M E M O R A N D U M

TO: Missouri Public Service Commission Official Case File,
Case No. GR-2008-0060
Missouri Gas Utility

FROM: Mark L. Oligschlaeger – Auditing Department
Thomas M. Imhoff, Energy Department - Tariffs/Rate Design

/s/ Thomas M. Imhoff 03/17/08	/s/ Sarah Kliethermes 03/17/08
Case Co-Coordinator/Date	General Counsel's Office/Date

SUBJECT: Staff Memorandum in Support of Stipulation and Agreement for Missouri Gas Utility

DATE: March 17, 2008

REVENUE REQUIREMENT ISSUES

Annual Revenue Requirement. The Stipulation provides for MGU to receive an overall base rate increase of $301,000 annually. This amount is "black box" in nature, in that it is a negotiated amount for which no details are spelled out in the agreement as to how the parties arrived at the amount.

MGU initially filed for a rate increase of $443,131. The Staff's direct filing recommended an increase of $207,732 annually for the Company. During the reconciliation process, the Staff's revenue requirement calculation was $214,227 at the time of the settlement conference for this case.

The Staff believes a $301,000 increase in MGU's rates is reasonable in the context of this overall settlement. The Staff's filed case was based upon a 9.05% return on equity (ROE) at the midpoint of its recommended ROE range. The Staff believes the

Commission would likely find reasonable a higher ROE for MGU if this case had gone to hearing, based upon what the Commission has ordered in recent proceedings. Movement to a higher ROE explains a substantial part of the Staff's movement to the stipulated revenue requirement amount. The other amount of movement from the Staff's corrected filed revenue requirement position of approximately $214,000 can be explained through the Staff's perception of the litigation risk inherent in taking the remaining major issues between the parties to the hearing process. While the Staff believed it was likely to prevail on a majority of these issues and their associated dollar values, it also assumed that it was unlikely to prevail on all issues if the case went to hearing.

The Staff notes that from its perspective the revenue requirement agreed to in the Stipulation is based upon proper accounting of MGU's capital costs and operating costs. Please refer to Section 4 of this memorandum for a discussion of the Staff's concerns in this area. The explanation provided herein is from the Staff's perspective only, and other parties may have an entirely different perspective as to how the stipulated rate increase amount was arrived at.

MGU Prospective Accounting Changes. In its audit of MGU's books and records resulting from this case, the Staff determined that MGU and its parent company, CNG Holdings, Inc. (Holdings), appeared to be deviating in its accounting in certain important respects from the requirements of the Uniform System of Accounts (USOA) prescribed by the Commission in 4 CSR 240-40.040 for natural gas utilities under its jurisdiction. These deviations included capitalization of marketing and sales costs (payroll, payroll benefits, advertising, direct mail costs) to plant in service accounts, and capitalization of the costs of obtaining regulatory approvals of applications before the

Missouri Commission to plant in service accounts. The Staff believes the USOA clearly provides for marketing/sales costs and regulatory commission costs to be charged to operating expense and not capitalized.

In its audit, the Staff also noted that the costs of certain activities associated with Holdings' "corporate governance" activities, including costs associated with its choice of ownership structure (privately-held stock ownership) and merger and acquisition investigations, were not separately identified on Holdings' and MGU's books and records for potential adjustment from its cost of service. The Staff believes that costs associated with Holdings' choice of ownership structure and its investigation of merger/acquisition opportunities generally are ownership costs that should not be included in customer rates.

Also, MGU failed to separately account for disconnection and reconnection revenues on its books and records, and to record occurrences of each disconnection and reconnection event.

The accounting practices discussed above had the overall impact, in the Staff's opinion, of overstating MGU's plant in service balances - and hence its rate base, and understating its operating expenses - hence overstating its book net income. The Staff proposed adjustments in its direct filing to disallow an estimate of the amount of over-capitalized plant and to increase MGU's test year payroll expenses so that its adjusted rate base and income statement would be stated in conformity with the provisions of the natural gas USOA. The Staff's adjustments had the net impact of increasing MGU' overall revenue requirement compared to that level produced under MGU's accounting practices.

A) Therefore, a Staff requirement for any global settlement of this case with MGU was that on a prospective basis MGU's accounting practices would be fully consistent with the USOA and, accordingly, with Commission rules. The language in this Stipulation and Agreement accomplishes this to the Staff's satisfaction.

The adherence of MGU and Holdings to the Stipulation's accounting provisions, which is to occur no later than April 1, 2008, the beginning of MGU's next fiscal year, should bring their books into compliance with the USOA and Commission rules, make its accounting practices reasonably comparable with other utilities operating in this jurisdiction. This will reduce the number of accounting issues that may arise in future MGU rate proceedings.

Case No. GR-2007-0178. In this Actual Cost Adjustment (ACA) case, an issue arose between MGU and the Staff concerning carrying charges on MGU's gas storage inventory (GSI). MGU wanted to receive recovery of its interest costs through the PGA/ACA process, while the Staff advocated that the Company be compensated for these costs in its base rates through general rate proceedings. The Staff's proposed treatment of these costs was consistent with that afforded all Missouri local distribution companies, except for Laclede Gas Company, whose tariffs explicitly allow for recovery of GSI carrying costs in its PGA rates. MGU's tariffs do not provide for recovery of its GSI carrying costs in PGA rates.

When resolution of this issue among the parties could not be reached in the GR-2007-0178 ACA case, the docket was consolidated with this general rate proceeding. In this global settlement, the GSI carrying cost issue was resolved by adoption of the Staff's position in the ACA case; i.e., the costs will be denied recovery in the PGA/ACA process for the period of time covered in Case No. GR-2007-0168. Case No. GR-2007-0168 pertains to the 12-month period ending August 31, 2006. The issue of GSI carrying cost recovery may still arise in subsequent ACA periods but will be reviewed in that appropriate period.

Rate Case Moratorium. As part of this settlement, the Staff, MGU, and OPC agree that they will not file a tariff or pleading with the Commission, or encourage or assist in such filings or pleadings, to seek a general increase or decrease in MGU's base rates prior to April 1, 2011. This provision is void if a "significant, unusual event" that has a major impact on the utility, including but not limited to terrorist activity, "acts of God," changes in federal or state tax laws, or changes in federal or state environmental laws or regulations occurs prior to April 1, 2011. This provision was a product of negotiations between MGU and OPC. The Staff supports this provision in that it serves to protect MGU's customers from further potential increases in customer rates for a substantial amount of time after this rate increase goes into effect, if the Commission adopts this Stipulation.

RATE DESIGN AND TARIFF ISSUES

Rate Design/Class Cost of Service. The Stipulation is based on customer charges equivalent to what was filed in the Company's direct testimony, with an equal percentage increase for all other classes' rate components. The agreement on rate design includes an annual contribution from the Company of $9,000 for conservation. These funds will be used to help low-income/high-use customers.

Tariff changes. The Company provided supporting documentation subsequent to Staff's filing which supports the Company's proposed increases in their miscellaneous tariff charges. Staff reviewed the support and is in agreement that these changes reflect the costs of the Company to perform these services. The customer causing these costs to the Company should pay for these services and not be subsidized by the general body of ratepayers.

ERRATTA SHEET

OF

THOMAS M. IMHOFF

MISSOURI GAS UTILITY

CASE NO. GR-2008-0060

On page 4, line 8, MGU's Customer Service should read MGU's Commercial Service.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the General Rate	)	
Increase for Natural Gas Service	)	Case No. GR-2008-0060
Provided by Missouri Gas Utility, Inc.	)	

AFFIDAVIT OF THOMAS M. IMHOFF

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Thomas M. Imhoff, of lawful age, on oath states: that he has participated in the preparation of the foregoing Staff Memorandum in Support of the Stipulation and Agreement and the attached Errata Sheet, to be presented in the above case; that the information in the Staff Memorandum and the Errata Sheet was given by him; that he has knowledge of the matters set forth in such Staff Memorandum and Errata Sheet; and that such matters are true to the best of his knowledge and belief.

Thom M. Imhoff
Thomas M. Imhoff

Subscribed and sworn to before me this 17th day of March, 2007.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

SUSAN L. SUNDERMEYER
My Commission Expires
September 21, 2010
Callaway County
Commission #06942086

Susan L Sundermeyer
Notary Public