BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Tariffs to Implement a General Rate Increase for Natural Gas Service	)))	**Case No. GR-2004-0209** Tariff No. YG-2004-0624

CONCURRING OPINION OF COMMISSIONER JEFF DAVIS

I respectfully concur in the opinion issued by the majority of the Commission allowing Missouri Gas Energy (MGE) an opportunity to recover its prudent costs and earn a fair return on its investments. My vote was necessary to obtain a majority decision; however, I am writing a separate opinion to emphasize several key points regarding witness credibility, return on equity and class cost of service.

Witness Credibility:

MGE presented the testimony of James Dunn and Dr. Roger Morin. Although there were occasional flaws in Dunn's testimony, Dunn acknowledged his mistakes and appeared credible. Dr. Roger Morin, a Professor of Finance for Regulated Industry at the Center for the Study of Regulated Industry at Georgia State University who received his PhD in Finance and Econometrics from the Wharton School of Finance at the University of Pennsylvania, appeared to be the most credible expert witness of all those proffered by any party both on paper and in person. Dr. Morin authored the textbook Regulatory Finance (1994), which is relied on by many experts in the field, including those in this case.

The Staff of the Missouri Public Service presented the testimony of David Murray. MGE vigorously contested David Murray's testimony. Murray's testimony left no doubt in this commissioner's mind that he came into possession of an old deposition from a previous case and plugged in MGE's information. Murray took positions designed to minimize the return allowed to MGE and stuck with those positions no matter what arguments and evidence were presented by the other parties. Such a rigid position is not helpful to this Commission and, in the opinion of this commissioner, is not consistent with this Commission's duty to balance the interests of both utilities and consumers. See <u>State ex rel. Union Electric Co. v. Public Service Com.</u>, 765 S.W.2d 618 (Mo. App. W.D. 1988)

The Office of the Public Counsel presented the testimony of Travis Allen. When Allen first gave deposition testimony in this case, he had been employed by the Office of the Public Counsel for approximately two weeks. Allen handled himself well on the stand and his testimony on behalf of the Public Counsel should improve with experience. He has the education needed to become an expert in regulatory finance but two weeks of experience in the regulatory field does not make him an expert such as can reasonably be relied on by the Commission. Moreover, it appeared in regard to certain issues, like return on equity, that he adopted a position on behalf of the Office of the Public Council, which was designed to achieve a lower number if the Commission decided to split the difference between the numbers recommended by MGE and the Office of the Public Counsel.

This commission found that the testimony of MGE's witnesses was the most credible and that finding is reflected in the majority opinion.

<u>Return on Equity (ROE):</u>

MGE's expert, John Dunn recommended a return on equity between 11% and 12%. Dunn further opined that his 12% recommendation was in order because of the regulatory risk associated with Missouri and its low depreciation rates comparable to those allowed in other states. Public Counsel's witness, Travis Allen and Staff's witness, David Murray, on the other hand, recommended a return on equity of approximately 9%. It should be noted that Murray's recommendation ranged as low as 8.52%.

Such a vast range in recommended return on equity is not the norm either for this Commission, or for other Commissions around the country. This commission heard undisputed testimony that the average award for ROE in contested utility rate cases is approximately 11.0%. Moreover, in MGE's last litigated rate cases in the late 1990s the return on equity recommendations of MGE, Public Counsel and Staff varied by only about 100 basis points. In that case, MGE was awarded the opportunity to earn a return on equity of approximately 11.3%, the low end of staff's recommendation as a result of poor customer service.

The great variation in recommended return on equity seen in this case requires the Commission to base its determination in large measure on the credibility of the experts. Witness credibility has already been discussed and the opinions of this author are obvious. David Murray's recommended return on equity recommendation was remarkably equivalent to Staff's recommendation for return on equity in the Empire District Electric Company's 2001 rate case despite differences, including capital structure. *See* In Re: Empire District Electric, 10 Mo. P.S.C. 3d 463 (2001). Murray's position on behalf of the Staff in this case, Staff's recommendation in 2001 Empire District Electric Case and Staff's recommendation in another 2001 rate case leave this Commissioner wondering if Staff will continue recommending 8.5% to 9.5% return on equity in future cases involving gas distribution companies or utilities in general no matter how the variables in future cases differ from the present case.

In conclusion, this commissioner found the testimony of MGE's expert witnesses to be the most credible and supports the finding of 10.5% return on equity, which is .5% below MGE's lowest recommendation for return on equity and approximately .6% below the average of return on equity awards throughout the United States. A strong argument could be made that this award is too generous to MGE ratepayers at the expense of the utility and, in the future, this commissioner could certainly support a recommended return on equity of 11.0% or more under the same or similar circumstances.

Class Cost of Service:

This Commission has once again rejected Public Counsel's modified RSUM method to allocate costs among the customer classes in its class cost of service study because it inappropriately assigns costs away from the residential class and pushes them onto the large volume service class. This methodology is an example of Public Counsel seeking a means to justify a result and it is my hope that the Office of Public Counsel will advocate a more reasonable method of allocating costs in future rate cases.

Conclusion:

The majority of this Commission reached a fair decision on the issues. Obviously, there are individual issues that each member of the majority might opine on a little differently if it were not necessary to achieve the majority necessary to issue a decision in this case. However, the fact that every commissioner is unhappy about some part of the report and order is an indication that we did meet in the middle, reaching a fair decision for MGE and its ratepayers.

Like the dissent in this case, I am very concerned that MGE customers won't be able to afford their heating bill this winter. The wholesale and retail price of natural gas has risen exponentially over the last few years due to increased demand. This trend is expected to continue in the near future. Arbitrarily reducing MGE's return on equity from 11.3% in its last rate case to 10.0% or less in this case would be of some assistance to ratepayers, but would unfairly penalize MGE, discourage future investment in Missouri and could increase their cost of capital so that the ratepayers receive very little benefit.

If we, as regulators, really want to help consumers cope with rising energy costs, we need to do a much better job of educating all consumers as to how they can save money on their utility bills. Reducing demand and the growth of baseload consumption for natural gas will lower energy prices and produce low rates for years to come.

Respectfully submitted,

Jeff Davis, Commissioner

(S E A L)

Dated at Jefferson City, Missouri,
on this 21st day of September, 2004.