not qualify for ISRS treatment. Staff removed this cost as an adjustment.

STAFF'S REVENUE CALCULATION

Based on its review, the Staff has determined the appropriate incremental revenue requirement annual increase for the pending ISRS Application is \$1,330,304 based on ISRS plant placed in service during the period June 1, 2008 through January 31, 2009. These costs are shown below:

	Staff
ISRS Plant in Service June 2008 - January 2009	\$8,751,232
Deferred Taxes GO-2008-0113 at 5/31/2009	(\$145,250)
Deferred Taxes GO-2009-0009 at 5/31/2009	(\$147,150)
Deferred Taxes GO-2009-0302 at 5/31/2009	(\$230,976)
Accumulated Depreciation GO-2008-0113 at 5/31/2009	(\$142,973)
Accumulated Depreciation GO-2009-0009 at 5/31/2009	(\$147,126)
Accumulated Depreciation GO-2009-0302 at 5/31/2009	(\$144,619)
Total ISRS Rate Base	\$7,793,139
Total Grossed Up Rate of Return per GR-2006-0422	11.19%
Return on ISRS Rate Base	\$872,079
Annual Depreciation Expense ISRS Plant Additions	\$207,092
Annual Depreciation Expense Plant Retirements	(\$7,642)
Property Taxes on 2008 Plant from GO-2009-0009 due 12/31/2009	\$44,631
Property Taxes on 2008 Plant from GO-2009-0302 due 12/31/2009	\$62,792
2008 Revenue Undercollection	\$151,352
Total ISRS Revenues	\$1,330,304

The total difference between MGE's incremental updated ISRS revenues of \$1,343,299 and the Staff's proposed level of \$1,330,304 is \$12,995. This difference is shown in the chart below and explained in the description of the Staff adjustments:

	Staff	MGE	Difference
ISRS Plant in Service June 2008 - January 2009	\$8,751,232	\$8,772,859	\$21,627
Deferred Taxes GO-2008-0113 at 5/31/2009	(\$145,250)	(\$185,922)	(\$40,672)
Deferred Taxes GO-2009-0009 at 5/31/2009	(\$147,150)	(\$135,311)	\$11,839
Deferred Taxes GO-2009-0302 at 5/31/2009	(\$230,976)	(\$61,081)	\$169,894
Accumulated Depreciation GO-2008-0113 at 5/31/2009	(\$142,973)	(\$173,545)	(\$30,572)
Accumulated Depreciation GO-2009-0009 at 5/31/2009	(\$147,126)	(\$168,193)	(\$21,067)
Accumulated Depreciation GO-2009-0302 at 5/31/2009	(\$144,619)	(\$75,648)	\$68,971
Total ISRS Rate Base	\$7,793,139	\$7,973,159	\$180,020
Total Grossed Up Rate of Return per GR-2006-0422	11.19%	11.19%	
Return on ISRS Rate Base	\$872,079	\$892,215	\$20,136
Annual Depreciation Expense ISRS Plant Additions	\$207,092	\$207,637	\$545
Annual Depreciation Expense Plant Retirements	(\$7,642)	(\$7,645)	(\$3)
Property Taxes on 2008 Plant from GO-2009-0009 due 12/31/2009	\$44,631	\$44,559	(\$72)
Property Taxes on 2008 Plant from GO-2009-0302 due 12/31/2009	\$62,792	\$62,792	(\$0)
2008 Revenue Undercollection	\$151,352	\$143,741	(\$7,611)
Total ISRS Revenues	\$1,330,304	\$1,343,299	\$12,995

Adjustment 1 – correction to remove the \$21,627 in plant costs associated with a project that was revenue producing as discussed above.

Adjustment 2 –In its Application, MGE only calculated the depreciation and deferred tax reserve out through January 31, 2009, the month before its February 19, 2009 filing. However,

Commission Rule 4 CSR 240-3.265(12) requires that the Commission issue an Order with an effective date no later than 120 days after the utility files an ISRS petition. This would make the effective date of the customer surcharge from this case at or about June 19, 2009. The Staff used a valuation of the depreciation reserve and deferred tax reserve associated with ISRS plant included in this case as of May 31, 2009, in its calculation of ISRS revenues, as that more closely reflects MGE's net investment in ISRS plant near the date the surcharge will go into effect. This is consistent with how Staff valued the depreciation and deferred tax reserve in MGE's last ISRS case, GO-2009-0009, as well as in Atmos Energy Corporation's ISRS Case Number GO-2009-0046 and Laclede Gas Company's ISRS Case Number GO-2009-0221.

Adjustment 3 – Staff recalculated the tax depreciation amounts for eligible ISRS plant based on the intent of the half-year convention Modified Accelerated Cost Recovery System (MACRS) depreciation schedule for 15-year property. Internal Revenue Service (IRS) Publication 946 for Tax Year 2008, page 44, states: “Under this convention, you treat all property placed in service or disposed of during a tax year as placed in service or disposed of at the midpoint of the year. *This means that a one-half year of depreciation is allowed for the year the property is placed in service or disposed of*” [emphasis added]. This half-year of depreciation is calculated into the Year 1 depreciation rate of 5%. Therefore, for ISRS plant placed in service in 2008, regardless of when in 2008 the plant was placed in service, the Staff calculated tax depreciation for the full allowable MACRS depreciation rate at twelve months, as MGE was allowed a full 5% tax depreciation in 2008 for these new ISRS plant additions. MGE had calculated tax depreciation for 2008 plant at the 5% depreciation rate, but pro-rated the amounts based on the number of months the plant additions were in service through January 2009. For 2009, all new ISRS plant additions from 2008 were computed by the Staff using the Year 2 depreciation rate (9.50%) because this is the rate that applies for the second year no matter in what month 2008 additions were placed in service. All new ISRS plant additions made in 2009 were also calculated by the Staff at the Year 1 depreciation rate (5%). However, depreciation for these plant additions was calculated for five months (January through May 2009) to be consistent with an anticipated June 2009 ISRS order effective date. In the prior MGE ISRS case (GO-2009-0009), although the effective date of the resulting order was October 1, 2008, in establishing the ISRS revenue requirement, the Staff had calculated tax depreciation through October 31, 2008. Therefore, for the current case, the Staff calculated tax depreciation on plant additions from the two prior cases (GO-2009-0009 and GO-2008-0113) beginning November 1, 2008 through May 31, 2009. Tax depreciation was calculated for two months in 2008 and for five months in 2009 based on the depreciation rate applicable for each plant addition's year of service. The depreciation rates were obtained from Table A-1 of IRS Publication 946 for Tax Year 2008, page 79. For each ISRS case, the total computed tax depreciation amounts were reduced by the applicable depreciation reserve amounts, the result of which was then multiplied by the effective tax rate to determine the deferred taxes.

Adjustment 4 – Per Commission Rule 4 CSR 240-3 (17), MGE submitted a reconciliation of the differences between revenues resulting from the two prior ISRS cases (GO-2008-0113 and GO-2009-0009) and the appropriate pretax revenue requirement amounts determined in those cases. The reconciliation resulted in an undercollection of ISRS revenues for the 12-month period ending December 31, 2008. In reviewing and verifying MGE's calculations, Staff determined

that, as a result of a subtraction of dates, MGE had not accounted for one day of revenue. Staff adjusted the amount to include the additional day of revenue.

The Staff recommends the Commission approve an incremental revenue requirement of \$1,330,304 based on an ISRS net investment date of May 31, 2009. If this recommendation is accepted, MGE's total ISRS revenue requirement will amount to \$4,115,945 which is a composite amount from this case (\$1,330,304) and Case Numbers GO-2009-0009 (\$1,445,763) and GO-2008-0113 (\$1,339,878).

THE ISRS RATE SCHEDULES

Staff notes that MGE's proposal is different from Staff's proposal in two aspects. First, the Company used 2007 customer counts when generating their filed rates. Staff has used updated customer counts that reflect the customer levels between January 2008 and December 2008. These updated customer counts along with the incorporation of historical class weightings reflect Staff's calculation and proposed ISRS rates in this case.

Second, in this current ISRS filing, Staff proposes MGE recover an additional \$1,330,304 of annual revenue from its customers, not the initially-requested \$1,343,299 increment. Staff's proposed ISRS rates are designed to recover \$4,115,945 revenues annually as opposed to the \$4,128,940 initially requested by MGE. Staff proposes the ISRS rates reflect the revenue requirements from the following ISRS cases: A) GO-2009-0302 - \$1,330,304, B) GO-2009-0009 - \$1,445,763, and C) GO-2008-0113 - \$1,339,878.

The Staff has verified that the Company has requested an extension to file its 2008 annual report. The Company is not delinquent on any assessment. The Staff is not aware of any other matter before the Commission that affects or is affected by this filing.

P.S.C. MO. No. 1

Ninth Revised Sheet No. 10, CANCELLING Eighth Revised Sheet No. 10

RECOMMENDATION

Based upon the above, the Staff recommends that the Commission issue an order in this case that:

1. Rejects the ISRS tariff sheet (YG-2009-0604) filed by MGE on February 19, 2009;
2. Approves the Staff's determination of the incremental ISRS surcharge revenues in the amount of annual pre-tax revenue increase of \$1,330,304 over existing ISRS rates ; and
3. Authorizes MGE to file an ISRS rate for each customer class as reflected in Appendix B.

MISSOURI GAS ENERGY

Missouri Gas Energy

Appendix B

CASE NO. GO-2009-0009

FILE NO. YG-2009-0008

Company's Total ISRS Revenues

\$4,115,945

ISRS RATE DESIGN

Customer Rate Class	Number of Customers	Customer Charges	Ratio To Res. Cust. Charge	Weighted Customer #	Customer Percentage	ISRS charge	ISRS Revenues
Residential	446,311	\$24.62	1.0000	446,311	80.0043%	\$0.61	\$3,292,934
Small General Service	65,727	\$18.39	1.3476	88,574	15.8774%	\$0.83	\$653,507
Large General Service	304	\$108.91	7.9828	2,427	0.4350%	\$4.91	\$17,905
Large Volume Service	500	\$835.95	41.0944	20,547	3.6832%	\$25.27	\$151,600
TOTAL	<u><u>512,842</u></u>			<u><u>557,859</u></u>	<u><u>100.0000%</u></u>		<u><u>\$4,115,945</u></u>

* Due to rounding to the nearest penny, the designed ISRS rates will under collect by \$24,776. However, it should be noted that the total amount collected will be true-up at a later date.

Notary Public

