BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Summit Natural Gas of	)	
Missouri Inc.'s Filing of Revised Tariffs	)	Case No. GR-2014-0086
To Increase its Annual Revenues For	)	
Natural Gas Service	)	

SNGMO'S REPLY BRIEF

COMES NOW Summit Natural Gas of Missouri, Inc. (SNGMO or Company), and, in reply to the Initial Briefs filed by the Staff of the Missouri Public Service Commission (Staff); Office of the Public Counsel (OPC); Missouri Propane Gas Association (MPGA); and, Missouri School Boards' Association ("MSBA"), states as follows to the Missouri Public Service Commission (Commission):

SNGMO's Reply Brief contains the following sections:

To the extent SNGMO does not reply to points raised in the other parties' Initial Briefs, it should not be interpreted as agreement with those points, but rather an indication that SNGMO believes the subject was adequately addressed in its Initial Brief.

I. COST OF CAPITAL

A. What is the appropriate cost of capital that the Commission should apply in this case to determine a revenue requirement for SNGMO?

<u>i.</u> What is the appropriate cost of common equity?

<u>ii.</u> What is the appropriate cost of long-term debt?

B. What Capital Structure should the Commission use in this case to determine a revenue requirement for SNGMO?

Response Staff Brief

Staff's brief states that its so-called "hypothetical" capital structure and cost of debt are "based on the assumption that the L[ake] O[f the] O[zarks] expansion did not occur." Further, it is based exclusively on a "financing plan" submitted by the Company as long ago as 2011 in Case No. GO-2012-0102. (Staff Brf., p. 6) Staff's contention in this case that the Company is effectively bound by that prior proceeding to any particular capital structure is not justified. The 0102 case contained a proposal to consolidate corporate indebtedness in the wake of the merger of SMNG with and into MGU, SNGMO's predecessor company. It had nothing to do with setting rates for service and, in fact, the Commission's Order Granting Application expressly disclaimed any such consequence by stating the following:

> **Nothing in the Commission's order shall be considered a finding by the Commission of the value of this transaction for ratemaking purposes, which includes, but is not limited to the capital structure**, and that the Commission reserves the right to consider the ratemaking treatment to be afforded these financing transactions and their results in cost of capital, in any later proceeding.

(Emphasis added)

There was no obligation imposed on MGU to achieve any particular capitalization as a condition to issuing the $88,000,000 in debt and, certainly, there was no discussion in the Commission's order of whether MGU was expected to achieve any particular level of leverage going forward.

Nevertheless, Staff in this case has grasped some isolated aspects of the Company's filing **three years ago** to make what it admits are "*pro forma* adjustments." The practical effect of

Staff's approach is to employ a hybrid, future/historical test year.[1] (Staff Brf., p. 7) Significantly, Staff points this Commission to no previous case in which the Commission has employed a postulated capital structure for ratemaking purposes. The reason is simple. No such case is on the books because it presents a mismatch of revenues and expenses for the relevant test year.

In those rare situations when the Commission has used something other than a utility's actual capitalization to set rates, there has been some sort of meaningful anchorage to reality. The Commission has looked to the parent company capitalization in those cases involving a subsidiary operating company. The Commission has looked to a group of proxy companies to ascertain what it believes is an industry-normal capitalization in the case of stand-alone utilities. In **all** of these situations, the Commission has relied on the verifiable capitalization of a holding company or a representative group of companies to use in lieu of the utility's actual capital structure. Staff has not use either of these approaches in this case. SNGMO is not aware of any case in which the Commission has applied a hypothetical capital structure based on pure speculation about what would have been, or what might yet be, as Staff has done in this case.

Staff claims that CNG is "a fair and reasonable proxy for what SNG's capital structure **would have been**" had it not expanded operations into the Lake of the Ozarks area. (Staff Brf., p. 8) (Emphasis added) This is not a proper proxy analysis in that it relies on information about a single company whose capital is not funding SNGMO's operations. Staff's only rationale is that CNG is an affiliate of SNGMO. In point of fact, CNG is being used by Staff as nothing

[1] In accounting and auditing parlance, *pro forma* statements serve the purpose of summarizing the projected or future status of a company. Ross, Stephen; Wasterfield, Randolph W. (2008). *Corporate Finance*. The McGraw-Hill. p. 64. *See also*, SSAE No. 10, AT sec. 401.04, *Presentation of Pro Forma Financial Information* and *Barron's Dictionary of Financing and Investment Terms*, 3rd Edition.

more than an **exemplar**; not a proxy. This novel approach is not justified.[2]

Staff's proposed 60:40 debt-to-equity capital structure is nothing more than woulda, coulda, shoulda ratemaking which is not justified by the fundamental principles long adhered to by the Commission to determine revenue requirement. Those principles include the use of an historical test year adjusted only for **known and measurable** items occurring during the period rates are to be in effect and the proper **matching of revenues and expenses** within that defined period. Staff's so-called "hypothetical" capital structure represents a stark departure from the Commission's long-standing, past practice on both counts. As such, it should be disapproved by the Commission.

Ultimately, Staff's return on rate base is 7.34% at the midpoint, compared to the Company's 8.22%. (Staff Brf., p. 3, 23) As between Staff and the Company, the case comes down to a difference of 88 basis points. That difference is almost entirely attributable to Staff's phantom capital structure recommendation.

Response OPC Brief

OPC provided no evidence or expert testimony on the topic of the proper cost of capital for ratemaking purposes. Rather, its brief articulates general support of Staff witness David Murray's testimony concerning ROE and capital structure.

OPC's arguments on the proper ROE in this case are unpersuasive and misleading. Its reliance at pages 25 and 26 on a decision of the Commission in 1995, nearly 20 years ago, addressing a proceeding of a remote, predecessor company is seemingly unconnected to any analysis of current circumstances. To the extent there is a connection, it is tenuous and

[2] There is no evidence that CNG's capitalization is normal for natural gas utilities or that CNG is similarly situated to SNGMO. In fact, the evidence shows that the average capitalization for Missouri natural gas utilities is approximately 50:50 and the industry average is only slightly less leveraged at 48:52 debt-to-equity. (SNGMO Brf., p. 16, FN. 19)

inconsequential. As a general matter, however, it would be inappropriate to attribute any statements/representations which may have been made by or about Tartan Energy in a certificate case in 1994 to SNGMO in this rate case in 2014.

OPC also attempts to mislead the Commission when it cites to Mr. Murray's testimony about the returns of natural gas companies in the first quarter of 2014. (OPC Brf., p. 27) Putting aside the obvious fact that this information is from outside the relevant test year in this case, OPC fails to take into account that Mr. Murray has recommended a 200 basis point risk adjustment which would drive that number up to 11.54% had it actually been adopted by Staff. Likewise, a similar adjustment, had Staff adopted a "corrected" ROE analysis by Mr. Anderson, would have resulted in a recommendation of 10.2%, as compared to Mr. Murray's actual 10.3% midpoint. Thus, the risk-adjusted ROE range that results from the numbers cited by OPC is actually10.2% to 11.54%, somewhere in between Staff and the Company. Of course, this is **not** the ROE range actually recommended by Mr. Murray so the whole exercise is more of a distraction than a principled basis upon which the Commission should make a decision.

In any event, the evidence to which OPC points was not the basis of Mr. Murray's ROE recommendation. Nor was it part of Mr. Anderson's ROE recommendation. Consequently, it should not be understood to be the recommendation of **either** cost of capital expert in this case. Additionally, OPC's analysis should be recognized for what it is; nothing more than a superficial manipulation of cherry-picked numbers casually mentioned in the record, but taken out of context and misapplied to the task at hand. OPC's argument should be disregarded as lacking seriousness and credibility.

OPC's points regarding the proper capital structure for ratemaking purposes add nothing to what Staff has contended in its brief. SNGMO already has fully addressed those points in its initial brief and above.

II. REVENUE REQUIREMENT

A. Should the Commission grant the Company a rate increase? If so, in what amount?

The Commission should grant SNGMO a rate increase in each of the four operating divisions that are the subject of this case (Gallatin, Warsaw, Rogersville, and Branson) as described in the Company's Initial Brief.

Response to MPGA Brief

MPGA's Brief states that "it is clear that SNGMO is asking the Commission to continue to allow it to charge customers in the Branson and Warsaw service areas at rates below full cost recovery." (MPGA Brf., p.8) The rates SNGMO proposed would result in full cost recovery. Presumably, MPGA refers to the Account 105 transfers proposed by SNGMO and Staff. These transfers are designed to recognize the portion of investment not utilized by the customers in Warsaw and Branson. The result is full cost recovery of the investment in plant that is used and useful to the customers.

MPGA also refers to the testimony of SNGMO witness Tim Johnston as support for the allegation that "SNGMO will be back before the Commission in the near future to ask for yet another rate increase." (MPGA Brf., p. 9) However, that is not the essence of Mr. Johnston's testimony. Mr. Johnston indicates that the Company would be seeking recovery on the full investment "as the customer count and the volumes for those systems achieve the original objectives." (Id. at p. 8; Tr. 251-252) Mr. Johnston explained in his Surrebuttal Testimony that "[a]s the capacity related to that investment is absorbed by new customers, the costs will also be spread over a larger customer base. So, just the opposite of Mr. Brooks' assertion is true. One can expect rates to decline over time as customer growth occurs." (Exh. 6, Johnston Sur., p. 3)

B. Should the Commission require SNGMO to impute a level of volumes, customer levels, and/or revenues in any of the four rate divisions in this rate case?

Response to OPC Brief

OPC's Initial Brief suggests imputations similar to that ordered in the original Rogersville certificate be used in this case for all services areas. (OPC Brf., p. 21). OPC, however, does not have a specific proposal for this proposed imputation.

Even if the numbers it provides are a moving target, OPC acknowledges that additional adjustments to its customer and use analysis may be necessary, stating that "the projections for Warsaw could be adjusted to reflect areas not served as identified under cross-examination." (OPC Brf., p. 16) This provision refers to the fact that OPC included customers and volumes associated with Buffalo and Bolivar in the Warsaw calculations – service areas that were never constructed.

OPC later tries to backtrack a little on the possible adjustment for the areas by stating that "it is not known whether the Commission would have granted the CCN had the Company eliminated certain communities that SNG has since chosen not to serve." (OPC Brf., p. 16) First, SNGMO has done more than "chosen not to serve." More importantly, it has chosen not to construct these systems. Thus, there is no plant investment to be addressed in this case associated with those areas. Secondly, OPC's statement shows a lack of knowledge about the certificates themselves. The Buffalo and Bolivar certificate case was a separate, stand-alone case, unassociated with the original Warsaw certificate. (*See* Case No. GA-2010-0189 (April 10, 2010)

OPC continues to quote other language associated with communities or cases that never resulted in construction or service to customers. (OPC Brf., 6-7) No systems have been constructed to serve Licking, Houston, Branson West, Bolivar and Buffalo. (Tr. 277, 279-280) However, OPC witness Meisenheimer used these customer counts and volumes in her workpapers. (Exh. 21) Additionally, the 2009 certificate granted for Camdenton, Osage and Lake Ozark was never exercised and was later replaced by the 2012 certificate for a similar area. (*See* Case No. GA-2012-0285 (July 27, 2012))

Lastly, OPC's Brief continues its practice of treating the feasibility studies as something they are not. Commission Rule calls for Feasibility studies that are "an estimate of the number of customers, revenues and expenses during the first three years of operation." (Commission Rule 4 CSR 240-3.205(1)(A)5) They are not, nor is a company required to provide, a minimum level of customers or volumes necessary for economic feasibility. OPC is attempting to change the nature and purpose of these studies, in some cases twenty years after their development, without any justification or basis in rule or order.

Warsaw and Branson - Account 105

OPC describes the Account 105 transfers proposed by Staff to be "a different and very limited approach as an alternative" to the imputation approach. (OPC Brf., p. 17) The proposal would transfer the following amounts to Plant Held for Future Use, FERC Account 105:

BRANSON	$27.64 Million
WARSAW	$6.97 Million

(Exh. 128, McMellen Sur., p. 7) This would represent a transfer to Account 105 of *56.71%* of the mainline investment in Warsaw and *78.56%* of the mainline investment in Branson. (Exh. 126, Jenkins Sur., p. 8, 9 (based on Staff's <u>*usage*</u> factors of 43.29% for Warsaw and 21.44% for Branson)) This is far from a "limited approach."

OPC suggests that “similar adjustments for other excess capacity costs throughout SNG’s distribution system should also be made.” (OPC Brf., p. 19) There is no justification for such further adjustment. SNGMO “believes it is inappropriate to burden existing customers with the full cost of recovery” for distribution mains (mainline investment) “designed to serve a larger population than currently exists.” (OPC Brf., p. 11) However, that problem does not exist beyond the mainline. Lines for customers are constructed as customers sign up for service. Thus, these smaller lines are fully utilized and there is no excess capacity.

OPC similarly suggests that operation and maintenance expense and corporate costs should also be adjusted. (OPC Brf., p. 11, 19) Such an adjustment is not justified given the relative age of the distribution mains given the circumstances in Warsaw and Branson. Both the Warsaw and Branson systems were placed into service after 2009 and require little to no maintenance at this point. Other operation and maintenance expenses exist either as a direct result of the current customers being served by the system or from unrelated matters that arise as result of operating a regulated utility regardless of size. Thus, there are no operation and maintenance expenses or corporate costs associated with excess capacity.

Gallatin

OPC recognizes that the Gallatin Division is “somewhat different from the other services areas” because it is smaller in size and because its origin was the acquisition of two then-existing municipal systems. (OPC Brief, p. 19) However, OPC’s suggestion that the revenue requirement be spread over the customer numbers reflected in the original feasibility study is misplaced.

During the time SNGMO has owned and operated the Gallatin system, it has grown the customer base from approximately 740 customers to almost 1,600 customers. (*In the Matter of the Application of Missouri Gas Utility, Inc*., Order Approving Stipulation and Agreement, Case

No. GO-2005-0120 (December 14, 2004); Exh. 203, Meisenheimer Sur., p. 3) This is significant growth for a system that was in trouble at the time of purchase.

Further, any adjustment that might have been necessary has already taken place. Gallatin's assets were brought onto SNGMO's books at a heavily discounted purchase price, and it was that amount, rather than the significantly higher outstanding municipal debt related to the system's cost of construction that became the foundation for Gallatin's rate base going forward in its first rate case. (Exh. 6, Johnston Sur., p. 8-9) Gallatin's customers, who would otherwise have been required to pay the costs associated with the original system investment, were relieved of that responsibility. (*Id.*)

This reduction of rate base was not a certainty at the time the system was acquired. Paragraph 10 of the Nonunanimous Stipulation and Agreement (Case No. GO-2005-0120, Order Approving Stipulation and Agreement (December 14, 2004)) stated, in part, that "there has been no determination made of whether the original cost of the Gallatin and Hamilton gas systems, as reflected on the books and records of Gallatin and Hamilton, was derived from prudent and reasonable expenditures, or quantified in a manner consistent with the Uniform System of Accounts. Accordingly, MGU's plant in service accounts will be initially valued on MGU's books in a manner deemed by MGU's management and external auditor as appropriate under these circumstances." The ultimate booking of the plant at a value less than the municipalities' construction costs, can be presumed to have reduced any required level of customers and volumes. OPC's analysis does not account for this fundamental change in cost.

Rogersville

The Rogersville Division is the only division where a specific standard was identified in a certificate case. The original certificate for this system was granted by Commission order issued on September 16, 1994. (Case No. GA-94-127) The Commission Order contained an open-ended requirement for base rates, and base rates in subsequent cases, to use a minimum throughput of 1,797,000 Mcf. (*Id.*) The annual volumes for the Rogersville Division, as updated through December 31, 2013 (the update period), total 1,869,737 Mcf. (Exh. 15, Porter Sur, p. 7, as corrected at Tr. 275) Therefore, the Rogersville Division volumes exceed the certificate standard.

OPC takes the position that the Rogersville Division has not met its minimum volumes. (OPC Brf., p. 12) This is not because it disagrees with the volumes used by that system in 2013. It is because OPC believes that numbers contained in other feasibility studies should be added to the volumes ordered in GA-94-127. (*Id.*) Of course, OPC is not completely sure what the number should be as it also states that "the 5-year projections could be modified to reflect areas not served as identified on cross-examination." (OPC Brf., p. 15)

OPC's approach seeks to penalize the Company for growing this system beyond what was originally planned. The entire Rogersville Division takes service through use of the mainline constructed as a result of Case No. GA-94-127. All of the volumes flow through the construction contemplated in GA-94-127. There is no reason to create a new test by adding additional volumes associated with the newer areas.

The OPC approach also continues the general problem of interpreting feasibility studies to be minimum economic feasibility levels - something Commission's Rules say they are not. Further, it has the issue that the original investment has been depreciated for almost twenty years. A straight addition of numbers, without subtracting areas not built and addressing investment levels that have been changed as a result of depreciation, has no meaning.

The only standard is the Rogersville Division is the volumes ordered by the Commission in Case No. GA-97-127. That level of volumes has been exceeded by the Company and, therefore, no imputation or other adjustment is warranted.

C. How should the former SMNG assets be booked to plant in service in light of MGU's merger with SMNG that was approved in GM-2011-0354?

The assets of the legacy Southern Missouri Natural Gas (SMNG) systems were brought to SNGMO's books at net original cost. This is consistent with long-standing Commission practice and the provisions of the Uniform System of Accounts adopted by Commission rule (4 CSR 240-40.040). There is no reason to deviate from that practice in this case, especially in that the ultimate owner of the assets did not change as a result of the merger. The merger purchase price should have no impact or import to the Commission's decision in this case.

OPC alleges that the $19 million difference between the "merger purchase price" means that SNGMO "has not expended the $19 million at issue." (OPC Brf., p. 22) OPC then cites 393.270.4 calling for a return on capital actually expanded for the proposition that in this case a return on the net original investment is not recoverable. (*Id*.)

Net original cost is the amount actually invested minus accumulated depreciation. It is based on the cost of the plant in the ground. The ultimate owner of the SMNG assets was the same before and after the merger transaction. (Exh. 8, Lawler Sur., p. 2) Further, the nature of a merger is that SMNG was not dissolved, it was merely absorbed by SNGMO. SMNG exists as a part of SNGMO, which is now legally responsible for SMNG's liabilities, contractual obligations, and other matters.

Nothing about this transaction changed the cost of the plant in the ground. It should not be used as a reason to abandon net original cost ratemaking

Court Cases Cited by OPC

OPC cites two cases in support of its argument – *State ex rel. Martigney Creek Sewer Company*, 537 S.W.2d 388 (Mo. 1976) and *Reinhold v. Fee Fee Trunk Sewer, Inc.*, 664 S.W.2d 599 (Mo.Ct. App. 1984). (OPC Brf., p. 22-23). While the quotes, taken out of context, sound like they might be applicable, the cases are not.

In *Martigney*, the Court was determining the appropriate treatment of contributions in aid of construction and contributed property. These are largely situations where plant was either donated or purchased by developers. The Court determined that these amounts should be subtracted from rate base. This treatment of contributions has been settled for many years and has nothing to do with a merger of affiliated, regulated entities.

Reinhold also concerned contributions in aid of construction. In *Reinhold,* the plaintiffs were developers who had contributed property to a regulated sewer company. The company was later sold to the Metropolitan St. Louis Sewer District. The Plaintiffs claimed that they were due a portion of the purchase price based on their prior contributions in aid of construction. In support of their position, the Plaintiffs cited *Martigney* and similar cases. The Court's discussion of *Martigney* resulted in the language quoted by OPC. However, the Court also stated that "these cases do not help the Plaintiffs" and found that the Plaintiffs had no cause of action. (*Id*. at p. 603)

Tax Benefits

OPC alleges that SNGMO has enjoyed "tax benefits" from "discounting the value of the assets." (OPC Brf., p. 23) This allegation is based upon the Rebuttal Testimony of Kerri Roth. Ms. Roth's educational and employment background reflects no specialty or expertise in the area of corporate tax. (Exh. 200, Roth Rebuttal, p. 2-3) She further admitted that her statement was not based upon any review of the actual knowledge of the situation. (Tr. 437-438)

SNGMO witness Rick Lawler responded to Ms. Roth's tax allegations. Mr. Lawler is the Chief Financial Officer of Summit Utilities, Inc., the parent company of SNGMO. (Exh. 7, Lawler Reb., p. 1) He is a certified public accountant. (*Id*. at p. 2) Mr Lawler stated that "in response to Ms. Roth's specific allegation of a 38% tax benefit to SNG's parent relative to its 'sale' of utility assets to SNG at less than book value, that presumption is entirely false as the transaction actually resulted in a detrimental monetary impact to SNG's owner's investors due to the pass-through nature of taxable gain on the sale." (Exh. 8, Lawler Sur., p. 3)

Ms. Roth's speculation does not carry the same weight as Mr. Lawler's testimony based on experience and knowledge of the event.

Fair Value

OPC further raises an issue related to the "fair value" of the assets with reference to Section 393.230, RSMo. (OPC Brf., p. 24)

As was discussed at length in SNGMO's Initial Brief, there is no evidence of fair value in this case. The following paragraph from the OPC Brief further makes this point:

> SNG and SMNG had common ownership, and therefore the acquisition by SNG of SMNG's assets was an affiliate transaction and, therefore, not conducted at arm's-length. There was no evidence of a competitive bid process wherein SMNG sought out a highest bidder, and by all appearances, there was no effort by SMNG to seek bids on the sale at all. It is therefore not known whether SMNG could have sold the assets for more or less than SNG's discounted price.

(OPC Brf., p. 24 (citations omitted)

In spite of this position, OPC apparently wants to use that defective merger purchase price as the value of the assets for ratemaking purposes on a going forward basis. That merger price is not fair value by any measure.

Affiliate Transactions Rule

Lastly, OPC continues its argument that the merger purchase price was subject to the Commission's affiliate transaction rules (Commission Rule 4 CSR 240-40.015). (OPC Brf., p. 24-25) In its Initial Brief, SNGMO explained why the affiliate transaction rule is not applicable to the transfer of goods between two regulated entities; the transfer of gas plant constituting an operating system or unit is not the transfer of "goods or services"; and, if it were, neither evidence of the fair market value of the system nor the fully distributed cost for SNGMO to provide the system for itself is available to the Commission.

However, still alleging applicability of the affiliate transaction rule, OPC states as follows:

> The conclusion to be reached by these facts is that either the acquisition violated the affiliate transaction rules because SMNG sold the assets below the greater of the fully distributed cost or fair market price, or the purchase price with the $19 million discount is the greater of fully distributed cost. Either the rules have been violated, or the fair market price is no more than the discounted purchase price.

(OPC Brf., p. 25)

This line of reasoning ignores the other side of the transaction, which merely points out the absurdity of trying to apply the affiliate transaction rule to two regulated entities. While a buying utility must purchase goods or services at the *lower* of fair market value and fully distributed cost, a selling utility must sell goods or services at the *higher* of fair market value and fully distributed cost. Assuming some difference between fair market value and fully distributed cost, either one of the regulated entities would be REQUIRED to violate the rule under OPC's interpretation or a deal between regulated entities could never be reached because the buyers price would have to be different from the seller's price. The bottom line is that this trick box need not be opened as the affiliate transactions rule is not applicable to this type of transaction.

Summary

The initial briefs provide no reason to deviate from the past policy that the Commission clearly articulated in *In the Joint Matter of UtiliCorp United In. and St. Joseph Light & Power Company*, Case No. EM-2000-292, 12 Mo.P.S.C.3d 388, 389-390 (February 26, 2004):

> *The net original cost rule was developed in order to protect ratepayers from having to pay higher rates simply because ownership of utility plant has changed, without any actual change in the usefulness of the plant.*
>
> ***
>
> Missouri has traditionally applied the net original cost standard when considering the ratemaking treatment of acquisition adjustments. That means that the purchasing utility has not been allowed to recover an acquisition premium from its ratepayers. But it also means that ratepayers do not receive lower rates through a decreased rate base when the utility receives a negative acquisition adjustment. *Even if a company acquires an asset at a bargain price, it is allowed to put the asset into its rate base at its net original cost.*

(emphasis added)

III. MISCELLANEOUS TARIFF ISSUES

A. Should the Commission approve SNGMO's proposed Conversion Program?

B. What conversion costs should SNGMO be required to charge?

C. Should SNGMO's conversion practices be revised?

No party opposed this matter in the initial briefs. The Commission should approve SNGMO's conversion program as proposed by the Company.

IV. RATE DESIGN

A. What is "rate shock"? If it exists, should the Commission address rate shock in this case and, if so, how?

Comparison to Other Companies

The OPC Brief primarily bases its arguments on a comparison of the potential increase in this case to increases granted by the Commission in a variety of natural gas rate cases. (OPC Brf., p. 29). OPC describes the companies it uses for comparison to be "typical" gas companies. (*Id*. at p. 28) SNGMO, however, is not a "typical" gas company.

Large parts of the SNGMO territory have been recently built and have never been the subject of a rate case (for example, the Branson and Warsaw Divisions). (Exh. 4, Moorman Dir., p. 5-6) This coincides with the Company's substantial (and largely undepreciated) investment in utility plant. The legacy SMNG territory has not been subject to a rate increase for three and a half years. (*Id*. at p. 5). The legacy Missouri Gas Utility, Inc. territory has not had a rate increase for six years. (*Id*. at p. 4).

These situations did not exist for the companies on OPC's list. The situation with which the Commission is faced in this case is drastically different and comparisons to "typical" gas companies of little value.

Phase-In

Both OPC and the MSBA suggest that the Commission should order some sort of phase-in of the rate increase. The OPC refers to a "gradualism approach." (OPC Brf., p. 30) The MSBA specifically calls for a "phase-in" as one of its two "viable remedies" to "rate shock." (MSBA Brf., p. 10)

First, neither of these parties has proposed any details surrounding a phase-in. No percentage increases, time period, deferral mechanisms for revenues not recorded, or carrying costs have been specified or suggested. These items would be a necessary part of a phase-in. (Tr. 347-348)

Second, a phase-in does not solve the issue in the long term. It merely compounds the issue in future years. In the next rate case, not only would customers have to address any rate increases that might be awarded, but they would also have to address rate increases associated with the deferred revenues and carrying charges created by the phase-in.

Lastly, there is a question as to whether this Commission has the authority to direct a phase-in for a natural gas company. MSBA sites as support Section 393.155, RSMo, which applies only to electrical corporations. In fact, the existence of a statute providing for a phase-in as to only one industry makes the point that there is no express statutory authority for the Commission to phase-in rates for a natural gas utility, such as SNGMO.

Schools

MSBA continues to claim "rate shock" based in great part upon circumstances beyond this rate case and an assumption that schools will not be able to successfully match their natural gas purchases with their usage. (MSBA Brf., p. 5)

Billing the schools at the appropriate tariff rate and on a per meter basis merely brings the schools within the requirements of the Company tariff. The past approach "would not be sufficient to generate revenue at least equal to all incremental costs caused by the aggregation program, and would therefore result in a negative financial impact on the Company" and "may violate Section 393.310.5." (Exh. 127, Lock Sur., p. 2) Additionally, the referenced loss of the discounted rate (flex rate) (MSBA Brf., p. 6) took place in the fall of 2013 after Staff imputed amounts of revenue in SMNG's last small company rate proceeding to reflect the difference between the full transport tariff rate and the discounted transport rate that had been given to the schools.

The "increase due to a new cashout provision" referred to by MSBA (MSBA Brf., p. 5) is not an "increase" and certainly not a rate increase. A cashout process is a financial means of attempting to influence a shipper's behavior in the effective and reasonable management of its imbalance. Given the large proportionate total gas transportation load on the SNGMO's system, Shippers can cause significant problems for the operation of the system resulting from its actions or inactions. For instance, if a Shipper uses more gas than it has bought and delivered onto the system (an under delivery), SNGMO must provide gas supply that it has purchased and not planned on using for any Shipper, including MSBA, in order to keep its system balanced. This is a situation that must be discouraged for the efficient operation of the distribution system and to insulate SNGMO's retail customers from additional costs.

The cashout provision will cost the schools no more than the fair market cost of gas, if they can keep their usage and gas purchases within a 5% tolerance (Imbalance Tier) on a monthly basis. (Partial Stipulation and Agreement, para. 5.b.) Imbalances within this tolerance are priced at a market-based index for the gas. Thus, there is no punitive aspect to the cashout under these circumstances. The schools merely are required to pay for the gas they used that otherwise would be purchased by SNGMO's retail customers. There are tools available to MSBA schools in order to minimize their imbalances. More particularly, there are tools available the experts hired by the schools – such as MSBA witness Ervin's company, Latham & Associates, and the program administrator (Tr. 349) -- to run this program that should keep the schools within the Imbalance Tier 1 tolerance thereby eliminating any additional costs associated with the cashout provisions for Imbalance Tiers 2 and/or 3.

Staff prepared a schedule to analyze the total rate increase percentage applicable to the schools. Because Staff is not privy to the schools' actual cost of gas, it used the Company's

PGA rate (the rate paid by SNGMO's sales customers) as a proxy. (Tr. 341-342) MSBA disagrees with the Staff numbers because the schools "buy gas on the open market and do not use the PGA rate." (OPC Brf., p. 7) The Staff's calculations show that the rate increase would result in total gas bill increases from 9.06%-24.87% for the various transporting schools using the price for gas paid by other customers. (Exh. 139) To the extent MSBA claims the percentages increases are much greater as a result of their purchase of gas on the market, this merely shows that the schools are already experiencing a discount from the gas costs borne by retail customers. Furthermore, it is important to note that any analysis that uses MSBA's historical imbalance data will be skewed due to the fact that such comparisons would be based on an unmanaged case. However, the Staff calculations remain valuable in analyzing the schools potential increase in relation to the increase that may be experienced by other customers.

WHEREFORE, SNGMO respectfully requests that the Commission consider this Reply Brief.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been sent by electronic mail this 26th day of September, 2014, to:

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