BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Tariffs	)	
Increasing Rates for Gas Service Provided to	)	**<u>Case No. GR-2006-0422</u>**
Customers in the Company's Missouri Service	)	Tariff File No. YG-2006-0845
Area	)	

REPORT AND ORDER

Issue Date: **March 22, 2007**

Effective Date: **March 30, 2007**

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Tariffs Increasing Rates for Gas Service Provided to Customers in the Company's Missouri Service Area	))))	**Case No. GR-2006-0422** Tariff File No. YG-2006-0845

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REGULATORY LAW JUDGE: Kennard L. Jones

REPORT AND ORDER

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Summary

In this report and order, the Commission finds that Missouri Gas Energy, a division of Southern Union Company, is entitled to a rate increase sufficient to generate a revenue increase of approximately $27,206,968.

FINDINGS OF FACT

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact.

Procedural History

On May 1, 2006, Missouri Gas Energy, a division of Southern Union Company, filed tariff sheets designed to implement a general rate increase for natural gas service in the amount of $41,651,345. The tariff sheets carried an effective date of June 2, 2006.

On May 12, 2006, the Commission suspended MGE's tariff until March 30, 2007. The maximum amount of time allowed for suspension under the controlling statute.[1] The Commission also directed that notice of MGE's tariff filing be provided to the public, setting June 1, 2006, as the deadline for the submission of applications to intervene.

The Commission granted timely applications to intervene that were filed by Trigen-Kansas City Energy Corporation, Midwest Gas Users Association, University of Missouri-Kansas City and Central Missouri State University. The Commission also granted requests to intervene, filed out of time, by The City of Kansas City, Missouri and the County of Jackson, Missouri. The Commission denied an untimely request to intervene by

[1] Section 393.150, RSMo 2000.

Cornerstone Energy, Inc. The Commission found that the former out-of-time requests were supported by good cause, while the latter was not.

On July 13, 2006, the Commission established the test year for this case as the 12-month period ending December 2005, updated for known and measurable changes through June 30, 2006. The parties also settled on a further true-up period through October 31, 2006, for the purpose of updating certain cost components. Also in its order, the Commission established a procedural schedule with the first day of the hearing beginning on January 8, 2007.

The Commission conducted local public hearings at which the Commission heard comments from MGE's customers regarding MGE's request for a rate increase. The hearings were held in Kansas City, Joplin, Republic, Warrensburg, Nevada, St. Joseph and Slater, Missouri.

The parties prefiled direct, rebuttal and surrebuttal testimony. The evidentiary hearing began on January 8, 2007, and continued through January 17. True-up testimony was entered into the record during the course of the hearing and with consent of all of the parties the true-up hearing was canceled as being unnecessary.

Partial Stipulations and Agreements

Prior to the start of the evidentiary hearing, MGE, Staff, OPC, MGUA, UMKC, CMSU and the County of Jackson, Missouri submitted a Partial Nonunanimous Stipulation and Agreement with regard to customer class cost of service. Although the City of Kansas City and Trigen did not enter the agreement, they did not oppose it. The Commission approved the agreement. The Commission also approved an unopposed Partial Nonunanimous Stipulation and Agreement, filed by MGE and Staff, concerning depreciation schedules.

Overview

MGE is a division of Southern Union Company. As a division, MGE has no separate corporate existence apart from Southern Union. MGE's divisional headquarters is located in Kansas City, Missouri and provides service to customers in Kansas City, St. Joseph, Joplin and other cities in western Missouri. MGE is a local distribution company, sometimes referred to by the acronym, "LDC." That means that MGE purchases natural gas from a supplier, pays to transport the gas to Missouri over one or more interstate pipelines, and then distributes the natural gas to its customers in this state. Southern Union is headquartered in Wilkes-Barre, Pennsylvania. In addition to MGE, Southern Union has one other division in New England that acts as an LDC.

Noted earlier, as an LDC, MGE must purchase natural gas from supply sources, transport the gas over an interstate pipeline, and then distribute it to its customers. This Commission does not have any authority to regulate the price that MGE must pay to purchase and transport gas over the interstate pipeline. The purchase price of natural gas is set by the market and transportation rates are regulated by the Federal Energy Regulatory Commission (FERC). As a result, this rate case has nothing to do with those aspects of the cost of natural gas.

The price that MGE must pay to purchase and transport natural gas is passed through, dollar for dollar, to its customers through the PGA/ACA process. Therefore, if MGE is to recover its cost of distributing natural gas to its customers, and earn a profit, it must have another source of income. It is those costs, and that source of income, that are at issue in this rate case.

MGE began the rate case process when it filed its tariff on May 1, 2006. In doing so, MGE asserted that it was entitled to increase its rates enough to generate an additional $41,651,345 in general revenues per year. MGE set out its rationale for increasing its rates in the direct testimony that it filed along with its tariff on May 1. In addition to its filed testimony, MGE provided work papers and other detailed information and records to the Staff of the Commission, Public Counsel and other intervening parties to determine whether the requested rate increase is just and reasonable.

Because of the complexity of a rate case, there are a multitude of matters about which the parties could disagree. However, there was agreement between the parties about many matters; hence, those potential issues were not brought before the Commission. Where the parties disagreed, they prefiled written testimony for the purpose of bringing those issues to the attention of the Commission. All parties were given an opportunity to prefile three rounds of testimony – direct, rebuttal, and surrebuttal. Prior to the start of the hearing, the parties submitted a Joint Statement of Issues that required resolution by the Commission.

As noted, the issues of depreciation and class cost of service were resolved by Stipulation and Agreement and will not be further addressed in this report and order. The remaining issues will be addressed in turn. The issue description for each issue is taken from the statement of issues. Factual matters will be addressed in the Findings of Fact section. If an issue also contains a legal aspect, that portion of the issue will be addressed in the Conclusions of Law section.

Generally, all parties agree that MGE has experienced a revenue deficiency. However, this does not mean that MGE operated at a loss. In fact, it did earn a return of between 5.74% and 8.29%.[2] For the calendar year of 2005 MGE's overall rate of return was 7.49%. And for 2006 it was considerably lower due to weather being 77% of normal.[3]

The Issues

1. Capital Structure

> ***Issue Description:*** *What is the appropriate capital structure (i.e., the relative proportions of long-term debt, short-term debt, preferred equity, and common equity) to use in calculating MGE's cost of service?*

Determining an appropriate capital structure for MGE is complicated by the fact that MGE is a division of Southern Union and does not issue its own debt or equity. Therefore, MGE does not have its own capital structure.

As a substitute for its non-existent capital structure, MGE proposes to use a hypothetical capital structure consisting of 46% equity and 54% debt. MGE's proposed structure is as follows:[4]

Common Equity	46%
Long-Term Debt	44.09%
Short-Term Debt	9.91%

However, if the Commission does not adopt the proposed hypothetical capital structure, MGE is willing to accept the actual capital structure of Southern Union as of October 31, 2006.[5]

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[2] Transcript, Page 950, Lines 12-24.

[3] Transcript, Page 590, Lines 12-16.

[4] Hanley Direct, Ex. 1, Page 3.

[5] Transcript, Page 170, Lines 17-23.

Southern Union has an identifiable capital structure.[6] Staff recommends that the Commission use the actual consolidated capital structure of Southern Union, as of October 31, 2006. The following is the capital structure offered by Staff:[7]

Common Equity	36.06%
Long-Term Debt	55.92%
Preferred Stock	4.71%
Short-Term Debt	3.3%

OPC did not take a position on this issue.

It is important to note that the capital structure recommended by Staff contains a much smaller proportion of common stock than does the structure recommended by MGE. It costs the company more to issue equity that it does to incur debt. Therefore, a capital structure that uses a lot of debt with relatively low levels of equity is less expensive for the company. That means, all else being equal, a capital structure that includes a low percentage of equity and a large percentage of debt will be less costly, resulting in a lower rate of return, and consequently a lower revenue requirement and lower rates to customers.

However, a high percentage of debt in a capital structure has an effect on the cost of equity. The shareholders in a company – the holders of equity – are subordinate to holders of debt. Generally, the company must pay the interest on debt, such as bonds issued by the company, before it can pay dividends to its shareholders or before it can invest profits in other ways that benefit the shareholders. If a company's gross income goes down, the risk is borne by the shareholders. Furthermore, if the company has to be liquidated, the

[6] Transcript, Page 60, Line 24.

[7] Murray True-Up, Ex. 205, Page 3, Lines 1-3.

holders of debt get paid first. The shareholders get whatever is left over. Therefore, a company with a capital structure that includes a high percentage of debt is more risky for shareholders. The shareholders will consequently demand a higher rate of return to compensate them for the increased risk caused by the high level of debt.

Southern Union's capital structure, as proposed by Staff, contains a good deal more debt and less equity than the capital structure proposed by MGE. That means the capital structure proposed by Staff poses more risk to the shareholder than that proposed by MGE. MGE contends that the use of its proposed capital structure, one using proxy companies to reflect the capital structure of a stand-alone LDC, is particularly appropriate in light of Southern Union's transition to being primarily a transportation and storage company.

This issue was discussed by the Commission in MGE's last rate case.[8] As discussed in that case, the capital structure of Southern Union is the result of its management decisions. Hence, Southern Union, and ultimately MGE, must operate with the result of its decisions. MGE stresses that the make-up of Southern Union has changed so dramatically, that use of a hypothetical capital structure is warranted. This premise, however, does not change the Commission's reasoning in MGE's last rate case. Therefore, the capital structure, as proposed by Staff, shall be used.

2. Rate Design

Issue Description: *What is the appropriate rate design for residential, small general service, large volume service and large general service classes?*

Historically, MGE has operated under a rate design that allows it to recover a portion of its fixed cost through a customer charge. The remaining portion is recovered through volumetric rates, the amount of gas MGE sells to its customers. Currently, MGE recovers

[8] Report and Order, Commission Case No. GR-2004-0209, *issued,* September 21, 2004.

55% of its fixed cost through a customer charge and 45% of its fixed cost through volumetric rates.[9] Since 1996, the annual average usage per residential customer has generally declined.[10] MGE posits that because of this decline, coupled with the fact that 90% of its customer base is residential, it has been unable to earn its Commission authorized rate of return.[11] Hence, MGE seeks Commission approval of a Straight-Fixed Variable (SFV) rate design for the Residential class because of the under-recovery of its costs through volumetric rates and because of the high degree of heat sensitivity effecting the class.[12] The SFV design is one through which the company will recover all of its fixed costs through a fixed, monthly customer charge. Although its preferred rate design is the SFV design, as an alternative MGE proposes a design consisting of a weather normalization adjustment mechanism applicable to Residential, Small General Service and Large General Service classes.[13] The only class omitted is the Large Volume Service class.

Staff agrees that the SFV design should be implemented.[14] Staff argues that customers in the Residential class are homogeneous with respect to the cost of serving them and that it is unfair to collect these costs through a volumetric rate design.[15] Staff goes on to reason that the volumetric rate design causes high-use customers to subsidize the cost of low-use customers. Staff also reasons that the SFV design will reduce volatility of customer bills. An additional benefit of the proposed rate design, set out by Staff and the company, is that the objective of the shareholders and ratepayers will be better aligned

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[9] Transcript, Page 634, Lines 2-5.

[10] Feingold, Schedule RAF-7.

[11] Transcript, Page 632, Pages 2-8.

[12] Transcript, Page 686, Lines 14-23.

[13] Transcript, Page 16, Lines 19-23.

[14] Staff Post Hearing Brief, Page 18.

[15] Staff's Post Hearing Brief, Page 18.

because the utility's revenues will no longer depend on how much gas it sells. Currently, MGE has an incentive to sell more gas to at least recover its costs. The current rate design therefore discourages natural gas conservation efforts on the part of the company. If the SFV design is adopted, the company is committed to offering several natural gas conservation initiatives. Finally, the SFV design will promote accuracy. Under the current design, presumptions are made about sales volumes to try to match MGE's fixed cost. In this instant, there is often over or under payment. The proposed rate design eliminates this concern with regard to the Residential class.

OPC opposes any change in the current rate design.[16] Although OPC opposes the SFV design, as a participant in an energy task force it agreed that the Commission should incorporate rate designs that remove the disincentive for utilities to pursue programs aimed as reducing usage.[17] OPC's recommendation in support of the current rate design does not remove the company's disincentive to pursue programs aimed as reducing natural gas usage.[18] As discussed above, the SFV rate design does just that. Also, as discussed above, declining customer usage coupled with the current rate design, will exacerbate MGE's inability to recover it fixed costs. OPC does not dispute that customer usage is declining and will continue to do so through 2010 to 2020, as put forth by MGE's witness in light of a forecast set out by the American Gas Association.[19]

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[16] Transcript, Page 562, Pages 6-16.

[17] Transcript, Page 566, Lines 4-10.

[18] Transcript, Page 537, Lines 10-15.

[19] Transcript, Page 534, Lines 1-18.

Although OPC opposes the SFV design because it lessens the customer's ability to have control over the amount of his or her bill,[20] OPC agrees that that under the SFV design customers would save by reducing their natural gas usage.[21] Further, OPC agrees that customers will not pay as much in colder-than-normal winters.[22] Under the SFV design, weather is removed from the risk factor calculation.[23] OPC opposed the SFV design as unjustifiable in a separate matter because the company had not proposed any meaningful conservation programs.[24] Notwithstanding, in this matter MGE has proposed conservation programs. Also, MGE has had in place a Low Income Weatherization program for some time.[25] Lastly, OPC particularly opposes the SFV design in conjunction with tariff language regarding seasonal disconnects,[26] which will be discussed below.

The Commission points out that MGE and Staff propose a SFV design only for MGE's Residential class and not for its Small General Service class because it is more heterogeneous than the Residential class.[27] The Commission finds MGE and Staff's arguments for a rate design that will protect MGE from the vagaries of weather to be persuasive. The Commission shall approve the SFV rate design for MGE's residential class.

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[20] Transcript, Page 537, Lines 10-18.

[21] Transcript, Page 580, Lines 23-25.

[22] Transcript, Page 579, Lines 14-18.

[23] Transcript, Page 92, Lines 6-12.

[24] Transcript, Page 541, Lines 4-9.

[25] Transcript, Page 541, Lines 10-13.

[26] Transcript, Page 571, Lines 15-18.

[27] Transcript, Page 684, Lines 13-20.

3. Unrecovered Cost of Service Amortization

Issue Description: *Should MGE recover $15.6 million in rates amortized over five years for alleged revenue loss due to lower customer gas use for the period of January through June of 2006?*

Staff and OPC argue that to authorize this expense would constitute retroactive ratemaking.[28] MGE agrees that to grant this request would constitute retroactive ratemaking.[29] Because all parties of interest[30] agree that this request is illegal, the Commission will deny MGE's proposal.

4. Property Tax Refund

Issue Description: *What is the proper treatment of $5,554,068 in property tax refunds received by MGE during the test year of 2005?*

During the test year of 2005, MGE received a refund of property taxes paid during 2002, 2003 and 2004. Staff proposes to put that money in a deferred account and to amortize it over five years; reducing the amount of property tax expense that would otherwise be included in rates.[31] Staff contends that to do so does not constitute retroactive ratemaking because the money was received during the test year.[32] However, Staff contends that in this regard, rates were properly set for the years 2002, 2003, and 2004.[33] Then Staff goes on to state that in light of the company having recovered the taxes, this expense was set too high in rates.[34] In setting rates, there is always a risk that the expense for property taxes will be under or over estimated. The company therefore has

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[28] Transcript, Page 1006, Lines 8-12.

[29] Transcript, Page 284, Lines 19-25.

[30] The only parties arguing this issue are MGE, Staff and OPC.

[31] Transcript, Page 848, Lines 12-20.

[32] Transcript, Page 850, Lines 21-25.

[33] Transcript, Page 851, Lines 21-22.

[34] Transcript, Page 854, Lines 3-4.

the risk of not recovering its property taxes. In this case, the property tax expense was set too high, just as cost of service was set too low in the preceding issue.

MGE argues that Staff's proposal constitutes retroactive ratemaking and that the Missouri Supreme Court has determined, in setting rates, that the Commission can consider past excess recovery by a utility only insofar as it is relevant to a determination of what rate is necessary to provide a just and reasonable return.[35] Interestingly, Staff notes in its opening argument that "the test year concept is to take a snapshot of the company's incoming revenues and outgoing expenses and work with those to determine the appropriate rates." Although Staff goes further to propose inclusion of the refund in rates, Staff's statement is consistent with the argument put forth by MGE.

Based on its Conclusions of Law and the above findings, the Commission will deny Staff's request to amortize the property taxes refunded to MGE in 2005.

5. Weather Normalization

> ***Issue Description:*** *What is the appropriate measure of normal weather to be used in calculating 1) MGE's revenue requirement and 2) the billing determinants to be used in establishing MGE's volumetric rate elements?*

The Commission has historically used a 30-year average in determining what the normal temperature should be.[36] Staff gathers its information from the National Oceanic Atmospheric Administration (NOAA). Currently, the NOAA's period for calculating a normal climate is the 30-year period between January 1, 1971 and December 31, 2000.[37] The "normal" temperature is ultimately used to determine what the cost of each unit of gas

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[35] Transcript, Page 855, Lines 11-17.

[36] Transcript, Page 671, Line 25 – Page 672, Line 2

[37] Transcript, Page 675, Lines 22-25.

should be. MGE proposes to use what is described as a 10-year rolling average to determine normal weather.

MGE argues Staff's recommendation of the 30-year period is flawed because Staff's proposal fails to consider circumstances that reasonable can be expected to occur while rates are in effect.[38] MGE goes on to argue that "the theory underlying the policy should generate a result that has some relationship to reality; otherwise, what we do here is just a formality."[39] MGE points out that if the Commission adopts the SFV rate design, weather normalization will not be an issue for its residential customers.[40]

Staff has problems with the 10-year normal because it's too short to provide the necessary stability. Temperature variations can span across decades. Also, the rolling average will change every year and depending on which year is the test year we could end up with different normals.[41] Staff's position is that the 30-year normal is a better reflection than the 10-year rolling average of what is normal.[42]

As noted above, the Commission has historically used the 30-year normal. As MGE has stated, under the SFV rate design this will not be an issue for 90% of the company's customers. The Commission continues to use the 30-year normal and finds that it should be consistent when applying a method of weather normalization between utilities. In the absence of more convincing evidence that this methodology should be changed, the Commission will continue to adopt the 30-year weather normalization as proposed by Staff.

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[38] Transcript, Page 665, Lines 2-7.

[39] Transcript, Page 668, Lines 9-11.

[40] Transcript, Page 668, Lines 14-21.

[41] Transcript, Page 742, Lines 16-25.

[42] MGE's current tariff. P.S.C Mo. No. 1, Fourth Revised Sheet No. 96.

6. Low Income Weatherization

Issue Description: *What is the appropriate level of low-income weatherization funding to be used in calculating MGE's cost of service and how should such funding be allocated among the geographic regions of MGE's service territory?*

MGE currently provides $367,000 of ratepayer funds to the weatherization program in Clay, Platte and Jackson Counties.[43] An additional $132,368 is administered throughout the rest of MGE's service territory for a total of $500,000. The program was initiated in 1994 and currently serves between 200-300 customers per year.[44] Among other things, the program includes appliance replacement, installation of insulation and energy audits.[45] As a result of demand for the program, the City of Kansas City, the program administrator, requests an additional $250,000. Kansas City states that the funds are exhausted before the end of each year.[46] Approximately $1,700 per person is spent through the program.[47] Kansas City states that it will be able to serve an additional 100-150 customers with the additional $250,000.

Staff and MGE support additional funding for the program. However, they agree that the additional funding should be $100,000 rather than $250,000. Further, at Staff's suggestion, they agree that an additional $20,000 should be used to evaluate the program's effectiveness.[48] MGE states that the $100,000 increase is sufficient in light of

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[43] Transcript, Page 132, Lines 15-16.

[44] Transcript, Page 135, Lines 17-19.

[45] Transcript, Page 137, Lines18-24.

[46] Transcript, Page 134, Lines 6-16.

[47] Transcript, Page 136, Lines 10-11.

[48] Transcript, Page 811, Lines 7-13.

the fact that Kansas City does not have much of a backlog and that a 20-25% increase at this time makes sense.[49]

The Commission finds that the existing low-income weatherization program has been successful and should be continued with additional funding. In light of the growing concern regarding energy conservation, the Commission will direct MGE to fund the low-income weatherization program with an additional $250,000 to be allocated in the same proportion as the current program.

7. Natural Gas Conservation

> ***Issue Description:*** *Should funding for natural gas conservation programs be included in MGE's cost of service?*

As discussed earlier, under the SFV rate design, MGE's disincentive to promote natural gas conservation is removed. With the disincentive removed, the company is willing to "offer" conservation programs to better align themselves with the interest of the customer.[50] The company offers $705,000 to be included in rates to go toward a gas water heater rebate program.[51] The Commission notes, however, that this program is particularly in the company's interest as it provides an incentive for customers to switch from electric to gas water heaters.[52] Additionally, the company is offering $45,000 to be included in rates to educate the public about energy conservation.[53] This program would be an on-line audit (energy calculator) linked to the Department of Energy.[54] MGE anticipates lowering its return requirement by $1 million under the SFV design and using that money for

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[49] Transcript, Page 625, Lines 2-14.

[50] Transcript, Page 390, Lines 20-25.

[51] Transcript, Page 440, Lines 9-11.

[52] Transcript, Page 441, Line 23 - Page 442, Line 4.

[53] Transcript, Page 439, Lines 7-25.

[54] Transcript, Page 627, Lines 3-10.

conservation programs.[55] The Commission shall approve the conservation program proposed by Staff and MGE.

8. Environmental Response Fund

> ***Issue Description:*** *Should the environmental response fund proposed by MGE be adopted and what, if any, level of environmental costs should be used in calculating MGE's cost of service? MGE requests that the amount of the fund be $500,000, annually.*

MGE is seeking authority to establish an environmental response fund of $500,000 annually, through rates, to meet its obligation to pay costs associated with several manufactured gas sites purchased by Southern Union.[56] The company proposes that $500,000 be set aside every year until such time as the costs are incurred.[57] MGE agrees that the costs associated with the clean-up are impossible to know.[58] MGE's contractual obligation with regard to the clean up of these sites is to seek rate recovery.[59] This proposal was rejected when presented to the Commission in MGE's last rate case.[60] The premises underlying that discussion have not changed.

In the future, MGE may incur an unknown and unknowable amount of financial liability for the cleanup of environmental hazards left over from the operation of manufactured gas facilities 100 to 125 years ago.[61] Manufactured gas facilities were used before the advent of interstate natural gas pipelines in the 1940s. Before there were interstate pipelines, gas could not be transported over long distances so gas companies

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[55] Transcript, Page 808, Lines 6-25.

[56] Transcript, Page 885, Lines, 15-22.

[57] Transcript, Page 918, Lines 14-17.

[58] Transcript, Page 899, Lines 8-13 and Page 909, 23-25.

[59] Transcript, Page 904, Lines 23-25.

[60] Transcript, Page 917, Lines 12-16.

[61] Transcript, Page 900, Lines 1-3.

manufactured gas by heating coal or oil and collecting the gas that was driven off in the process. The primary byproduct that came from this process is tar, which contains hazardous carcinogens. This is what primarily drives investigation and remediation of the sites.[62] MGE agrees that it is not possible to ascertain the costs of investigation and remediation.[63] That the magnitude of the costs associated with this effort is impossible to know is again noted by MGE.[64] Further, to date, MGE has not paid any costs associated with the environmental clean up.[65]

That these costs are not known and measurable precludes their inclusion in rates. Furthermore, the creation of a pre-funded source for the payment of these cleanup costs would remove much of Southern Union's incentive to ensure that only prudently incurred and necessary costs are paid. If the money has already been recovered from ratepayers and is being held in the Fund, Southern Union would have little incentive to not pay it out to settle claims brought against it. Although the Fund would be subject to audit by Staff and Public Counsel and they could seek a prudence adjustment, the need for a prudence adjustment is difficult to prove and is not a good substitute for the company's own desire to prudently minimize its costs to improve its bottom line. For these reasons, the Commission finds that MGE's proposal to create an Environmental Response Fund shall be rejected.

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[62] Transcript, Page 895, Lines 2-9.

[63] Transcript, Page 896, Line 23 – Page 897, Line 6.

[64] Transcript, Page 899, Lines 8-13.

[65] Transcript, Page 908, Lines 12-17.

9. Infinium Software

Issue Description: *Should the Unrecovered cost associated with MGE's Infinium Software be included in rates through an amortization and, if so, over what period of time?*

MGE purchased the Infinium Software in 1995 and the estimated life was 10 years. The company switched to different software, Oracle, in 2005.[66] Although the original investment was almost fully amortized, each year after 1995, until 2001, enhancements and modifications were made to the Infinium system. Each enhancement was given a new 10-year life rather than being amortized for the remaining life of the Infinium system.[67] MGE is now requesting amortization of the remaining balance of the entire system,[68] which is approximately $1.23 million.[69]

The enhancements to the system were included in rate base in MGE's last rate case in 2004.[70] MGE is currently earning a return on those enhancements until they come out of rate base.[71] MGE points out that it continues to use the Infinium Software for a time entry system, which it intends to do until March of 2007 if it converts the payroll system over to Oracle.[72]

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[66] Transcript, Page 1264, Lines 2-8.

[67] Transcript, Page 1264, Lines 11-21.

[68] Transcript, Page 1260, Lines 14-16.

[69] Transcript, Page 1035, Line 12-13.

[70] Transcript, Page 1266, Line 23 – Page 1267, Lines 2.

[71] Transcript, Page 1267, Lines 21-24.

[72] Transcript, Page 1257, Lines 9-18.

OPC argues that the system is not used and useful and opposes MGE's proposal.[73] In this regard, OPC refers to *State ex rel. Union Electric v. P.S.C.*, 765 S.W.2d 618 (Mo. App. 1988) in its post hearing brief. That case states that:

> The property upon which a rate of return can be earned must be utilized to provide service to its customers. That is, it must be used and useful. This used and useful concept provides a well-defined standard for determining what properties of a utility can be included in rate base.

However, MGE made an adjustment to remove the plant investment in the software out of it's rate base, which means MGE will not earn a return on the plant.[74] With the concept of "use and useful" being the premise of OPC's opposition, its argument must be rejected. Both Staff and MGE point out that the plant is not included in rate base. Therefore, the company will not earn a return on the property. The concept of "used and useful" thus becomes irrelevant. The Commission finds that the property shall be amortized over 5 years as proposed by Staff and MGE.

10. Rate Case Expense

> ***Issue Description:*** *What is the appropriate amount and treatment of rate case expense, including amortization of prior rate case expense, in this case?*

From MGE's last rate case in 2004, the Commission authorized the company to amortize its rate case expense over three years. A balance of $148,971 remains to be amortized as of March 2007.[75] MGE proposes to amortize the current rate case expense with the remaining $148,971 over a three-year period.[76] Although in its pre and post hearing briefs Staff argues that to allow MGE to amortize the remaining rate case expense

[73] Transcript, Pages 1284 -1285.

[74] Transcript, Page 1266, Lines 15-20 and Page 1267, Lines 6-9.

[75] Transcript, Page 1040, Lines 1-3.

[76] Transcript, Page 1044, Lines 10 -13.

would constitute retroactive ratemaking, there is no mention of this argument during the hearing. In fact, Staff's position is that the rate case expense be normalized.[77] The Commission will therefore disregard Staff's argument that recovery of this expense would constitute retroactive ratemaking.

The Commission resolved this issue in MGE's last rate case to allow the company to recover, what was determined to be prudent costs, through amortization over three years. The Commission will not vacate its order in that regard. Staff and MGE propose to amortize the remaining rate case expense with that incurred in this case. The Commission will grant that request and allow MGE to amortize the combined amounts over a three-year period.

11. Emergency Cold Weather Rule AAO Recovery

Issue Description: *What is the proper rate treatment for costs deferred under the Emergency Cold Weather Rule AAO Recovery Mechanism?*

MGE is requesting about $900,000 through an AAO as a result of complying with the Emergency Cold Weather Rule.[78] On September 21, 2006, the Commission issued an order granting authority for an AAO for cost incurred under the cold-weather rule. In that order, the Commission directed the parties to brief and present testimony on this issue.

Staff testified that $901,331 represents the difference between the amount that the company could have collected under the old cold weather rule and the amount that MGE actually collected.[79] Staff recommends that this amount be amortized over three years.[80] Consistent with the Commission's order of September 21, 2006, the Commission will grant

[77] Transcript, Page 1045, Lines 21–24.

[78] Transcript, Page 1074, Line 11.

[79] Harrison Direct, Page 17, Lines 7-9.

[80] Harrison Direct, Page 17, Lines 20-21.

MGE's request to amortize the deferred cost through an AAO and finds that $901,331 shall be amortized over a three-year period.

12. Seasonal Disconnects

Issue Description: *Should the seasonal disconnect tariff language proposed by MGE be approved?*

Of its 450,000 customers, MGE has about 1,275 customers who voluntarily disconnect their service for period of up to seven months. MGE seeks approval to include in its tariff, language that will require those who "seasonally" disconnect to pay their portion of the fixed costs to provide service that they would have otherwise paid had they remained on the system. The customer would also have to pay the already-approved $45 reconnection fee. The maximum a customer would have to pay to be reconnected after voluntarily disconnecting for 7 months would be $237.50.[81] Staff calculated this figure to be $209.36.[82] Based on a SFV rate design, MGE estimates that the cost of those who seasonally disconnect is about $140,000.[83] Staff estimates this figure to be $114,447.[84]

MGE recognizes that today, this is not a substantial issue. MGE's intent is to discourage seasonal disconnection in the future.[85] However, there is no proposed language to protect customers who voluntarily disconnect for hospital stays, military obligations, or for students who vacate in the summer to return in the fall.[86] OPC argues that the proposed language will force customers to pay for a service they did not use during

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[81] Transcript, Page 1095, Lines 8-20.

[82] Transcript, Page 1113, Lines 4-6.

[83] Transcript, Page 1085, Lines 14-17

[84] Transcript, Page, 1113, Lines 4-6.

[85] Transcript, Page 599, Lines 12-14.

[86] Transcript, Page 1094, Lines 20-24.

the time of disconnection, and it fails to take into account the various reasons a customer would need to be disconnected.[87]

Currently, customers pay a fixed charge of $11.65 per month. According to MGE, under the SFV rate design, this figure could increase to $27.50.[88] Essentially, MGE requests that the fixed monthly charge be increased while proposing language that punishes customers for disconnecting during a time of the year when gas is not needed. MGE's intent is to discourage people from disconnecting. However, under the higher fixed charge the opposite might occur. There is no way to predict what effect a SFV rate design will have on seasonal disconnection.

What is certain is that this currently not a big problem for MGE. Those who seasonally disconnect represent only .3% of MGE's residential customer base. The Commission realizes that it recently approved seasonal disconnection language in Atmos Energy Corporations' rate case.[89] However, in that case the customers who took advantage of seasonal disconnection comprised 10% of the company's residential customers. Also, the Atmos reconnection charge, at $24.00, is substantially lower than that of MGE. These distinctions justify the Commission taking a different course in this case. The Commission will, therefore, deny MGE's request to include language in its tariff regarding seasonal disconnection.

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[87] Transcript, Page 1149, Lines 3-7.

[88] Transcript, Page 1103, Line 6.

[89] Commission Case No. GR-2006-0387. Report and Order, *issued* February 22, 2007.

13. Kansas Property Tax AAO

Issue Description: *Should the Kansas Property Tax AAO be continued past the expiration date ordered by the Commission in Case No. GU-2005-0095?*

In Case No. GU-2005-0095, the Commission granted MGE an Accounting Authority Order allowing it to record on its books a regulatory asset representing the expenses associated with property taxes. The property tax concerns natural gas storage held by MGE in the state of Kansas.[90] MGE contends that it should not have to pay the tax and informs the Commission that the matter is now before the Supreme Court of Kansas.

Staff agrees with MGE that there is no reason to vacate the Commission's prior Order. It also agrees that this issue involves no money and will make no difference with regard to revenue requirement.[91] OPC opposes this request arguing that the AAO is inappropriate because the costs to be deferred are not known and measurable.[92]

In its order initially granting the AAO, the Commission reasoned that an AAO is appropriate if MGE demonstrates that the costs to be deferred are "extraordinary, unusual and unique, and not recurring." In this case, the costs that MGE seeks to continue deferring are property taxes. In most cases, the payment of property taxes by a utility would not be a fit subject for an AAO. MGE, like all investor-owned utilities, routinely pays property taxes. Again, like all investor-owned utilities, MGE is routinely allowed to recover the taxes it pays from its ratepayers through the inclusion of those tax payments in its cost of service when its rates are calculated in a rate case.

The Kansas property tax on gas held in storage in that state is unusual in that MGE, which does not serve customers in Kansas, has never before had to pay property tax in

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[90] Transcript, Pages 1288-1289.

[91] Transcript, Page 1291, Lines 9-19.

[92] Robertson Direct, Page 19.

Kansas. However, if the Kansas taxes are found to be legal in the ongoing court challenge, and MGE is required to pay the tax, it should be able to recover those tax payments for future years through its rates when it includes those taxes in its cost of service in a future rate case.

The problem is that, at the moment, MGE can not include the Kansas taxes in its cost of service in this rate case. As a general rule, for an item of cost to be included in a utility's cost of service, that item of cost must be both known and measurable. A utility's customers should not be expected to pay, through their rates, for costs that are speculative and uncertain. MGE's Kansas tax liability is now *measurable* – it has received a bill from the Kansas tax authorities for the 2004 year. Future tax bills can be estimated – but its Kansas tax liability is not yet *known* because of the uncertainty resulting from the ongoing legal challenge. If MGE prevails in court, it may never have to pay the Kansas property taxes.

The amount of taxes that MGE might have to pay in Kansas is significant to both MGE and to its ratepayers. It would not be appropriate to allow MGE to recover millions of dollars from its ratepayers for taxes that it might never have to pay. On the other hand, taxes are a legitimate cost of doing business for which ratepayers should be responsible. It would not be fair to MGE's shareholders to shift that burden on to them if those taxes ultimately must be paid. Furthermore, it was MGE's decision to challenge the legality of the Kansas taxes, a decision that could greatly benefit its ratepayers, that has placed MGE in this difficult position. If MGE had accepted the Kansas taxes without challenge, it could have simply passed the added taxes on to its ratepayers through this rate case. Instead, by looking out for the interest of its ratepayers, it has created the possibility that it will not be able to recover several million dollars to which it would otherwise be entitled. It is that conundrum that makes an AAO the appropriate means for dealing with the potential Kansas tax liability.

Having been granted an AAO, MGE may continue to defer the cost of paying the Kansas property taxes for consideration in a future rate case after the legality of those taxes is determined and the costs are both known and measurable. If those taxes are found to be illegal and MGE does not have to pay them, then the deferred amounts will simply be written off the balance sheet and neither the ratepayers nor the shareholders will be harmed. If, on the other hand, MGE ultimately must pay the taxes, it will be able to make its case for the inclusion of its additional tax liability into its cost of service in a future rate case.

This uncertainty surrounding MGE's obligation to pay a significant amount of taxes is an unusual and unique situation that is not likely to recur. As such, it meets the Sibley standard for the granting a continued AAO, which is appropriate.

14. Return on Equity

Issue Description: *What is the appropriate return on equity to use in calculating MGE's cost of service?*

Determining an appropriate return on equity is without a doubt the most difficult part of determining a rate of return. The cost of long-term debt and the cost of preferred stock are relatively easy to determine because their rate of return is specified within the instruments that create them. In contrast, determining a return on equity requires speciation about the desires and requirements of investors when they choose to invest their money in Southern Union rather than in some other investment opportunity. As a result, the Commission can not simply find a rate of return on equity that is unassailably, scientifically, mathematically, or legally correct. Such a "correct" rate does not exist. Instead, the Commission must use its judgment to establish a rate of return on equity that will be attractive enough to investors to allow the utility to fairly compete for the investors' dollar in the capital market, without permitting an excessive rate of return on equity that would drive up rates for MGE's ratepayers. In order to obtain guidance about what rate of return on equity is appropriate, the Commission must turn to expert advice offered by financial analysts.

Three financial analysts offered recommendations regarding an appropriate return on equity in this case. MGE's witness, Frank Hanley, comparing the four cost-of-common-equity models[93] to proxies arrived at an initial return on equity of 11.5%. Hanley then argues that this return should be increased because MGE faces more risk because it is smaller than the average company in the proxy group and because it lacks protection from the vagaries of weather. In light of these added risks, Hanley increased his suggested return on equity by 45 basis points to arrive at 11.95%.[94] However, Hanley reduces this amount by 35 basis points, to 11.6%, if the SFV rate design were adopted.[95] Hanley then deducts another 10 points.[96] Staff's witness David Murray, relying on the DCF model and testing its reasonableness using the CAPM, arrived at a recommended return on equity in the range of 8.35 – 8.95%. He then adjusted this amount upward by 30 basis points because the average bond rating for the proxy group he used was "A" and that of Southern

[93] The four models are: 1) Discounted Cash Flow Model (DCF); Risk Premium Model (RPM); Capital Asset Pricing Model (CAPM); and Comparable Earnings Model (CEM).

[94] Hanley Direct, Page 74, Lines 1-4.

[95] Transcript, Page 80, Lines 10-18.

[96] Transcript, Page 80, Lines 16-18.

Union is “BBB”. His resulting range for return on equity was thus, 8.65 – 9.25%.[97] Public Counsel’s witness, Russell Trippensee, suggests that the return on equity be in the range of 7.70% to 8.65%. Trippensee argues that risk associated with earnings variability is essentially eliminated under the SFV rate design.[98]

Between the three experts, there is obvious disagreement on this issue. The more varying suggestions are between MGE and OPC, which is at best a difference of 2.95%. Staff and MGE, both using the DCF model, differ at best by 2.35%. Of course the credibility of all of the experts was challenged. Trippensee’s expertise was even challenged to the extent of MGE moving to strike his testimony because he had not conducted an independent evaluation but instead simply critiqued those of Staff and MGE.

The Commission’s obligation under the law, and as a matter of practical necessity, is to allow Southern Union an opportunity to earn a return that will allow it to compete in the capital market. No one, including ratepayers, benefits if MGE is starved for capital.

Hanley’s recommended return on equity, on behalf of MGE, was 11.5%. Staff’s suggestion, at best, is 9.25%. OPC’s is even lower than that offered by Staff. The Commission notes that Staff, using the DCF model arrived at a return on equity for Southern Union of 10.83 to 13.43%.[99] This range does not consider proxies for MGE but rather considers the risks specifically associated with Southern Union. Because Staff argues that the actual capital structure of MGE should be used, Staff’s recommended range of 8.65% to 9.25% is inconsistent with Staff’s findings of an ROE directly associated with that capital structure.

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[97] Murray Direct, Page 37, Lines 7-23.

[98] Rebuttal Testimony, Page 1, Lines 1-6.

[99] Transcript, Page 246, Lines 8-13.

OPC's recommendation holds very little weight as it did not perform any independent study on this issue. Rather, OPC seemed to have simply looked to Staff's recommendation and opined that Staff and MGE's recommendations do not reflect a reduction in risk associated with the SFV rate design.[100] It doesn't appear that OPC recognizes that at least one of Staff's proxy companies had a SFV rate design. All of the companies had some sort of revenue decoupling rate design. Additionally, although MGE's residential class comprises 90% of its customer base, only 65% of the company's revenue is from its residential customers.[101] MGE's small commercial class, alone, accounts for $35-40 million.[102]

MGE's witness uses four cost-of-common-equity models to arrive at his eventual recommendation of 11.5%.[103] MGE's results of the Discounted Cash Flow, Risk Premium and Capital Asset Pricing models are 10.43%, 10.53% and 10.44%, respectively. The average of those is 10.47%. However, when averaged with Comparable Earnings Model, resulting in a 14.25% ROE, this average goes to 11.41%. The Commission finds that the Comparable Earnings model result, almost 400-points different than the other 3 models, is not credible and should be excluded. Additionally, Mr. Hanley supplied the Commission with a list of authorized returns on common equity for gas companies with an average ROE of 10.53.[104] This is consistent with the resulting average of the three models discussed above.

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[100] Trippensee Rebuttal, Page 12, Lines 1-6.

[101] Transcript, Page 176, Lines 21-25

[102] Transcript, Page 177, Lines 12-15.

[103] Hanley Direct, Schedule FJH-1.

[104] Hanley Direct, Schedule FJH-17.

From his original recommendation of 11.5% Mr. Hanley makes upward adjustments of 30 and 15 basis points due to MGE's size and its lack of protection from weather. To account for an SFV rate design for MGE, he makes a downward adjustment of 35 points to arrive at 11.6 and recommends 11.5. What is interesting about this downward adjustment is that it only reduces the ROE by 20 points. An SFV rate design protects the company from the vagaries of weather. Mr. Hanley first added 15 points for a lack of protection and then deducted 35 for such protection.

All of the parties agree that a determination of ROE is a complicated judgment call. The Commission is persuaded by Staff's conclusion of an ROE of 10.83 – 13.43%. This range is based on a recommended ROE for Southern Union, not an LDC standing alone. The Commission has found that the actual capital structure of Southern Union shall be used. Staff's conclusion is consistent with this finding. Because there must be consideration of the SFV rate design afforded MGE, the Commission will adopt the low end, 10.83%, of Staff's conclusion. Also, under Staff's DCF model, 10.83% is the projected cost of common equity.[105] This is where the Commission will start. Staff and MGE agree that the value of the SFV rate design is 30-35 basis points. As these suggestions are estimates, the Commission finds that the value of the SFV rate design is 32.5 points. A reduction of .325 from 10.83 results in a ROE of 10.5%. The Commission finds that MGE's return on equity shall be 10.5%, which is validated by the conclusions of the cost models, used by MGE and Staff, discussed above.

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[105] Murray Direct, Schedule 18.

CONCLUSIONS OF LAW

The Missouri Public Service Commission has reached the following conclusions of law.

MGE is a public utility, and a gas corporation, as those terms are defined in Section 386.020(42) and (18), RSMo 2000. As such, MGE is subject to the Commission's jurisdiction pursuant to Chapters 386 and 393, RSMo.

Section 393.140 (11), RSMo 2000, gives the Commission the authority to regulate the rates that MGE may charge its customers for natural gas. When MGE filed a tariff designed to increase its rates, the Commission exercised its authority under Section 393.150, RSMo 2000, to suspend the effective date of that tariff for 120 days beyond the effective date of tariff, plus an additional six months.

In determining the rates that MGE may charge its customers, the Commission is required to determine that the proposed rate is just and reasonable.[106] MGE has the burden of proving that its proposed increase is just and reasonable.[107]

Unrecovered Cost of Service Amortization

All parties to this matter agree that to allow MGE to amortize this expense would constitute retroactive ratemaking. A well worded, although colloquial definition, is set out by Staff's witness Oligschlaeger as:

> the setting of rates to allow a utility to recover the specific costs of past events incurred by the utility so as to make utility shareholders "whole" or, conversely, it is the setting of rates to reimburse customers related to past over-earnings of a utility so as to make the customers "whole"[108]

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[106] Section 393.150.2 RSMo 2000.

[107] Section 393.150.2, RSMo 2000.

[108] Oligschlaeger Rebuttal, Page, 4, Lines 6-10.

In light of the fact that all parties agree that to allow this cost to be amortized and included in current rates would constitute retroactive ratemaking, the Commission's conclusion must be consistent with that of all of the parties. Concluding that it would constitute retroactive ratemaking, the Commission will not allow MGE's request to amortize this lost.

Property Tax Refund

MGE argues that to amortize this refund and include it in current rates would constitute retroactive ratemaking. MGE points out that if the Commission allows Staff's request in this regard, it must also allow MGE's request under the issue of Unrecovered Cost of Service Amortization. Staff's reason for arguing that its request would not constitute retroactive ratemaking is that the money was received during the test year.

MGE's position assumes that Staff's request would constitute retroactive ratemaking. Then, in comparing this issue with Unrecovered Cost of Service, MGE argues that if the Commission adopts Staff's position on this issue it must adopt MGE's position under the previous issue. This argument simply begs the question of whether the Commission will allow retroactive ratemaking. Staff's position hinges on the test year.

The Commission will not adopt a position that would constitute retroactive ratemaking. As pointed out by MGE, "retroactive ratemaking is the setting of rates which permit a utility to recover past excess losses of which require it to refund past excess profit collected under at ate that did no perfectly match expenses plus rate-of-return with the rate actually established."[109] The same case goes on to hold that these past occurrences may

[109] *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission,* 585 S.W.2d 41 (1979).

be considered insofar as it is necessary to determine what a just and reasonable rate would be going forward.

Like the issue of Unrecovered Cost of Service, the Commission concludes that to adopt Staff's request in this regard would constitute retroactive ratemaking.

Infinium Software

OPC argues that the system is not used and useful and opposes MGE's proposal. In this regard, OPC refers to *State ex rel. Union Electric v. P.S.C.*, 765 S.W.2d 618 (Mo. App. 1988) in its post hearing brief. That case states that:

> The property upon which a rate of return can be earned must be utilized to provide service to its customers. That is, it must be used ad useful. This used and useful concept provides a well-defined standard for determining what properties if a utility can be included in rate base.

However, MGE made an adjustment to remove the plant investment in the software out of its rate base, which means MGE will not earn a return on the plant. With the concept of "use and useful" being the premise of OPC's opposition, its argument must be rejected. Both Staff and MGE point out that the plant is not included in rate base. Therefore, the company will not earn a return on the property. The Commission concludes that the concept of "used and useful" then becomes irrelevant and will allow continued amortization of the software as proposed by MGE and Staff.

DECISION

After its findings of fact and conclusions of law, the Commission has reached the following decision regard the issues as identified by the parties.

1. Capital Structure

Issue Description: *What is the appropriate capital structure (i.e. the relative proportions of long-term debt, short-term debt, preferred equity, and common equity) to use in calculating MGE's cost of service?*

Common Equity	36.06%
Long-Term debt	55.92%
Preferred Stock	4.71%
Short-Term Debt	3.3%

2. Rate Design

Issue Description: *What is the appropriate rate design for residential, small general service, large volume service and large general service classes?*

The rate design for the residential class shall be the Straight-Fixed Variable Design proposed by Staff. To the extent that they are consistent with the Stipulation and Agreement regarding class cost of service, the current rate designs shall remain in effect for all non-residential classes.

3. Unrecovered Cost of Service Amortization

Issue Description: *Should MGE recover $15.6 million in rates amortized over five years for alleged revenue loss due to lower customer gas use for the period of January through June of 2006?*

No. The Commission rejects MGE's proposal on this issue.

4. Property Tax Refund.

Issue Description: *What is the proper treatment of $5,554,068 in property tax refunds received by MGE during the test year of 2005?*

The Commission denies Staff proposal to amortize this refund. MGE will be allowed to keep this money as a gain.

5. Weather Normalization

> ***Issue Description:*** *What is the appropriate measure of normal weather to be used in calculating 1) MGE's revenue requirement and 2) the billing determinants to be used in establishing MGE's volumetric rates?*

The Commission adopts Staff position that the 30-year normal will be used and rejects MGE's proposal that a 10-year rolling average should be implemented.

6. Low Income Weatherization

> ***Issue Description:*** *What is the appropriate level of low-income weatherization funding to be used in calculating MGE's cost of service and how should such funding be allocated among the geographical regions of MGE's service territory?*

The Commission adopts the City of Kansas City's proposal to allocate $250,000 to the Low-Income Weatherization program.

7. Natural Gas Conservation

> ***Issue Description:*** *Should funding for natural gas conservation programs be included in MGE's cost of service?*

Yes. The Commission adopts Staff and MGE's proposal to allocate $705,000 for a water heater rebate program and $45,000 for educating MGE's customers about weather conservation.

8. Environmental Response Fund

> ***Issue Description:*** *Should the environmental response fund proposed by MGE be adopted and what, if any, level of environmental costs should be used in calculating MGE's cost of service? MGE requests that the amount of the fund be $500,000, annually.*

The Commission rejects the Environmental Response Fund proposed by MGE.

9. Infinium Software

> ***Issue Description:*** *Should the unrecovered cost associated with MGE's Infinium Software be included in rates through an amortization and, if so, over what period of time?*

The Unrecovered cost associated with MGE's Infinium Software should be included in rates and amortized over 5 years as proposed by Staff and OPC.

10. Rate Case Expense

> ***Issue Description:*** *What is the appropriate amount and treatment of rate case expense, including amortization of prior rate case expense, in this case?*

MGE shall be allowed to amortize the combined amounts over a three-year period.

11. Emergency Cold Weather Rule AAO Recovery

> ***Issue Description:*** *What is the proper rate treatment for costs deferred under the Emergency Cold Weather Rule AAO Recovery Mechanism?*

The Commission will grant MGE's request to amortize the deferred cost through an AAO.

12. Seasonal Disconnects

> ***Issue Description:*** *Should the seasonal disconnect tariff language proposed by MGE be approved?*

No.

13. Kansas Property Tax AAO

> ***Issue Description:*** *Should the Kansas Property Tax AAO be continued past the expiration date ordered by the Commission in Case No. GU-2005-0095?*

MGE is allowed to continue the Kansas Property Tax AAO beyond the date ordered in Commission Case No. GU-2005-0095 until a final determination is made on this issue by the Kansas courts.

14. Return on Equity

Issue Description: *What is the appropriate return on equity to use in calculating MGE's cost of service?*

The appropriate return on equity is 10.5%.

IT IS ORDERED THAT:

1. The tariff sheets filed by Missouri Gas Energy, a division of Southern Union Company, on May 1, 2006, and assigned tariff number YG-2006-0845, are rejected.

2. Missouri Gas Energy, a division of Southern Union Company, is authorized to file a tariff sufficient to recover the revenues as determined by the Commission in this order.

3. This Report and Order shall become effective on March 30, 2007.

BY THE COMMISSION

Colleen M. Dale
Secretary

(S E A L)

Davis, Chm., Murray, and Appling, CC., concur;
Gaw, C., dissents, with separate dissenting
opinion to follow;
Clayton, C., dissents;
and certify compliance with the provisions
of Section 536.080, RSMo.

Dated at Jefferson City, Missouri,
on this 22nd day of March, 2007.