BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Missouri Gas Energy for the Issuance of an Accounting Authority Order Relating to its Natural Gas Operations and for a Contingent Waiver of the Notice Requirement of 4 CSR 240-4.020(2)	))))))	Case No. GU-2011-0392

BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

On behalf of all Missouri ratepayers, the Office of the Public Counsel (OPC) encourages the Commission to strongly reject the notion that reductions in expected revenues can be deferred for recovery from future ratepayers. Southern Union Company (SUC) d/b/a Missouri Gas Energy (MGE) wants Missouri ratepayers in Joplin, Kansas City, and St. Joseph to shield SUC's shareholders against the risk of earning less than expected revenues due to the devastating May 2011 tornado that took many lives, and destroyed thousands of homes and businesses in Joplin. MGE's request should be denied. Granting MGE's request to defer "lost revenue" would be equivalent to telling ratepayers that the Commission considers it *probable* that ratepayers in 2013 and beyond will be required to pay an additional surcharge to guarantee shareholders the alleged unearned profits that MGE hoped it would collect from Joplin residents in 2011.

The Uniform System of Accounts (USOA) requires profits and losses to be recorded in the period in which they occurred. Deferring accounting treatment to future periods can only be done under extraordinary circumstances, and only if recovery in future rates is probable.[1] Recovery in this instance is highly *improbable* because

[1] USOA Account 182.3, Staff Ex. 5.

Missouri law prohibits the passing of unearned revenues to future customers for rate recovery because it constitutes retroactive ratemaking.[2] This prohibition protects both ratepayers and shareholders. Shareholders are protected by the prohibition against retroactive ratemaking because excess profits cannot be recouped by ratepayers from shareholders in future periods. Likewise, ratepayers are protected by the prohibition against retroactive ratemaking because profit losses cannot be recouped by shareholders from ratepayers in future periods. These balanced protections would be disrupted if suddenly ratepayers were no longer equally protected.

The first place MGE should look to replace the profits it expected to earn from the destroyed area of Joplin is the $1.7 million in over-earnings that MGE enjoyed just five (5) months before the May 2011 tornado, an over-earnings that likely continues today.[3] By MGE's own account it earned approximately $1,774,000 above its authorized amount in 2010.[4] These overearnings are based on rates that were in effect for only ten (10) months, and would have been even greater if the new rates had been measured for an entire year.[5] The likelihood that MGE continues to enjoy this level of over-earnings is corroborated by the fact that MGE has not experienced a decline in net sales revenues since the tornado, and has actually earned *record* net sales revenues since the tornado.[6]

MGE failed to bring these inconvenient facts to the Commission's attention as it asks the Commission to give blessing to the notion that the same over-paying customers of MGE should reach deeper into their pockets in 2013 and beyond to further reimburse investors from the additional profits MGE expected to earn from Joplin. MGE's attempt

[2] State ex rel. Utility Consumers Council of Missouri, Inc. v. P.S.C., 585 S.W.2d 41 (Mo. 1979)("*UCCM*").
[3] Transcript (Tr) 155.
[4] *Id.*
[5] *Id.*

to squeeze more out of ratepayers should be denied. If MGE is unable to earn what it considers to be a reasonable return, nothing is prohibiting MGE from filing a request with the Commission for a general rate increase as allowed by Missouri statutes.

I. Background

On May 22, 2011, an EF-5 tornado struck Joplin, Missouri, tragically killing 162 people and injuring more than 900. The tornado also destroyed several thousand homes and at least 300 businesses.[7] Many meters and other facilities belonging to Joplin's regulated gas and electric utilities were also destroyed. This includes facilities belonging to MGE, Joplin's natural gas provider, and The Empire District Electric Company ("Empire"), Joplin's electric service provider.

On June 6, 2011, Empire filed an application for an Accounting Authority Order (AAO) authorizing Empire to defer expenses and unearned revenues allegedly caused by the tornado.[8] Four (4) days later MGE filed a nearly identical application with the Commission, opening the present case.

In November 2011, the Commission approved a Unanimous Stipulation and Agreement resolving Empire's AAO request.[9] The Order authorized Empire "to defer actual incremental Operations & Maintenance expenses associated with repair, restoration, and rebuild activities associated with the May 22, 2011, tornado" and required Empire to withdraw "that portion of its application that seeks authority to defer

---

[6] OPC Ex. 2, Lafferty Surrebuttal, Attachments A and B.
[7] Ex. MGE 1, p. 3.
[8] *In the Matter of the Application of The Empire District Electric Company for the Issuance of an Accounting Authority Order Relating to its Electrical Operations and for a Contingent Waiver of the Notice Requirement of 4 CSR 240-4.020(2),* Case Number EU-2011-0387, Order Approving and Incorporating Unanimous Stipulation and Agreement, November 30, 2011.
[9] *Id.*

the lost fixed cost components of Empire's rates."[10] Unfortunately MGE did not agree to withdraw its request for recovery of unearned profits in exchange for agreeing to allow MGE to defer expenses caused by MGE's repair, restoration and rebuild activities associated with the tornado.

The parties present the Commission with two issues for resolution:

1. Should the Commission enter an order authorizing MGE to defer to Account 182.3, Other Regulatory Assets, actual incremental Operations & Maintenance and capital **expenses** incurred for repair, restoration, and rebuild activities associated with the May 22, 2011, Joplin tornado, including depreciation and carrying charges equal to MGE's ongoing Allowance for Funds Used During Construction rates?

2. Should the Commission enter an order authorizing MGE to defer to Account 182.3, Other Regulatory Assets, its loss of **expected revenues** related to the May 22, 2011, tornado, including carrying charges equal to its ongoing Allowance for Funds Used During Construction rates?

OPC strongly opposes an order authorizing MGE to defer expected revenues to Account 182.3 for probably future recovery. OPC takes no position on whether the Commission should authorize MGE to defer the actual incremental Operations & Maintenance and capital expenses incurred for repair, restoration, and rebuild activities including depreciation and carrying charges. OPC recognizes that the public will benefit from the repair, restoration and rebuilding of MGE's distribution system. Forcing consumers to insulate SUC's shareholders from any adverse effects of the devastating tornado, on the other hand, is unlawful and detrimental to the public.[11] According to

[10] *Id.*, Appendix A.
[11] Tr. 212. Mr. Oligschlaeger testified that deferred revenues are "more onerous" on customers than deferred expenses.

counsel for MGE, the Commission may defer categories of expenses and revenues, thus allowing the Commission to defer one and not the other.[12]

II. Argument

Prohibited retroactive ratemaking was defined by the Supreme Court of Missouri in the landmark 1979 Missouri utility regulation case State ex rel. Utility Consumers Council of Missouri, Inc. v. P.S.C., 585 S.W.2d 41, 59 (Mo. 1979) ("*UCCM*") as "the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established." The prohibition against changing rates retroactively works to protect both ratepayers and shareholders because it protects ratepayers from paying for past losses, and it protects shareholders from having to refund past excess profits. The Supreme Court in *UCCM* explained:

> The commission has the authority to determine the rate to be charged, § 393.270. In so determining it may consider past excess recovery insofar as this is relevant to its determination of what rate is necessary to provide a just and reasonable return in the future, and so avoid further excess recovery. See State ex rel. General Telephone Co. of the Midwest v. Public Service Comm'n, 537 S.W.2d 655 (Mo.App. 1976). It may not, however, redetermine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of his property without due process.[13]
>
> Past expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses, but under the prospective language of the statutes, §§ 393.270(3) and 393.140(5), they cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses.[14]

Including revenue deficiencies from 2011 in 2013 rates would redetermine rates already established and paid because ratepayers will have already paid rates for services provided

[12] Tr. 106.
[13] *UCCM*, p. 58.

in 2011. The Supreme Court determined that this would constitute retroactive ratemaking and it would deprive consumer of property without due process.

A. USOA Deferrals Must Meet a Probability Standard

MGE's accounting practices must follow the Federal Energy Regulatory Commission's (FERC's) Uniform System of Accounts (USOA) pursuant to Commission Rule 4 CSR 240-40.040. Under General Instruction Number 7 of the USOA, "It is the intent that net income shall reflect all items of profit and loss during the period".[15] The USOA creates an exception to this requirement, allowing deferral to a later period so long as the item to be deferred is extraordinary and recovery in a later rate case is probable.

These requirements are found in General Instruction Number 7 and in FERC's description of Account 182.3. General Instruction Number 7 states:

> 7. **Extraordinary items**. **It is the intent that net income shall reflect all items of profit and loss during the period** with the exception of prior period adjustments as described in paragraph 7.1 and long-term debt as described in paragraph 17 below. 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 shall be considered extraordinary items. **Accordingly, they will be events and transactions of significant effect** which are abnormal and significantly different from the ordinary and typical activities of the company, and which would not reasonably be expected to recur in the foreseeable future. (In determining significance, items should be considered individually and not in the aggregate. However, the effects of a series of related transactions arising from a single specific and identifiable event or plan of action should be considered in the aggregate.) To be considered as extraordinary under the above guidelines, an item should be more than approximately 5 percent of income, computed before extraordinary items. Commission approval must be obtained to treat an item of less than 5 percent, as extraordinary. (See accounts 434 and 435.) [emphasis added].

To be considered extraordinary**,** the item to be deferred must: 1) be of "unusual nature and infrequent occurrence"; 2) involve "events and transactions of significant effect"; and

[14] *UCCM*, p. 59.
[15] Staff Ex. 5.

3) "be more than approximately 5% of income". A later section of this brief explains why the loss of expected revenue that MGE seeks to defer is not extraordinary.

The requirement that rate recovery of the deferred amount be "probable" is found in the description of the USOA account in which MGE seeks to record the deferred asset, USOA Account 182.3. Account 182.3 of the USOA states in part:

> 182.3 Other regulatory assets.
>
> A. This account shall include the amounts of regulatory-created assets, not includible in other accounts, resulting from the ratemaking actions of regulatory agencies. (See Definition No. 31.)
>
> B. The amounts included in this account are to be established by those charges which would have been included in net income, or accumulated other comprehensive income, determinations in the current period under the general requirements of the Uniform System of Accounts but for it being **probable that such items will be included in a different period(s) for purposes of developing rates** that the utility is authorized to charge for its utility services. [emphasis added].

Future rate recovery of amounts placed in Account 182.3 must be "probable" before they can be placed into the account. This requirement is echoed by USOA Definition No. 31, which defines "regulatory asset" and states that allowing a loss to be carried from the period incurred to a future period as a regulatory asset requires that there be a probability "that such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services". MGE witness Mr. Noack concurred with this probability standard.[16] Staff witness Mr. Oligschlaeger also concurred with this probability standard and testified that independent financial auditors would also require under Financial Accounting Standard Board Statement No. 71 a finding that future recovery is probable, and if it is not probable, the company should be

[16] Tr. 138.

prohibited from booking that item as an asset on its books.[17] Since future recovery of past losses is prohibited by the prohibition against retroactive ratemaking, the USOA prohibits MGE from deferring the loss of expected revenues into USOA Account 182.3.

B. Guidance from the Other State Commissions

The issue of whether unearned revenues can be deferred for future recovery presents an issue of first impression for the Commission. Guidance in addressing this issue can be found in an order from the Delaware Public Service Commission (*See* Appendix A to this Brief for a copy). The Delaware PSC addressed a similar deferral case in 2010 and issued a decision that provides a thoughtful analysis of the issues facing state commissions in requests to defer unearned revenue to future periods.[18] In Delaware, United Water Delaware, Inc. ("United Water") requested authority to defer "revenue loss" that the utility expected to experience after a large customer curtailed its usage.

In its decision, the Delaware PSC first established that the "fundamental rule underlying the utility rate-making process is that 'rates are exclusively prospective in application and that future rates may not be designed to recoup past losses' in the absence of express legislative authority."[19] The rationale for this fundamental rule, "is that the Commission acts in a legislative capacity in exercising its rate making authority" and "legislative action operates prospectively and not retroactively."[20] The Delaware PSC further explained that under the "matching principle," rates are set by matching revenues and expenses within the same timeframe:

---

[17] Tr. 215.
[18] In the Matter of the Petition of United Water Delaware Inc. for Approval of Accounting Treatment to Defer and Extraordinary Industrial Revenue Loss, PSC Docket No. 10-171, Order No. 7838, September 21, 2010.
[19] *Id.* p. 4.
[20] *Id.* pp. 4-5.

> …comparing revenues and expenses from the same period is crucial, as it ensures adherence to the matching principle – that "the relationship or rate base, revenue and expenses be within the same time frame when we are setting just and reasonable rates for the future."
>
> Retroactive ratemaking runs counter to these fundamental principles because it seeks the "imposition on future rates of a surcharge to recover a utility's past losses from past services."

United Water urged the Delaware PSC to ignore the fact that recovery would constitute retroactive ratemaking because all it was seeking was deferred accounting treatment and not recovery. The Delaware PSC rejected this argument and stated, "The issue is not that simple… Just because a utility is not seeking actual recovery of an expense (here lost revenue) in seeking approval of deferred accounting treatment does not mean that the Commission applies no standard."[21] The Delaware PSC concluded, "we should exercise our authority to approve deferrals "sparingly" and only where "necessary.""[22] In denying the deferral, the Delaware PSC concluded:

> In any event, there does not appear to be any serious threat to United's financial integrity, nor does its anticipated loss appear to be "so catastrophic to the extent that the utility's ability to render safe and adequate service is likely to be impaired."… United's own projections show that it may earn a 8.5% ROE, compared to the 10% that it was permitted an *opportunity to earn* in its last rate case. In this present economy, such a return can hardly be considered a serious threat to financial integrity.[23]
>
> In denying recovery of United's request for deferred accounting, we are also mindful of applicable accounting standards. As the Company conceded during argument, its request for deferred accounting is a request for the establishment for a regulatory asset. The recording of a regulatory asset under applicable accounting standards presupposes that it is "probably" or "likely" that the regulator will allow recovery of that asset in rates at some future date. [emphasis added].[24]

[21] *Id.* p. 9
[22] *Id.* p. 9.
[23] *Id.* p. 12. Contrast this to the present MGE case where MGE failed to provide any calculations showing the impact on MGE's ROE. This is not surprising given the evidence of MGE's over-earnings, a fact that would not benefit MGE's deferral request.
[24] *Id.* p. 12.

> By seeking, and then recording, the revenue loss from the Refinery shutdown as a "regulatory asset", United would be indicating to the financial community that such a loss is an asset that it "probably" will recover in the future, here, in its next rate case, which it plans to file next year. The Commission will not, and need not, make any determination of the appropriateness of recording the anticipated lost revenue as a regulatory asset, where, as here, the Commission is not itself convinced of the asset's "probable" recovery. To the contrary, as discussed during our deliberations in this matter, far from being probably that United will recover this amount, it is, in fact, unlikely.[25]

This same "probability" standard applies to MGE's request, and OPC asks the Commission to carefully consider the above rationale in rendering its decision.

The Delaware PSC also looked to other state commissions for guidance, including the New York Public Utility Commission. The New York PUC explained that there is a distinction between allowing a utility to recover extraordinary expenses and the recovery of "lost revenue." The main distinction, explained the New York PUC, is that deferring expenses and property loss is in the public interest because it benefits the public, whereas deferred revenues provide no public benefits, only public detriments:

> The basic distinction [between recovery of extraordinary expenses or property loss and recovery of lost revenue] is that a ratepayer benefit or public interest is the underlying (if not always explicit) rationale for extraordinary expense or property loss treatment because the recoupment authorized is in contemplation of and directly related to the future or continued adequate provision of utility service at just and reasonable rates. For example, extraordinary storm damage expense cited by the Company is allowed to be recovered over time not only because of the financial effect on the utility's earnings, but because service restoration costs are incurred for the direct benefit of the utility's customers…. Thus, while in such instances, the allowance seeks to indemnify the utility or its stockholders for a prior event, a direct ratepayer benefit is nonetheless intended. Such benefit is consistent with the public interest because of the potential effect of (nonrecoupment for) that event on utility service to be rendered either in the future or in the near term period which rates are being set…. Moreover, New Rochelle overlooks – in essentially characterizing the two prior years of revenue overcollections to which Staff points as either irrelevant, non-comparable or overstated – that just as its stockholders derive the exclusive

[25] *Id.* p. 14.

> benefit of any such overcollections as a quid pro quo for its business risks, the risk of unforeseen revenue shortfalls is theirs exclusively, except possibly where the loss is catastrophic to the extent that the utility's ability to render safe and adequate service is likely to be impaired.[26]

Unless the alleged loss threatens MGE's ability to render safe and adequate service, the Commission should outright deny the request to defer unearned profits for future recovery. MGE's witness Mr. Noack testified that the tornado has not impacted MGE's ability to provide safe and adequate service.[27]

The Delaware PSC also looked to a decision of the New Jersey Supreme Court, which "held that it was impermissible retroactive ratemaking for the New Jersey Board of Public Utilities to hold a rate increase in abeyance in order to offset previous overearnings." The New Jersey Supreme Court addressed the impact that deferral from the period incurred to future periods has upon ratepayers:

> Customers are constantly being added and dropped by a utility. Those who have paid their utility bills have a right to expect that they will not be surcharged for the same service at a later date. New customers should not be called on to pay a present surcharge for service rendered prior to their becoming customers.

Likewise, the MGE customers in Joplin paid their monthly natural gas bills in 2011 and should not be charged again at a later date for services they were already provided and that they already paid for, which is precisely what would occur if unearned but expected revenues were added as a surcharge to future rates.

C. The Tornado's Impact on SUC Profits is Not Extraordinary

Deferrals under the USOA Instruction Number 7 must: 1) be of "unusual nature and infrequent occurrence"; 2) involve "events and transactions of significant effect"; and

[26] Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of the New Rochelle Water Company, Case 29201, 1986 N.Y. P.U.C. Lexis 207 (May 5, 1986).
[27] Tr. 127.

3) "be more than approximately 5% of income". MGE's "loss" of expected revenues, even if it could lawfully be recovered in future rates, fails to meet the definition of extraordinary item under the USOA because the effect is not significant, and it therefore fails the materiality standard for USOA deferrals. Furthermore, the impact is not more than approximately 5% of income, as demonstrated in the Rebuttal Testimony of OPC witness Mr. Shawn Lafferty.[28]

The facts of this case demonstrate that MGE's revenues have not been significantly impacted since the tornado, and cannot be considered "extraordinary." Mr. Lafferty's Attachment A to his Surrebuttal Testimony, which is an MGE response to an OPC data request, provides the impact of the tornado on MGE's net sales margin in months following the tornado as compared to MGE's historical net sales margin history for the same months in prior years.[29] It shows that MGE experience no decline in net margin sales following the tornado. In fact, what MGE did experience were *record* net margin sales. During the period from May 2011 through September 2011, MGE recorded net margin sales revenues of $78,104,399, up from the 2010 net margin sales of $77,733,526 for May-September 2010, which was already a 13% increase over the 2009 net margin sales of $67,748,854 for the months of May-September 2009. In other words, MGE's net sales margins have been steadily increasing, and the tornado appears to have had little if any impact on net margin sales.

This lends support to the possibility that MGE continues to earn above its authorized rate of return, an over-earnings which MGE witness Mr. Noack testified to be

[28] OPC Ex. 1, p. 19.
[29] OPC Ex. 2, Attachment A.

approximately $1.7 million in 2010, just five (5) months before the tornado.[30] If MGE continues to over-earn at the same rate (approximately $170,000 per month of over-earning),[31] MGE will over-earn by over $2 million in 2011. The financial integrity of MGE is strong and not threatened in the least by the tornado. Accordingly, the impact on revenues is not significant and therefore fails that element of the definition of extraordinary items from USOA Instruction Number 7. Any discrepancy between expected revenues and achieved revenues coming from the Joplin area appears to be diluted by MGE's financial success in 2010 and 2011 that allowed MGE to over-earn in 2010, and record profits for 2011.[32]

The evidence before the Commission also demonstrates that MGE's original impact estimates have been substantially improved due to a return of the majority of disconnected customers back to MGE's distribution system. According to MGE, approximately 975 old customers have reconnected at their old premise, and an additional 927 customers affected by the tornado have moved to another location within the MGE service territory.[33] This is a prompt return of approximately 1,900 of the 3,200 impacted residences, leaving only 1,300 still without service, a number which has likely been reduced even more if MGE continues this pace of reconnecting 316 customers each month.[34] Taking into account these new estimates, less than 1/3 of 1% of MGE's 515,000 total customers at the time of the tornado were still without service as of November 18, 2011.[35] This is not significant to SUC, and therefore not extraordinary.

[30] Tr. 154-155.
[31] MGE's most recent rate increase was in effect for only 10 months of 2010. When divided over 10 months, the $1.7 million in over-earnings equals approximately $170,000 per month in excess.
[32] Tr. 154.
[33] Staff Ex. 6.
[34] Tr. 147-148.
[35] Tr. 147-149.

OPC also questions the accuracy of concluding that all 1,300 customers still without service following the tornado were caused by the tornado. MGE's estimate does not take into account the normal fluctuations in customer numbers, which according to Mr. Noack, was in a steady decline prior to the tornado.[36]

MGE witness Mr. Noack conceded that MGE's total revenues exceed MGE's total expenses, even when taking tornado impacts into account.[37] Mr. Noack also testified that due to the tornado, MGE is receiving $1.1675 million less annually.[38] This figure, however, is not offset by the income tax savings that MGE would realize, which reduces MGE's $1.1675 million impact estimate down to approximately $720,000 annually.[39] This number should be adjusted downward an additional $16,000 because of saved billing expenses, bringing MGE's alleged revenue impact down to approximately $704,000.[40] As this number continues to dwindle, there should be no question that MGE's profits are well within the Commission's "zone of reasonableness" for MGE from the last rate case where the Commission established an ROE of 10%, but found that anything between 9.1% and 11.1% is also reasonable.[41]

D. Deferring Losses Would Create a Risk-Free Investment

MGE will likely hinge its entire interpretation of the USOA on the Commission's decision in what has been referred to as the "Sibley case."[42] However, in *Sibley* the issue involved only deferred expenses, not deferred revenues, and the analysis is not on point.

[36] Tr. 146-147.
[37] Tr. 122-123.
[38] Tr. 129.
[39] Tr. 129-130.
[40] Tr. 130.
[41] Tr. 135.
[42] In the Matter of the Application of Missouri Public Service for Issuance of an Accounting Order Relating to its Electrical Operations, Case No. EO-91-358, and In the Matter of the Application of Missouri Public

The Commission in *Sibley* recognized this distinction between deferring expense from deferring losses when it cites to the Court of Appeals decision in State of Missouri ex rel. Union Electric Company v. P.S.C., 765 S.W.2d 618 (Mo.App. W.D. 1988) (*UE*) and stated:

> In the Union Electric Callaway II cancellation case the Court upheld the Commission's denial of recovery of cancellation costs and reaffirmed the broad discretion of the Commission. In that case the Commission determined that the cancellation costs were not ordinary expenses but were similar to extraordinary losses. For extraordinary losses the Court upheld the Commission's decision to place the initial risk of cancellation on the shareholders since to do otherwise would be to make the investment practically risk-free. *UE* at 622. The Commission found that investors had been compensated for their investment through the use of the Discounted Cash Flow (DCF) method for calculating a return on equity for UE and therefore rate recovery was not reasonable.[43]

The Commission in *Sibley* accurately characterized the Court of Appeals decision in *UE*. In *UE,* the Court concluded:

> It is a well-accepted principle of regulation that common stockholders contribute what is known as "risk capital" to the utility company for which they receive a compensatory rate of return. Among the uncertainties that common stockholders accept in return for this added compensation is the danger of earnings shortfall, for whatever reason.[44]

In the present case, MGE's shareholders receive a compensatory rate of return for their risk capital investment, and in return should carry that risk rather than have it shifted to ratepayers by seeking additional compensation from ratepayers when an earnings shortfall occurs, *for whatever reason*. The testimony evidence before the Commission from OPC witness Mr. Lafferty corroborates the *UE* analysis:

> Business risk encompasses all the operating factors that collectively increase the probability that future earning flows accruing to investors may not be

---

Service for Issuance of an Accounting Order Relating to its Purchase Power Commitments, Case No. EO-91-360, Report and Order, December 20, 1991 ("*Sibley*").

[43] *Sibley*, p. 17.

[44] State of Missouri ex rel. Union Electric Company v. P.S.C., 765 S.W.2d 618 (Mo.App. W.D. 1988)(*UE*).

> realized, because of the fundamental nature of the firm's business. Many factors influence business risk, including: demand for services, sales volatility, availability of product and service substitutes, the Company's relative degree of fixed vs. variable costs, the revenue mix among customer types, regulatory policies, operating and capital investment cost uncertainty, general market risk, etc. Investors in utilities are well aware of that weather – including severe weather events – can affect utilities' earnings and thus the investor's return.[45]

Furthermore, Staff witness Mr. Oligschlaeger testified that business risk associated with acts of God was taken into account by the Commission in determining an ROE for MGE in MGE's last rate case.[46] Mr. Oligschlaeger also testified that the comparable companies used in the MGE rate case to establish rates likely included companies that faced the risk of hurricanes, which create an even greater risk to a distribution system than even an E-5 tornado.[47]

Evidence proving that investors are aware of the potential for earnings impacts caused by severe weather can also be found in SUC's Form 10-K filing with the Securities and Exchange Commission (SEC) for 2010.[48] SUC's Form 10-K includes a section titled "Risks that Relate to the Company's Distribution Business." Under that heading is the subheading, "Operational risks are involved in operating a distribution business." The paragraph below the subsection clearly identifies "tornadoes" as a risk that could cause "injury or loss of life, extensive property damage or environmental damage" and that "[i]nsurance proceeds may be inadequate to cover all liabilities or expenses incurred or revenues lost." The risk is clearly recognized by investors.

MGE's witness Mr. Hanley attempted to rebut evidence showing that shareholders factored weather related risks into their investment. However, in MGE's

[45] OPC Ex. 1, Lafferty Rebuttal, p. 14.
[46] Tr. 191.
[47] Tr. 210.

last rate case the Commission concluded that Mr. Hanley's risk premium analysis testimony applied an "arbitrary" adjustment that caused his analysis to be "substantially overstated" and that it could not "be relied upon for establishing ROE for MGE."[49] The Commission concluded that "MGE's analysis cannot be supported as a sound basis for setting just and reasonable rates." This should cause the Commission to question whether Mr. Hanley's analysis in this case is also overstated, understated, or simply unreliable. The most telling problem with Mr. Hanley's testimony was what it did not include – as an expert in ROE, OPC expected Mr. Hanley to provide an analysis showing the impact the Joplin tornado had upon MGE's ROE. If there was truly a concern that ROE was negatively impacted by the tornado, MGE would have had Mr. Hanley present those results to the Commission, which he did not do because he "didn't see a nexus between [his] testimony and [ROE]."[50]

E. Commission Options

As explained above, OPC believes the Commission must deny the request to defer unearned revenues to a future period. However, if the Commission agrees with MGE and the Commission's Staff and finds that the tornado's impact is greater than 5% of MGE's income, another option for the Commission would be to conclude that MGE's request is unnecessary since the USOA requires Commission approval only where the impact is below 5%. Under this option, the Commission would avoid having to conclude that recovery is probable, and the Commission will still be able to address the request for future rate recovery should MGE choose to make the asset deferrals. During opening

---

[48] OPC Ex. 3.
[49] In the Matter of Missouri Gas Energy and its Tariff Filing to Implement a General Rate Increase for Natural Gas Service, File No. GR-2009-0355, Report and Order, February 10, 2010, pp. 29-30.
[50] Tr. 114.

statements at the evidentiary hearing, counsel for MGE stated that granting the deferral is not necessary for MGE to defer items due to MGE's belief that the items to be deferred would have an impact of greater than 5%.[51]

F. Conclusion

OPC concurs with the characterization made by Staff counsel that granting the deferral would "be a really horrible idea."[52] The Straight Fixed Variable (SFV) rate design that MGE fought hard for in MGE's last rate case and that enabled MGE to over-earn and achieve record sales revenue since the tornado, is ironically the same rate design that MGE now blames for its alleged inability to recover the revenues it expected to earn from Joplin.[53] MGE's shameless use of the Joplin tragedy to further increase shareholder profits, on the backs of the same customer tragically impacted by the tornado, should be rejected. OPC urges the Commission to either deny MGE's request outright for the reasons explained above, or determine that a Commission order granting deferral is not necessary because the impact on MGE is greater than 5% of income.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

By: **/s/ Marc D. Poston**

Marc D. Poston (#45722)
Deputy Public Counsel
P. O. Box 2230
Jefferson City MO 65102
(573) 751-5558
(573) 751-5562 FAX
marc.poston@ded.mo.gov

[51] Tr. 41.
[52] Tr. 44.
[53] MGE Ex. 1, p. 8.

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to all counsel of record this 23rd day of December 2011:

Missouri Public Service Commission
Bob Berlin
200 Madison Street, Suite 800
P.O. Box 360
Jefferson City, MO 65102
Bob.Berlin@psc.mo.gov

Missouri Public Service Commission
Office General Counsel
200 Madison Street, Suite 800
P.O. Box 360
Jefferson City, MO 65102
GenCounsel@psc.mo.gov

Missouri Gas Energy
Dean L Cooper
312 East Capitol
P.O. Box 456
Jefferson City, MO 65102
dcooper@brydonlaw.com

Missouri Gas Energy
James C Swearengen
312 East Capitol Avenue
P.O. Box 456
Jefferson City, MO 65102
LRackers@brydonlaw.com

Missouri Gas Energy
Todd J Jacobs
3420 Broadway
Kansas City, MO 64111
todd.jacobs@sug.com

/s/ Marc Poston