Energy Efficiency Services
Laura Wolfe
Missouri Department of Natural
Resources - Missouri Energy Center
Direct Testimony-Rate Design
GR-2009-0434

MISSOURI PUBLIC SERVICE COMMISSION

EMPIRE DISTRICT GAS COMPANY

CASE NO. GR-2009-0434

DIRECT TESTIMONY

OF

LAURA WOLFE

ON

BEHALF OF

MISSOURI DEPARTMENT OF NATURAL RESOURCES

ENERGY CENTER

Jefferson City, Missouri November 3, 2009

TABLE OF CONTENTS

I.	INTRODUCTION	2
II.	EDG's REQUEST TO USE A STRIAGHT FIXED VARIABLE RATE DESIGN	2
III.	OTHER MISSOURI UTILITIES USING A SFV RATE DESIGN	5
IV.	OPINIONS OF NATIONAL ORGANIZATIONS REGARDING THE SFV RATE DESIGN	6
V.	RECOMMENDATION TO ALLOW A SFV RATE DESIGN ONLY IF ENERGY EFFICIENCY FUNDING IS SIGNIFICANT	11

1	I. INTRODUCTION	
2	Q. Please state your name and business address.	
3	A. My name is Laura Wolfe. My business address is Missouri Department of Natural Resources, Energ	şу
4	Center, 1101 Riverside Drive, P.O. Box 176, Jefferson City, Missouri 65102-0176.	
5	Q. By whom and in what capacity are you employed?	
6	A. I am employed by the Missouri Department of Natural Resources as an Energy Specialist in th	ıe
7	Energy Policy and Analysis Program in the Missouri Energy Center ("MDNR-EC"). The Missou	ri
8	Energy Center is located within the Missouri Department of Natural Resources, an agency of sta	te
9	government with its executive office located in Jefferson City, Missouri.	
10	Q. Are you the same Laura Wolfe who filed Direct Testimony regarding revenue requirement in	
11	the case?	
12	A. Yes, I am.	
13	Q. What is the purpose of your direct testimony in these proceedings?	
14	A. The purpose of my testimony is to address the Straight Fixed Variable ("SFV") rate design propose	ed
15	by Empire District Gas Company ("EDG"). I will specifically offer testimony regarding the	ıe
16	following items:	
17	(1) EDG's request to implement a SFV rate design;	
18	(2) other utilities in Missouri using a SFV rate design;	
19	(3) a summary of the opinions of various national organizations of the SFV approach to rates; and	
20	(4) a recommendation to allow SFV only if energy efficiency funding levels are established at	a
21	significant level.	
22	II. EDG's REQUEST TO USE A STRIAGHT FIXED VARIABLE RATE DESIGN	
23	Q. Describe the current rate design used by EDG.	
24	A. EDG witness, Mr. H. Edwin Overcast, provides a concise description in his Direct Testimony of	of
25	EDG's current rate design:	

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1 EDG's current residential service base rates consist of a customer charge and a flat volumetric 2 charge for distribution. Both the customer charge and the volumetric charge differ for the North 3 and South portions of the system when compared to the NW portion of the system. The volumetric charge is a per Ccf charge. The small general service base rates consist of a customer 4 5 charge and a volumetric charge. For both residential and small general service customers the rate 6 also includes a volumetric Purchased Gas Adjustment (PGA) charge and a Tax and License Rider 7 charge in addition to the applicable base rate charges. The PGA charge differs by each system-8 North, South and NW based on the costs associated with the interstate pipelines that serve each 9 segment of the system.¹

10 11

Q. How are EDG's costs to deliver natural gas to its customers recovered through this rate design?

- 12 A. Mr. Overcast also provides a concise description of cost recovery in his testimony:
- 13 The customer charge and volumetric charge, referred to as base rate charges, recover the delivery 14 service costs, including the costs that are incurred as a function of the number of customers and 15 the design day demand that is placed on EDG's distribution system. Base rate costs represent the 16 costs incurred to provide distribution service....²
- 17

18 Q. How are EDG's costs of natural gas recovered?

- 19 A. EDG recovers the cost of purchasing a supply of natural gas to meet the needs of its customers
- 20 through a Purchased Gas Adjustment ("PGA") similar to other natural gas utilities in Missouri.³

21 Q. How would you characterize EDG's current rate design?

- 22 A. I would characterize this as a volumetric rate design. The residential, small commercial firm, and
- small volume firm classes of customers each have a monthly flat customer service charge and also an
- energy charge applied to each Ccf used by the customer. EDG's remaining two classes of customers,
- 25 large volume form and large volume interruptible, have the same two rate elements (monthly
- 26 customer charge and an energy charge per Ccf) plus a billing demand charge applied to each Ccf
- used.

28 **Q. Does EDG detail any problems with the current rate structure?**

² Ibid.

¹ Direct Testimony of Mr. H. Edwin Overcast for Empire District Gas Company, page 23.

³ Empire District Gas Company, P.S.C. MO No. 2, Original Sheet 54 – Fourth Revised Sheet 63. Laclede Gas Company, P.S.C. MO No. 5, First Revised Sheet No. 15 – Fourth Revised 18a. Union Electric Company, P.S.C. MO No. 2, Seventh Revised Sheet 22 – Fourth Revised Sheet 29.1. Missouri Gas Energy, P.S.C. MO No. 1, Third Revised Sheet 14 – Nineteenth Revised 24.3.

A. Yes. Mr. Overcast presents two categories of problems he attributes to the current, volumetric rate
design: problems related to economically efficient price signals; and problems related to the failure to
provide a reasonable opportunity to collect the authorized level of revenue. Mr. Overcast also asserts
that the problems in both of the categories are made worse in the context of policy objectives that
promote cost-effective energy conservation to address resource constraints, obtain more efficient use
of capital and to help manage price level and volatility risks.

- 7
- 8 With regard to economically efficient price signals, Mr. Overcast states that:

9 When fixed costs are recovered volumetrically, customers who conserve save costs that the 10 Company does not save. As noted above, this causes more frequent rate cases and from an 11 economic perspective wastes resources. An economically efficient price signal matches the 12 reduction in cost for the company with the reduction in cost for the consumer. In the case of 13 EDG, the cost reduction from conservation is lower PGA related costs. Any customer savings in 14 excess of the cost of gas overstates the value of conservation and results in both excess 15 investments by the customer and cross subsidies among customers.⁴

17 With regards to the failure to provide a reasonable opportunity to collect the authorized level of 18 revenue, Mr. Overcast states that the revenue requirement for a natural gas company is based on 19 operating and maintenance costs, depreciations expenses and taxes, and an allowed rate of return, and 20 that none of these are weather normalized. These costs do not vary based on the volume of natural 21 gas used by customers. Mr. Overcast supports this statement stating "This fact is recognized by 22 regulatory bodies because they do not weather normalize any of these costs as would be appropriate if the costs varied with the volume of gas consumed."⁵ Mr. Overcast concludes that "a volumetric base 23 24 rate falsely suggests that a customer that reduces consumption will somehow produce a corresponding effect on the costs of providing base rate delivery service."⁶ 25

26 Q. Does EDG propose a different rate design?

⁴ Direct Testimony of Mr. H. Edwin Overcast for Empire District Gas Company, page 26.

⁵ Direct Testimony of Mr. H. Edwin Overcast for Empire District Gas Company, page 27.

⁶ Ibid.

1 A. Yes. Attachment LW-1 details the current rate elements and the proposed rate elements for residential 2 and commercial services. EDG proposes what I would characterize as a SFV rate design for its residential customers and its smaller small commercial firm customers.⁷ The proposed rate structure 3 4 for these customers consists of only two elements: a flat monthly charge and the PGA. EDG is not 5 proposing a true SFV rate design for all the small commercial firm customers, large volume firm 6 customers, and large volume interruptible customers at this time. EDG proposes a rate design that 7 still includes volumetric rate elements for the recovery of costs other than cost associated with the 8 purchase of natural gas (the PGA). Mr. Overcast characterizes this as an interim step in the direction 9 of a SFV rate design for these customers.

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III. OTHER MISSOURI UTILITIES USING A SFV RATE DESIGN

12 Q. Do other natural gas utilities in Missouri employ a SFV rate design?

13 A. Yes. The Commission approved a SFV rate design for Atmos Energy Corporation in Case No. GR-

14 2006-0387.⁸ However, the Commission's decision on the SFV rate design was challenged in court.

15 On June 23, 2009, the Missouri Court of Appeals, Western District, filed a decision stating:

16 Due to the absence of competent and substantial evidence to support the Commission's findings 17 regarding subsidization and Atmos's cost of service, we reverse the Commission's decisions 18 adopting the SFV rate design and approving consolidation of Atmos's districts and remand those 19 matters to the Commission for further proceedings.⁹

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⁷ EDG currently has customer classes: residential, small commercial firm, small volume firm, large volume firm, and large volume interruptible. EDG is proposing to restructure its classes into six classes: residential, small commercial firm - small, small commercial firm - medium, small commercial firm - large, large volume firm, and large volume interruptible.

⁸ In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Consolidate Rates and Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of Atmos, Missouri Public Service Commission Case No. GR-2006-0387, Report and Order, Effective March 4, 2007.

⁹ In the Missouri Court of Appeals, Western District, State of Missouri, ex rel. Public Counsel, Respondent, Atmos Energy Corporation, Appellant, vs. Missouri Public Service Commission, Respondent. Appeal from the Circuit Court of Cole County, Missouri, Case WD70219, Filed: June 23, 2009

- 1 The Commission's is seeking comments regarding this remand. The filing deadline was October 30,
- 2 $2009.^{10}$
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The Commission approved a SFV rate design for Missouri Gas Energy ("MGE") for residential customers in GR-2006-0422.¹¹ The Commission stated:

- ...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. 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.
- 12 This decision was also challenged in court. The Missouri Court of Appeals Southern District denied
- 13 the appeal for the SFV rate design.¹² MGE's SFV rate design for residential customers is currently in
- 14 effect ¹³
- 15

16 IV. OPINIONS OF NATIONAL ORGANIZATIONS REGARDING THE SFV RATE DESIGN

17 Q. Have nationally recognized organizations addressed the SFV rate design?

- 18 A. Yes. Several nationally recognized organizations have addressed the SFV rate design in the context
- 19 of moving our country toward more efficient use of our energy resources. For example, the National
- 20 Action Plan for Energy Efficiency ("NAPEE") released a report entitled *Customer Incentives for*
- 21 Energy Efficiency Through Electric and Natural Gas Rate Design. One of the conclusions reached in
- 22 this document is that shifting costs from volumetric to fixed charges, through rate designs such as

¹⁰ In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Consolidate Rates and Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of Atmos, Case No. GR-2006-0387, Order Establishing Deadline for Responses, Effective October 7, 2009.

¹¹ In the Matter of Missouri Gas Energy's Tariffs Increasing Rates for Gas Service Provided to Customers in the Company's Missouri Service, Missouri Public Service Commission Case No. GR-2006-0422, Report and Order, Effective March 30, 2007.

¹² In the Missouri Court of Appeals, Southern District, State of Missouri, ex rel. Public Counsel, Relator-Appellant, vs. Missouri Public Service Commission, Respondent-Respondent; Missouri Gas Energy, A division of Southern Union Company, Plaintiff-Appellant vs. Missouri Public Service Commission, Defendant-Respondent. Appeals from the Circuit Court of Greene County, Missouri, Case Nos. SD29278 & SD29308 and SD29297 & SD29320, ¹³ Missouri Gas Energy, P.S.C. MO No. 1, Seventh Revised Sheet 25 – Third Revised 26.

- 1 straight fixed-variable, does not encourage customer energy efficiency. Fixed-rate options actually
- 2 tend to discourage customer energy efficiency. Specifically, it was stated in this publication:

This approach places all utility fixed costs in a fixed charge and all variable costs in a variable charge. Because it tends to shift costs out of volumetric charges, it tends to reduce customers' efficiency incentive, because the marginal price of additional consumption is reduced. While SFV rates are being considered to better reflect the utility's costs behind the rate, these rates do not encourage customers to change energy usage behavior or invest in efficient technologies. Such customer disincentives persist even when SFV rates are applied to individual components of the bill, such as charges for distribution service.¹⁴

- 11 Another example is a report released in March 2009 by the Ernest Orlando Lawrence Berkeley
- 12 National Laboratory ("LBNL") entitled Financial Analysis of Incentive Mechanisms to Promote
- 13 *Energy Efficiency: Case Study of a Prototypical Southwest Utility.* In this report, LBNL states:

The Straight Fixed-Variable Rate Design has been proposed by a number of gas utilities and imposes a fixed charge to customers which is designed to recover all "fixed" costs.... This has the effect of stabilizing the revenues of a utility because changes in consumption by customers have much less impact on the overall amount of their bill. This rate design partially decouples a utility's revenues from its sales; however, it also has the effect of weakening the link between customers' total utility bills and their actual consumption levels, which reduces the price signal for individual consumers to conserve and undertake energy efficiency investments.¹⁵

- 22 The Regulatory Assistance Project has posted a relevant document on its website entitled *Rate*
- 23 Impacts and Key Design Elements of Gas and Electric Utility Decoupling: A Comprehensive Review,
- 24 states:

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It is ... possible to break the link between fixed cost recovery and ... natural gas consumption by changing how customers pay for energy utility services. In general, this is called "straight fixedvariable" rate design, in which the fixed monthly customer charge recovers all of the utility's fixed costs of service and the variable, energy-related charge, covers only the variable cost of energy. Some Commissions adopting this type of rate design have called it 'decoupling." While this rate design does break the link between sales and fixed cost recovery, it does so by greatly diminishing customer incentives to conserve or invest in energy efficiency.¹⁶

¹⁴ Customer Incentives for Energy Efficiency Through Electric and Natural Gas Rate Design, National Action Plan for Energy Efficiency, September 2009, http://www.epa.gov/RDEE/documents/rate_design.pdf.

¹⁵ Financial Analysis of Incentive Mechanisms to Promote Energy Efficiency: Case Study of a Prototypical Southwest Utility, Ernest Orlando Lawrence Berkeley National Laboratory, LBNL-1598E, pages 6 – 7, http://escholarship.org/uc/item/7fw490d0#

¹⁶ *Rate Impacts and Key Design Elements of Gas and Electric Utility Decoupling: A Comprehensive Review*, by Pamela G. Lesh, 6/30/2009, <u>The Electricity Journal</u> Volume 22, Issue 8, October 2009, pages 65-71. http://www.raponline.org/showpdf.asp?PDF_URL=%22/pubs/lesh-compreviewdecouplinginfoelecandgas-30june09.pdf%22

1 Q. Is there a consistent assessment of the impact of SFV rate design on energy efficiency incentives

2 for natural gas customers?

3 A. Yes. A rate design with greater fixed monthly charges and lesser volumetric charges produces less 4 impact on a customer's bill when the customer reduces his energy usage through energy efficiency 5 measures or conservation. The price signals for customers are not as strong for the natural gas 6 utility's customers, and do not incent customers to be energy efficient. Please refer to Schedule LW-7 2 for an example. Using an assumed monthly usage of 65Ccf for a residential customer on EDG's 8 south system, the calculations on LW-2 demonstrates the difference in the price signal a residential 9 customer gets from EDG's current, volumetric rate design versus EDG's proposed SFV rate design. With the current rate structure, customers who reduce natural gas usage by 10% see an 8.77% 10 11 decrease on their monthly bill. Reduction of usage by 15% results in a 13.15% reduction of a 12 monthly bill, and a 25% reduction in usage results in a 21.92 reduction in the monthly bill. Using the 13 EDG's proposed rates for a residential customer on the south system, the reductions to the monthly 14 bill corresponding to the reductions in usage are much less: a 10% reduction in usage garners a 6.23% reduction of the monthly bill; a 15% reduction in usage results in a 9.36% reduction of the monthly 15 16 bill; and a 25% reduction in usage generates a reduction to the monthly bill of 15.59%.

Q. Does the SFV rate design have an impact on the incentive to a utility company regarding energy efficiency and conservation?

A. Yes, it does. The SFV does not create an incentive for the natural gas utility to invest in energy efficiency, but it does remove a disincentive to energy efficiency investment. When a utility recovers a significant amount of its costs through volumetric rates, there is no reason for a utility to aggressively pursue energy efficiency measures. As Mr. Overcast stated in his direct testimony, "[w]hen fixed costs are recovered volumetrically, customers who conserve save costs that the Company does not save." The SFV rate design, however, stabilizes the recovery of the utility's costs

1	through flat, monthly rates rather than usage sensitive rates. A utility using a SFV rate design is not
2	as energy efficiency averse as a utility employing a volumetric rate design to recover its costs.
3	Q. Do nationally recognized organizations recognize and support removing disincentives for
4	utilities to promote energy efficiency?
5	A. Yes. In particular, the National Association of Regulatory Utility Commissioners ("NARUC") has
6	addressed the removal of disincentives for natural gas utilities to invest in energy efficiency. In July
7	of 2004, NARUC adopted a resolution submitted by the American Gas Association ("AGA") and the
8	Natural Resources Defense Council ("NRDC") entitled Joint Statement of the American Gas
9	Association and the Natural Resources Defense Council ("Joint Statement"). In the Joint Statement,
10	AGA and NRDC stated that:
11 12 13 14	many states' rate structures offer – quite unintentionally – a significant financial disincentive for natural gas utilities to aggressively encourage their customers to use less natural gas, such as by providing financial incentives and education to promote energy-efficiency and conservation techniques. ¹⁷
15 16	and
17 18 19 20	Our shared objective is to give utilities real incentives to encourage conservation and energy efficiency. With properly designed programs, the benefits could be significant and widespread ¹⁸
20	The Joint Statement was reviewed and endorsed by the Alliance to Save Energy ("ASE") and the
22	American Council of an Energy Efficient Economy ("ACEEE"). NARUC's adopted Resolution on
23	Gas and Electric Energy Efficiency "encourage[d] State Commissions to review and consider the
24	recommendations contained in the Joint Statement of the American Gas Association, the Natural
25	Resources Defense Council, and the American Council for an Energy Efficient Economy". ¹⁹
26	

¹⁷ Joint Statement of the American Gas Association and the Natural Resources Defense Council, Submitted to the National Association of Regulatory Utility Commissioners, July 2004, page 2.

http://ase.org/imgs/lib/e-FFICIENCY/joint_AGA_NRDC_NARUC_statement.pdf

¹⁸ Joint Statement of the American Gas Association and the Natural Resources Defense Council, Submitted to the National Association of Regulatory Utility Commissioners, July 2004, page 3.

http://ase.org/imgs/lib/e-FFICIENCY/joint_AGA_NRDC_NARUC_statement.pdf ¹⁹ *Resolution on Gas and Electric Energy Efficiency*. Adopted by the NARUC Board of Directors, July 14, 2004.

On November 16, 2005, NARUC adopted another pertinent resolution entitled *Resolution on Energy Efficiency and Innovative Rate Design*. In this resolution, NARUC "encourages State commissions and other policy makers to review the rate designs they have previously approved to determine whether they should be reconsidered in order to implement innovative rate designs that will encourage energy conservation and energy efficiency that will assist in moderating natural gas demand and reducing upward pressure on natural gas prices...."²⁰

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8 In May 2008, AGA and NRDC issued a Second Joint Statement of the American Gas Association and 9 the Natural Resources Defense Council (Second Joint Statement). The Second Joint Statement

10 supports three common objectives:

1) removing disincentives for utilities to promote energy efficiency and reduce greenhouse gas
 emissions, and uniting to achieve increased savings through programs and standards;
 developing performance-based incentives for utilities to promote energy efficiency and

- 14 reduced greenhouse gas emissions; and
- 15 3) recognizing the potential contributions of efficient natural gas use in promoting reduced
 greenhouse gas emissions.
 17

18 As with AGA and NRDC's original Joint Statement submitted in 2004, this Second Joint Statement

19 was reviewed and endorsed by ASE and ACEEE. NARUC adopted a resolution on Second Joint

20 Statement of AGA and NRDC stating it "encourages commissions to consider the principles and

- 21 recommendations set out in the Second Joint Statement of the American Gas Association and the
- 22 Natural Resources Defense Council and encourages State Commissions and other policymakers to
- 23 review and give strong consideration to favorably approving gas distribution proposals consistent
- 24 with these principles and recommendations."²¹

25 Q. Can you summarize the different impacts of rate design on customer and utility incentives to

26 **invest in energy efficiency**?

²⁰ Resolution on Energy Efficiency and Innovative Rate Design, http://fossil.energy.gov/epact/Section_1818/AGA_supp_energyefficiency_(2).pdf

A. Yes. A natural gas customer has a greater incentive to invest in energy efficiency measures when
rates are more volumetric than flat. Volumetric rate designs provide customers with a stronger price
signal than a SFV rate design. However, a natural gas utility that is recovering costs through
volumetric rates has a disincentive to invest in energy efficiency. The SFV rate design mitigates that
disincentive by lowering the threat of failing to recover costs and approved return on investment
when volumes decrease.

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V. RECOMMENDATION TO ALLOW A SFV RATE DESIGN ONLY IF ENERGY

EFFICIENCY FUNDING IS SIGNIFICANT

10 Q. What do you recommend to reconcile the reduced customer incentive with the reduced utility

11 disincentive to invest in energy efficiency created by the SFV rate design?

12 A. The SFV rate design is being employed in Missouri already by two natural gas utilities: MGE and

13 Atmos (although under remand). In both cases, the companies agreed to invest in energy efficiency

14 to help and encourage customers to use natural gas energy more efficiently. In the Commission's

15 Report and Order in GR-2006-0387, Atmos' 2006 rate case, the Commission stated:

Based on the specific facts in this case, the Commission finds that placing all non-gas costs into a fixed delivery charge, within the context of a zero revenue increase and the consolidation of the operating districts into three service areas (NEMO, WEMO, and SEMO) will provide for just and reasonable rates *if* it is accompanied by a meaningful energy efficiency and conservation program as described above. ... If Atmos chooses to enter into a significant energy efficiency and conservation program as set out in this order to be approved by the Commission, it may file tariffs including a fixed delivery charge rate design.²²

²¹ Resolution on Second Joint Statement of the American Gas Association and the Natural Resources Defense Council in Support of Measures to Promote Increased Energy Efficiency and Reduction in Greenhouse Gas Emissions. Adopted by the NARUC Board of Directors, July 23, 2008.

²² In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Consolidate Rates and Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of Atmos, Missouri Public Service Commission Case No. GR-2006-0387, Report and Order, Effective March 4, 2007, page 44.

1	On June 28, 2007, Atmos filed tariff sheets to implement Energy Conservation and Efficiency
2	Program, and the Commission approved the tariff sheets effective August 31, 2007. ²³
3	
4	The Commission approved a SFV rate design for MGE's residential customers in MGE's 2007 rate
5	case, GR-2006-0422. In the Report and Order in this rate case, the Commission stated that:
6 7 8 9 10	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. ²⁴
11	An investment in an aggressive portfolio of energy efficiency of programs will mitigate the weaker
12	price signals a customer receives from monthly bills issued by a natural gas utility employing a SFV
13	rate design. The natural gas company will not be harmed by reduced natural gas usage attributable to
14	energy efficiency measures with the SFV rate design.
15	Q. Do you recommend an aggressive energy efficiency portfolio for EDG to invest?
16	A. Yes. Please refer to my Direct Testimony regarding Revenue Requirement filed in this case. An
17	array of programs making up the portfolio are detailed in that testimony, as is the investment levels of
18	approximately \$217,000 for 2010, approximately \$327,000 for 2011, and approximately \$655,000 for
19	2012. This level of investment in energy efficiency is appropriate for EDG regardless of the rate
20	design employed. The impact of the SFV rate design on customers' incentive to invest in energy
21	efficiency, and the removal of the disincentive for the utility to invest in energy efficiency the SFV
22	rate design provides, provide additional support to the investment level I have recommended.
23	

²³ In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Consolidate Rates and Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of Atmos, Missouri Public Service Commission Case No. GR-2006-0387, Order Approving Tariff Sheets in Compliance with Report and Order, Effective August 31, 2007.

²⁴ In the Matter of Missouri Gas Energy's Tariffs Increasing Rates for Gas Service Provided to Customers in the Company's Missouri Service, Missouri Public Service Commission Case No. GR-2006-0422, Report and Order, Effective March 30, 2007, page 11.

1 Q. Does this conclude your testimony?

2 A. Yes, it does.