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In the Matter of Missouri Gas Energy's Tariff Sheets Designed to Increase Rates for Gas Service in the Company's Missouri Service Area.; In the Matter of Missouri Gas Energy's Proposed Modifications to its Facilities Extension Policy

Case No. GR-98-140 Tariff File No. 9800264; Case No. GT-98-237 Tariff File No. 9800387

PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

1998 Mo. PSC LEXIS 42; 7 Mo. P.S.C. 3d 394

August 21, 1998

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OPINION: As Corrected August 27, 1998

REPORT AND ORDER

I. Procedural History

On October 3, 1997, Missouri Gas Energy (MGE or Company), a division of Southern Union Company, submitted to the Missouri Public Service Commission (Commission) tariffs reflecting increased rates for gas service provided to the customers in the Missouri service area of the Company. The proposed tariffs contained [*3] a requested effective date of November 2, 1997, and were designed to produce an annual increase of $ 27,817,140 or 6.89 percent in the Company's revenues excluding gross receipts taxes, franchise fees or other similar fees or taxes. By order dated October 29, 1997, the Commission suspended the tariffs to September 2, 1998. The following entities filed timely applications to intervene, which were granted on December 9, 1997:

The County of Jackson, Central Missouri State University, University of Missouri-Kansas City, (Jackson County, et al.);
Williams Natural Gas Company (WNG);
Riverside Pipeline Company, L.P. and Mid-Kansas Partnership (Riverside/Mid-Kansas);
Mountain Energy Corporation (Mountain Energy); and
The City of Kansas City.

The Commission also granted the application of the City of St. Joseph to participate without intervention. By its order dated February 11, 1998, the Commission granted intervention to Kansas City Power & Light (KCPL) and Midwest Gas Users' Association (MGUA), and by its order dated February 26, 1998, the Commission granted intervention to Missouri Developers, et al. (MDEA).

On November 26, 1997, the Company filed its direct testimony and updated [*4] its direct testimony with a filing on January 30, 1998. On March 13, 1998, the Staff of the Missouri Public Service Commission (Staff) filed direct testimony, in addition to the Office of the Public Counsel (OPC) and MDEA. On March 17, Staff, OPC, Jackson County, et al. and MGUA filed rate design testimony.

A prehearing conference occurred the week of April 6.

The parties filed rebuttal testimony on April 23 and surrebuttal testimony on May 15. A hearing was held and evidence adduced from May 26 through June 4. All prefiled true-up testimony was filed on July 13. Initial briefs were filed on July 14. A true-up hearing was held on July 16 and reply briefs including true-up arguments were filed on July 31.

A. Stipulation and Agreements

1. Stipulation and Agreement Related to Rate Base, Income Statement and Return Issues:

On May 22, 1998, Staff, OPC and MGE filed a Stipulation and Agreement (Attachment A) in this proceeding relating to issues resolved under rate base, income statement and return. On May 29, intervenor Williams Natural Gas (WNG) filed a letter with the Commission indicating that WNG had no objection to the Stipulation and Agreement filed by the stipulating [*5] parties. On June 1, intervenors Jackson County, et al., and MGUA notified the Commission of their agreement with the Stipulation and Agreement.

The agreement provided that the parties have resolved various revenue requirement issues among themselves. If approved by the Commission, the Stipulation and Agreement would resolve the following issues:

1) Rate Base

a. Automated Meter Reading (AMR), except: 1) the issue between MGE and Staff of adding back meter readers consistent with the level of AMR investment in rate base prior to true-up; 2) the issue of the appropriate level of encoder-receiver-transmitters (ERTs) to

be held in inventory; and 3) the issue of the appropriate depreciation rate to be applied to ERTs;
b. Gas inventory;
c. Unamortized deferred credit per Case No. GM-94-40;
d. Customer advances;
e. Customer deposits;
f. Materials & supplies, except for the level of ERTs to be held in inventory;
g. Cash working capital; and
h. Prepayments.

2) Income Statement

a. Revenues and billing determinants;
b. Payroll, payroll taxes, benefits, insurance/injuries & damages;
c. Joint and common costs;
d. Uncollectibles;
e. Public Service Commission assessment;
f. Interest on [*6] customer deposits;
g. Clearing account issues;
h. State franchise and property tax issues;
i. Call center/telecommunications equipment upgrades;
j. Weatherization program expense;
k. 39th & Main public business office and Broadway building lease;
l. Dues and donations;
m. Controller's contingency;
n. Depreciation rate on corporate computer equipment;
o. Miscellaneous lease expense;
p. Legal, lobbying and other outside services expenses;
q. Advertising;
r. Federal income taxes, including but not limited to the rate base item of deferred taxes; and
s. Gross-up of revenue deficiency related to uncollectibles expense and gross down of revenue deficiency related to late payment charge revenues.

3) Return

a. Capital structure/cost of debt/cost of preferred stock.

The agreement provided that the resolution of these revenue requirement issues among Staff, OPC and MGE produced the starting point of Staff, OPC and MGE, from which adjustments were to be made as part of the true-up proceeding requested by MGE. The agreement also provided that resolution of the overall revenue requirement issues among Staff, OPC and MGE did not purport to affect the distribution of costs for such issues [*7] as class revenue responsibility. In particular, the agreement reflected that MGUA, Jackson County, et al., may desire to inquire into the distribution of costs to the various customer classes associated with: 1) gas storage inventory; 2)AMR; 3)customer advances; 4)customer deposits; 5)uncollectibles; and 6)flex rates, economic development rates and the number of billable large volume service meters (which are components of the revenues and billing determinants issue). The agreement also provided that

> commencing during the fiscal year which begins July 1, 1998, and continuing at least through the effective date of the new rates resulting from MGE's next rate proceeding, MGE will use a five-year average (when five years of information is available; prior to that time the average of the number of years of available information will be used) for determining the unrecognized net gain/loss to be amortized over five years in calculating MGE's direct FAS 87 and FAS 106 costs for financial reporting purposes.

The stipulating parties also agreed that

> in the event that in any given year the amount of the amortization of the unrecognized net gain/loss determined under the agreed-to [*8] methodology described above is less than the minimum amortization required under FAS 87 or FAS 106, then the amortization for such year shall be the minimum amortization required under FAS 87 and/or FAS 106.

Staff, OPC and MGE also agreed to the following miscellaneous tariff changes:

> 1. Reduce the late payment charge to 1.5% consistent with Staff recommendation (Solt Direct, p. 7; Cummings Rebuttal, p. 2).
>
> 2. Increase the reconnect fee currently set at $ 15 in MGE's tariff to $ 29.
>
> 3. Change the rate at which MGE pays interest on customer deposits to the prime rate plus one percentage point, and which rate is to be adjusted only in the context of future general rate proceedings consistent with OPC's recommendation. (Robertson Direct, p. 17) .

On June 1 Staff, OPC and MGE filed an Addendum to Stipulation and Agreement (Attachment B) with the Commission. The Addendum reflected the agreement of MGUA and Jackson County, et al., not to oppose the Stipulation and Agreement filed on May 20, 1998, as modified and supplemented in exchange for Staff, OPC and MGE's agreement to make the following modifications to the Stipulation and Agreement:

> 1) The following tariff change [*9] to tariff sheet No. 40 shall be accepted by the parties and made part of the Stipulation and Agreement:
>
> When more than one meter is set at a single address or location for the customer's convenience, an LVS customer charge shall be assessed for each of the first two meters. For each such remaining installed meter, customer charges will be computed at 50 percent of the LVS customer charge.
>
> Gas delivered through all meters set at a single address or location will be aggregated for the purpose of calculating the monthly sales or transportation charges.

This language will replace the last paragraph on tariff sheet No. 40. MGE agrees that, for the purpose of this case, no revenue adjustment associated with this agreed language change on tariff sheet No. 40 shall be incorporated in MGE's revenue requirement. The stipulating parties agreed that MGE will present in its next rate filing the results of a study to determine if cost reductions or economies of scale exist for Large Volume Service customers with multiple meters at a single address or location when compared to single meter customers. Staff, OPC and MGE agreed that Issues 1.9 Revenue and Billing Determinants Associated with [*10] LVS Meters, 1.10 Flexible Tariffs/EDR Rates, and 2.5.i. Multiple Customer Charges for Multiple Meters as set out in the Revised Hearing Memorandum would be removed and corresponding changes made to the hearing schedule.

On June 5 Staff, OPC and MGE filed a Second Addendum to Stipulation and Agreement (Attachment C) with the Commission. This addendum to the agreement was filed pursuant to the request of the Commission for clarification regarding interest on customer deposits. The stipulating parties clarified by stating

> The customer deposit interest rate shall be the current prime interest rate plus one. The current prime interest rate is 8.5%. This rate is published each day in the Wall Street Journal and is located in the Money and Investment section under the box labeled with banner, "MONEY RATES." For purposes of the stipulation and agreement the prime interest rate was determined as of May 20, 1998. It should be noted that the prime interest rate has not changed since May 20, 1998. The stipulation and agreement does not provide for a change in the rate on customer deposits until the next general rate case.

The stipulating parties requested that the Commission [*11] issue an order approving the Stipulation and Agreement filed on May 20, 1998, including all addenda to the Stipulation and Agreement.

The Commission has reviewed the agreement, the addenda to the agreement, and the evidence adduced relating to the agreement. The Commission finds the agreement just and reasonable and will approve the Stipulation and Agreement including all Addenda filed.

2. Stipulation and Agreement Regarding True-Up Audit and Hearing

On June 11, 1998, after an evidentiary hearing, the Commission issued its Order Establishing a True-Up Audit and Hearing. The Commission ordered that the true-up audit shall cover the period from January 1, 1998 through May 31, 1998, and was to address the specified items contained in the Stipulation and Agreement adopted in the same order. Further, the Commission ordered that the true-up hearing be held July 16. The evidence adduced in that hearing was briefed by the parties in the reply briefs filed July 31 and is considered as a part of this Report and Order.

B. Late-Filed Exhibits

Exhibit 211 was filed after the close of the evidentiary hearing. Exhibits 229, 231, 232, 235 and 236 were filed after the close of the true-up [*12] evidentiary hearing on July 16. These exhibits were filed at the direction of the bench. Counsel were afforded a ten-day period in which to file an objection to the admission of these exhibits.

The Commission has received no objections to the receipt of the late-filed exhibits.

Late-filed Exhibits 211, 229, 231, 232, 235 and 236 shall be received into the record.

C. Pending Motions

1. Motion for Addendum or Correction of True-Up Revenue Requirement

On August 5, 1998, Staff filed a letter with the Commission advising the Commission of its need to correct the costs shown on the revenue requirement scenarios associated with the rate case expense. Staff Counsel explained that Staff's true-up revenue requirement filed July 16 failed to include $ 39,550. This amount represented the cost for MGE to send the notice of public hearings separate from its normal billing cycle because of the shortened time frame between the Commission's notice and the day of public hearings. Staff noted that this would only be an issue if the Commission were to adopt the position proposed by Staff regarding rate case expense.

On August 6 OPC filed its Motion to Reject Staff's "Addendum to Revenue [*13] Requirement" and Request for Expedited Treatment. On August 10 MGUA and Jackson County, et al., filed their Motion to Reject "Addendum" filing or/and (sic) Alternative Motion to Strike with the Commission. On August 10 MGE's Response in Opposition to Public Counsel's Motion to Reject "Staff's Addendum to Revenue Requirement" was filed with the Commission. On August 10 Staff filed its Response to Public Counsel's Motion to Reject.

Given that the Commission has not adopted Staff's recommended revenue requirement in this Report and Order, this issue is moot and poses no controversy to be decided by the Commission. Staff's request is denied.

II. Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The Commission has reviewed and considered all of the evidence and arguments presented by the various parties and intervenors. Because of the volume of material presented to the Commission, some evidence and positions on certain issues may not be addressed by the Commission. The failure of the Commission to mention a piece of evidence or the position of a [*14] party indicates that, while the evidence or position was considered, it was not found to be necessary to the resolution of the issue.

Some evidence was introduced by the parties which is proprietary or highly confidential in nature and is protected by order of the Commission. While all protected material was considered by the Commission in making its decision, no highly confidential or proprietary information will appear in this order except by general reference.

1. Revenue Requirement

1.1 Return on Equity

Return on equity (ROE) is the actual or allowable profit earned on the investment made by the common shareholders. Return on equity equals the income available to common stock divided by the total common stockholders' equity.

MGE recommended a 12 percent return on equity. MGE believes this ROE to be commensurate with the risks assumed by Southern Union Company shareholders. MGE stated that the cost of equity estimates for MGE were developed using both the constant growth discounted cash flow (DCF) model and risk premium methods.

MGE contended that the use of DCF models to estimate the cost of equity is essentially an attempt to replicate the market valuation process [*15] which leads to the price investors are willing to pay for a share of a company's stock. It is predicated on the assumption that investors evaluate the risks and expected rates of return from all securities in the capital markets. Given these expected rates of return, the price of each share of stock is adjusted by the market so that investors are adequately compensated for the risks to which they are exposed. Applications of the DCF model to a group of 17 gas distribution utilities using both historical and projected growth rates produced cost of equity estimates ranging from approximately 6.4 to 11.9 percent.

By using a growth rate between 5.5 to 6.5 percent and combining it with the group's average dividend yield of 5.1 percent, MGE produced a DCF cost of equity range for the group of local distribution companies of between 10.6 and 11.6 percent. To account for the greater investment risk, MGE added 60 basis points to the DCF cost of equity range to bring MGE to a DCF cost of equity of between 11.2 and 12.2 percent.

With the risk premium method, MGE stated the cost of equity is estimated by determining the additional return investors require to forego the relative safety of bonds [*16] and to bear the greater risks associated with common stock, and then adding this equity risk premium to the current yield on bonds. Like the DCF model, risk premium analyses are capital market oriented, but unlike DCF methods where the cost of equity is indirectly imputed, risk premium methods estimate investors' required rate of return directly by adding an equity risk premium to observable bond yields. MGE also used the risk premium analysis relying on mechanistic estimates of the cost of equity, surveys, and historically-realized rates of return to determine equity risks. After making adjustments to reflect present capital market conditions and risk differences, MGE stated that the various risk premium methods produced cost of equity estimates for MGE ranging from 11.66 to 14.87 percent. After eliminating implausible values, and narrowing the resulting range to include all but the highest and lowest values, MGE arrived at a risk premium cost of equity range between approximately 11.8 and 13.0 percent.

MGE stated that neither Staff nor OPC witnesses made any increase in MGE's ROE recommendations to reflect the additional financial risk attributable to the low common equity ratio [*17] in the capital structure of MGE's parent, Southern Union. Also, MGE points out that in its last rate case, Case No. GR-96-285, Staff's approach was adopted by the Commission whereby MGE's ROE was increased to reflect the greater financial risk associated with the low common equity ratio in its capital structure.

From a financial analysis viewpoint, Staff recommended a return on equity range of 10.67 percent to 11.19 percent with a midpoint of 10.93 percent. Staff believes that the Commission has the authority to consider poor customer service when determining a reasonable return on equity. Staff used a continuous growth form of the DCF model in estimating the cost of equity for Southern Union. This model relies upon the fact that a company's common stock price is dependent upon the expected cash dividends and upon cash flows received through capital gains or losses that result from stock price changes. Staff could not directly analyze the cost of equity for Southern Union. In order to arrive at a company-specific DCF result, the Company must have common stock that is market-traded and pays cash dividends. Southern Union does not pay cash dividends; and therefore, Staff could not directly [*18] analyze the cost of equity for Southern Union.

Staff derived its range for MGE's return on equity between 10.67 to 11.19 percent by conducting two different DCF analyses. One DCF analysis was conducted on eight companies representative of the natural gas industry which have a common equity ratio of 53 percent compared to MGE with a common equity ratio of approximately 37 percent. The other DCF analysis was calculated on a group of four "comparable" local distribution companies that are riskier than the industry companies (common equity ratio of 49 percent). Staff stated that these results were checked for reasonableness by comparing them to the results obtained from using a risk premium model and a capital asset pricing model (CAPM). Based upon this analysis, Staff does not believe that Southern Union has a level of risk that requires additional basis points added to the ROE. This was also evidenced by the fact that Standard & Poor's upgraded Southern Union's credit rating from BBB to BBB+ in April 1998. A higher credit rating reflects lower business risk.

Flotation costs are the expenses incurred whenever capital such as a common stock is issued. MGE believes that it is necessary [*19] to recover flotation costs through an upward adjustment of the return on equity. Staff disagrees. Staff does not believe that flotation costs should be recovered by an adjustment to the ROE. Staff argued that this effectively protects the ratepayer from continually bearing the cost of "unascertained purported past expenses". Staff maintains that MGE did not provide any evidence to indicate that common stock would be issued within the test period for this case. In Case No. ER-83-49, the Commission adopted the position that "flotation cost adjustments should apply only to issues of new common stock, or issues that will occur during the period that the rates to be set will be in effect." *Kansas City Power & Light Company, 26 Mo. P.S.C. (N.S.) 104, 145 (1983).* Staff stated that where there is no evidence to show that common stock will be issued within the applicable test period, an adjustment for flotation costs is not appropriate. Further, Staff indicates that flotation costs are normally recovered on a dollar-for-dollar basis as opposed to being accounted for indirectly with an upward adjustment to the ROE.

OPC recommended MGE be authorized 10.7 percent return on equity. This return [*20] on common equity was determined using the discounted cash flow (DCF) method applied to a group of ten comparable companies and supported by a capital asset pricing model analysis and a market-to-book (MTB) ratio analysis. The MTB method is a derivative of the DCF model that compensates for differences between market price and book value per share of a firm's common shares. OPC did not make a specific adjustment to ROE to recognize Southern Union's Standard & Poor's bond rating of BBB (since increased to BBB+). OPC opposed such an adjustment. Southern Union's debt-heavy capital structure was the result of a decision of the Company's management and, therefore, the risk associated with that decision should not be borne by the ratepayers.

The Commission finds that the rate of equity should be 10.93 percent as supported by competent and substantial evidence adduced in this hearing. The recommendations of MGE, Staff and OPC range from 10.70 percent to 12.25 percent, with 10.93 percent being the midpoint of Staff's position. While MGE argued that its capital structure was riskier than all other companies, MGE's risk level decreased in April 1998 when its ratings improved to BBB+. Further, [*21] management determines the capital structure. Finally, MGE still provides less than satisfactory customer service. MGE has not yet fully complied with the commitments it made in the prior rate case, GR-96-285 through Stipulation and Agreement. Therefore, the Commission finds a return on equity of 10.93 percent is just and reasonable.

1.2 SLRP Deferrals

a. Carrying Cost Rate

This issue relates to the costs that MGE incurs by deferring the costs of improvements that MGE has made through its safety line replacement program (SLRP) by replacing mains and services lines pursuant to Commission Rule *4 CSR 240-40.030* (1995). The carrying costs of construction could be recovered immediately through a price increase if the Company were not a regulated industry required to obtain the approval of the Commission prior to any increase in rates. The Commission established the use of the accounting authority order (AAO) to allow MGE to book, in addition to the actual costs of the improvements, the carrying costs of those investments until the next rate case is filed with the Commission. The AAO has no guaranteed ratemaking treatment. The company is required to request ratemaking treatment [*22] of the amounts booked under the AAO in the next rate case the Company files. Under certain circumstances, companies regulated by the Commission are allowed to suspend normal accounting procedures through the use of an AAO.

MGE has used weighted average cost of capital-based carrying cost rates of 10.54 percent in calculating deferrals associated with the AAO granted in Case No. GO-94-234 and 9.46 percent in calculating deferrals associated with the AAO granted in Case No. GO-97-301. MGE believes that the 10.54 percent rate was ordered by the Commission when MGE was granted an AAO in Case No. GO-94-234. They cite the following language

> IT IS THEREFORE ORDERED:
> 1. That Missouri Gas Energy is authorized to defer and book to Account No. 182.3, beginning February 1, 1994, and continuing through January 31, 1997, depreciation expense, property taxes, and carrying costs at 10.54% on the costs incurred . . ."

The weighted average cost of capital in Case No. GO-97-301 was 9.46 percent.

Staff believes the deferral rate should approximate the actual financing cost rate incurred by MGE in financing the SLRP. Staff's position is that the Company's Allowance for Funds Used During Construction [*23] (AFUDC) rate is an appropriate measure of MGE's actual construction financing cost. In addition, Staff points out that orders in Case Nos. GO-94-234 and GO-97-301 did not guarantee any ratemaking treatment of the deferrals. The correct AFUDC rate for the 12 months ending December 31, 1997 is 6.107 percent.

Staff points out that under normal accounting, MGE's investment in the service line and main replacement program would not be entitled to a deferral of any carrying cost. Accounting authority orders were developed for the purpose of allowing companies to "defer and book" costs to Account No. 182.3 for consideration in the next rate case by the Commission. The Commission's grant of an AAO does not have any effect for the purposes of ratemaking.

OPC supports Staff's position. OPC utilized the AFUDC rate consistent with the Commission's decision on this issue in MGE's last rate case, GR-96-285. MGE opposed the use of a carrying cost rate based on its AFUDC rate.

The Commission finds that the AFUDC rate of 6.107 is the appropriate carrying cost rate for the deferred amounts pursuant to the AAOs granted to MGE in Case No. GO-94-234 and Case No. GO-97-301 and is supported by competent [*24] and substantial evidence. The Commission finds that Staff's position on this issue is just and reasonable.

b. Amortization Period

This issue relates to the adjustment to revenue for the SLRP deferrals and carrying costs which have been booked in temporary accounts and the period over which those SLRP deferrals and carrying costs should be recovered by the Company. Under the Federal Energy Regulatory Commission's (FERC) Uniform Standard of Accounting (USOA), amortization is defined as "the gradual extinguishment of an amount in an account by distributing such amounts over a fixed period, over the life of the asset or liability to which it applies, or over the period during which it is anticipated the benefits will be realized." In the prior MGE rate case, GR-96-285, the Commission found that the "20-year amortization is appropriate because the line replacements should last at least 20 years." The Commission stated in its Report and Order in Case No. GR-96-285 that the Commission had to choose between two extreme positions in this case, a three year amortization period proposed by MGE and a 20-year amortization period proposed by Staff.

MGE proposed a ten-year amortization period [*25] for the deferrals authorized by the Commission. MGE stated that a ten-year amortization period would be beneficial to the Company and to the customers. MGE stated that the customers would benefit by receiving a lower future cost of service. The Company benefits because accelerated amortization usually results in lower present value cost of capital. Although the accounting theory referred to as the "matching principle" requires revenues and expenses to be matched and costs to be allocated to reporting periods in a systematic and rational manner, MGE stated that the accounting principle of matching only relates to the matching of an expense with revenues related to the recovery of that expense for a particular item. Further, MGE stated that the Commission has historically used a five-year amortization period for extraordinary items related to income statement amounts, such as expense items. The amortization period for the SLRP deferral carrying cost is an expense item related to the plant in service.

Staff proposed and provides evidence in support of a 20-year amortization period. Staff stated a 20-year amortization period is more appropriate since it better corresponds to the actual [*26] recovery period of MGE's SLRP plant (service lines and mains). In addition, Staff stated the 20-year recovery period is consistent with Commission precedent. Staff continues by stating that the Commission could even consider a 28-year recovery period of MGE's SLRP deferrals because other construction costs to produce the plant are already being recovered over a 28-year period. However, Staff recommended a 20-year recovery or amortization period instead of a 28-year recovery period because it historically has recommended a 20-year recovery period. This approximates the full 28-year amortization period on actual plant in service while conservatively limiting the number of years the Company has to recover the carrying cost rate. A higher number of recovery years decreases the overall revenue requirement required annually to be paid by the ratepayer.

OPC has also proposed a 20-year amortization period for the same reasons as Staff. OPC stated this period is more appropriate since it better corresponds to the life of the service lines and mains. OPC stated this period is also consistent with the Commission's decision in MGE's last rate case, GR-96-285.

The Commission finds that competent [*27] and substantial evidence has been presented and adduced to support the Commission's approval of the recovery of the SLRP carrying cost over a ten-year period. Ten years relates better to the period in which it is anticipated the benefits will be realized and ten years relates closer to the deferral period itself, and is, therefore, just and reasonable. The Commission does note that Staff has provided ample evidence to show that its proposal of the 20-year amortization period was not extreme as noted in the Commission's Report and Order in the prior

MGE rate case, Case No. GR-96-285. While Staff has produced sufficient evidence to support its position, the Commission finds that it is not necessary to relate the amortization period for the deferral or carrying costs to the life of the property constructed but rather to the deferral period or the period during which it is anticipated the benefits will be realized.

c. Treatment of "Stub" Period

This issue relates to whether there are expenses deferred and booked under the AAO authorized in Case No. GO-97-301 which were not addressed in the last ratemaking case, Case No. GR-96-285, and which are carried over into this ratemaking [*28] period. The period of time at issue is the period from November 1, 1996 through January 31, 1997. Also at issue is the proper carrying cost rate.

MGE has calculated the deferral associated with Case No. GO-94-234 through January 31, 1997, in accordance with the language of that order which allows MGE to use 10.54 percent for its actual carrying costs. Staff's position is that the SLRP deferrals should be cut off at October 31, 1996, in accordance with the Commission's order in MGE's last rate case, Case No. GR-96-285. OPC supports the position of Staff.

The Commission finds that in its order in Case No. GR-96-285, the Commission stated that

> [MGE] may continue to record as regulatory assets the deferrals of carrying costs, property taxes, and depreciation expense incurred . . . for the period of November 1, 1996 through January 31, 1997, and may request rate recovery of such assets in its next rate proceeding.

All deferrals given rate recovery in this proceeding will be calculated beginning with a zero balance as of November 1, 1996 and ending with a deferral balance as of the end of the true-up period ordered by the Commission in this case, May 31, 1998. The Commission's order [*29] in GR-96-285 clearly stated the periods of deferral to be included and makes no reference to amounts carried over.

The Commission finds that the carrying cost rate for the period beginning November 1, 1996 through January 31, 1997 is 6.107 percent, for the reasons stated above in Section II.1.2.a.

The Commission finds that Staff's position that no "stub period" treatment is required is supported by competent and substantial evidence. Staff's position is just and reasonable because the account balance began at zero and the carrying cost rate is the same for the entire accrual period.

d. Inclusion of Unamortized Balance in Rate Base (OPC Issue)

This issue requires the Commission to determine whether the unamortized balance of the SLRP deferrals should be included in the rate base. If the unamortized balance of the SLRP deferral account is also included in rate base, not only would the Company have the opportunity to receive a "return of" its investment, but also would have the opportunity to receive a "return on" the investment.

MGE has included in rate base the unamortized balance of SLRP deferrals. MGE stated that this position is consistent with past Commission treatment [*30] of these deferrals.

Staff also included in rate base the unamortized balance of SLRP deferrals authorized.

OPC has not adjusted Company's rate base so that MGE can earn a "return on" the deferred balance. OPC believes that guaranteeing the Company a "return of" and "return on" the SLRP deferred balance is not a fair allocation of regulatory lag resulting from the Company's ongoing construction projects. This view is based on the fact that OPC believes management is responsible for planning and operating the activities of the Company. OPC argued that if the Company is unable to, or chooses not to, implement processes and procedures which would limit the effect of regulatory lag on its finances, the Company should not be protected by the Commission with "guaranteed earnings", or the total effect of the regulatory lag. Therefore, in order that ratepayers and shareholders both share in the effect of regulatory lag, OPC is recommending that MGE be allowed to earn a "return of" the SLRP deferred balance, but not a "return on" the SLRP deferred balance.

The Commission finds that the unamortized balance of SLRP deferrals should not be included in the rate base for MGE. The AAOs issued by the [*31] Commission authorize the Company to book and defer the amount requested but

do not approve any ratemaking treatment of amounts from the deferred and booked balances. AAOs are not intended to eliminate regulatory lag but are intended to mitigate the cost incurred by the Company because of regulatory lag. Given that the Company will recover the amortized amount of the SLRP deferral at the AFUDC rate in ten years, instead of the previous 20 years' amortization period, it is proper for the ratepayers and shareholders to share the effect of regulatory lag by allowing the Company to earn a return of the SLRP deferred balance but not a return on the SLRP deferred balance. The Commission has noted previously in the consolidated cases entitled In The Application of Missouri Public Service for the Issuance of an Accounting Order Relating to Its Electrical Operations, and In the Matter of the Application of Missouri Public Service for the Issuance of an Accounting Order Relating to its Purchase Power Commitments, *1 Mo. P.S.C. 3rd 200,* that "the Court upheld the Commission's decision to place the initial risk of cancellation on the shareholders since to do otherwise would be to make the [*32] investment practically risk-free." *State ex rel. Union Electric Company v. PSC (UE), 765 S.W.2d 618, 622 (Mo. App. 1988); State ex rel Hotel Continental v. Burton, 334 S.W.2d 75, 80 (Mo. 1960).* Most recently, the Western District Court found that "AAOs are not a guarantee of an ultimate recovery of a certain amount by the utility." *Missouri Gas Energy v. P.S.C, 1998 W.D. 54710* (Mo. App. Aug. 18, 1998). All of the parties agree that it is the purpose of the AAO to lessen the effect of the regulatory lag, not to eliminate it nor to protect the Company completely from risk. Without the inclusion of the unamortized balance of the AAO account included in the rate base, MGE will still recover the amounts booked and deferred, including the cost of carrying these SLRP deferral costs, property taxes and depreciation expenses through the true-up period ending May 31, 1998. The Commission finds that OPC's position on this issue is just and reasonable and is supported by competent and substantial evidence in the record.

e. Issuance of Another Accounting Authority Order (AAO)

MGE requests that the Commission issue another accounting authority order for MGE's extraordinary SLRP [*33] investment as it has numerous times in the past, using language similar to that adopted in Case No. GO-97-301. Staff is opposed to the issuance of another AAO at this time. Staff believes that it is premature for the Commission to issue another accounting authority order for MGE's SLRP investment in this case. Staff believes it is more appropriate to address this issue in a separate AAO application. OPC supports Staff's position.

The Commission finds that another AAO related to the SLRP costs, property taxes, and depreciation cost should be authorized by the Commission. These SLRP related costs have been considered "extraordinary items" since the gas safety rules issued by the Commission have required the companies to replace main and service lines within their service areas. As the majority of the SLRP project is almost complete, the Commission finds that MGE's position is just and reasonable and there is competent and substantial evidence to support MGE's request for an AAO. The Commission shall issue an AAO authorizing MGE to defer and book costs relating to SLRP deferral carrying costs, property taxes and depreciation expenses. The balance of the account for the deferral period [*34] beginning the day after the effective date of this Report and Order shall begin with a zero balance. MGE may book these costs at a reasonable rate as determined by the Company. In determining the rate at which it should book the deferral costs related to the SLRP, the Company should keep in mind the past ratemaking decisions which have determined that the SLRP carrying costs are recovered at the AFUDC rate. If for other reasons, including tax implications, the Company chooses to book the SLRP deferral rates at a higher rate than AFUDC, MGE should also keep in mind that it is not guaranteed any specific rate of return. Further, the period for which this AAO authorizes that costs be deferred and booked as an extraordinary expense begins on the day after the effective date of this Report and Order in Case No. GR-98-140 and GT-98-237. The period shall end at the end of the test year, or at the end of the known and measurable period following the test year, or at the end of true-up period, as applied in the next rate case filed by the Company. Nothing in this order authorizing the deferral of SLRP carrying costs, property taxes or depreciation expenses shall be considered to have any effect [*35] for the purpose of ratemaking treatment.

1.3 Billing Process Improvement Costs/Billing Correction Costs; Uncollectibles

MGE requests inclusion in the revenue requirement of its costs incurred for the billing process improvements project, certain billing correction costs not previously waived, and bad debt amounts uncollectible from the customers to whom the gas services were provided. At issue are the costs associated with the contract services of Theodore Berry & Associates (TBA) for its role in facilitating the billing process improvement project referred to as Billing Accuracy and Service Improvement Commitment (BASIC) Team Project. MGE stated that the beneficial results of the billing process improvement effort are demonstrated by the absence of any significant billing issues occurring in the winter of 1997-1998.

Staff took the position that these billing process improvements were actually improvements to MGE's Customer Service System which is booked to Account 303, Miscellaneous Intangible Plant. Staff stated that it would agree with the inclusion of any reasonable and prudently incurred costs related to the billing process as long as those costs were amortized over the [*36] remaining economic life of the Customer Service System, approximately nine years. MGE agreed with Staff's position on this point.

Staff reviewed all billing process improvements through the true-up period ending May 31, 1998, and Staff recommended that all prudently incurred costs associated with billing process improvements should be included in Account 303, Miscellaneous Intangible Plant. Staff also recommended that, in addition to the $ 237,970 costs incurred in the test year and capitalized in Account 303, an additional $ 1,070,971 in costs relating to billing process improvement should be added. The total capitalized amount would equal $ 1,308,941. Staff calculated the annual revenue requirement impact of capitalizing $ 1,308,941 and determined that it would be approximately $ 250,000 which is the amount of annual ratepayer benefits that must be achieved to offset costs incurred to avoid ratepayer detriment. Staff stated "Reductions in expense or additional revenue must exceed $ 250,000 per year for this to be a prudent expenditure." Therefore, Staff recommended reducing the billing cost expenses by $ 250,000 per year to allow for the required savings necessary to make these [*37] billing process improvement project costs prudent.

OPC recommended that the Commission disallow the Company recovery of all TBA costs shown on Schedule H-24 of MGE's updated revenue requirement work papers. OPC believes that these charges were incurred as a direct result of management downsizing to staffing levels so low that MGE was unable to provide basic levels of service, or were incurred to correct other problems that precipitated the filing of OPC complaint Case No. GC-97-497 and Staff complaint Case No. GC-97-33. In addition, OPC stated that these costs are non-recurring expenses. As for the non-TBA costs, OPC believes that only those costs which have the verifiable purpose of creating or bettering MGE's products or services should be capitalized. All remaining charges should be disallowed for the same reasons that the TBA costs should be disallowed. The total amount to be disallowed is $ 94,854 from expenses and $ 122,340 from rate base.

The Commission finds that OPC's position is just and reasonable, is supported by competent and substantial evidence and reasonably protects ratepayers from Company errors and costs related to those errors. The customers have a right to expect [*38] accurate and timely billing as a basic feature of the service they receive. The customers should not have to bear the cost of making corrections to the billing system so that it can meet that minimal basic expectation. Further, the Commission cannot find that all of the expenditures relating to the billing process improvements were prudent expenses. Those charges which were not found to be prudent are disallowed as recommended by OPC in the amount of $ 94,854 from expenses and $ 122,340 from rate base. While the Commission commends the Company for making efforts to restore its billing system to an acceptable level of accuracy, the Commission also requires the Company to continue to strive to satisfy basic customer needs.

MGE has made commitments in Case No. GC-97-497 and Case No. GC-97-33 to provide a cost/benefit analysis and a time schedule for completion of each item on the BASIC Team Summary of Findings. Neither of these commitments has been met. The agreement entered into by MGE in Case No. GC-97-497 and Case No. GC-97-33 was approved by the Commission. Therefore, the Commission expects the Company to comply with the Stipulation and Agreement as approved before the Company files [*39] its next rate proceeding.

Relating to the issue of uncollectibles, MGUA opposed MGE's proposed treatment of allocating costs associated with uncollectible accounts to transportation customers that are not caused specifically by transportation customers. The Commission will address these arguments in Section II.2.

1.4 Rate Case Expense; Customer Advance; Customer Deposits

MGE proposed that actual rate case expense, including costs not yet recovered for Case No. GR-96-285, be amortized over two years. True-up testimony indicated that MGE's claim for rate case expense had reached $ 928,210 as of May 31, 1998. At the true-up hearing, MGE indicated that it had reached an agreement with OPC and Staff to adjust rate case expense included in the revenue requirement by removing expenses for such items as stress balls, massages for staff at a rate case conference, mini-travel bottles, posters, opera tickets, calculators, a rate case luncheon at the rented Uptown Theatre, catered food items, rented tables and chairs, entertainment expenses for staff at a rate case luncheon, travel costs for corporate officers to travel from Austin to Kansas City for the rate case luncheon, expenses from [*40] hotel rooms that went unused and not timely canceled, and meal expenses for employees in the home base location.

Staff proposed a normalized level of rate case expense to be recovered over a two-year time period. Staff originally agreed with MGE that the actual rate case expense incurred for MGE's previous rate case, Case No. GR-96-285, was the

appropriate amount of rate case expense that should be included in the cost of service as a reflection of an ongoing level of rate case expense. However, MGE believes that amount should include the costs associated with the appeal of the order in Case No. GR-96-285 while Staff does not. Staff has identified the specific amount of $ 537,186 claimed as the rate case expense approved by the Commission in Case No. GR-96-285. Staff believes this is a reasonable estimate of the ongoing amount of rate case expense for purposes of the current case. Staff opposed any additions to the normalized rate case expense of $ 537,186 for appeals. The normalized rate case expense according to Staff's position recovered over a two-year period equals recovery of $ 268,593 per year.

OPC proposed the actual amount of rate case expense prudently incurred for this [*41] rate case is the most appropriate amount to include as the rate case expense. OPC performed a full audit on MGE's rate case expenses. OPC also recommended normalizing the actual amount of expenses for a two-year period, which OPC believes reflects the cycle of rate case occurrences. OPC also believes the consulting fees for Dennis Gillmore should be excluded from the rate case expense normalization. OPC stated Mr. Gillmore did not provide the services he was contracted to provide. The ratepayers should not pay for services the Company never received. OPC also stated the cost of the *amicus* brief filed by Coopers & Lybrand in the appeal of the Commission's decision in GR-96-285 is not an appropriate rate case expense, and it should be deducted. OPC's audit revealed numerous expenses which are inappropriately passed on to the ratepayers, some which MGE agreed to deduct at the true-up hearing. In its proposal, OPC has disallowed any questionable expense that MGE did not agree to remove from its own expenses.

In its true-up audit, OPC included all of the rate case expenses for the true-up period ordered by the Commission. OPC determined after completing its audit that MGE prudently [*42] incurred $ 579,565.64 in actual rate case expense. OPC's result of annualizing this total amount over a two-year period is $ 289,782.82.

The Commission finds that there is competent and substantial evidence to support OPC's position on the rate case expense and its position is just and reasonable. The costs claimed by the Company in this case in the amount of $ 928,210 is excessive and many of the costs the Company claims such as the fees for Dennis Gillmore and the Coopers and Lybrand's *amicus* brief are simply imprudent. The rate case litigated in GR-96-285 was a more complex case with 59 litigated issues, including several issues that were unique and controversial. Many of the issues in this case have been litigated in Case No. GR-96-285. Those issues were upheld in the Cole County Circuit Court, and that decision was affirmed by the Appellate Court, Western District of Missouri, on August 18, 1998. The expenses for the appeal should be born by the shareholders.

The remaining issues raised by MGUA and Jackson County, et al., relating to customer advances and customer deposits will be included in Section II.2., Class Cost of Service/Rate Base.

With regard to the most recent PSC [*43] assessment, OPC has recommended that MGE be allowed to include the July 1, 1998 Public Service Commission annual assessment in rates despite the fact that the assessment occurred beyond the true-up period ending May 31, 1998. Staff and OPC agreed, but OPC recommended making two additional adjustments. First, OPC normalized the Hancock Article X costs over a three-year period to reflect the three-year period these costs covered from 1995-1997. OPC also adjusted the costs for the one time move to the Hotel Governor over a two-year period. OPC is recommending that MGE be allowed a total normalized Commission assessment of $ 1,341,812.35. MGE and Staff recommend the new PSC assessment be included in current ratemaking expenses without the adjustments proposed by OPC.

The Commission finds that PSC assessment expenses may be included, even though they are beyond the true-up period, and OPC, Staff and MGE agree that it is reasonable to consider the latest assessment in this ratemaking case. No other objections were received. The Commission finds that no adjustments should be made to the PSC assessment and the PSC assessment expense should be included in current rate case expenses as recommended [*44] by Staff and MGE.

1.5 Public Affairs and Community Relations

MGE included in its request for costs to be recovered in the revenue requirement the costs of public affairs and community relations. These costs were incurred by the Public Affairs and Community Relations Department of MGE.

Staff's audit of MGE's Public Affairs and Community Relations Department indicated that this department engages in activities the cost of which are not properly recovered from ratepayers, such as lobbying, participation in charitable and civic organizations, and corporate image building. Staff also found that the department participates in activities related to education and safety which are properly recovered from ratepayers. However, the Company had less documentation supporting department activities than it did in MGE's last rate case, Case No. GR-96-285. The Company did not

have complete records, but was able to show that the department did perform some rate recoverable services. As a result, Staff recommended that only 50 percent of the cost relating to the activities of the Public Affairs and Community Relations Department be allowed.

OPC recommended that 75 percent of the adjusted expenses [*45] the Company incurred to operate and staff the department during the test year be excluded from the cost of service. OPC has based this recommendation on the fact that the employees of this department are involved in both activities whose costs are properly recovered from ratepayers and activities whose cost are not properly recovered from ratepayers. The costs of activities that should not be recovered from ratepayers include corporate image building, participation in charitable and various civic organizations, economic development activities, and legislative/lobbying activities.

Because documentation and records that would support a more accurate allocation of the recoverable expenses were not developed or maintained by the Company, OPC believes a 75 percent disallowance ($ 366,588) is appropriate. OPC believes that its recommendation is reasonable because it will more than likely prevent any allocation of inappropriate expenses being included in rates, and will also provide the Company with an incentive to develop and maintain auditable documentation before it files its next general rate increase case.

MGE opposed the proposals of Staff and OPC to disallow, respectively, 50 percent [*46] and 75 percent of the costs of the Public Affairs and Community Relations department's expenses. MGE believes that it has submitted adequate documentation and evidence through the testimony of the employees of the Public Affairs and Community Relations Department along with their expense account reports and personal calendars. MGE claimed the customers benefit from 100 percent of its proposed expenses. At most, MGE argued that only 15 percent of its expense is disallowable.

The Commission finds that the position of Staff is the most reasonable position supported by competent and substantial evidence which shows that the Public Affairs and Community Relations Department did participate in activities which are properly recovered from ratepayers. The difficulty is based upon the fact that MGE failed to create accurate documentation which would allow Staff or OPC to audit the Public Affairs and Community Relations Department to verify which activities are properly recovered from ratepayers and which are not. MGE should keep time records that would at least show the time expense spent by staff members on regulated or recoverable activities. This would give the Commission competent documentary [*47] evidence indicating the respective amount of time spent on the various activities assigned to the Public Affairs and Community Relations Department. Lacking such competent evidence, the Commission must disallow any expense that is not supported by competent and substantial evidence.

1.6 AMR Meter Reader Add Back; AMR

MGE, Staff and OPC announced at the true-up hearing on July 16, 1998 that they had reached an agreement on the AMR meter reading expense as of May 31, and that MGE would reflect that agreement in its revised reconciliation. Neither Staff nor OPC has any objection to the expense as it now appears in the revised reconciliation. Thus, there does not appear to be a controversy regarding this issue.

While MGUA and Jackson County, et al., did not take a position on the level of expenses or costs for AMR equipment, MGUA and Jackson County, et al., do not believe this item of expense benefits the Large Volume Service class and argue that there should be no portion of this cost allocated to transportation customers or to the Large Volume Service class. This objection will be addressed in Section II.2.

1.7 Encoder-Receiver-Transmitter(ERT) Inventory

MGE, Staff and [*48] OPC announced at the true-up hearing on July 16 that they had reached an agreement on the number of ERT devices in inventory as of May 31, and that MGE would reflect that agreement in its revenue requirement in the revised reconciliation. Neither Staff nor OPC has any objection to the expense as it now appears in the revised reconciliation. Thus, there does not appear to be a controversy regarding this issue.

While MGUA and Jackson County, et al., are not taking a position on the level of expenses or costs for ERT inventory, MGUA and Jackson County, et al., do not believe this item of expense benefits the Large Volume Service class and argue that there should be no portion of this cost allocated to transportation customers or to the Large Volume Service class. This objection will be addressed in Section II.2.

1.8 Depreciation Expense

There are three main issues under the general topic of depreciation. First, Staff proposed that the Commission adopt new depreciation rates for MGE's accounts which constitute almost 90 percent of the plant. These accounts are Account

376, Mains; Account 380, Services; Account 381, Meters; and Account 382, Meters/Regulator Installations. The second [*49] issue relates to the appropriate depreciation rate to be used for the automated meter reading (AMR) equipment MGE is currently installing. The AMR equipment is divided into two accounts for the two types of equipment: Account 397.1, Communications Equipment, for the ERT device which is attached to standard gas meters, and Account 385, Electronic Gas Metering (EGM), used for transportation customers. The third issue is Staff's request that MGE be ordered to re-create the documentation necessary to support a full depreciation study.

Under Rule 4 CSR 240.040(6), gas corporations subject to the Commission's jurisdiction are required to submit a depreciation study, data base and property unit catalog to the Commission and to OPC every five years. MGE was required to submit its first gas study according to the rule by July 1, 1995. MGE did submit a depreciation study to the Missouri Public Service Commission in June of 1995. On November 2, 1995, a letter was issued to MGE indicating that Staff proposed no change to the currently prescribed depreciation rates at that time. MGE will be submitting its next gas study by June, 2000.

a. Existing Rates

Staff believes that the Company's [*50] depreciation rates for its four major accounts need to be updated to reflect the service line replacement program. Because MGE does not have sufficient data to determine new rates based on Company retirement data, Staff used the depreciation rates of a neighboring gas utility, Missouri Public Service (MoPub), as a surrogate. Staff supports the choice of MoPub as a surrogate for the following reasons: 1) MGE and MoPub have common service areas, and 2) From an operations standpoint, Staff determined that MGE and MoPub are similar. Staff's proposed rates are: Account 376, Mains - 2.40 percent; Account 380, Services - 4.68 percent; Account 381, Meters - 1.67 percent; Account 382, Meter/Regulator Installations - 2.00 percent. OPC supports Staff's position.

MGE opposed the changes to existing depreciation rates proposed by Staff. MGE stated that Staff has relied upon the comparison of rates used by comparable companies in the industry which operate in Missouri, including Laclede, AmerenUE and Missouri Public Service. Staff's analysis and recommendation failed to note that MoPub has not updated its meter reading systems to include any AMR equipment, and therefore, the Commission finds that [*51] MoPub is not an appropriate comparable company.

The Commission finds that there is not sufficient evidence upon which to support any changes to the existing depreciation rates. Given the fact that MGE will be filing a new depreciation study by June, 2000, the Commission finds it would be appropriate to defer any change in existing depreciation rates for existing plant until then. The Commission expects the depreciation study and other documentation submitted pursuant to Rule *4 CSR 240-40.040(6)* filed by the Company to be as complete as possible and further expects the Company to cooperate with Staff and OPC in evaluating the need for changes to the existing property depreciation rates at that time.

b. Automated Meter Reading (AMR) Equipment

MGE, Staff and OPC agreed to the depreciation rate of 5 percent for EGMs in the parties' Stipulation and Agreement discussed under Section I.A.1. under Procedural History. Therefore, the part of this issue relating to depreciation rate for EGMs is resolved upon the Commission's approval of the Stipulation and Agreement, with Addenda. MGE proposed a depreciation rate of 6.67 percent for ERTs, to be booked to Account 397.1, Communication [*52] Equipment. MGE bases its proposed depreciation rate of 6.67 percent for ERTs on the fact that even though the ERT equipment has a service life of approximately 17 to 20 years, the batteries for the ERT only have a service life of 15 years. MGE claims that it does not intend to replace batteries in a ERT device that will only have a remaining life of approximately two years. This analysis allows MGE to claim a service life of 15 years for the ERT device. However, the manufacturer of the ERT device, Itron, requested a study by the American Appraisal Associates which recommended a 20-year useful life for the ERT devices.

Staff disagreed with MGE's position that the AMR equipment will only last 15 years. Staff's estimate shows that with a battery replacement, the equipment will last 29.7 years. Staff maintained that because batteries account for only 10 percent of the total cost of the ERT unit it would not make sense for MGE to scrap its ERT system (representing $ 27 to $ 30 million investment) if its useful life could be extended by a simple battery change.

OPC's analysis included the application and manufacture of the ERT devices which represent the bulk of the cost associated with [*53] the Company's AMR project. The apparent expectations of those making use of the ERT devices that a reasonable expected life for the devices should be on the order of two ERT battery lifetimes or approximately 27.5 years. Depreciation rates for this account should be based on this expected useful life.

While MGUA and Jackson County, et al., are not taking a position on the level of expenses or costs for depreciation on AMR equipment, MGUA and Jackson County, et al., do not believe this item of expense benefits the Large Volume Service class and argue that there should be no portion of this cost allocated to transportation customers or to the Large Volume Service class. This objection will be addressed in Section II.2.

The Commission finds that the evidence shows that the ERT devices have a service life of 20 years and that a depreciation rate for the ERT devices of five percent would be appropriate. The manufacturer completed an independent study that determined that the ERT equipment has 20-year service life. Given all other factors, including the standarized life assigned to the ERT batteries, the Commission finds it just and reasonable to adopt the ERT equipment service life as determined [*54] by the American Appraisal Associates of 20 years, without adjustments. MGE has established by its own evidence that a 20-year service life will result in a five percent depreciation rate. Therefore, the depreciation rate is appropriately calculated to be five percent.

c. Depreciation Data

Staff recommended that the Commission order MGE to update its depreciation records to comply with Commission rules. Specifically, Staff recommended that MGE should reconstruct and maintain plant property records for Account 376, Mains; Account 380, Services; Account 381, Meters; and Account 382, Meters/Regulator Installations. Staff also asks that MGE provide Staff and OPC with this data within three years of the effective date of the Report and Order in this case. OPC supports Staff's position.

MGE opposed Staff's recommended record keeping reconstruction. Some of the records needed for a good depreciation study do not exist, and some exist but are not complete, according to MGE. MGE further stated that it took legal action against Western Resources to obtain the documentation for either depreciation or retirement of certain properties which Western Resources presumably failed to maintain. [*55]

The Commission finds that it would not be appropriate to require the reconstruction or re-creation of records that apparently do not exist or cannot be completed by any reasonable efforts of MGE. As indicated in Section 1.8.a., the Commission will expect MGE to prepare a thorough depreciation study by June, 2000, and that all available information will have been gathered and submitted to Staff and OPC for review and consideration at that time.

1.9 Revenue and Billing Determinants Associated with LVS Meters

This issue was resolved by the Addendum to Stipulation and Agreement filed by the parties June 1, 1998, as discussed in Section I.A.1.

1.10 Flexible Tariffs/EDR Rates

This issue was resolved by the Addendum to Stipulation and Agreement filed by the parties June 1, 1998, as discussed in Section I.A.1.

2. Class Cost of Service/Rate Design

2.1 Class Cost of Service Issues (including 2.1.a. Services, Meters, Meter/Regulators Installations; 2.1.b. Mains; 2.1.c. Customer Records and Collection/Expense Allocation; 2.1.d. Allocators Used for Other Cost Categories; 2.1.e. Peak Demands That Should Be Used in the Allocation of Capacity-related Costs; 2.1.f [*56] Costs to be Collected Through the Monthly Customer Charge)

The purpose of a class cost of service study is to provide an indication of the costs incurred by a utility providing service to its various classes of customers in relation to the revenues collected from those customers. It provides a guide to the Commission for distributing the overall revenue increase to the various customer classes. While reliance on a cost of service study to design rates would produce cost based rates, other factors, such as the magnitude and impact of required increases on the individual rate classes should temper the use of the results.

For the purpose of cost of service studies, costs associated with MGE (mains, meters, services, etc.) were separated into the following cost components:

1. Customer costs depending only on the number of customers served, independent of gas usage;

2. Capacity costs depending upon the maximum delivery requirements of the distribution system on its peak days;

3. Commodity costs depending upon the volume of gas used.

To determine each class' responsibility for MGE's facilities costs, these costs were allocated to MGE's five rate classes:

1. Residential	(RES or residential);
2. Small General Service	(SGS or small general service);
3. Large General Service	(LGS or large general service);
4. Large Volume Service	(LVS or large volume service);
5. Unmetered Gas Lights	(UGL*).

(*UGL represents nominal amounts and will not be discussed further.)

[*57]
The class allocations are based on the relative numbers of customers for customer costs, contributions to peak demand for capacity costs, and relative sales volumes for commodity costs.

A large component of the differences in overall results among the parties for the respective class cost of service studies is the allocation of costs associated with MGE's distribution mains, because a substantial portion of the MGE's investment in facilities is represented by the cost of the mains.

MGE used a two inch diameter minimum system study to allocate distribution system costs to its various classes of ratepayers. The basic purpose of the minimum system study was to segregate the actual cost of mains in the existing distribution system by recognizing that this cost depends on the number of customers to be served, the locations (which determines main length), and the maximum amount of gas that has to flow through the mains to meet customer demands (which determines main diameter). In other words, it separates the embedded cost of mains in the existing system between customer-related and demand-related components. Customers must be connected to the system of distribution mains with at least [*58] a minimum size pipe if they are to receive any service. This portion of the mains costs is the customer-related component. The remainder of the costs of mains relates to the sizing of the mains to meet the demands customers place on the system. This portion of the mains costs is the demand-related component.

MGE did not develop a separate customer allocator for mains. Rather, the Company developed one composite allocator applicable to all customer-related costs. The purpose of developing one composite allocator was to recognize that it costs more to serve a large customer than a small one.

Staff submitted two class cost of service studies. The first class cost of service study was essentially an updated version of the cost of service study that Staff conducted in MGE's prior rate case, Case No. GR-96-285. Staff allocated distribution mains using a stand-alone integrated system method. This stand-alone method considers the length and diameter of mains required to serve a typical customer if that customer is located adjacent to the city gate. All other mains costs are assumed to be shared by all customers on the system.

In the second class cost of service study, Staff allocated costs [*59] to the various customer classes based on the value of the service that the class derives from a given functional category throughout the year. To allocate distribution mains, Staff used a capacity utilization method, which uses 12 monthly peaks to approximate the incremental demands and the benefits received by each class. To determine the customer/demand split for allocating meters and regulators, Staff used data from Case No. GR-97-272, Associated Natural Gas (ANG). Staff used ANG's data because it was readily available and MGE's was not. Staff believes that use of ANG's data is reasonable because MGE's costs for these items should be the same as ANG's costs.

OPC allocated distribution mains based upon the modified Relative System Utilization Method (RSUM). The modified RSUM allocators are calculated using incremental noncoincident monthly demands and the nonlinear cost-capacity relationship for distribution mains (The nonlinear cost-capacity relationship for mains comes from the result that the capacity of distribution mains increases faster than its cost). All costs associated with distribution mains less than four inches in diameter were allocated solely between residential and [*60] the small general service classes. Mains of less than four inches in diameter account for over 45 percent of the length of mains in MGE's distribution system. Distribu-

tion mains four inches and larger are considered to be part of the common system necessary to serve all customer classes. They were, therefore, allocated among all classes by modified RSUM allocators.

When OPC derived the meter, regulator and service allocators, costs were allocated by considering three factors: customer counts for each rate class; average costs for each type of meter, regulator and service; and the number of meters, regulators or services used by a customer for each customer class. The class meter, regulator and service allocators are based on the typical meter, service, regulator and installation costs provided by MGE and the updated, prorated customer count calculated by Staff.

OPC rejects methods which break the costs of the distribution system into two portions which supposedly depend on two different causes. Historically, OPC claims that the application of the *minimum system* method has resulted in residential and small commercial customers paying more than the fair share of distribution mains [*61] costs for both of these classes. The costs would be significantly higher to compose the system as a minimum system plus additions necessary to provide the current level of service.

MGUA and Jackson County, et al., believe that the methodologies recommended by MGE reflect the proper methods of functionalizing and classifying costs. For distribution mains, MGUA and Jackson County, et al., recommend use of the minimum system method. However, MGUA corrects MGE's method in two areas to more accurately allocate costs to the various customer classes. These areas dealt with the incorrect use of weighted customers to allocate certain customer related costs, and the allocation of MGE's gas storage inventory costs to transportation customers.

A summary of each party's allocation factors for four of MGE's five rate classes is given below:

Summary of Mains, Services, Meters, Meter Installation and Regulators

	RES	SGS	LGS	LVS	Total*
MGE mains	68.46	22.31	2.37	6.86	100.00 **
MGE other	75.67	20.82	0.99	2.52	100.00
Staff # 1 mains	60.26	20.97	2.94	15.83	100.00
Staff # 1 meters	78.67	15.34	0.64	5.34	100.00
Staff # 1 regs.	37.80	59.48	0.60	2.11	100.00
Staff # 1 services	82.02	16.51	0.72	0.76	100.00
Staff # 2 mains	51.06	19.89	3.58	25.48	100.00
Staff # 2 M&R	62.07	19.73	2.91	15.30	100.00
Staff # 2 services	81.34	13.93	0.75	3.98	100.00
OPC RSUM	52.46	20.47	2.70	24.37	100.00
OPC meters	67.06	22.29	1.58	9.08	100.00
OPC regulators	34.90	60.40	1.40	3.30	100.00
OPC services	83.50	13.10	0.90	2.50	100.00

No UGL figures are listed because the amounts are negligible.
** Totals approximate 100 percent; they may vary because of rounding.
[*62]

Methods of allocation used by MGE, Staff and OPC for other plant accounts are listed in each party's respective prefiled testimony. These accounts comprise a very small percentage of the overall rate base. However, MGUA and Jackson County, et al., disputed some of these allocations because they alleged that it unfairly assigns costs to transportation customers.

MGUA and Jackson County, et al., opposed the proposed treatment of allocating uncollectible accounts to transportation customers that are not caused by transportation customers. Sales customers' unpaid billings represent substantial amounts of gas purchased by MGE and delivered to sales customers for which these customers did not pay. Since transportation customers purchase gas directly, requiring the transportation customer to pay these charges in effect forces them to not only purchase its own gas supplies but also to pay for gas that is sold to system sales customers but not paid for by the system sales customers. MGUA and Jackson County, et al., state that unless and until these uncollectibles are broken out properly, MGUA, Jackson County, et al., oppose the recovery of uncollectible accounts as a revenue or rate base item [*63] for MGE.

In addition, MGUA and Jackson County, et al., dispute several other items in the other parties' class cost of service studies. Those issues that appear most controversial along with the position argued by MGUA and Jackson County, et al., are:

1.	Gas storage inventory:	No portion should be charged or allocated to transportation customers.
2.	Customer advances for construction:	Directly assign to Large Volume Service/LGS class.
3.	Customer deposits:	Directly assign to Large Volume Service/LGS class.
4.	AMR equipment costs:	Not the responsibility of transportation customers who are required to purchase its own EGM equipment.
5.	Uncollectible Accounts:	Transportation customers' class should be assigned only the portion of such costs for which they are responsible, if any.

MGE incorporated interruptibility in the peak demand calculation (reduction of 50 percent of peak demand) for its LVS class. The resulting diminished potential use of the Company's distribution system by Large Volume Service customers is recognized in this adjustment. MGE alleges support for the interruptibility recognition because there is a [*64] higher probability that Large Volume Service customers will be interrupted upstream of MGE's distribution system by higher priority customers.

In Staff's class cost of service study, actual peak day demands were weather normalized to properly reflect the extreme weather that has occurred over a 30-year period and were also adjusted for customer growth. Large Volume Service customers' peak day demands were increased by 25 percent to adjust for normal weather and growth.

A significant portion of the difference between MGE's and MGUA's class cost of service studies and those class cost of service studies performed by Staff and OPC is MGE's and MGUA's assumption that January volumes for Large Volume Service customers are reduced 50 percent. Staff contends that if these volumes were not reduced, the Large Volume Service revenue requirement would increase by $ 2.35 million. In addition, Staff stated that MGE has not experienced any distribution system constraints during its ownership. Both Staff and OPC believe that no sound reason exists for the 50 percent reduction (which MGE referred to as an "interruptibility recognition") in the Large Volume Service customer peak demands that were used [*65] by MGE and MGUA to allocate costs that MGE and MGUA believed were capacity related.

MGUA and Jackson County, et al., agree with MGE that some level of interruptibility or priority of service should be reflected in the demand allocator for transportation customers in the Large Volume Service class. MGUA does not agree with Staff's use of peak day demands because they are estimated and MGUA argued that "factoring up" large volume service demand by 25 percent artificially inflates capacity costs related to its customers.

The Commission has carefully reviewed each party's cost of service study. In doing so, the Commission has remained mindful that the cost of service is but one consideration in determining the reasonableness of rates. *Shepherd v. Wentzville, 645 S.W.2d 130 (Mo. App. 1982).* It is not just the methodology or theory behind any proposed rates but the rate impact which counts in determining whether rates are just, reasonable, lawful, and nondiscriminating. *State ex rel. Associated Natural Gas Co. v. Public Service Commission, 706 S.W.2d 870, 879 (Mo. App. 1985).* The quintessence of a just and reasonable rate is that it is just and reasonable to both the utility and [*66] its customers. *State ex rel. Val Sewage Co. v. Public Service Commission, 515 S.W.2d 845 (Mo. App. 1974).*

The Commission finds that the current division of cost by class remains just and reasonable. The Commission finds that there is not sufficient evidence presented in the record to support the findings proposed by the parties to change the current class cost of service percentage. There has not been any evidence of a significant change or development that would have supported any of the changes proposed. Therefore, there should be no change in the class cost of service as

allocated among the rate classes and found to be just and reasonable under the prior case, Case No. GR-96-285, issued on October 31, 1996.

2.2. Class Revenue Responsibility

MGE's cost of service study indicates that revenues collected from residential service and small general service classes should be increased, while large general service and large volume service revenues should be reduced. However, MGE does not propose to implement those reductions in order to temper the increases to residential and small general service rates. MGE proposed to reduce commodity rates for the large general service [*67] and large volume service classes only to the extent necessary to offset the proposed customer charge increases for these classes, thereby producing no overall change in revenues collected from each of these classes. Assuming the midpoint of Staff's revenue requirement increase of $ 8,388,834 is adopted, MGE proposed no change to the revenue responsibility of the large general service and large volume service customer classes and proposed that the revenue responsibility of the residential and small general service customer classes be increased by 8.4 percent and 5.6 percent, respectively. In the alternative, if the Commission believes that all customer classes should share in a revenue increase, then MGE proposed that large general service revenues be increased by no more than 3.5 percent and large volume service revenues should be increased by no more than 2.8 percent. MGE proposed that the remainder of the revenue increase be spread to the residential and small general service classes with each receiving the same percentage increase.

Assuming that Staff's proposed increase at the midpoint of $ 8,388,833 is adopted, Staff proposed that the residential class receive a 6.87 percent increase [*68] which is the percentage of overall recommended revenue increase. In addition, Staff proposed that the Small General Service and Large General Service classes receive approximately a 3.44 percent increase, or one half of the percent increase for the residential class. Staff further recommended that the Large Volume Service class receive the remaining increase which would be approximately a 17 percent increase.

If the Commission were to determine that the appropriate level of revenue increase is significantly greater than Staff's midpoint proposal of $ 8,388,835, then Staff recommended that the Commission give serious consideration to an equal percentage increase for all classes in order to lessen the rate impacts on the various customer classes.

OPC's class cost of service indicates that residential, small general service and large general service revenue requirements should be decreased. OPC recommended that the Commission adopt a rate design that considers rate impact and affordability factors when determining the amount of movement, if any, towards class cost of service. The Commission should impose, at maximum, revenue shifts equal to one-half of the revenue neutral shifts indicated [*69] by OPC's class cost of service study.

Additionally, to ensure that rates remain affordable and that the overall revenue requirement increase is shared equitably among the customer classes, OPC stated that two other factors should be considered. First, no class should receive a net decrease in revenue requirement (from the combined effect of interclass revenue shifts and an increase in the overall revenue requirement) while another class receives a net increase. Second, if the Commission decides to grant an increase in the overall revenue requirement that approaches the amount requested by the Company, then the Commission should not make any interclass revenue shifts and all customer classes should have its rates increased by equal percentages.

OPC suggests that the Commission consider the impact of significant increases in residential rates when it considers revenue shifts proposed by other parties in this case. OPC utilized a two step process in determining class revenue responsibility. To ease the impact of proposed revenue shifts on any one class, OPC halved the revenue neutral shifts indicated by its class cost of service study. Also, OPC limited the revenue shifts to ensure that [*70] no customer class receives a net decrease while another class receives a net increase.

MGUA's cost of service study, as does MGE's, reflects that the Large Volume Service and Large General Service classes have current rates that are too high while residential class rates are too low. MGUA and Jackson County, et al., would propose no revenue change to the Large Volume Service and Large General Service customer classes.

The Commission finds that the current class revenue responsibility remains just and reasonable. The Commission finds that there is not sufficient evidence in the record to support the positions of the parties regarding shifts in class revenue responsibility. Therefore, there should be no change in the allocated class cost of service. The allocation currently in place was found to be just and reasonable under the prior case, Case No. GR-96-285, issued on October 31, 1996.

2.3 Rate Design-Customer Charge Levels

MGE's cost of service study shows that substantial customer charge increases are warranted. MGE proposed that only a portion of the indicated customer charge increases be implemented at this time. Specifically, MGE originally proposed a residential customer [*71] charge of $ 12.75, a small general service customer charge of $ 15.50, a large general service customer charge of $ 92.50, and a large volume service customer charge of $ 575.00. For each class, the proposed charges recover a greater portion of customer related costs through customer charges rather than relying as extensively on volumetric rates to recover these costs. MGE argued that the proposed changes are more equitable to customers because each customer would pay an amount that reflects the costs to serve that customer, independent of the customer usage. The proposed customer charges would also serve to reduce seasonal billing impacts, and for weather sensitive customers, would lessen bill swings caused by seasonal weather variations. MGE's residential service customer charge, calculated on a minimum system approach, includes costs associated with distribution mains.

For the residential service and Large General Service classes, Staff is proposing that the customer charges remain at the current levels of $ 9.05 and $ 65.80, respectively. For the Small General Service class, Staff recommended that the customer charge be increased from $ 11.05 to $ 12.50. For the Large Volume Service [*72] class, Staff recommended that the customer charge be increased from $ 409.30 to $ 479.00.

Staff proposed to increase both the large volume service customer charge and the large volume service margin commodity charges by the same approximate percentage to lessen the impact on customers within the Large Volume Service class. If the percentage change in the customer charge is significantly different than the percentage change in the class revenue requirement, the impacts within classes could be a concern. Impacts within a class can be minimized by increasing the customer charge by the same percentage as class revenue.

OPC recommended that the residential customer charge remain at its current level of $ 9.05 because OPC's cost of service study indicates that the costs that should be collected through this charge are nearly identical to the current level of the customer charge. No costs associated with distribution mains are included in OPC's customer charge. According to OPC, this is because the addition of a single customer does not necessarily require any increase in investment in distribution mains. OPC believes that only costs that vary directly with the addition of customers should [*73] be included when determining a reasonable level of the monthly residential customer charge. These costs include the following:

1. services;
2. meters;
3. house regulators;
4. customer accounts;
5. associated depreciation expense;
6. associated O&M expenses;
7. return on rate base.

MGUA proposed the following customer charges: Residential Service, $ 15.77; Small General Service, $ 26.26; Large General Service, $ 138.13; and Large Volume Service, $ 390.94. MGUA and Jackson County, et al., propose that the customer charges for all classes be computed in a similar manner. The same costs that are included in the residential customer charge should be included in the Large Volume Service and Large General Service customer charges. In addition, MGUA, Jackson County, et al., recommend that smaller customers transporting gas pursuant to contiguous property language in the transportation tariff only be assessed a customer charge commensurate with the equipment in place for the customers.

Intervenor Mountain Energy takes the position that MGE's proposed large volume service customer charge level is excessive and unreasonable.

The Commission finds that current customer charge levels remain [*74] just and reasonable. The Commission finds that there is not sufficient evidence in the record to support any of the positions proposed by the parties regarding customer charge levels. Therefore, there should be no change in the customer charge levels for any of the rate classes. The customer charge rates were found to be just and reasonable under the prior case, Case No. GR-96-285, issued on October 31, 1996.

The increase in the revenue requirement should be collected through the commodity charges for all classes of service.

2.4 Facilities Extension Policy

This issue relates to MGE's tariff sheet R-58 which currently allows for the installation of free main extensions up to 75 feet for a customer whose annual gas consumption is less than 600 Mcf, and service line extensions at no charge to the customer for the first 40 feet or $ 450 in costs, whichever is less. Under MGE's current tariff, these free footage allowances are made regardless of the usage indicated as long as the projected annual usage is less than 600 Mcf. Free footage allowances for mains and service lines become a part of the rate base; customer contributions toward facilities extensions do not. Under the current [*75] facilities extension policy, 96 percent of the total cost of facilities extensions to serve new customers will be recovered through the rates to be set in this proceeding and paid by all customers. MGE proposed to increase the cost to be paid directly by a new customer to 25 percent, thereby reducing the amount of the cost to be recovered through rate base to 75 percent. MGE argued it could recover more of the costs of extensions from those who cause the costs, and reduce the amount of the costs that would otherwise be borne by MGE's other customers.

Staff does not object to MGE's proposed tariff changes regarding extensions of main lines, but opposed MGE's proposed changes as they pertain to service line extensions. With regard to the latter, Staff believes that new residential customers whose annual gas consumption is less than 600 Mcf should receive the first 60 feet of service line extension at no cost, provided there are no unusual construction conditions.

MGE's proposal is different from its existing tariff and the tariffs of other local distribution companies which provide for a set minimum amount of footage before charges are levied for an extension.

OPC opposed the proposed [*76] provisions because OPC argued that it is the Company's duty as a certificated (publicly franchised) provider of services to make the investments necessary to extend service to customers. Charges for excess extension costs have historically been put into place to provide reimbursement to companies for extensions which are more costly than the ordinary extension. Second, MGE's requested change in this tariff represents a marked departure from the policies established in the tariffs of other energy suppliers in this state. Such a change in the basic nature of these tariffs should not be considered on an unilateral basis.

KCPL objects to MGE's proposed facilities extension policy. KCPL maintains that some level of main and service line extensions should be provided to residential customers at no cost. KCPL states that its position is consistent both with the policies of other jurisdictional utilities and long-standing Commission practice to include some amount of extension facilities in the Company's rates. In addition, KCPL opposed MGE's proposal because the change is limited to customers under 600 Mcf as an attempt to tie construction deposit refunds to the amount and types of appliances [*77] installed in the home (i.e., greater refunds to homes with greater use of gas appliances). KCPL maintains that deposits should be refunded without regard to usage.

MDEA opposed MGE's proposed facilities extension policies tariff because: 1) it gives MGE too much discretion over setting gas facilities extension charges for residential subdivisions; 2) it changes the reimbursement of facilities construction advances to a revenue-based formula that would pressure builders to install gas piping that would increase the cost of homes, restrict new homeowners' end choice of appliances, and put the developer or builder in the role of marketer for MGE's services; 3) its proposed charge for four-inch main extensions is unreasonably high; and 4) it permits MGE too much discretion over construction deposits where MGE determines that greater than a four-inch line is required or where MGE finds unusual construction conditions.

The Commission finds that there is not sufficient evidence to support the amendment to the facilities extension policy proposed by MGE. MGE has failed to provide competent and substantial evidence to show that the proposed amendment would produce just and reasonable rates. [*78]

2.5 Other Tariff Issues

a. Pooled Transportation

MGE proposed tariff sheets No. 61.1 and 61.2 to introduce a voluntary pooled service option for transportation customers meeting some volume minimums, approximately 100 Mcf per day. Through this proposed service option, the gas supplies of a group of eligible customers served by a single supplier may be aggregated for the purpose of determining or avoiding penalties during pipeline operational orders and local distribution curtailments. Staff has no objection to MGE's proposal and OPC takes no position on this issue.

Mountain Energy objects to the proposed charge for the voluntary pooled transportation service, and argued that the service should be available to all customers, regardless of usage. Mountain Energy claims that the minimum required use of 100 Mcf per day is unreasonably restrictive and discriminates among the various users. Finally, Mountain Energy

stated that this pooled transportation service is not needed if the burner tip balancing (BTB) as set out in Case No. GR-93-240 is appropriately applied by MGE.

MGUA and Jackson County, et al., do not agree with the pooled transportation proposal offered by MGE [*79] either. MGUA and Jackson County, et al., do not believe that the pooled transportation service option, voluntary or otherwise, is necessary because all transportation customers currently participate in the burner tip balancing mechanism pursuant to the prior agreement.

The Commission finds that as the proposed service which MGE wishes to offer is a voluntary service, there is no harm in permitting MGE to include this proposed voluntary service in its tariff sheets. Since no entity is required to participate in this program unless it has negotiated an agreement voluntarily with MGE, there is no detriment to other ratepayers and the voluntary nature of the program makes the proposal just and reasonable. The Commission finds that the approval of tariff sheets 61.1 and 61.2 does not in any way negate any interpretation of the burner tip balancing agreements currently in place.

b. Deferral of Deliveries during System Emergencies

MGUA proposed to delete tariff sheet No. 68. Tariff sheet No. 68 permits MGE to defer delivery of a customer's gas in the event of a system supply emergency. A system supply emergency occurs when the supply of natural gas available to the Company in any [*80] area is less than the amount required to meet the demands of its sales customers. A system supply emergency would result from MGE failing to nominate sufficient gas supplies for its sales customers at a given time. A system capacity emergency, on the other hand, would result from an inadequate supply of gas being available from the pipeline to meet MGE's requirements. The priority of service section of tariff sheet No. 66 of MGE's tariff stated that

> if a supply deficiency occurs in the volume of gas available to the Company for resale, and the customer supply delivered to the Company for transportation continues to be available, then the customer may continue to receive transportation service even though sales gas of the same or higher priority is being curtailed.

Comparison of the language in tariff sheet No. 66 and tariff sheet No. 68 shows that the language of the two tariff sheets is contradictory. MGUA and Jackson County, et al., assert that this provision, which permits the borrowing of transportation customers' gas supplies, wherever appropriate, is no longer appropriate after FERC Order 636. MGE should be fully responsible for providing sufficient and reliable supplies [*81] of gas for its system supply customers without relying on its transportation customers' gas supplies. MGUA and Jackson Co., et al., argued that the Tariff 68 provision is also inconsistent with MGE's curtailment priorities. MGUA and Jackson County, et al., stated that transportation customers should no longer be required to provide free insurance against MGE's failures to fulfill its public utility obligation. The intervenors point out that this is not a safety or reliability issue; it is a responsibility issue for MGE.

MGE's opposition to MGUA's proposal regarding deferral of deliveries during system emergencies is based on its understanding of the Commission's policy to ensure that supplies are available during emergency situations to serve human needs customers. If the Commission determines that this is a policy that should be changed consistent with the position advanced by MGUA, MGE will accept that determination.

Staff agreed with the proposal of MGUA and Jackson County, et al., to delete the language on MGE's tariff sheet No. 68. This tariff language allows MGE to defer delivery of a transport customer's gas when MGE has failed to nominate sufficient gas supplies for its sales [*82] customers. Staff believes that deletion of the sheet No. 68 language would not compromise public safety because if a system supply deficiency became serious enough that human needs were jeopardized, there would almost certainly be enough gas on the pipeline available to MGE to meet human needs (even if at substantial cost and with substantial penalties attached). If gas were not available on the pipeline because the pipeline was physically incapable of supplying the gas, the situation would become one of a system capacity deficiency. Under MGE's tariff sheet Nos. R-81 and R-82, MGE may curtail gas to low priority customers when an inadequate supply of gas is available from the pipeline. Existing language in tariff sheet Nos. R-81 and R-82 provide sufficient protection for human needs in the event of an emergency.

Mountain Energy supports the position of the Midwest Gas Users' Association on this issue. OPC takes no position on this issue.

The Commission finds that tariff sheet No. 68 of MGE's tariff is neither warranted, just nor reasonable in light of the other tariff sheets available for the protection of critical human needs, such as Tariff Sheets R-81 and R-82. The language in [*83] tariff sheet No. 68 contradicts the language in tariff sheet No. 66, and given the fact that this tariff sheet language has never been invoked, the language in tariff sheet No. 68 is clearly not warranted. The Company shall be ordered to remove tariff sheet No. 68.

c. Unauthorized Use Charges

Under MGE's current tariffs, MGE is permitted to implement a separate unauthorized use charge when excess gas is delivered to a transportation customer, if at the same time such customer is subject to upstream interstate pipeline penalties.

Mountain Energy requests that MGE not be permitted to penalize a transport customer if MGE has not been penalized on the interstate pipeline system. Mountain Energy requests that the tariff sheet relating to unauthorized use charges be removed from MGE's tariff.

MGUA and Jackson County, et al., also recommended that all customers share in that portion of the penalty revenues in excess of the cost of gas. There is no reason to eliminate transportation customers from sharing non-gas penalty revenues. MGUA stated that to the extent that MGE collects penalty revenue from transportation customers that exceed the cost of the natural gas commodity that may [*84] have been taken in excess of current nomination, the excess should flow back to benefit transportation customers who are in compliance. MGUA alleges that by creating a profit center for MGE, in connection with the experimental gas tariff, a perverse incentive is created for MGE to penalize its transportation customers without justification.

Staff believes that MGE's current tariff provision is reasonable. Staff stated in support of its position that if there are shortfalls in deliveries, it is MGE's systems supply and transportation agreements that provide the swing capability necessary to maintain reliable and safe deliveries to all customers, including transportation customers. Staff stated that it is most appropriate to have penalty revenues credited to the sales customers to the extent they are paying the cost incurred. During critical periods on the interstate pipeline system, MGE's contracts are covering the transport customers' shortfalls to the detriment of the sales customers, who may pay a higher price for replacement supplies. Penalties in MGE's tariffs are for unauthorized taking of gas from MGE's system, not for activities on the upstream pipeline.

MGE supports its current [*85] tariff on unauthorized use charges. OPC takes no position on this issue.

The Commission finds that MGE's current tariff regarding the unauthorized use charges is reasonable and shall remain a part of MGE's tariff. There has not been sufficient evidence produced to support any change to the current tariff.

d. Twelve-Month Notice for Transport Switching

MGE tariff sheet No. 41 relates to the time required for notice to be given by customers to MGE to switch from transport service to sales service or from sales service to transport service.

In response to the concern of Mountain Energy, MGE is willing to allow customers who have never had transportation service to initiate transport service upon 60 days' notice (instead of the current 12 months) following installation of electronic gas measurement equipment. Customers wanting to switch from transportation service to sales service should still be required to wait 12 months, however.

Staff believes that MGE's current tariff provision is reasonable. Allowing a customer to initiate transportation service upon 60 days' notice may result in excess capacity which could harm the remaining sales customers. OPC takes no position on this [*86] issue.

Mountain Energy's position is that the 12-month notice for transport switching is excessively long and should be reduced. While Mountain Energy recognized that MGE needs some time and notice before a customer switches between these two services, it stated that in a competitive marketplace the 12-month provision is artificially high. Mountain Energy supports the initiative to change the existing tariff to allow a customer to initiate transport service upon 60 days' notice. Mountain Energy claims that the 60-day notice is sufficient to allow MGE to install the EGM equipment. It believes the 60-day notice should include installation of the EGM, not exclude it.

Mountain Energy stated that a transportation customer that wishes to switch from transportation service to sales service should not be required to wait the 12 months as proposed by MGE. The switch should be effected in no less than 60 days with that customer agreeing to take the higher of the system weighted average cost of gas or the additional in-

cremental cost of short-term supplies. Mountain Energy believes that such arrangements should not penalize a switching customer, but should be limited in duration, after which [*87] the customer should be treated as any other sales customer.

The Commission finds that the MGE tariff sheet No. 41 is reasonable and no changes should be made. This tariff sheet permits MGE time to adjust its upstream pipeline capacity contracts and its separate commodity contracts to match its projected sales and service requirements. There is not sufficient evidence to support any change to the tariff regarding switching from transportation service to sales service or from sales service to transportation service without the required 12 month notice.

e. LVS Complaint Procedures

MGUA requests the Commission require MGE to incorporate a Large Volume Service complaint procedure into its tariffs. MGUA stated that the current complaint procedure is discriminatory and unreasonable in that it treats large volume service customers differently. Mountain Energy supports Midwest Gas Users' Association on this issue.

MGUA and Mountain Energy believe that MGE should have a process applicable to all its customers that prevents MGE from threatening to cut off service to force payment of amounts that are in dispute. These parties believe that residential customers have this protection and [*88] that protection is needed for large customers also. MGUA has proposed a tariff change which will make MGE tariffs consistent with the tariffs of other utilities in this regard.

MGE opposed the proposals of MGUA and Mountain Energy to implement a complaint procedure in its tariff for large volume service customers.

Staff presented evidence that indicated that this issue is not an appropriate issue for a rate case. It is a general policy question applicable to all utilities, not something that is unique to MGE. The Commission's existing policy is that a dispute resolution procedure is appropriate for residential customers. It has had such provisions in place in Chapter 13 of its rules (4 CSR 240-13) for more than 20 years. There has been no evidence presented here of a need for such a procedure for nonresidential customers. There is no need for a such a provision.

The Commission finds that, given that MGE has a separate department set up to deal specifically with large volume customers, which represent approximately 400 customers on the system, a tariffed informal complaint procedure does not appear to be warranted. Additionally, a Large Volume Service customer may file a formal or informal [*89] complaint with the Commission pursuant to *4 CSR 240-2.070.*

f. Fifteen-Day LVS Bill Payment Requirement

Mountain Energy claims that MGE's requirement that Large Volume Service (LVS) customers pay their bills in 15 days instead of 21 days as allowed for the other customer classes is unreasonable and discriminatory.

MGE opposed the proposal of Mountain Energy to increase the time within which large volume service customers have to pay their bills from 15 to 21 days. Any change in this requirement will increase revenue requirement impact by an amount which has not been quantified, and therefore no action on this request should be taken. Since the current provision is currently deemed just and reasonable, MGE stated that Mountain Energy bears the burden of convincing the Commission otherwise.

Staff believes that MGE's current tariff provision requiring full payment within 15 days is reasonable. Staff witnesses testified that Large Volume Service customers tend to be very large, and their gas supply and transportation service is governed by contractual relations. Given that common industry practice requires payment for supply and transportation services in a 10 to 15 day time frame, [*90] MGE's requirement that Large Volume Service customers pay their bills within 15 days is not onerous. OPC takes no position on this issue.

The Commission finds that Staff's and MGE's position regarding MGE's current tariff provision relating to the 15-day Large Volume Service bill payment requirement is reasonable, and the tariff provision remains just and reasonable. There is not sufficient evidence to show that this provision warrants any change.

g. EGM Cost

MGUA and Jackson County, et al., recommend that the Commission order MGE to aggressively explore less costly electronic gas measurement (EGM) technology for its customers. Mountain Energy concurs with Midwest Gas Users' Association that the EGM cost should be decreasing as other technology of this type decreases in cost and becomes more efficient.

MGE continues to believe that EGM equipment is necessary for large volume transportation customers. In addition, the cost incurred for EGM installations is reasonable. Under MGE's tariff, the Large Volume Service customer is charged the lesser of the actual cost or $ 5,000 per EGM meter.

Staff believes that MGE's current tariff provision is reasonable. OPC takes no position [*91] on this issue.

The Commission finds that the current tariff regarding the Large Volume Service customer's EGM cost is reasonable and adopts Staff's and MGE's position on this issue. Under MGE's tariff, the Large Volume Service customer is charged the lesser of the actual cost or $ 5,000 per EGM meter. As $ 5,000 is the maximum price per EGM meter permitted under the tariff, and the EGM equipment is absolutely necessary for operation of the Large Volume Service customer's gas service, the Commission finds that MGE's current tariff continues to be just and reasonable. There is not sufficient evidence to support any change in this current tariff.

h. SGS, LGS, LVS Volume Distinctions

It is Mountain Energy's position that the volume distinctions and classifications between Small General Service (SGS), Large General Service (LGS) and Large Volume Service (LVS) place an artificial barrier between the levels of customers who could potentially transport. Mountain Energy points out that Illinois has no barriers on who can transport. Mountain Energy stated that because these volume distinctions are based on peak usage and not on an annual usage they can have unfair effects. Mountain Energy [*92] proposed that these distinctions be modified or removed to allow those customers who can benefit from transportation to take advantage of the open marketplace.

MGE has made no specific proposal to alter class definitions in this case. MGE made a proposal to make transportation service available to large general service customers primarily on the grounds that EGM should have been required for large general service customers in Case No. GR-96-285. The Commission rejected MGE's proposal at that time. Given the short period of time between this case and the last, MGE made no proposal to expand transportation availability in this case. MGE claims it will be addressing these matters in a filing to be made with the Commission in the future, and therefore, MGE argued that the Commission need not adopt Mountain Energy's concept in this proceeding. MGE points out that the record in this case lacks sufficient evidence to support such a change in the current tariff provisions regarding classification of service.

Staff is opposed to modification in the Small General Service, Large General Service and Large Volume Service class definitions in this case. Such changes could impact the Company's revenues, [*93] as well as the cost other customers pay.

The Commission finds that there is not sufficient evidence in the record to support any changes to volume distinctions and classifications and adopts Staff's position as just and reasonable. Given the various proposals in the last rate case and this rate case, the Commission suggests that the parties request an investigation to allow for the discussion of the modification of volume distinctions and classifications among classes as a separate case. A separate case would provide other parties with the opportunity to intervene and propose language for changes.

i. Multiple Customer Charges for Multiple Meters

See Issue I.A.1., infra.

j. Expansion of Transportation Availability

Mountain Energy proposed that MGE eliminate the tariffed threshold for a customer to transport gas on MGE's system. Mountain Energy supports the expansion of transportation services to customers who are currently not able to transport under MGE's existing tariffs.

MGE indicates that this issue is conceptually similar to the volume distinctions and classifications among customers as discussed Section II.2.5.h. of this Report and Order, *supra.* MGE has not [*94] proposed to expand transportation availability in this case. MGE believes its current tariff remains just and reasonable.

Staff also believes that MGE's current tariff provision is reasonable. Staff is concerned that changes could impact the Company's revenues, as well as the costs other customers pay.

The Commission finds that there is not sufficient evidence to warrant any change of this tariff at this time. Further, the Commission finds that MGE's current provision is just and reasonable and adopts Staff's and MGE's position. As indicated under the Commission's findings in Section II.2.5.h., this issue may be appropriate for discussion as part of another case along with the issue of volume distinction and customer classification.

k. Ccf Billing

MGE proposed to change its billing units from Mcf (1,000 cubic feet) to Ccf (100 cubic feet) to improve customer understanding of bills during periods of low gas usage. Staff supports the Company's proposal. Mountain Energy has no position on this issue. No parties objected to MGE's proposal on this issue.

The Commission finds that MGE's proposal to change its billing units from Mcf (1,000 cubic feet) to Ccf (100 cubic feet) is just [*95] and reasonable, and is hereby approved by the Commission.

l. Limit LVS Class to Transport Customers

MGE proposed to establish the large general service schedule as the large customer sales service schedule and make the large volume service schedule transportation-only service.

Staff believes that MGE's current tariff provision is reasonable. Staff stated that MGE has only two current sales customers in the Large Volume Service class and those customers have usage characteristics consistent with the other Large Volume Service customers.

The Commission finds that MGE's current tariff provision is reasonable and adopts Staff's position on this issue. There is not sufficient evidence to support any change to the current tariff provision.

3. Customer Service Matters

It is the Commission's understanding that the customer service matters were addressed and evidence presented by the parties for the Commission's information to advise the Commission of the status of MGE's ongoing projects on which MGE is working. Despite a delay in implementing these customer service programs, it was apparent by the evidence that MGE has begun to make improvements in its customer service areas. [*96] The Commission urges the Company to redouble its efforts and fulfill prior commitments made in Case No. GR-96-285 in order to ensure timely and successful completion of customer service improvements. The Commission wishes to reinforce the parties' understanding that prior commitments ordered in Case No. GR-96-285 remain in effect and will continue to be in effect until such time as an order relieving MGE of said commitments is issued. The Commission will accept and seriously review any complaints received where it appears that MGE has failed to comply with the commitments ordered in Case No. GR-96-285, or any other valid order of this Commission. The Commission commends MGE's current efforts and encourages MGE to continue these efforts toward improved customer service.

MGE has undertaken substantial measures that have directly improved the quality of customer service. MGE claims that most, if not all, of these measures represent continuous and ongoing, rather than "one-time," projects that will continue to improve the levels of customer service quality in the future.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law: [*97]

Missouri Gas Energy, a division of the Southern Union Company, is a public utility engaged in the provision of natural gas service to the general public in the state of Missouri and, as such, is subject to the general jurisdiction of the Missouri Public Service Commission pursuant to Chapters 386 and 393, RSMo 1994.

The Commission has authority under Chapter 393, RSMo 1994, to set just and reasonable rates for the provision of service by regulated gas utilities.

The orders of the Commission must be based on substantial and competent evidence, taken on the record as a whole, and must be reasonable and not arbitrary, capricious, or contrary to law. In that regard, and in setting rates which are just and reasonable, the Commission has considered all relevant evidence and determines, as set out in the findings of fact, that Missouri Gas Energy's revenue requirement will be increased in the amount of $ $ 13,217,754 as set out in this Report and Order.

The proposed Stipulation and Agreement, with Addenda, is treated as unanimous by operation of rule *4 CSR 240-2.115*, is in the public interest, and is approved.

IT IS THEREFORE ORDERED:

1. That the Commission's Scenarios A and B are made [*98] a part of the the Report and Order, marked as Attachment D, pp. 1-2, and attached to this Report and Order.

2. That Tariff No. 9800264 and Tariff No. 9800387, submitted in File No. GR-98-140 and GT-98-237 respectively, by Missouri Gas Energy, a division of Southern Union Company, on October 3, 1997, and December 10, 1997 respectively, are hereby rejected.

3. That the Commission approves the Stipulation and Agreement with the Addenda filed.

4. That Missouri Gas Energy, a division of Southern Union Company, is hereby directed to file, not later than September 2, 1998, revised tariff sheets with a thirty day effective date in accordance with the findings in this Report and Order, which should include the rate increase of $ 13,297,499 and all other changes consistent with this order.

5. That the above-ordered increase in rates will be applied as commodity charges at an equal percentage across all rates and rate classes.

6. That Missouri Gas Energy, a division of Southern Union Company, the Office of the Public Counsel, and the Staff of the Commission are ordered to recalculate and file depreciation rates, either jointly or separately, in accordance with the findings in this Report and Order no later than August 27, 1998. [*99]

7. That Missouri Gas Energy is granted an Accounting Authority Order as set out in the findings of this Report and Order. Nothing in this order granting this new Accounting Authority Order (AAO) shall be considered to have any effect for the purpose of ratemaking treatment.

8. That all objections not specifically ruled upon are overruled and all motions not specifically ruled upon are denied.

9. That this Report and Order shall become effective on September 2, 1998.

BY THE COMMISSION

Lumpe, Ch., and Crumpton, CC., concur. Schemenauer, C., concurs with opinion to follow. Murray, C., dissents with opinion. Drainer, C., dissents with opinion.

Dated at Jefferson City, Missouri, on this 21st day of August, 1998.

ATTACHMENT A

STIPULATION AND AGREEMENT

COMES NOW the Staff of the Missouri Public Service Commission ("Staff"), the Office of the Public Counsel ("Public Counsel") and Missouri Gas Energy ("MGE") and stipulate and agree as follows:

1. As a result of discussions held during the prehearing conference of April 6-10, 1998, as well as communications that occurred thereafter, the Staff, Public Counsel and MGE have resolved various revenue requirement issues as [*100] among themselves. The revenue requirement issues resolved are:

Rate Base

a. Automated meter reading ("AMR"), except: 1) the issue between MGE and the Staff of adding back meter readers consistent with the level of AMR investment in rate base prior to true-up; 2) the issue of the appropriate level of encoder-receiver-transmitters ("ERTs") to be held in inventory; and 3) the issue of the appropriate depreciation rate to be applied to ERTs;

b. Gas inventory;

c. Unamortized deferred credit per Case No. GM-94-40;

d. Customer advances;

e. Customer deposits;

f. Materials & supplies, except for the level of ERTs to be held in inventory;

g. Cash working capital; and

h. Prepayments.

Income Statement

a. Revenues and billing determinants;

b. Payroll, payroll taxes, benefits, insurance/injuries & damages;

c. Joint and common costs;

d. Uncollectibles;

e. Public Service Commission assessment;

f. Interest on customer deposits;

g. Clearing account issues;

h. State franchise and property tax issues;

i. Call center/telecommunications equipment upgrades;

j. Weatherization program expense;

k. 39th & Main public business office and Broadway building lease;

l. Dues and donations;

m. Controller's [*101] contingency;

n. Depreciation rate on corporate computer equipment;

o. Miscellaneous lease expense;

p. Legal, lobbying and other outside services expenses;

q. Advertising;

r. Federal income taxes, including but not limited to the rate base item of deferred taxes; and

s. Gross-up of revenue deficiency related to uncollectibles expense and gross-down of revenue deficiency related to late payment charge revenues.

Return

a. Capital structure/cost of debt/cost of preferred stock.

2. The resolution of these revenue requirement issues as between the Staff, Public Counsel and MGE produces the following revenue requirements (prior to true-up): the Staff--approximately $ 11.7 million at its mid-point rate of return of 9.47%; Public Counsel--approximately $ 9.1 million at a rate of return of 9.38%; and MGE--$ 19,811,314 at a rate of return of 9.97%. These revenue requirements represent the "starting point" of the Staff, Public Counsel and MGE, respectively, from which adjustments will need to be made to account for the Commission's resolution of issues that remain to be litigated. These "starting point" revenue requirements will be reflected, respectively, in the revised accounting schedules [*102] of the Staff, the revised accounting schedules of Public Counsel and the revised revenue deficiency summary of MGE. The revised revenue deficiency summary of MGE was filed with the Commission on May 15, 1998. The revised accounting schedules of the Staff and the revised accounting schedules of Public Counsel shall be filed with the Commission no later than May 20, 1998. MGE has provided its revised revenue deficiency summary to all parties by next business day mail transmitted on May 1, 1998. The Staff and Public Counsel will transmit their respective revised accounting schedules to all parties no later than May 20, 1998.

The resolution of these issues as among the Staff, Public Counsel and MGE for overall revenue requirements purposes does not purport, and is not intended, to control the distribution of such issues for purposes of determining class revenue responsibility. In particular, the Staff, Public Counsel and MGE understand that the Midwest Gas Users' Association ("MGUA") and Jackson County, Central Missouri State University and University of Missouri-Kansas City ("Jackson County, et al.") may desire to inquire into the distribution of costs to the various customer classes, [*103] as opposed to the overall level of costs, associated with the following issues: 1) gas storage inventory; 2) AMR; 3) customer advances; 4) customer deposits; 5) uncollectibles; and 6) flex rates, economic development rates and the number of billable large volume service meters (which are components of the revenues and billing determinants issue).

The MGE witness on class revenue responsibility and rate design matters, F. Jay Cummings, is scheduled to be available for cross-examination with respect to those matters on Monday, June 1, 1998. At that time he will also be available for inquiry regarding item 6) above (flex rates, economic development rates and the number of billable large volume meters). MGE witness Langston will be available for inquiry regarding item 1) above (gas storage inventory) on Monday, June 1, 1998, at the time scheduled for cross-examination on Large Volume tariff issues. MGE witness Dively will be available for inquiry regarding item 2) above (AMR) on Friday, May 29, 1998, at the time scheduled for cross-examination on Miscellaneous AMR-related issues. MGE witness Hernandez will be available for inquiry regarding items 3) and 4) above (customer advances and [*104] customer deposits) on Thursday, May 28, 1998, at the time scheduled for cross-examination on Rate Case Expense. MGE witness Harbour will be available for inquiry regarding item 5) above (uncollectibles) on Wednesday, May 27, 1998, at the time scheduled for cross-examination on the Billing Process Improvements issue.

The Staff witness on flex rates, Tom Imhoff, will be available on Monday, June 1, 1998 for cross-examination at the time scheduled for Class Revenue and Rate Design. The Staff witnesses on gas storage, Anne Allee and Jim Busch, will be available for cross-examination on June 1, 1998 at the time scheduled for Large Volume tariff issues. The Staff witness on AMR, Chuck Hyneman, will be available for cross-examination on Friday, May 29, 1998, at the time scheduled for cross examination on Miscellaneous AMR-related issues. The Staff witness on uncollectibles, Tom Shaw, will be available for cross-examination on Wednesday, May 27, 1998, at the time scheduled for the Billing Process Improvements issue. The Staff witness on customer deposits and customer advances, Lisa Canady, will be available for cross-examination on Thursday, May 28, 1998, at the time scheduled for Rate Case [*105] Expense.

Public Counsel will make witnesses Robertson, Hall and Kind available for cross-examination at the time they take the stand. Public Counsel will make witness Carver available on either June 1, 1998 or June 2, 1998.

3. The Staff, Public Counsel and MGE agree that, commencing during the fiscal year which begins July 1, 1998, and continuing at least through the effective date of the new rates resulting from MGE's next general rate proceeding, MGE will use a five-year average (when five years of information is available; prior to that time the average of the number of years of available information will be used) for determining the unrecognized net gain/loss to be amortized over five years in calculating MGE's direct FAS 87 and FAS 106 costs for financial reporting purposes. This paragraph concerns costs associated with post-retirement benefits, including pension and non-pension benefits (FAS 87 and FAS 106), and reflects MGE's willingness to agree to the recommendation made by Staff witness Williams at page 28, line 17 through page 29, line 4 of his direct testimony regarding the financial reporting of unrecognized net gains/losses. The Staff, Public Counsel and MGE also agree [*106] that in the event that in any given year the amount of the amortization of the unrecognized net gain/loss determined under the agreed-to methodology described above is less than the minimum amortization required under FAS 87 or FAS 106, then the amortization for such year shall be the minimum amortization required under FAS 87 and/or FAS 106.

4. The Staff, Public Counsel and MGE also agree to the following miscellaneous tariff changes:

. reduce the late payment charge to 1.5% consistent with the recommendation of Staff witness Solt made at page 7 of his direct testimony and referenced by MGE witness Cummings at page 2 of his rebuttal testimony;
. increase the reconnect fee currently set at $ 15 in MGE's tariff to $ 29;
. change the rate at which MGE pays interest on customer deposits to the prime rate plus one percentage point as recommended in the direct testimony of Public Counsel witness Robertson at page 17, which rate is to be adjusted only in the context of future general rate proceedings.

5. The Staff, Public Counsel and MGE further agree that none of them, as a result of entering into this document, shall have been deemed to have approved or acquiesced in any ratemaking [*107] or procedural principle, any method of cost determination or cost allocation, or any service or payment standard, and none of the signatories shall be prejudiced or bound in any manner by the terms of this Stipulation and Agreement in this or any other proceeding, except as otherwise expressly specified in paragraphs 3 and 4 herein upon the Commission's approval of this Stipulation and Agreement.

6. The Staff, Public Counsel and MGE further agree that this Stipulation and Agreement has resulted from extensive negotiations. The terms of this Stipulation and Agreement are interdependent. In the event the Commission does

not approve and adopt the entirety of this Stipulation and Agreement, then this Stipulation and Agreement shall be void and no signatory shall be bound by any of the agreements or provisions hereof.

7. This Stipulation and Agreement does not resolve all of the issues in this general rate proceeding; it does, however, resolve numerous issues as among the Staff, Public Counsel and MGE. The Staff, Public Counsel and MGE therefore agree that certain testimony may be received into the record by the Commission without the necessity of the following sponsoring witnesses taking [*108] the stand: the direct testimony of Staff witnesses, Gray, Patterson, and Warren; and the direct testimony of Public Counsel witnesses Brosch and Trippensee. In the event the Commission approves this Stipulation and Agreement, the Staff, Public Counsel and MGE waive cross-examination of the foregoing witnesses with respect to settled issues.

8. The Staff, Public Counsel and MGE have reached the agreements above, in part, to avoid the time and expense of litigating the issues. The signatories respectfully request the Commission to issue an order adopting this Stipulation and Agreement in total as soon as possible so the parties and the Commission have the certainty of knowing that the issues have been finally resolved. The Commission may, of course, defer a ruling on the Stipulation and Agreement; however, if the Commission does not accept the terms of this Stipulation and Agreement in total, the signatories expressly reserve the right to litigate these issues and therefore request that they be informed of such action by the Commission sufficiently in advance for the issues to be litigated during the scheduled hearings in this case, or at such later dates in this proceeding as the Commission [*109] may schedule. The Staff, Public Counsel and MGE estimate that it would take at least five (5) days of hearings to litigate the issues settled by this document.

9. This Stipulation and Agreement does not replace or modify the Stipulation and Agreement Regarding True-up Audit & Hearing previously filed by the Staff, Public Counsel and MGE.

10. The Staff, Public Counsel and MGE may submit to the Commission testimony explaining each party's rationale for entering into this Stipulation and Agreement. Each party of record shall be served with any such testimony and shall be entitled to submit to the Commission, within five (5) days of receipt of such testimony, responsive testimony which shall also be served on all parties. Such testimony regarding the Stipulation and Agreement shall not bind or prejudice the party submitting such testimony, or any other party, in this or any future proceeding, whether or not the Commission approves this Stipulation and Agreement.

11. The Staff, Public Counsel and MGE also agree that the Staff shall also have the right to provide, at any agenda meeting at which this Stipulation and Agreement is noticed to be considered by the Commission, whatever oral explanation [*110] the Commission requests, provided that the Staff shall, to the extent reasonably practicable, promptly provide other parties with advance notice of when the Staff shall respond to the Commission's request for such explanation once such explanation is requested from the Staff. The Staff's oral explanation shall be subject to public disclosure pursuant to the Protective Order issued in this case.

12. To assist the Commission in its review of this Stipulation and Agreement, the Staff, Public Counsel and MGE also request that the Commission advise them of any additional information that the Commission may desire from them relating to matters addressed in the Stipulation and Agreement, including any procedures for furnishing such information to the Commission.

WHEREFORE, the Staff, Public Counsel and MGE respectfully request that the Commission issue an order approving this Stipulation and Agreement at its earliest opportunity.

Respectfully submitted,

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ATTORNEYS FOR MISSOURI GAS ENERGY

ATTACHMENT B

ADDENDUM TO STIPULATION AND AGREEMENT

COME NOW the Staff of the Missouri Public Service Commission ("Staff"), the Office of the Public Counsel ("Public Counsel") and Missouri Gas Energy ("MGE") and stipulate and agree as follows:

1. On May 20, 1998, the Staff, Public Counsel and MGE filed a Stipulation and Agreement in the referenced cases.

2. In consideration of the agreement of Midwest Gas Users' Association and Jackson County et al. not to oppose the Stipulation and Agreement filed on May 20, 1998, as modified and supplemented herein, the Staff, Public Counsel and MGE agree to the following modifications to the Stipulation and Agreement.

3. The following tariff change to tariff sheet No. 40 shall [*112] be accepted by the parties and made part of the Stipulation and Agreement:

> When more than one meter is set at a single address or location for the customer's convenience, an LVS customer charge shall be assessed for each of the first two meters. For each such remaining installed meter, customer charges will be computed at 50 percent of the LVS customer charge.
>
> Gas delivered through all meters set at a single address or location will be aggregated for the purpose of calculating the monthly sales or transportation charges.

4. The language in paragraph 3 will replace the last paragraph on tariff sheet No. 40.

5. MGE agrees that, for purposes of this case, no revenue adjustment associated with paragraph 3 shall be incorporated in MGE's revenue requirement.

6. The Staff, Public Counsel, and MGE agree that Items 1.9, Revenue and Billing Determinants Associated with LVS Meters, 1.10, Flexible Tariffs/EDR Rates, and 2.5.i, Multiple Customer Charges for Multiple Meters of the Revised Hearing Memorandum shall be removed and that corresponding changes should be made to the hearing schedule.

7. All references to Item 6 on pages 4 and 5 of the May 20, 1998, Stipulation and Agreement [*113] are removed. These references appear on the last three lines of paragraph 1 on page 4, lines 3 and 4 of paragraph 2 on page 4, and lines 1 and 2 of paragraph 1 of page 5.

8. In MGE's next rate filing, MGE will present the result of a study to determine if cost reductions or economies of scale exist for LVS customers with multiple meters at a single address or location when compared to single meter customers.

9. This Addendum is not a waiver of, or intended to affect, any party's position in the Missouri Court of Appeals, Western District, appeal of the Cole County Circuit Court's decision in Case No. CV197-504cc, or any further judicial or administrative proceeding thereto.

WHEREFORE, the Staff, Public Counsel and MGE respectfully request that the Commission issue an order approving the Stipulation and Agreement filed on May 20, 1998, including this Addendum To Stipulation and Agreement.

Respectfully submitted,

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ATTORNEYS FOR MISSOURI GAS ENERGY

ATTACHMENT C

Second Addendum To Stipulation And Agreement

COMES NOW the Staff of the Missouri Public Service Commission ("Staff"), the Office of the Public Counsel ("Public Counsel") and Missouri Gas Energy ("MGE") and stipulate and agree as follows:

1. On May 20, 1998, the Staff, Public Counsel and MGE filed a Stipulation and Agreement in the above referenced cases.

2. On June 1, 1998, the Staff, Public Counsel and MGE filed an Addendum To Stipulation and Agreement.

3. Staff, Public Counsel and MGE pursuant to the request of the Commission provide the following clarification regarding interest on customer deposits:

> The customer deposit interest rate shall be the current prime interest rate plus one. [*115] The current prime interest rate is 8.5%. This rate is published each day in the Wall Street Journal and is located in the Money and Investment section under the box labeled with banner, "MONEY RATES." For purposes of the stipulation and agreement the prime interest rate was determined as of May 20, 1998. It should be noted that the prime interest rate has not changed since May 20, 1998. The stipulation and agreement does not provide for a change in the rate on customer deposits until the next general rate case.

WHEREFORE, the Staff, Public Counsel and MGE respectfully request that the Commission issue an order approving the Stipulation and Agreement filed on May 20, 1998, including all Addenda to the Stipulation and Agreement.

Respectfully submitted,

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ATTACHMENT D

SCENARIO A

CASE NO. GR-98-140, ET AL.

REVENUE REQUIREMENT DECISION/IMPACT BASED UPON REVISED RECONCILIATION "A"
C = Company S = Staff O = Office of the Public Counsel

	Revenue Requirement
Company's Filed Reconciliation	27,817,140
Settled items and corrections	5,970,020
Company's True-Up Recommendations filed 7/17/98	21,847,120

C = Company S = Staff O = Office of the Public Counsel

	Issue	Decision	Revenue Requirement Revenue Effect ($)
1.1	Return on Equity	S 10.93%	-2,864,692
1.5	Public Affairs and Community Relations Expense	S	-316,578
1.4	Rate Case Expense	O	-210,038
1.2b	SLRP Amortization Period	C	-652,769
1.8	Depreciation Expense		
1.8a	Depreciation Rate Expense - Change in service lives	C	-0-
1.8b	Service life and rate of AMR equipment	C-ERT 5%/EGM 5%	-411,647
1.2a	Income Taxes - SLRP Equity Addback	S	-524,957
	SLRP Deferral Carrying Costs		
	SLRP AAO GO-92-185	S	-1,194
	SLRP AAO GO-94-234	S	-498,496
	SLRP AAO GO-94-301	S	-2,953
	SLRP Deferred Income Taxes		
	Deferred Inc. Taxes on GO-94-234	S	-29,183
	Deferred Inc. Taxes on GO-97-301	S	-35,814
1.2c	SLRP Deferral "Stub" Period GO-94-234	S	-284,597
1.2d	Inclusion of Unamortized Balance	O	-2,499,509
1.3	Billing Process Improvements/ Theodore Barry & Associates	O	-94,854
	Billing Process Improvements/TBA	O	-122,340
1.3	Call Center/Telecommunications	C	-0-
1.4	PSC Assessment Expense	C	-0-
Scenario A Adjusted Revenue Requirement		(tax included)	$ 13,297,499

[*117]

SCENARIO B

CASE NO. GR-98-140, ET AL.

REVENUE REQUIREMENT DECISION/IMPACT BASED UPON REVISED RECONCILIATION "B"

C Company S = Staff O = Office of the Public Counsel

	Revenue Requirement
Company's Filed Reconciliation	27,817,140
Settled items and corrections	5,970,020
Company's True-Up Recommendations filed 7/17/98	21,847,120

	Issue	Decision	Revenue Effect ($)
1.1	Return on Equity	S 10.93%	-2,864,692
1.5	Public Affairs and Community Relations Expense	S	-316,578

C Company S = Staff O = Office of the Public Counsel

			Revenue Requirement
1.4	Rate Case Expense	O	-210,038
1.2b	SLRP Amortization Period	C	-652,769
1.8	Depreciation Expense		
1.8a	Depreciation Rate Expense - Change in service lives	C	-0-
1.8b	Service life and rate of AMR equipment	C-ERT 5%/EGM 5%	-411,647
1.2a	Income Taxes - SLRP Equity Addback	S	-524,957
	SLRP Deferral Carrying Costs		
	SLRP AAO GO-92-185	S	-930
	SLRP AAO GO-94-234	S	-388,546
	SLRP AAO GO-94-301	S	-2,301
	SLRP Deferred Income Taxes		
	Deferred Inc. Taxes on GO-94-234	S	-22,747
	Deferred Inc. Taxes on GO-97-301	S	-27,915
1.2c	SLRP Deferral "Stub" Period GO-94-234	S	-221,825
1.2d	Inclusion of Unamortized Balance	O	-1,996,209
1.3	Billing Process Improvements/ Theodore Barry & Associates	O	-94,854
	Billing Process Improvements/TBA	O	-95,356
1.3	Call Center/Telecommunications	C	-0-
1.4	PSC Assessment Expense	C	-0-
	Tax factor-up of rate base items total effect		$ 718,257
Scenario B Adjusted Revenue Requirement			$ 13,297,499

[*118]

CONCURBY: Robert G. Schemenauer, Commissioner

CONCURRING OPINION OF COMMISSIONER ROBERT SCHEMENAUER

I wholeheartedly concur with the decision of the majority on all issues of this case. I specifically concur with the decision to disallow the inclusion of the unamortized balance of the Safety Line Replacement Program (SLRP) deferrals in MGE's (Company) rate base.

The arguments presented by the Company and Staff in support of the inclusion of the SLRP deferrals in rate base rely upon the premise that this Commission's decision regarding this issue must not only be consistent with prior Commissions decisions in Case Nos. GR-96-285 and ER-93-37 but it must mirror those decisions. This argument is weak at best, and suffers from many defects. The most damaging being that future Commissions be bound to render decisions in perpetuity based on the illogical premise that consistency requires it. Rather, Commissions are required to conduct their deliberations and base their decisions upon the facts and evidence presented to them in the context of the case under consideration. If the majority had based its decisions in this case solely upon this "consistency premise" without consideration of the [*119] facts, evidence and arguments presented, an illogical conclusion would have been reached.

The decisions in GR-96-285 and ER-93-37 were rendered by different Commissions based upon their examination and evaluation of the facts, evidence and arguments presented. Both of the cited cases were evaluated and decided in an entirely different context. The situations presented to the Commissions then and the urgency, expense and unknown

complexities were much different from the situation presented in this case. After five years MGE should be well versed in its understanding of regulatory lag. Regulatory lag is not an economic phenomenon. It is not an unusual, significant, or unaccountable occurrence that suddenly appears for no explainable reason. Management is responsible for planning and operating the activities of the Company. If the Company is unable to or chooses not to implement processes and procedures which would limit the effect of regulatory lag upon its finances, it should not expect the Commission to protect it from any resulting economic detriment if any occur. To do so would unfairly foist costs upon its customers of $ 2 million in additional annual rate increases.

Utility customers [*120] served by a monopoly provider, by and large, have no choice regarding the price they must pay for a commodity or from whom they may purchase it. Neither are they able to purchase reasonable substitutes or to forego purchasing the commodity. The deferral amounts being amortized over ten years allow the Company to recover all of its costs (interest, taxes and depreciation) from its customers. The planning, timing and execution of decisions regarding those costs were made solely by the Company with no input from its customers.

Lastly, the majority correctly based its decision to allow a 10-year recovery period for the deferrals upon sound accounting principles. The principle of matching an expense with revenues related to the recovery of that expense was applied. The SLRP deferrals are expenses related to previous periods when the rates were not sufficiently tariffed to provide revenue recovery. The Commission in a previous case granted an Accounting Authority Order (AAO) to the Company which allowed it to suspend normal accounting requirements and to defer the SLRP costs until the next rate case was filed.

Those deferrals included the expenses of depreciation, interest and taxes from [*121] the prior periods and were considered for treatment in this case. Here, the majority granted relief by allowing full recovery of these deferred costs over 10 years rather than 20 years. It was rightfully concluded that a 10-year amortization period more closely matched revenues with the expenses deferred from the prior period. No injustice was done to the Company by disallowing the inclusion of these deferrals into its rate base.

For all of the foregoing reasons I reiterate my concurrence.

Respectfully submitted,

Commissioner Robert G. Schemenauer

Dated at Jefferson City, Missouri, on this 24th day of August, 1998.

DISSENTBY: M. Dianne Drainer, Vice Chair; Connie Murray, Commissioner

DISSENTING OPINION OF VICE CHAIR M. DIANNE DRAINER

I respectfully disagree with the opinion of the majority in the Report and Order. I am not convinced that the evidence presented is sufficient to support the findings of the majority on the issues of Billing Process Improvement Costs/Billing Corrections Costs and Inclusion of Unamortized Balance in Rate Base. I found the evidence presented by the Missouri Public Service Commission Staff to be more persuasive, just and reasonable with respect to the above [*122] two issues. For this reason, I respectfully dissent.

Respectfully submitted,

Vice Chair M. Dianne Drainer

Dated at Jefferson City, Missouri, on this 21st day of August, 1998.

DISSENTING OPINION OF COMMISSIONER CONNIE MURRAY

Based upon my disagreement with the findings and conclusions of the majority on two important issues, I respectfully dissent. I would include the unamortized balance of the Safety Line Replacement Program (SLRP) deferrals in rate base and would include in the revenue requirement the costs associated with the contract services of Theodore Berry & Associates (TBA).

Both MGE and Staff include the unamortized balance of SLRP deferrals in rate base. This is consistent with Commission decisions in Case Numbers GR-96-285 and ER-93-37.

The reasoning of the majority that "it is proper for the ratepayers and shareholders to share the effect of regulatory lag by allowing the Company to earn a return of the SLRP deferred balance but not a return on the SLRP deferred balance" is flawed. Regulatory lag is a phenomenon that occurs because of the lapse of time between a petition for a rate change and the formal action by the regulatory body which allows the rate change [*123] to become effective. Regulatory lag is not a carrot that regulatory bodies award to one or another party to a rate case as the majority's reasoning seems to suggest. The effects of regulatory lag should not form the basis of a decision on inclusion of the unamortized balance in rate base.

Neither should a 10-year recovery period versus a 20-year recovery period form the basis of a decision on inclusion of the unamortized balance in rate base. The majority's disallowance of a return on the unamortized portion of the deferral results in the company recovering one amount fixed over time. The amount recovered does not change whether the time is tomorrow or 10 years or 20 years. Therefore, the value of the recovery to the company diminishes over time. While it is true that the value to the company will be greater with a 10-year recovery period than with a 20-year recovery period, that value remains less than the present value of the SLRP costs.

The SLRP costs are real costs of providing service. They represent dollars that MGE has already spent. The Commission has determined that these costs were prudently incurred. Therefore, the company is entitled to recovery in rates. In order to prevent [*124] the ratepayers from bearing these extraordinary costs all at once, the Commission appropriately is requiring the company to amortize them over a period of 10 years, thereby waiting 10 years to be made whole. In the meantime, all unamortized amounts remain unavailable to the company for other investments. It is as if the shareholders are making a loan to the ratepayers in the amount of the SLRP deferrals to be repaid over a period of 10 years. The company should be allowed to include the unamortized amounts in rate base; otherwise, the loan to the ratepayers is interest free.

The majority cites OPC's arguments against guaranteeing the Company a return on the unamortized portions of the deferred amounts without pointing out, as it should, that utilities are never *guaranteed* that a fair return will be realized. The inclusion of the unamortized amounts in rate base would merely assure the *opportunity* to earn a fair return on the SLRP investments. I believe the Company is entitled to this opportunity.

The other issue upon which I disagree with the majority is the treatment of the costs associated with the contract services of Theodore Berry & Associates (TBA) for its role in facilitating [*125] the billing process improvement project referred to as Billing Accuracy and Service Improvement Commitment (BASIC) Team Project. Staff's position is that MGE should be allowed to capitalize the costs associated with billing process improvements which are "in-service" to the Miscellaneous Intangible Plant Account 303 and to amortize them over the remaining economic life of the Customer Service System (CSS), which is nine years. Staff also recommends an offsetting reduction in the billing cost expenses of $ 250,000 per year. I would adopt Staff's position on this issue.

The BASIC team was formed in February of 1997. From then until the first part of May 1997, the BASIC team's primary focus was on the correction of past billing errors.

As a result of Case Number GC-97-497, MGE absorbed the following costs to correct billing errors from the 1996-1997 winter heating season:

a. waived under billings	$ 394,492
b. Interest on over billings	16,321
c. $ 15 settlement credit	1,578,480
d. Low income assistance	550,000
	2,539,293

The shareholders have already absorbed more than 2.5 million dollars related to the billing errors of the past.

Theodore Barry & Associates was hired [*126] in May of 1997 to work with the BASIC team to provide expertise for future billing improvements. MGE presented evidence that the focus of the BASIC team after the inclusion of TBA was forward looking. The company testified that TBA did not work on correcting any past billing errors, but directed its efforts solely at improvement of MGE's billing and other customer-service related processes. Recommendations resulting from the project included identifying and implementing improvements in the meter reading, billing and service-order processes. The design and implementation of CSS enhancements were paramount.

Some of the billing improvements that have been realized and can be expected to continue into the future include appointments for service orders; same-day completion of service orders in the field; same-day completion of service orders in the CSS; enhanced training of phone center consultants. Evidence was presented that there were 21,000 fewer estimated meter readings in December of 1997 than the previous December, that estimated bills were down from 10 percent during the test year to less than 1 percent from February through May of 1998, and that no major billing issues arose during [*127] the 1997-1998 winter season. Because ratepayers have benefitted and will continue to benefit from these billing process improvements, it is appropriate that the costs of these improvements should be included in the revenue requirement.

For the foregoing reasons, I dissent.

Respectfully submitted,

Connie Murray, Commissioner

Dated at Jefferson City, Missouri, On this 21st day of August, 1998.

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