Also, contrary to the assertions of OPC, the clean up costs do in fact relate to the provision of gas service to Missouri customers. The remediation of past environmental problems at Missouri sites is part and parcel with MGE's statutory duty to serve. There is certain liability associated with these gas plants, and MGE is faced with the remediation costs. (Ex. 22 at 2:19 to 3:1, 3:5-19, 4:3-19) OPC acknowledges that MGE, as a current owner of sites requiring clean up efforts, is a "potentially responsible party" under CERCLA guidelines. (OPC Br., pp. 73-74) And, contrary to Staff's assertions, MGE did in fact incur gas plant-related clean up costs during the test year (Ex. 22 at 2:15-16), and MGE will continue to incur such costs in the future. (Ex. 22 at 3:5-19) Apparently, Staff is trying to distinguish between costs *incurred* by Southern Union Company and costs *allocated* to MGE. This is a hollow distinction. As the Commission is well aware, MGE is but a division of Southern Union. The costs have been incurred and will continue to be incurred.

MGE's proposed environmental response fund would not be the first of its kind. MGE's proposal is very similar to a plan approved in Massachusetts in 1990 (Ex. 11 at 9:14-15, Sch. MRN-3), and Schedule MRN-1, attached to Exhibit 11, sets out some of the other jurisdictions which have adopted mechanisms similar to MGE's proposal. CERCLA mandates that responsible parties remediate contaminated sites, and potential liability is broad. (*The Citizens Utility Board v. The Illinois Commerce Commission*, 651 N.E.2d 1089, 1093 (Sup. Crt. Ill. 1995)) As the Supreme Court of Illinois recognized in reviewing an order of the Illinois Commerce Commission, gas and electric utilities face potential liability for site clean up under environmental statutes, even when the plants were operated with the attendant care and proper procedures of the day. (*Id).* In *Citizens*

Utility Board, the costs at issue had been or were to be incurred to remediate environmental damage stemming from coal-tar residue at former manufactured gas plant sites. (*Id.*) Most of the plants had been out of operation since the 1950s. (*Id.*)

Public utilities are entitled to recover in their rates certain operating expenses. In *Citizens Utility Board*, both the commission and the utilities noted that expenses incurred to comply with the mandate of federal and state law have historically been recoverable from ratepayers. (*Id.* at 1095) As an example, the court pointed to income taxes. Taxes are a legally mandated cost of doing business and are recoverable from ratepayers as a component of a utility's revenue requirement. As the court stated, "taxes are not directly linked to providing a ratepayer with either gas or electric service, but are a necessary expense of utility operations. The payment of taxes can be seen as benefiting the ratepayer, because a public utility must fulfill its tax obligations to remain in business." (*Id.* at 1096)

Analogous to the government requirement that MGE pay taxes, MGE is required to incur certain cleanup expenses under CERCLA and similar state environmental laws. These expenses benefit MGE's ratepayers, "because payment of this legally mandated cost allows a utility to remain in business and to continue to provide service to its customers." (*Id.*) The Illinois Supreme Court thus stated, "remediation costs can be viewed as conferring benefits on utility customers. We do not believe that the Commission exceeded its authority in recognizing coal-tar costs as recoverable from ratepayers." (*Id.*)

OPC's and Staff's references to possible recovery from Western Resources and other sources and Staff's references to single-issue ratemaking are also without merit.

MGE's proposal would allow recovery only for costs actually incurred by MGE on a going-forward basis. The proposal also provides for an audit and true-up. These aspects of the plan should adequately address OPC's and Staff's concerns regarding other recovery sources. Additionally, like with the PGA/ACA process, the environmental response fund mechanism does not violate the principle of single-issue ratemaking. The mechanism will be established in a rate case, with all relevant factors being considered by the Commission. As with the PGA process, the Commission will be able to take into consideration the establishment of the fund in setting the overall rate to be approved in this case. Further, like with gas fuel costs, the environmental clean up costs being incurred by MGE are of a unique nature.

Addressing the environmental clean up cost issue in the manner proposed by the Company is in the public interest. MGE's proposal promotes intergenerational equity by spreading cost recovery over a wide base of customers, helps mitigate the possibility of future rate shock, and ensures appropriate regulatory review of cost recovery. Again, only prudently incurred costs will ultimately be recovered. MGE's proposal is a fair and balanced method to deal with environmental clean up costs, and the Company's proposal to fund the plan initially at a level of $750,000 per year should be approved.

D. Lobbying/Legislative Costs

This issue involves the appropriate rate treatment for the salaries of MGE employees Jim Oglesby, Rob Hack and Paul Snider.

MGE recognizes that "lobbying" expenses are customarily not allowed to be flowed through rates, and consequently, excluded from its rate request all expenses associated with its outside contract lobbyists along with the dues it pays to the Missouri

Energy Development Association (Ex. 10 at 13:16-18). MGE however included in its rate request the salaries of Mr. Oglesby, its Chief Operating Officer, Mr. Hack, its General Counsel, and Mr. Snider, its Legislative Liaison.

The Staff has proposed an adjustment to the books and records of the Company and seeks to eliminate from rate treatment 100% of Mr. Snider's salary and 10% of the salaries of Mr. Oglesby and Mr. Hack. Since this is a Staff adjustment, to sustain the disallowance, the Staff must demonstrate, in the first instance, that the expenses should not be allowed by tying those expenses to some non-recoverable activity. The Staff, however, does not provide any evidence as to how or why it arrived at the 100% or 10% disallowance percentages, and thus its recommended disallowance is supported by nothing more than Staff witness Hyneman's ("Hyneman") arbitrary judgment. Stated another way, without presenting any empirical calculation or objective formula or other substantive evidence, the Staff has subjectively determined that 100 % of Mr. Snider's and 10% of Mr. Hack's and Mr. Oglesby's salaries should be disallowed for ratemaking purposes. The Staff apparently makes this unsupported determination by imposing its subjective view that any activity that bears any relationship at all to the legislative process is classified as "lobbying" and therefore rate recovery is inappropriate. This approach is without precedent and represents a gross misapplication of the term "lobbying."

The evidence in this case does not support Staff's conclusion that 100% of Mr. Snider's activities constitute "lobbying" according to the commonly accepted definition of that term -- activities undertaken for the purpose of influencing the decisions of public officials. If even one minute of one day of Mr. Snider's time working for MGE was spent on any activity that was not related to "lobbying" then a 100% disallowance cannot be supported. On this point the record shows that Mr. Snider does things other than undertaking legislative activities, including special projects. (Tr. 1185:5-6; Ex. 816 at 8:14, 9:1) Hyneman *admitted* that, according to his understanding of the term, something *less* than 100% of Mr. Snider's time was spent on lobbying activities, but nonetheless he proposed a *100%* disallowance of Mr. Snider's salary. Mr. Hack and Mr. Oglesby's time was, according to Hyneman, spent on lobbying activities "to a lesser extent," but in no way did Hyneman empirically support a 10% disallowance of those salaries. Furthermore, Hyneman admitted that there is no mathematical certainty to the percentages of "lobbying" activity he assigned to Messrs. Snider, Oglesby or Hack. (Ex. 816 at 9:13-17)

The key factor with respect to this issue is the use of the term "lobbying" and its application to the activities and performance of the three involved MGE employees. While the Staff, OPC and MGE are all in agreement on the accepted definition of "lobbying," it is the practical application of this definition, to the real world, that has led to the differences in the parties' positions on this issue.

All of the parties agree that this Commission has defined lobbying as "*activities undertaken for the purpose of influencing the decisions of public officials.*" (*See, Kansas City Power & Light Company,* 24 Mo. PSC. (N.S.) 386, 400 (1981) (emphasis added)) The Staff and OPC, however, improperly and inaccurately characterize legislative activities that are a necessary part of operating a public utility as "lobbying." The overly broad and expansive application of "lobbying" proposed by Staff and OPC ignores the fact that an activity must have a *purpose of influence* associated with it to rise to the level of lobbying, and meet the Commission accepted definition.

While Staff and OPC make much of Mr. Snider's calendar, the Staff and OPC have failed to demonstrate that Mr. Snider's calendar entries also show that there was a "purpose of influence."

Neither the Staff nor OPC has adduced any evidence regarding the "purpose" of the meetings or the matters discussed in Mr. Snider's calendar entries. There are many possible purposes, apart from lobbying, that exist. (*See, Proceeding on Motion of Commission as to the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corp., Case 28896,* 1985 N.Y. PUC LEXIS 637, issued April, 11, 1985) Common sense makes clear that a simple calendar listing, indicating a meeting with a particular legislator, cannot provide the sole basis for a determination by Staff or OPC, that the meeting was lobbying. Rather it would be necessary to also demonstrate a *purpose of influence* to rise to the definitional standard of "lobbying" and thus meet Staff's burden of persuasion to support a disallowance. This is something which neither the Staff nor OPC accomplish in the record currently before the Commission.

While Mr. Snider's job title is "Legislative Liaison," his work also includes special projects. (Rr. 1185:4-5; Ex. 10 at 14:9-14) Mr. Snider's responsibilities are not limited to legislative matters. (Ex. 10 at 14:8-9) Mr. Snider's responsibilities include "media relations as well as special projects in addition to his legislative responsibilities" as explained by Company Witness Noack (Ex. 10 at 14:10-11) and therefore a 100% disallowance of his salary is simply unsupported by the evidence.

It is important to recognize that even the use of a broad general brush stroke to characterize "lobbying" has not resulted in the type of disallowance suggested by the OPC in the present case. In *Missouri Power & Light Company for Authority to File Tariffs Increasing Rates*, Case No. HR-82-179, 1982 Mo. PSC LEXIS 11, *Report and Order*, issued October 29, 1982 (quoting *In the Matter of Kansas City Power & Light Company*, Case No. ER-81-42, *Report and Order*, issued June 17, 1981), the Commission stated as follows:

> [T]he mere fact that an activity might fall within the very broad general definition of lobbying as used by Public Counsel should not necessarily mean that it is an improper expense for ratemaking purposes. This question is one of benefit or lack of benefit to the ratepayers.

Simply put, lobbying costs can be a proper expense for ratemaking purposes if there is a ratepayer benefit. In this regard, Staff and OPC ignore evidence which demonstrates that the challenged activities by MGE employees have provided a direct benefit to the ratepayers.

In both St. Joseph and Joplin, during the public hearings in this case, witnesses presented testimony that indicates the efforts of MGE provided a direct benefit to them. In discussing the experimental school transportation program enacted by the General Assembly as Section 393.310 in 2002, Witness Cherry said:

> … the smaller school couldn't economically afford to be in the program. [ ] we went to the legislature … We had roughly ten districts that qualified for the program. And we went to the legislature in 2002 and got some language inserted which, again, we went through – before the Missouri Public Service Commission in speaking with the other utilities. Basically, it opened the door, if you will, for any size school to participate in this natural gas program. One of the – one of the utilities that was extremely cooperative from the very beginning – there was basically two that were extremely cooperative, and one was Missouri Gas Energy.

(Public Hearing, April 29, 2004, St. Joseph, Missouri, Tr. Vol. 5, 16:7–20) And Witness Barr stated at the public hearing in Joplin that:

> … in 2002, legislation proposed by the Missouri School Boards Association was passed into law that enables small and large schools through Missouri to aggregately purchase natural gas beginning in 2003. One of the utilities that has been cooperative from the beginning is the (sic) Missouri Gas Energy.

(Public Hearing, April 27, 2004, Joplin, Missouri, 8:17-22)

Knowing the positive and beneficial impact of this legislation for Missouri schools, and the evidence showing that this legislation has benefited MGE customers, a full disallowance of Mr. Snider's salary is unwarranted. Even assuming that Staff did make a case to disallow a portion of internal payroll costs, the evidence proves that 100% of Mr. Snider's time should not be disallowed. Because Staff and OPC use a single brush to paint a wide stroke in evaluating what constitutes "lobbying" and without recognizing the benefits to ratepayers that "lobbying" has delivered they have failed to support their recommended disallowance of these costs.

In view of the foregoing, it is clear that the Staff has failed to meet its burden and that MGE should prevail on this issue.

E. Incentive Compensation

This issue, with an approximate value of $210,000, involves the appropriate level of incentive compensation expense to be included in rates in this proceeding. MGE's current incentive compensation plan is composed of a customer service goal, a safety goal, and a financial goal. (Tr. 1610:21-25) The Staff has recognized and allowed for ratemaking purposes the amount of incentive compensation that is based on customer service and safety goals. (Staff Br., p. 38) The Staff, however, opposes rate recovery in this case for any incentive compensation tied to financial goals. (Ex. 809 at 2:27-28; Tr.

1830:1-8) OPC believes costs associated with MGE's financial and service goals should be excluded from cost of service. (OPC Br., pp. 66-67)

Staff's objection is apparently based on the theory that financially based incentive compensation and/or goals may present a risk of harm to customers. (Ex. 809 at 3:1-2). There is absolutely no evidence in the record, however, to support the notion that the Company's financially based incentive compensation program somehow puts customers at risk. OPC argues disallowance for costs related to financial goals because shareholders benefit from the Company's success. (OPC Br., pp. 67-68) This fact is irrelevant, however, if customers also benefit. OPC argues disallowance for the costs related to the customer service goal solely on the basis that it involves a call answer speed which OPC alleges to be above the so-called industry average. (OPC Br., p. 68) As demonstrated by MGE on pages 31-33 of this reply brief, these OPC claims are unsupported and wrong.

As the evidence demonstrates, MGE's use of incentive compensation, including incentive compensation tied to "financial" goals, is well within the mainstream of market practices. More significantly, use of such a plan is necessary for the Company to attract and keep quality employees. (Tr. 1612:8 to 1613:21, 1617:18 to 1618:12) MGE competes with both regulated and nonregulated businesses when it comes to hiring and retaining employees. Without providing compensation in line with its "competitors," MGE would not be able to hire and retain quality employees. And without quality employees, MGE would not be able to provide a high level of service to its Missouri customers.

MGE's compensation plan is clearly consistent with the interests of its ratepayers. MGE's desire to achieve solid financial performance is driven to a considerable extent by customers' interests and thus benefits utility operations as a whole. Incentive compensation awarded on the basis of achieving financial objectives should be included in cost of service because it is in the best interest of the Company's customers to have a financially efficient utility. Staff's witness admitted that MGE's employees are providing safe and reliable gas utility service to its customers. (Tr. 1826:2-5) *Additionally, the Staff witness agreed that being efficient encompasses financial efficiency and that efficiency ultimately benefits customers.* (Tr. 1830:9 to 1831:1)

Staff attempts to support its position by asserting that MGE has had ample opportunity to modify its incentive compensation plan and remove financially-based goals. (Staff Br., p. 41) This argument misses the point completely. MGE management has exercised its management prerogative and has implemented an incentive compensation plan which helps MGE acquire and retain high quality employees and which helps MGE efficiently provide safe and adequate service to its Missouri customers. As the Staff witness admitted, what and how MGE pays its employees is a management prerogative. (Tr. 1826:19 to 1827:1)

Staff and OPC both point to the Commission's order in a *prior* MGE rate case proceeding (Case No. GR-96-285) to support their positions that costs associated with MGE's incentive compensation plan should be excluded from cost of service. In its Initial Brief, Staff points to a statement of an OPC witness in that *prior* case. The OPC witness stated that incentive compensation should be excluded "[u]nless the Company can demonstrate that cost reductions pursuant to which incentive compensation has been awarded were achieved while maintaining the quality of service." (Staff Br., p. 40) The present pending rate case, however, must be decided on the record evidence in *this* proceeding and not on what may have occurred in some prior case. The record evidence in *this* case is clear. As Staff admitted, MGE's employees -- even with the incentive compensation plan in place -- are providing safe and reliable gas utility service to MGE's customers. Moreover, Staff admitted that financial efficiency, one of the goals of MGE's incentive compensation plan, benefits customers. As demonstrated on pages 34-38 of this reply brief, MGE operates very efficiently in comparison to other Missouri LDCs. This efficiency does not happen by accident but by management focus and attention, much of which is induced through MGE's incentive compensation plan.

There is simply nothing in the record in this proceeding to support the underlying premise of Staff's position -- that MGE's customers have been harmed or are at risk of harm because of MGE's incentive compensation plan. In fact, Staff's own testimony is to the contrary. There is also nothing in the record to support OPC's position that a benefit to shareholders may not also be a benefit to ratepayers, nor is there anything in the record to support OPC's position that MGE should not be allowed to recover costs associated with its customer service incentive compensation merely because the goal is not above "industry average." Staff's arguments on this issue are based on groundless speculation; OPC's arguments are also without merit. Accordingly, Staff's and OPC's proposed adjustments should be rejected, and MGE's incentive compensation expense should be included in its rates.

F. Corporate Expenses

1. New York Office

2. Lindemann/Brennan Salaries

The costs of Southern Union executive officers, Mr. George Lindemann and Mr. John Brennan, and their related support costs are appropriate for rate recovery in this proceeding. Staff fails to apply a consistent standard in supporting the allowance of the costs associated with Mr. Tom Karam as compared to the costs associated with Mr. Lindemann and Mr. Brennan. Staff apparently uses a "physical presence test" to justify rate recovery of Mr. Karam's costs without offering any explanation as to why "physical presence" at a particular location is relevant or appropriate. Applying its "physical presence test" to Mr. Lindemann and Mr. Brennan, the Staff takes the extreme position that in a day and time of advanced technology, including telephone, wireless internet and e-mail, that cost recovery must be tied to physical locality. The Staff's test is inappropriate. It is not the *physical location* of these employees that should determine cost recovery, but rather whether or not they provide a service that benefits customers.

There is no disagreement between MGE and Staff that Mr. Lindemann and Mr. Brennan are involved with MGE at a level above that of general Southern Union board members. (Tr. 1758: 4–9). Further, their service on the Executive Committee provides them with the authority to exercise all of the powers of the board in management of the business, property and affairs of the Company. (Ex. 18 at 6: 5-14). The concession by Staff that these two employees are "active" and that some of their costs above those as routine board members should be recovered through rates demonstrates that benefits are brought to MGE and its customers because of the "active" roles taken. These roles are above that which are contributed by general board members, and thus provide a benefit to ratepayers and should be permitted recovery in rates. To disallow *any* recovery of the costs associated with "active" employees, such as Mr. Lindemann and Mr. Brennan, could have a chilling effect on the level of participation these individuals offer in the future, including the benefits their active involvement brings to MGE and MGE's ratepayers.

Mr. Lindemann and Mr. Brennan are more involved in MGE's business than a general board member. In fact their duties are those of Executive officers and as such, their costs should be fully recovered. (Tr. 1758: 4–9) As indicated, Staff has conceded that more of their costs should be passed through to Missouri ratepayers than costs associated with other Southern Union Board members. *(Id.)*

The New York office of Southern Union serves as more than a physical location at which Mr. Lindemann and Mr. Brennan may base their activities, but is also provides an access point for Southern Union with investors, rating agencies and other parties interested in dealing with the Company. There is intrinsic value in having a "New York" address when dealing with the New York financial community for capital attraction. Therefore, the particular amount of time that is physically spent in the New York office by Mr. Lindemann or Mr. Brennan, as suggested by Staff, is simply not a reasonable approach to valuing the costs associated with the New York office and its associated personnel. Consequently, the fully allocated share of *all* of the costs associated with Mr. Lindemann and Mr. Brennan, including the related administrative support and office space costs, should be allowed in rates.

G. Class Cost-of-Service/Rate Design

1. Class Revenue Responsibility

Although MGE adequately addressed this issue in its initial brief and will not belabor the record by simply repeating those points in this reply brief, two factual inaccuracies contained in the initial brief of the Midwest Gas Users' Association, et al., ("MGUA") need to be corrected.

First, MGUA appears to allege that the portion of the cost of electronic gas metering ("EGM") equipment paid for by Large Volume customers has been allocated by MGE's class cost-of-service study to the Large Volume class. (MGUA Br., pp. 13-14) This is simply wrong. EGM costs paid by Large Volume customers are treated as contributions. Because these costs are excluded from MGE's plant-in-service, they are therefore excluded from MGE's rate request for all purposes, including the allocation of costs accomplished through MGE's class cost-of-service study. (Ex. 26 at 34:11-15) Therefore, EGM costs paid by Large Volume customers have not been allocated by MGE to the Large Volume customer class or any other customer class. MGUA appears to believe that Large Volume customers pay for *all* EGM costs. This is wrong, too. Large Volume customers only pay for the *initial* EGM installation at a given meter location and that payment is limited to $5,000 per meter. (Tr. 2057:5-12) To the extent the cost of the initial EGM installation exceeds $5,000, or a second EGM installation is required at a given meter location (due to obsolescence of the initial EGM installation, for example), those costs are borne by MGE and would therefore appropriately be reflected in both MGE's revenue requirement and the costs allocated pursuant to MGE's class cost-of-service study.

Second, MGUA utterly confuses the distinction between MGE's gas supply personnel -- who are responsible for acquisition, storage management and transportation management of commodity requirements for system sales customers -- and other MGE personnel who have either primary responsibility, or a significant amount of time dedicated to responsibility, for meeting the needs of Large Volume transportation customers. (MGUA Br., 19-21) The points Dr. Cummings made during the exchange with counsel for MGUA -- which points apparently continue to befuddle MGUA -- are that 1) the costs of MGE's gas supply personnel (who are primarily devoted to serving the needs of system sales customers) and the costs of MGE personnel with primary or significant responsibility for the requirements of Large Volume transportation customers have been allocated to the various customer classes in the very same way (*i.e.*, applying the general and administrative expense allocation factor), and 2) the number of MGE personnel responsible for the requirements of the Large Volume transportation customers is greater than the number of MGE gas supply personnel responsible for the commodity requirements of system sales customers. This means that, on balance, this approach allocates fewer costs to the Large Volume transportation customers than if the costs of gas supply personnel were totally, or largely, allocated only to system sales classes and the costs of personnel responsible for Large Volume transportation customer requirements were totally, or largely, allocated only to the Large Volume transportation customer class.

2. Fixed Monthly Rate Elements

In its initial brief, the Staff argues that MGE's current rate design should not change. (Staff Br., p. 49) The OPC also argues in its initial brief that its rate design proposal "retains the status quo with respect to Residential rates." (OPC Br., p. 93) These arguments are curious inasmuch as the Staff and OPC rate design witnesses both agreed during cross-examination at the Hearing that their rate design proposals would increase MGE's reliance on volumetric rate elements:

> Q. [MGE Counsel:] Would you agree, therefore, that one result of adopting your proposal would be an increased reliance on volumetric rates to recover residential revenues for MGE?
>
> A. [MR. BECK:] I think the – there would be a reduction in that – in that 55/45 percentage split. So I think that would be a true statement.
>
> Q. And so – yeah. The - -
>
> A. From a percentage-wise, that would be a true statement. Obviously there would be more revenue being collected, but there would be a lot more revenue being collected on the commodity side.
>
> (Tr. 2233:25 to 2234:12) (Emphasis supplied)
>
> Q. [MGE COUNSEL:] And Public Counsel, for its rate design proposal, recommends that any revenue increase authorized for the residential class be recovered 100 percent for volumetric rate elements; is that correct?
>
> A. [MR. BUSCH:] That's my understanding of our proposal, yes.
>
> Q. And adoption of the Public Counsel proposal would therefore necessarily result in a higher proportion of residential distribution revenues being recovered by way of the volumetric rate element in comparison to the situation currently, correct?
>
> A. Yes, sir.
>
> Q. And would it be fair to say, then, that the adoption of the Public Counsel rate design for the residential class would increase MGE's exposure to weather related revenue variability?
>
> A. I don't know the magnitude, but I think it would.
>
> (Tr. 2168:24 to 2169:18)

In its initial brief, the Staff also alludes to some kind of methodology that purports to design rates based on the cost of gas. (Staff Br., p. 50) The Staff's ill-defined proposal to somehow factor the purchased gas adjustment ("PGA") rate into the design of MGE's permanent distribution rates is not worthy of serious consideration. As the Commission well knows, the PGA rate of all LDCs, including MGE, can vary considerably over relatively short periods of time. It is therefore quite likely that MGE's PGA rate as of the date the Commission issues its order in this case will be different -- and perhaps significantly different -- than the PGA rate which will be in effect for MGE on November 1, 2004 and thereafter. Fundamentally, even if the Staff had adequately explained how its proposal actually works, the Commission should reject it because distribution rates should be based on distribution costs (which are largely fixed in nature), not gas commodity costs (which are subject to significant market price fluctuations over relatively short periods of time).

Appropriately focusing on distribution rates and revenues in this non-gas cost rate proceeding, the undisputed record evidence proves that 1) MGE's actual earnings have been significantly lower than authorized levels for the past eight years (Ex. 25 at 31:4-6); 2) MGE's consistent earnings shortfalls have been significantly driven by the fact that actual average use per residential customer has fallen short of the average use per residential customer assumed through the rate setting process (Ex. 23 at 8); and 3) MGE's rate design is heavily dependent on volumetric revenue recovery, with approximately 45% of residential distribution revenues attributable to volumetric rate elements. (Tr. 2168:16-23; 2233:17-24 and Ex. 23, Sch. FJC-3[8]) Given this evidence, the rate design proposals of the OPC and the Staff -- which significantly increase MGE's reliance on volumetric revenue streams -- make no sense whatsoever. In fact, this evidence fully supports the kind of rate design changes MGE has proposed (*i.e.,* increased fixed monthly rate elements and some form of weather mitigation rate design for volumetric rate elements). Only MGE's rate design proposal would tend to reduce the variability of revenue streams derived from the residential and small general service classes. By contrast, the Staff and OPC rate design proposals will only worsen the consistent earnings shortfalls MGE has historically experienced due to the current rate design.

Clearly then, if the Commission is not inclined to increase the percentage of distribution revenues MGE derives from the residential and small general service fixed monthly rate elements, it should not make the existing situation worse by increasing MGE's reliance on volumetric revenue recovery. By arguing in their initial briefs for no change in the existing rate design and retention of the status quo with respect to residential rates, the Staff and OPC appear to support an approach that would not change the existing 55%/45% relationship of fixed monthly rate element to volumetric rate element revenue recovery. The following table shows the residential fixed monthly rate element necessary to maintain or change the existing 55%/45% relationship of fixed to volumetric revenues at various overall revenue increases:

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[8] Ex. 23, Sch. FJC-3 shows 5,337,625 annual residential bills and residential volumes of 393,967,586 Ccf. With the current $10.05 fixed customer charge and the current $0.11423 per Ccf volumetric rate, these billing units produce $45,002,917 in volumetric revenue and $98,646,049 in total revenues. Of the total residential distribution revenues, 45.6% is, then, attributable to the volumetric rate element.

Overall Revenue Increase		Residential Increase (1)	Residential Fixed Monthly Charge		% Revenue Dependent on Volumes
Current Rates (2)		--	**$**	**10.05**	**45.6%**
$	15,000,000	$ 11,305,500	$	10.05	51.2%
			$	11.00	46.6%
			$	**11.20**	**45.6%**
			$	12.00	41.7%
			$	13.55	34.2%
$	20,000,000	$ 15,074,000	$	10.05	52.8%
			$	11.00	48.4%
			$	**11.60**	**45.6%**
			$	12.00	43.7%
			$	13.55	36.4%
$	25,000,000	$ 18,842,500	$	10.05	54.3%
			$	11.00	50.0%
			$	11.95	45.7%
			$	**12.00**	**45.5%**
			$	13.55	38.4%
$	30,000,000	$ 22,611,000	$	10.05	55.8%
			$	11.00	51.6%
			$	12.00	47.2%
			$	**12.35**	**45.6%**
			$	13.55	40.4%

(1) Based on 75.37% of overall increase assigned to the Residential Class, consistent with the MGE's recommended revenue responsibility (Ex. 25 at 22:8, as corrected in Ex. 26 at 30:20 to 31:2.

(2) Ex. 23, Sch. FJC-3 shows Residential bills and volumes of 5,337,625 and 393,967,586 Ccf. Based on current rates and these billing units, 45.6% of Residential revenue is volumetrically dependent with today's rates, or (393,967,586 x $0.11423) divided by ($10.05 x 5,337,625 + 393,967,586 x $0.11423).

The bold entries in the foregoing table shows the fixed monthly rate element necessary for the residential class to maintain the status quo for MGE in terms of fixed vs. volumetric revenue recovery. For example, with a $25,000,000 overall revenue increase, a $12.00 residential customer charge would be required *merely to maintain* the current 55%/45% fixed vs. volumetric revenue recovery. In order to avoid continuation of the history of earnings shortfalls that MGE has experienced with the current rate design, the Commission must approve a residential customer charge above this $12.00 level.

Increasing the fixed monthly rate element for the residential class is not inimical to customer interests as OPC suggests. For the residential class, the vast majority of volumes are consumed during the winter season, when gas costs tend to be the highest. Recovering costs through the fixed monthly rate element therefore mitigates increases to volumetric rate elements billed to customers during the winter season when customers' bill-paying difficulties are most likely to emerge. (Ex. 23 at 28:21 to 29:1) Moreover, recovering costs through fixed monthly rate elements tends to mitigate the impact of rate increases on higher volume users within the customer class. In the instance of the residential class, it is obvious that high volume usage occurs by some customers due to the presence of older, less energy efficient housing, stock and appliances. These customers may already be having difficulty paying their bills. To magnify that burden by needlessly recovering all, or the vast majority, of the revenue increase by way of volumetric rate elements -- as would be required if the OPC proposal to reject any increase to the residential fixed monthly rate element is adopted -- makes no sense.

3. Volumetric Rate Elements

As discussed above and in MGE's initial brief, both Staff and OPC propose that the bulk, if not all, of any revenue increase authorized by the Commission in this case be recovered by increasing volumetric rate elements. The Staff's initial brief scarcely addresses the issue of volumetric rate elements (Staff Br., pp. 49-50), so MGE has no further reply to this aspect of the Staff's presentation on volumetric rate elements beyond MGE's discussion of the fixed monthly rate element issue set forth above.

Despite recommending that the entirety of any revenue increase authorized in this case be recovered through volumetric rates, OPC still opposes either a Laclede-type weather mitigation rate design or a more traditionally structured weather normalization clause. (OPC Br., p. 94) In support of its recommendation, and in opposition to any meaningful form of weather mitigation rate design for MGE, OPC: points to general customer opposition to rate increases (OPC Br., p. 96); asserts that mitigating weather risk inappropriately guarantees revenues to MGE and harms MGE's customers (OPC Br., pp. 96-104; and declares the use of a traditionally structured weather normalization clause unlawful in Missouri (OPC Br., pp. 105-112). MGE will address each of these items in turn.

a. OPC's Arguments Against Weather Mitigation Rate Design Are Based On Flawed Analysis.

With regard to OPC's argument that customers generally oppose rate increases, MGE agrees. In fact, as a customer of many vendors itself, MGE also generally opposes rate and price increases. This general opposition to paying more for basically the same service, while understandable and perhaps universal, serves as no reasonable basis for the Commission to decide any of the issues presented in this case. In fact, of MGE's more than 500,000 customers, fewer than 33 chose to testify during the local public hearings. Moreover, a reading of the local public hearing transcripts reveals that of the 33 individuals who testified during the local public hearings, 10 actually testified about positive actions MGE and its employees have taken in the community.

OPC's argument that a weather mitigation form of rate design "guarantees" or "locks-in" a certain level of revenues warrants a number of responses. First, the undisputed evidence proves that *never* in the past five years has MGE's actual average use per residential customer reached the use per customer assumed in the rate setting process. Effectively, this means that MGE has been guaranteed revenue and earnings *shortfalls* for at least the past five years. This is clearly not the desired result of the regulatory ratemaking process and it certainly deserves a better regulatory response than the "status quo" proposed by OPC and the Staff. Second, the example shown on pages 97 and 98 of OPC's Brief attempting to describe the impact of warmer than normal weather on the weather mitigation rate design is wrong in that it erroneously assumes that only higher use residential customers are affected by weather and that no residential customer who typically consumes up to 68 Ccf in a given winter month will actually consume less gas under warmer than normal conditions. A residential customer's non-weather sensitive usage, or base load is in the range of 17-19 Ccf (Ex. 23, Sch. FJC-1), *not* 68 Ccf, as the OPC calculation requires. And, 23% of winter residential bills register 68 Ccf or less usage, and usage on those bills will fall under warmer than normal weather. (Ex. 26 at 45:18) Furthermore, under the weather mitigation rate design, each lost unit under 68 Ccf carries a higher price and, therefore, a correspondingly larger revenue impact. Clearly, in ignoring these facts, this erroneous OPC example misportrays the impact of the weather mitigation rate design which, as the name denotes, mitigates -- but does not eliminate -- the impact of weather.

In attempting to conjure up customer harm from the weather mitigation rate design, OPC argues that it would foreclose customers' ability to control their gas bills.

(OPC Br., p. 98) This is ludicrous. The PGA rate will remain a separate rate element under the weather mitigation rate design, so any conservation enhancements a customer is able to achieve will be reflected on that customer's gas bill as a direct savings in commodity costs. At the current PGA rate, each 10 Ccf reduction in usage translates into a savings of $7.50, a strong incentive to control bills. (Ex. 26 at 44:4-6)

OPC makes additional unsubstantiated claims in arguing that the weather mitigation rate design will result in larger PGA/ACA adjustments due to weather variation (OPC Br., pp. 99-101) that are not symmetrical between the Company and the customer. (OPC Br., pp. 103-104) MGE demonstrated that the analysis by OPC witness Meisenheimer ("Meisenheimer") purporting to show that the weather mitigation will cause customers to pay more because its design is structured to undercollect gas costs is simply wrong. (Ex. 26 at 46:19 to 49:13) In its brief, though, OPC tries to salvage its flawed analysis by concocting a reality-defying scenario under which usage in the first rate block (i.e., up to 68 Ccf) increases, but usage in the second rate block (i.e., above 68 Ccf) declines. (OPC Br., p. 101) Although the calculations associated with the scenario are mathematically accurate, OPC fails to explain how, or under what circumstances, such shifts in usage among the first and second rate blocks could actually occur. This is because there are no circumstances under which this OPC scenario could actually come to pass: if weather is warm, usage in both rate blocks will decline; if weather is cold, usage in both rate blocks will increase. The fundamental structure of the weather mitigation rate design -- that average use customers pay less in gas costs than are recovered from greater than average use customers -- continues to elude OPC. Table 4, on page 104 of OPC's initial brief, illustrates OPC's continued confusion, as explained by Dr. Cummings. (Ex. 26 at 47:4 to 48:16)

For its final salvo of alleged customer harm associated with the weather mitigation rate design, OPC argues that it will subject the gas cost portion of customer bills to greater volatility. (OPC Br., pp. 102-103) Contrary to OPC's assertion that increased use in the winter will "cause relatively *higher bills* under the Company's proposal" (OPC Br., p. 103; emphasis supplied), MGE demonstrated that with higher usage under colder than normal weather conditions, the weather mitigation rate design results in *lower* total bills. (Ex. 26 at 50:1-19)

b. The Commission Has The Legal Authority To Adopt A Weather Normalization Clause For MGE On An Experimental Basis.

In light of the unexpected opposition by the Staff and OPC to implementing the weather mitigation rate design that was just adopted for Laclede Gas Company, MGE has proposed an alternative: the adoption, on an experimental basis, of a more traditionally structured weather normalization clause. (Ex. 25 at 34:1 to 38:12)

OPC devotes significant verbiage to its attempt to convince the Commission that adopting a weather normalization clause for MGE is unlawful because it supposedly would violate the holding of the Missouri Supreme Court in *State ex. rel. Util. Consumers Council, Etc., v. P.S.C.*, 585 S.W. 2d 41 (Mo. Banc 1979). ("*UCCM*") Although this analysis may be persuasive to OPC, it neglects to address two very significant points.

First, MGE has proposed that the Commission adopt the weather normalization clause as an experiment. (Ex. 25 at 37:13-21) The Commission possesses authority recognized by the courts to establish experimental rates. (*See State ex rel. Fischer v. MO P.S.C.*, 670 S.W.2d 24 (Mo.App. W.D. 1984); *State ex rel. Laclede Gas Company v. MO P.S.C.*, 535 S.W. 2d 561 (Mo.App. K.C.D. 1976); *State ex rel. McKittrick v. MO P.S.C.*, 175 S.W. 2d 857 (Mo. banc 1943); *State ex rel. Campbell Iron Company v. MO P.S.C.,* 296 S.W. 998 (Mo. banc 1927); *State ex rel. City of St. Louis v. MO P.S.C.*, 296 S.W. 790 (Mo. banc 1927); *State ex rel. Watts Engineering Company v. MO P.S.C.,* 191 S.W. 412 (Mo. banc 1917)) OPC's legal analysis utterly fails to address why the Commission lacks authority to approve a weather normalization clause on an experimental basis as proposed by MGE.

Second, *UCCM* concerned the lawfulness of a mechanism called a fuel adjustment clause for an electric utility, not a weather normalization clause for a gas utility. In fact, no Missouri court has ever declared a weather normalization clause to be unlawful. Even though the Missouri Supreme Court declared the fuel adjustment clause unlawful in *UCCM*, the Commission has recently approved similar adjustment clauses -- called interim energy charges -- for two electric utilities *on an experimental basis*. (*See*, Case No. ER-2001-299, *Re: Empire District Electric* (Report and Order Dated September 20, 2001); and Case No. ER-2004-0034, *Re: Aquila* (Order Approving Stipulation and Agreement Dated April 13, 2004)) OPC's legal analysis utterly fails to explain how the Commission can possess authority to authorize the implementation of experimental interim energy charges even though a similar fuel adjustment clause was declared unlawful in *UCCM*, but lacks the authority to approve an experimental weather normalization clause, even though no similar clause has been declared unlawful by any Missouri court.

Given all of this precedent, some very recent and some relatively old, MGE submits that the Commission clearly has the authority to adopt the weather normalization clause proposed as an alternative by MGE in this case. Therefore, OPC's legal analysis should stand as no barrier to implementation of an experimental weather normalization clause for MGE in this case.

OPC also advances a few policy-based arguments against the adoption of an experimental weather normalization clause for MGE, stating that MGE's ROE must be reduced on account of reduced risk, that a weather normalization clause does not serve the public interest, and that a weather normalization clause would inappropriately guarantee MGE's ability to catch fish. (OPC Br., pp. 108, 110-111) As indicated in MGE's initial brief, many of the companies in the comparative company groups used by each of the rate of return witnesses in this proceeding have weather normalization clauses in effect and, consequently, any risk/return reducing effects have already been reflected in the DCF analyses. (MGE Br., p. 86) OPC's own initial brief contains information showing how a weather normalization clause serves the public interest -- under a weather normalization clause "[I]n an unusually cold month, the customer would have paid a lower unit rate for his actual usage than MGE's current tariffed rate." (OPC Br., p. 109) Similar to the weather mitigation rate design, a weather normalization clause helps mitigate high bills during unusually cold weather, a time when many customers typically have a difficult time paying their gas bills. The fact that a weather normalization clause would reduce the significant variability MGE has experienced in its volumetric revenue streams is an additional benefit to this positive customer outcome, but this is not to say that implementation of a weather normalization clause would somehow "guarantee"

MGE's earnings. A host of other potential revenue-related risks remain, including the risk of customer losses and associated volumetric revenue shortfalls due to economic and employment conditions, high gas costs, increased appliance efficiency and improved construction practices, or competition from alternative energy providers (primarily electricity and interstate pipelines). Certainly a weather normalization clause can have absolutely no effect on the non-revenue related risks to which MGE is subject (cost increases, litigation, etc.). The bottom line is that while implementation of a weather normalization clause would help better align MGE's variable revenue streams with its largely fixed cost structure, many other risks will remain and MGE must be successful in its own efforts in order to optimize its earnings.[9]

4. Miscellaneous Service Charges

Although MGE adequately addressed this issue in its initial brief and will not belabor the record by simply repeating those points in this reply brief, a couple of points deserve to be made. OPC bemoans the magnitude of the increase in the Connection charge and asserts that high Connection and Reconnection charges are a barrier to

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[9] Many regulatory authorities outside the State of Missouri have seen the public interest benefits in implementing weather normalization clauses for LDCs. *See, In Re: Petition for Approval of Addition to Current Tariff to Implement, on a Three-Year Experimental Basis, a Weather Normalization Adjustment (WNA) rider by West Florida Natural Gas Company*, Docket NO. 960831-GU; Order No. PSC-96-1192-FOF-GU, Florida Public Service Comm'n, 1996 Fla. PUC LEXIS 1587, 96 FPSC 9:525, September 23, 1996. (stating that "Brooklyn Union Gas Company introduced the first weather normalization clause in 1980. Since then over thirty gas utilities in fourteen states have implemented weather normalization procedures. These states are: Alabama, California, Connecticut, Georgia, Kentucky, Maryland, New Jersey, New York, North Carolina, Ohio, South Carolina, Tennessee, Texas and Virginia. Interest in weather normalization appears to be growing. A recent survey conducted by the American Gas Association indicated that forty-four companies, operating in fifty-two jurisdictions across twenty-six states and Canada, have either filed for, or put weather normalization clauses into effect.")

customers initiating service. (OPC Br., pp. 113-114) First, the $45 Connection and Reconnection charges proposed by MGE are consistent with the charge for such services approved by the Commission for Laclede ($36 and $54, respectively); OPC makes no attempt whatsoever to explain how these charges for Laclede are not a barrier to service while similar charge levels for MGE are purportedly unreasonable barriers to service. Second, by simply paying their gas bills, customers may avoid the Reconnection charge altogether. Third, according to MGE's tariff (Section 3.03, Sheet No. R-20), the Connection charge can be spread out and paid over a period of four months at the customer's option. Clearly, the Connection and Reconnection charges proposed by MGE and supported by the Staff are not unreasonable barriers to service.

H. Low-Income Proposals

MGE does not have its head in the sand, as alleged by OPC. MGE recognizes that many customers have difficulty paying their gas bills, and MGE has demonstrated an extensive track record of support for and participation in energy affordability initiatives. MGE's activities in the low-income area include: 1) the employment of "customer advisors" whose primary responsibility is to help connect customers in need of energy assistance with providers of energy assistance; 2) the low-income weatherization program, initially in partnership with the City of Kansas City and later with other providers; 3) being the first energy utility in Missouri to implement a low-income rate; and 4) working to enhance the delivery of energy assistance to special needs customers and to expand utilization of Earned Income Tax Credits in Missouri. (Ex. 10 at 30:3-17; Ex. 14 at 13:22)

In light of its extensive involvement with low income programs thus far, MGE must focus its low-income activities on matters that can be shown to provide demonstrable benefits to MGE's customers and which do not require burdensome administrative oversight by MGE. (Ex. 10 at 30:19-22) Consequently, MGE cannot support adoption of the Non-unanimous Stipulation and Agreement filed on July 7, 2004 by Staff, OPC, and other parties to this case ("Non-Unanimous Stipulation").

1. Weatherization

MGE supports expanding funding of the existing low-income weatherization program by $160,000 annually, because the program has been demonstrated to be effective and does not require significant administrative involvement of MGE personnel. (Ex. 10 at 31:6-17) MGE does not support the proposed changes to the program proposed by the signatories to the Non-unanimous Stipulation .

2. ELIR

The existing experimental low-income rate ("ELIR") program has not been operational long enough to generate data sufficient to adjudge the program either a success or a failure. (Ex. 10 at 31:19-21) However, because sufficient funds remain in hand to continue the existing ELIR without collecting additional amounts from residential customers, MGE supports continuation of the existing ELIR program in the Joplin area without any changes through July of 2006 or until funding runs out, whichever occurs first. MGE is willing to commit resources to continue administering the existing ELIR as long as no changes are made to the program which would require additional administrative resources from MGE.

The program has required significantly more administrative involvement than MGE originally anticipated (Ex. 10 at 31:22 to 32:1), and it is unclear whether the low-income rate offering has had any material impact on customer payment practices (Ex. 10 at 31:20-21). Further, the terms of the Non-unanimous Stipulation and Agreement place further burdens and costs upon MGE. The existence of such additional costs is clear by reading the Non-unanimous Stipulation that devotes more than two full pages and 12 separate paragraphs to proposed modifications to the existing ELIR. To suggest that an outside agency could step in and handle all of the details associated with implementing these proposed modifications with no additional involvement and expense by MGE is unrealistic. Furthermore, the $10,000 in additional cost recovery proposed to administer these complicated modifications is clearly inadequate, and MGE does not consent to absorb the additional costs associated with implementing such modifications.

The signatories to the Non-unanimous Stipulation have made absolutely no effort to explain the source of the Commission's authority to impose the suggested modifications to the ELIR on MGE. The reason for this failure is simple: no such authority exists. By adding obligatory weatherization for participant's homes, Staff and OPC have exceeded what courts consider an experimental rate. The costs and resources for improving a participant's home go beyond a "rate" which is appropriate for a general rate case proceeding. Consequently, MGE is unable to support the modifications to the ELIR program suggested by other parties to this case.

3. PAYS

MGE is unwilling to implement the PAYS program described by OPC witness Meisenheimer and proposed through the Non-unanimous Stipulation. The Commission has not made any policy statement regarding energy efficiency initiatives such as PAYS in the course of its ongoing case looking into these matters (Case No. GW-2004-0452), and MGE is of the opinion that implementation of the PAYS program at this time would be premature. (Ex. 10 at 32:10-16) Further, like all organizations, MGE has limited resources. MGE has a responsibility to focus its resources in the manner it best sees fit, recognizing that its core constituencies are customers, employees and shareholders. (Ex. 14 at 3:13-15)

None of the signatories to the Non-unanimous Stipulation has made any effort to explain the source of the Commission's authority to impose the obligation to implement PAYS upon MGE. No such authority exists. Nor have any of the signatories made any effort to explain why such a program should be undertaken by any utility -- at the direction of the Commission -- in any event. To the extent that energy efficiency improvements are sought by government for a broad base of customers who have not been shown to need external assistance, then such a governmental initiative should properly be funded through tax revenues and be subject to the accountability controls of the ballot box and the Hancock amendment.

MGE supports responsible adoption of weatherization programs, but the development of PAYS remains in its early stages. To characterize MGE's stance on energy affordability matters as uninvolved or uncommitted significantly misstates the facts. Having said this, MGE does not believe implementation of another program such as PAYS is reasonable at this time.[10]

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[10] MGE continues to be a participant in Case No. GW-2004-0452, however, and, as indicated by MGE witness Noack on the stand remains willing to evaluate the prospects for implementation of a program such as PAYS in the future. (Tr. 2371:22 to 2372:20)

I. Other Issues

1. Merger & Acquisition Record Keeping

The matter currently before the Commission is a general rate case for the purpose of setting rates, and therefore Staff's proposal for certain detailed time reporting records is not properly before the Commission in this proceeding. A Commission requirement that MGE maintain certain records meets the statutory definition of a "rule" under Section 536.010 RSMo 2000. Agencies that seek to avoid statutory rulemaking requirements are not tolerated by the General Assembly in that any rules made that do not follow the procedure specified are "null, void and unenforceable." Section 536.021.7 RSMo 2000.

Staff's request that this Commission order MGE to implement detailed time reporting records is outside the authority of the Commission during a general rate proceeding, and amounts to improper rulemaking and therefore should be denied. As the Commission has clearly recognized, rules are appropriate when the Commission mandates that similarly situation entities submit information in a uniform format. The filing and reporting requirements located in 4 CSR 240-3 indicate that the Commission understands the framework for rulemaking. Staff unfortunately believes that rulemaking by Commission order is permissible and in this mistaken belief proposes action by the Commission which is beyond the scope of its authority. Therefore any suggestion by

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MGE does not possess limitless resources for such evaluation efforts, however, as it has neither a marketing department nor a research and development department and, consequently, no costs for such non-existent departments are included in its revenue requirement in this case. (Tr. 2383:3-11) Moreover, MGE's regulatory department is staffed by a total of two employees, in addition to an administrative assistant, who have many additional responsibilities -- regulatory and otherwise -- beyond evaluation of programs like PAYS. (Tr. 2494:9-11)

Staff to suggest to the Commission that such legal subterfuge is appropriate, should be rejected.

2. Gas Purchasing Plan/Reliability Plan Reporting

Staff was the only party, other than MGE, to submit an initial brief on this issue. Nothing in Staff's brief demonstrates that MGE is incorrect in its assessment that, if the Commission wants this information from gas companies, the appropriate and required procedure is a Chapter 536 RSMo rulemaking.

Staff's brief on page 58 suggests that the only way the Commission can be assured that MGE "will not fail its customers" by not planning carefully enough is to require MGE periodically to "file sufficient information" with the Staff. The Staff is simply wrong about that, on several levels.

MGE has been operating in Missouri since February of 1994. There is no evidence that MGE has *ever* failed to serve a single customer because it did not plan appropriately or secure an adequate supply of natural gas. (Tr. 1637:19 to 1638:10) So the implication that MGE will fail in its duty *unless* the Staff has this certain information is certainly not apparent after more than a decade of performance by MGE. MGE has been quite capable of fulfilling its duty in the absence of this specific periodic reporting requirement and there is no evidence to the contrary.

Next, the Staff suggests that the only manner in which the Commission can "accomplish its obligation" is by ordering MGE to file this information. (Staff Br., p. 58) Wrong again. This assertion completely ignores the fact that the Staff can seek to request information from MGE at *any* time on *any* subject. The Commission's procedural rules allow all of the types of discovery used in civil litigation. In addition, it has a unique format which the Commission calls "data requests." (*See*, 4 CSR 240-2.090 Discovery and Prehearings) Staff's witness Jenkins admitted that no one has taken away the Staff's ability to send data requests or to take depositions of MGE employees. (Tr. 1653:6-11) So the Staff already has sufficient tools to obtain information from MGE. She also admitted that MGE has not refused to provide any information in its possession. (Tr. 1653:12 to 1655:7)

All of this demonstrates that the Staff simply wants MGE and the other gas companies to be ordered to submit the same general type of information periodically without the Staff having to go to the inconvenience of asking for it. That has *nothing* to do with a rate case and *everything* to do with the statutory definition of a "rule," as MGE explained in its initial brief. (MGE Br., pp. 93-96)

Staff says in its initial brief on page 59 that "planning is essential" and provides examples of why it believes that. MGE wholeheartedly agrees that planning is essential. There is no evidence, however, that MGE has failed to adequately plan for service to its customers. Staff seems to be suggesting, however, that it alone knows the proper procedure for planning and that only by the Commission ordering MGE to file certain data that this proper planning will take place. There are myriad unproven assumptions contained in that suggestion, including the assumption that the Staff somehow possesses superior planning expertise in this area. That is a highly debatable assertion. There does not appear to be anyone on the Staff who has any practical experience or professional training whatsoever in gas supply procurement or planning that would be equal or superior to the experienced, trained and knowledgeable workforce employed by MGE.

On page 60 of its initial brief, Staff suggests that "employee turnover" is a "major reason" to have written procedures in place. Again, MGE does not dispute these generalities. MGE does take issue, however, with the implication that its management decisions regarding the staffing of its gas supply function have somehow jeopardized service, and that the periodic filing of some information with the Staff is somehow going to ensure there will never be any problems. Staff has not produced any evidence whatsoever to substantiate these assertions.

On page 61 of its initial brief, Staff claims generally that MGE has not given Staff adequate information. This is apparently a repetition of unproven allegations which have been either raised or already litigated, or both, in pending cases at the Commission. MGE still maintains that it is improper for the Staff to be raising them again in this inappropriate forum while they are under consideration elsewhere.

On page 61 of its initial brief, Staff finally tackles MGE's assertion that if the Staff's proposal has any merit at all, it should be considered in the context of a rulemaking. Staff claims that the Commission does not have to engage in a rulemaking because it has authority to assure that MGE is able to meet its customers' needs pursuant to section 393.140(1) RSMo. That cited subsection gives the Commission "general supervision" over all utilities. The connection between "general supervision" and the instant topic is not readily apparent. There are arguably other statutory provisions that would be more relevant.

Staff claims on page 61 of its initial brief that there is "no need for a rule" that a utility company "should be operated efficiently to meet its customers needs." MGE is not certain as to how that is relevant to the issue, either, but simply observes that it could be very difficult for the Commission to craft a rule or an order defining "efficiency" in this particular context. MGE is already subject to the statutory requirement that it provide safe and adequate service. (Section 393.130 RSMo)

Staff then claims on page 61 of its initial brief that a rule is general by nature and "MGE's plans must be designed for its specific service areas." Those two statements are both facially correct. But the implication that simply because MGE must plan for a specific area inherently excludes a general rule is wrong on so many levels that it could take dozens of pages to fully discredit it. There are also statements on the same page that "the Commission's ruling in this case must be customized to fit MGE's situation." Suffice it to say that this same faulty analysis applies to every company's annual report, which is mandated by *statute* and implemented by Commission *rules*. The *responsive information* in annual reports may be unique to the utility's service area, but the *requirement to file the information* is general in nature. There certainly was no evidence in this case that the Staff was requesting *categories* of information unique to MGE or western Missouri where it serves. Indeed, the Staff witness plainly said: "I'm not asking for more than I'm getting from the others [gas companies]." (Tr. 1650:4-5) So these assertions in the Staff's brief that this information requirement is somehow unique to MGE are in direct opposition to the testimony of the witness.

Then Staff claims on page 61 of its initial brief that MGE is "unique" because it is the only utility that recently "completely dismantled" its gas supply department. This is hyperbole that does not comport with the facts and is certainly not justification for the unlawful imposition of a reporting requirement. There has *always* been a gas supply department serving MGE. For several years it was physically located in Texas and served another state besides Missouri. After Southern Union sold its Texas gas distribution properties, it was moved to Missouri. Now it is physically located in Kansas City and serves only the interests of Missouri customers. (Tr. 1640:17 to 1641:1) The Staff's witness doesn't know how many gas supply people are in the Kansas City office: "If I had to guess, I'd say four or five individuals." (Tr. 1648:11-15) She also has no familiarity with their experience or training. (Tr. 1649:6-8) None of these facts make MGE so unique that it lawfully excludes a rulemaking. Staff clearly wants information in a uniform format on a periodic basis from all the gas companies. The Staff witness admitted that. Some of the other companies have apparently voluntarily agreed to provide some of this information. MGE so far is the only company to point out that the law requires the Commission to follow a different procedure to lawfully implement such a requirement.

The Staff alleges at the bottom of page 61 of its initial brief that "the law does not require the Commission to promulgate a rule" to require a company to do a "good job of purchasing gas for its captive customers." MGE completely agrees. In fact, the statute already requires MGE to provide "safe and adequate" service. There has been no specific allegation in this case that MGE has failed to do that. Moreover, the statute does not specify "good" service. And the Staff does not suggest a definition of what "a good job" would be. Whether the particular information Staff seeks will necessarily translate to doing a "good job" is something that should be subjected to the full range of comment and criticism inherent in the rulemaking process, not debated in the context of a rate case.

The Staff then claims that the Commission may choose to regulate by adjudication or by rulemaking, citing *State ex rel. Atmos Energy Corp. v. PSC*, 103

S.W.3d 753, 760 (Mo. 2003) ("*Atmos*"). That case is really not on point here because in that case the PSC *did* choose to pursue a rulemaking. That is what MGE is saying the Commission should do in this instance. A rulemaking is the appropriate procedure to deal with the proposed filing requirement because what the Staff wants to do meets the statutory definition of "rule." Apparently, the General Counsel's office is now telling the Commission that it does not have to follow the same procedure the General Counsel's office defended in the *Atmos* case. From MGE's perspective, that is less than sound legal advice.

As documented in MGE's initial brief, the Staff wants the *same* general information to be *periodically submitted* by *all* of the gas companies. That clearly meets the statutory definition of a "rule." The Commission, while it may have the power to choose between adjudication and rulemaking in appropriate situations, is not above the law and *Atmos* did not purport to give the Commission the authority to violate Chapter 536 RSMo. It applies to the Commission just as it does to other agencies, as the Commission discovered when courts struck down and held as unenforceable unpublished policies of the Commission that met the definition of "rule." (*State ex rel. Gulf Transport Co. v. Public Serv. Comm'n*, 658 S.W.2d 448, 454 (Mo.App. W.D. 1983) and *State ex rel. Beaufort Transfer Co. v. Public Serv. Comm'n*, 610 S.W.2d 96, 99 (Mo.App. W.D. 1980)) Also, as indicated in MGE's initial brief, the General Assembly has recently tightened those requirements with the enactment of provisions that allow parties to seek attorneys fees in situations where a rule is determined to have been necessary.

In summary, the Commission should resolve this issue by simply telling the Staff that if it wants gas companies to be required to file periodic information with the

Commission regarding gas supply, it should initiate a rulemaking proceeding. Preferably, it would commence in an informal process involving all affected parties so that an attempt could be made to work out a lot of the issues before any formal process was initiated. In that manner, all of the issues presented by the Staff's proposal can be debated and addressed in a proper and lawful forum, as opposed to taking up valuable time and resources in a rate case.

3. Legislative/Lobbying Time Reporting

The matter currently before the Commission is a general rate case for the purpose of setting rates, and therefore Staff's proposal for certain detailed time reporting records is not properly before the Commission in this proceeding. A requirement that MGE maintain certain records meets the statutory definition of a "rule" under Section 536.010 RSMo 2000. Agencies that seek to avoid statutory rulemaking requirements are not tolerated by the General Assembly in that any rules made that do not follow the procedure specified are "null, void and unenforceable." (Section 536.021.7 RSMo 2000)

Staff's request that this Commission order MGE to implement detailed time reporting records is outside the authority of the Commission during a general rate proceeding, amounts to improper rulemaking and therefore should be denied.

4. Response Time to Commission-referred complaints/inquiries

The Staff has made no attempt to explain the source of the Commission's authority to order MGE, in the context of this general rate case -- which is a contested case proceeding under the Missouri administrative procedure act -- to respond to Commission-referred complaints/inquiries within specified time frames. The reason for this failure is simple: no such authority exists. The Commission should decline the invitation of its Staff to engage in unlawful procedure.

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

Southern Union has complied with the study requirements of the Stipulation and Agreement approved by the Commission in Case No. GM-2003-0238 and contained specifically in paragraph III. 3. G. Southern Union has provided to Staff a Cost Allocation and a Joint and Common Costs Model. (Ex. 828 at 10:12-16) However Staff has taken the position that this is not the specific study it *contemplated* in the Stipulation and Agreement. (Staff Br., p. 64)

At the most rudimentary level, Staff's complaint on this issue is that MGE delivered the goods but what Staff really wanted wasn't what MGE delivered, despite the fact that what MGE delivered meets the parameters of the Stipulation and Agreement.

MGE points out here to the Commission that stipulations and agreements are routinely hammered out between regulated utilities and the Staff. That joint input in the drafting of these agreements provides Staff with an opportunity to outline, in detail, what would ensure that their "contemplations" are accurately manifest by the utility. The actions of Southern Union with regard to the Stipulation and Agreement fulfill the special study requirements of paragraph III. G. 3. No record evidence to the contrary supports Staff's complaint and therefore no further action by the Commission is required.

J. True-Up Issues

1. Rate Case Expense

MGE requests rate recovery of rate case expense actually incurred and invoiced as of the True-Up Hearing date (July 23, 2004), normalized over three years ($435,111) or, if the rate relief authorized by the Commission from this case is sufficient to enable the resulting rates to remain in effect for four years, a four-year normalization ($345,833). Instead of using actual rate case expense, however, the Staff and OPC have chosen to fabricate rate case expenses for inclusion in MGE's revenue requirement, amounts which rely significantly on MGE rate case expense in prior general rate proceedings. (Staff Br., p. 67; OPC Br., pp. 80-81) These fabricated amounts are neither appropriate nor reasonable to use for setting rates in this case.

Both the Staff and OPC assert that MGE has failed to justify its decision to employ the services of Messrs. Herschmann and Fay in this matter. MGE adequately disposed of those threadbare assertions in its initial brief. (MGE Br., pp. 102-105) OPC alleges that the work of Ms. Dodds (of the Watson Bishop law firm) duplicated the work of other attorneys (OPC Br., pp. 81-82), yet the OPC witness making this allegation admitted that she really had no basis to make it in that she: is not a lawyer (Tr. 2571:2-3); has never worked at a law firm (Tr. 2571:4-5); has never hired a lawyer or law firm (Tr. 2571:22-24); has never had any training in assessing the reasonableness of attorneys' fees (Tr. 2571:6-10); has never evaluated the effectiveness of a lawyer or law firm (Tr. 2574:9-11); does not know how to evaluate the effectiveness of a lawyer or law firm (Tr. 2574:12-14); and does not have a firm grasp at all of how lawyers prepare for litigation or how much lawyers responsible for a rate of return issue worth more than $20 million should prepare (Tr. 2575:19 to 2576:19). This OPC witness clearly has no basis to form any reliable opinions on the question of the reasonableness of attorneys' fees, as confirmed by a ruling from the bench. (Tr. 2580:24 to 2581:1)

OPC also argues that MGE witnesses Quain ("Quain") and Morin ("Morin") were either unnecessary or excessively compensated. (OPC Br., 82-83) Both Morin and Quain are individuals uniquely qualified to render their expert opinions through pointed testimony germane to the policy questions facing the Commission in this case and particularly relevant to the rate of return issue, valued at more than $20 million. It is MGE's belief, and this is the very reason each of the individuals who were retained as outside consulting experts were selected by MGE to assist in this case, that both Quain and Morin materially improved MGE's ability to provide the Commission with solid and meaningful information that will assist the Commission in making its decision. As to Quain's testimony, this OPC argument, if adopted, would usurp what is clearly a function that is reserved to management. Dr. Morin is acknowledged to be one of the preeminent experts in the rate of return field by both the Staff and OPC, and insight and advice from an expert of Dr. Morin's stature on the most significant issue in this case -- an issue that is worth more than $20 million per year -- can only be helpful to the Commission.[11] Furthermore, the Commission has in the past recognized that adoption of such proposals could have a chilling effect on companies' efforts to put forward effective cases in violation of companies' procedural rights. (*Re: St. Joseph Light & Power Company*, 2 Mo. P.S.C.3d 248, 260-261 (1993))

[11] OPC also tries to make much of the fact that Mr. Oglesby did not approve Dr. Morin's retention until three days after the filing of his testimony. (OPC Br., p. 83) As indicated in Hearing Exhibit 50 (at approximately the 11th page of the document), "[D]ue to severe time constraints associated with testimony filing deadlines, I [Rob Hack] approved prior to obtaining formal, up-line approval." This document, as well as the other material comprising Hearing Exhibit 50, demonstrates that MGE and Southern Union Company management devoted significant attention to the process of retaining necessary consulting experts for the effective prosecution of this rate case.

The Staff quibbles about business meals, automated research and out-of-pocket costs, apparently arguing that MGE must lack fiscal controls because MGE witness Noack ("Noack") could not provide line item detail for these invoice amounts on the stand. (Staff Br., p. 67) This Staff argument is ludicrous on its face and need not be dignified with a response here, except to point out that the invoice entries about which Staff counsel queried Noack amounted to a total of less than $7,000.

The real irony in all of these Staff and OPC allegations concerning allegedly excessive rate case expense can be found by comparing them to the Staff and OPC response to the evidence demonstrating MGE's superior O&M cost-effectiveness. (*See*, Staff Br., pp. 20-22; OPC Br., p. 61) This comparison reveals that although the Staff and OPC find it very difficult, and well nigh impossible, to perceive or acknowledge cost-effectiveness by MGE in terms of annual O&M cost per customer, neither the Staff nor OPC has any qualms whatsoever about leveling allegations of excessive rate case expense. Such one-sided advocacy would perhaps be expected by a party like OPC which is specifically charged with representing and protecting the interests of the public. (*See*, section 386.710.1(2) RSMo) A more balanced approach from the Staff, however, would be proper and more helpful to this Commission.

2. Kansas Property Tax on Storage Gas

MGE has requested that the Commission either include the approximately $1.2 million in increased costs associated with this newly enacted Kansas tax in rates or grant an accounting authority order ("AAO") permitting MGE to defer such costs so that MGE may request rate recovery in MGE's next general rate proceeding.[12] The Staff opposes rate recovery of these costs in this case, but does recommend that the Commission grant an AAO to MGE for these costs in its order in this case. (Staff Br., p. 69) OPC, on the other hand, opposes both rate recovery *and* the granting of an AAO. (OPC Br., pp. 84-85)

OPC makes a slew of arguments in an effort to persuade the Commission to ignore the cost impact of this newly enacted Kansas law on MGE. None of the OPC arguments withstands scrutiny.

OPC first argues that the Commission should ignore this new item of cost because MGE did not raise it in direct, rebuttal or surrebuttal testimony. (OPC Br., p. 85) Since MGE was not aware that the new tax was going to be collected until after receiving correspondence from Kansas tax assessment authorities dated July 2, 2004 (Ex. 49, Sch. MRN-2, p. 4 of 6; Tr. 2531:20-24), MGE's inability to raise the matter in testimony filed prior to that time is not surprising. MGE's lack of clairvoyance on this matter certainly serves as no reasonable basis for the Commission to ignore the cost impact of this new tax on MGE.

OPC next argues that the new tax will not be paid until late in 2004 and is therefore an out of period adjustment. (OPC Br., pp. 85-86) Unfortunately for OPC, this is the same situation for *all* property taxes included in MGE's cost of service, which – like the new Kansas property tax on storage gas – are based on plant balances as of

12 Assuming reasonable ratemaking treatment in this rate case that would not require MGE to file another general rate case in the immediate or near future, MGE projects that it will file its next rate case no later than July 1, 2008.

December 31, 2003, and are to be paid in late 2004. MGE has not trued-up the new Kansas property tax on storage gas to April 30, 2004, as MGE witness Noack testified:

> Q. And is that the methodology [e.g., as of April 30, 2004] that you have proposed for the storage gas?
>
> A. No. We are using December 31st, 2003, like we are with all the rest of the plant.
>
> Q. For the plant -- the property taxes assessed on the plant balances as of 12/31/03, Missouri plant, when will those property taxes be paid?
>
> A. I believe they will be paid at the-- they will be paid in 2004.
>
> Q. When in 2004?
>
> A. I believe at the end of the year in December.
>
> (Tr. 2533:14 to Tr. 2534:1)

MGE's request that the new Kansas property tax on storage gas be included in MGE's revenue requirement in a manner consistent with all of the other property taxes certainly serves as no basis for the Commission to ignore the cost impact of this new tax on MGE.

In opposing the AAO alternative suggested by MGE and recommended by the Staff, OPC argues that because property taxes are recurring items, the cost impact on MGE of this new Kansas property tax does not qualify for AAO treatment. (OPC Br., pp. 86-90) OPC cannot both have its cake and eat it, too. If the tax is recurring, it should be included in rates now. If the tax is not recurring, it qualifies for AAO treatment which should be granted now. MGE is comfortable with either the rate recovery or AAO alternative, but simply ignoring the cost impact of this newly enacted tax -- as OPC proposes -- is unreasonable.

III. Conclusion

This record offers the Commission a very clear-cut choice.

If a majority of the Commission does not seek to create a regulatory environment that discourages investment in the State of Missouri by authorizing substandard returns, then MGE's position on capital structure and ROE should be chosen.

If a majority of the Commission does not seek to create a regulatory environment that ignores MGE's operating reality and the associated cost and revenue impacts, then MGE's position on capacity release/off-system sales revenues, environmental response fund, legislative costs, rate case expense, Kansas storage gas property tax, and rate design should be chosen.

If a majority of the Commission does not seek to create a regulatory environment that discourages efficiency and innovation, then MGE's position on incentive compensation, corporate expenses, and the rate of return adjustment for management efficiency should be chosen.

MGE believes that a majority of the Commission does, in fact, seek to create a regulatory environment that does not discourage investment in the State of Missouri, does not ignore utility operating realities and associated cost and revenue impacts, and does not discourage management efficiency and innovation. Consequently, for all of the foregoing reasons, and for those set forth in its initial brief and evidence, MGE requests that the Commission adopt its position on all of the contested issues in this proceeding.

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Respectfully submitted,

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Certificate of Service

I hereby certify that the foregoing has been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record on this 17th day of August, 2004.

James C. Swenegen