BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Tariffs Increasing Rates for Gas Service Provided to Customers in the Company's Missouri Service Area.	))))	Case No. GR-2006-0422

APPLICATION FOR REHEARING

COMES NOW Missouri Gas Energy ("MGE"), a division of Southern Union Company ("Southern Union"), by and through the undersigned counsel, pursuant to RSMo §386.500, 4 CSR 240-2.080, and 4 CSR 240-2.160, and for its application for rehearing respectfully states as follows to the Public Service Commission of the State of Missouri (the "Commission"):

1. On March 22, 2007, the Commission issued its *Report and Order* in the above-captioned case, to be effective March 30, 2007.

2. MGE is greatly appreciative of the Commission's decision to authorize the Straight Fixed-Variable ("SFV") rate design in this case. The SFV proposal is fair in that it will result in each residential customer paying his or her own share of MGE's fixed costs and eliminate existing subsidies while affording MGE a reasonable opportunity to earn its authorized return. It will also eliminate an existing disincentive in MGE's current volumetric-reliant rate design for MGE to promote natural gas conservation. Through the annual expenditure of $750,000 that has been included in rates on the

conservation programs proposed by the Staff and Company in this case and approved by the Commission, MGE will encourage its residential customers to conserve natural gas. Furthermore, in authorizing approval of the SFV rate design the Commission lowered MGE's awarded return on equity by 32.5 basis points, which translates into a reduction to the Company's cost of service and thus savings for its customers in the approximate amount of $1,128,000 annually. In anticipation, however, that other parties will request rehearing with regard to the SFV rate design issue and perhaps other matters and may ultimately seek judicial review of the *Report and Order*, to protect its interests MGE must position itself accordingly. As a consequence, MGE files this Application for Rehearing.

3. At page 15 of the *Report and Order*, the Commission found and/or concluded as follows:

> "The Commission continues to use the 30-year normal and finds that it should be consistent when applying a method of weather normalization between utilities. In the absence of more convincing evidence that this methodology should be changed, the Commission will continue to adopt the 30-year weather normalization as proposed by Staff."

At page 36 of the *Report and Order*, the Commission found and/or concluded and/or decided as follows:

> "The Commission adopts Staff position that the 30-year normal will be used and rejects MGE's proposal that a 10-year rolling average should be implemented."

These findings, and/or conclusions and/or decisions are unlawful, unjust and unreasonable for the reasons stated herein.

4. In all of MGE's past rate cases, test year temperatures were "normalized" using assumptions about temperature that were adopted by this Commission based on 30 years of weather pattern data. For this case, MGE witness Russ Feingold conducted a detailed statistical analysis and clearly demonstrated through competent and substantial evidence that of proposed 5-year, 10-year, 20-year and 30-year HDD averages, the 10-year HDD average was by far the best predictor of temperatures for the following two years in the future. (Exh. 11(Feingold Direct), pp. 9-12 and Sch. RAF-3 and RAF-4) Based on this evidence, the Commission should have adopted the 10 year HDD average for purposes of this case.

5. The Staff, through its witness, Curt Wells, argued for a continued use of the 30-year HDD average promulgated by the National Oceanic & Atmospheric Administration ("NOAA"). As indicated, the Commission, in its Report and Order in this case, adopted the Staff's position. The record demonstrates, however, that there is no principled rationale for the Staff's position and therefore the Commission's reliance on the Staff's position for purposes of the Report and Order is misplaced and renders the Report and Order unlawful, unjust and unreasonable.

6. The Staff's justification for using NOAA data is because NOAA uses it and because 30-year HDD averages are supposedly more "stable" and are better for establishing a "normal year." This notion, however, is illogical because the evidence

demonstrates that trend in weather has been increasing warmth and consequently average weather measurements in the distant past – *i.e.*, 1971 – have no logical bearing on predicting temperatures in 2007 or 2008. Put another way, weather *trends* over the last 30 years might assist in predicting temperatures in 2007/2008, but weather *averages* over the same period do not.

7. One of the Commission's duties in determining utility rates is predicting the future. "The purpose of using a test year is to create or construct a reasonably expected level of earnings, expenses and investment *during the future period during which rates to be determined herein will be in effect.*" *In re Southwestern Bell Telephone Company*, 23 Mo.P.S.C. (N.S.) 374, 377 (1980)(emphasis added). "One of the fundamental principles that has long governed ratemaking in this jurisdiction is the axiom that ratemaking *is and should be a forward-looking and prospective process.*" (Exh. 104 (Schallenberg Rebuttal), p. 3; emphasis added) Accordingly, if the rate setting process is to truly be forward-looking then predictions about "normal" conditions in the future must be as accurate as possible. A reasonable rate of return does not meet the requirements of *Hope* and *Bluefield*[1] if, through faulty assumptions about the weather, its "impact" becomes unreasonable. *See Hope, supra*, 320 U.S. at 602 ("Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. It is not theory but the impact of the rate order which counts")(citations omitted).

8. The Staff evidence on this issue on which the Commission relied, did not contradict the persistent revenue shortfalls that MGE has experienced due, in part, to the

[1] *Bluefield Water Works v. PSC* 262 U.S. 679 (1923); *Federal Power Comm. v. Hope Natural Gas Co.* 320 U.S. 591 (1944)

30-year HDD averages incorporated into its rate structure. Further, the Staff offered no evidence to refute MGE's witness Feingold's statistical showing that 10-year HDD averages – although not perfect – are better at predicting future weather patterns than 30-year HDD averages. In fact, Staff witness James Gray testified that statistical analysis is the preferred method of describing the relationship between daily space-heating sales per customer in Ccf to the daily HDD. (Exh. 110 (Gray Direct), 6:7-11). If statistical analysis is the preferred method of analysis by Staff in one area of weather normalized sales, it cannot be ignored or dismissed in the other areas of the analysis.

9. At page 9 of the *Report and Order*, in discussing the capital structure issue, the Commission found and/or concluded and/or decided as follows:

> This issue was discussed by the Commission in MGE's last rate case (Report and Order, Commission Case No. GR-2004-0209, issued, September 21, 2004). As discussed in that case, the capital structure of Southern Union is the result of its management decisions. Hence, Southern Union, and ultimately MGE, must operate with the result of its decisions. MGE stresses that the make-up of Southern Union has changed so dramatically, that use of a hypothetical capital structure is warranted. This premise, however, does not change the Commission's reasoning in MGE's last rate case. Therefore, the capital structure, as proposed by Staff, shall be used.

These findings, and/or conclusions and/or decisions are unlawful, unjust, and unreasonable for the reasons stated herein.

10. At page 35 of the *Report and Order*, the Commission found and/or concluded and/or decided that the appropriate capital structure to use in calculating MGE's cost of service is as follows:

Common Equity	36.06%
Long-Term debt	55.92%
Preferred Stock	4.71%

Short-Term Debt 3.3%

These findings, and/or conclusions and/or decisions are unlawful, unjust, and unreasonable for the reasons stated herein.

11. Because MGE has no discretely identifiable capital structure of its own and is a division of Southern Union – a corporation with diverse interests – an appropriate capital structure must be calculated in the setting of MGE's rates to ensure that MGE is not judged by the capital structure of other, differing enterprises or ventures that have significantly different risk characteristics. Because Southern Union's market prices are not reflective of the risks associated with an LDC, it cannot be utilized as a proxy for how MGE's rate base should be financed. The use of comparable risk LDCs as proxies is essential to determining how MGE's rate base should be financed consistent with the principles of fair rate of return established in *Hope* and *Bluefield*.

12. Using Southern Union's capital structure as a proxy for MGE's is erroneous and backward-looking with regard to capital structure and related ratios; there is a mismatch between the use of the December 31, 2005 Southern Union capital structure and its 36.31 percent common equity ratio and current 2006 market data which reflects investors' very different perspective of Southern Union (not as a gas distribution company), and understatement of common equity cost rate; and the use of a subsequent period such as October 31, 2006 for a true-up further exacerbates the understatement, because it ignores the risk to which the capital invested in MGE is put, causing a mismatch between capital structure and common equity cost rate.

13. Southern Union's capital structure for a subsequent period is not reflective of the risk of a LDC like MGE. Applying a common equity cost rate derived from a

proxy group of LDCs, which has a significantly greater average common equity, to Southern Union's common equity ratio, results in a mismatch and understatement of the required common equity cost rate as well as the overall fair rate of return related to MGE's rate base.

14. Use of the Southern Union consolidated capital structure -- which includes all of Southern Union's long-term debt capital, including that held by the Panhandle Eastern subsidiaries, but excludes the carrying costs associated with those subsidiaries -- is incorrect. At page 9 of the Report and Order, the Commission states that this issue was discussed by the Commission in MGE's last rate case (Report and Order, Commission Case No. GR-2004-0209, issued, September 21, 2004). In the 2004 Report and Order, the Commission specifically found as follows:

> Panhandle Eastern's debt is the debt of a subsidiary company and is not the debt of Southern Union. That debt was raised by Panhandle Eastern for its own purposes and is rated separately by the rating agencies. Furthermore, that debt is non-recourse to Southern Union. That means that the debt restricts the assets that the debt holders can use to satisfy the debt. In other words, if Panhandle Eastern were to default on its debt, the debt holders would not be able to seize the assets of Southern Union to collect the debt.

The Commission, in imposing Southern Union's "more risky" capital structure on MGE, included the non-recourse Panhandle debt even though that debt, as the Commission so found, is the debt of a subsidiary company and not the debt of Southern Union and that the debt is non-recourse to Southern Union. Looking to Panhandle debt for any purpose in this proceeding is improper and unreasonable, and including Panhandle debt for one purpose (i.e., determining the percent of long-term debt in MGE's regulatory capital structure) in the rate calculation process, while excluding it for another purpose (i.e.,

determining the cost rate to be applied to long-term debt ascribed to MGE) results in rates which are confiscatory, unlawful, unreasonable, unjust, arbitrary, and capricious.

15. Southern Union is no longer recognized by investors or major rating agencies as a natural gas distribution company. Southern Union is now considered a "midstream" natural gas company, and comparison of Southern Union to a more traditional natural gas distribution company such as MGE is inappropriate. Because Southern Union's capital structure is no longer representative of how a gas distribution entity is financed, it should not have been utilized in this proceeding. Rather, a hypothetical capital structure as suggested by the Company should have been utilized.

16. The Commission's decision to set MGE's rates using a "more risky" capital structure with 36.06 percent common equity, in conjunction with a return on common equity of only 10.5%, is unlawful, unjust, unreasonable, arbitrary, capricious, and confiscatory and is not based on competent or substantial evidence. The Commission should have utilized a hypothetical capital structure as suggested by the Company or alternatively should have awarded a return on equity in excess of 10.5% to comply with the requirements of the *Hope and Bluefield* decisions.

17. At page 7 of the Report and Order, the Commission finds and concludes that, if the Commission does not adopt the proposed hypothetical capital structure, MGE is willing to accept the actual capital structure of Southern Union as of October 31, 2006. This finding is in error. To support its finding, the Commission points to transcript page 170, lines 17-23. A careful reading of that portion of the transcript, as well as Company witness Noack's testimony, reveals that MGE simply suggested that the Commission use the actual capital structure of Southern Union Company *as of October 31, 2006*, in the

event that the Commission did not adopt the Company's position. MGE did not agree to accept or otherwise acquiesce in the use of Southern Union Company's capital structure.

18. For the foregoing reasons, MGE respectfully submits that the *Report and Order* is unlawful, unjust, unreasonable, arbitrary, capricious, confiscatory, involves an abuse of discretion, is unsupported by competent and substantial evidence upon the whole record, is in excess of statutory authority, is made upon unlawful procedure, is inadequately explained, and is unconstitutional, all in material matters of fact and law, individually or cumulatively, or both, in the particulars and for the reasons stated herein.

WHEREFORE, Missouri Gas Energy, a division of Southern Union Company, respectfully requests that the Missouri Public Service Commission grant rehearing with respect to its March 22, 2007, *Report and Order* issued in the above-captioned case, as requested herein, and upon rehearing and reconsideration of the issues raised herein issue a new *Report and Order* consistent with this pleading.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing document was electronically transmitted, sent by U.S. Mail, postage prepaid, or hand-delivered, on this 29th day of March, 2007, to:

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