BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Tariff Sheets Designed to Increase Rates for Gas Service in the Company's Missouri Service Area	))))	Case No. GR-2004-0209

MOTION FOR CLARIFICATION
AND APPLICATION FOR REHEARING

COMES NOW Missouri Gas Energy ("MGE"), a division of Southern Union Company ("Southern Union"), by and through the undersigned counsel, pursuant to RSMo. §386.500, 4 CSR 240-2.080, and 4 CSR 240-2.160, and respectfully moves for clarification and applies to the Public Service Commission of the State of Missouri (the "Commission") to grant rehearing all with respect to the Commission's *Report and Order* issued in the above-captioned case on September 21, 2004, to be effective October 2, 2004.

Motion for Clarification

1. In its conclusions of law regarding the issue of volumetric rate elements, the Commission erroneously mixes its use of the phrases "weather mitigation rate design" and "weather normalization clause" as if the two have the same meaning. In particular, on page 59 of the *Report and Order* the Commission finds and concludes that:

> 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*, 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. (*Report and Order*, page 59 of 73; emphasis supplied)

The Commission then continues in that section of the *Report and Order* to find and conclude that:

> [A]s 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. (*Report and Order*, page 60 of 73)

MGE moves the Commission to clarify its findings and conclusions of law to correctly distinguish between the weather mitigation rate design originally proposed by MGE and the weather normalization clause proposed by MGE as an experimental alternative.

2. A review of the Public Counsel's initial and reply briefs on this issue reveals that Public Counsel **never** argued that the *Utility Consumers* decision prohibited, or in any way affected or related to the Commission's authority to adopt, the weather mitigation rate design originally proposed by MGE. (*See*, Public Counsel Initial Brief, pages 96-105). In fact, Public Counsel only used the *Utility Consumers* decision in relation to the weather normalization clause proposed by MGE as an experimental alternative. (*See*, Public Counsel Initial Brief, pages 105-112). Nor did any other party argue that the weather mitigation rate design is inconsistent with Missouri law. The reason that no such arguments were made is simple. Specifically, unlike a weather normalization clause, the base rates under the weather mitigation rate design do not vary and are not adjusted depending on weather or any other factor. To the contrary, once those rates are established they remain constant until subsequently changed in a general rate case proceeding.

3. In view of these considerations, the Commission should clarify its *Report and Order* to correct this error so that the *Report and Order* accurately reflects the argument made by Public Counsel and adopted by the Commission.

Application for Rehearing

For the reasons stated herein, the *Report and Order* is unlawful, unjust, unreasonable, arbitrary, capricious, confiscatory, involves an abuse of discretion, is unsupported by competent and substantial evidence upon the whole record, is in excess of statutory authority, is made upon unlawful procedure, is inadequately explained, and is unconstitutional, all in material matters of fact and law, individually or cumulatively, or both, in the particulars hereinafter stated and for the following reasons and in the following respects:

1. On pages 14 and 86 of the *Report and Order*, the Commission finds and concludes that the 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 in this case is the Southern Union consolidated capital structure, to wit: common stock-29.99%, preferred stock-6.40%, and long-term debt-63.61%. These findings and conclusions are in error.

The competent and substantial evidence before the Commission in this proceeding demonstrates that the capital structure for MGE for purposes of this case should be one which consists of 41.10% common equity, 11.49% preferred equity, and 47.41% long term debt. This capital structure is based on Southern Union's consolidated capital structure as of April 30, 2004, the true-up date in this proceeding, with the debt and equity associated with Southern Union's 2003 acquisition and ownership of Panhandle Eastern Pipeline Company removed pursuant to generally accepted accounting principles. Alternatively, the competent and substantial evidence before the Commission in this proceeding demonstrates that the capital structure for MGE for purposes of this case should be one which consists of 40.30% equity, 53.96% long term debt, and 5.74% preferred equity, a capital structure based on a hypothetical capital structure calculated by

analyzing the capital structures of the proxy group of utility companies utilized by Public Counsel witness Travis Allen.

2. On pages 20, 23 and 86 of the *Order*, the Commission finds and concludes that "10.5% is a fair and reasonable return on equity for MGE that will allow Southern Union an opportunity to compete in the capital market for the funds needed to keep MGE healthy" and that a return on equity of 10.5% is "supported by the evidence presented in this case." These findings and conclusions are in error.

The competent and substantial evidence before the Commission in this proceeding demonstrates that the required return on equity for MGE should be 12%, or at least at or above the 11% national average. The lower recommendations of the Commission Staff and Public Counsel are based on unreliable data sets, flawed methods, a self-serving selection of conflicting calculations, and are otherwise not competent and substantial evidence for the reasons stated herein.

3. The Commission's decision to set MGE's rates using a capital structure composed of less than 30% common equity in conjunction with a return on common equity of 10.5%, as stated in the *Report and Order*, is confiscatory, effectuates a denial of MGE's due process and equal protection rights, and violates the United States Supreme Court's decision in *Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia*, 262 U.S. 679 (1923). In *Bluefield*, the Supreme Court stated that:

> **[A] public utility is entitled to such rates as will permit it to earn a return on the value of the 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** . . .

Id. at 692-93 (emphasis supplied).

4. The Commission's decision to set MGE's rates using a capital structure composed of less than 30% common equity in conjunction with a return on common equity of 10.5%, as stated in the *Report and Order*, is arbitrary, capricious, and unlawful, and is an unreasonable deviation from past Commission precedent. In *In the Matter of St. Joseph Light & Power Co. ("St. Joseph"),* Case No. ER-93-41, 1993 Mo. PSC LEXIS 36, 2 Mo. P.S.C. 3d 248 (1993), Public Counsel, through its witness John Tuck, recommended that the Commission adopt a hypothetical capital structure in the determination of a reasonable rate of return capital for a utility. The Commission followed the Public Counsel's advice and held:

> By adopting a hypothetical capital structure for SJLPC, the Commission is not indicating a preference for hypothetical capital structures in establishing revenue requirements for a company. The Commission, in other cases, has utilized the actual capital structure whenever the debt equity ratio has not been shown to be outside a zone of reasonableness. **However, when as in this case, the actual capital structure is so entirely out of line with what the Commission considers to be a reasonable range, a hypothetical capital structure must be adopted to balance properly the interests of the shareholders and ratepayers.**
>
> The Commission, therefore, determines that the hypothetical capital structure as proposed by Public Counsel should be adopted in this proceeding.

St. Joseph, 1993 Mo. PSC LEXIS 36 at 11-12 (emphasis supplied).

The Commission has failed to adequately explain why the rationale adopted in *St. Joseph* does not apply here when it is undisputed that the actual capital structure of Southern Union (which the Commission used for ratemaking purposes in this case) is outside the zone of reasonableness. Moreover, the Commission's explanation for deviating from the *St. Joseph* rationale, inadequate as it is, is also arbitrary, capricious, unlawful, and unreasonable because, in stating (at page 11 of 73 of the *Report and Order*) that the decision to use a hypothetical capital structure in *St. Joseph* was necessary to protect ratepayers from a management decision but should not be used in this case to protect management from the consequences of its own

decisions, the Commission disregards its obligation to fairly balance the interests of customers and shareholders in violation of Supreme Court precedent that "the fixing of 'just and reasonable' rates, involves a balancing of investor and consumer interests" and "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks." *Federal Power Commission, et al. v. Hope Natural Gas Company*, 320 U.S. 591, 603 (1944).

5. The Commission's decision to set MGE's rates using a capital structure composed of less than 30% common equity in conjunction with a return on common equity of 10.5% unreasonably and unlawfully reflects, gives weight to, or relies upon incompetent testimony. In reaching its conclusions as stated in the *Report and Order*, the Commission considered, gave weight to, and/or relied upon testimony presented by Public Counsel witness Allen and Commission Staff witness Murray. Neither of these witnesses, per *State Board of Registration for the Healing Arts v. McDonagh*, 123 S.W.3d 146 (Mo. banc 2003), and RSMo. §490.065, satisfy the requirements for testifying as an expert witness. Accordingly, the "expert" testimony of Allen and Murray should not have been allowed or should have been stricken from the record, as requested by MGE. Alternatively, the lack of experience of these witnesses should have been carefully considered in judging the weight and credibility of the testimony, and the Commission should not have considered, given weight to, or relied upon Public Counsel witness Allen's or Commission Staff witness Murray's opinion testimony.

WHEREFORE, Missouri Gas Energy, a division of Southern Union Company, respectfully requests that the Missouri Public Service Commission clarify and grant rehearing with respect to its September 21, 2004, *Report and Order*, as requested herein, and upon

rehearing, that errors of the Commission be corrected and thereafter a new order be issued consistent with the evidence and applicable law as more fully set forth above in this pleading.

Respectfully submitted,

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ATTORNEYS FOR MISSOURI GAS ENERGY

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 1st day of October, 2004.

Diana C. Farr