5. The PGA Approach With a Sharing Grid Makes the Most Sense

Since there is no accurate way right now to predict the level of MGE capacity release revenues for 2005 and beyond, any number picked by anyone at this point to stick into base rates lacks evidentiary support as to its reasonableness. Ratemaking cannot be premised on that, especially when more than a million dollars per year is potentially at stake. As explained previously, if a number – say $1.5 million – is put into base rates, but not achieved, MGE suffers a detriment because its rates will have been set on the basis of phantom revenues. If that happens, how is MGE to replace those non-existent revenues? It would be like having to pay rent with income from a paycheck you never received.

Ratemaking should be based on evidence. Neither the Staff nor the OPC witness testified they were confident that their recommended levels of capacity release revenues would be achieved by MGE in 2005. Allee admitted she did not know how Cheyenne Plains would impact the capacity release revenues. (Tr. 1577:10-12)

Fortunately, there is a reasonable alternative approach readily available that eliminates the guesswork. It is MGE's proposal to return these revenues to the ratemaking process where they have been before – the PGA/ACA. The beauty of that process, as the Commission well knows, is that it is subject to historical audits. (Tr. 1548:22 to 1549:2) Therefore, there is no need for the Commission to guess about a number to plug into the revenue calculation for base rates because with MGE's approach there will be invoices and receipts that can be audited and verified for accuracy.

It is a logical approach. The *costs* for this pipeline capacity are already treated as a part of the PGA/ACA process, and have been since MGE came into existence. (Tr.

1549:22-24) Other Missouri gas companies have capacity release revenues accounted for through the PGA process now. (Tr. 1559:9-13) It is quite logical to also put actually achieved *revenues* from MGE's occasional sales of the *same* capacity into the ACA process and net them against the costs since even the Staff admits they are directly related. (Tr. 1554:16 to 1555:4) There is no need to rely upon shaky estimates because there will be actual amounts. Indeed, the Staff says that if the Commission does not put a guessed-at number into base rates, the revenues should be treated as a part of the PGA/ACA process. (Ex. 802 NP at 8:1-3) The Staff is already proposing that the capacity release revenues from the Experimental School Transportation Program be treated in that manner. (Ex. 800 NP at 5:18 to 6:7)

6. Everyone Wants an Incentive Approach

All three of the parties actively addressing this issue have recommended that an incentive be applied to capacity release revenues. They disagree on its form, though. MGE has proposed a sharing grid within the context of the PGA/ACA process. (Ex. 10 at 28:19 to 29:13) Staff wants to keep the incentive of a fixed amount being put into the assumed level of revenues for base rates, but raise the hurdle by $140,000. (Ex. 802NP at 7:21 to 8:3) OPC wants the same, but to raise the hurdle by $300,000. The common thread is that all parties want an incentive applied.

OPC and Staff differ in that, if the Commission decides to move it back into the PGA/ACA process, OPC says the single target incentive approach should be maintained. (Ex. 214 at 22:10-12) For no logical or apparent reason, though, the Staff says if it goes back into the PGA/ACA process, the incentive should disappear and "100% of this item should be flowed through to the ratepayers." (Ex. 802NP at 8:3)

The Commission should note that there was never any testimony from the Staff that attempted to provide an evidentiary basis for this curious position. When capacity release revenues are assumed in base rates, it is by definition an incentive. Both Staff and OPC agree on that and advocate that approach. The underlying rationale for their positions is that it is appropriate for MGE to have an incentive to seek as much capacity release revenue as it can obtain. But if the revenues are merely accounted for in a different way – through the PGA/ACA process -- somehow the need for an incentive for MGE to do that magically disappears as far as the Staff is concerned. If there is an underlying need for an incentive, as advocated by all three parties, there was no explanation as to why it disappears if it is handled through the PGA. There was simply no testimony to justify this inconsistency by the Staff.

The obvious benefit of MGE's proposal is that both MGE and the ratepayers share in any capacity release revenues and the uncertainty of what the future levels may be is eliminated. (Tr. 1504:17 to 1505:2) That way, MGE has a financial incentive to generate the maximum capacity release revenues reasonably possible, but is not harmed if the future levels predicted by Staff and OPC do not materialize. And the added benefit is that if levels greater than those assumed by the Staff and OPC do materialize, the ratepayers could be even better off than they are with an assumed level in base rates. MGE witness Noack explained in detail how, if MGE's proposal is followed, and capacity release revenues total $2 million in the future, the ratepayers are better off with a sharing grid than an assumed level in base rates. (Tr. 1506:20 to 1507:8) MGE's proposal assures than any and all revenues received are shared with the ratepayers after an audit. (Ex. 10 at 28:9-14) It is a graduated sharing grid in which MGE never receives more than 30 percent. (Ex. 10 at 29:5-8)

It is also logical and reasonable to treat the capacity release revenues through the PGA process because of recent recommendations of the Staff regarding MGE's capacity levels. As explained by Noack, Staff is currently advocating in a pending ACA proceeding that certain capacity costs of MGE be disallowed. (Ex. 10 at 27:20 to 28:14) Assuming that were to occur (MGE is not conceding anything by discussing this here, and will vigorously defend itself in that case), a patently unfair structure exists. Under the present approach of $1.2 million being assumed in revenues built into the base rate calculation, it is inappropriate to give the ratepayers the benefit of the revenues generated from that capacity reserved for their benefit, but then make the shareholders responsible for the costs. (Ex. 10 at 28:5-9) In other words, if the shareholders are going to bear the costs of that capacity because it is allegedly "excess capacity," then the shareholders ought to get the benefit of any revenues MGE can produce from selling it temporarily to someone else. That would be like the Commission kicking an electric power plant out of rate base on the justification that it is not needed, but then forcing the electric company to use its output to supply the customers and denying the company the right to sell the power somewhere else. That is called confiscation. The point is that the Commission should have the opportunity to examine these costs and related revenues on a contemporaneous basis.

For the Commission to examine *only* the costs in the ACA process *every* year, but then separately examine the corresponding revenues every three years or so in a rate case, is to create a functional and institutional disconnect between these directly related expenses and revenues. MGE's proposal explained by Noack eliminates that problem. It allows the expenses and revenues to be examined simultaneously by the Commission each year in the context of the ACA audit.

Conclusion: MGE's proposal eliminates the guesswork of having to pick a number out of the air for capacity release revenues. No one can accurately predict what it will be with a major new pipeline coming in and disrupting the capacity market. MGE's proposal allows ratepayers and shareholders to each benefit from the very first dollar of any revenues, and maintains the incentive that everyone agrees should be there, instead of betting everything on whether some single magic number can be achieved. It also allows the expenses and revenues to be examined simultaneously, as they should be.

C. Environmental Response Fund

MGE has proposed in this case the creation of an environmental response fund for the rate recovery of the environmental costs related to manufactured gas plant facilities that were operated by former owners of the Company's properties. MGE seeks to establish a mechanism, to operate on a going-forward basis, regarding these environmental clean up expenditures, which the Company will continue to experience in the future. (Ex. 8 at 23:7-18) The plan is described in detail in Schedule H-28 to Exhibit 8. Because MGE proposes that the mechanism be funded initially at a level of $750,000 per year, the issue is worth that amount in revenue requirement.

By way of background, MGE has spent approximately $9.3 million on manufactured gas plant environmental clean up activities since acquiring its Missouri properties in February 1994. (Ex. 11 at 9:9-11) These expenditures have averaged in excess of $900,000 per year. (Tr. 1865:1) MGE's customers, however, have not paid these costs because none of these expenses, have been included in rates, (Ex. 11 at 9:9-11) and, MGE is *not* now requesting that the Commission authorize rate recovery of these *past* expenditures. However, because the Company has incurred millions in environmental clean up costs in the test year in this case, (Ex. 22 at 2:13 to 3:1), and is certain to continue to incur some significant level of such costs in the future, (Ex. 22 at 3:3 to 4:19) MGE can no longer continue to incur these costs without seeking rate recovery.

The exact amount of environmental clean up costs is site specific and thus cannot be determined precisely on a going-forward basis. Consequently, MGE proposes the creation of a fund to be supported by rates in the amount of $750,000 per year. To accomplish recovery, the Company suggests the inclusion of this amount in the per unit delivery charge on all customer classes as a separate rate element in its tariffs. (Ex. 8 at 23:11-14) The revenues collected by this charge will be segregated in an interest bearing trust account and will be subject to audit and "true-up" at some point in the future when the amounts collected through rates can be compared with the environmental clean up amounts actually expended by the Company.

While opposing MGE's plan, the Staff apparently does concede that MGE should recover prudently incurred costs for environmental clean up once all other sources are exhausted. (Tr. 1852:10-14) MGE believes that its plan meets these requirements as its proposal has features to ensure that the Company will use its best efforts to minimize costs consistent with sound environmental policies. (Ex. 8, Schedule H-28; Ex. 11 at 6:3 to 7:2) Only prudently incurred costs will ultimately be recovered. Unused collected amounts can be refunded with interest or otherwise credited to customers. The entire process is similar to the purchased gas adjustment ("PGA") and related ACA process for gas companies. (Tr. 1884:12-18) MGE's proposal adequately addresses Staff's concerns and is not inconsistent with the goal of the stipulation and agreement entered into by this Commission in 2001 in FERC Docket No. RP93-109-000. That agreement established a $1.7 million annual environmental service allowance for Williams Natural Gas Company (now known as Southern Star Central). (Ex. 11 at 7:4-14, Sch. MRN-2)

In essence, what MGE is proposing has the characteristics of an accounting authority order that is funded on the front end (Ex. 11 at 5:7-9) with the monies collected and placed in a segregated account. The proposal also has the characteristics of a "tracking" mechanism similar to the PGA/ACA procedure and is designed to ensure that there is no mismatch between the environmental clean up costs included in rates and those costs actually experienced by the Company. (Ex. 11 at 4:19-22) The proposal is very similar to a plan approved in Massachusetts in 1990. (Ex. 11 at 9:14-15, Sch. MRN-3) Schedule MRN-1, a 49 page document attached to Exhibit 11, sets out various other jurisdictions which have adopted mechanisms for the regulatory treatment of these costs similar to MGE's proposal.

Approaching the environmental clean up cost issue in the manner proposed by the Company in this case is in the public interest. MGE's proposal serves the beneficial purpose of mitigating rate shock in the event significant clean up costs are incurred in the future and also promotes intergenerational equity by spreading cost recovery over a wider base of customers. The proposal has features to ensure that costs will be minimized. Again, only prudently incurred costs will be ultimately recovered. MGE's proposal is a fair and balanced method to deal with environmental clean up costs and the Company's plan should be approved.

D. Lobbying/Legislative Costs

This issue concerns the proper ratemaking treatment for MGE's costs associated with certain of the Company's activities that are a necessary part of operating a public utility, but which the Staff and OPC have improperly characterized as "lobbying." This is but another example of a proposed adjustment which, if adopted by the Commission, will eliminate from rate recovery costs which the Company must incur, thereby preventing MGE from earning its authorized return. The value of the issue is approximately $95,000.[17]

"Lobbying" is commonly understood to be activities undertaken for the *purpose of influencing the decisions of public officials* and MGE does not quarrel with this definition. Generally, expenditures involving such activities are not allowed in cost of service for ratemaking purposes, although the wisdom and fairness of this policy remains subject to question.

Recognizing that "lobbying" expenses are customarily not allowed to be flowed through rates, in order to eliminate controversy in this case, MGE excluded from its rate request all expenses associated with its outside contract lobbyists as well as the dues which it pays to the Missouri Energy Development Association. (Ex. 10 at 13:16-18) Unfortunately, not satisfied with the Company's efforts to eliminate controversy, the Staff and OPC have sought to expand the commonly understood definition of "lobbying"

[17] In connection with this issue, the Staff has requested that the Commission order MGE to keep certain detailed time reporting records on what the Staff characterizes as "lobbying and lobbying related activities." (Ex. 816 at 10:5-7) This request should be denied. (*See* pp. 94-95, *infra*.)

and propose to disallow 100% of the internal payroll costs of MGE employee Paul Snider ("Snider"), and 10% each of the internal payroll costs of MGE employees Jim Oglesby ("Oglesby") and Rob Hack ("Hack"). The basis for this proposed disallowance is the totally unsubstantiated claim that 100% of Snider's payroll cost and 10% of Oglesby and Hack's payroll costs are for "lobbying" activities.

There are two key problems with the Staff and OPC's proposed adjustment. First, while the Staff and OPC recite and pay lip service to the commonly understood definition of "lobbying" (*i.e.,* any attempt to influence the decisions of legislators or public officials), the Staff and OPC fail to properly apply that definition to the work performed by Snider, Oglesby and Hack, but rather mix and mingle the terms, "lobbying," "legislative activities" and "community relations" activities. Second, and to compound this problem, the Staff and OPC really have no idea as to how much time, if any, that these three individuals actually spent during the test year on activities that truly could be called "lobbying," and therefore the proposed adjustment is simply an arbitrary calculation. Staff's counsel admitted as much when he conceded that the Staff simply made what he called "reasonable estimates." (Tr. 1931:5-6)

The record evidence in this case does not support these so-called Staff's purported "reasonable estimates." The evidence demonstrates that Snider has responsibilities for a variety of matters in connection with his employment which is within the Company's Community Relations department. His job description (Ex. 10, Sch. MRN-5, p. 1) recognizes his title as "Legislative Liaison," but describes his essential job functions as "Policy analysis; Writing press releases and other forms of external communications; Interfacing with the Company's many different public entities to strengthen customer service; Disseminating useful information to ratepayers on safety and Company operations; and Serving as a public spokesperson." In fact, Staff witness Hyneman ("Hyneman") admitted that he was fully aware that Snider has responsibilities for external communications, including press releases, working with MGE's outside communications consultants, internal communications and communicating to the public with respect to various MGE activities. (Tr. 1964:2-15) In spite of this, Hyneman urges the elimination from cost of service 100% of Snider's costs!

The functions, set out in Snider's job description, and conceded by the Staff, clearly extend beyond "legislative" activities. Moreover, the phrase "legislative activities" encompasses activities beyond the narrower activity of "lobbying." The evidence in this case demonstrates that Mr. Snider spends less than 50% of his time on "legislative" activities and even a lesser amount of time, if any, on "lobbying." As a practical matter, given the length of the Missouri legislative session, it is obvious that even if Mr. Snider "lobbied" for the entirety of the legislative session, the percentage of his time devoted to "lobbying" would be less than 50% and far below the 100% claimed by the Staff and OPC.

With respect to Oglesby and Hack, the evidence demonstrates that they spend less than 10% of their time, if any, on "legislative" matters, most, if not all of which would not fall under the accepted definition of "lobbying." (Ex. 15 at 4:14 to 5:5) In any given year it is possible that <u>none</u> of the activities undertaken by these three individuals can be fairly characterized as either "legislative" or "lobbying." (Tr. 1951:2-6)

Aside from the improper application of the term "lobbying," the basic problem with the proposed Staff and OPC adjustment is that it fails to come to grips with the fact that attention to legislative matters or the legislative process is a fundamental responsibility of operating a business affected with the public interest. Certainly no one would dispute that MGE, in serving the public, must monitor legislative activities and identify matters that impact the Company's operations. When laws are passed that affect the Company and its customers, this information must be communicated to appropriate MGE personnel. Sometimes as a result of new legislation, certain actions must be taken by the Company. Evaluating legislation that has been passed by the Missouri General Assembly in order to determine necessary and appropriate responses or conduct is not the same as "lobbying" or attempting to influence the decisions of public officials. As Oglesby explained:

> Furthermore, the notion that such activities are not a necessary part of operating a utility is fundamentally at odds with reality. MGE serves nearly 160 municipalities. We must communicate effectively with officials in those cities, which requires that MGE personnel know those people and visit them on a regular basis. We must also communicate effectively with our customers as well as various entities to whom those customers may look for information and service, including energy assistance providers, media outlets, and policy makers. In addition, it is simply unreasonable for the Commission to believe that a company of the size, geographic scope and complexity of MGE should ignore the legislative process. (Ex. 14 at 15:5-14)

Just because the Staff and OPC characterize an activity as "lobbying" and interchange the term with "legislative activities" or "community relations" does not necessarily mean that the undertaking does not involve a proper expense for ratemaking purposes. To the extent that the named employees are involved in the analysis of legislation, both proposed and enacted, and the dissemination of this information within the Company and to customers, the costs related to these activities are necessary expenses which benefit customers and are a legitimate cost of doing business which should be recovered through rates. The Staff and OPC do not provide a sufficient basis to prevail on this issue simply by unfairly and inaccurately characterizing all of these activities as "lobbying."

In the final consideration, it is clear that the Staff and OPC have incorrectly represented the amount of time Snider, Oglesby and Hack spend on what can fairly be characterized as "legislative" activities. Furthermore, the Staff and OPC have not made any effort to distinguish between "lobbying," on the one hand, and other "legislative" or "community relations" activities, on the other hand, activities which the Company would be expected to undertake in the prudent operation of its business, and the costs for which should be recovered through rates.

E. Incentive Compensation

This issue involves the appropriate level of incentive compensation expense to be included in rates in this proceeding. The issue has a value of approximately $210,000.

MGE currently has an incentive compensation plan that is composed of a customer service and a safety goal as well as a financial goal. (Tr. 1610:21-25) The Staff has recognized and allowed for ratemaking purposes those amounts of incentive compensation paid to Southern Union employees at both the corporate level and at the MGE divisional level which compensation is based on customer service and safety goals. The Staff, however, opposes rate recovery of any incentive compensation which is tied to financial goals based on the theory that such compensation and/or goals may be harmful to customer service. (Ex. 809 at 2:27-28; Tr. 1830:1-8)

There is no question that the aspect of the Company's incentive compensation plan to which the Staff objects is currently in effect and was in effect during the test year in this proceeding. Real dollars have been expended by MGE in compensating employees for services. Moreover, it appears that the Staff does not oppose rate recovery of these costs because it claims they were never incurred. Rather, the Staff's objection is based on the false premise of a risk of harm to customers. (Ex. 809 at 3:1-2). There is absolutely no evidence in the record, however, to support the notion that the Company's financially based incentive compensation program has harmed customers or somehow put customers at risk. The Staff's case on this point is based on groundless speculation and accordingly the Staff adjustment should be rejected.

What is not groundless speculation, however, is the fact that MGE's use of incentive compensation, including incentive compensation tied to "financial" goals, is well within the mainstream of market practices and is necessary for the Company to be able to attract and keep quality employees. Simply stated, it is a fact of life, given its competition with other companies for personnel. (Tr. 1612:8 to 1613:21, 1617:18 to 1618:12) Furthermore, use of an incentive compensation plan is the method which the Company, in the exercise of its management discretion, has chosen as the means to compensate its employees for the services they render. In fact, the Staff witness admitted that MGE's employees were providing safe and reliable gas utility service to its customers. (Tr. 1826:2-5) He also agreed that *what* and *how* MGE pays its employees is a management prerogative. (Tr. 1826:19 to 1827:1)

MGE's compensation plan is clearly consistent with the interests of its ratepayers. That is because the desire for MGE to achieve solid financial performance is driven to a considerable extent by customers' interests and thus benefits utility operations as a whole. Incentive compensation, which is awarded by MGE on the basis of achieving financial objectives, should be included in cost of service because it is in the best interest of the Company's customers to have a financially efficient utility providing service. Incentives to bring about this goal ultimately benefit customers. In fact, the Staff witness agreed that being efficient encompasses financial efficiency and that efficiency ultimately benefits customers (Tr. 1830:9 to 1831:1):

Q. [TO MR. EAVES] And would you also agree that this Commission should encourage those utilities under its jurisdiction to be efficient?

A. Yes, I think that's correct.

Q. And is that because efficiency ultimately benefits customers?

A. Yes, I think efficiency would lead to decreased costs, thereby benefitting the ratepayers. Yes.

Q. And being efficient would encompass financial efficiency, would it not?

A. Yes.

(Tr. 1830:12-22)

Given the testimony of this Staff witness, there is nothing in the record in this proceeding to support the underlying premise of the Staff's position -- that MGE's customers have been harmed or are at risk because of its incentive compensation plan. Nor is there any evidence to suggest that this Commission does not want its utilities to be financially efficient. In fact, MGE believes that just the opposite is true, that is, this Commission does want the utilities under its jurisdiction to operate in a financially efficient manner which will ultimately inure to the benefit of customers. The ruling on this issue in this case will clearly demonstrate the Commission's goals in this regard.

F. Corporate Expenses

1. New York Office

2. Lindemann/Brennan Salaries

These two issues involve the ratemaking treatment to be afforded the costs of certain Southern Union executive officers and their related support costs. The issue is worth approximately $656,000 in revenue requirement.[18]

Southern Union Company is run by an Executive Committee consisting of three people - George Lindemann ("Lindemann"), the Chairman of the Board and Chief Executive Officer; John Brennan ("Brennan"), the Vice Chairman of the Board; and Tom Karam ("Karam"), President and Chief Operating Officer. The Staff proposes to allow, for ratemaking purposes, all of the costs associated with Mr. Karam, but only part of the costs associated with Mr. Lindemann and Mr. Brennan. (Ex. 816 at 30:18-24). It is Staff's belief, according to its prefiled testimony, that Mr. Lindemann and Mr. Brennan function more as "active board members" of Southern Union than as "executive officers" and as such, the fully allocated portion of their costs should be disallowed. (Ex. 816 at 30:18 to 31:5). In addition, the Staff proposes to disallow certain related costs associated with the two administrative support personnel and office space located in New York City. Once again, the Staff proposes adjustments which, if adopted by the Commission, will eliminate from rate recovery real and necessary costs incurred by the Company to run the business, thereby denying MGE the opportunity to earn its authorized rate of return.

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[18] In connection with this issue, the Staff has requested that the Commission order Southern Union to keep certain time reports on the amount of time which corporate employees spend on what the Staff characterizes as "merger and acquisition activities." (Ex. 816 at 34:17-20) This request should be denied. (*See* pp. 90-91, *infra.*)

The underlying basis for Staff's position on these issues did not become apparent until the hearing. At the hearing, Staff witness Hyneman acknowledged that Lindemann and Brennan did, in fact, provide more of an executive officer type of service for the Company than do regular board members. (Tr. 1758:4-9). For this reason, the Staff supports allowing more of the costs of Lindemann and Brennan to be passed through to Missouri ratepayers than the costs associated with the other Southern Union Board members. *Id.*

The Staff however makes the unsupported "judgment" that the *value* of service provided by Lindemann and Brennan does not rise to the point that the Staff can recommend the entire amount of the allocable compensation be recovered through rates, (Tr. 1761:17 to 1762:20), despite the fact that Staff's witness makes clear in his testimony that he "didn't get into value." (Tr. 1758:10-14). Hyneman went so far as to testify that Staff's disallowance was simply a "judgment call." (Tr. 1762:21 to 1763:2).

Part of Staff's evidence to support their belief, or "judgment call," is that Lindemann and Brennan are incapable of performing duties *unless* they are physically present at Southern Union's corporate offices in Wilkes-Barre, Pennsylvania. For example, Hyneman testified that while he *believes* Karam is at the Wilkes-Barre, Pennsylvania office on a day-to-day basis, "Mr. Lindemann hasn't been to Pennsylvania in, I know, the last twelve, fourteen months." (Tr. 1763:8-9). Hyneman offered nothing to support his *belief* concerning Karam's whereabouts and further made no mention of where he thought Brennan might have spent his time. Hyneman is of the opinion that neither Lindemann, the Company's Board Chairman and CEO, nor Brennan, the Vice Chairman, can provide executive office service for MGE unless they are physically located in Wilkes-Barre, at Southern Union's corporate office, when providing that service!

In other words, Staff has made a "judgment call" that neither Lindemann nor Brennan can contribute to the management affairs of Southern Union without being physically present at Southern Union's headquarters, (Tr. 1772:16-22), and thus the majority of these costs should be disallowed. Amazingly, however, Hyneman did not know where Lindemann and Brennan were physically located when they performed those services for Southern Union which the Staff *is* recognizing in rates in this case. (Tr. 1765:12 to 1766:6). Given all of this, it is clear that the Staff proposed disallowance is nothing more than an unsupported, arbitrary and speculative adjustment.

Under Southern Union's corporate structure, the executive management team, including its Executive Committee, consists of its Board Chairman and CEO; its Vice Chairman; and its President and COO. These individuals provide the corporate leadership and expertise necessary for the Company to be able to provide gas service in Missouri through its MGE operating division. The Executive Committee has the authority to exercise all of the powers of the board in the management of the business, property and affairs of the Company. (Ex. 18 at 6:5-14). The three members of the Executive Committee, including Lindemann and Brennan, are actively involved in the day-to-day management of the Company. (Tr. 1332:3-9) The evidence demonstrates that Lindemann and Brennan and their support staff are fairly compensated for the services that they provide to Southern Union. (Ex. 18 at 7:1-14).

Moreover, these are essential services. Lindemann, the Chairman and CEO, and Brennan, the Vice Chairman, lead Southern Union's executive management team and their contributions as executives help to promote fiscal discipline throughout the Company, including the MGE operating division, thus benefiting both ratepayers and shareholders alike. (Ex. 18 at 8:1-15). Consequently, the fully allocated share of *all* of the costs associated with Lindemann and Brennan, including the related administrative support and office space costs, should be allowed in rates.

G. Class Cost-of-Service/Rate Design

1. Class Revenue Responsibility

This issue involves the assignment of revenue responsibility as among or between the customer classes—inter-class revenue responsibility. (Ex. 23 at 20:16-17) The starting point for determining class revenue responsibility is typically a class cost-of-service study or, as in this case, a set of class cost-of-service studies. Class cost-of-service studies seek to assign cost responsibility based on cost causation principles by classifying all cost elements as customer-related, demand-related or commodity-related. (*Id.,* at 21:1-9) The vast majority of the cost of service elements for a natural gas local distribution company like MGE are either customer- or demand-related. (*Id.*, Sch. FJC-3 at 2-7) Customer-related costs, such as the meter, depend on the number of customers served. (*Id.,* at 21:2-4) Demand-related costs, such as city gate measurement and regulation equipment, depend on the maximum delivery requirements of the distribution system. (*Id.,* at 21:4-6)

In determining class revenue responsibility in this case however, the Commission needs to keep in mind that although " . . . reliance on a cost of service study to design rates would produce cost based rates, other factors, such as the magnitude and impact of required increases on the individual rate classes should temper the use of the results." ***Re: Missouri Gas Energy***, 7 Mo. P.S.C. 3d 394, 418 (1998).

The class cost-of-service studies conducted by MGE, the Staff and OPC show the following class revenue responsibilities:

	Residential	Small General Service	Large General Service	Large Volume Service
MGE	75.37%	17.09%	1.00%	6.54%
Staff	72.03%	18.87%	1.03%	8.07%
OPC	62.95%	21.79%	1.43%	13.83%

(Ex. 25 at 22:8-10 as corrected by Ex. 26 at 30:18 to 31:2)

In addition to the significant revenue requirement differences among the parties, the different conclusions result largely from the differing treatment of two factors: 1) the way in which the cost of mains is allocated to the customer classes and 2) the way in which automated meter reading ("AMR") equipment is allocated to the customer classes.

On the basis of zero-intercept methodology, MGE classified 34.7% of the investment in mains as being customer-related and 65.3% as demand-related. (Ex. 23 at 24:8 to 25:7) The Staff classified 28.3% of mains investment as being customer-related. (Ex. 25 at 24:4-5) OPC, on the other hand, using a relative system utilization methodology ("RSUM"), classified investment in mains as being entirely demand-related, thus OPC allocated none of the mains cost based on the number of customers served and effectively shifts costs away from the Residential class and towards the other customer classes. (Ex. 25 at 24:5-16) One fallacy in OPC's approach is that in classifying none of the mains investment as customer-related the RSUM method ignores the fact that absent the construction of mains, customers would not have access to the gas distribution system. In fact, the Commission has determined at least once already that "[A]pplication of Public Counsel's modified RSUM method of allocating costs of distribution mains results in an over-allocation of costs to LVS customers." ***Re: Missouri Gas Energy***, 10 Mo. P.S.C. 3d 1, 27 (2001).

MGE uses AMR equipment (amounting to an investment of approximately $34 million) to read the meters of system sales customers (primarily in the Residential, Small General Service and Large General Service classes) remotely by way of four trucks driving through its service territory instead of dozens of traditional meter readers who read meters manually. (Ex. 25 at 25:14-18; Ex. 15 at 3:6-10) MGE classified AMR investment as customer-related because the level of AMR investment varies directly with the number of customers on which the AMR equipment is installed. (Ex. 25 at 25:20-23) Neither the Staff nor OPC recognize AMR equipment as being solely customer-related and thus both classify a portion of AMR investment as demand-related. As a result, both the Staff and OPC understate the responsibility of the Residential class for AMR equipment. (Ex. 25 at 25:23 to 25:16)

In summary, because OPC's RSUM method over-allocates mains costs to the LVS class and because both the Staff and OPC under-allocate AMR costs to the Residential class, MGE's class cost-of-service study is the most accurate measure of class cost responsibility in this record. Therefore, the Commission should adopt the class revenue responsibility recommended by MGE in setting rates in this case. The revenue responsibility of each class, expressed as a percentage as shown above in the preceding table, should be multiplied by the Commission-adopted revenue requirement to determine the class revenue level on which rates would be set.

Alternatively, if the Commission declines to adopt MGE's recommendations as to class revenue responsibility, then any rate increase authorized in this case should be allocated to the customer classes based on current class revenue responsibility, resulting in an equal percentage increase for each customer class. (Ex. 25 at 28:1-8)

2. Fixed Monthly Rate Elements

MGE seeks to increase fixed monthly rate elements to the following levels: residential-$13.55 (from $10.05); small general service-$18.30 (from $13.55).[19] (Ex. 23 at 28:18 to 38:2) Because MGE understands the issue with respect to fixed monthly rate elements to involve only the residential and small general service classes, the balance of MGE's brief on this point will address only these classes.

The Staff proposes only a nominal increase to MGE's fixed monthly rate elements for the residential class. (Tr. 2232:7 to 2233:11). OPC opposes any increase to MGE's fixed monthly rate elements for the residential class. (Ex. 212 at 11:2-5)

The proposals of the Staff and OPC will increase MGE's exposure to variability in revenue streams, a problem which has historically caused MGE to suffer consistent earnings shortfalls.

a. The Staff and OPC proposals unreasonably increase reliance on volumetric revenue recovery, exacerbating MGE's historical earnings shortfall problem.

Residential customers comprise about 85% of MGE's customer base. (Tr. 2237:13-18) Both the Staff and OPC acknowledge that approximately 55% of MGE's

[19] For the two other customer classes MGE has proposed the following fixed monthly rate elements: large general service$112.40 (from $83.25); large volume service-$614.00 (from $409.30). MGE has also proposed that the multi-meter discount applicable to the large volume service class would be retained such that the increased fixed monthly rate element applicable to large volume service customers would apply only to two meters at a single address or location and the charge for meters in excess of two at a single location would be held at the current level of $204.65). (Ex. 25 at 38:14 to 40:3) With this change, it is MGE's understanding that no party objects to the fixed monthly rate elements MGE has proposed for these classes.

current residential distribution revenues are derived from fixed monthly rate elements and the remaining 45% of MGE's current residential distribution revenues are derived from volumetric rate elements. (Tr. 2167:10 to 2168:23; Tr. 2233:12-24) Both the Staff and OPC have also admitted that their fixed monthly rate element proposals for the residential class will, if adopted by the Commission, increase the proportion of residential distribution revenues MGE derives from volumetric rates. (Tr. 2168:24 to 2169:18; Tr. 2233:25 to 2234:20) In fact, the witness for the Staff, which proposes at least a nominal increase in the fixed monthly rate element for the residential class and is therefore less extreme than the OPC proposal, testified as follows:

> Q. [MGE COUNSEL] Would you agree, therefore, that one result of adopting your proposal would be an increased reliance on volumetric rates to recover residential revenues for MGE?
>
> A. [MR. BECK] I think the – there would be a reduction in that – in that 55/45 percentage split. So I think that would be a true statement.
>
> Q. And so – yeah. The –
>
> A. From a percentage-wise, that would be a true statement. Obviously there would be more revenue being collected, **but there would be a lot more revenue being collected on the commodity side.**

(Tr. 2233:25 to 2234:12) (Emphasis supplied)

By seeking to increase MGE's reliance on volumetric revenue streams, the Staff and OPC residential fixed monthly rate element proposals ignore the fact that MGE has historically experienced an inability to reach the use per residential customer used in the rate setting process. In fact, the record evidence establishes that for at least the last five fiscal years, MGE has never—not even once—achieved actual average use per residential customer equivalent to the rate case average use per residential customer:

Fiscal Year	Actual Annual Regular Bill Usage (Ccf)	Rate Case Regular Bill Usage (Ccf)
1999	889.0	1,047.4
2000	820.0	1,047.4
2001	1,021.7	1,047.4
2002	805.1	965.8
2003	919.7	965.8

(Ex. 23 at 8)

This evidence has not been disputed, nor has it even been mentioned by the Staff or OPC. The result is unfortunate – MGE has been consistently unable to achieve the revenue levels that were used to set rates and, thus, has not had a reasonable opportunity to achieve the rates of return authorized by the Commission.

The variability of customer usage on MGE's system as shown above is substantial, capable of swinging more than 200 billing units from year to year. With its heavy reliance on volumetric revenue recovery, the current rate design causes significant revenue swings. Ignoring the significant risk MGE has experienced historically related to volumetric residential revenue streams will not make that risk disappear. Furthermore, ignoring the significant risk MGE has experienced historically related to volumetric residential revenue streams, as both the Staff and OPC proposals on the residential fixed monthly rate element would apparently have the Commission do, is not a rational way to set prospective rates. If there is a problem—and the evidence demonstrates that heavy reliance on volumetric rate elements at the residential level is a significant driver of MGE's consistent historical earnings shortfall problem (Ex. 23 at 8:1 to 9:16: Ex. 25 at 30:20 to 31:9)—then action should be taken to help address the problem.

* * *

The residential fixed monthly rate element proposals of the Staff and OPC, if adopted by the Commission, will only exacerbate the historical problem created by MGE's heavy reliance on residential volumetric rate elements. MGE's proposal for residential and small general service fixed monthly rate elements, on the other hand, is a rational response to help mitigate that problem and should therefore be adopted by the Commission.

3. Volumetric Rate Elements

MGE has experienced significant revenue shortfalls over the past several years due to actual average per customer usage falling short of average per customer usage assumed in the rate setting process. (Ex. 23 at 8) To help address this problem, MGE has proposed the implementation of either a weather mitigation rate design similar in structure to that which the Commission recently adopted for Laclede Gas Company, or a more straightforward weather normalization clause.

Both the Staff and OPC recommend that the vast majority of any revenue increase authorized in this case be recovered by way of volumetric revenue streams. Nevertheless, both oppose the implementation of any meaningful rate structure changes for volumetric rate elements applicable to the residential and small general service classes that could help alleviate the problem MGE has experienced with variability in volumetric revenue streams.

a. The Staff and OPC proposals unreasonably fail to mitigate variability in revenue streams associated with the current rate design's heavy dependence on volumetric revenue recovery.

In 2002, the Commission approved a form of weather mitigation rate design for Laclede Gas Company. ***Re: Laclede Gas Company***, Case No. GR-2002-0356, Report and Order (November 18, 2002). In ***Laclede***, the Commission discussed the company's need for weather mitigation rate design and made a number of findings, including the following: "[G]as distribution companies are well-known to be weather-sensitive with respect to sales, revenues and gas costs[.]" (*Id.*, at 12); "[E]xcept for the cost of gas, most of Laclede's operating costs are fixed and do not vary with fluctuations in weather[.]" (*Id.*); and "Thus, since Laclede has used a volumetric rate to recover one-half of its non-gas costs in the past, weather that is warmer than normal causes Laclede to under-recover its costs while weather that is cooler than normal causes Laclede to over recover its costs." (*Id.*)

In this case, the record evidence demonstrates that 1) MGE, like other gas companies, is weather-sensitive with respect to sales, revenues and gas costs; 2) except for the cost of gas, most of MGE's operating costs are fixed and do not vary with fluctuations in the weather; and 3) volumetric rates are used to recover nearly one-half of MGE's costs of serving residential customers. (Tr. 2231:12-24; Tr. 2167:10 to 2168:23; 2233:12-24) Unlike the ***Laclede*** case, however, the evidence of record in this case does not indicate that MGE has at any time ever over-recovered its costs as a result of greater than expected revenues due to cooler than normal weather. Instead, the record evidence establishes that MGE has for the last five fiscal years consistently fallen short of volumetric sales and revenue projections assumed in the rate setting process. (Ex. 23 at 8) As indicated earlier, neither the Staff nor OPC nor any other party to this proceeding has disputed this evidence of volumetric revenue shortfalls, and resulting earnings shortfalls, actually experienced on MGE's system.

Despite the similarities of MGE's situation to the facts in ***Laclede***, however, and despite the fact the MGE's volumetric revenue history is actually worse than Laclede's -- because MGE has never been able to achieve sales above rate case projections -- both the Staff and OPC have opposed any meaningful form of weather mitigation rate design for MGE in this case. They advance a number of reasons for such opposition, but none of those reasons withstand even the most cursory review.

First, both the Staff and OPC have testified that the weather mitigation rate design was adopted for Laclede as an "experiment" and should not be adopted again for any other company until the "experiment" has run its course. (Ex. 804 at 16:3-7; Ex. 213 at 3-24) However, the Staff witness admitted on cross-examination that nowhere in the Stipulation and Agreement, Report and Order or implementing tariffs related to the Laclede rate case, Case No. GR-2002-0356, is the weather mitigation rate design ever described as being an "experiment" or adopted on an "experimental" basis. (Tr. 2235:3-24) Moreover, the Staff witness on this issue -- an individual with nearly twenty years of regulatory experience in Missouri -- also admitted that when this Commission adopts something on an experimental basis then it typically does so by directly and specifically designating that something as an "experiment." (Tr. 2235:25 to 2237:12) No such direct or specific "experimental" designation has been made by the Commission with respect to the weather mitigation rate design adopted for Laclede. Therefore, this so-called reason serves as no reasonable barrier to adopting a weather mitigation rate design for MGE.

Both the Staff and OPC assert a number of technical difficulties presented by weather mitigation rate design, ranging from the increased importance and complexity of getting the volumetric billing determinants correctly quantified and assigned to the proper rate blocks and the increased complexity of the actual cost adjustment ("ACA") process. These assertions deserve a number of responses.

First, if complexity alone is to rule out proposals, then the entire rate making process will come to a standstill. The purpose of creating an agency with the expertise to address technical and admittedly complex subject matter would be utterly defeated if the parties simply throw up their hands and cry "uncle" any time something "too complicated" comes up.

Second, MGE was very aware of the difficulties experienced in the development of the Laclede weather mitigation rate design and, as a consequence, was very careful to develop extensive detailed billing determinant information as necessary to quantify and assign the rate blocks properly. (Ex. 26 at 39:20 to 40:12)

Third, MGE is perhaps more aware than anyone of the importance of correctly quantifying billing determinants because, as the record evidence amply demonstrates, residential volumetric billing units have been consistently set too high in MGE's rate cases, with the resulting shortfall in actual average use per customer translating into millions of dollars in earnings shortfalls for MGE over the past five fiscal years. (Ex. 23 at 8:1 to 9:16; Ex. 25 at 30:20 to 31:9)

Finally, MGE has proposed as an alternative the implementation of a traditional weather normalization clause on an experimental basis because MGE understands that the weather mitigation rate design adopted for Laclede may be characterized as a "workaround" that is more cumbersome and less straightforward than the traditional weather normalization clause which has been adopted for natural gas local distribution companies in numerous jurisdictions throughout the country. (Ex. 25 at 34:1 to 38:12; Ex. 26 at 52:7-23)

Both the Staff and OPC also claim that mitigating the variability in MGE's volumetric-based revenue streams by a weather mitigation form of rate design would reduce MGE's business risk and therefore require a reduction to the return on equity indicated by the DCF model. (Ex. 804 at 17:17-24; Ex. 201 at 22:3-8) The Commission should question the legitimacy of these Staff and Public Counsel claims for a number of reasons. First, although the Staff and OPC are quick to argue for reductions in the DCF-indicated return on equity due to business risk mitigation, neither the Staff nor OPC proposed to increase the DCF-indicated return on equity to reflect the increased risk to which MGE's volumetric revenue streams would be exposed under the rate design proposals of the Staff (which is heavily weighted toward volumetric cost recovery) or OPC (which would be accomplished entirely through volumetric cost recovery). (Tr. 2169:13-23) Second, the record evidence shows that many companies included in the comparative company groups used by the Staff, OPC and MGE in their respective applications of the DCF model have weather normalization clauses in effect as a part of their existing rate structures. (Ex. 3 at 35:1-12) Consequently, the impact of the presence of such risk mitigation has already been accounted for in the DCF analysis and no further adjustment is needed. (*Id.*) Ultimately, a weather mitigation form of rate design should be adopted because, as established by the undisputed record evidence, MGE's actual average use per customer has consistently fallen short of the average use per customer assumed in the rate setting process. To suggest -- as both the Staff and OPC do -- that mitigating a problem which has directly resulted from the regulatory process itself and has directly caused MGE's actual earnings to fall short of Commission-authorized levels would require a further reduction in MGE's authorized earnings level is a classic Catch-22.

* * *

Neither the Staff nor OPC has disputed the evidence put forward by MGE that shortfalls in actual average per customer usage in comparison to average per customer usage assumed in the rate setting process has been a significant driver of MGE's lower-than-expected earnings over the past several years. Despite the link between MGE's historical earnings shortfalls and the current rate design's heavy reliance on volumetric revenue recovery, both the Staff and OPC propose that the bulk, if not all, of any rate increase authorized in this case be recovered by way of volumetric rate elements. Both have opposed any structural changes for residential and small general service volumetric rate elements that could provide any significant help with the earnings problem MGE has experienced with the current rate design. Adopting the rate design recommendations of the Staff and OPC will make the existing situation, which is problematic at best, even worse for MGE in terms of variability in revenue streams and likely earnings shortfalls. Consequently, the alternative weather mitigating forms of rate design proposed by MGE are the only reasonable rate design recommendations presented in this record regarding volumetric rate elements for the residential and small general service class. MGE therefore asks the Commission to adopt either the weather mitigation rate design based on the recently adopted Laclede structure or the weather normalization clause proposed by MGE on an experimental basis.

4. Miscellaneous Service Charges

The Commission should adopt MGE's proposal, which is supported by the Staff, to increase the following miscellaneous service charges: Connection-$45 (from $20); Reconnection-$45 (from $35); Transfer-$6.50 (from $5). (Ex. 23 at 19; Ex. 818 at 6:12 to 7:7). For purposes of this case, MGE has dropped its proposal to increase fees related to Reconnection at the Curb and Reconnection at the Main. (Ex. 25 at 19:10-20) Only OPC opposes these miscellaneous service charge increases, and the basis of OPC's opposition contradicts well-established cost causation principles.

a. The miscellaneous service charges proposed by MGE appropriately recover the cost of providing the services from the customers to whom the services are provided.

If the service charges proposed by MGE are not adopted, then an additional amount of approximately $1.3 million will need to be collected through a combination of fixed monthly rates and volumetric rates. (Ex. 25 at 18:19 to 19:20) In that event, customers who require Connection, Reconnection and Transfer services would be subsidized through higher distribution rates paid by all customers. (Ex. 25 at 20:13-19)

In opposing these proposed service charges, OPC argues that the increase is too large for residential customers to bear and criticizes the cost study supporting the proposed charges. (Ex. 209 at 18:8-11 and 21:14-15)

The magnitude of the increase in the Connection charge is largely driven by the fact that when the charge was approved for the first time in MGE's last rate case, it was set at a level that recovered approximately one-half of the cost to provide the service. (Ex. 26 at 27:12-20) Absent adjustment now, the relationship between the charge for the service and the cost to perform Connections will become further and further out of line over time, requiring even greater increases in the future if cost causation principles are to be followed. (*Id.*) Moreover, the $45 charge proposed by MGE for Connection and Reconnection is consistent with the charges approved for such services for Laclede Gas Company of $36 and $54, respectively. (Ex. 26 at 27:22 to 28:3)

OPC's criticisms of the cost study supporting the service charges proposed by MGE provide no reasonable basis for the Commission to reject those service charges. The significant point here is that none of these OPC criticisms refutes the evidence put forward by MGE in support of the proposed service charges. For example, whether it is possible to avoid certain costs, field personnel payroll for example, is not at all relevant to determining how to assign such costs appropriately to the causers of such costs. (Ex. 26 at 28:8-18). And although MGE disagrees with OPC's criticism about the inclusion of field personnel non-productive time in the cost study—because such costs are an inescapable element of the full labor cost associated with a field service employee—the use of this factor, as noted by Staff witness Imhoff, ". . . did not materially affect the rate calculation." (Ex. 818 at 7:22 to 8:2). Finally, even while acknowledging it is appropriate from a cost causation perspective, OPC argues that it is unfair to include missed appointments in the cost study because customers who keep appointments should not pay the costs associated with customers who miss appointments. This element of the cost study reflects a real cost of providing the service -- and removing it contrary to cost causation principles. Nevertheless, while not defensible based on cost causation principles, removing the cost of missed appointments and filed personnel non-productive time from the cost study would still produce a cost of approximately $41, well above the current level for such services ($20 for Connection, and $35 for Reconnection). (Ex. 26 at 29:11-23)

* * *

Adopting OPC's recommendation would result in customers who do not require Connection or Reconnection paying approximately $1.3 million each year in increased monthly and/or volumetric rate elements simply to subsidize those customers who do require such services. The Staff has reviewed MGE's cost study supporting the proposed service charges and has found the study to be reasonable. The Commission should reject OPC's arguments and adopt the miscellaneous service charges proposed by MGE.

H. Low-Income Proposals

1. Weatherization

MGE supports expanded funding of the existing low-income weatherization program—by $160,000 annually, to be apportioned among the regions of MGE's service territory according to the existing arrangement (e.g., of the total $340,000 in existing funding, $250,000 is administered by the City of Kansas City in the Kansas City metro area and $90,000 is administered by agencies throughout the balance of MGE's service territory)—because the program has been demonstrated to be effective and does not require significant administrative involvement of MGE personnel. (Ex. 10 at 31:6-17)

2. Experimental Low-Income Rate

MGE supports continuation of the existing experimental low-income rate ("ELIR") program in the Joplin area without any changes through July of 2006 or until funding runs out, whichever occurs first, because 1) the existing ELIR has not been operational long enough to generate data sufficient to adjudge the program either a success or a failure; 2) sufficient funds remain in hand to continue the existing ELIR without collecting additional amounts from residential customers to fund changes to the program; and 3) MGE has available resources to continue administering the existing ELIR as long as no changes are made to the program which would require additional administrative resources from MGE. (Ex. 10 at 31:19 to 32:7)

3. PAYS

MGE has demonstrated an extensive track record of support for and participation in energy affordability initiatives. MGE's activities in the low-income area include: 1) the employment of "customer advisors" whose primary responsibility is to help connect customers in need of energy assistance with providers of energy assistance; 2) the low-income weatherization program, initially in partnership with the City of Kansas City and later with other providers; 3) being the first energy utility in Missouri to implement a low-income rate; and 4) working to enhance the delivery of energy assistance to special needs customers and to expand utilization of Earned Income Tax Credits in Missouri. (Ex. 10 at 30:3-17; Ex. 14 at 13:22) Therefore, to characterize MGE's stance on energy affordability matters as uninvolved or uncommitted would significantly misstate the facts.

However, like all organizations, MGE's resources are not limitless. And like other organizations, MGE has a responsibility to focus its resources in the manner it best sees fit, recognizing that its core constituencies are customers, employees and shareholders. (Ex. 14 at 3:13-15) In light of these considerations -- as well as the fact that the Commission has not made any policy statement regarding energy efficiency initiatives such as PAYS in the course of its ongoing case looking at those matters (Case

No. GW-2004-0452) -- MGE is unwilling to implement the PAYS program. (Ex. 10 at 32:9-16)

I. Other Issues

1. Merger & Acquisition Recordkeeping

The Staff has requested that the Commission order Southern Union to keep certain time reports on the amount of time which corporate employees spend on what the Staff characterizes as "merger and acquisition activities." (Ex. 816 at 34:17-20) The request should be denied. First, the Staff's proposal has nothing to do with setting rates in a general rate case and is therefore not properly before the Commission in this proceeding. Second, assuming that the reporting requirement is otherwise appropriate, state law requires the Commission to follow the rulemaking process to implement it. The statutory definition of a rule is "each agency statement of general applicability that implements, interprets, or prescribes law or policy ... ." Section 536.010 RSMo 2000. A requirement that MGE maintain certain records meets the statutory definition.

The General Assembly has made clear that it will not tolerate agencies that seek to avoid the statutory rulemaking requirements. The law provides that any rules made that do not follow the procedure are deemed "null, void, and unenforceable." Section 536.021.7 RSMo 2000. There are several reported cases where Missouri courts have struck down actions by agencies that were determined to be rules but were applied without the agency following the statutory rulemaking process. *See*, e.g., ***NME Hospitals, Inc. v. Dept. Of Soc. Servs.***, 850 S.W.2d 71 (Mo. Banc 1993); ***Tonnar v. Mo. State Highway and Transp. Comm.***, 640 S.W.2d 527 (Mo.App. W.D. 1982); ***State ex rel. Gulf Transp. Co. v. Pub. Serv. Comm'n of Mo.***, 610 S.W.2d 96 (Mo. App. W.D.

1980). As a further deterrent, the General Assembly has enacted a remedy for persons damaged as a result of the agency's unwillingness to follow the statutory procedure. Section 536.021.9 RSMo 2000 contains the process whereby an aggrieved party can seek an award of attorney fees if the agency's action was based on a "statement of general applicability that should have been adopted as a rule."

2. Gas Purchasing Plan/Reliability Plan Reporting

Summary: The Commission should reject the Staff's ill-advised proposal to order MGE to file various plans because, if such a requirement is appropriate in the first place, state law requires the Commission to follow the rulemaking process to implement it. The Staff's proposal has nothing to do with setting rates in a general rate case and therefore does not even belong in this proceeding. Finally, the date of October 1, 2004, proposed by Staff for such reports is problematic, since if it were ordered, MGE could not produce them in a timely fashion as the operation of law date, and presumably the effective date of the Commission's order in this case, is October 2, 2004.

Rulemaking is the Appropriate Procedure: The Commission has enacted dozens of rules in the past and continues to enact new and revised ones, so it is quite familiar with the rulemaking process in Chapter 536 RSMo. According to the compilation on the Commission's website, its rules are apportioned into 32 chapters. The chapter that by its title applies only to gas corporations (4 CSR 240-40) contains ten rules, varying in length from 1 to 24 pages. In addition to prescribing standards, one of the major aspects of Commission rules is the requirement to submit filings either on a periodic or per incident basis. An example of this is 4 CSR 240-3, an entire chapter entitled "Filing and Reporting Requirements."

As the Commission has clearly recognized, rules are appropriate when the Commission mandates that similarly situated entities submit information in a uniform format. The statutory definition of a rule is "each agency statement of general applicability that implements, interprets, or prescribes law or policy ... ." Section 536.010 RSMo 2000. A requirement that gas companies submit data or information on a periodic basis in a uniform format meets the statutory definition. The 57 pages of filing and reporting requirements in 4 CSR 240-3 clearly indicate that the Commission understands this concept.

The Staff, apparently, does not. It has proposed in this rate case that MGE be ordered by the Commission to submit various reports relating to natural gas supply and planning. The requirement to file those reports has not been assigned a dollar value in this case. (Tr. 1641:11-16) That should at least raise the question about why something that is not an accounting, tax, expense, rate base, service, revenue, or rate design issue is even being considered in a general rate case.

The subject matter of the proposed reports is not particularly relevant to this discussion either. What is relevant is that the Staff obviously wants all of the gas companies that engage in generally the same activity to provide this same type of information on a periodic basis. The Staff has so far apparently persuaded other companies to provide at least some of the information periodically on a voluntary basis (Tr. 1649-1650, 1652), although the record is devoid of any evidence indicating what such companies actually provide.

The type of information Staff seeks from MGE is apparently the same as that some of the other gas companies are providing. (Tr. 1652) Staff witness Jenkins admitted: "I'm not asking for more [from MGE] than I'm getting from the others." (Tr. 1650:4-5) So the information and filing requirements Staff is seeking are apparently uniform and "of general applicability." Ms. Jenkins did not identify any category of information she sought that was unique to MGE.

This is not a situation where MGE is refusing to supply data or information in its possession. (Tr. 1653; 1655-1656) No one has taken away the Staff's right to send data requests asking for this information, or the Staff's right to depose MGE employees to obtain information. (Tr. 1653:6-11; 1654) MGE responds to the Staff's data requests in this subject matter area. (Tr. 1661-1662) So this is *not* a situation where the Staff has been willfully *denied access* to information that already exists. Instead, this is a situation where the Staff wants to establish a formal, institutionalized process whereby the gas company for the indefinite future will be required to submit specified types of information on a periodic basis. That is a legislative type of function and it sounds *amazingly* like a Commission rule!

The General Assembly has made clear in the statutes that it will not tolerate agencies that seek to avoid the statutory rulemaking requirements. The law provides that any rules made that do not follow the procedure are deemed "null, void, and unenforceable." Section 536.021.7 RSMo 2000. There are several reported cases where Missouri courts have struck down actions by agencies that were determined to be rules but were applied without the agency following the statutory rulemaking process. See, e.g., ***NME Hospitals, Inc. v. Dept. of Soc. Servs.***, 850 S.W.2d 71 (Mo. banc 1993); ***Tonnar v. Mo. State Highway and Trans. Comm.***, 640 S.W.2d 527 (Mo.App.W.D. 1982); ***State ex rel. Gulf Transp. Co. v. Pub. Serv. Comm'n of Mo.***, 610 S.W.2d 96 (Mo.

App. W.D. 1980). As a further deterrent, the General Assembly has enacted a remedy for persons damaged as a result of the agency's unwillingness to follow the statutory procedure. Section 536.021.9 RSMo 2000 contains the process whereby an aggrieved party can seek an award of attorney fees if the agency's action was based on a "statement of general applicability that should have been adopted as a rule."

Conclusion: What the Staff seeks to do here fits the definition of an administrative rule. If the Commission wishes to require all the gas companies to supply this information, the law requires the Commission to follow the statutory rulemaking process, as it has done numerous times and continues to do in other situations. The Commission should decide this issue by declining to follow the Staff down an unlawful path.

3. Legislative/Lobbying Time Reporting

The Staff has requested that the Commission order MGE to keep certain detailed time reporting records on what the Staff characterizes as "lobbying and lobbying related activities." (Ex. 816 at 10:5-7) The request should be denied. First, the Staff's proposal has nothing to do with setting rates in a general rate case and is therefore not properly before the Commission in this proceeding. Second, assuming that the reporting requirement is otherwise appropriate, state law requires the Commission to follow the rulemaking process to implement it. The statutory definition of a rule is "each agency statement of general applicability that implements, interprets, or prescribes law or policy ... ." Section 536.010 RSMo 2000. A requirement that MGE maintain certain records meets the statutory definition.

The General Assembly has made clear that it will not tolerate agencies that seek to avoid the statutory rulemaking requirements. The law provides that any rules made that do not follow the procedure are deemed "null, void, and unenforceable." Section 536.021.7 RSMo 2000. There are several reported cases where Missouri courts have struck down actions by agencies that were determined to be rules but were applied without the agency following the statutory rulemaking process. *See*, e.g., ***NME Hospitals, Inc. v. Dept. Of Soc. Servs.***, 850 S.W.2d 71 (Mo. Banc 1993); ***Tonnar v. Mo. State Highway and Transp. Comm.***, 640 S.W.2d 527 (Mo.App. W.D. 1982); ***State ex rel. Gulf Transp. Co. v. Pub. Serv. Comm'n of Mo.***, 610 S.W.2d 96 (Mo. App. W.D. 1980). As a further deterrent, the General Assembly has enacted a remedy for persons damaged as a result of the agency's unwillingness to follow the statutory procedure. Section 536.021.9 RSMo 2000 contains the process whereby an aggrieved party can seek an award of attorney fees if the agency's action was based on a "statement of general applicability that should have been adopted as a rule."

4. Response Time to Commission-referred Complaints/Inquiries

Summary: The Commission should reject the Staff's ill-advised proposal to order MGE to provide responses to customer complaints or inquiries referred to them by the Commission or its Staff within specified time periods because, if such a requirement is appropriate in the first place, state law requires the Commission to follow the rulemaking process to implement it. The Staff's proposal has nothing to do with setting rates in a general rate case and therefore does not even belong in this proceeding.

Rulemaking is the Appropriate Procedure: The Commission has enacted dozens of rules in the past and continues to enact new and revised ones, so it is quite familiar with the rulemaking process in Chapter 536 RSMo. According to the compilation on the Commission's website, its rules are apportioned into 32 chapters. The chapter that by its title applies only to gas corporations (4 CSR 240-40) contains ten rules, varying in length from 1 to 24 pages. In addition to prescribing standards, one of the major aspects of Commission rules is the requirement to submit reports or filings either on a periodic or per incident basis. An example of this is 4 CSR 240-3, an entire chapter entitled "Filing and Reporting Requirements."

As the Commission has clearly recognized, rules are appropriate when the Commission mandates that similarly situated entities submit information in a uniform format. The statutory definition of a rule is "each agency statement of general applicability that implements, interprets, or prescribes law or policy . . .." Section 536.010 RSMo 2000. A requirement that companies provide responses to customer complaints or inquiries referred to them by the Commission or its Staff within specified time periods in a uniform format meets the statutory definition. The 57 pages of filing and reporting requirements in 4 CSR 240-3 clearly indicate that the Commission understands this concept.

The Staff, apparently, does not. It has proposed in this rate case that MGE be ordered by the Commission to provide responses to customer complaints or inquiries referred to MGE by the Commission or its Staff within specified time periods. The requirement to provide responses within such specified time periods has not been assigned a dollar value in this case. (*See* Hearing Ex. 857) That should at least raise the question about why something that is not an accounting, tax, expense, rate base, service, revenue, or rate design issue is even being considered in a general rate case.

The subject matter of the proposed requirement is not particularly relevant to this discussion either. What is relevant is that the Staff obviously wants all of the companies that engage in generally the same activity to provide responses within the same time frames. (Tr. 1295:9 to 1296:10) The Staff has so far apparently persuaded other companies to provide responses within such time frames (Tr. 1295:15-21), so the response time requirements the Staff is seeking are apparently uniform and "of general applicability." But the Commission has approved such required response times only in the context of stipulated rate case resolutions. (Tr. 1296:11 to 1297:4) Staff witness Bernsen did not identify anything unique to MGE in seeking to impose this requirement without following rulemaking procedures.

This is not a situation where MGE is refusing to respond, or refusing to respond in a timely manner, to customer complaints or inquiries referred to it by the Commission or its Staff. (Tr. 1298:14 to 1299:5) In fact, Staff witness Bernsen acknowledged that MGE's internal response time objective is more rigorous than the response time requirement the Staff is asking the Commission to impose on MGE by order. (Tr. 1304:4 to 1305:7) So this is *not* a situation where the Staff has been willfully *denied access* to information that already exists. Instead, this is a situation where the Staff wants to establish a formal, institutionalized process whereby the company for the indefinite future will be required to provide responses to customer complaints or inquiries referred by the Commission or its Staff within specified time frames. That is a legislative type of function and it sounds *amazingly* like a Commission rule!

The General Assembly has made clear in the statutes that it will not tolerate agencies that seek to avoid the statutory rulemaking requirements. The law provides that any rules made that do not follow the procedure are deemed "null, void, and unenforceable." Section 536.021.7 RSMo 2000. There are several reported cases where Missouri courts have struck down actions by agencies that were determined to be rules but were applied without the agency following the statutory rulemaking process. See, e.g., ***NME Hospitals, Inc. v. Dept. of Soc. Servs.***, 850 S.W.2d 71 (Mo. banc 1993); ***Tonnar v. Mo. State Highway and Trans. Comm.***, 640 S.W.2d 527 (Mo.App.W.D. 1982); ***State ex rel. Gulf Transp. Co. v. Pub. Serv. Comm'n of Mo.***, 610 S.W.2d 96 (Mo. App. W.D. 1980). As a further deterrent, the General Assembly has enacted a remedy for persons damaged as a result of the agency's unwillingness to follow the statutory procedure. Section 536.021.9 RSMo 2000 contains the process whereby an aggrieved party can seek an award of attorney fees if the agency's action was based on a "statement of general applicability that should have been adopted as a rule."

Conclusion: What the Staff seeks to do here fits the definition of an administrative rule. If the Commission wishes to require all the gas companies to supply this information, the law requires the Commission to follow the statutory rulemaking process, as it has done numerous times and continues to do in other situations. The Commission should decide this issue by declining to follow the Staff down an unlawful path.

5. GM-2003-0238 Cost and Allocation Study Issue

This issue concerns whether the Commission should order MGE to complete and file a study concerning the impacts of the Panhandle Eastern Pipeline acquisition on Southern Union's administrative and general expenses and cost allocation method.

It is the position of MGE that there is no reason for the Commission to order the Company to complete and file a study. In fact, MGE has fully complied with the requirement to perform and provide the study called for in paragraph III.3.G. of the Stipulation and Agreement approved by the Commission in Case No. GM-2003-0238.

That paragraph of the Stipulation and Agreement provides as follows:

> Southern Union agrees that within six (6) months of the closing of the Transaction, it shall perform, provide, and discuss with all interested parties subject to a Commission protective order a study of the impact of the acquisition and operation of SUPC and its Successor Entities on Southern Union's structure, organization, and costs. This study will address the specific impacts of the acquisition and operation of SUPC and Successor Entities on Southern Union's administrative and general ("A&G") expense and cost allocation methodology. Southern Union will specifically identify the process used to allocate A&G costs and expenses to its regulated, merger and acquisition, sale and non-regulated functions of its regulated divisions as well as its non-regulated subsidiaries. Southern Union agrees that the types and availability of raw data necessary to perform allocations of corporate overhead costs shall be discussed at the meeting to occur within six (6) months of the close of the Transaction. The raw data to be discussed should include, but not be limited to, regulated and non-regulated information concerning customer numbers and billing information, revenue data, asset information (gross and net plant, etc.), management work time allocations, employee numbers and other payroll data, and the Missouri jurisdiction rate of return on investment ("ROR") and return on equity ("ROE"). The allocation procedures to be disclosed shall include, but need not be limited to, the use of cost allocation manuals, timesheets, time studies, and/or other means of tracking and allocating costs. The allocation procedures agreed upon should provide a means to identify and substantiate the portion of each individual corporate employee's time and associated payroll cost being allocated to Southern Union's regulated divisions.

Southern Union has complied with the study requirements of this paragraph. Within six months of the closing of the Panhandle acquisition, the Company prepared and provided to the Staff and the Public Counsel Southern Union's Joint and Common Cost ("JCC") Model as of June 30, 2003. Southern Union also updated this JCC Model through December 31, 2003, and provided that update to the Staff and Public Counsel. (Ex. 18 at 10:20-24)

Southern Union also prepared and provided to the Staff and Public Counsel a special study of staffing changes in the corporate organization occurring between June 30, 2003 (less than three weeks following the closing of the acquisition) and December 31, 2003. (Ex. 18 at 10:26-29)

These actions by Southern Union fulfill the special study requirements of paragraph III.3.G. of the Panhandle stipulation. There is no record evidence in this case to the contrary. No further action is required.

J. True-Up Issues

1. Rate Case Expense

MGE seeks to include in rates expenses actually incurred to prosecute this rate proceeding through June 30, 2004 on the basis of invoices received up to the date of the true-up hearing. (Ex. 49 at 5:4-12) Since the evidentiary hearing concluded on July 2, 2004, this means that post-hearing work is not included in the rate case expense MGE seeks to recover. (*Id.*) Consistent with its position in the initial phase of the case, MGE has proposed to normalize this actual rate case expense over three years, resulting in an annual cost of service amount of $461,111. (*Id.,* at 5:9-10) However, if the rate relief granted by the Commission in this case is sufficient to enable the resulting rates to remain in effect for four years, MGE believes that a four-normalization would be appropriate, resulting in an annual cost of service amount of $345,833. (*Id.,* at 5:10-12)

Both the Staff and OPC propose to disallow significant amounts of rate case expense that MGE has actually incurred, alleging that such disallowed costs are either unreasonable, unnecessary or both. (Ex. 234 at 1:14-17; Ex. 861 at 3:8-9) In support of these arguments, both the Staff and OPC significantly rely on the amount of rate case expense included in rates from MGE's first two rate cases, processed in 1996 and 1998. (Ex. 234 at 2:1-9; Ex. 861 at 3:15-20)

It was clear, however, that in placing such significant reliance on the rate case expense from MGE's 1996 and 1998 rate cases, neither the Staff nor Public Counsel gave any consideration whatsoever to the outcome of MGE's 1996 and 1998 rate cases. (Tr. 2618:9 to 2620:12) In fact, the evidence establishes that the rates resulting from those cases were not sufficient to enable MGE to achieve its Commission-authorized rate of return. (Ex. 11 at 14:4-13) Despite the lack of success in these two MGE rate cases, both the Staff and OPC nevertheless seem to believe that MGE should have prosecuted this case in essentially the same fashion. This kind of "head in the sand" position may be acceptable to the Staff and OPC, but MGE cannot reasonably operate its business that way. When results are less than optimal, then it is reasonable to change the approach that was used to generate those less than optimal results and MGE did so in prosecuting this rate case. MGE chose to employ the services of Mr. Herschmann on the rate of return issue in this case because of his experience as a litigator in complex matters, his track record of success in significant complex litigation on behalf of Southern Union Company and the fact that rate of return is the most significant issue in this case, amounting to approximately $25 million or more than 90% of the value of all of the revenue requirement issues in dispute. (Tr. 2481:18 to 2483:3, 2484:16 to 2485:19; Hearing Ex. 857)

Claims have also been made about competitive bidding for certain services. However, the reality of prosecuting a rate case simply does not permit that luxury because the company does not know what positions the other parties are going to take until approximately five weeks prior to the time when the company is required to respond to those positions. (Tr. 2492:6-20) Company regulatory personnel are also required to undertake numerous other activities during the five-week period when it is drafting rebuttal testimony, including participating in local public hearings (four of them in this case -- Joplin, St. Joseph, Kansas City and Blue Springs) as well as participating in a week-long prehearing conference (in Jefferson City) and, therefore, this amount of time does not permit a competitive bidding process. (Tr. 2492:21 to 2493:9)

It was also clear that the Staff did not make any effort to examine underlying differences from rate case to rate case—such as different staffing levels at MGE and Southern Union—that may reasonably lead to a different level of rate case expense from one case to another. (Tr. 2611:4-13, 2628:5 to 2631:17) Nor did the Staff seem to have any idea whether consulting and legal fees -- the primary component of rate case expense -- had increased since MGE's 1996 and 1998 rate cases. (Tr. 2616:4 to 2617:8) Even in the absence of any meaningful analysis of factors which may have affected MGE's specific level of rate case expense over time and despite having no idea whether consulting and legal fees have increased since MGE prosecuted its first rate case in 1996, the Staff continues to insist that MGE's rate case expense in this case is excessive.

The Staff also suggests—for the first time in the true-up hearing even though it had the opportunity to review invoices much earlier (Tr. 2623:17 to 2624:15) -- that certain invoices submitted are insufficient. MGE disagrees and the subject invoices are now a part of the record so the Commission can see for itself. Moreover, each of these service providers has been a substantial participant in this proceeding with ample opportunity for the Staff to observe the nature, amount and quality of the work each has done. (Tr. 2625:16 to 2627:19)

In summary, neither the Staff nor OPC has put forward any reasonable basis to disallow rate case expenses MGE has actually incurred in the prosecution of this case. Therefore, one of MGE's alternative positions on this issue should be adopted.

2. Kansas Property Tax On Storage Gas

On July 2, 2004, property tax assessment authorities in the State of Kansas initiated the process of collecting *ad valorem* taxes on natural gas held on MGE's account by interstate pipeline and storage companies. (Ex. 49, Sch. MRN-2 at 4 of 6) This intended tax assessment is the result of new legislation recently passed in the State of Kansas. (Ex. 49, at 5:25 to 6:12, Sch. MRN-2) MGE has never before paid property taxes on gas held in storage in the State of Kansas. (Tr. 2531 10-19) MGE estimates that the tax will be approximately $1.3 million, based on storage balance allocations as of December 31, 2003. (Ex. 49 at 6:7) MGE has been advised that the tax will need to be paid, even though MGE plans to challenge the lawfulness of the newly enacted legislation. (*Id.*, at 6:7-8)

In light of the fact that all other property taxes included in MGE's revenue requirement in this case are based on plant balances as of December 31, 2003 -- similar to the Kansas property tax on storage gas -- MGE seeks to include this cost item in revenue requirement. (Tr. 2478:25 to 2480:7) Otherwise, this expense will not be supported by any revenue. (Tr. 2481:9-11)

However, MGE plans to challenge of this tax, and it is possible that the newly enacted legislation will be struck down. (Ex. 49 at 6:8) MGE would then be able to obtain a refund of any amounts collected unlawfully. In light of these plans by MGE, it would be reasonable for the Commission to grant MGE an accounting authority order ("AAO") in this case, similar to that which it has granted MGE in other cases, permitting MGE to defer any such Kansas property taxes on storage gas actually incurred for potential recovery in a future rate case. (Tr. 2480:8 to 2481:8) The Staff supports the granting of an AAO for this item in this case. (Tr. 2607:19 to 2608:25)

Re: Missouri Public Service, 1 M.P.S.C. 3d 200 (1991) is the primary case announcing the Commission's policy regarding AAOs. In that case the Commission stated

> The decision to defer costs associated with an event turns on whether the event is in fact extraordinary and nonrecurring. * * * Factors such as those proposed by Staff as criteria can influence that decision but the primary focus is on the uniqueness of the event, either through its occurrence or its size.
>
> The issues of whether the event has a material or substantial effect on a utility's earnings is also important, but not a primary concern. The company, under the USOA, is required to seek Commission approval if the costs to be deferred are less than five percent of the company's income computed before the extraordinary event. This five percent standard is thus relevant to materiality and whether the event is extraordinary but is not case-dispositive.

(*Id.* at 205-206.)

The standard for granting an AAO is clearly met in this situation since 1) MGE has never before had to pay these taxes in the State of Kansas, 2) the amount of the expense is significant, particularly since it will accrue annually unless the new law is struck down in which case any amounts paid will be returned to MGE, and 3) the tax is a pure expense in the sense that it creates absolutely no new business or revenue for MGE.

MGE therefore requests that the Commission either include the new Kansas property tax amount in rates or grant the requested AAO.

III. Conclusion

For all of the foregoing reasons, MGE respectfully requests that the Commission adopt its position on each of the contested issues in this proceeding.

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Respectfully submitted,

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Certificate of Service

I hereby certify that the foregoing has been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record on this 2nd day of August, 2004.