REBUTTAL TESTIMONY

OF

JAMES A. BUSCH

CASE NO. GR-2004-0209

MISSOURI GAS ENERGY

Q. Please state your name and business address.

A. My name is James A. Busch and my business address is P. O. Box 2230, Jefferson City, MO 65102.

Q. By whom are you employed and in what capacity?

A. I am a Public Utility Economist with the Missouri Office of the Public Counsel (Public Counsel).

Q. Are you the same James A. Busch who filed direct testimony earlier in this proceeding?

A. Yes I am.

Q. What is the purpose of your rebuttal testimony in Case No. GR-2004-0209?

A. The purpose of my rebuttal testimony is to address Missouri Gas Energy (MGE or Company) witness F. Jay Cummings's allocation methodology relating to mains costs, to address MGE's request to increase its residential customer charge and to bring to the Commission's attention some of Public Counsel's concerns with MGE's rate design proposal. Public Counsel witness Barbara Meisenheimer will also be addressing some of Public Counsel's concerns regarding MGE's proposed rate design.

Q. How is your rebuttal testimony organized?

A. My rebuttal testimony is organized in the following manner. First, I will discuss the problems of using the zero-intercept method as witness Cummings did in his class cost of service study (COS) for allocating mains cost. Second, I will discuss MGE's proposed rate design, including an increase to the customer charge.

MAINS COST ALLOCATION

Q. Please discuss witness Cummings's methodology used in determining the allocation of mains cost.

A. According to page 24 of his direct testimony, witness Cummings employs a zero-intercept method in order to split the mains investment between customer and demand components. Basically the zero-intercept method uses regression analysis to fit a curve based on the cost associated with various sizes of equipment. The analysis is then extended as if the facility was of zero size, that is, the regression line has a zero-intercept. It can also be looked at as the portion of the main that gives the customers access, but does not provide any service.

Q. Why is the zero-intercept methodology inferior to Public Counsel's methodology?

A. The major problem with the zero-intercept methodology, as pointed out by George Sterzinger in his article, "The Customer Charge and Problems of Double Allocation of Costs," is that it divides the mains costs into two distinct groups, customer and demand. The portion that is related to the number of customers is related to the cost at the zero-intercept. All other costs are associated with the actual demands placed on the system by the various customer classes. When mains cost is divided into these two components, those customers that use small

amounts of natural gas are potentially being allocated excessive costs.[1] Sterzinger further states in his article that when the distribution system is split between a minimum usage portion and an above-minimum usage portion, and allocated on a customer/demand basis respectively, the low use residential customer ends up paying for more of the distribution system than is required to serve that customer.[2] Thus the residential, low use customer pays for a portion of the costs that are supposedly "customer" related, plus that portion of the costs that are demand related, by the summing of his individual demand with the overall demand of his class. Sterzinger argued then, that the way to alleviate this problem is to allocate costs in a consistent manner; that is to not split them into demand and customer components. The best way to accomplish that is to allocate mains cost via a demand allocator. Public Counsel only used a demand allocator in its direct testimony.

Q. On page 24, lines 1 – 6, witness Cummings states that as new customers are added to the system, a main has to be built simply to reach that customer, regardless if that customer uses any gas or not. Is that reason enough to divide mains costs into customer and demand components?

A. No. MGE does not simply extend a main to a new subdivision or any potential new customer unless those new premises are going to use natural gas. The main will be built in order to provide service to any new customer. The new customer will then have a given level of demand that will be added to the classes' total

[1] "The Customer Charge and Problems of Double Allocation of Costs," by George Sterzinger, 108 PUBLIC UTILITIES FORTNIGHTLY pp. 30 – 32, July 2, 1981.
[2] Ibid

demand. Therefore to receive compensation for merely having a line available to the consumer does not make sense. Thus it is more appropriate to classify the costs of mains as demand-related only, instead of splitting them into customer-related costs and demand-related costs.

RESIDENTIAL CUSTOMER CHARGE AND RATE DESIGN

- **Customer Charge**

Q. Currently, what is the residential customer charge?

A. Currently, the residential customer charge for a MGE consumer is $10.05.

Q. What was Public Counsel's recommendation concerning the residential customer charge?

A. Public Counsel recommends that there is no change in the customer charge.

Q. What is MGE's recommendation concerning the residential customer charge?

A. MGE is recommending a customer charge of $13.55. This is an increase of nearly 35% in the customer charge.

Q. What is the argument for a customer charge?

A. The argument for a customer charge is that there are certain fixed costs that are present whether or not the customer uses any natural gas.

Q. What types of costs would be considered as fixed costs?

A. According to the NARUC Gas Distribution Rate Design Manual of June 1989, examples of those fixed costs would include services, meters, regulators, meter reading expense and certain administrative costs.

Q. What costs does MGE include in its customer charge?

A. MGE includes any costs that it considers related to the number of customers in its calculation of the customer charge. Some examples include, a return on mains, a return on miscellaneous intangible plant, and a return general plant. These items go far beyond the scope of items that should be included in a customer charge according to the NARUC manual.

Q. What does Public Counsel include in its customer charge?

A. Consistent with the NARUC manual Public Counsel includes a return on MGE's services, meters, meter installation, and regulators plus the associated expenses with those items, and the administrative and general expenses associated with customer accounts.

Q. Should customer charges be relatively higher or lower?

A. Customer charges should be set as low as possible in order to promote efficiency in the market.

Q. Please explain.

A. First, one of the Commission's functions is to try and replicate a competitive market. Competitive markets are not characterized by firms that collect a customer charge just for being in business. For instance, McDonald's does not collect a charge from the customer unless that customer purchases something. Wal-Mart does not have its people greeters collect an entrance fee from its customers as they walk in the door. In fact, a customer can go to Wal-Mart, look around for hours, not purchase anything, and never pay a dime.

Second, a higher customer charge necessarily means a lower per-unit price. This harms the low-use user. Further, the higher customer charge and lower per-unit

rate does not promote conservation. In today's market, of high natural gas prices, there should not be any incentives for consumers to purchase more natural gas than is necessary.

- **Rate Design**

Q. Currently, what is the per-unit delivery charge?

A. The per-unit delivery charge is currently $0.11423 per Ccf.

Q. What is MGE's proposal in this proceeding concerning the residential usage charge?

A. In this proceeding, MGE is proposing a radical shift in the manner it collects non-gas costs from its ratepayers. In the winter months, which MGE defines as November – April, MGE is proposing to collect all of its non-gas costs within the first 68 Ccfs. In other words, instead of a flat rate for each Ccf used by a customer, be it one or 1,000, MGE has calculated a substantially higher per Ccf rate for the first 68 Ccfs of usage, in this case $0.32599 per Ccf based on MGE's filed case, and will charge nothing for usage that is greater than 68 Ccfs. This type of structure is an extreme example of a declining block rate.

Q. Does any other Local Distribution Company (LDC) in Missouri have this type of rate design.

A. Yes. Laclede Gas Company, in its last rate case, Case No. GR-2002-356, implemented this type of rate design based on a Stipulation and Agreement signed by the parties in that proceeding.

Q. What is Public Counsel's recommendation in this rate case?

A. Public Counsel is recommending that the Commission stay with the traditional method of establishing rates in this proceeding. For a further discussion of Public Counsel's recommendation against MGE's proposed rate design methodology, please see Public Counsel witness Barbara Meisenheimer's rebuttal testimony.

Q. Why is Public Counsel opposed to this new rate design methodology?

A. There are various reasons why Public Counsel is opposed to this methodology.

Q. What is one reason that Public Counsel has for being opposed to this methodology?

A. One reason, similar to my earlier discussion concerning the customer charge, is that regulation is supposed to act as a surrogate for competition. With competition, there are certain risks that all firms face. In the natural gas industry, one risk is weather. Rates are set on the basis of normal weather. Thus if it is colder than normal, more volumes are used by the consumers, and the LDC earns more money, all else equal. Conversely, if weather is warmer-than-normal, fewer volumes are used, and the LDC may not earn as much, all else equal.

MGE's weather rate design eliminates much of the weather risk. As witness Cummings points out in his direct testimony on page 31, average usage in the six months that it considers winter ranges from 48 Ccfs in November up to 176 Ccfs in January. In fact, only the month of November has average usage less than 68 Ccfs. Furthermore, average usage is so high in the other five months, that even usage as much as 20% less than normal would still have average usage greater than 68 Ccfs. This means that any risk that MGE had due to weather has been virtually eliminated. That is not the role of regulation or this Commission. The

Commission should not guarantee the rate of return for any investor-owned utility (IOU). Instead it should offer the opportunity for the IOU to earn a normal rate of return. For a further discussion of MGE's proposal and how it affects the return on equity of the Company, please see Public Counsel witness Travis Allen's rebuttal testimony.

Q. What is another one of Public Counsel's criticisms of MGE's proposal?

A. During the winter months, this declining block rate is essentially a glorified customer charge. Since only substantially warmer than normal weather would cause average usage to be less than 68 Ccfs in any given month (and that would probably only happen in April), the customers will be basically charged a fixed dollar amount per month. Please see my earlier discussion against high customer charges.

Q. Doesn't MGE's rate design address the concern about price signals by turning the PGA rate into an increasing block rate so that the total per Ccf charge is the same no matter the usage?

A. Yes, MGE does split the PGA to keep the total Ccf rate the same. However, this leads to other problems. During normal, warmer-than-normal, and certain colder-than-normal weather conditions, the Company will collect all of its non-gas costs, however, it will under-collect its gas costs, all else equal. This happens because in order to keep the effect of this radical rate design transparent to the consumer, the PGA rate has to be lowered for the first 68 Ccfs. It is than raised for each Ccf used in excess of 68. However, as Ms. Meisenheimer shows in her rebuttal testimony, under warmer-than-normal and average use conditions, MGE cannot

collect enough in its PGA rate to pay for its gas costs under this type of rate design. The effect of this under-collection is than felt during the following year when the ACA has to be increased in order to make up the shortfall. Therefore, consumers are worse off under this rate design methodology than under the traditional, widely accepted methodology.

Q. Laclede has this same type of rate design, what has happened so far in its experiences?

A. We do not know. Laclede has just recently filed its first ACA case under its new rate design proposal. It will take time for a review to be conducted to determine the overall effects their experiment has on customer's bills.

Q. You mentioned experiment, why?

A. Because Laclede's plan, as agreed to in the Stipulation and Agreement in Case No. GR-2002-356, was proposed as an experiment. Before the Commission should agree to a similar design, the results of the first experiment need to be reviewed and analyzed. Without a proper analysis, a plan that may be proven to be extremely harmful to ratepayers may be implemented on more 500,000 ratepayers due to a rush to judgment. A more balanced approach would be for the Commission to reject MGE's proposal and undertake a thorough review of Laclede's experiment to ensure that any radical changes to the traditional rate design methodology do not harm ratepayers unnecessarily simply in order to give the LDC a guaranteed rate of return.

Q. Are there any other points the Public Counsel would like to make?

A. Yes. In this proceeding, MGE has proposed to implement the radical rate design that was approved on an experimental basis for Laclede Gas Company. Further, MGE has also asked for a nearly 35% increase in the residential customer charge. These two proposals, if approved by the Commission would go a long way towards providing the Company a guaranteed rate of return. Considering MGE currently is operating with an ISRS (Infrastructure System Replacement Surcharge), a device that gives the Company upfront recovery of certain capital investments, MGE will become a Company that has very little risk. The Commission should not approve either of MGE's rate design proposals in this proceeding. However, if the Commission does decide to lower the risk of the Company, it should focus more on the customer charge, instead of the rate design proposal.

Q. MGE is proposing the winter season should be November – April. Do you agree with this demarcation?

A. No. It is widely accepted in the natural gas industry that the winter months or heating season is November through March. Further, the injection season for natural gas storage is April through October, and the withdrawal season runs from November through March. If the Commission does decide to accept this new weather rate design, the winter months should be from November through March to match generally accepted industry standards.

Q. Is MGE's weather mitigation rate design proposal symmetrical between the potential benefits to MGE's shareholders and MGE's ratepayers?

A. No. This rate design proposal would provide substantial benefit to the shareholders of MGE by nearly eliminating the weather risk that is normally associated with LDCs. On the other hand, ratepayers receive no benefit, and in fact could be harmed in the long-run as I pointed out earlier in my testimony and as Ms. Meisenheimer shows in her rebuttal testimony.

Q. Should this Commission approve any plan that provides benefits to one party that may also potentially harm another party?

A. No.

SUMMARY

Q. Please summarize your rebuttal testimony.

A. The Commission should reject MGE's zero-intercept cost allocation methodology for mains. The Commission should reject MGE's proposed increase in the customer charge from $10.05 to $13.55. Finally, the Commission should reject the Company's proposed rate design methodology.

Q. Does this conclude your rebuttal testimony?

A. Yes it does.