BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy and	)
Its Tariff Filing to Implement a General Rate	) Case No. GR-2009-0355
Increase for Natural Gas Service	) Tariff No. YG-2009-0714

MGE'S STATEMENT OF POSITION/PREHEARING BRIEF

Comes now Missouri Gas Energy, a division of Southern Union Company (MGE), and for its Statement of Position, states the following to the Missouri Public Service Commission (Commission) concerning the issues contained in the List of Issues, Order of Witnesses, Order of Cross-Examination and Order of Opening Statement, filed on October 21, 2009 (a Table of Contents that follows the Joint List of Issues starts on page 2):

INTRODUCTION

Missouri Gas Energy's ("MGE" or "Company") focus is to be a low-cost local distributor of natural gas with quality customer service. MGE aims to do so while appropriately balancing the interests of its primary stakeholder groups – customers, employees, and shareholders. The record in this case will show that while MGE provides the most cost-effective service of any Missouri LDC, it has not been able to achieve its Commission-authorized rate of return. (Hack Direct 10 and 16)

MGE has made the necessary decision to file a general rate case principally due to MGE's inability to achieve its Commission-authorized return on investment; its need to obtain a sufficient authorized rate of return, and need for a ratemaking solution on Former Manufactured Gas Plant costs. (Hack Direct at 19)

The Company's change to a Straight Fixed Variable (SFV) rate structure for its residential class of customers in 2007 has provided more stable revenue streams for

the Company while enabling lower winter-time bills than would have occurred under the volumetric-reliant rate structure. (Hack Direct at 15-16) The SFV rate design has also enabled the Company to successfully develop energy efficiency and education efforts for the residential class. The SFV rate design has worked for the Company and its customers and is sound energy policy for Missouri. The Company looks forward to expanding to the newly-proposed Small General Service Class with SFV rate design.

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I. REVENUE REQUIREMENT

A. Cost of Capital Issues

MGE Position: The cost of capital issues in this proceeding involve the appropriate capital structure to be utilized by the Commission in setting rates for MGE as well as the cost of the various components of the capital structure. Both the Staff and MGE recommend the use of a capital structure based on their respective peer companies, although these two parties differ somewhat as to ratios and cost rates for the various components. The Office of the Public Counsel (Public Counsel) takes a different approach and recommends that the Commission utilize Southern Union Company's capital structure for purposes of setting MGE's rates.

The positions of the parties can best be illustrated by the following tables:

MGE's Recommended Capital Structure and Cost Rates

	Ratio	Cost	Weighted Cost
Long-Term Debt	41.06%	6.080%	2.496%
Short-Term Debt	10.94%	5.492%	0.601%
Common Equity	48.00%	10.50% (ROE)	5.040%
		Rate of Return =	**8.137%**

Staff's Recommended Capital Structure and Cost Rates

	Ratio	Cost	Weighted Cost
Long-Term Debt	40.47%	5.92%	2.40%
Short-Term Debt	8.47%	1.00%	0.08%
Common Equity	51.06%	9.50% (ROE)[1]	4.85%
		Rate of Return =	**7.33%**

[1] Using the mid-point of Staff's ROE range of 9.25 to 9.75 percent.

Public Counsel's Recommended Capital Structure and Cost Rates

	Ratio	Cost	Weighted Cost
Long-Term Debt	56.16%	6.258%	3.514%
Short-Term Debt	3.26%	5.920%	0.193%
Preferred Equity	1.92%	7.758%	0.149%
Common Equity	38.66%	10.0% (ROE)[2]	3.866%
		Rate of Return =	**7.722%**

MGE witness Frank J. Hanley[3] and Staff witness David Murray agree that a hypothetical capital structure should be used in this proceeding for determining a fair rate of return for MGE. On the other hand, the Public Counsel recommends the use of Southern Union Company's consolidated capital structure, apparently because that is what the Commission has ordered in the past. (*See* Lawton Dir., pp. 50-51) Contrary to his own recommendation to use Southern Union's capital structure, however, Public Counsel witness Daniel Lawton acknowledges that MGE's proposed capital structure, which includes a 48% equity ratio, "compares quite favorably" to the equity ratios for the natural gas utility industry. (Lawton Dir., p. 49)

MGE witness Hanley recommends a cost of common equity (ROE) for MGE of 10.5 percent. The Staff recommends the 9.5 percent midpoint of its ROE range, 9.25 – 9.75. The Public Counsel recommends the 10 percent midpoint of its range, 9.5 – 10.5.[4]

MGE witness Hanley recommends a 6.08 percent long-term debt cost rate. He also explains that while a short-term debt cost for his proxy group could not be

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[2] Using the mid-point of Public Counsel's ROE range of 9.5 to 10.5 percent.

[3] Mr. Hanley is the Principal and Director of AUS Consultants in New Jersey. He has testified as an expert witness on rate of return and related financial issues before 33 state public utility commissions. He has appeared on behalf of investor-owned companies, municipalities, and state public utility commissions. (Hanley Dir., p. 1) Mr. Hanley prepared and filed direct, rebuttal, and surrebuttal testimony on the issue of a fair rate of return for MGE.

[4] The Public Counsel witness also recommends a cost of service reduction in the amount of $1,842,034 "for the risk shifting associated with decoupling."

determined, a 4.367 percent prospective short-term cost rate should be used for a gas distribution company such as MGE. (Hanley Reb., p. 38) Also indicating that he was unable to determine an average cost of short-term debt for his chosen proxy companies, Staff witness Murray recommends looking at only two companies out of his seven peer companies and using a short-term debt cost rate of only 0.89 percent in calculating Staff's recommended rate of return for MGE. (Staff Report – Cost of Service, pp. 30-31) The Public Counsel's short-term debt cost rate is 5.92 percent.

Capital Structure: What capital structure should be used for determining MGE's rate of return?

MGE Position: MGE witness Hanley and Staff witness Murray both recognize and explain why the use of Southern Union Company's corporate capital structure is inappropriate for determining MGE's rate of return and why a hypothetical capital structure should be used instead. MGE submits that a hypothetical capital structure consisting of 52 percent total debt and 48 percent common equity should be used in this proceeding. The Staff says the hypothetical capital structure should consist of 49 percent debt and 51 percent common equity. .

MGE, as an operating division of Southern Union Company, has no common stock which is traded. (Hanley Dir., p. 4) Southern Union's capital structure represents its collective operations and has what Standard & Poor's considers an "aggressive" level of financial risk. (Hanley Dir., p. 6) Further, MGE is somewhat more risky than the average gas distribution company (LDC) due to its smaller size. (Hanley Dir., p. 4) For the numerous reasons outlined in Mr. Hanley's direct testimony, and as illustrated in

Schedule FJH-4, Southern Union Company is in no way representative of an LDC and thus, its capital structure and related capital cost components are unrelated to MGE.

To account for this situation and in formulating his recommendations in this case, Mr. Hanley analyzed market evidence of common equity cost rates of a proxy group of nine LDCs of similar risk for insight into a capital structure and related ratios. He also reviewed the component costs of debt and common equity capital appropriate for use in establishing a fair rate of return for MGE. The use of comparable risk proxies adds reliability to the exercise of informed expert judgment and is consistent with the principles of fair rate of return established in *Hope* and *Bluefield* infra. (Hanley Dir., p. 4)

The financial literature demonstrates that risk relates to where capital is invested. Since MGE has no stock which is traded, investors must look to similar risk enterprises to see how MGE should be financed, as well as for an indication of MGE's cost of capital. (Hanley Dir., p. 19; Sch. FJH-7) When dealing with divisional cost of capital and divisions with differing risks, as with Southern Union and its operating division, MGE, different rates of return which are commensurate with individual risks are required. (Hanley Dir., pp. 20-21; Sch. FJH-8) MGE's debt cost and equity cost rates must relate to MGE's risk, and that level of risk is best estimated by observing a group of similar risk enterprises. (Hanley Dir., p. 21) This is exactly what has been done through the selection by Mr. Hanley of an appropriate proxy group and the formulation of a hypothetical capital structure.

The Staff's decision to recommend the use of a hypothetical capital structure is explained in detail at pages 20-27 of the Staff Report – Cost of Service. In essence, the Staff is of the view that the continued use of the Southern Union corporate capital

structure for ratemaking purposes would cause MGE's customers to pay higher capital costs.

Both the Staff and MGE believe it would be inappropriate to use Southern Union's capital structure, which includes a 38.66 percent common equity ratio, in determining a common equity cost rate for MGE in this case. The Public Counsel is the outlier on this issue. Of interest here is the fact that at page 49 of his direct testimony, the Public Counsel witness confirms that MGE's proposed capital structure with 48 percent common equity compares "quite favorably" to the equity ratios in the natural gas utility industry.

Return on Common Equity: What return on common equity should be used for determining MGE's rate of return?

MGE Position: A proper common equity cost rate for MGE in this case is 10.5 percent. This ROE is necessary in order for MGE to continue to provide safe and adequate service to its customers while also having the opportunity to earn a fair and reasonable return on its investments committed to the public service.

With regulated public utilities, regulation traditionally acts as a substitute for marketplace competition. Analyses based on companies whose securities are actively traded in the marketplace are therefore imperative in estimating a proper common equity cost rate. The common equity cost rate should be adequate to fulfill investors' requirements and assure that the utility will be able to fulfill its obligations to its customers. (Hanley Dir., p. 8) The standards for a fair rate of return have been established by the United States Supreme Court in *Federal Power Commission v. Hope*

Natural Gas Co., 320 U.S. 591 (1944), and *Bluefield Water Works v. Public Service Commission*, 262 U.S. 679 (1922).

To arrive at his recommended ROE, Mr. Hanley utilized four well-tested market-based cost of common equity models, as applied to a proxy group – the Discounted Cash Flow Model (DCF), the Risk Premium Model, the Capital Asset Pricing Model (CAPM), and the Comparable Earnings Model (CEM). All four of the models utilized are market-based, as they are predicated upon the Efficient Market Hypothesis – the cornerstone of modern investment theory. (Hanley Dir., pp. 5-6, 26) Mr. Hanley placed no reliance on the results of his CEM analysis, because it is an extreme high-side outlier when compared to the results derived from the application of the DCF, risk premium, and CAPM models. (Hanley Direct, p. 6) Mr. Hanley applied his common equity models to a proxy group of nine LDCs (local gas distribution companies).[5]

Because Mr. Hanley found it would be appropriate to provide the Commission with an updated study which is more reflective of current and prospective capital market conditions, with his rebuttal testimony, he adjusted for significant changes in the capital markets over the approximately seven months since he originally formulated his ROE recommendation. (Hanley Reb., p. 2) With his updated study (Sch. FJH-21), Mr. Hanley has determined that a 10.5 percent ROE is proper for MGE at this time. (Hanley Reb., pp. 2-3)

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[5] Mr. Hanley selected the comparable companies using the following criteria: (1) included in the Value Line Natural Gas Utility Group; (2) having a Value Line five-year projections of growth rate in EPS; (3) having a Value Line beta; (4) having not cut or omitted their cash common stock dividends during the five previous years; (5) deriving 60% or greater of both net operating income and assets from regulated gas operations; and (6) having not publicly announced involvement in any merger or acquisition activity at the time of the study. (Hanley Dir., p. 17) Nine companies met all of the criteria. Their financial profile is summarized in Schedule FJH-5.

Mr. Hanley's updated study utilizes the same methodologies as were used by him in his original study. An explanation of one change, however, is needed.[6] When Mr. Hanley prepared his direct testimony, the stock market was near the 2008-2009 low, yielding the considerable potential for capital appreciation. (Hanley Reb., p. 6) This resulted in Mr. Hanley applying the risk premium and CAPM/ECAPM models in a way which only gave 20 percent weight to the market appreciation potential in order to estimate a norm. The potential for capital market appreciation has declined dramatically since March of 2009. It is Mr. Hanley's opinion that under more normal conditions, investors give equal weight to long-term historical market risk premia and expected market risk premia. As such, with his updated study performed under current conditions, Mr. Hanley gives 60% weight to historical appreciation and 40% weight (up from 20%) to the Value Line forecasted appreciation potential. (Hanley Reb., p. 7)

This decline in the potential for capital market appreciation is not to say that capital costs are back to pre-financial crisis levels and that there is little expectation of capital appreciation on the part of investors. The bottom of investment grade long-term debt of utilities (Baa) is still more costly than prior to the financial crises. The rate of increase in capital appreciation expectations will continue to decline, but will remain significant. Greater risk equals investors' greater expected return for the commitment of capital. (Hanley Reb., p. 18)

Cost of Debt: What long term and short term cost of debt should be used for determining MGE's rate of return?

[6] A second variance from Mr. Hanley's original study to his updated study is that at the time of Mr. Hanley's original study, 2008 actual results were not yet available. These numbers, including those from the Morningstar 2009 Valuation Yearbook, are now available and have been incorporated into Mr. Hanley's updated study and recommendation. (Hanley Reb., p. 8)

MGE Position: The basis of Mr. Hanley's long-term debt cost rate of 6.08 percent is explained in his direct testimony beginning at page 23 and is grounded in the long-term debt interest cost rate for each company in his proxy group of nine LDCs. The average inherent cost for the group is 5.93 percent to which is added an allowance of 0.15 percent for issuance costs resulting in a cost rate of 6.08 percent.

A 5.492 percent prospective short-term cost rate should be used for purposes of setting MGE's rates in this case.

The precise basis of the cost of short-term debt for each of the proxy companies is not available. However, a short-term debt cost rate based upon a utility with a similar credit rating to the proxy group would consist of three-month LIBOR rate plus 262.5 basis points plus an upfront fee of 200 basis points according to Mr. Hanley. In this regard, Mr. Hanley relies upon recent capital market information for Integrys Energy if its credit rating was split that is S&P A and Moody's A3 similar to Mr. Hanley's peer group average ratings (Schedule FJH-21, page 35) as presented to Southern Union Company by Calyon Credit Agricole CIB. (Hanley Reb., pp. 37-38, Sch. FJH-27) Short-term debt cost rates fluctuate, and ratemaking is to be prospective in nature. As such, the use of a three-month prospective average LIBOR rate is appropriate. As of September 1, 2009, the six quarter average forecast three-month LIBOR rate is 0.8667 percent. (Hanley Reb., p. 38; Sch. FJH-21) When added to the market-required margin of 262.5 basis points over the LIBOR rate plus a 200 basis point upfront fee, a 5.492 percent prospective short-term debt cost rate is indicated for a gas distribution company with a credit rating of Moody's A3 and an S&P rating of A. (Hanley Schedule FJH-32, Note 3)

Staff witness Murray argues that a short-term debt cost rate of only 0.89 percent should be used for determining MGE's rate of return. This recommendation, however, is based upon a flawed analysis. Yields on government securities, including U.S. Treasuries, have increased considerably as of late, and the spot cost rate utilized by Mr. Murray is understated. Further, as explained by Mr. Hanley, it is inappropriate for Mr. Murray to utilize and rely on a spot short-term cost rate based upon only two companies. (Hanley Reb., p. 37)

B. Risk: Would the Commission's adoption of MGE's proposed rate design that recovers all non-gas costs in a fixed customer charge for Residential and SGS customers reduce MGE's business risks? If the answer is "yes," should that reduced risk be recognized in the determination of either cost of capital or the revenue requirement?

MGE Position: To the extent the Straight Fixed-Variable (SFV) rate design reduces MGE's business risks, this risk reduction is already reflected in the calculation of the appropriate return on equity (ROE) for MGE in this proceeding. This is because MGE witness Hanley arrived at his ROE recommendation by utilizing four well-tested market-based cost of common equity models, as applied to a proxy group. As explained by Mr. Hanley:

> . . . a common equity cost rate derived from my proxy group of nine LDCs . . . is reflective of a similar level of risk reduction for MGE as a result of its SFV rate design. Thus there is a quid pro quo vis-à-vis the proxy group of nine LDCs and no adjustment to common equity cost rate derived from the proxy group is needed as a result of MGE's SFV rate design.

(Hanley Dir., p. 7) It is the Company's position that a proper common equity cost rate for MGE in this case is 10.5 percent, but absent MGE's existing SFV rate design, the common equity cost rate should be no less than 10.75 percent. This is because the proxy gas distribution companies overwhelmingly have protection from the

unpredictability of weather and declining usage per customer. An ROE derived from market data of these proxy gas distribution companies already reflects any risk-reducing benefits derived from a SFV-type rate mechanism. (Hanley Reb., pp. 7-8)

OPC witness Lawton argues that a 50 basis point reduction in ROE is appropriate due to the SFV rate design, but his reasoning is illogical. In a 2000 Maryland Public Service Commission case, a 50 basis point reduction in ROE was taken as a result of the implementation of Rider 8 – a decoupling mechanism accounting for changes in weather and other factors affecting as usage. In 1999 and 2000, the gas distribution proxy companies did not have decoupling mechanisms in place. When the same companies returned in 2005, the Maryland Commission did away with the equity cost rate reduction because the impact of the same was reflected in the data of the proxy companies. (Lawton Reb., pp. 12-13)

As explained by Mr. Hanley, OPC witness Lawton ignores the fact that the nine appropriate proxy gas companies currently have nearly 85% of their revenues either wholly or partially decoupled. (Hanley Reb., p. 10; Sch. FJH-3, p. 2) Eight of the proxy companies have decoupling mechanisms in place to varying degrees, and all nine companies have protection from the vagaries of weather – the largest single variant of sales and revenues. For proxy company AGL Resources, its largest jurisdiction is Georgia, which employs the SFV rate design. For proxy companies New Jersey Resources and South Jersey Industries, the Consumer Incentive Program (CIP) decoupling mechanism is in place. This CIP protects the companies against the weather variances and eliminates the disincentive to promote conservation. (Hanley Reb., pp.

10-11) The various other decoupling mechanisms and similar protections for the proxy companies are set forth on page eleven of Mr. Hanley's rebuttal testimony.

OPC witness Lawton appears to completely ignore these mechanisms and other protections afforded to the proxy companies. Although it is difficult to classify and quantify the various mechanisms by degree and effectiveness with regard to the reduction in equity risk, they cannot be ignored while still arriving at an appropriate ROE recommendation. Under the Efficient Market Hypothesis, the benefits of these mechanisms are reflected by investors in the market prices they pay for securities, and, accordingly, common equity costs rates derived from this market data already reflect the mechanisms' risk-reducing benefits. (Hanley Reb., pp. 11-12)

MGE's proposed SFV rate design is cost-based, equitable, and beneficial both to the Company and to its customers. With the SFV rate structure, when it is colder-than-normal, customers do not overpay for the Company's fixed costs, and the Company does not over recover margin. Conversely, when it is warmer-than-normal, customers do not underpay for the Company's fixed costs, and the Company does not under recover margin. (Feingold Dir., p. 18)

A downward adjustment to ROE would be inappropriate with the continuation of the SVF rate design for MGE. On the other hand, if MGE does not have its SFV rate design, its risk will be greater than the proxy companies, and an upward adjustment of 25 basis points will be necessary. (Hanley Reb., pp. 12, 36)

C. Expense Issues

Environmental Expenses: What amount related to former manufactured gas plant (MGP) remediation expenses should be used in determining MGE's cost of service?

MGE Position: The three year average (calendar year 2006-2008) of MGE environmental remediation costs, or $2.546 million, should be used in determining MGE's cost of service. The subject remediation costs primarily concern former manufactured gas plant (MGP) sites that have been utilized as service centers for MGE. In Commission Case No. GU-2007-0480, the Commission found, among other things, that "Remediation of former manufactured gas plant sites is a normal cost of doing business for a local distribution gas company."

The amount recommended by MGE is consistent with the three year average computed in the Staff Report – Cost of Service (p. 110). However, the Staff reduced this amount by the average of environmental insurance recoveries over the last three years ($663,000) and then further reduced it by fifty percent (50%) in reliance on the Environmental Liability Agreement between MGE and Westar Resources, Inc. which expired in January of 2009.

The primary purpose of a rate case is to set rates prospectively. With this in mind, neither the ELA nor the past insurance recoveries should be used to normalize environmental expense. The ELA has no applicability to environmental expenses that MGE incurs after January 31, 2009, and therefore, it is clear that the ELA will provide no recovery to MGE concerning the environmental expenses it will incur in future periods. Further, the insurance recovery process referenced by the Staff adjustment has been under way for many years. Such recoveries are necessarily limited, uneven and, at

some point, will cease. MGE has no way of knowing or controlling what, if any, insurance recoveries may be made during the period of time these rates will be in effect.

Similarly, OPC raises an issue concerning past tax treatment of MGE's environmental remediation costs. This issue has nothing to do with the level of costs MGE will incur during the period of time the new rates will be in effect. Whatever tax impact may have been associated with past expenditures, the base costs are evidence of what MGE will have to spend during the period of time the new rates will be in effect.

If there is a concern about possible variability of the environmental costs and/or insurance recoveries, MGE has proposed in the Rebuttal Testimony of Michael R. Noack specific language for a tracker as an alternative way to address these costs. Using the proposed tracker would account for the costs and recoveries in a way that would reduce the chances that the Company would either under or over-recover its environmental costs and mitigate somewhat the significance of what number is used for the purpose of setting rates in this case.

Michael R. Noack Direct (p. 20-21)
Michael R. Noack Rebuttal (p. 1-7)
Michael R. Noack Surrebuttal (p. 2-3)
Dennis Morgan Rebuttal (All)
Derek J. Tomka Rebuttal (All)
Derek J. Tomka Surrebuttal (All)

Infinium Software: What amount related to MGE's Infinium Software amortization should be used in determining MGE's cost of service?

MGE Position: MGE has continued to make use of the Infinium software, albeit on a somewhat limited basis for time-entry purposes since the last rate case. The costs related to the Infinium software are not included in MGE's rate base. MGE is proposing to merely continue to amortize the remaining balance of the Infinium software. This is

the ratemaking treatment that was directed by the Commission in Case No. GR-2006-0422, and affirmed by the Court of Appeals in Case No. SD29278, et al., issued on August 28, 2009.

OPC challenges MGE's right to make use of the Infinium software. First, the dollars that MGE spent in regard to the Infinium software were spent many years ago. Further, the Commission's order in Case No. GR-2006-0422 did not rely on any finding of current usefulness. The Commission found that because the investment was not being included in rate base, it did not matter whether the software was or was not used and useful at this time. *See* Report and Order, p. 34, Case No. GR-2006-0422 (March 22, 2007). Lastly, Southern Union Company contracted with Island Software to develop the time entry functionality within Infinium several years ago and owns the rights to this work. Infinium was informed in 2005 that Company did not intend to renew its annual license. MGE has the right to make continued use of the existing version of Infinium, which includes the time entry functionality developed by Island Software.

Michael R. Noack Rebuttal (p. 14-16)
Michael R. Noack Surrebuttal (p. 8-10)

SLRP Amortization: What amount related to the Safety Line Replacement Program amortizations should be used in determining MGE's cost of service?

MGE Position: The safety line replacement program (SLRP) refers to a large line replacement program that was undertaken in the 1990's in response to a series of Gas Line Safety Rules promulgated by the Commission. As the name implies, the rules required gas utilities to substantially replace all of their older service lines and mains.

There were ultimately six SLRP deferrals of costs associated with the replacements. The first deferral has been fully amortized for several years. SLRP deferrals 2, 3 and 4 were fully amortized as of August 2008. SLRP deferrals 5 and 6 are still being amortized and will not be fully amortized until sometime in 2011 for the 5th deferral and 2014 for the 6th deferral.

OPC proposes that amounts associated with the amortization of SLRP deferrals 2, 3 and 4 arguably recovered by the Company between July 2008 and the time new rates go into effect be used to reduce the balances of SLRP deferrals 5 and 6.

The fact that the subject amortization periods did not match the periods the rates were in effect, is a form of regulatory lag that, in this case, may advantage the Company. However, whatever advantage MGE may have had was not sufficient for it to earn its authorized rate of return during this period. (Noack Dir., p. 23) Moreover, the Commission previously determined that such regulatory lag would be accepted in regard to this issue. In Commission Case No. GR-98-140, MGE requested that the unamortized balance of the SLRP deferrals be given rate base treatment. The Commission denied rate base treatment and, in doing so, stated that "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."

It appears that the Commission found these types of regulatory lag effects to be acceptable when it denied MGE rate base treatment of the unamortized balance and accepted the fact that some forms of regulatory lag associated with these deferrals would disadvantage the Company.

OPC's proposed adjustment to the SLRP amortization should be denied.

Michael R. Noack Rebuttal (p. 10-12)

FAS 106/ OPEBs:

a. Is it lawful and reasonable to require MGE to fund its external OPEB trusts in an amount equal to the FAS 106 allowance included in rates such that MGE is required to deposit a "catch-up" amount into its OPEB trusts in order to make use of FAS 106 in determining MGE's cost of service?

b. If so, what is the appropriate "catch-up" amount?

c. What is the appropriate level of OPEB expense to use in determining MGE's cost of service?

MGE Position:

a. No. Section 386.315.1, RSMo provides, among other things, that for ratemaking purposes, the Commission must recognize "the actual level of expenses the utility is required by FAS 106 to record for post retirement employee benefits . . . ."

Section 386.315.2, RSMo states that a utility that uses FAS 106 shall be required to use "an independent external funding mechanism that restricts disbursements only for qualified retiree benefits."

Section 386.315.3, RSMo provides that that a utility that receives a rate order between January 1, 1993 and August 28, 1994 may file one set of tariffs modifying its rates to reflect the revenue requirements associated with the FAS 106 expenses "if

such utility is funding the full extent of its FAS 106 obligation at the time such tariffs are filed."

Nowhere does the statute state that the utility must fund the "external mechanism." It only addresses "disbursements" (subsection 2). Full funding is required only under the circumstances described in subsection 3 – the one time rate filing. That situation does not exist in this case.

b. MGE's financial statements recognize the proper amounts pertaining to FAS 106 obligations on its books according to the actuarial reports provided by the Company's actuary and already maintains a liability on its books in an appropriate amount. Thus, there is no "catch-up" amount necessary.

c. For the purpose of determining rates in this case, the Commission should utilize the FAS 106 expense reflected in the report of MGE's actuary. In the alternative, the Commission could implement a tracker based on an agreed to recovery in rates that would ensure such amounts are reconciled back to the amounts expensed per books.

John A. Davis Rebuttal (p. 1-4)
Michael J. Muth Rebuttal (All)

Regulatory Commission Expense: What amount related to regulatory expenses should be used in determining MGE's cost of service?

MGE Position: MGE's actual rate case expenses should be amortized over a three year period in order to determine MGE's cost of service. Annual regulatory expenses in the amount of $213,355 should be utilized for determining MGE's cost of service for regulatory matters other than rate cases.

The Commission has previously stated as follows concerning attacks on the recovery of rate case expense:

> The Commission does not want to put itself in the position of discouraging necessary rate cases by discouraging rate case expense. This is a particularly treacherous area for the Commission to be addressing in that the Commission cannot be viewed as having a dampening effect upon a regulated company's statutory procedural rights to seek out a rate increase when it believes that facts so justify it. Disallowing prudently incurred rate case expense can be viewed as violating the company's procedural rights.

In re St. Joseph Light & Power Company, 2 Mo.P.S.C.3d 248, 260 (1993); *See also In re St. Joseph Light & Power Company*, 3 Mo.P.S.C.3d 207, 214 (1994).

MGE believes that the expenses it has incurred for both state and federal regulatory matters are reasonable, prudent and appropriate for inclusion in the rates to be set in this case. MGE strives to hire outside consultants and experts at competitive rates. The Company also conducts a competitive request-for-proposal ("RFP") process in which it evaluates both the estimated fees along with the experience of outside experts for each rate case. MGE has made a determination that contracting with additional counsel on an as-needed basis and for peak periods is less expensive both for the Company and its customers.

Michael R. Noack Rebuttal (p. 16-22)

Bad Debts: What amount related to uncollectibles expense should be used in determining MGE's cost of service? Should the emergency cold weather rule amortization have an impact upon this amount?

MGE Position: Staff and MGE are recommending that this expense be set at $9,843,535, based on a three year average of MGE's experience, while OPC witness

Trippensee is recommending the use of $9,685,323, based on a five year average. Mr. Trippensee is further recommending that his number be reduced by $387,256 as a result of monies previously received by MGE pursuant to the Emergency Cold Weather Rule amortization.

The cold weather rule amortization has expired and will have nothing to do with MGE's bad debt expense on a going forward basis. The most representative evidence of what that expense will be on a going forward basis is the three-average of bad debt write offs utilized by the Staff and MGE, without any offset in regard to the one time cold weather rule amortization.

Michael R. Noack Direct (p. 12-13)
Michael R. Noack Rebuttal (p. 7-10)
Michael R. Noack Surrebuttal (p. 3-8)

Credit Card Fees: Should the cost to accept a credit card payment be included in MGE's cost of service? If so, what amount should be included?

MGE Position: Yes. An expense for the cost to accept a credit card payment from a customer for the balance of their gas bill should be included in MGE's cost of service. Currently that cost is assessed to the customer by the credit card company which reduces the incentive for a customer to pay with a credit card. It is in the Company's and its customers' interest to accept a credit card payment as that debt if later unpaid would revert to the credit card company and not MGE, therefore potentially reducing uncollectibles on a going forward basis. $800,982 should be added to MGE's cost of service to address this expense.

Michael R. Noack Direct (p. 19)

II. KANSAS PROPERTY TAX AAO (CASE NO. GU-2010-0015)

Should the Commission grant MGE an accounting authority order concerning Kansas property taxes on natural gas in storage in the State of Kansas?

MGE Position: Yes.

On April 17, 2009, Kansas House Substitute for Senate Bill No. 98 became effective. This Kansas contains a provision designed to place stored natural gas on the Kansas tax rolls. The legislation was made retroactive to inventories held as of January 1, 2009, which means property taxes will be assessed in 2009 based upon gas in storage as of January 1, 2009.

The amount of taxes assessed to MGE by Kansas is based on the value of the gas in storage as of December 31 for each year. Because it is based on the value of the stored gas, the amount of tax owed will fluctuate in future years as the value of the gas goes up and down.

The estimated amount of property taxes to be billed and payable, based on January 1, 2009 storage volumes in Kansas, is $1,745,560. Seven months of the estimated tax has been accrued on MGE's books as of July 31, 2009. A monthly accrual of $145,463 will continue to be recorded for each of the remaining months in 2009.

MGE requests that the Commission issue an Accounting Authority Order ("AAO") that will allow MGE to defer for consideration in the next rate case, property taxes assessed by Kansas tax authorities, and paid by MGE, on inventories of gas held on MGE's account for resale and stored in underground formations (gas in storage) in the State of Kansas.

This is an approach that the Commission took the last time that Kansas attempted to impose a property tax on gas held in storage. MGE challenged the 2004 Kansas legislation through appeals. During the pendency of those appeals, the Commission granted MGE an AAO concerning the 2004 Kansas property tax legislation (Case No. GU-2005-0095). The Commission's order found in part as follows:

> The Kansas property tax on gas held in storage in that state is unusual in that MGE, which does not serve customers in Kansas, has never before had to pay property tax in Kansas. However, if the Kansas taxes are found to be legal in the ongoing court challenge, and MGE is required to pay the tax, it should be able to recover those tax payments for future years through its rates when it includes those taxes in its cost of service in a future rate case.

A very similar situation lists in regard to the 2009 legislation. Accordingly, MGE believes that similar treatment is warranted.

Staff recommends that the Commission approve MGE's request for an AAO related to the Kansas property tax with certain additional provisions. MGE does not object to the issuance of an AAO that includes the Staff-proposed provisions.

Michael R. Noack Direct (p. 17-18)
Michael R. Noack Direct in Case No. GU-2010-0015 (All)
Michael R. Noack Rebuttal (p. 24)
Michael R. Noack Surrebuttal (p. 10-13)

III. ENERGY EFFICIENCY

A. Relationship to rate design
Should the continuation (for residential customers) or implementation (for small general service customers) of energy efficiency programs be contingent on the adoption of a rate design that recovers all non-gas costs through a fixed customer charge?

B. Funding
Should funding for energy efficiency programs be included as an ongoing expense in rates, or should the Company provide upfront funding with such expenditures to be deferred (after expenditure of

the surplus unspent funds for residential energy efficiency programs (expected to be approximately $1 million) that still remain at the time new rates from this case become effective) and included in rate base (with a 10-year amortization period) in subsequent rate cases?
What should the annual funding level be and how should the funding level be determined?
Should interest be applied to unspent residential energy efficiency funds and, if so, at what rate?

C. Continuation/Form of Collaborative
Should the energy efficiency collaborative formed after MGE's most recently concluded rate case as a result of the Commission's approval of the Unanimous Stipulation and Agreement in Case No. GT-2008-0005 be modified to an advisory group rather than a consensus decision making collaborative?

MGE Position: Subject to the approval in the Company's 2006 rate case of SFV rate design for its residential class of customers, MGE agreed to administer a number of energy efficiency (EE) programs consistent with the funding levels authorized by the Commission. Those programs include (1) communication and education regarding energy efficiency and (2) promotion of a water heater rebate program designed to encourage the installation of energy efficient appliances and, therefore, improve natural gas conservation efforts. They have been overseen by an energy efficiency collaborative (EEC) comprised of representatives of MGE, Staff, Public Counsel and the Missouri Department of Natural Resources. Since its inception, the program has been expanded to include space heating, natural gas boiler systems and combination furnace/water heating systems.

The results of these EE programs have been gratifying and are evidence of an increasingly successful conservation initiative. Thousands of energy efficiency kits have been purchased for distribution by senior serving organizations; 470 of which have been installed. General information has been made available through print media, bill inserts,

radio advertising and on the MGE website. The website traffic in 2007 and 2008 reflects substantial visits made to the energy efficiency and water heater pages. Nearly 560 high efficiency water heaters have been approved for a total of $84,800. Thirteen (13) furnace applications have been approved for a total of $2,600.

MGE is willing to expand the program to include the new SGS customer class if the Commission adopts a rate design for this class that leaves the Company financially indifferent to the volumes of gas consumed, as is the case with SFV rates, and includes the cost of these initiatives in the calculation of rates, as is currently the situation. MGE proposes that the current funding level of $750,000 per year be applied proportionally to customer numbers such that the new SGS class receives 10% of the funding and the RS class receives 90%. MGE does not oppose segregating program funds already received, but not spent, and any additional funds to accrue interest on a going-forward basis at the short-term debt rate included in the capital structure approved by the Commission.

MGE is of the view that the funding levels for EE programs be kept in line with the actual demand for them because, ultimately, the cost of such programs is reflected in the cost of service for all of MGE's customers. As demand increases over time, which the Company would expect, the appropriate funding levels can be revisited in a subsequent rate case.

MGE supports the continuation of the EEC created in Case No. GT-2008-0005 modified such that it acts in an advisory capacity as opposed to its current "consensus" capacity. This is similar to the manner in which EECs are structured for other Missouri utilities.

David Hendershot Direct (All)
David Hendershot Rebuttal (All)
David Hendershot Surrebuttal (All)
Michael R. Noack Rebuttal (p. 29)

IV. RATE DESIGN/COST OF SERVICE

A. Class Cost of Service/ Spread the Increase: What is the appropriate level of revenue responsibility to be borne by each customer class?

MGE Position: MGE caused to be prepared an independent class cost of service study (CCOS) by Dr. F. Jay Cummings in support of the Company's revenue requirement in this case. The fundamental purpose of the CCOS is to fully allocate the Company's revenue requirement to each customer class such that operating expenses, depreciation, taxes, and required rate of return are distributed based on cost causation principles. Dr. Cummings' CCOS was prepared in three steps, that is, functionalization, classification and allocation; each of which is exhaustively described in his Direct Testimony. In summary, functionalization involves breaking down elements of cost of service according to production and storage, transmission, and distribution. These functionalized components are then classified into customer-related, demand-related, commodity-related and revenue-related costs. Finally, the classified components are fully assigned to customer classes according to the rate schedule categories in the Company's tariff. Whenever possible, Dr. Cummings' CCOS directly assigns costs, a method that best reflects cost causation.

One of the key components in this process is the classification and allocation of Mains. These steps are central to the process in that distribution mains constitute the single largest component of rate base, representing more than $251 million in net plant

on which a return is required. The allocation of mains also affects mains depreciation expense (almost $9 million) and mains-related operation and maintenance expenses (approx. $12.7 million). Dr. Cummings used a zero intercept analysis, a method endorsed by the Commission in MGE's 2004 rate case (Case No. GR-2004-0209). This method splits these costs between the customer component (i.e., the cost of providing access to gas service) at 38.41% and the demand component (i.e., the sizing of mains to meet peak demand) at 61.59%. MGUA, like MGE, uses zero intercept.

The CCOS sponsored by Dr. Cummings distributes total Company cost of service and indicates that a substantial increase in the current Residential (RES) class is required, a relatively small Small General Service (SGS) revenue increase is needed, and relatively small Large General Service (LGS) and Large Volume Service (LVS) decreases are indicated. The corrected CCOS sponsored by Dr. Cummings and attached to his Rebuttal Testimony distributes total Company cost of service as follows: RES – 75.58%; SGS – 17.41%; LGS – 0.99%; LVS – 6.03%.

The CCOS prepared by Daniel Beck and sponsored by Staff does not use an allocation method that splits the mains investment into customer-related and demand-related components. Staff instead uses a "stand alone/integrated system" factor. This approach does not reflect the investment required to size mains to meet peak day loads and it does not capture the cost of providing customer access to MGE's distribution system. It is both conceptually and practically flawed in that it is premised on the idea that a customer obtains service through a certain length of main whereas a customer actually receives service through a network of mains installed throughout the distribution system. The Staff stand alone/integrated system calculation requires significantly more

footage of mains than currently are in service in the Company's distribution system. It requires 47,355,129 feet of distribution mains, or 2,170,671 more feet of mains than is in service in the Company's system.

The CCOS prepared by Barbara Meisenheimer and sponsored by Public Counsel, while using an allocation method that splits main investment into customer-related and demand-related components, uses an "average-and–excess" method applied to the demand-related portion of mains investment. This approach does not recognize the fact that mains are sized to meet system peak day load requirements. OPC's incorporation of usage throughout the year, which does not drive the non-customer portion of mains cost, into the demand factor understates the number of design day Heating Degree Days (HDD), a key cost causation consideration.

MGE's corrected CCOS should be endorsed by the Commission as the most accurate allocation cost of service between customer classes. The methods utilized by Dr. Cummings are consistent with the Commission's decision in the 2004 MGE rate case and are conceptually sound from an operational and policy perspective in that they most accurately allocate revenue requirement based on principles of system design/operation and cost causation.

Based on cost of service as established by Dr. Cummings' corrected CCOS, present class revenue contributions and customer impact considerations, MGE witness Russell Feingold proposes that current class revenue allocations be increased by 6.8%, 3.3%, 1.3% and 6.6%, respectively, for the RS, SGS, LGS and LVS customer classes.

F. Jay Cummings Direct (All)
F. Jay Cummings Rebuttal (All)
F. Jay Cummings Surrebuttal (All)
Russell A. Feingold Direct (Sch. RAF-5)

B. Rate Design

1. What rate design should the Commission adopt for the residential customer class?
2. What rate design should the Commission adopt for the small general service customer class?
3. What rate design should the Commission adopt for the large general service customer class?
4. What rate design should the Commission adopt for the large volume service customer class?
5. What miscellaneous service charges should the Commission approve?

MGE Position: MGE is proposing that existing Straight Fixed-Variable (SFV) rate design that was approved by the Commission in 2006 for the Company's residential class (RS) of customers be retained and that it also be expanded to apply to the new Small General Service (SGS) class which will include customers with annual gas usage less than or equal to 10,000 Ccf. The fixed costs to serve each class are reasonably homogenous so a uniform delivery charge within each class is fair to all customers within each class.

The SFV name reflects the fact that the rate design includes all fixed costs of delivery service in a flat monthly fee whereas the actual gas commodity costs will be collected on a volumetric basis each month through the Purchased Gas Adjustment (PGA). This is to be contrasted with Public Counsel's recommendation that the Commission direct that the Company revert to a volumetric rate design whereby a portion of the fixed costs of delivery be collected in a monthly customer charge and that the balance of those costs be factored into a volumetric rate component that also includes the gas commodity cost.

The Company proposes that the fixed monthly charge be increased for customers served under its new Large General Service (LGS) rate class to move it closer to customer cost of service.

For Large Volume Service (LVS) customers, MGE proposes an increase in all current charges by the overall percent increase in base revenues it has proposed.

The Company proposes to eliminate the seasonal differentials in the volumetric delivery charges contained in the SGS, LGS and LVS rate classes.

Conceptually, SFV rate design for the RS and new SGS classes of customers represents a superior billing approach because it aligns the financial interests of MGE with those of its customers. Under a SFV rate design, the Company no longer has an incentive to meet its profit objectives by selling larger volumes of gas as was the case under the traditional volumetric rate design. The gas commodity cost is a dollar for dollar pass-through expense so MGE has no financial incentive to induce customers to consume more natural gas. Consequently, SFV rates have ushered in innovative, company-sponsored energy efficiency programs that provide incentives for the typical customer to conserve on the 70% of a typical annual bill attributable to natural gas used for space and water heating, as well as other household uses.

This rate design has been particularly beneficial to high-use customers, many of whom are from low-income households, because the price of natural gas is not loaded with distribution costs that are independent of usage and the actual commodity cost. The continuation of this straight-forward rate design for the RS class, and its expansion to the new SGS class, sends clear and meaningful price signals, eliminates intraclass cross-subsidies,

encourages further conservation efforts, moderates seasonal bill fluctuations and eliminates the prospect of over- or under-recovery of fixed distribution network costs.

Regulatory policy pronouncements on both the state and federal levels have been strongly supportive of rate decoupling rate designs, like SFV, for the reasons set forth in the prior paragraph. Jay Nixon, when he was the state's Attorney General, issued a recommendation that the practice of collecting a gas company's fixed costs through usage-based rate elements be discontinued. More recently in March of this year, Governor Nixon urged this Commission to align a utility's financial incentives with those of their customers. SFV rates do exactly that. Public Counsel's recommendation is a denial of the current best thinking where the topic of energy conservation by customers of natural gas utilities is concerned. It is also inconsistent with Public Counsel's expressed support of revenue decoupling rate design set forth in a 2004 task force report to the Commission.

Public Counsel's volumetric rate design proposal is deficient in that it lacks the basic, necessary detail to qualify as a proposal the Commission could actually adopt were it to be inclined to do so. Additionally, Public Counsel has offered no concrete alternative to its discredited volumetric rate design proposal to address the regulatory necessity of revenue decoupling to facilitate energy conservation measures. Public Counsel is simply not credible on this subject.

SFV rates have been a success story for MGE's customers. They have resulted in significant savings for MGE's residential customer class. Over the last nine month winter periods (2007-2008 and 2008-2009), residential customers saved on average $81 or about $36.4 million in the aggregate. It has also been overwhelmingly beneficial to MGE's low-income customers who tend to be higher than average users of natural gas for space and

water heating. Over 80% of the Company's customers who receive low-income energy assistance would experience higher winter gas bills under a Public Counsel-recommended volumetric rate design than would be the case with SFV rates.

Russell A. Feingold Direct (p. 13-22)
Russell A. Feingold Rebuttal (p. 5-24)
Robert J. Hack Rebuttal (All)
Philip B. Thompson Rebuttal (All)
Russell A. Feingold Surrebuttal (All)

V. TARIFF CHANGES

A. Transportation/Threshold for Eligibility:

Should the Commission reduce the currently approved volume threshold for transportation service eligibility? If so, to what level and under what conditions?

MGE Position: MGE does not support Constellation NewEnergy's (Constellation) request that the Commission direct MGE to lower the threshold to provide transportation service in its service territory at this time because of concerns about the cost of stranded interstate transportation capacity that will be borne by Firm Customers, the consequent need for changes to the balancing provisions in MGE's tariff (which MGE is not presently prepared to make)and the need to provide a transition period for the installation of telemetry equipment.

David N. Kirkland Rebuttal (p. 16-17)

B. Transportation/Other:

Should the Commission approve the changes proposed by MGE to its Large Volume Transportation Service tariff for which MGE alleges an intent to encourage Large Volume Transportation Service Customers to maintain a closer balance between their deliveries to the system and their usage on the system, to-wit:

i) Deadline for notice of pool changes;
ii) Proposed elimination of multiple pools per aggregation area;
iii) Transportation charge component of cash-outs for imbalances (amount and symmetry of the charges);
iv) Index price for cash outs;
v) Circumstances and conditions for calling OFOs;
vi) Supplier/agent's ability to move customers from a pool on one pipeline to another pipeline in the event of capacity constraints; and,
vii) Miscellaneous language changes.

MGE Position: MGE has proposed revisions the Transportation Provisions (TRPR) if its tariffs to address Aggregation, Daily Scheduling Requirements and Monthly Cash Out and to add a Periods of Daily Balancing section. MGE has also has included definitions of terms. The Commission's Staff is supportive of the Company's proposed tariff changes.

As to Daily Scheduling Requirements, the Company's proposal is in lieu of strict daily balancing and retains the flexibility afforded by monthly cash out to encourage transportation customers to manage their business within the intent of daily balancing. The tariff language is designed to clarify that customers are expected to schedule nominations in kind with usage, as adjusted for lost and unaccounted for gas.

Aggregation changes are to clarify that the agent will pool customer nominations and usage by pipeline.

Cash out has been changed to narrow balancing tolerances to 5%, to change the cash out value to the lower of index prices when MGE is purchasing cash out supply and to the higher of index prices when MGE is selling supply. The intent is to encourage customers to reduce imbalance volumes. This is important because otherwise Firm Customers bear the cost of purchasing supplies from LV customers when the supplies are not needed and storing these supplies until they are needed.

The PGA transportation component has been removed because MGE has already incurred this cost in the PGA. These provisions will reduce the impact of cash out to MGE commodity customers.

The addition of a Period of Daily Balancing (PODB) provision addresses customer over-nominations at receipt points. The intent is to encourage customers to meet the daily balancing intent of the tariff. This provision is needed to address the issue of customers who regularly under-nominate. MGE does not oppose a limitation that a PODB can be called in the event an LV customer or agent under-nominates by more than 10% of usage on any of 5 days within a month.

MGE does not agree with Constellation's contention that MGE should not be allowed to call an Operational Flow Order (OFO) if the interstate pipeline has not done so. An OFO requires LV customers to control nominations for gas flowing to MGE. MGE needs to have this ability to address situations when service is threatened to existing customers or in order to comply with the requirements of upstream pipelines. The transportation tariffs of other LDCs, like Mid America Energy, contain such provisions. MGE recently called an OFO when supplies into Kansas City would have been adversely impacted.

Michael R. Noack Direct (p. 24-26)
David N. Kirkland Surrebuttal (p. All)

C. Non Transportation:

1. Liability limitation

MGE Position: Staff has proposed that changes be made to MGE's Sheet No. R-34 addressing the scope of civil liability to mirror a Laclede Gas Company (Laclede)

proposal in Case No. GT-2009-0056. This is not an issue that is properly before the Commission in this case. MGE has not proposed any changes to this tariff sheet which was approved by the Commission in MGE's last rate case, Case No. GR-2006-0422.

Additionally, this topic is the subject of a complaint that has been filed by Staff and docketed as Case No. GC-2009-0036. Consequently, any differences as between Staff and MGE where this subject is concerned should be addressed in the context of the complaint case because different orders of proof and burdens of proof apply. For the Commission to weigh in on the subject of this tariff would also represent a prejudgment of the merits of the Staff complaint on the part of the Commission.

Finally, the hearings in the Laclede case just recently concluded and that case still has not been briefed by the parties or decided by the Commission. As such, Staff's reference to the utilization of the Laclede approach as a template for MGE is premature and vague.

Michael R. Noack Rebuttal (p. 22-23)

2. Tariff clean-up (ELIR, etc.)

MGE Position: MGE should be allowed to amend its tariff to eliminate "experimental" from the title of its school transportation program and to eliminate the experimental low income rider (ELIR).

Michael R. Noack Direct (p. 26-27)

D. Purchased Gas Adjustment (PGA)

Bad Debt/Uncollectibles in PGA: Should the gas portion of uncollectibles be recovered through MGE's PGA?

MGE Position: Yes. The year to year fluctuation of uncollectibles can either harm the customer and enrich the shareholders or harm the shareholders to the benefit of customers. By including just the gas portion of uncollectibles in the PGA, 65-75% of that fluctuation would be eliminated.

Michael R. Noack Direct (p. 13-15)
Michael R. Noack Surrebuttal (p. 16)

Property Taxes on Storage Gas in PGA: Should the new Kansas gas storage tax be recovered through MGE's PGA?

MGE Position: Yes. As an alternative to addressing Kansas storage gas tax in base rates or through the proposed accounting authority order, MGE proposed tariff language that would include property taxes on gas held in storage in Kansas in the current cost of gas in the Purchased Gas Adjustment portion of MGE's tariff.

Such an approach would be consistent with this Commission's approach in regard to gas price mitigation efforts. Commission Rule 4 CSR 240-40.018(1)(B) states in part that "financial gains or losses associated with price volatility mitigation efforts are flowed through the Purchased Gas Adjustment (PGA) mechanism, subject to the applicable provisions of the natural gas utility's tariff and applicable prudence review procedures."

The subject tax is directly associated with MGE's price mitigation efforts as the tax will rise and fall based on the amount of gas MGE has in storage in the state of Kansas and the price MGE pays for that gas. The Commission should allow MGE to modify its tariffs to allow for recovery of the Kansas storage gas property tax through the PGA.

Michael R. Noack Direct (p. 15)
Michael R. Noack Surrebuttal (p. 13-15)

FERC Regulatory Expense in PGA: Should MGE's FERC regulatory expenses be recovered through MGE's PGA?

MGE Position: Yes. FERC regulatory costs can vary substantially from year to year (usually depending on whether a pipeline rate case occurs) and are incurred by MGE solely in connection with interstate pipeline transportation and storage services, the costs of which are collected exclusively through the PGA clause. Further, recovering FERC regulatory costs through the PGA ensures that such costs are borne only by those customers who benefit from such costs.

Michael R. Noack Direct (p. 15)
Michael R. Noack Surrebuttal (p. 15)

VI. CAPACITY RELEASE/OFF-SYSTEM SALES:

Should the Commission amend the currently approved sharing grid pursuant to which net revenues derived from MGE's capacity release and off-system sales activities are shared between customers and shareholders? If so, what changes should be made?

MGE Position: A "capacity release transaction" occurs when pipeline capacity is sold to third parties for specific periods of time and at a cost established either by negotiation with a third party or through a competitive bidding process. "Off-system sales" typically occur when MGE purchases supply and resells this supply at an alternate location.

These sales are currently shared between MGE and its customers in accordance with the following sharing percentage thresholds originally approved in Commission Case No. GR-2004-0209:

Annual CR Credits and OSS Margins	MGE Retention Percentage	Firm Sales Customer Retention Percentage
First $300,000	15%	85%

Second $300,000	20%	80%
Third $300,000	25%	75%
Amounts over $900,000	30%	70%

The Staff has recommended that the sharing thresholds be increased from $300,000 to $2,000,000. This recommendation is based on incomplete information and does not consider the future revenue opportunities in a dynamic market. MGE's recent success through managing the capacity portfolio does not guarantee any repeat of this success in the future. The capacity release and off systems sales annual revenues are not uniform, are price competitive and respond to market forces including price signals, transportation costs, well head production capacity and pipeline export capacity.

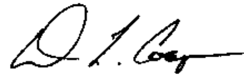
If any changes are to be made in the capacity release/off-system sales revenue sharing grid, they should be significantly more moderate than the nearly seven-fold increase proposed by the Staff. If the Commission believes changes in the grid are warranted, MGE would suggest that the sharing threshold be increased from $300,000 to $600,000.

David N. Kirkland Rebuttal (p. 3-15)

WHEREFORE, MGE respectfully requests that the Commission consider these

statements of position.

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 22nd day of October, 2009, to:

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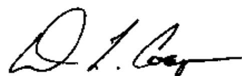

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