

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the matter of Missouri Gas Energy 's,)	
Tariffs to Implement a General Rate)	Case No. GR-2004-0209
Increase for Natural Gas Service)	

**MGE'S RESPONSE TO STAFF'S REVENUE REQUIREMENT
RECONCILEMENT**

COMES NOW Missouri Gas Energy ("MGE"), a division of Southern Union Company, by counsel, and for its response to the updated revenue requirement reconciliation filed herein by the Staff on or about September 15, 2004, respectfully states as follows to the Missouri Public Service Commission ("Commission"):

1. MGE does not dispute the mathematical accuracy of the updated reconciliation filed by the Staff. MGE is concerned, however, that the document may not provide the Commission with sufficient meaningful information to allow the Commission to understand the nature and effect of potential decisions on the issues. For example, the updated reconciliation does not indicate the weighted average cost of capital ("WACC") or any of the component pieces of the total capitalization (i.e., proportion and cost rate for the various components of equity and debt). The return on equity ("ROE") on which the updated reconciliation is based is not indicated. Whether Panhandle's cost of debt has been imputed to MGE for purposes of calculating the overall revenue requirement is not indicated. Other relevant information is not included. For example, Note 2 indicates that "The above revenue requirements for each party do not reflect their position on or settlement of tariff items, such as late payment and miscellaneous service charges[.]", but Note 2 does not provide the dollar value of those items. Therefore, in an effort to provide

the Commission with useful information on the nature and effect of potential decisions on the issues, MGE submits this response.

2. MGE will provide the Commission with two kinds of information. First, this response provides detail regarding certain items included in the updated reconciliation (including the components of the parties various WACC recommendations on which the updated reconciliation is based, as well as quantification of the late payment charge and miscellaneous service charge items). Second, this response provides “scenarios” which produce overall revenue requirements based on three alternative sets of comprehensive assumptions regarding the outcomes of all of the revenue requirement issues in the case.

Details Regarding Items Included in the Staff’s Updated Reconciliation

3. The capital structure, capital cost rates, and resulting WACC of the Staff, MGE, and OPC producing the revenue requirement recommendations of these parties following the true-up hearing (i.e., line numbers 1, 24 and 35 of the updated reconciliation for MGE, the Staff and OPC, respectively) are as follows:

	Staff		
	<u>Proportion</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long-term debt	63.61%	6.15%	3.91%
Short-term debt	0.00%	0.00%	0.00%
Preferred stock	6.40%	7.76%	0.50%
<u>Common equity</u>	29.99%	9.02%	<u>2.71%</u>
Total			7.11%

	MGE		
	<u>Proportion</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long-term debt	47.41%	7.43%	3.525%
Short-term debt	0.00%	0.00%	0.00%
Preferred stock	11.49%	7.76%	0.891%
<u>Common equity</u>	41.10%	12.0%	<u>4.932%</u>
Total			9.348%

OPC			
	<u>Proportion</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long-term debt	59.77%	7.40%	4.42%
Short-term debt	5.80%	1.87%	0.11%
Preferred stock	6.06%	7.76%	0.47%
<u>Common equity</u>	28.37%	9.01%	<u>2.56%</u>
Total			7.56%

4. The reduction of the late payment fee from 1.5% to 0.5% reduces current revenues by \$770,156. The increased miscellaneous service charges would increase current revenues by \$1,122,959. The net effect of these changes is \$352,803.

5. The September 13, 2004, Order Directing Staff To File Updated Reconciliation (“September 13 Order”) requested the “effect on revenue requirement resulting from Public Counsel’s alternative hypothetical capital structure proposal.” The September 13 Order did not, however, indicate: whether short-term debt should be included, whether the cost of Panhandle debt should be imputed to MGE, or what ROE should be utilized.

6. Using the OPC hypothetical capital structure, including short-term debt, with the capital cost rates recommended by the Staff (mid-point ROE and including imputation of the cost of Panhandle debt), MGE, and OPC (low-end ROE) produces the following range of WACCs:

	<u>Proportion</u>	Cost Rates			Weighted Cost		
		<u>Staff</u>	<u>MGE</u>	<u>OPC</u>	<u>Staff</u>	<u>MGE</u>	<u>OPC</u>
Long-term debt	53.07%	6.15	7.43	7.40	3.26	3.94	3.93
Short-term debt	5.71%	1.87	1.87	1.87	0.11	0.11	0.11
Preferred stock	5.80%	7.76	7.76	7.76	0.45	0.45	0.45
<u>Common equity</u>	<u>35.42%</u>	9.02	12.0	9.01	<u>3.19</u>	<u>4.25</u>	<u>3.19</u>
Total	100%				7.02	8.75	7.68

The Total WACC figures shown above produce the revenue requirements for the Staff, MGE and OPC shown in Note 3 of the updated reconciliation.

Alternative Revenue Requirement Scenarios

7. Because the September 13 Order did not indicate whether short-term debt should be included or not, and because the discussion during agenda sessions has indicated consideration of various alternatives, among them the exclusion of short-term debt from the capital structure as well as the adoption of Southern Union's consolidated capital structure without imputation of the cost of Panhandle debt to MGE, MGE believes it would be helpful for the Commission to know the revenue requirements resulting from alternative scenarios. Assumptions¹ common to these alternative scenarios are as follows:

- Capacity Release/Off-system Sales Revenues—Do not impute these revenues for purposes of calculating base rates.
- Environmental Response Fund—Disallow expense from revenue requirement.
- Rate Case Expense—Include \$250,000 in expense as proposed by the Staff.
- Property Taxes-KS—Disallow expense from revenue requirement.
- Legislative/Lobbying Payroll Adjustment—Disallow \$47,633 of expense (50% of the Staff's proposal).
- Incentive Compensation—Disallow financially-based and customer service-based incentive compensation expenses.
- Corporate Expenses—Adopt disallowance proposals of the Staff.

¹ These assumptions, and those set forth in paragraphs 8, 9 and 10 with respect to WACC, are simply based on MGE's observations of discussions during agenda sessions. Inclusion of these assumptions does not indicate MGE's agreement with them, nor does it indicate that the Commission or any Commissioner or Commissioners has decided any particular issue in any particular way.

8. Using the OPC hypothetical capital structure, including short-term debt, not imputing the cost of Panhandle debt to MGE (using the OPC cost rate for Southern Union debt), and using an ROE of 10.5% produces the following WACC:

	<u>Proportion</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long-term debt	53.07%	7.40%	3.93%
Short-term debt	5.71%	1.87%	0.11%
Preferred stock	5.80%	7.76%	0.45%
<u>Common equity</u>	<u>35.42%</u>	10.50%	<u>3.72%</u>
Total	100%		8.21%

Based on the assumptions shown in paragraph 7, above, and a WACC of 8.21%, MGE's revenue requirement would be \$23,294,747.

9. Using the OPC hypothetical capital structure, excluding short-term debt, not imputing the cost of Panhandle debt to MGE (using the OPC cost rate for Southern Union debt), and using an ROE of 10.5% produces the following WACC:

	<u>Proportion</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long-term debt	58.22%	7.40%	4.31%
Preferred stock	6.36%	7.76%	0.49%
<u>Common equity</u>	<u>35.42%</u>	10.50%	<u>3.72%</u>
Total	100%		8.52%

Based on the assumptions shown in paragraph 7, above, and a WACC of 8.52%, MGE's revenue requirement would be \$25,086,113.

10. Using the Southern Union consolidated capital structure, excluding short-term debt, not imputing the cost of Panhandle debt to MGE (using the OPC cost rate for Southern Union debt) and using an ROE of 10.5% produces the following WACC:

	<u>Proportion</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long-term debt	63.61%	7.40%	4.71%
Preferred stock	6.40%	7.76%	0.50%
<u>Common equity</u>	<u>29.99%</u>	10.50%	<u>3.15%</u>
Total	100%		8.36%

Based on the assumptions shown in paragraph 7, above, and a WACC of 8.36%, MGE's revenue requirement would be \$22,359,137.

WHEREFORE, MGE respectfully submits this response.

Respectfully submitted,

/s/ Robert J. Hack

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile, or emailed to all counsel of record this 16th day of September, 2004.

/s/ Robert J. Hack
