BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Tariff Sheets Designed to Increase Rates for Gas Service in the Company's Missouri Service Area	))))	Case No. GR-2009-0355

REPLY BRIEF AND TRUE UP BRIEF OF MISSOURI GAS ENERGY

COMES NOW Missouri Gas Energy, a division of Southern Union Company ("MGE and/or "Company"), and for its Post-Hearing Reply Brief and True Up Brief respectfully states the following to the Missouri Public Service Commission (the "Commission"):

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I. Rate Design

A. Introduction

In its Initial Brief, Public Counsel asks the Commission to return to a residential rate design that: has demonstrably failed MGE in the past; artificially pushes recovery of fixed costs to customers' highest billing months; detrimentally affects LIHEAP customers and other low- income/high- use customers in the winter; and runs counter to national trends toward decoupled rate designs. Public Counsel's stubborn adherence to an outdated rate design must be compared to the mountain of evidence that volumetric rate designs have historically failed both MGE and its customers.

The Commission approved MGE's move away from this failed volumetric residential rate design in MGE's 2006 rate case. In doing so, the Commission aligned the interests of both MGE and its customers with a decoupled rate design that mitigates weather-related risks symmetrically for both the Company and its customers, removes the Company's incentive to sell more gas to its customers, levels customer bills, and permits the Company to implement energy efficiency programs that benefit its customers and society.[1]

MGE is mindful of the dissent in its 2006 rate case, which urged caution for a then-untested rate design for a Missouri natural gas utility and the need for a comprehensive energy efficiency program.[2] In response to that concern, MGE has shown the beneficial effects of its decoupled Straight Fixed Variable (SFV) rate design on its customers since SFV was implemented as well as the robust energy efficiency

[1] See Report and Order of the Public Service Commission, In the Matter of Missouri Gas Energy's Tariffs Increasing Rates for Gas Service Provided to Customers in the Company's Missouri Service Area, GR-2006-0422, March 22, 2007).
[2] See Dissenting Opinion of Commissioners Robert M. Clayton III and Steve Gaw, Case No. GR-2006-0422)

programs that the Company has developed After three years of this rate design, these are proven benefits - not empty theory or argument.

The implementation of the residential rate design has been a demonstrable success for MGE and its customers. Decoupled rate designs have been adopted in numerous jurisdictions for natural gas utilities for the simple reason that they effectively balance stakeholder interests with the policy considerations of the present. Public Counsel has provided no compelling evidence that this Commission should revisit the failures of the past. This Commission should retain the current residential rate design and expand it to the Company's proposed SGS class.

B. MGE's Decoupled Residential Rate Design Has Addressed the Shortcomings of the Volumetric Rate Design and Has Had a Beneficial Impact on the Company and Its Customers. As a Result, SFV Should Be Expanded to the SGS Class.

In its Initial Brief, Public Counsel has taken the astounding (and thoroughly unsupported) position that "reverting to a traditional rate design will not harm MGE" in that it will "simply continue the rate design that has given MGE an opportunity to earn its authorized return for years."[3] The evidence shows, however, that since 1996, MGE has consistently failed to achieve its authorized rate of return despite its demonstrated ability to manage efficiencies.[4] This situation has only improved recently, after SFV was implemented for its residential customer class. The impact of this rate design is now

[3] Public Counsel Brief, p. 6

[4] As Mr. Hack notes in his surrebuttal, while Staff expresses concerns at a detailed level with regard to Mr. Noack's Schedule MRN-1, Schedule G-4, (which describes the Company's earnings shortfalls) Staff does not deny Mr. Hack's general assertion that MGE routinely failed to achieve the Commission-authorized earnings level even though MGE provides high quality customer service at prices and costs that compare favorably to peer companies. (Ex. 12 , Hack Surr., p. 2).

proven. SFV has not guaranteed earnings, nor has it over-compensated the Company. It has simply allowed the Company a better opportunity to achieve its authorized ROE.

1. MGE's Consistent and Significant Revenue Shortfalls under a Volumetric Rate Design.

In MGE's 2006 rate case, the Commission ordered a decoupled residential rate design to address business challenges which had caused MGE to experience increased risk and price volatility[5]. These same pressures exist today and include:

- weather variability,
- declining use per customer,
- high and volatile wholesale natural gas prices;
- and the resulting increases and volatility in customers' bills.[6]

These issues have posed a serious challenge to the financial integrity of the Company and the ability of its customers to manage their energy needs.[7] The rate design changes approved by the Commission in the last rate case address these challenges for the residential class, but are still present in the Company's SGS rate class.[8]

These business challenges are not unique to MGE, but are present in other natural gas local distribution companies ("LDCs"). The Kansas Corporation

[5] In its Report and Order in MGE's last rate case, the Commission specifically noted the Company's evidence on declining average residential gas use, weather variability, and proposed conservation programs; among other factors. (See Report and Order of the Public Service Commission, In the Matter of Missouri Gas Energy's Tariffs Increasing Rates for Gas Service Provided to Customers in the Company's Missouri Service Area, GR-2006-0422, March 22, 2007, pp. 10-12)
[6] Ex. 7, Feingold Dir., p. 14.
[7] Id.
[8] Id.

Commission recently noted[9] that "natural gas utilities face a unique situation in that natural gas usage per customer in general has declined over recent years" and that "because a significant portion of a gas utility's fixed costs are recovered via volumetric charges, the decline in per customer usage has limited gas utilities' ability to recover the revenue necessary to maintain their distribution systems and meet other fixed costs." (In the Matter of a General Investigation Regarding Cost Recovery and Incentives For Energy Efficiency Programs, 2008 Kan. PUC LEXIS 1664, November 14, 2008, Final Order, pp. 24 -25)

The Kansas Commission went on to note that for LDCs, "the lack of revenue presents a serious problem" and that "the issue is maintaining revenue stability." (Id., p. 25) To address these issues, the Kansas Commission noted that "many states that have implemented decoupling have done so for natural gas utilities," and further recognized its responsibility to "regulate natural gas utilities in a manner that provides them with the ability to maintain their economic vitality." (Id.) These are the very factors that caused MGE to request, and the Commission to adopt, the SFV for its residential class in 2006 and to now request the expansion of that rate design to a new SGS class.

The impact of these industry challenges is readily apparent in a review MGE's earnings history. MGE's history of under-earning should serve as a stark rebuttal to Public Counsel's assertion that returning to a volumetric rate design would not harm MGE. What is also evident from the record is that there has been a notable positive impact on earnings since SFV went into effect in 2007.

[9] This case was an investigatory docket opened by the Kansas Corporation Commission. In the case, the KCC cited both arguments in favor and opposed to SFV, but recognized the strong need for decoupling in the natural gas industry. The KCC invited decoupling proposals from companies (including proposals with SFV rate designs) that addressed its noted concerns and included energy efficiency programs.

There is no credible dispute that the record evidence shows that MGE has experienced significant and debilitating earnings shortfalls.[10] For the annual fiscal periods ending 6/30/96 through 12/31/06 (i.e., prior to the implementation of SFV for its residential customers), MGE's actual return fell short of its Commission-authorized return by 189 basis points, on average; translated into dollars, the earnings shortfall averaged $9.19 million per year.[11]

For the annual fiscal periods ending 12/31/07 and 12/31/08 (i.e., after implementation of SFV for its residential customers), MGE's actual return fell short of its Commission-authorized return by 60 basis points, on average; translated into dollars, the earnings shortfall averaged $3.661 million per year.[12]

In sum, based on two years of actual experience, SFV appears to have improved MGE's earnings performance (when comparing actual to Commission-authorized earnings levels) by approximately 129 basis points or $5.529 million per year. While this improvement is meaningful and shows that SFV is serving at least part of its intended purpose (i.e., stabilizing margin revenues), MGE continues to experience substantial earnings shortfalls even with SFV. So, more work remains to be done.

2. The SFV Rate Design Has Reduced Earnings Shortfalls, but Has Not Guaranteed Earnings.

What is notable about MGE's earnings history is the impact that SFV has had since it was implemented in 2007. While MGE still failed to meet its authorized rate of

[10] Again, as Mr. Hack notes in his surrebuttal, while Staff expresses concerns at a detailed level with regard to Mr. Noack's Schedule MRN-1, Schedule G-4, (which describes the Company's earnings shortfalls) Staff does not deny Mr. Hack's general assertion that MGE routinely failed to achieve the Commission-authorized earnings level even though MGE provides high quality customer service at prices and costs that compare favorably to peer companies. (Ex. 12 , Hack Surr., p. 2).

[11] Ex. 30, Schedule MRN-1; Schedule G-4.

[12] Id.

return in 2007 and 2008, its earnings shortfalls were lower than in previous years. Public Counsel's dire warning in 2006 – that SFV is a "rate design that virtually eliminates all earnings risk for a utility" – has simply not materialized. (Brief of the Office of Public Counsel, GR-2006-0422, p. 3). MGE's earnings history since SFV was adopted also calls into question Public Counsel's predictive ability. In 2006, Public Counsel warned that "the decoupling proposals before the Commission would essentially guarantee a specific return and ensure revenue neutrality for MGE by allowing MGE to recover its revenue requirements...". (Id., p. 20) These same concerns have been raised in this case by Public Counsel,[13] but they are simply not supported by actual experience.

MGE's earnings have not been guaranteed under the SFV rate design. MGE has not achieved its authorized return in the past two years because at least in part, the same pressures addressed in its residential class need to be addressed in its SGS class.[14] As MGE's earnings history shows, SFV has not guaranteed a rate of return and has not resulted in the Company over-earning. It has simply reduced earnings shortfalls that were caused by factors beyond MGE's control.

As Commission decisions note, an authorized rate of return is not a guarantee.[15] Utilities are still expected to run their business effectively, looking for opportunities to manage costs. MGE has managed its operations and maintenance costs very effectively as compared to other reasonably comparable Missouri LDCs.[16] MGE has

[13] In his direct testimony, OPC Witness Lawton asserted that "customers are essentially insuring the Company's revenue stream through the proposed rate design." (Exhibit 69, Lawton Direct, p. 10). This assertion is clearly contradicted by MGE's earnings since SFV was implemented.
[14] Ex. 7, Feingold Dir., p. 14.
[15] See Staff of Missouri Public Service Commission. v. Southwestern Bell Telephone Co., 1994 WL 323583, Mo.P.S.C. 1994, January 01, 1994, p.65 (in the context of ROE).
[16] Ex. 10, Hack Dir. p. 10.

done this while providing high quality service to its customers.[17] The record evidence also shows[18] that MGE's residential bills are lower-priced than other comparable Missouri LDCs.[19] MGE has continued to be one of the most efficient LDCs in Missouri, even after Public Counsel's dire warning in MGE's 2006 rate case that "decoupling will reduce incentives for MGE to operate efficiently". (Brief of the Office of Public Counsel, GR-2006-0422, p. 18)

MGE's proven efficiency raises the question of how a company that is managed well and that regularly prosecutes rate cases is still unable to achieve its authorized rate of return. In MGE's case, the problem was primarily due to an antiquated volumetric rate design which resulted in excessive variability for the Company and its customers caused primarily by weather.

3. SFV Has Reduced Earnings Shortfalls Caused by Weather.

A decoupled rate design has worked for MGE because it addresses one variable that a natural gas utility and a ratepayer cannot control – the weather. No matter how well MGE manages its business, provides quality customer service, or manages its costs; it cannot control the huge impact that weather has on its earnings. Weather variability has had a significant impact on customer bills and company earnings under the multiplying effect of a volumetric rate design. (discussed more fully *infra*) An SFV rate design does not change the fact that heating customers will use more natural gas in the winter, nor does a SFV rate design change the fact that the highest percentage of a

[17] Id. at p. 16.
[18] Staff does not dispute that MGE's residential rate levels are "currently lower than the other Missouri LDCs considered in MGE's analysis." (Ex. 60, Oligschlaeger Reb. p. 17). In that testimony, Staff only argued that MGE's analysis did not address what impact MGE's rate increase would have on these figures.
[19] Id.

customers' bill still reflects the amount of gas that they use.[20] But SFV certainly avoids the multiplying effect of Public Counsel's proposed volumetric rate design and the fact that the vast majority of fixed costs are recovered in the winter (when bills and gas costs are the highest), further compounding the effect on customers. Under a volumetric rate design, the Company was put in the position of hoping for colder-than-normal weather while customers hoped for warmer-than-normal weather. Hope is simply not a method by which one can manage a business or a monthly utility bill.

Public Counsel seems to recognize the fact that weather variability causes significant earnings shortfalls and risk for MGE.[21] Public Counsel witness Meisenheimer recognized that residential customers are particularly prone to weather variability.[22] In arguing against a decoupled rate design for MGE, however, Public Counsel seems to dismiss this significant issue. In doing so, they offer no credible solutions to a real problem for MGE and its customers.

4. SFV Has Leveled Customers' Bills Month-to-Month and Year-to-Year, and Has Reduced Residential Customer's Winter Bills.

The SFV rate design has eliminated the multiplying effect of the volumetric rate design and the shift of fixed cost recovery to the highest billing months, which has caused a significant reduction in customers' winter bills and a leveling of customer bills

[20] For an average customer under SFV, 70% of their bill is comprised of gas costs. (Ex. 11, Hack Reb., p. 2) Given that fact, as will be discussed more fully *infra*, it is perplexing why Public Counsel insists that SFV does not send proper price signals or that it does not encourage energy efficiency if a customer can still exert such significant control over their gas use. Lower than average-use customers will have a lower percentage of their bill comprised of gas costs, but this situation is no different than would be the case under a volumetric rate design. The difference is that SFV properly puts all fixed costs –the amount that it costs to serve similar customers in the residential class, whether they are "high" or "low" use, into a monthly customer charge rather than artificially lowering it. The customer can still see price signals for the amount of gas that they use.

[21] Public Counsel argues this by asserting that risks associated with weather have somehow been shifted to consumers, (Ex. 69, Lawton Dir., p. 10). This ignores the fact that by implementing SFV, the Company will no longer see significant revenue increases in colder weather under the volumetric rate design.

[22] Ms. Meisenheimer noted that "residential customers are weather sensitive – very weather sensitive...". Tr. 601.

throughout the year. According to Staff witness Ross, residential customers paid nearly $2,205,000 less in calendar year 2008 with SFV than they would have paid under OPC's proposed volumetric rate design since temperatures were colder than normal.[23] MGE's analysis of revenues over the past nine winter months show that residential customers saved an average of about $81.00 in the winter with the SFV rate design when compared to the volumetric rate design.[24] In its initial brief, OPC is notably silent on the winter savings that MGE's customers have experienced under the SFV rate design[25], other than to raise the curious argument that MGE's impact data on the SFV rate design should be disregarded because it focused on winter months.[26]

MGE has focused on its customer' winter time savings under SFV for the obvious reason that natural gas use increases dramatically in the winter due to increased heating demands. Common sense and regulatory experience would lead one to reasonably conclude that natural gas customers would be most concerned about impacts on their winter bills, which is why MGE witness Feingold pointed out that customers have experienced significant winter savings under SFV.[27] As Mr. Feingold noted, over the last nine winter period months (2007-2008 and 2008-2009), MGE residential customers saved about $36,400,000 under the SFV rate design compared to the amounts that would have been billed under a volumetric rate design.[28] SFV's fixed monthly delivery charge reflects accurate cost causation principles in that customers

[23] Ex. 63, Ross Reb. p. 9.
[24] Ex. 7, Feingold Dir. p. 16; Sched RAF-6
[25] Other than to argue that low volume customers (according to Public Counsel, 18% of MGE's customers) will pay more under SFV than under a volumetric rate, an assertion that will be discussed *infra*. (Initial Brief of the Office of Public Counsel, p. 13). Unsurprisingly, Public Counsel is also silent on their misleading and spurious claim that customers paid $18,000,000 more under the SFV rate design, an assertion that was eviscerated in Staff's Initial Brief as completely misleading. (See Initial Brief of the Staff of the Public Service Commission, p. 33-4).
[26] Initial Brief of the Office of Public Counsel, p. 22.
[27] Ex. 7, Feingold Dir. pp. 16-17, Sch RAF-6.
[28] Id.

pay for the costs to serve them, which are very similar for their class and do not vary with use. Accordingly, since fixed costs are similar for members of a similar class, the monthly charge would not vary under an SFV rate design. The fixed costs to serve residential and the proposed SGS class are reasonably homogenous, so a uniform delivery charge within each class is fair to all customers within the class.[29] Unlike SFV, a volumetric rate design does not charge similarly-situated customers the actual cost to serve them.[30] The delivery service revenue (and customers' bills) generated under a volumetric rate design are artificially low in the summer and artificially high in the winter (when natural gas use is the greatest). Further, under the volumetric rate design, low use customers do not pay the actual cost that the Company incurs to serve them. SFV eliminates this intra-class subsidization.

The monthly and seasonal impact on customers' bills under either a volumetric or SFV rate design is best illustrated by the following charts. They show the real-world impact of how an SFV rate design reduces customers' winter bills, levels bills over the course of the year and reduces the impact of cold winters and higher than normal gas use.

To illustrate the impact of the two rate designs, the charts below show the impact of certain variables (low PGA rates compared to high PGA rates, normal usage patterns compared to higher usage patterns to show impact of colder weather, monthly and annual customer bills, etc.) on customer bills under SFV and a volumetric rate design.[31]

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[29] Ex. 9, Feingold Sur., p. 9

[30] Id. at p. 4.

[31] To develop volumes, the Company has taken the total bills for certain customer classes, total usage, and total revenues to develop usage and revenue characteristics for each class and all of MGE's customers. For residential service, MGE has used the following figures: Total Bills: 5,231,729, Total Usage: 358,194,480 Ccf, Total Revenues: 130,760,163. To show the impact of the rate increase, MGE has chosen an estimated $18,000,000 increase in MGE's current rates. In doing so, MGE has chosen an SFV monthly customer charge of $27.47. For the volumetric

The following charts use volumetric and SFV rates for an $18M rate increase and a SFV monthly customer charge of $27.47. For the volumetric rate, the charts use a $15.11 fixed charge with a volumetric charge of $0.18054. The chart below shows the impact of changes in the PGA with the different rate designs for average residential natural gas usage (e.g. a normal winter).

		$18 million increase at highest PGA			$18 million increase at lowest PGA		
	Average Volumes (6)	SFV Rate Design	Volumetric Rate Design	Difference	SFV Rate Design	Volumetric Rate Design	Difference
July	16	$ 46.58	$ 37.18	$ 9.41	$ 36.34	$ 26.93	$ 9.41
August	14	$ 44.05	$ 34.25	$ 9.80	$ 35.16	$ 25.37	$ 9.80
September	17	$ 46.81	$ 37.43	$ 9.37	$ 36.44	$ 27.07	$ 9.37
October	19	$ 49.54	$ 40.59	$ 8.95	$ 37.71	$ 28.76	$ 8.95
November	54	$ 90.25	$ 87.59	$ 2.66	$ 56.60	$ 53.95	$ 2.66
December	129	$ 178.03	$ 188.95	$ (10.92)	$ 97.34	$ 108.26	$ (10.92)
January	157	$ 210.23	$ 226.12	$ (15.90)	$ 112.28	$ 128.18	$ (15.90)
February	156	$ 209.28	$ 225.03	$ (15.75)	$ 111.84	$ 127.59	$ (15.75)
March	113	$ 159.71	$ 167.80	$ (8.09)	$ 88.84	$ 96.92	$ (8.09)
April	68	$ 106.64	$ 106.52	$ 0.12	$ 64.21	$ 64.09	$ 0.12
May	36	$ 69.04	$ 63.11	$ 5.93	$ 46.76	$ 40.83	$ 5.93
June	19	$ 49.21	$ 40.21	$ 9.00	$ 37.56	$ 28.56	$ 9.00
Total	796	$ 1,259.37	$ 1,254.79	$ 4.58	$ 761.09	$ 756.51	$ 4.58

(6) Feingold Exh 7, Schedule RAF-7 - Page 1 of 11

PGA Rate		
highest in last 5 years	1.16771	Effective Nov. 1, 2005 Case No. GR-2005-0169
lowest in last 5 years	0.5419	Effective Apr. 17, 2009 Case No. GR-2009-0268

The above chart shows that in comparison to the volumetric rate design proposed by Public Counsel, the SFV rate design collects fewer revenues in winter

rate, MGE has used a $15.11 fixed charge with a volumetric charge of $0.18054. The detail on the source of this data, along with record cites, are detailed in Appendix A, which is attached hereto.

months when customer use is the highest. The chart also shows that pushing fixed costs to winter months under the volumetric rate design only increases customer bills when they are already paying more in gas costs. Finally, it shows that in a year with normal volumes, SFV levels customers' seasonal bills by eliminating the "multiplying effect" of a volumetric rate design.

The chart below is a comparison of monthly natural gas bills under the SFV and volumetric rate design with the effect of a colder than normal winter – by using a 105% of normal volumes.

		$18 million increase at highest PGA			$18 million increase at lowest PGA		
	5% Higher Volumes	SFV Rate Design	Volumetric Rate Design	Difference	SFV Rate Design	Volumetric Rate Design	Difference
July	17	$ 47.54	$ 38.28	$ 9.26	$ 36.78	$ 27.53	$ 9.26
August	15	$ 44.88	$ 35.21	$ 9.67	$ 35.55	$ 25.88	$ 9.67
September	17	$ 47.77	$ 38.55	$ 9.22	$ 36.89	$ 27.67	$ 9.22
October	20	$ 50.64	$ 41.86	$ 8.78	$ 38.22	$ 29.44	$ 8.78
November	56	$ 93.38	$ 91.21	$ 2.17	$ 58.06	$ 55.89	$ 2.17
December	135	$ 185.56	$ 197.64	$ (12.08)	$ 100.84	$ 112.92	$ (12.08)
January	164	$ 219.37	$ 236.67	$ (17.31)	$ 116.52	$ 133.83	$ (17.31)
February	163	$ 218.37	$ 235.53	$ (17.16)	$ 116.06	$ 133.22	$ (17.16)
March	119	$ 166.32	$ 175.43	$ (9.11)	$ 91.91	$ 101.02	$ (9.11)
April	71	$ 110.60	$ 111.09	$ (0.49)	$ 66.05	$ 66.54	$ (0.49)
May	37	$ 71.12	$ 65.51	$ 5.61	$ 47.73	$ 42.11	$ 5.61
June	20	$ 50.30	$ 41.47	$ 8.83	$ 38.06	$ 29.23	$ 8.83
Total	836	$ 1,305.86	$ 1,308.46	$ (2.61)	$ 782.67	$ 785.27	$ (2.61)

What the above chart shows is the multiplying effect that a volumetric rate design has on customer bills with a high PGA, high volumes, and cold weather. The chart also

shows that costs are significantly lower under the SFV rate design in the same situation. Customers are severely impacted by volumetric rate designs, with dramatically increased costs in winter months. This is the very issue that faced Missourians during the winter of 2000-2001 and caused then-Attorney General Nixon to recommend decoupled rate designs.[32] Under a cold winter scenario (even at only 5% increased consumption) customer's winter rates are dramatically increased under the volumetric rate design as compared to SFV, while SFV offers leveled bills over the year.

The situation that occurred in the winter of 2000/2001 and illustrations in the charts above both show that volumetric rate designs dramatically increase customer bills in the winter – a time when bills and gas costs are already the highest. While the Commission cannot change the weather, or the fact that most natural gas use will occur in the winter, it can affect the periods in which fixed costs are recovered. The Commission can choose to retain and expand a SFV rate design that spreads costs throughout the year and reduces winter bills. The Commission can choose to not return MGE's customers to a volumetric rate design that piles on costs in winter months when gas costs and gas use is the highest.

By stubbornly clinging to its untenable position that non-gas costs should be recovered based on volumes, Public Counsel has made a conscious policy choice to magnify the cost impact on customers in the winter. Public Counsel witness Meisenheimer testified that "with respect to a rate that's based on volumes, it allows the customers to pay costs more in line with when those – or what drives those costs. *For*

[32] As noted in MGE's Initial Brief, a study was directed by then Governor Holden due to the dramatic spikes in natural gas costs during an extremely cold winter. This "perfect storm" of factors – high gas costs, cold weather, and a volumetric rate design, caused then-Attorney General Nixon to recommend "allowing industry to recover fixed distribution costs on a monthly basis rather than through volumetric charges. The current system requires customers to pay a substantial portion of those costs during high heating bill months." (Ex. 11, Hack Reb., p. 3, Sch. RJH-1)

example, peak demand in the winter drives cost to the residential class. Residential customers are weather-sensitive, very weather-sensitive, and that has an impact on the total system that has to be designed."[33] It is difficult to imagine that customers who use natural gas for their heating needs would appreciate the fact that their bills are even higher in the winter because of Public Counsel's esoteric policy choices.

As the Commission well knows from the winter of 2000-2001, these concerns are not mere theory. Notably, at the time that this brief is being filed, winter temperatures in Kansas City are frigid, with a predicted high of 4 degrees and a predicted low of negative 9 degrees for Thursday, January 7th. Rate design has a real impact on real people who need smart energy policy choices from the Commission.

5. SFV Has Allowed The Company to Implement Effective Energy Efficiency Programs.

As MGE discussed more fully in its Initial Brief, the implementation of a decoupled SFV rate design has removed any economic disincentive that MGE had to create and promote energy efficiency programs. SFV breaks the link between revenues and the volumes of gas delivered. A natural gas utility should not be put in the position of working against its own economic interests if it does not have a rate design that squarely addresses the link between volumes of gas used and revenues. As the clear trend in other jurisdictions shows, decoupling is good energy policy because it aligns the interests of customers and LDCs.

[33] Tr. 601, emphasis added.

Again, MGE is mindful of the dissent's expressed concerns in MGE's 2006 rate of the need for "significant and comprehensive energy efficiency programs."[34] MGE has taken its responsibilities to implement these programs quite seriously and has endeavored to develop, in conjunction with the Energy Efficiency Collaborative, effective programs that offer real solutions to customers to reduce their natural gas use. These types of programs are simply not possible without a decoupled rate design.

Public Counsel is again notably silent in its Initial Brief regarding the effectiveness of MGE's energy efficiency programs, simply because these programs have been a success. These energy efficiency programs are growing with the assistance of the Energy Efficiency Collaborative and the Company hopes that they will be allowed to continue to grow. Issues related to the funding of these programs, as well as whether the programs should be continued, are addressed below.

With respect to its energy efficiency programs, the Company hopes that the Commission heard the enthusiasm and pride that testifying MGE employees have for the Company's energy efficiency programs. Under SFV, the Company is financially indifferent to the volumes of natural gas consumed. MGE employees are enthusiastic about these programs, simply because it is the right thing to do and consistent with good conservation policies that this country should be – and now is – focused on.

C. Public Counsel Asks This Commission to Ignore the Clear Trend Toward Decoupling In Missouri, Nationally and In Other Jurisdictions.

Public Counsel would have this Commission believe that energy policy in the United States is moving toward archaic volumetric rate designs that have no features to

[34] See Dissenting Opinion of Commissioners Robert M. Clayton III and Steve Gaw, Case No. GR-2006-0422, p. 3.

address the serious issues facing the natural gas industry and its customers. This mischaracterization cannot be dismissed as mere advocacy – as it represents a "head in the sand" approach to current energy policy that is breathtaking.

1. SFV Is a Form of Decoupled Rate Design that Is Sweeping the Country.

As Public Counsel notes, SFV is a "form of revenue decoupling" that "eliminates the linkage between the amount of gas consumed and the margin revenues recovered by the utility."[35] Public Counsel's argument that SFV is an "unpopular" form of rate design that it expects more state commissions to reject[36] should come as a surprise to Public Counsel's expert Lawton. In fact, Mr. Lawton acknowledged that the straight fixed variable rate design is "starting to sweep the country."[37] "I'm seeing it all over the country, called different things." Mr. Lawton went on to explain that this rate design is "really picking up – picking up steam in – among regulatory authorities around the country."[38] As Mr. Lawton noted, decoupled rate designs may have many names, including "SFV," but the trend is clear: the volumetric rate design that Public Counsel stubbornly clings to is on the decline and no longer represents sound energy policy.

2. Public Counsel Would Have This Commission Ignore the Mountain of Support for Decoupled Rate Designs Like SFV.

Despite the volumes of studies, reports, policy statements, and statutes that support decoupled rate designs including SFV, Public Counsel provided only selective

[35] Initial Brief of the Public Counsel, pp. 2-3, citing Ex. 69. p. 8
[36] Id. at p. 3.
[37] Tr. 358
[38] Id.

and therefore misleading policy quotations from two sources that only mention energy efficiency goals. Public Counsel has downplayed or failed to mention the strong support in those same sources for revenue decoupling concepts. By focusing on energy efficiency goals only, Public Counsel has abandoned the clear regulatory imperative that the interests of various stakeholders must be balanced.

For example, Public Counsel omitted a significant amount of text from its reference to the policy objectives of the American Recovery and Reinvestment Act of 2009 (H.R. 1)(ARRA), policy objectives that Governor Nixon endorsed in a letter to Chairman Clayton and confirmed to Secretary Chu of the Department of Energy.[39] Keeping in mind that Public Counsel omitted the bold text quoted below, the Act requested that to obtain federal energy program funding, Governors should certify that their state's regulatory agency implements a policy "**that insures a utility's financial incentives are aligned with helping their customers use energy more efficiently and that provide timely cost recovery and a timely earnings opportunity for utilities associated with cost-effective measurable and verifiable energy savings, in a way that enhances** *utility customers' incentives to use energy more efficiently.*"[40] By citing only the italicized text (the need for energy efficiency) and by omitting the bold text (the need to address the financial concerns of utilities), Public Counsel ignores (and would have this Commission ignore) the language containing a strong endorsement for a decoupled rate design like SFV. Failing to consider the impact on the Company,

[39] See discussion in MGE's Initial Brief, p. 13, citing Ex. 11, Hack Reb., p. 8, Sch. RJH-4 and RJH-5.
[40] Emphasis added, Public Counsel's Initial Brief at p. 9, citing Ex. 11, Sch. RJH-4

however, is simply not consistent with the interest-balancing approach that the Commission is required to follow.[41]

There are numerous other additional policy statements (discussed more fully in MGE's Initial Brief beginning on p. 10), that the Public Counsel failed to cite and would seemingly have this Commission ignore:

- Then-Attorney General Nixon's findings that there needed to be a long-term solution "allowing industry to recover fixed distribution costs on a monthly basis rather than through volumetric charges. The current system requires customers to pay a substantial portion of those costs during high heating bill months." (Ex. 11, Hack Reb., p. 3, Sch. RJH-1)

- This Commission's 2001 Natural Gas Commodity Price Task Force that called for the "redesign of base rates for fixed (non-commodity related) distribution charges placing more or all costs in a monthly service charge and less or none in the commodity charge." (Ex. 11, Hack Reb., p. 3, Sch. RJH-2).

- The Commission's 2001 Natural Gas Commodity Price Task Force that observed that an LDC "may have little incentive to facilitate programs designed to reduce energy use because in doing so the LDC may be reducing its revenue base." (Id.)

- The Commission's 2004 Cold Weather Rule and Long-Term Energy Affordability Task Force that had the recommendation that the Commission consider "rate designs that remove disincentives for utilities to pursue programs aimed at reducing usage." (Ex. 11, Hack Reb., p. 4, Sch. RJH-3).

- SB 179, which authorizes a rate adjustment clause to address weather variability.

- MDNR witness Buchanan's discussion of a resolution of the National Association of Regulatory Commissioners "strongly supporting the removal of disincentives for utilities to promote energy efficiency." (Ex. 88, Buchanan Reb., p. 15).

- The Energy Independence and Security Act of 2007, Section 532, which asks each state regulatory authority to consider "separating fixed cost

[41] See, e.g. Section 386.610, RSMo., which requires the Commission to seek "substantial justice between patrons and public utilities."

recovery from the volume of transportation or sales service provided to the customer." (Ex. 9, Feingold Sur., pp. 13-14). Section 532 also states that

- Each State regulatory authority and each nonregulated utility shall consider-
  - (i) separating fixed-cost revenue recovery from the volume of transportation or sales service provided to the customer;
  - (ii) providing to utilities incentives for the successful management of energy efficiency programs, such as allowing utilities to retain a portion of the cost-reducing benefits accruing from the programs;
  - (iii) promoting the impact on adoption of energy efficiency as 1 of the goals of retail rate design, recognizing that energy efficiency must be balanced with other objectives; and
  - (iv) adopting rate designs that encourage energy efficiency for each customer class.

Most, if not all, of these policy statements feature interest-balancing approaches to energy policy that this Commission should support. These statements are replete with the notions that volumetric rates do not benefit customers, that decoupled rate designs should be implemented, and that energy efficiency programs must be accompanied by incentives for utilities. As noted by the Commission in MGE's 2006 rate case, Public Counsel participated in various task forces that recommended decoupled rate designs with fixed costs in monthly services charges and little or no commodity charges but inexplicably abandons those positions today. (Report and Order, GR-2006-0422, p. 11). The Company acknowledges that energy efficiency programs are a critical component of today's energy policy considerations. The Company fully supports such programs, but only if the Company is financially indifferent to the volumes of natural gas used by its customers so that it is not financially harmed by such programs. This interest-balancing aligns multiple interests and is a policy choice that this Commission should continue to follow.

3. Public Counsel's Primer on SFV in Other States Is Incomplete and Misleading.

Beginning at pages 16-21 of its brief, Public Counsel purports to provide the Commission with a "sampling" of jurisdictions that have considered revenue decoupling rate design. That listing is woefully incomplete and in many instances, the descriptions of the cases are misleading.

Public Counsel appears to have limited its analysis to those decisions that it deems to have a SFV rate design (or rate designs similar to SFV), whereas revenue decoupling (of which SFV is only one type) can take many forms, have many different features, and can be called many different things. In the words of OPC's witness Lawton, he has seen SFV rate design "all over the country, called different things."[42]

Currently, twenty-three (23) states (including Missouri) have adopted the ratemaking concept of revenue decoupling, which is far more than the few cases cited by Public Counsel. A number of other states are considering its adoption. The list of these 23 jurisdictions is attached hereto as Appendix B. It is readily apparent, as Lawton observed, that decoupled rate designs (including SFV) are "starting to sweep the country."[43] As to the specific decisions from the several states it discusses in its brief, Public Counsel's regulatory "spin" is misleading at best.

Kansas: Public Counsel's most notable mischaracterization is the investigatory docket of the Kansas Corporation Commission. (In the Matter of a General Investigation Regarding Cost Recovery and Incentives For Energy Efficiency Programs, 2008 Kan. PUC LEXIS 1664, November 14, 2008, Final Order, pp. 24 -25). As an investigatory docket, the decision discusses many arguments – both pro and con – regarding rate

[42] Tr. 358.
[43] Id..

designs and how rate designs impact the Kansas Commission's desire for effective energy efficiency programs.

In the context of that investigatory docket and exploring the issues of a yet-untested rate design in Kansas, the Kansas Commission noted their questions (and questions raised by the various parties) on the impact of various rate designs (including SFV) and policy considerations which included risk allocation considerations, how energy efficiency programs would be implemented, and what impact the rate design would have (if any) on low-use or low-income customers. While Public Counsel's selective quotation would have the Commission believe that the Kansas Corporation Commission roundly rejected SFV, the opinion is notably supportive of SFV for gas utilities. In fact, the Kansas Commission specifically stated that it would entertain proposals for SFV rate structures:

- For purposes of this docket, the Commission has decided to focus on the throughput incentive in the context of energy efficiency. However, the Commission wishes to acknowledge that it will consider decoupling proposals from natural gas companies with concerns about revenue stability. Gas companies with such concerns are invited to make an application to the Commission, and the Commission will address each application on a case-by-case basis. (Id. pp. 25-26).

- Natural gas utilities may, as an alternative to decoupling, propose straight fixed-variable rate structures. The Commission will entertain such proposals from natural gas utilities because of the inherent differences in rate structure between natural gas and electric utilities. (Id. p. 32).

In response to this guidance from the Kansas Commission, Kansas Gas Service recently submitted an application for approval of a full revenue decoupling mechanism.[44]

[44] Application of Kansas Gas Service, dated December 18, 2009, in Docket No. 10-KGSG-421-TAR.

Arizona: The Arizona Corporation Commission did not adopt Southwest Gas Corporation's revenue decoupling proposal, but the reason it did not do so was because of its belief "that consideration of revenue decoupling through *the pending generic docket* is the appropriate method of addressing those issues." (emphasis added) (In the Matter of the Application of Southwest Gas Corporation... , 270 P.U.R. 4th 465, Az. C.C. 2008, December 24, 2008, p. 28). The Arizona Commission said the generic docket would allow stakeholders the opportunity to "bring forth a comprehensive array of options" that would encourage energy efficiency programs. (Id.) As such, the Southwest Gas decision, far from a rejection of SFV rate design, simply shows that the Arizona Corporation Commission resolved the matter as it did for purely procedural reasons.

Georgia: Public Counsel points to several features distinguishing the SFV rate design authorized for Atlanta Gas Light Company (AGL) and MGE, but the fact that particular aspects of SFV rate design vary from state to state or that company-specific costs may lead to differences in the calculation of the fixed charge do not invalidate the regulatory parallel offered by Company witness Feingold. Public Counsel's own witness recognized that SFV and other decoupled rate designs are not identical.[45] Public Counsel's comment that SFV has been a failure because AGL was twice ordered to have a rate reduction is of little import. MGE's earnings history under both SFV and the volumetric rate design should provide Public Counsel comfort that AGL's overearnings problem is unlikely to replicate itself for MGE. (See discussion on MGE's history of under-earning, *supra* and Ex. 30, Sch. MRN-1, Sch. G-4).

[45] Lawton, Tr. 358

Ohio: The Columbia Gas of Ohio decision cited by Mr. Feingold represents a transitional decision toward collecting the full fixed costs of utility operations after the utility's rates have been in effect for one year through a monthly fixed charge, and is not in any way a repudiation of decoupled rate designs. That a particular state's approach is not identical MGE's rate design certainly should not invalidate the approach here.

The Duke Energy Ohio case mentioned by Public Counsel (which proposed a "modified" SFV rate design) contains the following language which Public Counsel has chosen to omit:

> [A] rate design which separates or "decouples" a gas company's recovery of its cost of delivering the gas from the amount of gas customers actually consume is necessary to align the new market realities with important regulatory objectives. We believe it is in the interest of all customers that Duke has adequate and stable revenues to pay for the costs of its operations and capital and to ensure the continued provision of safe and reliable service. We further believe that there is a societal benefit to removing from rate design the current built-in incentive to increase gas sales. (In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Rates, 265 P.U.R.4th, 182 Oh.P.U.C. 2008, p. 13).

These observations strongly reinforce MGE's arguments in this and its prior rate case.

Oklahoma: In the West Texas Gas case mentioned by Public Counsel, the issue of rate design was settled. As such, it is hardly indicative of a policy pronouncement by the Oklahoma Corporation Commission. The decision in the Oklahoma Natural Gas case, on the other hand, fully validates Mr. Feingold's statement that SFV rate design has been authorized by the Oklahoma Commission.[46] That it has

[46] Tr. 394.

features that differ from that the SFV rate design administered by MGE does not undermine that testimony.

Federal Energy Regulatory Commission: Public Counsel's observation that FERC uses SFV rate design that has a demand component to it should be considered in proper context.[47] The term SFV, though used both to describe MGE's residential rate design and regulation at the federal level of interstate pipelines, means two quite different things. As such, fact that there may be a demand component in the rates transportation customers pay pipeline companies is an apples to oranges comparison and should be disregarded by the Commission.[48]

4. Public Counsel's Reference To Old Rate Design Arguments Have No Bearing On A Changed Energy Policy Environment.

In its discussion of rate design history in Missouri, Public Counsel's initial brief is like a trip in Mr. Peabody's Wayback Machine[49]. It takes one back to the Commission's decisions in the MGE's 1996 rate case[50], MGE's 1998 rate case[51] and MGE's 2004 rate case.[52] This regulatory fossil record of rate design decisions is useful largely as a curiosity until one examines the earnings produced by these rate design decisions.

As noted above, for the annual fiscal periods ending 6/30/96 through 12/31/06 (i.e., prior to the implementation of SFV for its residential customers), MGE's actual return fell short of its Commission-authorized return by 189 basis points, on average;

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[47] Public Counsel Brief p. 22.
[48] Tr. 50-54.
[49] For those not in the know, Mr. Peabody's Wayback Machine is "a reference to a segment from The Rocky and Bullwinkle Show in which Mr. Peabody and Sherman use a time machine called the 'WABAC machine' to witness, participate in, and more often than not alter famous events in history." See http://en.wikipedia.org/wiki/Wayback_Machine.
[50] Public Counsel Brief, p. 5.
[51] Public Counsel Brief p. 6.
[52] Public Counsel Brief p. 8.

translated into dollars, the earnings shortfall averaged $9.19 million per year. (Ex. 30, Sch. MRN-1; Sch. G-4)

For the annual fiscal periods ending 12/31/07 and 12/31/08 (i.e., after implementation of SFV for its residential customers), MGE's actual return fell short of its Commission-authorized return by 60 basis points, on average; translated into dollars, the earnings shortfall averaged $3.661 million dollars per year. (Id.)

In sum, based on two years of actual experience, SFV appears to have improved MGE's earnings performance (when comparing actual to Commission-authorized earnings levels) by approximately 129 basis points or $5.529 per year.

Public Counsel would have the Commission ignore the impact of its rate design decisions on the Company but the interest balancing obligations that the Commission has simply does not permit the Commission to do so. (See, e.g. Section 386.610, RSMo., which requires the Commission to seek "substantial justice between patrons and public utilities.") Further, in *In the Matter of the Application of Kansas City Power & Light Company*, Case No. ER-2006-0314, 2006 Mo. PSC LEXIS 1734 (December 21, 2006), the Commission found a constitutional requirement that "in determining whether rates are just and reasonable, the Commission must balance the interests of the investor and the consumer." *Kansas City Power & Light Company* citing *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1943) and *Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia*, 262 U.S. 679. 690 (1923) ("Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and

confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.").

In addition to these real earnings considerations, Public Counsel's "once upon a time" approach to the issue glosses over the important facts and energy policies that matter in the present. Energy policy has changed with the considerations that exist today. Likewise, the Commission's rate making approach for MGE changed starting with the Commission's decision in MGE's 2006 rate case.

5. Public Counsel's Focus on the Atmos Decision Is Misplaced.

Public Counsel spends an inordinate amount of time on the Atmos[53] decision, while it banishes the appellate history of MGE's last rate case (in which the SFV rate design was upheld) to mere footnotes.[54] In doing so, Public Counsel would have the Commission believe that a case with different facts, different evidence, and a different company somehow has relevance to the Commission's decision in this case. The Atmos decision is not a rejection of the SFV rate design. That decision was solely based the appellate court's analysis of the sufficiency of the evidence in Atmos' rate case. In reviewing the Commission's decision, the Western District reviewed the Commission's findings to determine if 1) the order was lawful and 2) whether the order was reasonable and based on competent and substantial evidence. (See Public Counsel v. Public Service Commission, 289 S.W. 3d 240, 246, (Mo. App. W.D. 2008). In doing so, appellate courts look for "substantial evidence" (Id. at 247) and only set aside an order if it is "clearly contrary to the overwhelming weight of the evidence." (Id.)

[53] Public Counsel v. Public Service Commission, 289 S.W. 3d 240 (Mo. App. 2009).
[54] Mention of the appeal of MGE's case, 293 S.W. 3d 63 (Mo. App. S.D. 2009), can be found tucked away in footnotes 1 and 27 of Public Counsel's Initial Brief.

The Atmos decision is not, as Public Counsel would wish the Commission to believe, a general policy pronouncement from the Western District about rate design or energy policy. In fact, what Public Counsel fails to mention in its discussion of the Atmos decision is this footnote by the Western District: "***our holding should not be interpreted to discourage the Commissions' adoption of alternative rate designs, including an SFV rate design, when supported by competent and substantial evidence.***" (Id. at p. 251, FN 5, emphasis added).

The Atmos decision reflects an appellate court's opinion on the sufficiency of the evidence in that case. The fact that an appellate court overturned another company's rate case simply has no relevance to MGE's current rate case.[55]

Notably absent from Public Counsel's initial brief is any analysis of the appellate history of MGE's last rate case, in which the Southern District upheld the Commission's order, including the section of the order related to MGE's residential SFV rate design.[56] MGE would not make the same broad and inaccurate inferences as Public Counsel – that an appellate court has made a pronouncement on the merits of a particular rate design, but simply that an appellate court found that competent and substantial evidence existed for the implementation of the residential SFV rate design in MGE's last rate case. The decision speaks for itself.

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[55] Public Counsel twice makes the false claim that MGE submitted argument in the Atmos decision. On pp. 11 and 12 of its Initial Brief, Public Counsel states "In the prior Atmos Energy Corporation Rate Case, MGE and Staff argued that the shift to low volume users is cost justified..." and that "MGE and Staff alleged this subsidization occurs because...", both with cites to the Atmos decision. (See pp 11-12 of Public Counsel's Initial Brief and FN 12.). MGE would give Public Counsel the benefit of the doubt that the two references to MGE's involvement in the Atmos case and the same two references to MGE's purported arguments in that case were two separate typographical errors (replacing "Atmos" with "MGE"). MGE wishes the Commission to note, however, that it did not submit such arguments in the Atmos rate case, so Public Counsel's references to MGE's involvement in that case should not be considered.

[56] See 293 S.W. 3d 63 (Mo. App. S.D. 2009).

D. Measures of Demand in Class Cost of Service Studies are Only Relevant to Inter-Class Cost Allocations.

The central thesis of Public Counsel's continued advocacy[57] of a failed volumetric-based rate design is its assertion that "this methodology recognizes that margin costs are usage sensitive."[58] This is a misguided effort to cobble together a cost justification where none actually exists. The cost to serve the customers in the residential class, given the relatively small volumes used in that class (even "low" or "high" users fall within a relatively narrow range) simply do not cause the Company's costs to vary.[59] MGE's costs to serve residential customers are driven by factors other than customer usage, including customer density in the service area, age of the equipment, terrain, and distance from the transmission pipeline. (Ex. 43, p. 10) As Staff witness Ross notes, the vast portion of MGE's costs are fixed, in that they include the cost to serve every customer (employees, office space, billing systems, pipeline systems, etc.). (Ex. 63, Ross Reb. p. 3). The fact that the costs to serve residential customers is the same – regardless of volumes used – is effectively explained in Staff's Initial Brief and will not be repeated in detail here.

The apparent basis for Public Counsel's argument is MGE's class cost of service (CCOS) study and the manner in which demand costs were addressed by MGE witness F. Jay Cummings, Ph.D.[60] Public Counsel's discussion of demand costs in support of

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[57] Public Counsel's advocacy of a volumetric-based rate design in this and the previous MGE rate case is less than credible in light of Public Counsel's support in two Commission-sponsored gas utility workshops that, variously, recommended that there be a "redesign of base rates for fixed (non-commodity related) distribution charges placing more or all costs in a monthly service charge and less or none in the commodity charge" and that the Commission consider implementing "rate designs that remove disincentives for utilities to pursue programs aimed at reducing usage." As noted in footnote 11 of MGE's Initial Brief, the Commission specifically recognized that Public Counsel was speaking out of both sides of its mouth at page 11 of its March 27, 2007, Report and Order in Case No. GR-2006-0422.

[58] Public Counsel Brief, p. 2.

[59] Ex. 8, Feingold Reb. p. 7).

[60] Public Counsel Brief, p. 11.

its rate design recommendation is misplaced. As Staff accurately points out in its Initial Brief at pages 32 and 33, while a measure of demand is used to allocate some of MGE's costs *between* classes, it is incorrect to utilize that notion to support a claim that there are intra-class subsidies based on usage. To the contrary, the whole purpose of a CCOS study is to create classes of customers having similar size and usage patterns.

The fundamental flaw is that Public Counsel is trying to disguise demand costs as costs that vary with customer usage[61] combining demand costs with commodity (or volumetric) costs and a substantial portion of customer costs to cost-justify its volumetric-based rate design. Demand costs, however, "depend on the maximum delivery requirements of the gas system"[62], or loads on the system peak day[63]. Public Counsel witness Meisenheimer argues, for example, that measuring equipment located at the entry point to MGE's gas distribution system are sized based on the flow of gas and, consequently, should not be considered a fixed cost. This notion (i.e., that designing a piece of equipment so that it will accommodate maximum flow required to serve customers shows that it is a usage-sensitive cost) is a misapplication of the concept of fixed costs. Fixed costs do not vary with the volume once the cost is incurred.[64] The *only costs* that that vary with the volume of gas used are commodity (or volumetric) costs.[65] In the Company's CCOS study, only 0.05% of the residential cost

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[61] *Id.*
[62] Ex. 3, Cummings Dir., p, 5, ll. 19-20.
[63] *Id.*, p. 29, ll. 12-13.
[64] Ex. 8, Feingold, Reb. p. 6, ll. 9-21.
[65] Public Counsel's effort to treat demand costs interchangeably with commodity costs plagues not only its initial brief's support for its residential rate design but also its CCOS study. That study appropriately classifies a portion of distribution mains as customer costs, but then inappropriately classifies the remaining portion as a mixture of volumetric and demand costs. (Ex. 72, Meisenheimer Dir., p. 25, ll. 15-16). The non-customer component of the mains investment relates to the sizing of mains to meet peak day delivery requirements; it has nothing to do with gas volumes used throughout the year (Ex. 5, Cummings Sur., p. 13, ll. 16-19).

of service consists of commodity costs.[66] The remaining 99.95% of residential costs are fixed costs that do not vary with customer usage (i.e., customer costs and demand costs).[67]

The simple truth is that a cost-based rate design recovers fixed costs through fixed charges and commodity costs (i.e., those that vary as a result of volumetric throughput) through volumetric charges. Shifting from the current SFV residential rate design to Public Counsel's preferred volumetric-based rate design would dramatically move MGE's rates *away* from any cost basis.

Based on this evidence, the fact that MGE's fixed costs will not vary with residential customer use and demand is illustrated by a common sense example. If a residential customer replaced an electric furnace with a natural gas furnace, MGE would not have to dig up service lines and replace them with larger sized lines to carry this additional load. Similarly, if a customer replaced all of their electric appliances with natural gas appliances, perhaps adding demand above the impact of a natural gas fireplace that the customer used previously, MGE would not have to install a new meter, hire more service personnel, call center personnel, build new buildings, or buy new equipment to support that customer. The costs to serve the customer are the same regardless of usage. Even with the increased demand, because of the relatively narrow annual volume range within the residential class, the Company's existing distribution facilities can accommodate such increases in demand.[68] The customer, on the other

[66] Ex. 3, Cummings Sch. FJC-1, line 3, column (c) divided by line 4, column (c), or $91,000 divided by $166,742,683.
[67] The distinction between commodity costs and demand costs is clearly articulated in NARUC's *Gas Distribution Rate Design Manual* (June 1989). "Energy or commodity costs increase or decrease as more or less gas is consumed." (p. 23) "Demand or capacity costs vary with the quantity or size of plant and equipment. They are related to maximum system requirements which the system is designed to service during short intervals and do not vary with the number of customers or their annual usage." (pp. 23-24)
[68] Ex. 8, Feingold Reb. p. 7, Ex. 9 Feingold Surreb. pp. 5-6.

hand, would still receive significant price signals because the customer would pay for the amount of gas that he or she used. Accordingly, Public Counsel's insistence that demand costs should be considered for this group of customers simply does make any sort of cost causation sense.

E. Public Counsel's Focus on Low-Use Customers Is Unwarranted.

Public Counsel's sole focus on customers with minimal gas use in this case is simply unwarranted. As the evidence in this case shows, low users pay a fixed monthly delivery charge to account for the fixed cost to serve them, just like high use customers. Like any customer, they pay for the amount of gas that they use, which provides proper signals on their gas use. As is discussed below, however, "low use" residential customers are not likely to use natural gas for heat and consist of a very small percentage of MGE's residential customer class.

The usage characteristics of MGE's residential customers are seen in the following chart, which is a residential billing frequency analysis of customers and usage for 2008.[69]

[69] Ex. 120.

Case: GR-2009-0355
DR 0326
Residential Frequency

Year ending 2008 usage	Customers	% of customers	Usage	% of Usage		
0-50	1,711	0%	27,990	0%		
51-100	1,175	0%	91,058	0%		
101-200	4,108	1%	634,973	0%		
201-300	7,101	2%	1,808,066	1%		
301-400	12,077	3%	4,283,460	1%		
401-500	19,517	5%	8,868,154	3%		
501-600	29,802	8%	16,497,133	5%	percent customers	80%
601-700	39,889	11%	26,024,102	8%		
701-800	46,133	13%	34,644,941	10%	percent usage	74%
801-900	45,131	12%	38,356,002	12%		
901-1000	39,512	11%	37,501,664	11%		
1001-1100	31,184	8%	32,707,085	10%		
1101-1200	23,974	7%	27,527,145	8%		
1201-1300	17,788	5%	22,195,803	7%		
1301-1400	12,820	3%	17,278,167	5%		
1401-1500	9,381	3%	13,582,769	4%		
1501-1600	6,826	2%	10,562,546	3%		
1601-1700	4,818	1%	7,936,883	2%		
1701-1800	3,548	1%	6,202,813	2%		
1801-1900	2,540	1%	4,693,234	1%		
1901-2000	1,800	0%	3,506,708	1%		
2001-3000	5,727	2%	13,290,069	4%		
3001-4000	731	0%	2,468,865	1%		
4001-5000	176	0%	771,042	0%		
Above 5000	127	0%	837,023	0%		
	367,596		332,297,695			

The first column shows customer usage in primarily 100 Ccf increments, but because only 2% of customers use more than 2001 Ccf of natural gas per year, these increments increase to 1,000 Ccf after that point. The chart also shows the numbers and percent of customers in each usage range, the volumes those customers used, and the percent of usage.[70]

The average customer uses 824 Ccf per year and therefore falls within the range of 801 to 900 Ccf a year in the chart.[71] As the chart shows, the great majority of MGE's

[70] Noack Tr. 1161.
[71] Noack Tr. 1164

residential customers fall within a relatively narrow band of use between 401 and 1300 Ccf per year (highlighted in the shaded area).[72]

Those customers who use between 0 to 400 Ccf per year are unlikely to be heating customers, given the small amount of gas that they use throughout the year.[73] Accordingly, their gas use (and gas costs) would be very low. Low use customers who do not use natural gas for heat comprise approximately 6% of MGE's residential customers.

Those customers who use between 401 and 800 Ccf per year are still below-average users of natural gas, but given the slightly increased use, are likely to use natural gas for heating.[74] These customers comprise 26% of MGE's residential customers.[75] Given the low volumes of gas used in this narrow range of (between 33 and 66 Ccf per month), even the slight increase that these customers pay under SFV as compared to the volumetric rate design is minor. Again, it is important to note that with the SFV rate design, these customers are only paying their fair share of costs for access to the system.

Ultimately, the fact that some of the customers within the residential class are financially better off (and some are slightly worse off) under *any* particular rate design is an inherent and unavoidable feature of averaged rates. Were the Commission to revert to a volumetric-based rate design, heating customers will be unhappy about the result, particularly in the winter when usage and commodity prices are highest. It is simply not possible to construct and administer 440,000 individualized rates based on each

[72] Noack Tr. 1162.
[73] Noack Tr. 1164
[74] Id.
[75] Id.

customer's specific cost of service, especially when each customer's fixed costs are the same. *Somebody* is always going to want *something* different, but that, by itself, is no basis for making policy. In fact, the SFV rate design simply does not have the detrimental impact on the majority of MGE's customers that Public Counsel would have the Commission believe.

F. SFV Rates Do Not Penalize Low-Income Customers.

Public Counsel's argument that SFV rates penalize MGE's low-income customers is also contradicted by the record.[76] In the Company's Initial Brief, at pages 20 and 21, MGE explained that a study by Philip Thompson, Ph.D., concluded that a volumetric-based rate structure would likely have a negative impact on low-income customers because low-income customers in MGE's service territory consume higher than average volumes. This testimony was confirmed by the real world experience of Pamela Levetzow, MGE's Director of Customer and Government Relations, who testified that the Company's LIHEAP customers were particularly adversely impacted by the spike in gas prices in the winter of 2000 to 2001 when MGE's volumetric-based rate design was collecting a high percentage of non-gas distribution costs *in addition to* fuel costs.[77] In the context of her responsibilities for MGE and based on her personal experience, she has recognized that low-income customers of MGE tend to have high fuel usage characteristics.[78] This conclusion is also supported by Public Counsel's own studies, which find that LIHEAP customers - those low income customers who qualify

[76] Public Counsel Brief, p. 13.
[77] Tr. 1130.
[78] Tr. 1128.

for energy assistance – are not low-volume users.[79] As noted by Mr. Noack, extremely low volume users are unlikely to use natural gas for heating. (Tr. 1164)

In the end, Public Counsel's desperate attempt to discredit Dr. Thompson's MGE territory-specific study is itself revealing. Dr. Thompson's data supports the conclusion that a volumetric-based rate design in MGE's service territory detrimentally affects low income customers, undermines Public Counsel's assumption that low-income customers are low use customers of MGE.[80] Dr. Thompson's study is the most reliable information in the record because it quantifies the natural gas usage/income relationship within MGE's service area, the only service area relevant to the Commission's decision in this case. It is therefore the most accurate, as it does not rely on regional and national data of which Missouri data is only a small component.

Public Counsel spends much time at pages 14 and 15 of its brief trying to undermine Dr. Thompson's study and findings. Those challenges are unconvincing and misguided. Public Counsel claims that Dr. Thompson's study suffers from too much data aggregation, which is supremely ironic given that the Energy Information Administration (EIA) data cited by Public Counsel witness Barbara Meisenheimer relies on data aggregated over several states (in contrast to Dr. Thompson's study which addresses the usage in MGE's service territory only). The EIA study fails to account for variations across cities and states in terms of housing ages. Consequently, it cannot

[79] Ex. 74 Meisenheimer Sur. P. 4.

[80] That this assumption is incorrect was exquisitely illustrated by Customer No. 12 of MGE witness Noack's Exhibit 119 whose concern was that the fixed monthly charge made it expensive for him to use his decorative gas fireplace. Here is the hardship story:
"My bill is out of sight. My home is all electric except the pilot light on my gas fireplace. I think it's ridiculous that I am paying 30 to $35 a month for this service. MGE says I must pay a minimum, but that's a little extreme. So no, you shouldn't raise our rates."
(Noack Tr. 1165) This, apparently, is the subclass of residential customers Public Counsel has chosen to champion in this case over the interests of low-income customers who use much more fuel on an annual basis for water and space heating.

properly account for the effect of different housing ages or consumption levels in MGE's service territory. Even more troubling is that Ms. Meisenheimer never mentions the impact on fuel use by those living in older housing (which lower income customers predominately occupy). Ignoring housing age in such an analysis simply defies common sense.

Public Counsel's suggestion that the EIA numbers contradict Dr. Thompson's study is wishful thinking on Public Counsel's part. It is entirely possible for MGE's service territory to have Dr. Thompson's U-shaped income/usage relationship[81] while the overall north central region (of which MGE's service territory is but a very small piece), does not.[82] If anything, this shows that nationwide aggregations of data mask local usage characteristics.

Public Counsel also has the curious critique that Dr. Thompson "has not testified on his low-income usage theory before any other state commission." (Tr. 624). Since Dr. Thompson conducted a study confined to MGE's service territory, it is unsurprising that he has not testified elsewhere. Dr. Thompson's study is unique to MGE and MGE's customers. It shows that in MGE's service territory, low income customers tend to use more natural gas than the average MGE customer and are therefore adversely impacted by the volumetric rate design proposed by Public Counsel.

Finally, Public Counsel's claim at page 14 of its Initial Brief that lower income customers "cannot afford to consume more than average amounts of gas" is unhelpful

[81] Dr. Thompson described this relationship as follows: "People at the lowest income levels use above average amounts of gas, people at the highest income levels -- and again, I'm referring to income -- I'm referring to the zip codes in my study when I say "people." I'm saying these -- the average incomes and usages of these zip codes. So -- so zip codes that have the lowest income levels have above-average usage, zip codes with the highest usage levels per household have above-average usage and zip codes that fall in the middle have below-average usage, and that's what derives the U-shape, is the appearance of those ideas on a graph." Tr. 642-643.
[82] Thompson, Tr. 643-644.

to the point of being bizarre. There is no evidence in this record of what may or may not be "affordable." In any event, Public Counsel's own evidence undermines this claim. It shows that total energy expenditures per household are never more than 15 percent of income and are generally less than 10 percent for income levels up to $30,000.00.[83] Moreover, this figure includes electricity usage. Consequently, natural gas would be even a smaller proportion of income.

G. There Is No Meaningful Customer Opposition to SFV Rates.

Another striking feature of Public Counsel's case is its claim that MGE's customers oppose SFV rate design.[84] Like the rest of Public Counsel's opposition to SFV rate design, this particular story line is also unsupported by the facts.[85]

As noted in MGE's Initial Brief, only 11 customers addressed the topic of rate design at the local public hearings, several of whom have been shown by the Company to actually be *better off* under SFV rates.[86] Contrary to her characterization of the evidence, Staff witness Gay Fred's tabulation of complaints filed with the Commission clearly shows that the level of complaints *decreased* after SFV rates went into effect.[87] MGE witness Pam Levetzow testified that her experience of personally handling customer communications since mid-2007 when SFV rates went into effect did not reveal any particular unhappiness with the current rate design.[88] And finally, the only

[83] Ex. 74, Meisenheimer Sur., Sch. 5, p. 2 of 6.
[84] Public Counsel brief, p. 15.
[85] Public Counsel brief, p. 15.
[86] MGE brief at 16-17.
[87] MGE brief at 17; Ex. 103.
[88] Tr. 1123-1124.

comprehensive analysis of the much discussed comment cards[89] show that only approximately 10 percent of them (a mere 0.3 percent of MGE's total residential customer class) mentioned MGE's rate structure[90] and, of those approximately 1,200 cards, approximately 24 percent were actually *better off* in that they realized year round savings under SFV rates, but apparently do not perceive it that way. A striking 76 percent of them are better off if one considers only wintertime savings.[91] Staff witness Ross, the only other witness who undertook a systematic review of the cards,[92] also came to the conclusion that MGE's customers did not have a significant negative reaction to the SFV rate design. (Tr. 652). Unlike the Company, Ross did not review and categorize every comment card, but her analysis showed that very few of the customers who submitted comment cards were opposed to the SFV rate design. (Tr. 660) Specifically, of the 114 comment cards that she pulled, only 18 were opposed to the rate design. (Tr. 660)

The claim or suggestion that SFV rates have been a significant source of customer unhappiness since mid-2007 is simply not borne out by the facts. The fact that

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[89] Never has so much been made of something of so little practical value. The 12,000+ returned comment cards are not a random sample so it is not representative of MGE's customer class. (Levetzow, Tr. 1111-1113) Nor do they represent a meaningful survey of any particular topic or matter. *Id.* As such, they are of no real value in measuring customer sentiment. The actual feedback is, as one would expect, all over the place. (Levetzow, Tr. 1121-1123) Public Counsel, the party that requested that the cards be sent along with the customer notice apparently could not be troubled to read them all or to perform an assessment of them. That unenviable, Herculean task was left to the Company and, presumably, the various commissioners who have been urged to read them. *See*, Public Counsel Brief p. 15.

[90] This figure almost certainly overstates the number because MGE's screening criteria were very broad.

[91] Noack, Tr. 1159; Ex. 119. The Commission admitted the comment cards into the record of this case over the objections of MGE as Exhibit 106. By providing rebuttal testimony concerning the cards at the hearing on December 23rd and by reference in this brief does not constitute a waiver of MGE's evidentiary objections. MGE restates, ratifies and confirms its objections to the admission of comment cards, that is, they are not competent evidence under the standards of the Missouri Constitution, the Missouri Administrative Procedure Act or under the Commission's rules of evidence.

[92] Staff witness Fred did not conduct a detailed review or survey of the comment cards because "she wasn't asked to." (Tr. 801-802) Public Counsel witness Meisenheimer similarly did not conduct a detailed review or analysis of the cards. While both Fred and Meisenheimer read a number of cards, when reading the testimony of both witnesses, it is apparent that they were giving subjective impressions without detailed analysis. Their testimony is directly contradicted by the analysis conducted by the Company and Staff witness Ross. Ms. Meisenheimer's testimony was particularly not compelling, as she had very little understanding of how (or if) Public Counsel even tracked customer complaints or how they were measured. (Tr. 537-543)

a mere fraction of a percent of MGE's total customer class may have voiced some level of concern regarding the fixed monthly delivery charge proposed by MGE in no way justifies reinstituting intraclass cross-subsidies that have space and water heating customers paying more than their actual cost of service for the benefit of those who use natural gas in limited, non-essential ways.

It is unsurprising that there is very little public opposition to the SFV rate design because of its positive impact on customers when they need it the most – the winter. As was shown above, those customers who use under 400 Ccf per year are unlikely to use natural gas for heat. There is a relatively narrow band (those who use 400 to 800 Ccf per year, under the average user of 824 Ccf per year) who will have slightly higher monthly winter bills under SFV. Ultimately, average use customers see that 70% of their bill is comprised of gas costs, so they know that they can directly impact their use through conservation, including those programs the Company is able to offer under a decoupled rate design like SFV. (see detailed discussion and citation *supra*)

Ultimately, the Commission has to ask itself whether it is appropriate to discard MGE's residential rate design because of the impact that it has on 6% of MGE's residential customers who are unlikely to use natural gas for heat and who use less than 400 Ccf a month. Like Customer No. 12 of MGE witness Noack's Exhibit 119, the customers with the most to gain by returning to a volumetric rate design would be those who do not use natural gas for heating, have few natural gas appliances, and use very low volumes of natural gas. This was well illustrated by Customer No. 12, whose main concern was that the fixed monthly charge made it expensive for him to use his

decorative gas fireplace, which was his only natural gas appliance. Customer No. 12 submitted a comment card with the following statement:

> "My bill is out of sight. My home is all electric except the pilot light on my gas fireplace. I think it's ridiculous that I am paying 30 to $35 a month for this service. MGE says I must pay a minimum, but that's a little extreme. So no, you shouldn't raise our rates." (Noack Tr. 1165)

This, apparently, is the subclass of residential customers Public Counsel has chosen to champion in this case over the interests of low-income customers who use much more fuel on an annual basis for water and space heating. Under a volumetric rate design, this subset of customers would pay less than it costs the Company to serve them. Accordingly, these low-use and non-essential use customers would benefit under a volumetric rate design. Ultimately, is the goal of rate design to focus on those customers with decorative fireplaces, or those customers who need it the most, the vast majority of MGE customers who use natural gas for heating?

H. SFV Rates Do Not Discourage Energy Efficiency Programs and Energy Conservation.

Public Counsel's argument at page 7 of its Initial Brief that SFV rates discourage energy efficiency programs and conservation are simply and plainly wrong. An analysis of Public Counsel's arguments on this issue is illustrative. Public Counsel argues that because consumers cannot reduce their *fixed costs* (the monthly charge) through energy efficiency measures, that the SFV rate structure does not provide a proper pricing signal. (Id.) In doing so, Public Counsel ignores the fact that an average residential customer can still influence 70% of his or her monthly bill (the gas cost) under SFV.

The non-gas cost of service for a typical residential MGE customer represents only approximately 30 percent of the customer's bill. The remaining 70 percent is associated with the commodity costs flowed through to the customer through the Company's PGA.[93] Consequently, the vast majority of an MGE customer's bill is one over which the customer can exert meaningful control through energy efficiency and conservation practices. Where this topic is concerned, it is important to point out that Public Counsel's claim is at odds with the conclusions of the Commission's energy task force reports of 2001 and 2004 of which Public Counsel was a participant and contributor. The vast majority (80 percent) of MGE's residential customers use approximately 70 percent of the fuel consumed by that class. As such, they stand to benefit significantly from energy efficiency and gas conservation practices.[94]

Public Counsel's argument is also at odds with the testimony of MDNR's witness in this case. Despite the fact that MDNR has sought to profess neutrality at page 2 of its initial brief by claiming that it "does not take a position on the rate design aspects of this case", MDNR witness John Buchanan acknowledged that the elimination of SFV rates would remove any incentive the Company has "to offer residential energy efficiency initiatives following the conclusion of the pending rate case."[95] More importantly, he testified that: "the use of the SFV rate design that includes a commitment to fund energy efficiency programs by MGE as a condition of a favorable rate design creates the initiative for the company to offer energy efficiency programs."[96] Contrary to the position MDNR has taken in its brief, this sworn testimony by MDNR's

[93] Ex. 11, Hack Reb., p. 2
[94] Noack Tr. 1168; Ex. 120.
[95] Exhibit 88, p15.
[96] Id.

witness expressly supports SFV rates for MGE. There can be no other plausible interpretation of Mr. Buchanan's testimony.

I. Concluding Observations about Revenue Decoupling Rate Design.

The consequence of ignoring a history of consistent historical earnings shortfalls by MGE under a volumetric-based rate design should be considered by the Commission when deciding whether eliminate the SFV rate design as Public Counsel urges it to do. This will once again place MGE in the position of being unable to respond to declining and unpredictable usage due to the uncontrollable impact of weather. MGE will be obligated to look to costs it can control such as its staffing levels which could have an adverse impact on service quality. It is difficult to justify hiring people when faced with substantial revenue shortfalls. In Mr. Hack's testimony, he stated that when a company experiences a $16,000,000 revenue shortfall, as was the case for MGE under volumetric rates in 2006 is "catastrophic" when trying to "run a business, make hiring decisions, [and] invest in facilities necessary to provide service to customers."[97] This just points to the fact that MGE's ability to actually earn a reasonable return on plant dedicated to public service is beneficial to both the consuming and investing public.

[97] Hack, Tr. 79.

II. Energy Efficiency Programs

A. The Commission Has No Statutory Authority to Mandate Energy Efficiency Programs.

Public Counsel flippantly suggests that the Commission should require that the Company administer its energy efficiency programs regardless of the rate design chosen,[98] but the Commission has no statutory authority under the Public Service Commission Act to impose such a requirement on a gas corporation such as MGE. That the Commission lacks the statutory authority to order gas corporations to undertake energy efficiency measures can be readily discerned by examining the Public Service Commission Act. The only specific authority granted by statute to the Commission on the topic of energy efficiency – section 393.1075 RSMo. – applies only to electrical corporations. And while MDNR has at least attempted to conjure up statutory authority for the Commission to order gas corporations to undertake energy efficiency initiatives, plain reading of the section cited by MDNR, 393.130.1 RSMo., does not confer the authority MDNR suggests.

To order the Company to resurrect a volumetric-based rate design and simultaneously require it to continue to offer energy efficiency programs is unreasonable, unlawful and unfair. Any such mandate would constitute an unconstitutional taking of property in violation of the United States and Missouri Constitutions in that MGE would incur costs associated with administering the programs and, also, would be denied the margin revenues that it would be entitled to but for the availability of the programs.

[98] OPC Brief, p. 32.

Also, the types of non-core services that are offered by a utility are relegated exclusively to its informed discretion.[99] The Commission has no power to compel the continuation of these programs because the Commission does not have the statutory authority to become involved in the day-to-day management of the utility's business, particularly when it does not address the offering of a fundamental public service.[100] There is ample legal authority for the proposition that the Commission has no authority to manage the utilities it regulates.

The Commission's authority to regulate certain aspects of a public utility's operations and practices does not include the right to dictate the manner in which the company conducts its business. *State ex rel. City of St. Joseph v. Public Service Commission*, 30 S.W.2d 8 (Mo. banc 1930). The *City of St. Joseph* case involved an appeal by the City of St. Joseph, Missouri, of an order of the Commission affixing the value of property of St. Joseph Water Company for ratemaking purposes and approving a schedule of rates. In rejecting the applicant's contention that the Commission should not have authorized an administrative charge imposed on the operating company by its parent company, the Missouri Supreme Court stated the following:

> The holding company's ownership of the property includes the right to control and manage it, subject, of course, to state regulation through the Public Service Commission, but it must be kept in mind that the Commission's authority to regulate does not include the right to dictate the manner in which the company should conduct its business. The company has the lawful right to manage its own affairs and to conduct its business in any way it may choose, provided that in doing so, it does not injuriously affect the public. The customers of a public utility have the right to demand efficient service at a reasonable rate, but they have no right to

[99] The fact that energy efficiency programs are non-essential offerings is proven by the simple fact that no such programs were offered by MGE until as recently as 2007.

[100] This includes a service that would be regulated by the Commission if it were to be offered. In *Re Southwestern Bell Tel. Co*, 2 Mo.P.S.C. 3d 125 (1993), the Commission recognized it was Southwestern Bell Telephone Company's decision whether to include Caller ID in three service offerings it had proposed. The Commission found it was a business decision of Southwestern Bell and declined to require Caller ID service.

> dictate the methods which the company must employ in that rendition of that service. It is of no concern of either the customers of the water company or the Commission, if the water company obtains necessary material, labor, supplies, etc., from the holding company so long as the quality and price of the service rendered by the water company or what the law says it should be.

Id. at 14.

In short, the Commission's powers are "purely regulatory in nature." *State ex rel. Harline v. Public Service Commission*, 343 S.W.2d 177, 181 (Mo.App. W.D. 1960). The Commission does not have the "authority to take over the general management of any utility." *State ex rel. Laclede Gas Company v. Public Service Commission,* 600 S.W.2d 222, 228 (1980). The *Harline* court was emphatic concerning this principle.

> The utility's ownership of its business and property includes the right to control and management, subject, necessarily to state regulation through the Public Service Commission. The powers of regulation delegated to the Commission are comprehensive and extend to every conceivable source of corporate malfeasance. Those powers do not, however, clothe the Commission with the general power of management incident to ownership. The utility retains the lawful right to manage its affairs and conduct its business as it may choose, as long as it performs its legal duty, complies with lawful regulation and does no harm to the public welfare.

Id. It is clear that the Commission may regulate a public utility's operations as the law expressly permits but it may not substitute its business judgment for that of the company's management so long as safe and adequate service is being provided.

B. The Funding of The Energy Efficiency Programs Can Be Structured In a Manner to Satisfy the Legitimate Concerns of the Various Parties.

Finally, the level of funding for the Company's energy efficiency programs has been an issue. Public Counsel addresses a number of concerns at pages 34 through 36 of its Initial Brief.

As to the "Funding Source" issue,[101] MGE has proposed the following:

→The Company will initially fund an annual amount of $1 million per year for its energy efficiency programs, beginning when rates go into effect in this case. This annual funding amount would initially not be included in the Company's rates.

→The Company's annual funding amount will be deferred and treated as a regulatory asset with a 10 (ten) year amortization period. The amortization would begin with the effective date of any rates resulting from the Company's next general rate case. Any amounts would be included in the Company's rate base in its next general rate case.

As to the "Funding Amount" issue[102], MGE has proposed the following:

→The Company will initially fund an annual amount of $1 million per year for its energy efficiency programs, beginning when rates go into effect in this case.

→Funds will be divided proportionally between classes (the new SGS class would receive up to 10% of funding, Residential will receive up to 90% of the funding)

→On an annual basis, the energy efficiency collaborative will review the Company's annual funding amount to and expenditures for its energy efficiency programs. The energy efficiency collaborative (or the members, if agreement cannot be reached) may submit a recommendation to the Commission to increase or decrease the Company's annual funding amount. The recommended increase or decrease to the annual amount of funding may be contested by any member of the energy efficiency collaborative.

As to the "Funding Interest" issue[103], the Company has proposed the following:

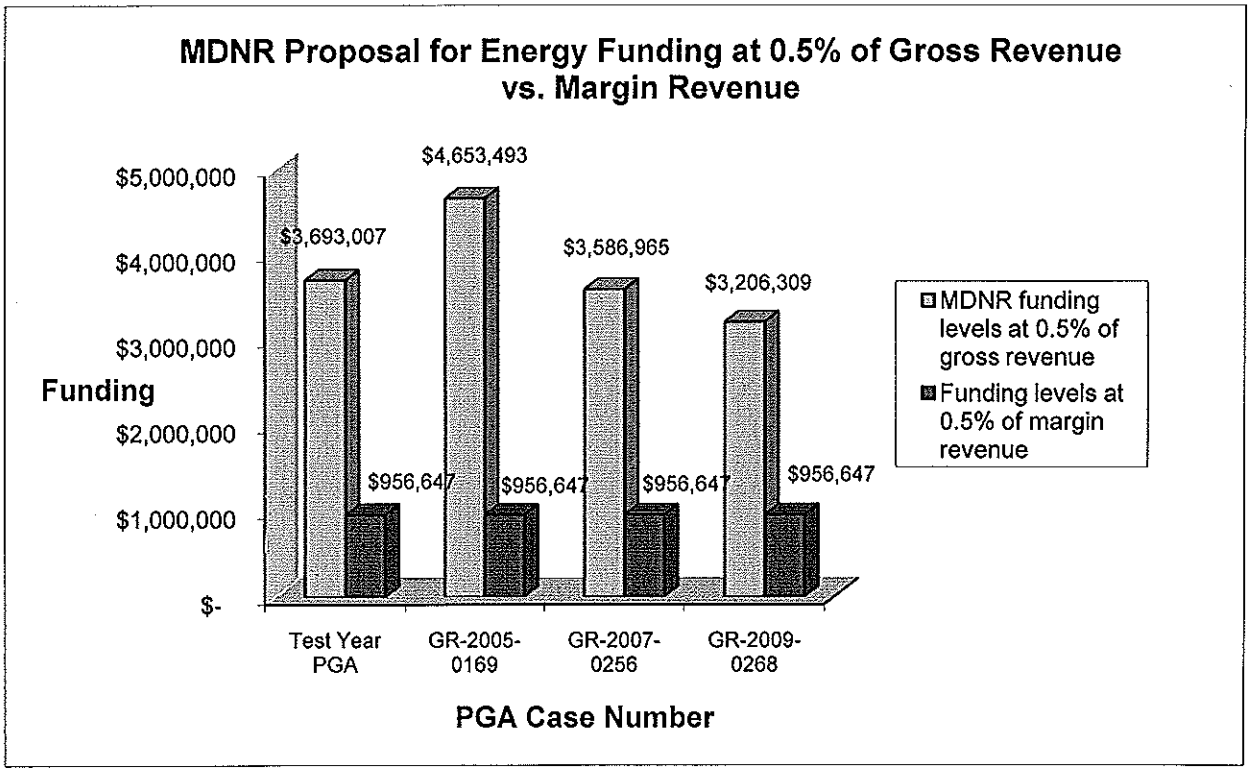
→The Company would assign the same short term interest rate determined in this case to any unspent amounts previously collected in rates on a going forward basis (MGE recommends 5.492%).

These are selected items out of a comprehensive proposal set forth in MGE's Initial Brief at pages 28 through 30. MGE suggests that its integrated proposal provides a more fair, complete, balanced approached to the topic than the random, isolated

[101] Public Counsel Brief p. 34.
[102] *Id.*
[103] Public Counsel Brief, p. 35.

recommendations offered by Public Counsel. This all is subject to SFV rate design being maintained for the Company's residential class of customers and that it is expanded to a restructured SGS class.

Where the question of funding amounts is concerned, the Missouri Department of Natural Resources ("MDNR") has requested that MGE's energy efficiency programs initially start at 0.5% of the Company's gross revenues and then move to the upper limit of 1% of the Company's gross revenues by 2012.[104] As an initial matter, using gross revenues as a marker is inappropriate, as they are significantly affected by gas prices and weather such that annual funding could fluctuate substantially from year to year. The impact of gas prices and weather on MDNR's proposal can be seen in the following graph:



[104] MDNR Brief, p. 1.

This graph shows the impact of different annual PGA's at 0.5% of gross revenue with different PGA's with a high of $1.16771 (in GR-2005-0169) to a low of $0.69754 (from GR-2009-0268). A funding proposal that has swings of this magnitude is not appropriate for a well-designed and planned energy efficiency program.

MDNR also seems to forget that MGE's low-income weatherization program, funded at $750,000 annually, will continue following the conclusion of this rate case. Combined with the $1 million funding level MGE has proposed for energy efficiency programs that are not income-based, a total of $1.75 million annually will be devoted to improving the energy efficiency of MGE's customers (which amount could increase in the future upon the recommendation of the energy efficiency collaborative).

Perhaps more to the point, however, this MDNR funding recommendation is not at all justified by the current spending levels. MDNR admits at page 5 of its Initial Brief that the monies collected to date (even at the $750,000 level) have not been expended. MGE believes that it is not prudent to saddle ratepayers with a funding obligation that is not justified by current (or even projected) demand. Nevertheless, as noted above, the Company suggests that the energy efficiency collaborative review the Company's annual funding amount to and expenditures for its energy efficiency programs. The Company's recommendation would allow for an opportunity to increase or decrease to annual funding based on actual demand as evidenced by burn rates at approved funding levels. MGE believes that its approach represents a good, practical solution that can be monitored by the Commission.

MDNR's claim that MGE's proposed level of funding is "stagnant" in terms of the amount of funding for these programs does not recognize that MGE is proposing to fund

these programs at a level of $1 million dollars (divided proportionately between the residential and the restructured SGS classes) and that this annual funding amount would initially not be included in the Company's rates. This represents a $250,000 increase (33%) over current funding levels. MGE believes this represents a significant movement on its part to support its increasingly successful energy efficiency programs.

Moreover, to the extent that the current upward trajectory of these programs continues (justifying funding in excess of $1 million annually), MGE has proposed that the energy efficiency collaborative have the authority to recommend increasing the funding amount in the future. The Company does not believe, however, that its ratepayers should be treated as an alternative funding source to a general revenue appropriation. The amounts of money funding energy efficiency programs (whether provided by MGE's ratepayers, shareholders or both) should be considered in the context of overall demand, and energy conservation considerations; and not as an abstract numerical target.

C. Public Counsel's Ill-Defined Lost Margin Revenue Recovery Mechanism.

As discussed more fully in MGE's Initial Brief, Public Counsel's ill-defined lost margin revenue recovery mechanism (LMRRM) is not worthy of serious consideration by the Commission.[105] That it is a hastily-added and unclear proposal is readily apparent when reviewing the manner in which it was presented. Public Counsel did not recommend the LMRRM until rebuttal testimony, well after Ms. Meisenheimer filed her

[105] MGE brief, pp. 30-32-

rate design recommendation. Mr. Kind's entire proposal on the LMRRM in rebuttal consists of one paragraph.[106]

Although MGE's Initial Brief discusses this topic in detail, a few comments on Public Counsel's attempted comparison to New England Gas Company, ("NEGC", also a division of Southern Union Company), is warranted here. Public Counsel's comparison of MGE to NEGC fails on several levels. First, NEGC has a number of other cost recovery riders that allow it to cover its cost of service and earn a reasonable return, a key detail that Mr. Kind was unaware of.[107] Second, Mr. Kind was completely ignorant of the fact that utilities in Massachusetts were ordered to implement revenue decoupling mechanisms in their next rate cases.[108] Also, although NEGC has this particular mechanism, it was deemed suitable solely for NEGC and for NEGC's particular situation. It is a regulatory approach for a different company, with different circumstances, and in a different jurisdiction. This mechanism's suitability for NEGC has never been shown by Public Counsel, let alone its specific suitability for MGE.[109]

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[106] Ex. 76, Kind Reb., pp. 8-9
[107] Kind, Tr. 861-864
[108] Kind, Tr. 870.
[109] Not all jurisdictions have been enamored with this mechanism. Significantly, the Kansas Corporation Commission has expressed reservations about the LMRRM approach based on concerns about its administration, the likely contentious nature of the process and the precision of the results, matters glossed over by Public Counsel. The Kansas Commission stated that "The Commission does not favor Lost Margin Recovery because of the high premium this method places on accurate evaluation of program impacts and the increased potential for expensive and time-consuming litigation arising from disputes. Furthermore, while Commission staff expertise is growing in this highly technical field, at this time the Commission does not have the depth of experience available to consider this method without reliance on outside firms." The Kansas Commission went on to write that "another problem with the Lost Margin Recovery method is dealing with the issue of measuring the effect of "free ridership" when evaluating the impacts of an energy efficiency program. Free riders are a term for customers who take advantage of an energy efficiency program but would have undertaken their energy efficiency efforts whether the utility offered that program or not. The laudable, self-directed efforts of these customers result in overestimation of the decline in energy caused by the energy efficiency program unless accounted for accurately. The full decoupling method avoids this and other difficult issues involved in accurately assessing a decline in usage actually attributable to an energy efficiency program because the reason for a decline in usage is irrelevant. The utility will recover its lost sales no matter whether the reason is weather, the economy, or energy efficiency programs. (see *Re a General Investigation*

While it is of some interest that a particular company has a certain element to its rate design, a one-size-fits all approach to rate making is improper. The Commission has not been provided with competent and substantial evidence that the LMRRM is suitable for MGE, nor has it been shown information on how this mechanism would affect MGE. It is simply not a serious proposal.

III. Cost of Capital

The cost of capital issues in this case concern 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 that capital structure. The positions of MGE on these issues should be adopted by the Commission and are illustrated by the following table:[110]

	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%

Both MGE and the Staff recommend the use of a hypothetical capital structure, derived from the study of a group of proxy companies. As illustrated, MGE recommends an ROE of 10.5 percent applied to a hypothetical capital structure with 48 percent common equity. The Staff recommends an ROE of 9.5 percent applied to a hypothetical capital structure with 50.49 percent common equity.[111] Public Counsel, on the other hand, urges the use of Southern Union Company's more-risky consolidated capital structure

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Regarding Cost Recovery and Incentives for Energy Efficiency Programs, 2008 Kan. PUC LEXIS 1664, Final Order dated November 14, 2008. (pp. 29-30)

[110] *See* Ex. 15, Hanley Surreb., Sch. FJH-32. MGE witness Hanley updated his recommendations utilizing data through September of 2009.

[111] Using the mid-point of Staff's ROE range of 9.25 to 9.75 percent and representing Staff's true-up capital structure and cost rates. Ex. 111, Murray True-up Dir., p. 3.

which has a low common equity ratio of only 38.66 percent. Public Counsel recommends an ROE of 10 percent.[112] There is also an issue with regard to the proper cost of short-term debt. Public Counsel recommends a short-term cost rate of 5.920 percent, MGE recommends a short-term cost rate of 5.492 percent, and Staff recommends a short-term cost rate of only 0.94 percent.

The Commission's decision on the cost of capital issues will likely transcend this case, in that the result will be considered by the financial community and utility industry as an indication of the current regulatory environment in Missouri. A decision that is considered to be outside the mainstream could not only increase MGE's cost of capital, to the ultimate detriment of its customers, but could also have a chilling effect on utility investment in Missouri generally, with a resulting adverse impact on economic growth and ultimately jobs within the state.

A. Capital Structure: For the Purposes of Setting Rates in This Proceeding, the Commission Should Utilize a Hypothetical Capital Structure Consisting of 52% Total Debt and 48% Common Equity.

MGE is an operating division of Southern Union Company. Consequently, MGE does not issue its own debt or equity and has no independent capital structure. In past cases involving MGE, the Commission has used the actual capital structure of Southern Union Company for purposes of setting MGE's rates, based on the circumstances that existed at the time of those decisions. Whatever those past circumstances, however, it is now readily apparent that Southern Union is in no way representative of a local gas distribution company and that accordingly the Southern Union capital structure should not be used in this case. Both the Staff and MGE based their proposed hypothetical

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

capital structures on a study of a proxy group of companies similar to MGE. While the Company and Staff differ somewhat as to the particular ratios of the various components of their proposed capital structures, as well as their costs, both recognize that MGE, for ratemaking purposes, should have a capital structure based on the capital structures of LDCs that are comparable to MGE. Southern Union Company is clearly not comparable to MGE.

At page six of its Initial Brief, Staff said that "each successive MGE rate case necessarily requires Staff to determine anew the appropriate method to use in determining a cost of capital recommendation. For several reasons, Staff is now of the opinion that the approach used in the past is no longer appropriate." The Staff is absolutely correct on this point. The application of sound economic theory to the facts of this case leads to the conclusion that Southern Union's capital structure should not be used for ratemaking purposes for MGE in this proceeding.

As discussed in MGE's Initial Post-Hearing Brief, in setting rates the Commission must balance the interests of the utility's owners (i.e., stockholders) and those of its customers.[113] In addition, the Commission must provide a utility a reasonable opportunity to earn a fair return on the assets it has devoted to the public service.[114] This is a constitutional right of the stockholders of the utility.[115] These principles – the balancing of interests and affording the utility a reasonable opportunity to earn a fair

[113] "The provisions of this chapter shall be liberally construed with a view to the public welfare, efficient facilities and substantial justice between patrons and public utilities. RSMo. §386.610 (emphasis added).
[114] *Utility Consumer's Council of Missouri v. Public Service Commission*, 585 S.W.2d 41, 49 (Mo. banc 1979).
[115] *State ex rel. Missouri Public Service Company v. Fraas,* 627 S.W.2d 882, (Mo.App. 1981); *State ex rel. Washington University v. Public Service Commission*, 272 S.W. 971, 973 (Mo. banc 1925) ("The enactment of the Public Service Act marks a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but to further insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guarantee of fair returns for capital invested. . . . These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say 'fair', we mean fair to the public, and fair to the investors.") (emphasis added).

return – are fundamental to determining the capital structure issue in this case and the related capital structure cost components.

Underlying all of this is what can be characterized as the "risk" issue. It is well understood that the greater the amount of debt in a capital structure the greater the financial risk, or, stated another way, the lower the ratio of equity to debt, the greater the financial risk. Southern Union Company, with a 38.66 percent common equity ratio, has a capital structure with greater financial risk which is not representative of the risk reflected in a capital structure of a typical local gas distribution company such as MGE. (Ex. 13, Hanley Direct, Sch. FJH-4, p. 1) To satisfy the constitutional mandates of an opportunity to earn a fair return, the Commission must address and deal with this imbalance.

In setting MGE's rates in this proceeding, the greater risk associated with Southern Union's capital structure may be addressed in essentially one of two ways – (1) a risk premium may be added to the recommended return on common equity ("ROE"), or (2) a more balanced, more representative, more conservative hypothetical capital structure may be used instead of Southern Union's actual corporate capital structure. As outlined in MGE's Initial Post-Hearing Brief, MGE submits that the use of a hypothetical capital structure is the approach the Commission should take in this case.

To satisfy the constitutional mandates of an opportunity to earn a fair return, the Commission should view MGE as a stand-alone entity, separate from its relationship to Southern Union Company, and impute a capital structure that is "more normal" for a local gas distribution company, one that consists of an LDC industry average amount of

equity and debt. The facts are that Southern Union's capital structure represents its collective operations and has what Standard & Poor's considers an "aggressive" level of financial risk. (Ex. 13, Hanley Dir., p. 6) On the other side of the ledger, MGE, the entity that this Commission regulates, is somewhat more risky than the average local gas distribution company due to its smaller size. (Ex. 13, Hanley Dir., p. 4) For the numerous reasons outlined in Mr. Hanley's testimony, and as illustrated in Schedule FJH-4, Southern Union Company is in no way representative of a local gas distribution company and thus, its capital structure and related capital cost components are unrelated to and not representative of MGE.

Southern Union is considered primarily a "natural gas transmission company," while MGE, as well as the appropriate proxy companies, are considered "gas distribution companies." (Ex. 13, Hanley Dir., p. 16) The Staff recognizes these striking changes and differences in the character of Southern Union Company. Southern Union uses a liberal amount of debt, and its business risk has increased due to its movement away from being predominately a natural gas distribution company to predominately being a midstream gas company. Southern Union's corporate credit rating is only one step above junk status. (Ex. 40, Staff Report – Cost of Service, p. 22) Southern Union's corporate credit rating was downgraded on November 20, 2006, due primarily to Southern Union's higher business risk profile associated with its natural gas gathering and processing operations. (Ex. 40, Staff Report – Cost of Service, p. 27) The Staff explains that the continued use of the approach utilized in MGE's last two rate cases (use of Southern Union's consolidated capital structure with a cost of long-term debt that excluded debt issued by Panhandle Eastern) would unfairly require MGE's

ratepayers to pay a higher embedded cost of debt in this case. (Ex. 40, Staff Report – Cost of Service, pp. 26-27)[116]

While both the Staff and MGE recognize that it would be inappropriate to use Southern Union's capital structure, with its 38.66 percent common equity ratio, for purposes of setting MGE's rates, the Public Counsel takes the opposite view and recommends that Southern Union's more risky capital structure should be used in setting the Company's rates in this case. On page 24 of its Initial Brief, Public Counsel argues that "the most equitable capital structure" for MGE is the consolidated capital structure of Southern Union. Public Counsel, however, provides no credible support for this opinion. In fact, contrary to his own recommendation to use Southern Union's capital structure, Public Counsel cost of capital witness Lawton 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. (Ex. 69, Lawton Dir., p. 49)

An additional conceptual error exacerbates the Public Counsel's mistaken use of Southern Union's capital structure. In direct violation of the Supreme Court's directive found in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944), that authorized returns must be "commensurate with returns on investments in other enterprises having corresponding risks," OPC witness Lawton relied upon his proxy group of gas distribution companies in formulating a recommended ROE for MGE, but then failed to rely on this same group when it comes to the capital structure

[116] Additionally, the financial literature demonstrates that risk relates to where capital is invested – i.e., the purpose to which the capital has been devoted. Since MGE has no traded stock, 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. (Ex. 13, Hanley Dir., p. 19; Sch. FJH-7) As noted, MGE is an operating division of Southern Union Company. When dealing with divisional cost of capital and divisions with differing risks, different rates of return which are commensurate with individual risks, are required. (Ex. 13, 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. (Ex. 13, Hanley Dir., p. 21) This is exactly what has been done through Mr. Hanley's selection of an appropriate proxy group and the formulation of a hypothetical capital structure.

issue. Instead, he applied his common equity cost rate derived from his 12 proxy companies – with an average equity ratio of 54.25 percent for 2009[117] – to the amount of equity in Southern Union's capital structure – 38.66 percent. In taking this approach, however, because Southern Union's capital structure has a relatively low common equity ratio, Mr. Lawton was required by sound economic practice to take the next step and make a financial risk adjustment to his ROE recommendation. He failed to do so, however, in spite of his admissions that an "equity ratio of about 39% is below the gas industry average" and "reflects higher financial risks" for MGE. (Ex. 69, Lawton Dir., p. 49) The financial risk adjustment which Mr. Lawton should have made would have substantially increased the required ROE due to Southern Union's much lower common equity ratio. (Ex. 14, Hanley Reb., p. 35)

As discussed above, Public Counsel recommends that a capital structure consisting of 38.66 percent common equity be used for the setting of MGE's rates, as contrasted with the recommendations of the Company and Staff for common equity ratios of 48 and 50.49 percent, respectively. Interestingly, in the two cases cited to by the Public Counsel on the issue of risk,[118] the Maryland Commission rejected the recommendations of the Maryland People's Counsel to utilize capital structures with only 29 percent (Potomac Electric) and 31 percent (Delmarva) equity. Instead, in the Potomac Electric case, a capital structure with 47.69 percent common equity was utilized, and in the Delmarva case, a capital structure with 48.63 percent common equity was utilized. The Maryland Commission noted that a capital structure containing only

[117] Ex. 69, Lawton Direct, Sch. DJL-5.
[118] *See* page 32 of the Initial Brief of the Office of the Public Counsel. *In the Matter of the Application of Delmarva Power and Light Company*, Maryland Case No. 9093, 2007 Md. PSC LEXIS 14 (July 19, 2007); *In the Matter of the Application of Potomac Electric Power Company*, Maryland Case No. 9092, 2007 Md. PSC LEXIS 13, 258 P.U.R.4th 463 (July 19, 2007).

29 or 31 percent common equity "would impose significant risks and would require a considerably higher return on equity than that authorized herein" and "would be extremely risky and would impair the Company's financial integrity in violation of applicable legal standards."

In reaching its decision on this issue, the Commission should focus on the approach taken by MGE witness Hanley. Consistent with sound economic theory, MGE witness 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 considered the component costs of debt and common equity capital for this proxy group as appropriate for use in establishing a fair rate of return for MGE. Mr. Hanley's approach – 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 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). (Ex. 13, Hanley Dir., p. 4) For the purposes of setting rates in this proceeding for MGE, the Commission should utilize a hypothetical capital structure consisting of 52 percent total debt and 48 percent common equity.

B. Return on Common Equity: An Authorized ROE of 10.5% is Necessary In Order for MGE to Have the Opportunity to Earn a Fair and Reasonable Return on its Capital Devoted to Public Service.

MGE submits that based on the testimony of its witness Hanley and sound economic theory and legal principles, a proper common equity cost rate for MGE in this case is 10.5 percent. This 10.5 percent ROE is necessary in order for the Company to

continue to provide safe and adequate service to its customers while also having the opportunity to earn a fair and reasonable return on the capital MGE has devoted to public service.

Based on MGE's recommended ROE and the midpoints of the ROE ranges of Staff and Public Counsel, the Commission is presented with a relatively narrow ROE range in this case of 9.5 to 10.5 percent. In fact, this spread is really much narrower. The actual range derived by Staff when based on its proxy companies[119] indicates a 10.25 percent ROE is reasonable. The Public Counsel witness conceded that an ROE of 10.5 percent would be appropriate.[120] So in reality, the ROE range can be said to be 10.25 to 10.50 percent.

At page 30 of its Initial Brief, Public Counsel claims that neither Staff witness Murray nor Public Counsel witness Lawton "needed to update their analysis." MGE witness Hanley, on the other hand, correctly recognizes that the most-current market conditions should be analyzed, as ratemaking is to be prospective in nature. In fact, at the time of Mr. Hanley's initial filing, the country was in the deepest recesses of the worst financial crisis experienced by the nation since 1929. Credibility and common sense mandated an updating due to the passage of time and dramatic changes in the capital market conditions over the six-month period of time between February and August of 2009. Because of these circumstances, Mr. Hanley quite appropriately provided the Commission with an updated study which is more reflective of current and

[119] The Staff's study, based on a 9 company proxy group, supports a common equity range of 9.25 to 10.25, with a true mid-point of 9.75 percent, but the Staff witness elected to ignore this and elected to use a range of only 9.25 to 9.75. "Staff's estimate of the proxy group's cost of common equity . . . is 9.25 percent to 10.25 percent." (Ex. 40, Staff Report – Cost of Service, p. 36)

[120] "Every number from the bottom to the top is a reasonable estimate . . . [10.5 percent] is within the reasonable results of the study . . ." Mr. Lawton went on to explain that he found no reason to select any particular point within his range. (Tr. 320-321)

prospective capital market conditions and adjusted for significant changes in the capital markets over the approximately seven months since he originally formulated his ROE recommendation. (Ex. 14, Hanley Reb., p. 2)

Contrary to the misrepresentations of Public Counsel (*see* page 28 of the Initial Brief of the Office of the Public Counsel), and contrary to the entirely misleading representations found in the table at page 10 of Staff's Initial Brief, MGE is not recommending an ROE of 15.25, 13.9, or even 11.25 percent. Instead, MGE witness Hanley, utilizing current and prospective market data, recommends an ROE of 10.5 percent for MGE in this proceeding. This is a "main-stream" recommendation consistent with what is going on in the industry. As noted by Staff, the average authorized ROE for natural gas utilities for the first three quarters of 2009 was 10.11 percent, resulting in an ROE "zone of reasonableness" extending up to 11.11 percent.[121] In fact, looking at the 11 reported decisions for the fourth quarter of 2009, one arrives at an average ROE of 10.27 percent, resulting in an ROE "zone of reasonableness" extending up to 11.27 percent for the final quarter of 2009.[122] Also significant, with regard to the data supplied on Staff's Exhibit 96 pertaining to gas rate

[121] *See* page 12 of Staff's Initial Brief and Staff Exhibit 96.

[122] Orange & Rockland Utilities, Inc., New York Commission Case No. C-08-G-1398, October 16, 2009, ROE – 10.4%, Equity Ratio – 48%; Avista Corp., Oregon Commission Case No. D-UG-186, October 26, 2009 ROE – 10.1%, Equity Ratio -50%; Southwest Gas Corp., Nevada Commission Case No. D-09-04003 (Southern & Northern), November 3, 2009 ROE – 10.15, Equity Ratio – 47.09; Bay State Gas Co., Massachusetts Commission Case No. DPU 09-30, October 30, 2009 ROE – 9.95% Equity Ratio – 53.57; Wisconsin Electric Power Co., Wisconsin Commission Case No. D-5-UR-104 (WEP-GAS), December 18, 2009, ROE – 10.40, Equity Ratio – 53.02%; Wisconsin Gas LLC, Wisconsin Commission Case No. D-5-UR-104 (WG), December 18, 2009, ROE – 10.50%, Equity Ratio – 46.62%; Hope Gas, Inc., West Virginia Commission Case No. C-08-1783-G-42T, November 20, 2009, ROE – 9.45%, Equity Ratio – 42.34%; Wisconsin Power and Light Co., Wisconsin Commission Case No. 6680-UR-117 (gas), December 18, 2009, ROE – 10.40, Equity Ratio – 50.38%; Madison Gas and Electric Co., Wisconsin Commission Case No. D-3270-UR-116 (gas), December 22, 2009, ROE – 10.40, Equity Ratio – 55.34%; ONEOK, Inc., Oklahoma Commission Case No. Ca-PUD200900110, December 14, 2009, ROE – 10.50, Equity Ratio – 55.30%; Michigan Gas Utilities Corp., Michigan Commission Case No. C-U-15990, December 16, 2009, ROE – 10.75, Equity Ratio – 50.26%

case decisions for the first three quarters of 2009, is the fact that the average common equity ratio for the gas companies was 47.62 percent, compared with the 48 percent recommended by MGE in this proceeding and contrasted with the 38.66 percent recommended by Public Counsel.

It is also noteworthy that Staff's Exhibit 96 demonstrates that only two authorized ROEs for the first three quarters of 2009 were lower than Staff's outlier ROE recommendation of only 9.5 percent. An ROE of 9.31 was authorized for Connecticut Natural Gas, and an ROE of 9.26 percent was authorized for Southern Connecticut Gas. Of significance is the fact that each such authorized ROE reflects a 10 basis point penalty reduction for billing errors. If these two penalty-driven ROEs are removed from the calculation, the average ROE for natural gas utilities for the first three quarters of 2009 would be 10.25 percent, resulting in an ROE "zone of reasonableness" extending up to 11.25 percent.

In arriving at their ROE recommendations, both the Staff and Public Counsel rely primarily on the DCF model, and both, in effect, criticize MGE witness Hanley for utilizing multiple cost of equity models. The financial literature, however, encourages reliance upon multiple models, as no single cost of common equity estimation model is so theoretically superior or precise that it should be used to the exclusion of all other models. (Ex.13, Hanley Dir., p. 6) In fact, in contrast to the arguments being made by the Staff and Public Counsel in this proceeding, the Commission has acknowledged the superiority of using multiple cost of equity models. *In the Matter of Union Electric Company*, Case No. ER-2008-0318, Report and Order dated January 27, 2009 (". . . the problems with those models illustrate the desirability of considering his model that

produces a relatively high return on equity as a balance to his DCF models that show a relatively low return on equity. In that way, the possibly unreasonable impact of one model is counterbalanced by other models."). Exclusive reliance on any single method, including the DCF, as the primary tool in arriving at a recommended ROE is inconsistent with the Efficient Market Hypothesis (EMH). Multiple models should be utilized to be consistent with the EMH. (Ex.14, Hanley Reb., p. 39) In summary, the literature, past Commission decisions and common sense make it clear that reliance upon multiply methods is mandatory.

As noted above, Staff's study, based on a nine-company proxy group, supports a common equity range of 9.25 to 10.25, with a mid-point of 9.75 percent. Staff witness Murray, however, elected to ignore this and chose instead to use a range of only 9.25 to 9.75. (Ex. 40, Staff Report – Cost of Service, p. 36) On close examination, Staff witness Murray's reliance on the lower half of his cost of equity range is seen to be without merit. While admitting that his comparable companies have decoupled rate designs, Mr. Murray nonetheless adopts the lower half of his ROE range for the stated reason that his proxy companies "all have at least some degree of non-regulated operations." (Ex. 14, Hanley Reb., p. 39; Ex. 40, Staff Report, p. 36) This rationale does not hold up under scrutiny.

All seven of Mr. Murray's proxy companies are included in the Edward Jones gas distribution companies group and all are included in the Value Line natural gas utility group. Further, MGE also engages in unrelated operations, with significant earnings in 2007 and 2008 coming from capacity release and off-system sales transactions. In any event, the average of Staff's seven proxy companies had 73.45% of net operating

income in 2008 derived from gas distribution operations, with an average of 82.87% of total assets being devoted to gas distribution operations. It is clear that investors consider these companies to be gas distribution utilities and that the use of the lower half of Mr. Murray's recommended ROE range is without justification. (Ex. 14, Hanley Reb., pp. 39-40) Staff's estimate of its proxy group's cost of common equity is 9.25 to 10.25 percent. (Ex.40, Staff Report – Cost of Service, p. 36) Accordingly, without Staff's unwarranted downward adjustment, the midpoint of Staff's ROE range is actually 9.75 percent, and the high end of Staff's range, 10.25 percent, is quite close to MGE's recommendation.

In the final analysis, Mr. Hanley's 10.5% ROE recommendation must be considered as "main-stream" and realistic as it clearly falls within the bounds of any "zone of reasonableness" and is consistent with recent awards in the industry.

The Commission should also remember that although the Company is recommending an ROE of 10.5 percent, absent MGE's presently authorized and existing SFV rate design, the common equity cost rate should be no less than 10.75 percent. As discussed below in the section on risk, the proxy gas distribution companies overwhelmingly have protection from the unpredictability of weather and declining usage per customer, and an ROE derived from market data of these proxy gas distribution companies reflects any risk-reducing benefits derived from a SFV-type rate mechanism. (Ex. 14, Hanley Reb., pp. 7-8) Under the EMH, 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. (Ex. 14, Hanley Reb., pp. 11-12) If MGE is not

allowed to retain its SFV rate design, its risk will be greater than the proxy companies, and an upward adjustment of 25 basis points from MGE's ROE recommendation of 10.5 percent will be necessary. (Ex. 14, Hanley Reb., pp. 12, 36)

C. Cost of Debt: a 5.492 % Prospective Short-Term Cost Rate Should Be Used for Purposes of Setting Rates in This Case

MGE submits that a 5.492 percent prospective short-term cost rate should be used for purposes of setting the Company's rates in this case. Public Counsel, based on Southern Union's consolidated capital structure, recommends a 5.92 percent short-term debt cost. Staff, however, looking to just a single company as a proxy for MGE, recommends only a 0.94 percent cost of short-term debt.

As noted by both MGE and the Staff, the precise basis of the cost of short-term debt for each of the proxy companies is not available. Short-term debt cost rates fluctuate, and, as is frequently noted by this Commission and the courts, 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. (Ex. 14, Hanley Reb., p. 38; Sch. FJH-21) When added to the market-required margin of 262.5 basis points (2.625%) 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. (Ex. 15, Hanley Surreb., Sch. FJH-32, Note 3)

Staff witness Murray, in his true-up testimony, suggests that a short-term debt cost rate of only 0.94 percent should be used for determining MGE's rate of return. This recommendation, however, is based upon a remarkably 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 of his seven proxy companies. (Ex. 14, Hanley Reb., p. 37) These rates, based upon credit facilities that were arranged in a much less risky credit environment, are clearly retrospective in nature and should be ignored. In fact, making matters worse, Mr. Murray looked to the short-term cost of debt for only one company when he prepared his true-up testimony, lowering his recommended cost of short-term debt from 1.0 percent to 0.94 percent. (Ex. 111, Murray True-up Dir., p. 4) As noted, a proper short-term cost rate is 5.492 percent.

D. Risk: To Determine Whether the Continuation of the SFV Rate Design Has An Impact on MGE's Authorized ROE, the Commission Must Compare the Company's Risk Profile with SFV in Place Relative to the Proxy Group, and Not Look Only to the Company's Risk With and Without the Rate Design; to the Extent the SFV Rate Design Reduces MGE's Business Risks, This Risk Reduction is Already Reflected in MGE's Recommended 10.5% ROE

The relevant analysis in determining whether the continuation of the Straight Fixed-Variable (SFV) rate design has an impact on MGE's authorized ROE is not properly derived by looking at the Company's risk with and without the rate design in place, but rather by comparing the Company's risk profile with SFV in place relative to the proxy group. To the extent the SFV rate design reduces MGE's business risks, this risk reduction is already reflected in MGE's 10.5 percent proposed return on equity (ROE) 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 in MGE's pre-hearing and initial post-hearing briefs and in the prefiled testimony of 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.

(Ex. 13, 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.

As explained in MGE's Initial Post-Hearing Brief, the situation with gas distribution companies and decoupling mechanisms is analogous to the situation presented to this Commission in Case No. ER-2008-0318, involving AmerenUE and the implementation of a fuel adjustment clause (FAC). This Commission correctly recognized that, when looking at an ROE derived from cost estimates as applied to a group of proxy companies, an upward adjustment may be appropriate in the absence of a FAC, but that a downward adjustment to ROE is not warranted when the proxy companies have similar mechanisms in place. *See In re Union Electric Company*, Report and Order dated January 27, 2009, Case No. ER-2008-0318. Similarly, in this case involving MGE, a downward adjustment to ROE would be inappropriate with the continuation of the SVF rate design for the Company. On the other hand, if MGE is not allowed to continue to operate under its SFV rate design, the Company's risk will be greater than the proxy companies, and a minimum upward adjustment of 25 basis points to its authorized ROE will be necessary and appropriate. (Ex. 14, Hanley Reb., pp. 12, 36)

Public Counsel witness Lawton argues that a 50 basis point reduction in ROE is appropriate due to the SFV rate design.[123] In its Initial Brief, the Public Counsel claims that this recommended 50 basis point reduction is consistent with decisions of other state commissions. Public Counsel, however, cites two 2007 decisions of the Maryland Public Service Commission which are not on point and which do not support Public Counsel's claims.[124] In each of these cases, the Maryland Commission authorized the implementation of a Bill Stabilization Adjustment (BSA) mechanism for all rate classes of the electric utility, whereby the utility will have a levelized stream of revenue based on the test year revenue requirement. Unlike with the SVF rate design for MGE, the Maryland Commission found that the BSA will insure that the electric utilities will achieve their approved levels of revenue. In each case, the Maryland Commission found that the ROE for the rate effective period should be set at 10.5 percent, then made its adjustment for the BSA and authorized a final ROE of 10 percent.

Previously, the Public Counsel witness pointed to a 2000 Maryland Public Service Commission gas case.[125] MGE, however, demonstrated that this Maryland decision does not support Public Counsel's argument. In fact, to the contrary, the Maryland gas decisions support the arguments of MGE with regard to risk relative to the proxy group. In the 2000 Maryland proceeding, a 50 basis point reduction in ROE was imposed as a result of the implementation of "Rider 8" – a decoupling mechanism accounting for changes in weather and other factors affecting gas usage. In 1999 and 2000, the proxy gas distribution companies that were under consideration did not have

[123] Public Counsel witness Lawton proposes either a revenue requirement or cost of service reduction in the amount of $1,842,034 or a 50 basis point reduction to ROE. (Tr. 307-308)
[124] *In the Matter of the Application of Delmarva Power and Light Company*, Maryland Case No. 9093, 2007 Md. PSC LEXIS 14 (July 19, 2007); *In the Matter of the Application of Potomac Electric Power Company*, Maryland Case No. 9092, 2007 Md. PSC LEXIS 13, 258 P.U.R.4th 463 (July 19, 2007).
[125] Baltimore Gas and Electric Company, Maryland Case No. 8829, Order No. 76260, dated June 19, 2000.

decoupling mechanisms in place. When the issue came before the Maryland Commission in 2005, the Commission eliminated the 50 basis point reduction because the impact of decoupling was then reflected in the data of the proxy companies. (Ex. 14, Hanley Reb., pp. 12-13)

As explained by Mr. Hanley, the facts of this MGE case are that the nine appropriate proxy gas companies currently have nearly 85% of their revenues either wholly or partially decoupled. (Ex. 14, 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 decoupling mechanism is in place. This CIP protects the companies against the weather variances and eliminates the disincentive to promote conservation. (Ex. 14, 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.

In making his "risk" adjustment, Public Counsel witness Lawton completely ignores these mechanisms and other protections afforded to the proxy companies. However, 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. (Ex. 14, Hanley Reb., pp. 11-12) Public Counsel has offered no rebuttal to these arguments. In fact, as noted, Mr. Lawton acknowledged

that the straight fixed variable rate design is "starting to sweep the country." (Tr. 358) "I'm seeing it all over the country, called different things." (Tr. 358) Mr. Lawton went on to explain that this rate design is "really picking up – picking up steam in – among regulatory authorities around the country." (Tr. 358) Although it is difficult to classify and quantify the various mechanisms by degree and effectiveness with regard to the reduction in equity risk, and although they might not all go by the same name, they cannot be ignored while still arriving at an appropriate ROE recommendation.

IV. True-Up

A. Introduction

MGE has raised two true-up issues for the Commission's resolution. These issues concern the amount of the prepaid pension asset and depreciation expense. MGE will also address in this section the issue raised by the Office of the Public Counsel (Public Counsel) in regard to rate case expense. The cost of capital issues discussed at the true-up hearing will be addressed in the reply portion of this brief along with the other cost of capital issues.

B. Appropriateness of True-Up Issues

The Commission Staff argues that the prepaid pension asset and depreciation expense issues are inappropriate for the true-up process and alleges that MGE has somehow already agreed to the numbers utilized by Staff.

Contrary to the Staff's argument, true-up treatment of these items is provided for both by the Commission's Order Establishing True-Up and the Partial Stipulation and

Agreement (hereinafter "Stipulation", filed on November 5, 2009). The Order Establishing True-Up[126] (through its incorporation of the Request for Order Establishing True-Up) indicates that the rate base will be trued up for "Prepaid pension asset and pension tracker assets," "Pensions and OPEBs" and "Depreciation and amortization expense." (Request for Order, p. 2, filed on September 14, 2009)

The Partial Stipulation and Agreement also indicates that "Prepaid pensions" "will be a part of the true-up in this case in regard to rate base" (Stipulation, p. 3) and that "Depreciation expense" "will be a part of the true-up in this case in regard to total operating expenses." (Stipulation, p. 4)

C. Prepaid Pension Asset Issue

There are two separate sub-issues as to the amount of the prepaid pension asset. The first is a timing issue. That is, whether the amortizations of the prepaid pension assets created in Cases Nos. GR-2004-0209 and GR-2006-0422 should begin the month after the true-up date in those cases or with the effective date of the Report and Order in each case.

The second prepaid pension asset sub-issue concerns the Staff's proposed application of a capitalization ratio. This question is whether a capitalization ratio should be applied to the prepaid pension asset (which would reduce the amount of that prepaid pension asset included in rate base), in addition to applying the capitalization ratio to the prepaid asset expense. The combined revenue requirement value of these two sub-issues is approximately $527,101.

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126 Case No. GR-2009-0355 (issued September 15, 2009).

1. What Is the Prepaid Pension Asset?

The prepaid pension asset reflects the difference between the amount of pension expense included in the cost of service and the actual level of pension expense incurred. (Ex. 108, Noack True-Up Reb., p. 6) Said another way, it is the difference between the pension expense included in rates and the amount funded by the company. (Stipulation, p. 10) If the actual pension expense exceeds the amount included in rates, the company records the difference as a regulatory asset, which is included in rate base and which will be recovered through amortization of the asset in subsequent rate cases. *Id.* If the actual pension expense is less than the amount included in rates, the company records a regulatory liability which is deducted from rate base and which will be refunded to customers through amortization of the liability in subsequent rate cases. *Id.* The regulatory asset or liability is simply the difference between what is included in rates and the actual expense. *Id.*

What is referred to as the "prepaid pension asset" in this case is actually the combination of three prepaid pension assets – the assets created in MGE's prior two rate cases (GR-2004-0209 and GR-2006-0422) and the asset created by this case.

2. Timing: Amortization of the Prepaid Pension Asset Should Not Begin Before the Effective Date of the Report and Order.

Determining the amount of the prepaid pension assets created in Cases Nos. GR-2004-0209 and GR-2006-0422 requires a calculation that depends in part upon when the amortization of the asset is deemed to have started. The Staff's position is that the amortization of the assets created in the past cases should have started the

month after the true-up period in those cases. Ex. 113, Foster True-Up Reb., p. 2. Under the Staff's approach, amortization would begin **before** the effective date of the respective Report and Order. On its books, MGE began amortizing the prepaid assets on the effective date of the respective Commission Orders in those cases. (Ex. 108, Noack True-Up Reb., p. 7)

The absurdity of the Staff's position can be seen by an examination of how Staff's approach would be applied in the future to the prepaid pension asset created by this case. The true-up period in this case ended on September 30, 2009. (Tr. 973, Foster) For rate-making purposes, Staff suggests that the amortization of this asset should start the month after the balance has been established, or in October of 2009. (*Id.* at 975) Thus, using Staff's theory, MGE should already be amortizing the asset created by a case that will not conclude for another two months.

In October, November, December, 2009 and, in all likelihood January and February of 2010, MGE charged and will continue to charge the rates that were established by this Commission in Case No. GR-2006-0422. (*Id.* at 974) Those rates have no provision or consideration of the prepaid pension expense associated with this case or the subject amortization. (*Id.* at 975) The purpose of the pension asset on liability is to make either the company or customer whole with respect to pension costs. If amortization is recorded before rates are effective, then the whole difference between rates and funding is not being taken into account.

Only after the effective date of the Commission's Report and Order in this case (and the effective date of the resulting tariff sheets) will MGE be able to charge rates that provide recovery for this amortization. Staff's approach would require MGE to

amortize this asset for five months even though, as Staff admits, there is no consideration in MGE's rates related to this amortization expense. (*Id.* at 975).

The Staff approach to amortization of the prepaid pension assets created in Cases Nos. GR-2004-0209 and GR-2006-0422 should be rejected. Finding in favor of MGE's position on the timing sub-issue will increase Staff's calculation of the prepaid pension asset (and, therefore, rate base) by $1,077,181.[127]

3. Capitalization: The Amount of the Prepaid Pension Asset Included In Rate Base Should Not Be Reduced By a Capital Expense Ratio.

Staff has reduced the balance of the prepaid pension assets created in Case No. GR-2006-0422 and this case by applying an expense capitalization ratio to the balance. Ex. 108, Noack True-Up Reb., p. 8. Those assets should not be reduced by an expense/capitalization ratio. *Id.* A capitalization ratio is generally applied to expenses in the income statement to reflect that some payroll and benefit cost relate to construction work and therefore should be capitalized. *Id.* While MGE agrees that the ratio should be applied to the resulting amortization of the pension assets (or amortization expense), the ratio should not be applied to the asset itself, which is a rate base item. *Id.* Reducing the prepaid pension assets in this fashion is both inconsistent with the history of this process and with the amortizations that have been established in this case. An example might help clarify MGE's position. If the amount included in rates was zero ($0), (as was the case in the 2004 rate case) and the pension costs funded was $10,000,000, the amount of the pension asset would be $10,000,000. Staff would have the Commission first reduce this amount by a percentage (for example,

[127] Ex. 108, Noack True-Up Reb., Sch. MRN-4 and Ex. 113, Foster True-Up Reb., "New Pension Numbers," p. 3

22%) so that rate base item would now be $7,800,000 instead of $10,000,000. MGE would never recover this difference went though that is the intent of the tracker language.

During the cross-examination of MGE witness Noack, Staff counsel took Mr. Noack through several pieces of his testimony from MGE's last rate case - Case No. GR-2006-0422 – to examine start times for the prepaid pension asset amortization. (Tr. 940-943) On redirect, Mr. Noack explained that the prepaid pension asset figures reflected in the GR-2006-0422 testimony matched the asset amounts he utilized in this case ($7,975,181 associated with Case No. GR-2004-0209 and $4,016,500 associated with Case No. GR-2006-0422). (Tr. 961-964) These amounts are consistent with the starting points utilized by Mr. Noack in True-Up Rebuttal Schedule MRN-4 and were not reduced for a capitalization ratio. (Ex. 108; Tr. 962-964).

More compelling evidence of the parties' intention in this regard is found in the Partial Stipulation and Agreement that has been filed in this case. Paragraph 20 of the Stipulation provides in part that "the rates established in this case include recovery of the amortization of prepaid pension assets established in prior cases and the amortization of the prepaid pension asset established in this case as follows:

a. $1,139,310 – GR-2004-0209;

b. $803,300 – GR-2006-0422;

c. $2,828,673 – GR-2009-0355."[128]

Simple multiplication of these annual amortizations by the ordered number of years reveals that there could be no intent to reduce the asset by a capitalization ratio.

[128] Paragraph 20 further states that the amounts "are stated prior to application of transfer rate." As indicated above, MGE agrees that the transfer rate, or capitalization ratio, should be applied to the resulting amortization in order to determine the amortization expense.

The asset from Case No. GR-2004-0209 was to be amortized over seven years. $1,139,310 multiplied by seven equals approximately $7,975,181 ($7,975,170). Tr. 965. The asset from Case No. GR-2006-0422 was to be amortized over five years. $803,300 multiplied by five equals $4,016,500. Tr. 965-966. The asset from this case is also to be amortized over five years. $2,828,673 multiplied by five equals approximately $14,143,364 ($14,143,365). (Tr. 966).

These numbers track the base asset amounts used by MGE (Ex. 108, Noack True-Up Reb., Sch. MRN-4, Ln 1(c), 3(d) and 5(c)) as well as the base asset amounts used by the Staff for Cases Nos. GR-2004-0209 and GR-2006-0422 (Foster True-Up Reb.,p. 4 and "New Pension Numbers," p. 1-3) and could not possibly have been reduced by a capitalization ratio. Further, if the prepaid pension asset is reduced by a capitalization ratio as suggested by the Staff, the amortization ($2,828,673 annually for five years) will far exceed the value of the asset.

Staff's application of a capitalization ratio to the prepaid pension asset is contrary to both past practice and the intent of the parties as reflected in the Partial Stipulation and Agreement. Accordingly, the prepaid pension asset should reflect the calculation of that asset without the application of a capitalization ratio and should be found to be equal to $18,430,238, which reflect the correction of the timing issue discussed above and the absence of an applied capitalization ratio. (Ex. 107, Noack True-Up Dir., Sch. MRN-2, ln. 10(c)).

D. Depreciation Expense

The true-up depreciation issue concerns the proper depreciation rate for a single depreciation account. That account is Account 374.2 (Land Rights). Staff suggests that the rate for this account should be zero percent (0.00%), while MGE believes that the rate should be equal to the rate that has been ordered by this Commission in past cases (2.09%).

Staff alleges that the Account 374.2 rate should be 0.00% based on the account's absence from a Depreciation Expense Accounting Schedule referenced by the Commission's Order in Case No. GE-2010-0030 (Ex. 110, Oligschlaeger True-Up Reb., p. 5-6) and also attached to the Partial Stipulation and Agreement filed on November 5, 2009 in this case (Id. at p. 7). The Staff position, however, ignores the actual language of both the GE-2010-0030 Order and the Partial Stipulation.

The second ordered paragraph in the Commission's Order Granting Waiver in Case No. GE-2010-0030 (issued August 12, 2009), states as follows:

> Missouri Gas Energy, a division of Southern Union Company, shall retain the current depreciation rates, as listed in Schedule A to Staff's Recommendation, *and as agreed upon in the Partial Nonunanimous Stipulation and Agreement in Commission case No. GR-2006-0422.*(Ex. 108, Noack True-Up Reb., Sch. MRN-2 (emphasis added))

Thus, the Order sought to "retain the current depreciation rates,"[129] as described in the Schedule of Rates and as "agreed upon in the Partial Nonunanimous Stipulation and Agreement in Commission case No. GR-2006-0422."[130]

[129] The only exception to this is found in Ordered paragraph 3, which specifies that a new transportation subaccount will be added.

[130] The Partial Nonunanimous Stipulation and Agreement in Commission case No. GR-2006-0422 was approved by the Commission's Order Approving Stipulation and Agreement issued January 30, 2007.

Staff's position ignores the second part of the Commission's ordered paragraph. The Partial Nonunanimous Stipulation and Agreement in Commission Case No. GR-2006-0422 stated in part "The depreciation rate for Land Rights (Account 374.2) shall be 2.09%." Ex. 108, Noack TrueUp Reb., Sch. MRN-3.

The Partial Stipulation and Agreement in this case maintains the results of Case No. GE-2010-0030. It states in relevant part:

> The conditions ordered by the Commission in Case No. GE-2010-0030 shall also remain in effect, as well, for purposes of this Stipulation and Agreement. (Partial Stipulation and Agreement, Case No. GR-2009-0355, para. 19)

The Staff's argument that MGE should have raised this issue earlier in the proceeding can be easily turned around and applied to the Staff as well. MGE has consistently used 2.09% as the depreciation rate for its filings in this case. (Ex. 30, Noack Dir., Sch. MRN-1, H-12; Ex. 31, Noack Upd. Test Year Dir., Sch. MRN-1, H-12; Sch. 107, Noack True-Up Dir., Sch. MRN-6; Tr. 953) Yet the Staff has provided no testimony challenging MGE's use of this rate.

What is clear is that the language of the Commission's Order in Case No. GE-2010-0030 and the Partial Stipulation and Agreement of the parties to this case establishes that the Account 374.2 rate should be 2.09%. The Staff's failure to include depreciation expense in the true-up of this matter at the rate of 2.09% appears to be an error, and an error that needs to be corrected. The revenue requirement in this case should be increased by $45,582, to reflect the use of the appropriate depreciation rate for Account 374.2 (Land Rights).

E. Rate Case Expense

The Commission has ordered a true-up in this case and has included rate case expense as one of the items to be addressed by that true-up. Moreover, the Partial Stipulation and Agreement that has been filed in this case also contemplates a true-up of "rate case expense (to be updated through September 30, 2009, *to include an estimate for the remainder of the case*)" and establishes that the base amount of rate case expense from which to measure the true-up adjustment is $72,382. (Ex. 108, Noack True-Up Reb., p. 9)

The Public Counsel's true-up testimony appears to suggest that as a part of the true-up MGE's costs associated with legal representation and outside consultants should be eliminated. (Ex. 115, Robertson True-Up Dir., p. 2)

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).

The expenses MGE has incurred for this case 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. (Ex. 32, Noack Rebuttal, p. 16-22)

MGE has made a management decision to utilize its legal representation and consultants on an "as needed" basis, and only pay them when needed, rather than hiring persons that would necessarily receive a salary and benefits each and every year. (Ex. 32, Noack Reb., p. 19) Since MGE's existing personnel already have full time jobs, Public Counsel's position would encourage MGE to staff for "peak" periods, an approach that would be more expensive on a long term basis for both the Company and its customers. (*Id.* at p. 22) In addition to cost savings associated with MGE's approach, the Company is generally able to take advantage of persons with a wider range of both technical and practical rate case experience than in-house employees would have. (*Id.* at p. 19)

It is unclear what wrong Public Counsel is attempting to right with this proposed adjustment. The history of MGE's rate case expense, as provided by Staff witness Foster, indicates that rate case expense has decreased over the last three cases. (Ex. 49, Foster Reb., p. 4) Public Counsel's approach appears to be a solution in search of a problem.

Moreover, the use of outside consultants is common in this industry, to include similar decisions that have been made by the Public Counsel and the Commission itself. In this very case, the Public Counsel engaged two consultants to review and address issues related to cost of capital and depreciation. (Ex. 32, Noack Reb., p. 19)

Additionally, the Commission, which has approximately 200 employees (the overwhelming majority of whom specialize in some aspect of utility regulation), recently hired an outside consultant to assist it with it ethics/Commission contact rules. (*Id.*)

While it was not mentioned in Public Counsel's true-up testimony, the Public Counsel has also previously argued in this case that ratepayers should be held accountable for only "a proportionate share" of expenditures deemed to be reasonable and necessary to prepare and present a rate case based on its assertion that "both ratepayers and shareholders benefit" from the occurrence of rate cases. Ex. 82, Robertson Reb., p. 12.

Such an approach would be contrary the Commission's past treatment of utility rate case expense and violate the principles outlined in the *St. Joseph* case described above. To assert that the Company benefits from the rate case/regulatory process, ignores the history of this process. But for the regulatory framework, a public utility, like the seller of any unregulated commodity, would have the right in the first instance to change its rates without government approval. It is only the existence of the state regulatory scheme that requires the Company to even incur rate case expense. As a result, the Commission may not deny a public utility recovery of its reasonable and prudent regulatory expense absent some extraordinary circumstance.

No such extraordinary circumstances exist In this case. The almost certain result of this case establishes that it has not been frivolously filed and that there is no reason to implement a novel, and likely unlawful, approach to the recovery of rate case expense.

Rate case expenses are normal operating expenses, since it is not by choice that the Company litigates its rate increases. There is no other "normal operating expense" that is "shared" between shareholders and customers.

MGE originally recommended total normalized rate case expense of $293,958. Staff's recommendation found in its True-Up Direct Accounting Schedules is $293,352. MGE is willing to accept Staff's rate case expense number. Ex. 108, Noack True-Up Reb., p. 9-10.

V. Conclusion

MGE's focus is to be a low-cost local distributor of natural gas with high quality customer service. There is no evidence in this record that suggests that MGE has not met these objectives. But in order for MGE to be able to continue doing so, it must have a competitive authorized return and reasonable prospects of actually being able to achieve that authorized return. The SFV residential rate design has served the Company and its customers well, but more needs to be done. Regardless of the titles used for rate design: "decoupled," "straight-fixed variable," "volumetric," or "traditional," the key is to determine which one works, which one balances various interests, and which one is consistent with current energy policy. The Commission has clear and convincing evidence before it that SFV has worked for MGE and its customers. It should expand that rate design to the SGS class. Further, the Commission should use a hypothetical capital structure in determining MGE's authorized rate of return and authorize an ROE of 10.5 percent.

Respectfully submitted,

/s/

James C. Swearengen Mo. Bar 21510
Paul A. Boudreau Mo. Bar 33155
Dean L. Cooper Mo. Bar 36592
Brydon, Swearengen & England P.C.
312 East Capitol Avenue
P. O. Box 456
Jefferson City, Missouri 65102-0456
Telephone: (573) 635-7166
Facsimile: (573) 636-6450

Todd J. Jacobs Mo. Bar 52366
Missouri Gas Energy
3420 Broadway
Kansas City, Missouri 64111
Telephone: (816) 360-5976
Facsimile: (816) 360-5903

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing document was delivered by first class mail, electronic mail or hand delivery on the 5th day of January, 2010, to the following:

Lera Shemwell, Missouri Public Service Commission
Governor's Office Building
200 Madison Street
P.O. Box 360
Jefferson City, Missouri 65102
Lera.shemwell@psc.mo.gov

Stuart Conrad, Finnegan, Conrad & Peterson, LC
3100 Broadway, Suite 1209
Kansas City, MO 64111
stucon@fcplaw.com

William D. Steinmeier, William D. Steinmeier, P.C.
2031 Tower Drive
P.O. Box 104595
Jefferson City, MO 65110-4595
wds@wdspc.com

Marc Poston, Governor's Office Building
200 Madison Street
P.O. Box 7800
Jefferson City, Missouri 65102
marc.poston@ded.mo.gov

Jeremiah Finnegan, Finnegan, Conrad & Peterson, LC
3100 Broadway, Suite 1209
Kansas City, MO 64111
jfinnegan@fcplaw.com

Sarah Mangelsdorf
Shelley A. Woods
Assistant Attorney General
P.O. Box 899
Jefferson City, Missouri 65102
shelley.woods@ago.mo.gov
sarah.mangelsdorf@ago.mo.gov

Charles W. Hatfield, Stinson Morrison Hecker LLP
230 West McCarty Street
Jefferson City, MO 65101
chatfield@stinson.com

Mark Comley, Newman, Comley & Ruth P.C.
P.O. Box 537
Jefferson City, MO 65102
comleym@ncrpc.com

/s/

Paul A. Boudreau

Missouri Gas Energy - Case No. GR-2009-0355
Rate Design Comparisons
Straight Fixed Variable vs. Volumetric

	Total Bills		Total Usage		Total Revenues	
Residential Service	5,231,726	(1)	358,194,480		130,760,163	
Small General Service	729,450	(2)	145,335,010		35,863,929	
Large General Service	3,440	(3)	13,503,795		2,092,961	
Transportation Service	5,532	(4)	265,667,602	(4)	13,038,884	
Miscellaneous	-		-		4,789,682	
Total Sales (Ccf)	5,970,148		782,700,887		186,545,619	(5)
					18,000,000	
					9.903%	

(1) Exh 26 Loos Rebuttal Schedule 1, Column H, Line 1 (before True-Up Adj)
(2) Exh 26 Loos Rebuttal Schedule 1, Column F, Line 2
(3) Exh 26 Loos Rebuttal Schedule 1, Column F, Line 3
(4) Per Stipulation and Agreement
(5) Exh 114 True-Up Direct Staff Accounting Schedules, Schedule 9, Pg 1, Ln 1, Col H

	SFV Rate Design	Volumetric Fixed Chg	Volumetric Volumetric Chg
$18 million	$ 27.47	$ 15.11	$ 0.18054

	Average Volumes (6)	$18 million increase at highest PGA: SFV Rate Design	Volumetric Rate Design	Difference	$18 million increase at lowest PGA: SFV Rate Design	Volumetric Rate Design	Difference
July	16	$ 46.58	$ 37.18	$ 9.41	$ 36.34	$ 26.93	$ 9.41
August	14	$ 44.05	$ 34.25	$ 9.80	$ 35.16	$ 25.37	$ 9.80
September	17	$ 46.81	$ 37.43	$ 9.37	$ 36.44	$ 27.07	$ 9.37
October	19	$ 49.54	$ 40.59	$ 8.95	$ 37.71	$ 28.76	$ 8.95
November	54	$ 90.25	$ 87.59	$ 2.66	$ 56.60	$ 53.95	$ 2.66
December	129	$ 178.03	$ 188.95	$ (10.92)	$ 97.34	$ 108.26	$ (10.92)
January	157	$ 210.23	$ 226.12	$ (15.90)	$ 112.28	$ 128.18	$ (15.90)
February	166	$ 209.28	$ 225.03	$ (15.75)	$ 111.84	$ 127.59	$ (15.75)
March	113	$ 159.71	$ 167.80	$ (8.09)	$ 88.84	$ 96.92	$ (8.09)
April	68	$ 106.64	$ 106.62	$ 0.12	$ 64.21	$ 64.09	$ 0.12
May	36	$ 69.04	$ 63.11	$ 5.93	$ 46.76	$ 40.83	$ 5.93
June	19	$ 49.21	$ 40.21	$ 9.00	$ 37.56	$ 28.56	$ 9.00
Total	796	$ 1,259.37	$ 1,254.79	$ 4.58	$ 761.09	$ 756.51	$ 4.58

(6) Feingold Exh 7, Schedule RAF-7 - Page 1 of 11

PGA Rate		
highest in last 5 years	1.16771	Effective Nov. 1, 2005 Case No. GR-2005-0169
lowest in last 5 years	0.5419	Effective Apr. 17, 2009 Case No. GR-2009-0268

	5% Higher Volumes	$18 million increase at highest PGA: SFV Rate Design	Volumetric Rate Design	Difference	$18 million increase at lowest PGA: SFV Rate Design	Volumetric Rate Design	Difference
July	17	$ 47.54	$ 38.28	$ 9.26	$ 36.78	$ 27.53	$ 9.26
August	15	$ 44.88	$ 35.21	$ 9.67	$ 35.55	$ 25.88	$ 9.67
September	17	$ 47.77	$ 38.55	$ 9.22	$ 36.89	$ 27.67	$ 9.22
October	20	$ 50.64	$ 41.86	$ 8.78	$ 38.22	$ 29.44	$ 8.78
November	56	$ 93.38	$ 91.21	$ 2.17	$ 58.06	$ 55.89	$ 2.17
December	135	$ 185.56	$ 197.64	$ (12.08)	$ 100.84	$ 112.92	$ (12.08)
January	164	$ 219.37	$ 236.67	$ (17.31)	$ 116.52	$ 133.83	$ (17.31)
February	163	$ 218.37	$ 235.53	$ (17.16)	$ 116.06	$ 133.22	$ (17.16)
March	119	$ 166.32	$ 175.43	$ (9.11)	$ 91.91	$ 101.02	$ (9.11)
April	71	$ 110.60	$ 111.09	$ (0.49)	$ 66.05	$ 66.54	$ (0.49)
May	37	$ 71.12	$ 65.51	$ 5.61	$ 47.73	$ 42.11	$ 5.61
June	20	$ 50.30	$ 41.47	$ 8.83	$ 38.06	$ 29.23	$ 8.83
Total	836	$ 1,305.86	$ 1,308.46	$ (2.61)	$ 782.67	$ 785.27	$ (2.61)

Appendix B

Arkansas

Centerpoint Energy:	2007 Ark. PUC LEXIS 408; 261 P.U.R.4th 107
Arkansas Western Gas:	2007 Ark. PUC LEXIS 282; 260 P.U.R.4th 209
Arkansas Oklahoma Gas:	2007 Ark. PUC LEXIS 282

California

Southwest Gas: http://www.utilityregulation.com/content/orders/04CA35920.pdf

Colorado

Public Service Company of Colorado:
http://www.dora.state.co.us/puc/DocketsDecisions/decisions/2007/C07-0568_06S-656G.doc

Georgia

AGL Resources: 2002 Ga. PUC LEXIS 11

Illinois

People's Gas Light and Coke Co.:	2007 Ill. PUC LEXIS 18
North Shore Gas Co.:	2007 Ill. PUC LEXIS 17

Indiana

Vectren Indiana Gas/Southern Indiana G&E:	2006 Ind. PUC LEXIS 376
Citizen's Gas & Coke Utility:	2007 Ind. PUC LEXIS 254

Maryland

Baltimore Gas and Electric 1998 Md. PSC LEXIS 5

Washington Gas (Visit url and search for Case No. 8990):
http://webapp.psc.state.md.us/Intranet/Casenum/CaseAction_new.cfm?RequestTimeout=500?

Massachusetts

Bay State Gas: 2009 Mass. PUC LEXIS 74

Minnesota

CenterPoint Energy Minnesota Gas Company:
https://www.edockets.state.mn.us/EFiling/edockets/searchDocuments.do?method=showPoup&documentId={10B15DA3-3318-469C-A4A0-29E379D980B9}&documentTitle=200911-43518-01

Missouri

Missouri Gas Energy: 2007 Mo. PSC LEXIS 408; 256 P.U.R.4th 250

Atmos Energy: 2007 Mo. PSC LEXIS 278; 255 P.U.R.4th 536

Nevada

Southwest Gas: 2009 Nev. PUC LEXIS 237

New Jersey

New Jersey Gas/South Jersey Gas: 2006 N.J. PUC LEXIS 99

New York

Consolidated Edison of NY: 2007 N.Y. PUC LEXIS 323; 261 P.U.R.4th 1

National Fuel Gas Distribution: 2007 N.Y. PUC LEXIS 449; 262 P.U.R.4th 233

North Carolina

Piedmont Natural Gas: 2005 N.C. PUC LEXIS 1574; 246 P.U.R.4th 287

Public Service Co of NC: 2008 N.C. PUC LEXIS 1729

North Dakota

Xcel Energy: 2005 N.D. PUC LEXIS 13; 241 P.U.R.4th 395

Ohio

Vectren Ohio: 2006 Ohio PUC LEXIS 553; 251 P.U.R.4th 497

Duke Energy Ohio:	2008 Ohio PUC LEXIS 323
Dominion East Ohio:	2008 Ohio PUC LEXIS 655
Columbia Gas of Ohio:	2008 Ohio PUC LEXIS 736
Vectren Energy:	2009 Ohio PUC LEXIS 12

Oklahoma

Oklahoma Natural Gas:	2005 Okla. PUC LEXIS 201

Oregon

Cascade Natural Gas:	2006 Ore. PUC LEXIS 169
NW Natural Gas:	2002 Ore. PUC LEXIS 347; 220 P.U.R.4th 91

Utah

Questar Gas Company:	2007 Utah PUC LEXIS 171

Virginia

Virginia Natural Gas:	2008 Va. PUC LEXIS 1021; 270 P.U.R.4th 371

Washington

Avista Corp.	2007 Wash. UTC LEXIS 55
Cascade Natural Gas:	2007 Wash. UTC LEXIS 28; 254 P.U.R.4th 194

Wisconsin

Wisconsin Public Service:	2008 Wisc. PUC LEXIS 622

Wyoming

Questar Gas Company:	2009 Wyo. PUC LEXIS 290