

\$100,000, which is more than three times the salary allowed to other board members.⁹²

Staff would also eliminate the costs of Lindemann's and Brennan's administrative support staff in the New York office.

Staff would impose this limit because it believes that Lindemann and Brennan are active board members, but are not actually involved enough in the day-to-day operations of the company to justify a larger salary. Staff supports this position by pointing out that Lindemann and Brennan maintain offices in New York, rather than at the corporate headquarters in Wilkes-Barre, Pennsylvania. Furthermore, Staff argues that Lindemann's and Brennan's calendars reveal that they spend most of their time at their homes in Florida rather than at Southern Union's offices.

MGE replies that Lindemann and Brennan lead Southern Union's executive management team. Lindemann is also chief executive officer of the company. Because of their contributions as managers who help promote fiscal discipline throughout Southern Union, which benefits both customers and shareholders, MGE contends that their salaries should be allowed in cost of service. MGE argues that Lindemann and Brennan are quite capable of leading the company from their homes in Florida.

The evidence supports Staff's adjustment. Lindemann's and Brennan's calendars reveal that they spend very little time at Southern Union's corporate offices. Although they can keep in touch by telephone, e-mail, and many other modern conveniences, their distance from the corporate office indicates that they are not heavily involved in the day-to-day operations of the corporation. Both men are also involved in owning and operating other business interests. Clearly, they do provide service to Southern Union as involved

⁹² Hyneman Direct, Ex. 816, Page 30, Lines 18-24.

board members, and Staff's adjustment properly recognizes that level of service. However, neither man is so involved in the day-to day operations of Southern Union as to justify an annual salary larger than the \$100,000 allowed by Staff. The costs of Lindemann's and Brennan's administrative support staff in the New York office will also be eliminated.

Revenue Allocation Issues

Once the Commission has determined the amount of revenue that MGE will be authorized to earn, it must determine the means by which that revenue will be collected from customers. Furthermore, it must determine the share of that revenue that MGE will collect from each customer class. That is the next set of issues.

12. Class Revenue Responsibility

Issue Description: *What is the appropriate level of revenue responsibility for each customer class to be used in calculating revenue?*

Class Cost of Service Issues:

This issue concerns the proper allocation of revenue responsibility among MGE's four revenue-producing classes: Residential, Small General Services, Large General Services, and Large Volume Services. In other words, what percentage of MGE's total revenue requirement should each class be required to pay?

An allocation of revenue among the various classes begins with a class cost of service study. Such studies seek to assign cost responsibility based on cost causation principles by classifying all cost elements as customer-related, demand-related, or commodity-related. The guiding principle is that the class that causes the cost should be required to pay rates that will allow the utility to recover that cost. For a local distribution

company like MGE, the vast majority of cost of service elements will be either customer or demand related.

There are two full class cost of service studies in the record: those of MGE and Public Counsel. In addition, the Federal Agencies' witness Gary Price evaluated the other studies and corrected a mathematical error in MGE's study. MGE's witness acknowledged his error in his surrebuttal testimony, and during the hearing, and agreed that Price's rebuttal testimony shows the corrected numbers for MGE's study.⁹³ The intervenor group comprised of Midwest Gas, UMKC, CMSU and Jackson County supports the use of the MGE study, as corrected, as the best available class cost of service study.⁹⁴ However, that group contends that MGE's study still overstates the costs attributed to the large volume service customers – largely because the large volume service customers are transportation service only customers – it just does so less than the other studies.⁹⁵

The percentage of revenue derived from each class under the various studies is shown in the following chart:⁹⁶

⁹³ Cummings Surrebuttal, Ex. 26, Pages 30-31, Lines 20-22, 1-2. Transcript, Page 2048, Lines 17-23.

⁹⁴ Initial brief at page 13.

⁹⁵ Johnston Rebuttal, Ex. 600, Pages 8-10.

⁹⁶ This chart is based on that appearing as Table 4, Price Rebuttal, Ex. 500, Page 13.

Description	Residential	Small General Service	Large General Service	Large Volume Service	Total
Current Rate Revenue Percentage	69.80%	20.56%	1.99%	7.65%	100.00%
MGE COS (corrected)	75.37%	17.09%	1.00%	6.54%	100.00%
Public Counsel COS	62.95%	21.79%	1.43%	13.83%	100.00%
Federal Agencies	75.09%	17.87%	0.80%	6.24%	100.00%

The differences between the cost studies largely derives from a disagreement on how to allocate the cost of mains, which are MGE's largest investment, representing about 39% of its total plant in service.⁹⁷ MGE uses a zero-intercept method to classify 34.7% of the investment in mains as being customer-related and 65.3% as demand-related. Public Counsel uses a relative system utilization methodology – know by the acronym RSUM – to classify investment in mains as entirely demand related.

The zero-intercept method used by MGE recognizes that when a main is built to reach a customer, a certain portion of the cost of the main will be incurred no matter how much gas the customer uses. Thus the cost of a zero inch main would be the customer-related portion of the cost of the main. The extra cost derived from installing larger mains, mains that are large enough to meet peak demand, would be the demand-related portion of the cost of the main.⁹⁸

⁹⁷ Cummings Rebuttal, Ex. 25, Page 23, Lines 20-21.

⁹⁸ Cummings Direct, Ex. 23, Pages 25-26, Lines 8-23, 1-7.

Public Counsel's witness James Busch testified that he allocated the cost of mains using a modified RSUM. Public Counsel's method seeks to identify the portion of capacity that corresponds to each month's demand and then allocate the costs that correspond to that capacity to the customers that use gas in that month.⁹⁹ Public Counsel's method allocates mains costs based only on demand and does not allocate any cost of mains to customer-related costs.¹⁰⁰ Public Counsel contends that its method recognizes that mains are in the ground to provide service throughout the year and not just at peak demand.¹⁰¹ Peak demand on MGE's system is driven by residential customers¹⁰² so minimizing the effect of peak demand tends to reduce the residential class' share of costs.

This is not the first case in which Public Counsel has used the modified RSUM method to allocate costs. In its consideration on remand of a prior MGE rate, the Commission rejected Public Counsel's RSUM method as over-allocating costs to the large volume service class.¹⁰³ The Commission will again reject Public Counsel's RSUM method as inappropriate.

Public Counsel's method, by treating all mains costs as demand related, ignores the fact that unless mains are constructed, at a cost, customers would not have access to the gas distribution system.¹⁰⁴ Furthermore, any gas distribution system must be built to accommodate peak demand, and peak demand on MGE's system is driven by residential

⁹⁹ Busch Direct, Ex. 212, Page 5, Lines 19-22.

¹⁰⁰ Busch Rebuttal, Ex. 213, Pages 2-4.

¹⁰¹ Busch Surrebuttal, Ex. 214, Page 3, Lines 9-15.

¹⁰² Ex. 610.

¹⁰³ In Re: Missouri Gas Energy, 10 Mo.P.S.C. 3d 1, 27 (2001).

¹⁰⁴ Cummings Rebuttal, Ex. 25, Page 25, Lines 3-8.

heating. Public Counsel's cost allocation method fails to recognize that fact and under allocates the cost of those mains to the residential and small general service customers that cause the systems peak requirement.¹⁰⁵ MGE's zero-intercept method recognizes the different nature of these costs and is a preferable method. As a result, the Commission finds that the class cost of service study presented by MGE, as modified by the Federal Agencies' witness provides the best estimate of the actual revenue that might appropriately be derived from each class

Revenue Requirement to be Assigned to Each Class:

The class cost of service studies are just the starting point in the Commission's determination of the amount of revenue that should be recovered from each class. As MGE's witness explained:

The simple fact is that any cost of service study necessarily entails simplifications and judgments. As a result, no study should be considered anything more than a guide to the regulatory authority as it decides how a revenue increase should be distributed among customer classes.¹⁰⁶

Class cost of service studies serve as a guide to the ultimate goal of just and reasonable rates, but the Commission does not need to slavishly adhere to any particular study.

Not surprisingly, the parties have varying recommendations about how to divide up the revenue recovery assignments. Public Counsel recommends that the percentage of the revenue requirement to be recovered from the residential and large general service classifications be held constant, while the bulk of the increased revenue is recovered from

¹⁰⁵ Price Rebuttal, Ex. 500, Page 10, Lines 5-9.

¹⁰⁶ Cummings Surrebuttal, Ex. 26, Page 33, Lines 4-7. The Federal Agencies' witness, Gary Price, expresses the same opinion at Price Rebuttal, Ex. 500, Pages 4-5, Lines 20-22, 1-2.

the Large Volume Class.¹⁰⁷ MGE recommends that the Commission determine rate increases based on MGE's class cost of service, or if it doesn't wish to do that, by simply allocating the revenue increase to customer classes based on current revenue percentages.¹⁰⁸ Midwest Gas, UMKC, CMSU, and Jackson County recommend that the percentage paid by the large volume class should be no larger than the level recommended in the MGE cost of service study, as corrected by the Federal Agencies witness Price.¹⁰⁹ Staff simply suggests that any rate increase be apportioned to the classes equally.¹¹⁰ Finally, the Federal Agencies recommend that the large general services class receive an increase that is only 75% of the increase allocated to the other classes.

The Federal Agencies' witness, Gary Price, includes the following table in his testimony:¹¹¹

Description	Residential	Small General Services	Large General Services	Large Volume Service	Total
Current Rate Revenue	69.80%	20.56%	1.99%	7.65%	100.00%
Federal Agencies COS	75.09%	17.87%	0.80%	6.24%	100.00%
Difference as a Percentage	7.57%	-13.09%	-59.94%	-18.32%	

Price's table suggests that currently the revenue that MGE collects from the residential class is under-recovering the costs assigned to the residential class by 7.57%. The

¹⁰⁷ Meisenheimer Direct, Ex. 208, Page 4, Table 1.

¹⁰⁸ Cummings Rebuttal, Ex. 25, Page 28, Lines 6-8.

¹⁰⁹ Initial Brief of Midwest Gas, UMKC, CMSU, and Jackson County at page 14.

¹¹⁰ Beck Direct, Ex. 803, Page 5, Lines 7-17.

¹¹¹ Price Rebuttal, Ex. 500, Page 14, Table 5.

revenue collected from other classes is over-recovering the costs assigned to those classes. However, all of the classes, except Large General Service, are currently within 20% of their appropriate revenue recovery assignment. Large General Services is the exception because as a class it is currently over-recovering its assigned expenses by almost 60%.

Price suggests that the Large General Service class' substantial over-recovery be ameliorated by assigning the Large General Service class only 75% of the system revenue increase. The remaining customer classes would receive the system average increase and would share proportionally any remaining revenue increase not assigned to the Large General Service class. For example, if MGE were granted a 5% increase in revenue, Large General Services would see an increase of 3.75% while the other classes would see an increase of 5.05%.¹¹²

The Commission will adopt Price's suggestion. That suggestion has the virtue of minimizing the only glaring inequity in the current class revenue assignments, while protecting the residential class, from the shock of the substantial rate increase that would be required to bring all classes into complete agreement with MGE's corrected class cost of service study.

13. Fixed Monthly Rate Elements

Issue Description: *What is the appropriate level and structure for fixed monthly rate elements including the residential customer charge?*

MGE recovers its distribution revenues from a combination of fixed and volumetric rate elements. Fixed rates are predetermined and do not vary with the amount of natural

¹¹² Price Rebuttal, Ex. 500, Pages 14-15, Lines 6-16, 1-3.

gas consumed in a month. Volumetric rates are added to the cost of the natural gas that is consumed in a given month. When a customer consumes less gas, either because of warm weather or efforts to conserve, he or she will pay less in volumetric rates. Obviously, when a customer pays less in volumetric rates, MGE receives less revenue, which it needs to cover its costs.

Currently, MGE recovers approximately 55% of its residential distribution revenues from fixed elements and the remaining 45% from volumetric rate elements. MGE would like to shift some of its revenue recovery from volumetric rates to fixed monthly elements to address a problem of earnings shortfalls resulting from decreased customer usage due to warmer than normal weather. As part of its effort to shift its revenue recovery, MGE wants to increase the fixed monthly rate for the residential and small general service customer classes. It would increase the customer charge for residential from \$10.05 to \$13.55 and for small general services from \$13.55 to \$18.30.

Public Counsel flatly opposes any increase in the customer charge and would require MGE to recover any rate increase through volumetric rates.¹¹³ Staff would allow MGE to increase the customer charge but only proportionally to current levels.¹¹⁴

High fixed monthly customer charges tend to defeat customer efforts to reduce their bill by conserving natural gas. As a result, the Commission finds that the public interest is best served by setting customer charges as low as reasonably possible. MGE's proposal to increase the residential customer charge from \$10.05 to \$13.55 would result in an increase of nearly 35% and is not reasonable. However, simply leaving the customer

¹¹³ Busch Rebuttal, Ex. 213, Page 4, Line 11.

¹¹⁴ Beck Surrebuttal, Ex. 805, Pages 9-20.

charges unchanged while allowing MGE to otherwise increase its rates would necessarily require that the vast majority of the rate increase be collected through volumetric rates.¹¹⁵ That result would not be fair to MGE because MGE is already having difficulty in recovering its costs under the current rate structure. An increased reliance on volumetric rate elements will only increase MGE's weather risk and reduce its chance to actually recover its costs, which for the most part do not vary with the weather or the amount of gas sold.¹¹⁶ The Commission finds that current ratio between fixed and volumetric rate elements, whereby MGE recovers approximately 55% of its residential distribution revenues from fixed elements, is appropriate. In order to be fair to the company and to its ratepayers, the Commission will order that the customer charge for the residential and small general service classes may be increased to an amount sufficient to maintain the current ratio between volumetric rate elements and fixed charges elements.

14. Volumetric Rate Elements

Issue Description: *What is the appropriate level and structure of volumetric rate elements?*

Volumetric rate elements are the flip side of the fixed monthly rate elements discussed in the previous issue. Volumetric rate elements allow MGE to recover its costs by adding a small amount to each volume measure of gas that it sells. Under its current rates, that amount is \$0.11423 per Ccf.¹¹⁷ MGE proposes that the Commission adopt a

¹¹⁵ A portion of the revenue increase would be collected through increased connection, reconnection, and transfer fees, which the Commission is authorizing elsewhere in this report and order.

¹¹⁶ Transcript, Page 2231, Lines 12-24.

¹¹⁷ Busch Rebuttal, Ex. 213, Page 6, Line 6.

weather-mitigation rate design for the residential and small general service rate classes to avoid volatility in the company's revenue stream. The rate design that MGE has proposed is based on the rate design that the Commission approved for Laclede Gas as part of a stipulation and agreement in Case Number GR-2002-0356.¹¹⁸

MGE's proposed weather mitigation rate design is fairly complicated; but, essentially, MGE's customers would pay more for the first block of gas they use during the winter months so that a greater percentage of delivery costs would be recovered in the first rate block. MGE also proposes to adjust the PGA to offset the bill impacts on small and moderate size users.¹¹⁹ The result of the proposed rate design would allow MGE to recover a greater percentage of its costs even when warm weather results in the sale and consumption of fewer units of natural gas.

Staff opposes MGE's weather mitigation rate design proposal, but Public Counsel voices the most vehement opposition. Public Counsel correctly points out that the proposed rate design would reduce MGE's risk associated with warmer than normal weather by effectively creating a second, fixed, customer charge.¹²⁰ As a result, customers would not receive as much of a benefit from warmer than normal weather. Furthermore, customers would have less ability to lower their bills by conserving energy. As the Commission found in its discussion of fixed rate elements, such a result is contrary to good public policy.

¹¹⁸ Laclede's rate design was approved as part of a stipulation and agreement but the parties bitterly disagreed about the implementation of the rate design, necessitating an emergency hearing and rejection and revision of the implementing tariffs. See Beck Rebuttal, Ex. 804, Pages 15-18.

¹¹⁹ Cummings Direct, Ex. 23, Pages 28-29.

¹²⁰ Busch Rebuttal, Ex. 213, Page 8, Lines 7-12.

Public Counsel also raises several legal arguments against MGE's proposed weather mitigation rate design. Those arguments are addressed in the Conclusions of Law section of this report and order. Based on its conclusions of law and the facts that it has found, the Commission concludes that MGE's proposed weather mitigation rate design must be rejected.

15. Miscellaneous Service Charges

Issue Description: *Should the Commission change the current tariffed charges for customer connects, standard customer reconnects, and transfer fees?*

MGE currently charges customers additional fees for providing certain services. In this case, MGE proposes to increase its connection fee from \$20 to \$45, its reconnection fee from \$35 to \$45, and its transfer fee from \$5.00 to \$6.50. Staff supports the requested fee increases but Public Counsel opposes them.

Public Counsel argues that the increases are unreasonably large and would be a burden on low-income customers. The connection fee in particular would increase by 125% and the reconnection fee would increase by 28.6%.¹²¹ Public Counsel is concerned that such large increases could be a barrier to the initiation or restoration of service.¹²² Public Counsel also attacked the validity of the cost study that MGE performed to evaluate the cost of performing the connections for which it is seeking increased fees. Public Counsel contends that the study should have looked at the incremental cost of providing

¹²¹ Meisenheimer Rebuttal, Ex. 209, Page 18, Lines 8-11.

¹²² Meisenheimer Rebuttal, Ex. 209. Pages 18-19, Lines 20-23, 1-7.

the connection and reconnection services, and instead included joint and common costs that should not properly be ascribed to those activities.¹²³

It is important to set the fees that MGE will charge for these services at a rate that will recover the actual cost of providing that service. These are services that are requested by a particular customer and general principles of cost causation suggest that the person responsible for a cost should be required to bear that cost. If the fee does not cover the actual cost of providing the service, other customers will be subsidizing the cost causer through higher than necessary base rates.¹²⁴ In other words, MGE incurs these costs. If they are not recovered through the increased fees, they will be recovered through base rates.

Public Counsel also suggests that the cost studies used by MGE to support its determination of the actual cost of providing these services overstate the actual costs because they do not measure the incremental cost of providing the service by excluding any allocation of joint or common costs associated with shared facilities or expenses needed to provide the company's other services.¹²⁵ There is no support for Public Counsel's suggestion that such fees should be calculated on an incremental cost basis. MGE is not attempting to price an optional service that it is offering for sale. Rather it is attempting to allocate the cost of providing a service to its customers. It is only fair that the customer using the service pay the costs associated with that service because those costs

¹²³ Meisenheimer Rebuttal, Ex. 209, Pages 20-22.

¹²⁴ Imhoff Direct, Ex. 818, Page 7, Lines 1-3. See also Cummings Rebuttal, Ex. 25, Page 20, Lines 16-19.

¹²⁵ Meisenheimer Rebuttal, Ex. 209, Pages 20-21, Lines 11-23, 1-6.

cannot be avoided. If the customer using the service does not pay those costs, they will be paid by other ratepayers.¹²⁶

Finally, Public Counsel challenges the inclusion of specific costs in MGE's study. In particular, Public Counsel disagrees with MGE's inclusion of field personnel nonproductive time in the cost study.¹²⁷ That would include such things as vacation, sick leave, holiday pay, training, and standby time.¹²⁸ MGE contends that those costs are a part of the cost of providing the service and are properly included in the cost study. Staff's witness Tom Imhoff agrees with Public Counsel's position on this question but concludes that MGE's inclusion of nonproductive time in the cost study did not materially affect the rate calculation.¹²⁹ In other words, the inclusion of nonproductive time in the calculations did not have a large enough effect to make any difference in the rate that MGE proposes to charge.

The Commission finds that the proposed fees for connection, reconnection, and transfer are consistent with MGE's actual cost of providing those services. Public Counsel's suggestions to the contrary are not supported by the evidence. While the connection fee is more than doubling, a substantial increase is needed because the connection fee was deliberately set at half its actual cost in the last rate case to avoid shocking consumers.¹³⁰ The Commission is mindful of the need to avoid shocking ratepayers and certainly does not wish to create a barrier that would prevent them from

¹²⁶ Cummings Rebuttal, Ex. 26, Page 28, Lines 12-15.

¹²⁷ Meisenheimer Rebuttal, Ex. 209, Page 22, Lines 6-10.

¹²⁸ Cummings Rebuttal, Ex. 26, Page 29, Lines 2-3.

¹²⁹ Imhoff Direct, Ex. 818, Pages 7-8, Lines 21-22, 1-2

¹³⁰ Cummings Surrebuttal, Ex. 26, Page 27, Lines 12-20.

obtaining gas service. However, ratepayers will not incur these fees frequently so the increased fees should not be a shock to their budgets.¹³¹

Low-Income Issues

16. Weatherization

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

MGE's ratepayers have provided funding for a low-income weatherization program since 1994. The weatherization program provides financial assistance to MGE's low-income customers to make improvements to their homes to improve energy efficiency. The average cost to weatherize a home in Missouri is \$2,600 and weatherizing a home can provide annual natural gas savings of as much as 23% and annual electric savings of about 12%.¹³² Aside from reducing the energy bill of the customer whose home is weatherized, the program also benefits all of MGE's customers by reducing MGE's expenses required to collect debts, by reducing the amount of late payments, and by reducing the amount of uncollectable bills.¹³³

Since the program began in 1994 over 800 homes have been weatherized. The current program requires little administrative support from MGE as, at least in Kansas City, the program is administered by the City of Kansas City.¹³⁴ The weatherization program is

¹³¹ Transcript Page 2022, Lines 9-25.

¹³² Ross Direct, Ex. 836, Page 15, Lines 16-23.

¹³³ Ross Direct, Ex. 836, Page 16, Lines 17-21.

¹³⁴ Jackson Direct, Ex. 300, Page 2.

quite popular and currently has a waiting list of more than 500 applicants in Kansas City.¹³⁵

The cost of the weatherization program is currently built into rates and recovered from MGE's customers through those rates.¹³⁶

MGE acknowledges that the weatherization program has been effective and does not require significant administrative involvement by MGE's employees. As a result, MGE proposes to increase low-income weatherization funding by \$160,000 to be allocated according to the existing proportions.¹³⁷ Of the \$340,000 in current funding, \$250,000 is administered by the City of Kansas City and \$90,000 is administered throughout the balance of MGE's service territory. If existing proportions were maintained, MGE's proposal would result in a \$118,000 funding increase for the weatherization program in Kansas City.

The City of Kansas City contends that the weatherization program has been very successful and cost effective, and asks for a funding increase of \$250,000 for the Kansas City service area. If current proportions are maintained, a total weatherization increase of approximately \$340,000 would be required to give the City of Kansas City an additional \$250,000 in weatherization funding.

During the course of the hearing, Staff, Public Counsel, and the City of Joplin filed a non-unanimous stipulation and agreement dealing with the three low-income issues. With regard to weatherization, that stipulation and agreement provides that weatherization funding should be increased by 15% across the board, totaling \$51,000 per year. The

¹³⁵ Jackson Direct, Ex. 300, Page 3.

¹³⁶ Transcript, Page 2408.

¹³⁷ Noack Corrected Rebuttal, Ex. 10, Page 31, Lines 6-17.

stipulation and agreement would also direct an additional \$50,000 per year to the City of Kansas City and \$50,000 to MGE's non-Kansas City, and non-Joplin service areas. Weatherization for the Joplin service area would be set at \$130,000 and would be included in the existing experimental low-income rate (ELIR) program, which is the subject of the next issue. Joplin currently receives \$31,000 in weatherization funding.¹³⁸ The non-unanimous stipulation also provides that the weatherization funding, as well as funding for all other low-income programs, would be recovered through volumetric rates rather than through a specific surcharge or adder on the customer's bill.¹³⁹ The total annual funding requirement of the programs proposed in the non-unanimous stipulation and agreement would be \$896,000.¹⁴⁰

MGE opposes the non-unanimous stipulation and agreement. As a result, Commission rule 4 CSR 240-2.115(2)(D) provides that the stipulation can only be treated as a statement of the positions of the signatory parties to which no party is bound. As a result, the Commission cannot "approve" or "disapprove" the stipulation and agreement. Instead, the Commission must address each issue on its own merits.

The Commission finds that the existing low-income weatherization program has been successful and should be continued with additional funding. The Commission is not, however, willing to increase funding beyond the amount requested by the company. The Commission will order that annual funding for the low-income weatherization program be

¹³⁸ Ross Rebuttal, Ex. 837, Page 16, Table.

¹³⁹ Transcript, Page 2409, Lines 2-5.

¹⁴⁰ Non-Unanimous Stipulation and Agreement, Attachment A.

increased by \$160,000 to a total of \$500,000. The additional funding is to be allocated consistent with the current funding plan.

17. Experimental Low Income Rate

Issue Description: *What, if any, modifications should be made to the existing Experimental Low Income Rate Program?*

The existing experimental low-income rate ("ELIR") was established in the Joplin service area as a result of the stipulation and agreement that resolved MGE's last rate case. The goal of the program is to make it possible for low-income ratepayers to pay their bills and thereby reduce MGE's bad debt expenses. Under the program, low-income ratepayers participating in the program receive a \$40 monthly bill discount if their household income is 50% or less of the federal poverty level, provided that they make timely payment of their gas bill. Participating ratepayers whose household income is 51%-100% of the federal poverty level receive a \$20 monthly bill discount. The program has been funded by an \$0.08 adder to all MGE residential customer bills.¹⁴¹ That adder, which expired in August 2003, collected enough funds to allow the program to continue at current levels until July 2006 without collecting any more funds from ratepayers.¹⁴²

MGE is willing to continue the current ELIR through July 2006, or until funding runs out, but opposes proposals to expand the program. MGE contends that the changes and expansion proposed by Staff, Public Counsel, and Joplin are too costly, would impose

¹⁴¹ Meisenheimer Direct, Ex. 207, Page 6, Lines 11-16.

¹⁴² Noack Corrected Rebuttal, Ex. 10, Page 32, Lines 3-5.

additional administrative requirements on MGE, and will likely complicate evaluation of ELIR results.¹⁴³

The non-unanimous stipulation and agreement provides that the ELIR will continue with some modifications: participation in the weatherization program will be required for ELIR participants; the bill discount levels will be revised; and the Joplin Community Action Agency will be asked to replace MGE as administrator of the ELIR. The stipulation and agreement would not renew the \$0.08 adder and would instead recover the cost of the program through volumetric rates.

The ELIR is an interesting attempt to make natural gas bills more affordable for low-income customers while ultimately saving money for MGE and its other ratepayers by reducing expenses that result from bad debts. However, it is only an experimental program and it has had problems. For example, nearly half of the participants that initially entered the program dropped out by January 2004.¹⁴⁴ The Commission is not willing to pour more ratepayers funds into this program, particularly without the agreement of MGE. The Commission will allow the program to continue in its current form through July 2006, or until funding runs out, whichever occurs first.

18. Experimental Energy Efficiency Programs including PAYS

Issue Description: *Should the Pay As You Save (PAYS) program proposed by the Office of Public Counsel be adopted?*

The Pay As You Save (PAYS) program is an experimental program designed to help residential ratepayers finance weatherization projects for their homes. It would essentially

¹⁴³ Noack Corrected Rebuttal, Ex. 10, Page 32, Lines 5-7.

¹⁴⁴ Ross Rebuttal, Ex. 837, Page 12, Lines 20-22.

loan money to the ratepayers to pay for new windows, insulation, a new furnace, etc. The ratepayer would pay back the loan by way of his or her monthly utility bill. The idea is that the savings from increased energy efficiency would lower the customer's monthly bills enough so that the loan could be repaid from the savings. The program would not necessarily be limited to low-income ratepayers and the seed money to make the loans could be provided by MGE or by some other lender.¹⁴⁵

The non-unanimous stipulation and agreement provides for a feasibility study to determine whether a PAYS program could be implemented in the Kansas City area. Funding for the feasibility study and a potential PAYS system would be set at \$100,000 per year for two years, collected through volumetric rates. MGE opposes the proposal to explore the development of a PAYS program as part of this rate case.

The Commission is interested in further consideration and development of the PAYS program. However, such consideration needs to take place in a broader setting than is afforded by MGE's rate case. The Commission agrees with MGE that this rate case is not the appropriate setting for the funding of such a study. As a result, the Commission will reject the proposal offered by Staff, Public Counsel, and the City of Joplin.

Requests by Staff to Require Action by MGE

Staff has asked the Commission to order MGE to take several specific actions regarding its operations. These requests are addressed in the following issues.

¹⁴⁵ Meisenheimer Direct, Ex. 207, Page 11, Lines 2-13 and Warren Rebuttal, Ex. 839, Page 3, Lines 7-20.

19. Merger and Acquisition Recordkeeping

Issue Description: *Should the Commission adopt Staff's proposal to order Southern Union to keep time reports related to merger and acquisition activities?*

Staff asks the Commission to order Southern Union to keep records of the time spent by Southern Union corporate personnel on merger and acquisition related activity. Staff is concerned that Southern Union is very involved in merger and acquisition activities, and would like to exclude such activities from Southern Union's revenue requirement in future rate cases but says that it cannot do so unless Southern Union's executives keep better time records to allow Staff to separate out the merger and acquisition activities.¹⁴⁶ Southern Union contends that the Commission has no authority to make such an order in a rate case. Instead, if the Commission wants to make such a requirement, it must do so through a rulemaking that would apply to all gas companies. This legal issue is addressed in the Conclusions of Law section of this report and order.

Based on its conclusions of law, the Commission finds that the order requested by Staff is not a rulemaking and that the Commission has the authority to issue such an order. However, the Commission finds that such an order is neither needed nor appropriate in this case. The Commission does not wish to attempt to manage either Southern Union or MGE by ordering the company to keep specific time records regarding merger and acquisition activities. If Staff, or any other party, wishes to obtain specific information from Southern Union or MGE, it may do so through the discovery techniques that are recognized and commonly used at this Commission. If, in a future rate case, Staff or another party wishes to propose an adjustment regarding merger and acquisition activities and the company has

¹⁴⁶ Hyneman Direct, Ex. 816, Pages 34-35, Lines 15-23, 1-2.

not kept sufficient records, the company will bear the risk of an imprecise adjustment, as it did in this case with the ordered adjustment for lobbying activities.

20. Gas Purchasing/Reliability Plan Reporting

Issue Description: *Should the Commission order MGE to submit by October 1, 2004, a Natural Gas Supply Plan (updated annually)? Should the Commission order MGE to submit by October 1, 2004, a Natural Gas Supply Reliability Analysis (updated every two to three years)?*

Staff is concerned that MGE is not doing enough to plan for the reliability of its natural gas supply and asks the Commission to order MGE to periodically submit such a plan, including a specific supply reliability analysis, which Staff insists be submitted by October 1, 2004, even though the effective date of this report and order will be October 2, 2004.¹⁴⁷ Staff indicates that it is simply seeking the same information from MGE that is already voluntarily provided by other gas companies.¹⁴⁸ But Staff adds that it is particularly concerned about MGE because it recently replaced its entire gas supply department.

MGE replies that it is doing all that it needs to do to assure that its supplies of gas are reliable. It states that it is perfectly willing to answer data requests and to open its records to Staff as required. However, it contends that the Commission has no authority in a rate case to order MGE to submit such reports. It further argues that if the Commission wants to make such a requirement it should do so through a rulemaking that would apply to all gas companies.

¹⁴⁷ See. Staff's Reply Brief at page 55.

¹⁴⁸ Transcript, Page 1649-1650.

Based on its conclusion of law regarding Issue 19, Merger and Acquisition Recordkeeping, the Commission finds that the order requested by Staff is not a rulemaking and that the Commission has the authority to issue such an order. However, the Commission finds that such an order is neither needed nor appropriate in this case. Staff has not presented any evidence that would indicate that MGE is not properly planning for its future gas needs. Staff has many discovery tools at its disposal to allow it to obtain any information from MGE that it believes it needs. If Staff believes that all gas companies should file such report, and Staff's witness indicated that other gas companies have supplied such reports voluntarily, then Staff should avail itself of the rulemaking procedures to promulgate a rule that will apply to all gas companies.

21. Legislative/Lobbying Time Reporting

Issue Description: *Should the Commission adopt Staff's proposal to order MGE to keep detailed time reporting on the amount of time employees spend on lobbying and lobbying related activities?*

Staff asks the Commission to order MGE to keep records of the time spent by its personnel on lobbying activity. Staff and Public Counsel have argued that lobbying activity should be excluded from MGE's revenue requirement in this and future rate cases but says that it cannot easily do so unless MGE's employees keep better time records to allow Staff to separate out the lobbying activities. Staff contends that MGE is already required to keep such records by Commission rule and wants an order requiring MGE to comply with those requirements.

MGE contends that the Commission has no authority to make such an order in a rate case. It further argues that if the Commission wants to make such a requirement it should do so through a rulemaking that would apply to all gas companies.

Based on its conclusion of law regarding Issue, 19 Merger and Acquisition Recordkeeping, the Commission finds that the order requested by Staff is not a rulemaking and that the Commission has the authority to issue such an order. However, the Commission finds that such an order is neither needed nor appropriate in this case. The Commission does not wish to attempt to manage either Southern Union or MGE by ordering the company to keep specific time records regarding lobbying activities. If Staff, or any other party, wishes to obtain specific information from Southern Union or MGE, it may do so through the discovery techniques that are recognized and commonly used at this Commission. Furthermore, if Staff believes that MGE is currently refusing to comply with Commission regulations, it may bring a complaint against MGE. Finally, if, in a future rate case, Staff, or another party, wishes to propose an adjustment regarding lobbying activities and the company has not kept sufficient records, the company will bear the risk of an imprecise adjustment, as it did in this case.

22. Response Time to Commission-referred Customer Complaints/ Inquiries

Issue Description: *Should the Commission order MGE to respond to Customer Complaints/Inquiries within three business days?*

Staff asks the Commission to order MGE to respond to Commission forwarded customer complaints/inquiries within three business days of receiving the complaint or inquiry. For interruption of service issues, the response time should be within twenty-four hours. Staff's witness indicated that there is not a particular problem at MGE but that it is

trying to hold all utilities to this standard.¹⁴⁹ Other companies have already agreed to this standard and Staff specifically mentions Missouri-American Water Company as one company that has agreed to this requirement in a stipulation and agreement.¹⁵⁰

MGE contends that the Commission has no authority to make such an order in a rate case. It further argues that if the Commission wants to make such a requirement it should do so through a rulemaking that would apply to all gas companies.

Based on its conclusion of law regarding Issue 19, Merger and Acquisition Recordkeeping, the Commission finds that the order requested by Staff is not a rulemaking and that the Commission has the authority to issue such an order. However, the Commission finds that such an order is neither needed nor appropriate in this case. Staff failed to show any reason why this order should be entered in this case. If this standard is appropriate for all utilities, then Staff should avail itself of the appropriate rulemaking procedure rather than attempt to impose the requirement on utilities one at a time.

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

Issue Description: *Should the Commission order MGE to complete and file a study concerning the impacts of the Panhandle Eastern Pipeline Company acquisition on Southern Union's administrative and general expenses and cost allocation methodology?*

In the unanimous stipulation and agreement that resolved the merger case regarding Southern Union's acquisition of Panhandle Eastern, Southern Union agreed to perform a study within six months regarding the effect of the acquisition on corporate cost allocations following the acquisition. Southern Union provided Staff with some information, but Staff

¹⁴⁹ Transcript, Pages 1294-1299.

¹⁵⁰ Bernsen Direct, Ex. 806, Page 9, Lines 10-16.

complains that Southern Union did not provide sufficient information regarding its merger and acquisition activities. Staff asks the Commission to order Southern Union to complete this study, file it in this case before the operation of law date for this order, and provide its completed study to the parties in the merger case.¹⁵¹ Southern Union replies that it has fully complied with all the requirements of the stipulation and agreement and that no action by the Commission is required.

This issue simply does not belong in this case. If Staff believes that Southern Union has failed to comply with a requirement of the stipulation and agreement in the merger case – GM-2003-0238 – it may file a motion in that case bringing the alleged failure to the Commission's attention. If any relief is needed, it will be granted in that case.

True-Up Issues

The next two issues arose for the first time at the true-up hearing.

24. Rate Case Expenses

MGE is entitled to recover its reasonable and prudently incurred cost of presenting this rate case to the Commission. Such costs are routinely accepted as a cost of doing business for which the company will be allowed to recover its costs in rates and no party disputes MGE's right to recover its rate case expenses in this case. There is a dispute, however, over how much MGE should be allowed to recover.

MGE has claimed \$1,383,333 in expenses relating to the presentation of this rate case. That figure does not include any amount for post-hearing work.¹⁵² MGE submitted statements from its attorneys and expert witnesses to support that amount. MGE suggests

¹⁵¹ Oligschlaeger Direct, Ex. 828, Pages 9-10, Lines 14-22, 1-18.

¹⁵² Noack True-Up Direct, Ex. 49, Page 5, Lines 4-12.

that rate case expense be amortized over 3 years, resulting in an annual cost of \$461,111, which would be included in MGE's cost of service for inclusion in the rates established for this case. MGE is also willing to accept a 4-year amortization at an annual cost of \$345,833 if the rates that result from this case are sufficient to allow them to remain in effect for four years.¹⁵³

Staff argues that that the rate case expenses submitted by MGE are not reasonable. In particular, Staff contends that the fees paid to MGE's New York law firm – Kasowitz, Benson, Torres & Friedman, LLP – are excessive, especially given what Staff asserts is that firm's inexperience in regulatory law. Staff also contends that MGE failed to present enough documentation to justify some of its submitted expenses. Staff's witness Charles Hyneman recommends that the Commission allow \$650,000 for rate case expenses because that is the amount the Commission found to be reasonable and prudent in MGE's last litigated rate case, GR-98-140. As an alternative, he recommends that the Commission allow recovery of \$750,000, which Staff claims is the highest amount of rate case expense ever allowed for a utility in a Missouri rate case.¹⁵⁴

The Commission finds that Staff's proposal to limit MGE's rate case expenses to an amount found to be reasonable in a previous rate case is completely arbitrary and capricious. There was no evidence presented that would allow the Commission to conclude that this case was so comparable to any other case that the Commission would be justified in placing an arbitrary limit on recovery of rate case expense. Furthermore, the rate cases that Staff would use to limit MGE's recovery took place five or six years ago.

¹⁵³ Noack True-up, Ex. 49, Page 5, Lines 4-12.

¹⁵⁴ Hyneman True-up, Ex. 861, Page 10, Lines 11-19.

When asked, Staff's witness could not even say whether attorney fees and consultant fees have increased since 1997.¹⁵⁵ Staff's proposal to limit recovery of rate case expense to the amounts recovered in earlier cases must be rejected.

Public Counsel also disputes MGE's request for rate case expenses, but Public Counsel would come at MGE's rate case expenses from the opposite direction. Public Counsel suggests that certain costs be removed from MGE's expenses as imprudently incurred. Specifically, Public Counsel would reduce the hourly fees charged by Kasowitz, Benson, Torres & Friedman, MGE's New York law firm, from \$690 per hour to \$200 per hour. That would allow only \$171,950 of that firm's charges to be recovered in rates, a reduction from \$614,000 requested by MGE. Public Counsel would also disallow \$47,522 in fees charged by MGE's Texas counsel, Watson Bishop London and Brophy, because the work that firm did was allegedly duplicative of the work done by Kasowitz, Benson, Torres & Friedman and MGE's Missouri counsel, Brydon, Swearingen & England. Public Counsel would also exclude \$36,303 paid to the law firm of MGE's witness John Quain. Quain, a former commissioner from Pennsylvania, offered public policy testimony that Public Counsel found to be insubstantial. Public Counsel would also reduce recovery of the fee that MGE paid to its witness, Dr. Morin, from \$30,000 to \$9,800. All of Public Counsel's adjustments would result in a total rate case expense of \$787,766.¹⁵⁶

Public Counsel contends that this amount is still too high. It would average its adjusted total of \$787,766 with the amounts allowed MGE for rate case expense in its last two litigated rate cases to arrive at an average of \$634,839, which it would amortize over

¹⁵⁵ Transcript, Page 2616, Lines 4-6.

¹⁵⁶ Bolin True-up Direct, Ex. 234, Page 13, Lines 9-16.

three years for an annual cost of \$211,613. As the Commission indicated when rejecting Staff's proposal, the arbitrary reliance on past rate cases to establish a limit on MGE's rate case expense recovery in this case is improper. Therefore, Public Counsel's proposal to further adjust its recommended rate case expense will be rejected.

However, the Commission will further examine Public Counsel's proposals to reduce specific rate case expenses for which MGE is seeking recovery. The first expense challenged by Public Counsel is the \$614,000 in bills submitted by Kasowitz, Benson, Torres & Friedman. That firm billed MGE at a rate of \$690 per hour and Public Counsel suggests that the hourly rate be reduced to \$200, which is the hourly rate charged by MGE's local counsel. At \$200 per hour, multiplied by 859.75 hours, the total bill from Kasowitz, Benson, Torres & Friedman would be \$171,950.¹⁵⁷ That amount does not include travel and meal expenses because at the time Ms. Bolin submitted her testimony those expenses were not properly documented. Additional invoices were submitted at the hearing and at least Staff's witness was satisfied that nearly all of the submitted expenses were now supported by invoices.¹⁵⁸ The expenses submitted by Kasowitz, Benson, Torres & Friedman, including travel and meal expenses, total \$16,250.75.¹⁵⁹

The Commission is hesitant to disallow expenses incurred by MGE in prosecuting its rate case. The company is entitled to present its case as it sees fit and the Commission will not lightly intrude into the company's decisions about how best to present its case. However, the Commission has a responsibility to ensure that the expenses that the

¹⁵⁷ Bolin True-Up Direct, Ex. 234, Page 8-9, Lines 11-22, 1-4.

¹⁵⁸ Transcript, Page 2638, Lines 8-21.

¹⁵⁹ Exhibit 51.

company submits to its ratepayers are reasonably and prudently incurred. Otherwise, the company could take a cost-is-no-object approach to its rate case presentation, secure in the knowledge that the ratepayers would be required to pay for any cost that the company might incur.

In this case, MGE, or perhaps Southern Union, chose to hire the Kasowitz, Benson, Torres & Friedman law firm out of New York. MGE explained that it chose that firm because it had previously represented Southern Union in other complex litigation and the company was very pleased with the results obtained in that case.¹⁶⁰ The other litigation for which the Kasowitz firm had represented Southern Union was, however, a merger and acquisition case and this case was the firm's first litigated regulatory rate case.¹⁶¹

Eric Herschmann and Michael Fay of the Kasowitz firm did a good job of representing their client at the hearing. But the firm charged up to \$690 per hour for its work. That rate is far higher than the typical rates charged by lawyers appearing before this Commission. The company is certainly entitled to hire lawyers with whom it is comfortable, but it would not be fair to require ratepayers to pay such high rates. The Commission will reduce the rate to \$200 per hour, which is the rate charged by MGE's local counsel. The \$16,250.75 in expenses incurred by the Kasowitz firm will be allowed. The total allowed for representation by Kasowitz, Benson, Torres & Friedman is \$188,200.75.

Public Counsel urges the Commission to disallow \$47,522 in fees charged by the Austin Texas firm of Watson Bishop London and Brophy. Public Counsel contends that the work done by that firm did was duplicative of the work done by Kasowitz, Benson, Torres &

¹⁶⁰ Transcript, Pages 2482-2483, Lines 24-25, 1-3.

¹⁶¹ Transcript, Page 2499, Lines 7-17.

Friedman and MGE's Missouri counsel, Brydon, Swearingen & England.¹⁶² MGE explained that Christine Dodds, an attorney with Watson Bishop, served as second chair for Eric Herschmann at the hearing. She assisted Herschmann in preparation of witnesses, issues, and cross-examination questions.¹⁶³ The Commission does not wish to disparage the work done by the Watson Bishop firm, but \$47,522 is more than ratepayers should pay for the services performed by the firm. The fees charged by Watson Bishop will be disallowed in their entirety.

Public Counsel would also exclude \$36,303 paid by MGE to Klett Rooney Lieber & Schorling, the law firm of MGE's witness John Quain. In fact, at the true-up hearing, an updated statement from Klett Rooney was admitted into evidence showing that the bill submitted by Klett Rooney totaled \$20,115, not \$36,303 as previously estimated.¹⁶⁴ Quain, a former commissioner from Pennsylvania, offered public policy testimony that Public Counsel found to be insubstantial. The Commission found Quain's testimony to be helpful and his fees will be allowed as a rate case expense.

Public Counsel would also reduce recovery of the fee that MGE paid to its witness Roger A. Morin from \$30,000 to \$9,800 because it believes that the fee paid to Dr. Morin is excessive if calculated as a per hour fee. Public Counsel estimated that Morin worked 35 hours and if his full fee were allowed that would amount to an hourly fee of \$857. Public Counsel would allow only \$280 per hour for Dr. Morin's time for a total of \$9,800. The

¹⁶² Bolin True-Up Direct, Ex. 234, Page 9, Lines 7-14.

¹⁶³ Transcript, Pages 2509-2510, Lines 24-25, 1-7.

¹⁶⁴ Transcript, Page 2490, Lines 14-21.

Commission does not agree with Public Counsel. Dr. Morin is a highly respected expert in his field. His \$30,000 fee is not excessive and will be allowed as a rate case expense.

MGE's rate expense claim will be adjusted in the following manner. \$1,383,333 - \$425,799.25 (the amount of reduction in Kasowitz bill) - \$47,522 (the Watson Bishop fee) - \$16,188 (the difference between the estimated and final bills from Klett Rooney) = \$893,823.75. Amortizing that amount over three years, results in an annual amount of \$297,941.25, which the Commission finds to be appropriate for inclusion in MGE's annual cost of service.

25. Kansas Property Taxes

At its last legislative session, Kansas imposed a new property tax on gas held in inventory in Kansas. MGE began to incur liability for this tax for the tax year beginning January 1, 2004. It will actually have to begin paying the tax in December 2004, with the balance of the year's tax payment due in June 2005. MGE's tax liability is based on the level of natural gas held in storage in Kansas as of December 31, 2003. MGE indicated that it questions the legality of Kansas' new tax and indicates that it will pay the taxes under protest while it challenges the tax in the courts.¹⁶⁵ Nevertheless, MGE contends that this is a known cost that it will incur during the period covered by the rate that will be established in this case. It asks that it be allowed to recover \$1,262,059 annually in rates for these new taxes.¹⁶⁶

Because MGE did not learn about the creation of this new tax until after the hearing was completed, it did not raise this issue until it filed true-up direct testimony on July 19.

¹⁶⁵ Transcript, Page 2523, Lines 17-25.

¹⁶⁶ Noack True-Up Direct, Ex. 49, Pages 5-6, Lines 24-26, 1-12.

The question was the subject of rebuttal testimony and cross-examination at the true-up hearing held on July 23.

Staff opposes allowing MGE to recover those taxes in this case but suggests that the Commission instead issue an accounting authority order (AAO) that would allow MGE to defer those increased costs until its next rate case.¹⁶⁷ MGE would accept the issuance of an AAO.¹⁶⁸ Public Counsel, Midwest Gas, UMKC, CMSU, and Jackson County oppose allowing MGE to recover those tax costs in this case and they also oppose the issuance of an AAO.

The Commission agrees that MGE cannot recover the new Kansas taxes in this case. These taxes were not paid during the test year established for this case and the taxes will not be paid at all, until December 2004. MGE also indicated that it would be paying the taxes under protest. That means that if its legal challenge is upheld MGE would receive a refund from the state of Kansas. However, MGE's witness testified that if MGE received a tax refund, it probably would not pass that refund back to ratepayers unless it was ordered to do so by this Commission.¹⁶⁹ As a result, MGE's potential tax liability is not currently known or measurable and on that basis it cannot be included in MGE's cost of service for this case.

Furthermore, property taxes were not included as a true-up issue.¹⁷⁰ The parties had no notice that this issue even existed until MGE filed its true-up direct testimony four

¹⁶⁷ Transcript, Pages 2607-2608, Lines 19-25, 1-25.

¹⁶⁸ Transcript, Page 2480, Lines 13-23.

¹⁶⁹ Transcript, Pages 2524-2525, Lines 1-25, 1-13.

¹⁷⁰ Transcript, Page 2558, Lines 17-24.

days before the hearing. As a result, this entirely new issue cannot be considered in this case.

This is a harsh result for MGE, as it will likely be paying taxes that are not included in its cost of service for calculation of rates in this case. An accounting authority order allowing MGE to defer those tax payments for possible recovery in its next rate case would be a means of avoiding that result. However, this case is not the appropriate forum for deciding whether to grant MGE such an AAO. The other parties have not been given a reasonable opportunity to present testimony and arguments to the Commission regarding this issue. If MGE wishes to request an AAO, it may file a separate application, to which the Commission will give due consideration.

CONCLUSIONS OF LAW

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

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

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

In determining the rates that MGE may charge its customers, the Commission is required to determine that the proposed rate is just and reasonable.¹⁷¹ MGE has the burden of proving that its proposed increase is just and reasonable.¹⁷²

Issues

The parties raised legal arguments regarding some, but not all of the identified issues. The legal arguments relating to those issues are discussed in this section.

1-5. Rate of Return Issues

In determining whether the rates proposed by MGE are just and reasonable, the Commission must balance the interests of the investor and the consumer.¹⁷³ The Commission's failure to establish just and reasonable rates would, in fact, violate the United States Constitution. In discussing the need for a regulatory body to institute just and reasonable rates, the United States Supreme Court has held as follows:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.¹⁷⁴

In the same case, the Supreme Court provided the following guidance on what is a just and reasonable rate:

What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the

¹⁷¹ Section 393.150.2, RSMo 2000

¹⁷² Section 393.150.2, RSMo 2000

¹⁷³ Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603, (1943).

¹⁷⁴ Bluefield Water Works & Improvement Co. v. Public Service Commission of the State of West Virginia, 262 U.S. 679, 690 (1923).

property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.¹⁷⁵

The Supreme Court has further indicated:

'[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.¹⁷⁶

In undertaking the balancing required by the Constitution, the Commission is not bound to apply any particular formula or combination of formulas. Instead, the Supreme Court has said:

Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.¹⁷⁷

¹⁷⁵ Bluefield Water Works & Improvement Co. v. Public Service Commission of the State of West Virginia, 262 U.S. 679, 692-93 (1923).

¹⁷⁶ Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944) (citations omitted).

¹⁷⁷ Federal Power Commission v. Natural Gas Pipeline Co. 315 U.S. 575, 586 (1942).

14. Volumetric Rate Elements

Public Counsel points out that the weather mitigation rate design proposed by MGE would effectively result in the creation of rates that vary with the weather, contrary to Missouri law that requires rates to be fixed. Public Counsel also contends that allowing rates to vary with the weather would be forbidden as single issue ratemaking because it would allow the single issue of weather to determine whether MGE could charge a higher rate for gas without consideration of other factors that might indicate that the company was earning other income that could offset the need for a higher rate. Public Counsel cites State ex rel Utility Consumers Counsel of Missouri Inc. v. Public Service Commission,¹⁷⁸ a Missouri Supreme Court decision rejecting a fuel-adjustment clause for electric utilities, as support for its position. After reviewing that decision, the Commission concludes that Public Counsel has correctly interpreted the Utility Consumers decision.

The fuel adjustment clause at issue in the Utility Consumers case established a complicated formula that allowed an electric utility's rates to automatically adjust up or down depending upon the cost of fuel used to generate electricity. In rejecting that clause, the Missouri Supreme Court held as follows:

By permitting an electric utility to utilize a fuel adjustment clause [FAC], the commission permits one factor to be considered to the exclusion of all others in determining whether or not a rate is to be increased. That is, although the FAC may not *itself* be a rate, by approval of an FAC in a utility's rate schedule, the commission in advance approves any increase (or decrease) in rates which will automatically result through application of the FAC if the price of fuel to the utility increases or decreases.

Although the Utility Consumers decision does not address a weather normalization clause by name, its reasoning would equally apply to the clause that is at issue in this case.

¹⁷⁸ 585 S.W.2d 41 (Mo. banc 1979).

Under the weather normalization clause proposed by MGE, the rates paid by the company's customers would vary depending upon the amount of gas used, which depends in large measure upon the weather. Those rates would change without any further evaluation by the Commission of whether the new rates are just and reasonable. That is defined as single-issue ratemaking and is forbidden by the Utility Consumers decision.

In addition to condemning the fuel adjustment clause as single-issue ratemaking, the Utility Consumers decision also held that the fuel adjustment clause would:

negate the effect of §393.140(11), by which all rates are printed and open for public inspection. The purpose of thus providing the customer with a method of ascertaining what rates are in effect and enabling him to take the appropriate steps to challenge those rates would be destroyed with a fuel adjustment clause. Upon reference to the filed rate schedule of the utility, the consumer would be confronted with a formula and a rate filed as a result thereof.

Again, the proposed weather normalization clause suffers from the same defect as the fuel adjustment clause and would violate the requirements of Section 393.140(11), RSMo (2000).

As an alternative to the weather normalization clause that it originally proposed, MGE suggests that the Commission implement what it terms a "traditional weather normalization clause" on an experimental basis.¹⁷⁹ MGE argues that if Commission adopts its "traditional weather normalization clause" on an experimental basis, it can avoid the restrictions of the Utility Consumers decision.

Whatever support there may be for the dubious proposition that the Commission has the authority to establish experimental rates that would otherwise violate state law,¹⁸⁰ there

¹⁷⁹ Cummings Rebuttal, Ex. 25, Pages 34-38.

¹⁸⁰ The six cases cited by MGE at page 77 of its reply brief discuss the Commission's authority to establish interim rates. They do not support the proposition urged by MGE.

is nothing about MGE's proposal to institute a "traditional weather normalization clause" that is in any way experimental. The Commission will not call a weather normalization clause experimental just to try to find a way around a very clear ruling by the Supreme Court of this state.

19. Merger and Acquisition Recordkeeping

Staff asks the Commission to order MGE to keep time records concerning the amount of time corporate employees spend on merger and acquisition activities. MGE contends that the order that Staff is requesting has nothing to do with setting rates and is not properly before the Commission in a rate case. MGE further contends that Staff's proposal to require MGE to keep specific records is properly the subject for a rulemaking. MGE suggests that any order that the Commission might enter in this case would be "null, void, and unenforceable" as an improperly promulgated rule.

A cursory examination of Missouri's statute concerning administrative rulemaking reveals that MGE is incorrect. Section 536.010, RSMo 2000, defines "rule" as:

each agency statement of general applicability that implements, interprets, or prescribes law or policy, or that describes the organization, procedure or practice requirements of any agency. The term includes the amendment or repeal of an existing rule, but does not include:

(d) A determination, decision, or order in a contested case.

This is a contested case. Thus, by definition, an order that the Commission issues in this case cannot be a rule and need not be promulgated in compliance with the rulemaking requirements of Chapter 536, RSMo.

DECISION

After applying the facts as it has found them to its conclusions of law, the Commission has reached the following decisions regarding the issues identified by the parties.

1. Capital Structure

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

Common Stock:	29.99%
Preferred Stock	6.40%
Long-Term Debt	63.61%

2. Embedded Cost of Long-Term Debt

Issue Description: *What is the appropriate cost of long-term debt in calculating MGE's cost of capital?*

The embedded cost of long-term debt is 7.4155%.

3. Return on Equity

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

The appropriate return on equity is 10.5%.

4. Cost of Preferred Stock

Issue Description: *What is the appropriate cost of MGE's preferred stock in calculating MGE's cost of capital?*

The appropriate cost of preferred stock is 7.758%

5. Rate of Return Adder

Issue Description: *Should MGE be granted an additional 25 basis points of rate of return on account of its level of management efficiency?*

No.

6. Capacity Release/Off System Sales

Issue Description: *What, if any, is the appropriate level of capacity release/off-system sales revenues to be used in calculating MGE's cost of service? As an alternative to including capacity release/off-system sales revenues in the calculation of MGE's revenue requirement, should the PGA-based revenue sharing mechanism proposed by MGE be adopted?*

MGE shall be authorized to implement, through its PGA mechanism, a revenue sharing grid pursuant to which revenues generated by capacity release and off-system sales (net of revenues from off-system sales made for "system protection" purposes) shall be shared between MGE and its customers as follows:

First \$300,000 – 15% to MGE and 85% to customers
Second \$300,000 – 20% to MGE and 80% to customers
Third \$300,000 – 25% to MGE and 75% to customers
Above \$900,000 – 30% to MGE and 70% to customers.

7. Environmental Response Fund

Issue Description: *Should the environmental response fund proposed by MGE be adopted and what, if any, level of environmental costs should be used in calculating MGE's cost of service?*

The Commission rejects the Environmental Response Fund proposed by MGE.

8. Lobbying/Legislative costs

Issue Description: *What is the proper ratemaking treatment of lobbying/legislative activities in calculating MGE's cost of service?*

50% of the salary of Paul Snider and 90% of the salaries of Jim Oglesby and Rob Hack may be recovered in rates as part of MGE's cost of service.

9. Incentive Compensation

Issue Description: *What, if any, is the appropriate level of MGE's incentive compensation expense to be used in calculating MGE's cost of service? What, if any, is the appropriate level of Southern Union's allocated incentive compensation expense to be used in calculating MGE's cost of service?*

The financial incentive portion of Southern Union's incentive compensation plan is excluded from MGE's cost of service and may not be recovered in rates.

10. Corporate Expenses: New York Office

Issue Description: *What, if any, is the appropriate level of cost associated with Southern Union's New York office to be used in calculating MGE's cost of service?*

The costs associated with Southern Union's New York office are excluded from MGE's cost of service and may not be recovered in rates.

11. Corporate Expenses: Lindemann/Brennan Salaries

Issue Description: *What is the appropriate amount of salaries for Southern Union's Chief Executive Officer/Chairman of the Board and Vice Chairman of the Board to be used in calculating MGE's cost of service?*

The annual salary allowed for Lindemann and Brennan shall be \$100,000. The cost of their administrative support staff at the New York office shall not be included in MGE's cost of service.

12. Class Revenue Responsibility

Issue Description: *What is the appropriate level of revenue responsibility for each customer class to be used in calculating revenue?*

The Large General Service class is assigned 75% of the system revenue increase. The remaining customer classes will be assigned the system average increase and will share proportionally any remaining revenue increase not assigned to the Large General Service class.

13. Fixed Monthly Rate Elements

Issue Description: *What is the appropriate level and structure for fixed monthly rate elements including the residential customer charge?*

MGE's fixed monthly rate elements may be increased enough to maintain the current ratio between volumetric rate elements and fixed rate elements.

14. Volumetric Rate Elements

Issue Description: *What is the appropriate level and structure of volumetric rate elements?*

MGE's proposed weather mitigation rate is rejected.

15. Miscellaneous Service Charges

Issue Description: *Should the Commission change the current tariffed charges for customer connects, standard customer reconnects, and transfer fees?*

The customer connect charge shall be increased from \$20 to \$45, the customer reconnect charge shall be increased from \$35 to \$45, and the transfer fee shall be increased from \$5.00 to \$6.50.

16. Weatherization

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

Funding for MGE's low-income weatherization program shall be increased by \$160,000. The additional funding is to be allocated consistent with the current funding plan.

17. Experimental Low Income Rate

Issue Description: *What, if any, modifications should be made to the existing Experimental Low Income Rate Program?*

The Experimental Low Income Rate Program shall continue in its current form until July 2006, or until current funding runs out.

18. Experimental Energy Efficiency Programs including PAYS

Issue Description: *Should the Pay As You Save (PAYS) program proposed by the Office of Public Counsel be adopted?*

The proposal to fund a feasibility study of the PAYS program through this rate case is rejected.

19. Merger and Acquisition Recordkeeping

Issue Description: *Should the Commission adopt Staff's proposal to order Southern Union to keep time reports related to merger and acquisition activities?*

No.

20. Gas Purchasing/Reliability Plan Reporting

Issue Description: *Should the Commission order MGE to submit by October 1, 2004, a Natural Gas Supply Plan (updated annually)? Should the Commission order MGE to*

submit by October 1, 2004, a Natural Gas Supply Reliability Analysis (updated every two to three years)?

No.

21. Legislative/Lobbying Time Reporting

Issue Description: *Should the Commission adopt Staff's proposal to order MGE to keep detailed time reporting on the amount of time employees spend on lobbying and lobbying related activities?*

No.

22. Response Time to Commission-referred Customer Complaints / Inquiries

Issue Description: *Should the Commission order MGE to respond to Customer Complaints/Inquiries within three business days?*

No.

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

Issue Description: *Should the Commission order MGE to complete and file a study concerning the impacts of the Panhandle Eastern Pipeline Company acquisition on Southern Union's administrative and general expenses and cost allocation methodology?*

No.

24. Rate Case Expenses

MGE will be allowed \$893,823.75 for rate case expense. That expense is to be amortized over three years.

25. Kansas Property Taxes

MGE will not be permitted to recover the new Kansas property tax for gas in storage in this case. The Commission will not issue an Accounting Authority Order in this case but MGE may file an application for such an order in a new case if it wishes to do so.

IT IS THEREFORE ORDERED:

1. That the tariff sheets filed by Missouri Gas Energy, a division of Southern Union Company, on November 4, 2003, and assigned tariff number YG-2004-0624, are rejected.
2. That Missouri Gas Energy, a division of Southern Union Company, is authorized to file a tariff sufficient to recover revenues as determined by the Commission in this order.
3. That any pending motions that the Commission has not specifically ruled upon are denied.
4. That this report and order shall become effective on October 2, 2004.

BY THE COMMISSION

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

(S E A L)

Murray and Appling, CC., concur;
Davis, C., concurs, with concurring opinion to follow;
Gaw, Ch., dissents, with dissenting opinion to follow;
Clayton, C., dissents; certify compliance with the
provisions of Section 536.080, RSMo 2000.

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