TUCK – SURREBUTTAL
CASE NO. GR-2004-0209
Schedule (1)

CASES:

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UtiliCorp United Inc. (Mo. Public Service); Case No. ER-93-37

United Cities Gas Company; Case No. GR-93-47

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Western Resources, Inc.; Case No. GR-93-240

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Subj:	**FW: Risk Adjustment**
Date:	4/16/2004 3:00:10 PM Central Standard Time
From:	RHack@mgemail.com
To:	jcdunn@aol.com
File:	**Murray.Cross.Outline.doc** (73216 bytes) DL Time (TCP/IP): < 1 minute

Sent from the Internet (Details)

Here's what I have from Chris in the way of an outline.
-----Original Message-----
From: Christina Dodds [mailto:CDodds@watsonbishop.com]
Sent: Thursday, April 01, 2004 1:05 PM
To: rhack@mgemail.com
Cc: Eric D. Herschmann (E-mail); Christina Dodds
Subject: Risk Adjustment

Hi Rob.

I have attached my notes (organized loosely by topic for the Murray cross-examination outline) for you to review before we get too far down the line with the actual questions. I want to be sure we aren't missing anything or on the wrong track. I have had several discussions with Mike Fay about the Daubert motion that have centered around the "risk adjustment" issue. We may need some additional guidance on this.

not a problem

Essentially, the concern is one we discussed in great detail during our meetings: Why should the Commission increase the recommended rate of return to reflect the greater risk associated with higher debt, when the company created that "problem"? As Mike puts it, why should MGE benefit from its failure to optimize its own capital structure? As I understand it so far, our response to this is as follows:

(1) We aren't asking for MGE to be rewarded or to benefit because it has a higher level of debt. Instead, we are asking that the Missouri ratepayers not be allowed to benefit unfairly at the expense of the shareholders who really bear the burden of the increased risk of high debt. In other words, if the Staff does not make an adjustment, then a lower rate of return will be recommended, which will ultimately result in lower rates for the ratepayer and less money for the company. This only increases the risk that the shareholders bear instead of balancing it out between shareholders and ratepayers.

(2) The Panhandle debt should not be included in the MGE capital structure. That debt is non-recourse to Southern Union in part because the MPSC insisted on it, and insisted there should be no impact on MGE as a result of the acquisition of Panhandle. The Commission didn't want any cross-subsidization and there hasn't been any. So how is it fair to include Panhandle now in the MGE capital structure?

(3) Dunn has testified that it is the accepted methodology/industry practice that, as a matter of economics, the rate of return is adjusted upward to recognize the increased risk of a capital structure with a high debt to equity ratio. It is simply wrong for the Commission not to do it, according to Dunn. What evidence can we gather on this point—that this type of risk adjustment is made in other jurisdictions?

Of course, we also argue that there should be an increased rate of return in recognition of the regulatory risk that MGE faces in this jurisdiction. We have discussed the difficulty of making this argument to the regulatory body we are complaining about, but we definitely want to preserve it for appeal.

What are we missing on this issue? Thanks, Rob.

Chris

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