

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

In the Matter of )  
KCPL Greater Missouri Operations Company's )  
Request for Authority to Implement ) File No. ER-2012-0175  
General Rate Increase for Electric Service )

**INITIAL BRIEF**

**OF**

**SOUTHERN UNION COMPANY**

**D/B/A MISSOURI GAS ENERGY**

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## **I. THE PROBLEM**

Approximately sixty-five percent (65%) of MPS' Residential customers and sixty-two percent (62%) of L&P's Residential customers are subsidizing specially-priced, discounted rates that encourage the increased use of electricity. For eight months of the year, an MPS or L&P Residential General Use customer who does not have electric space heating equipment pays more for electricity than a neighbor who installs electric heating equipment under MPS' and L&P's discounted Residential Space Heating rates. These rates are a product of a different era and are at odds with current energy policy priorities which should encourage energy conservation and strive for cost-based rates. No other investor-owned electric utility in Missouri has these specially-priced Residential rates for customers who space heat with electricity.

Electric Space Heating rates are the primary growth area in GMO's Residential customer base. While overall numbers of MPS' and L&P's General Use Residential customers have declined, Residential Space Heating customers have increased - presumably attracted, through false price signals, to this discounted rate. Accordingly, this subsidized rate is unsustainable in the long term - with increasingly fewer numbers of Residential General Use customers supporting discounted rates of increasing numbers of Residential Space Heating customers. The Commission should act now to freeze or eliminate the availability of these rates.

MPS' and L&P's discounted Residential Space Heating rates are not cost-based and result in the subsidization of Residential service seasonally and the subsidization of Residential Space Heating customers by all other Residential customers in the winter. We know this because GMO's own class cost of service (CCOS) studies show that:

- A. The MPS winter Residential rate of return is lower than the summer Residential rate of return;

- B. The L&P winter Residential rate of return is higher than the summer rate of return; and,
- C. For both MPS and L&P, the winter Residential Space Heating rate of return is lower than the winter rate of return for Residential General Use and the Residential class as a whole.<sup>1</sup>

Importantly, the Staff agrees that L&P Residential Space Heating customers' winter rates must be increased by an amount higher than the system average increase awarded by the Commission in this case in order to move those rates closer to the cost of providing that service.<sup>2</sup> The Office of the Public Counsel, while not providing testimony on this issue, supports Staff's position. While Staff moves in the right direction for L&P, its proposal does not adequately address the L&P problem and ignores the MPS problem.<sup>3</sup>

## **II. THE PROPOSALS**

The following proposals to address the identified problem have been made by the parties in this case:

- A. ***GMO*** – GMO has ignored the problem and recommends an across-the-board increase for all MPS and L&P rate elements<sup>4</sup>;
- B. ***Staff*** – Acknowledging the existence of the problem for L&P (but not MPS), Staff proposes to increase winter L&P Residential Space Heating rates on a revenue neutral basis prior to assignment of any increase awarded in this case<sup>5</sup>; and,

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<sup>1</sup>Exh. 132, Normand Direct, pages 25-26, Tables 3A-MPS and 3B-L&P.

<sup>2</sup> Exh. 268, Scheperle Direct, page 3, lines 1-8.

<sup>3</sup> Exh. 629, Cummings Rebuttal, page 3, line 8 - page 5, line 12 and Rebuttal Schedule FJC- 1.

<sup>4</sup> Exh.134, Rush Direct, page 12, lines 1-3 and Exh. 136, Rush Surrebuttal, page 12, lines 13-15.

C. *MGE* –MGE proposes that the Commission adjust current MPS and L&P Residential rates on a revenue-neutral basis to remove 100% of the existing seasonal inequities in the collection of revenue in relation to cost, as well as the inequities in the collection of winter revenue among customers taking service on different rate schedules.<sup>6</sup> This adjustment would occur whether Space Heating rates are frozen or eliminated. MGE recommends that any Residential rate increase that may be awarded in this case should be assigned to MPS and L&P Residential rates in a way that preserves the movement to cost-based rates within the MPS and L&P Residential classes.<sup>7</sup>

After making these adjustments, MGE has two alternate proposals. As its primary proposal, MGE recommends that the Commission eliminate the availability of MPS' and L&P's Residential Space Heating rates as separate rate schedules.<sup>8</sup> If the availability of Space Heating rates is eliminated, MPS' and L&P's current Space Heating winter block rate structure should be used to develop a consolidated General Use rate on which both current General Use and Space Heating customers would take service.<sup>9</sup> In the alternative, MGE recommends that the Commission indicate its intent to eliminate MPS' and L&P's Residential Space Heating rates in a subsequent rate case, freeze the availability of these rates, and require tariff language to ensure

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<sup>5</sup> Exh. 268, Scheperle Direct, page 3, lines 1-8. Staff does not propose a corresponding revenue-neutral shift for MPS.

<sup>6</sup> Exh. 628 Cummings Direct, page 10, line 18 - page 143, line 9; page 20, lines 12-23; page 25, line 3 - page 264, line 17; and Schedules FJC-3A, FJC-3-B, FJC-8A, and FJC-8B.

<sup>7</sup> Exh. 628, Cummings Direct, page 28, line 13 - page 29, line 17 and Schedules FJC-9A and FJC-9B.

<sup>8</sup> Exh. 628, Cummings Direct, page 21, line 3 - page 23, line 2; Exh. 630, Cummings Surrebuttal, page 11, line 3 - page 14, line 7 and Surrebuttal Schedule FJC-1.

<sup>9</sup> Exh. 628, Cummings Direct, page 25, line 11 - page 26, line 11 and Schedules FJC-8A and FJC-8B. As explained in this testimony, GMO has not provided the necessary billing determinants to implement this recommendation for L&P. As a result, a uniform winter energy charge is developed for the L&P consolidated General Use rate.

the effectiveness of freezing the availability of the rate schedules.<sup>10</sup> Rates that would result from both elimination and freezing the availability of Space Heating rates on a revenue-neutral basis are illustrated on pages 20-21 below.

### **III. DISCUSSION AND ANALYSIS**

#### **A. *ISSUES LIST***

The above subject is generally represented in the Issues List as a part of GMO issue 7.

More specifically, the following issues from the list apply directly to MGE's concerns:

7. d. Residential rate adjustments:

- i. Should current Residential rates be adjusted to reflect a revenue neutral shift seasonally and among Residential rate schedules in the winter based on GMO's class cost of service study?
- ii. How should any Residential rate increase be assigned to rate elements?

7. a. Residential Space Heating services:

- i. Should GMO's Residential Space Heating services be eliminated?
- ii. In the alternative, should GMO's Residential Space Heating services be scheduled for elimination in a subsequent rate case by freezing their availability in this case?
- iii. Should the Commission adopt Staff's proposal to increase the residential space heating rates?

#### **B. *RESIDENTIAL RATE BACKGROUND***

To understand the underlying issues with these discounted rates, it is important to understand how the majority of GMO's customers pay more for electric service for eight months of the year. The following table shows the portion of GMO Residential customers now served

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<sup>10</sup> Exh. 628, Cummings Direct, page 23, line 4 - page 24, line 17.

under each current rate schedule for MPS and L&P:

	<u>MPS</u>	<u>L&amp;P</u>
General Use	64.9%	62.4%
Electric Space Heating	34.8	34.1
Electric Space/Water Heating – Separate Meter (frozen)	N.A.	0.1
Other Use	0.3	3.4

GMO's General Use customer base has steadily declined for a number of years while at the same time that its Residential Space Heating customer base has continually grown.<sup>11</sup> This imbalanced growth within the MPS and L&P Residential classes has resulted from discounted pricing for Space Heating services compared to General Use services, that MGE shows are not supported by ratemaking and policy considerations.

As indicated above, L&P Electric Space/Water Heating was previously frozen by this Commission. The Commission later addressed separate all-electric space and separately-metered space heating services provided to KCPL general service customers in Case No. ER-2007-0291. In that case, the Commission froze the availability of KCPL services to existing customers' locations and reduced the price advantage of these services over the general service schedules, with findings and decisions that included:

- Waiting until anywhere from 2009 to 2012 to address the rate disparities that the separately-metered space heating and all-electric tariff customers pay compared to the general service tariff customers is waiting too long.
- Trigen's and Staff's argument that increasing all class' rates the same percentage would effectively increase the size of the general service-space heating discounts, and exacerbate the current problem, is compelling.
- In a future rate case, the Commission might be willing to consider eliminating the discounts altogether. Allowing even more customers to use those discounts flies

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<sup>11</sup> Exh. 628, Cummings Direct, page 19, lines 1-7 and Schedule FJC-6.

in the face of a possible move, supported by Staff, towards eliminating them entirely.<sup>12</sup>

MGE believes that the Commission should make similar findings regarding GMO's Residential Space Heating rates based on the record evidence in this case.

The current summer energy charges are the same for General Use and Space Heating for MPS and L&P, and these summer energy charge are higher than current winter energy charges.<sup>13</sup> In the winter, both General Use and Space Heating services of MPS and L&P have declining block energy charges. Average winter energy prices are lower for Electric Space Heating than for General Use for MPS and L&P (above 600 kWh for MPS).<sup>14</sup>

The winter price advantage of MPS' and L&P's Space Heating has increased over time through a series of GMO rate increases that generally resulted from stipulations and across-the-board increases, or equal percentage increases in all rates.<sup>15</sup> GMO proposes to enlarge these Space Heating winter advantages in this case.<sup>16</sup> While GMO alleges, without explanation, that its CCOS studies support the lower winter price for MPS' and GMO's Space Heating compared to General Use and justifies increasing the Space Heating price advantages, quite the opposite is, in fact, the case.<sup>17</sup> In fact, the MPS and L&P Space Heating winter price advantages drop dramatically if the winter rates of return are equalized among the various Residential rate

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<sup>12</sup> Report and Order, Case No. ER-2007-0291, issued December 6, 2007, pages 77, 78, and 82. The Commission also froze Residential General Use and Space Heat - 2 Meters in this case.

<sup>13</sup> MPS' and L&P's current Residential rates are described in Exh. 628, Cummings Direct, page 6, line 1- page 7, line 2 and are shown in Schedules FJC-1A and FJC-1B.

<sup>14</sup> L&P frozen Space/Water Heating - Separate Meter schedule serves only 51 customers with single block energy charges that are lower in the winter than in the summer. Exh. 628, Cummings Direct, page 6, footnote 4 and Schedule FJC-1B.

<sup>15</sup> Exh. 628, Cummings Direct, page 7, lines 16 - page 8, line 13 and Schedules FJC-2A and FJC-2B.

<sup>16</sup> Exh. 628, Cummings Direct, page 7, lines 4-14; page 8, lines 12-13; and Schedules FJC-2A and 2B.

<sup>17</sup> Exh. 628, Cummings Direct, page 9, line 3 - page 10, line 9 and footnote 10.



schedules for MPS and L&P.<sup>18</sup> GMO has simply provided no evidence to support the current Space Heating winter price advantages for MPS or L&P, much less increases in them.

GMO's Residential Space Heating discounts are unique among Missouri electric utilities regulated by the Commission. Neither of the other investor-owned Missouri electric utilities has a separate all-electric or space heat rate.<sup>19</sup> The standard Residential services of Ameren Missouri and The Empire District Electric Company have declining block winter energy charges as do MPS' and L&P's General Use schedules. MPS and L&P already have a strong potential to add winter load through their current General Use schedules with their declining winter energy prices without the need for separate, significantly lower-priced Space Heating schedules.<sup>20</sup>

### ***C. RESIDENTIAL REVENUE-NEUTRAL RATE ADJUSTMENTS***

Equity considerations suggest that each customer rate class should pay the cost to serve the class. Achieving full equity results in identical rates of return for each class, which is based on the revenue produced from rates and the cost to serve each class. If the equity objective is not met, a portion of the cost to serve one or more classes is borne by other class(es).<sup>21</sup> That is, the cost to serve the customer class (or sub-class) with a lower-than-system-average rate of return is being subsidized by the customer class (or sub-class) with a higher-than-system-average rate of return.

The following example illustrates the inequities in revenue collection among hypothetical Residential rate schedules with differing rates of return. Suppose a utility serves its Residential

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<sup>18</sup> Exh. 628, Cummings Direct, page 14, line 11 - page 15, line 10 and Schedules FJC-3A and FJC-3B.

<sup>19</sup> Exh. 628, Cummings Direct, page 15, lines 12-17 and Schedule FJC-4.

<sup>20</sup> Exh. 628, Cummings Direct, page 15, line 19 - page 16, line 17.

<sup>21</sup> Exh. 628, Cummings Direct, page 10, line 18 - page 11, line 5.

customer class through two rate schedules, A and B. The first row in the table below shows Current Revenue for each rate schedule and for the class as a whole. The second row provides Operating Expenses for each schedule determined in a CCOS study. The third row, Net Operating Income, is the difference between Current Revenue and Operating Expenses. This row is the dollar amount available to provide a return on investment, or Rate Base. Each rate schedule's Rate Base, shown in the fourth line, is developed in the CCOS. The Rate of Return in line 5 is Net Operating Income divided by Rate Base.

<u>Line</u>		<u>Rate Schedule</u>		<u>Class</u>
		<u>A</u>	<u>B</u>	<u>Total</u>
1	Current Revenue	10,000	5,000	15,000
2	Operating Expenses	7,000	4,000	11,000
3	Net Operating Income	3,000	1,000	4,000
4	Rate Base	50,000	30,000	80,000
5	Rate of Return	6.00%	3.33%	5.00%
6	Cost of Service to Meet			
	<u>Current Class Rate of Return</u>			
7	Operating Expenses	7,000	4,000	11,000
8	Return at 5%	2,500	1,500	4,000
9	Total Current Cost of Service	9,500	5,500	15,000
10	Current Revenue Less Total			
	Current Cost of Service (at 5%)	500	(500)	-

In this example, with Residential rates and resulting Current Revenue, Rate Schedule A earns a 6.00% return and Rate Schedule B earns a 3.33%, while the class as a whole provides a 5.00% return at current rates. If each rate schedule were to provide the class total 5.00% return,

Rate Schedule A rates would have to be reduced to produce \$500 less revenue and Rate Schedule B rates must be increased to collect \$500 more revenue, as shown on line 10. Alternatively stated, at current rates, customers on Rate Schedule A provide revenue that covers not only their own cost of service of \$9,500, but also subsidizes \$500 of the cost to serve Rate Schedule B customers' \$5,500.

The same inequity exists in MPS' and L&P's current Residential rate schedules. MPS and L&P CCOS results show that winter revenue produced from current Residential rates - and the resulting winter rates of return for Space Heating relative to General Use - do not support the discounted winter Space Heating rates.<sup>22</sup> Specifically, at current rates, the MPS and L&P CCO studies show the following winter rates of return:

	<u>MPS</u>	<u>L&amp;P</u>
General Use	6.304%	6.438%
Space Heating	3.264%	2.754%
Residential Class Total	4.919%	4.085% <sup>23</sup>

Furthermore, at MPS' current rates, the winter Residential rate of return of 4.919% is less than the summer Residential rate of return of 5.905%; and at L&P's current rates, the winter Residential rate of return of 4.448% is greater than the summer Residential rate of return of 3.598%.<sup>24</sup>

As illustrated in MPS' and L&P's own CCOS, General Use customers - the majority of MPS' and L&P's customers - are subsidizing a portion of the cost to serve Space Heating customers in the winter. This inequity is inconsistent with the Commission's obligation to establish rates that are not unduly discriminatory. "Under Section 393.130.3, [public utilities]

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<sup>22</sup> Exh. 628, Cummings Direct, page 10, lines 11- 16; page11, lines 7- page 12, line 22; Exh. 630, Cummings Surrebuttal, page 6, lines 5-19.

<sup>23</sup> Exh. 628, Cummings Direct, Schedule FJC-3A, line 11 and Schedule FJC-3B, line 11.

<sup>24</sup> Exh. 628, Cummings Direct, Schedule FJC-3A, line 4 and Schedule FJC-3B, line 4.

are forbidden from granting undue preference or advantage to any ratepayer, just as they may not unduly or unreasonably prejudice or disadvantage any ratepayer in the provision of services.”

*State ex rel City of Joplin v. PSC*, 186 S.W.3d 290, 296 (Mo.App.W.D. 2005).

In addition, L&P’s CCOS shows that for the Residential class as a whole, current rates and the resulting revenue produce a lower rate of return in the winter than in the summer while MPS’ CCOS results show a higher rate of return in the winter than in the summer. These inequities seasonally and within rate schedules have persisted since at least GMO’s last rate case, when its CCOS studies for MPS and L&P showed similar inequities.<sup>25</sup> Furthermore, GMO’s proposal to apply any revenue increase awarded by the Commission in this case across the board to the various MPS and L&P Residential schedules in this case not only ignores GMO’s own CCOS studies, but also exacerbates the current inequities shown above.<sup>26</sup>

For example, application of a ten percent increase for illustrative purposes to rates in equal percentages causes the rate of return difference between General Use and Space Heating to increase from 3.040% to 3.448% for MPS and from 3.685% to 4.424% for L&P, enlarging the discount provided to the Space Heating customers.<sup>27</sup> Given GMO’s position in this case, this disparity will continue to grow with successive rate cases until it is no longer sustainable and until the customer impact will only be greater. The Commission should act now to freeze or eliminate these discounted Space Heating rates.

Based on the MPS and L&P CCOS results, MGE recommends revenue shifts and resulting energy charge adjustments to eliminate the seasonal inequities in Residential rates and

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<sup>25</sup> Exh. 628, Cummings Direct, page 13, line 1 - page 14, line 9.

<sup>26</sup> Exh. 628, Cummings Direct, page 20, lines 1-10 and Schedule FJC-7.

<sup>27</sup> Exh. 628, Cummings Direct, Schedule FJC-7.

resulting revenue collection and to correct the current relative under pricing of the discounted Space Heating services in the winter.<sup>28</sup> Residential revenue in total is unchanged with the rate adjustments, with winter General Use rates declining and winter Space Heating rates increasing for MPS and L&P.

No party has questioned the accuracy of MGE’s recommended revenue shift.<sup>29</sup> The Staff CCOS cannot be used to develop the revenue shifts required to cure the inequities in the collection of current Residential revenue as recommended by MGE.<sup>30</sup> The Staff CCOS is based on its then-recommended revenue requirement, not current revenues and, second, the study is structured in a manner that does not identify operating expenses and rate base by season and rate schedules. This expense and rate based information is required to develop MGE’s current revenue shift.

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<sup>28</sup> For MPS, the required Residential shift requires a \$3,094,328 increase in winter revenue offset by a corresponding decrease of \$3,094,238 in summer revenue. The increased winter revenue must be assigned to the Residential rates schedules as follows in order to equalize the winter rates of return on all schedules (numbers in parentheses represent revenue reductions):

<u>General Use</u>	<u>Space Heating</u>	<u>Other Use</u>	<u>Time of Day</u>
(\$ 3,409,168)	\$ 6,541,217	(\$ 37,811)	\$ --

For L&P, the required Residential shift requires a \$684,386 decrease in winter revenue offset by a corresponding increase of \$384,386 in summer revenue. The decrease in winter revenue must be assigned to the Residential rates schedules as follows in order to equalize the winter rates of return on all schedules (numbers in parentheses represent revenue reductions):

<u>General Use</u>	<u>Space Heating</u>	<u>Separate Meter</u>	<u>Other Use</u>
(\$ 1,997,310)	\$ 1,341,026	\$ 1,110	(\$ 29,223)

Exh. 628, Cummings Direct, page 3, lines 10-18; page 19, lines 13-22; page 20, lines 12-23; page 25, lines 3-9; page 26, lines 14-17; Schedules FJC-A and FJC-3B; and Schedules FJC-8A and FJC-8B, lines 1 and 2. Also, see Exh. 630, Cummings Surrebuttal, page 7, line 7 - page line 9 and page 8, line 11 - page 9, line 2 for an explanation of the use of MPS’ and L&P’s CCOS to develop the recommended revenue shifts.

<sup>29</sup> GMO mischaracterized MGE’s revenue shift in indicating that it solely equalizes seasonal rates of return for the Residential class. Exh. 630, Cummings Surrebuttal, p. 2, line 19 - page 3, line 12.

<sup>30</sup> In addition to GMO and Staff, Ag Processing, Federal Executive Agencies, Midwest Energy Consumer’s Group, Energy Users’ Association and Missouri Industrial Energy Consumers (“Industrials”) filed a CCOS. The Industrials CCOS results are provided only for the Residential class as a whole on an annual basis. Residential results by season and rate schedule are not available in the Industrials CCOS.

In contrast to the Staff CCOS, the MPS and L&P CCOS results in this case provide an appropriate basis for correcting Residential revenue collections inequities. For reference, the same CCOS approach was adopted by the Kansas Corporation Commission (“KCC”) in KCPL’s 2010 rate case.<sup>31</sup> Based on the KCPL CCOS results, the KCC designed Residential rates based on a shift in revenue collection away from General Use customer toward Space Heating customers.

It is very important to note that Staff recognizes that L&P’s Residential Space Heating services are underpriced and, therefore, are being subsidized by General Use rates.<sup>32</sup> That conclusion has caused Staff to recommend that the first block of the L&P Residential Space Heating rates be increased by 6%.<sup>33</sup> However, Staff’s recommended revenue shift does not go far enough to address the current inequities in the collection of winter revenue from L&P’s Residential customers served on different schedules and does not correct the seasonal inequity in the collection of current Residential revenue.<sup>34</sup>

Staff does not recommend a corresponding winter revenue shift toward MPS’ Residential Space Heating and away from General Use even though its own CCOS results also support these rate adjustments.<sup>35</sup>

As can be seen from MGE’s testimony, a \$3.2 M increase to the MPS’ Space Heating rates and a \$4.7 M increase to L&P’s Space Heating rates are required to eliminate the inequities

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<sup>31</sup> Exh 630, Cummings Surrebuttal, page 15, lines 5-9 and footnote 39; Exh. GMO-133, Normand Rebuttal, page 12, lines 9-13.

<sup>32</sup> Exh. 268, Scheperle Direct, page 3, line 1-8.

<sup>33</sup> *Id.*

<sup>34</sup> Exh. 629, Cummings Rebuttal, page 3, line 8- page 4, line 3 and Rebuttal Schedule FJC-1.

<sup>35</sup> Exh. 629, Cummings Rebuttal, page 4, line 5 – page 6, line 12 and Rebuttal Schedule FJC-1.

resulting from the current discounts. However, the Staff’s proposal would not increase MPS’ rates at all and would only increase L&P rates by a total of \$1.1 M.<sup>36</sup> If cost-based rates are appropriate, as Staff indicates, the proper approach is to eliminate or freeze the availability of these rates in a way that removes all of the existing inequities as recommended by MGE. The Staff proposal, while directionally correct, is simply insufficient.

Moreover, it should also be noted that under Staff’s proposal, a portion of the L&P shift would immediately be negated if any revenue increase was spread across rates on an equal percentage basis. The following table illustrates how even a 5% “across-the-board” increase will diminish the impact of Staff’s L&P shift and begin to again increase the discount for Space Heating rates:

<b><u>L&amp;P:</u></b>	Current - Before Staff 6% Shift	After Staff 6% Shift	Assuming a 5% Increase
General Use second block winter rate	\$ 0.07310	\$ 0.07310	\$ 0.07676
Space Heat second block winter rate	\$ 0.05210	\$ 0.05523	\$ 0.05799
Difference between second block winter rates	\$ 0.02100	\$ 0.01787	\$ 0.01877
<b><u>MPS:</u></b>	Current	After Staff's No Shift	Assuming a 5% Increase
General Use second block winter rate	\$ 0.07450	\$ 0.07450	\$ 0.07823
Space Heating second block winter rate	\$ 0.05460	\$ 0.05460	\$ 0.05733
Difference between second block winter rates	\$ 0.01990	\$ 0.01990	\$ 0.02090

<sup>36</sup> Exh. 630, Cummings Surrebuttal, Schedule FJC-1.

MGE's recommended current Residential rate adjustments for MPS and L&P are consistent with sound ratemaking concepts, are fully supported by the record evidence, and should be adopted by the Commission in this case.

***D. PRIMARY RECOMMENDATION – ELIMINATE AVAILABILITY OF SPECIALLY-PRICED SPACE HEATING RATES***

In the 1970s, rising natural gas demand and declining production along with supply availability concerns provided public policy support for favoring the use of electricity over natural gas, including offering special space heating rates to encourage the installation of electric space heating equipment. Energy market conditions today no longer provide this public policy basis for preferential treatment of electricity for space heating purposes. Instead, today's energy-related public policy focuses on promoting end-user energy conservation, limiting environmental impacts related to energy production and delivery, and encouraging efficiency in energy consumption.<sup>37</sup> Consistent with today's energy policy considerations, a number of electric utilities nationally have discontinued or closed the availability of specially-priced Residential Space Heating services, including utilities in Arkansas, California, Connecticut, Massachusetts, Nebraska, New Jersey, North Carolina, Ohio, Pennsylvania, and Wisconsin.<sup>38</sup> No other investor-owned electric utility in Missouri makes specially-discounted Residential Space heating rates available.

Policy considerations dictating elimination of GMO's discounted Residential Space Heating services include:

1. The current MPS and L&P General Use winter declining block rate structures encourage winter load additions. By offering even lower-priced Space Heating services, customers are

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<sup>37</sup> Exh. 628, Cummings Direct, page 21, lines 11-23.

<sup>38</sup> Exh. 628, Cummings Surrebuttal, page 9, line 6 - page 10, line 18.



not incented to conserve electricity used for both heating and non-heating purposes, a point unrebutted by GMO in testimony.<sup>39</sup>

2. The additional electricity production and delivery caused by discounted Space Heating services results in adverse environmental impacts, a point unrebutted by GMO in testimony.<sup>40</sup>
3. Encouraging the use of electricity through discounted Space Heating services ignores the fact that natural gas is more efficient than electricity for space heating purposes, which was also unrebutted by GMO in testimony.<sup>41</sup>
4. Space heating with natural gas is less expensive than heating with electricity from GMO, another point unrebutted by GMO in testimony.<sup>42</sup>
5. The current MPS and L&P General Use winter rate structures have declining winter energy rates. Through these price signals, MPS and L&P have a stronger potential to encourage winter usage through their General Use schedules than does Ameren Missouri and Empire District through their Residential rates – rates that do not offer discounts for Space Heating. Discounted Space Heating services are not needed for winter-load building.<sup>43</sup>
6. Customers choose electricity rather than natural gas for space heating simply because they receive winter price breaks not only for space heating purposes but also for lighting their homes, operating their televisions and refrigerators, and using other electric appliances.<sup>44</sup> Aside from promoting false price signals, these rates are not sustainable in the long term.
7. Elimination of Space Heating services is consistent with factors that GMO articulates as being important in assessing rate design proposals.<sup>45</sup>

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<sup>39</sup> Exh. 628, Cummings Direct, page 22, lines 7-10.

<sup>40</sup> Exh. 628, Cummings Direct, page 21, line 23 - page 22, line 2; page 22, lines 11-13; Exh. 630, Cummings Surrebuttal, page 11, line 12 - page 12, line 2 and Surrebuttal Schedule FJC-1.

<sup>41</sup> Based on U.S. Department of Energy efficiency standards for residential furnaces and heat pumps, the consumption efficiency, i.e., combined appliance and fuel cycle efficiency, for a natural gas furnace is 74-82 percent while the consumption efficiency is 50 percent for an electric heat pump and 23 percent for an electric furnace. Exh. 628, Cummings Direct, page 22, line 15 – page 23, line 2. Also see Exh. 630, Cummings Surrebuttal, page 11, line 3 – page 13, line 12 and Surrebuttal Schedule FJC-1.

<sup>42</sup> Exh. 628, Cummings Direct, page 17, lines 1-14 and Schedule FJC-5.

<sup>43</sup> Exh. 628, Cummings Direct, page 15, line 19 – page 16, line 17.

<sup>44</sup> Exh. 628, Cummings Direct, page 18, lines 1-18.

<sup>45</sup> Exh. 135, Rush Rebuttal, page 12, line 8 – page 13, line 22; and Exh. 630, Cummings Surrebuttal, page 16, line 3 – page 24, line 10.

Sound ratemaking and policy considerations clearly support the elimination of the specially-priced Space Heating services.<sup>46</sup> The only question is whether these specially-priced services should be eliminated in this case or a subsequent rate case.<sup>47</sup> MGE recommends that these services be eliminated in this case. The resulting rates are shown on the table below on pages 20-21.

***E. ALTERNATE RECOMMENDATION: FREEZE AVAILABILITY OF SPECIALLY-PRICED SPACE HEATING RATES***

However, if the Commission prefers a more gradual approach, MGE recommends in the alternative that the Commission indicate its intent to eliminate these services in a subsequent rate case, adopt the recommended Residential revenue neutral shift in this case, freeze the availability of these specially-priced services, and require tariff language to ensure the effectiveness of freezing the schedules and to simplify their future elimination.<sup>48</sup>

***F. RESIDENTIAL RATE DESIGN***

MGE provides rate design recommendations based on the elimination of Space Heating services and on the alternative of freezing the availability of these services.<sup>49</sup> If MPS' Space Heating services are eliminated, its current Space Heating winter block rate structure along with

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<sup>46</sup> MGE shows that the specially-priced Space Heating services are inconsistent with public policy considerations. Contrary to GMO's claim, this conclusion does not mean that electricity should not be used for space heat services. Exh. 630, Cummings Surrebuttal, page 13, line 14 – page 14, line 7.

<sup>47</sup> Exh. 628, Cummings Direct, page 3, line 20 – page 4, line 8.

<sup>48</sup> Exh. 625, Cummings Direct, page 4, line 10 – page 5, line 3 and page 23, line 4 – page 24, line 17. The required tariff language should clearly indicate that the service is available to existing customers at existing premises at the rates on the date rates in this case become effective. A customer cannot receive the service in a different location and the premise is not eligible to continue the service when the customer moves or otherwise terminates service.

<sup>49</sup> Exh. 628, Cummings Direct, page 25, line 3 – page 27, line 11 and Schedules FJJ-8A and FJC-8B. GMO incorrectly describes MGE's recommendations as "a series of scenarios to revise Residential rate blocking" (Exh. 630, Cummings Surrebuttal, page 3, line 17 – page 4, line 16) based on "modifications to the Company's billing determinates [sic]" (Cummings Surrebuttal, page 5, lines 12-18 and footnote 12).

MGE's current revenue shift are used to develop a consolidated MPS General Use rate on which both current General Use and Space Heating customers would take service after this case. If L&P's Space Heating services are eliminated, MGE preferred to develop the consolidated L&P General Use schedule based on the current Space Heating rate blocks and rate block rate differences, as is the case for MPS, but GMO would not provide the requested billing determinants to enable the rate calculation on this basis.<sup>50</sup> Absent this billing determinant information, the consolidated L&P General Use schedule recommended by MGE contains a single-block winter energy charge. In addition, the L&P Space/Water Heating - Separate Meter schedule with its 51 customers is not included in the consolidated General Use schedule. If MPS and L&P Space Heating services are frozen, current Space Heating customer rates are adjusted to reflect MGE's revenue shift.<sup>51</sup>

The following tables show current rates (from Exh. 628, Cummings Direct, Schedules FJC-1A and FJC-1B) and the rates associated with MGE's recommendations (from Exh. 628, Cummings Direct, Schedules FJC-8A and FJC-8B) for the alternatives of eliminating Space Heating and freezing Space Heating. This first table compares current rates with rates upon the

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<sup>50</sup> Exh. 628, Cummings Direct, pages 4 and 26.

<sup>51</sup> Exh. 628, Cummings Direct, page 26.

elimination of Space Heating for MPS and L&P:

	<u>Current</u>	<u>Space Heating Elimination</u>	<u>Space Heat Retained/Frozen</u>
<b><u>GMO-MPS:</u></b>			
<b>Electric Space Heating</b>			
Service Charge	10.43	10.43	10.43
Energy Charge			
Summer			
First 600 kWh	0.1088	0.1059	0.1059
Next 400 kWh	0.1120	0.1091	0.1091
Excess	0.1176	0.1147	0.1147
Winter			
First 600 kWh	0.1088	0.1147	0.1049
Next 400 kWh	0.0586	0.0645	0.0706
Excess	0.0485	0.0544	0.0660
<b>General Use</b>			
Service Charge	10.43	10.43	10.43
Energy Charge			
Summer			
First 600 kWh	0.1088	0.1059	0.1059
Next 400 kWh	0.1120	0.1091	0.1091
Excess	0.1176	0.1147	0.1147
Winter			
First 600 kWh	0.1088	0.1147	0.1049
Next 400 kWh	0.0745	0.0645	0.0706
Excess	0.0745	0.0544	0.0706

	<u>Current</u>	<u>Space Heating Elimination</u>	<u>Space Heat Retained/Frozen</u>
<b>GMO-L&amp;P:</b>			
<b>Electric Space Heating</b>			
Service Charge	9.75	9.75	5.21
Energy Charge			
Summer			
All kWh	0.1117	0.1144	0.1170
Winter			
First 1000 kWh	0.0776	0.0742	0.0823
Over 1000 kWh	0.0521	0.0742	0.0568
<b>Water/Space Heating - Separate Meter</b>			
Service Charge			
Energy Charge	5.21	5.21	5.21
Summer			
All kWh	0.1143	0.1170	0.1170
Winter			
All kWh	0.0619	0.0664	0.0664
<b>General Use</b>			
Service Charge	9.75	9.75	9.75
Energy Charge			
Summer			
All kWh	0.1117	0.1144	0.1144
Winter			
First 650 kWh	0.0993	0.0742	0.0904
Over 650 kWh	0.0731	0.0742	0.0642

The rates in these tables result from MGE’s revenue neutral rate adjustment before any Residential revenue increase approved by the Commission is implemented. MGE has provided recommendations regarding how these rates should be adjusted to incorporate any Residential increase approved by the Commission.<sup>52</sup> MGE’s recommendation ensures that the seasonal equity resulting from MGE’s recommended current Residential rate adjustments continue after implementation of any approved Residential revenue increase. By contrast, GMO’s across-the-

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<sup>52</sup> Exh. 628, Cummings Direct, page 5, lines 5 – 12; page 28, line 13 – page 29, line 17; and, Schedules FJC-9A and FJC-9B.

board increase to all Residential rate schedules and rate elements would introduce additional seasonal inequities in the collection of Residential revenue.<sup>53</sup>

In order to effectuate a less comprehensive L&P Residential revenue shift than recommended by MGE, Staff recommends a rate design change that increases the winter price differential between the current Space Heat rate blocks.<sup>54</sup> Staff provides no support for continuing the historical pattern of an increasingly-pronounced winter declining block rate structure and the resulting additional encouragement of winter load additions.<sup>55</sup> By contrast, MGE recommends a revenue shift assigned to rate blocks to maintain the current rate block differentials, consistent with the policy considerations discussed above.

#### ***G. RESIDENTIAL BILL IMPACTS***

Mindful that rate shifts should not take place in a vacuum, MGE examined and provided the customer bill impacts that would result from its recommendations.<sup>56</sup>

MGE's recommendations result in annual bill reductions for current General Use customers prior to any overall increase in rates granted by the Commission in this case.<sup>57</sup> A typical L&P General Use annual bill will *decrease* by 9.6% if Space Heating is eliminated and by 3.6% if Space Heating is frozen. A typical MPS General Use annual bill will basically stay the same if Space Heating is eliminated and will *decrease* by 3.0% if Space Heating is frozen. MPS and L&P General Use customers - who have been footing a part of the specially-priced

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<sup>53</sup> Exh. 628, Cummings Direct, page 20, lines 1 – 10 and Schedule FJC-7.

<sup>54</sup> Exh. 268, Scheperle Direct, page 6, lines 1 – 3.

<sup>55</sup> Exh. 629, Cummings Rebuttal, page 5, line 16 – page 6, line 4.

<sup>56</sup> Exh. 630, Cummings Surrebuttal, page 22, line 13 – page 24, line 10; page 26, lines 1 – 7; and Surrebuttal Schedules FJC-2 and FJC-3.

<sup>57</sup> Exh. 630, Cummings Surrebuttal, Schedule FJC-2, pages 1 and 2.

Space Heating customer bills - comprise 65% MPS' Residential class and 62% of L&P's Residential class. On the other side, if Space Heating is eliminated, the L&P Space Heating typical annual bill will increase by 7.8%. If Space Heating is frozen, the L&P Space Heating typical annual bill will increase by 5.0%. The typical annual MPS Space Heating bill will increase by 3.2% if Space Heating is eliminated and by 3.7% if Space Heating is frozen.

For comparison purposes, KCPL's recent experience in Kansas has value. The annual Space Heat bill impacts resulting from the KCC's Order in KCP&L's 2010 rate case – 18.4% -- were substantially larger than those resulting from MGE's recommendations in this case - 3.2% for MPS and 7.8% for L&P, if the discounted rate is eliminated, and 3.7% for MPS and 5.0% for L&P, if discounted rate is frozen.<sup>58</sup>

Moreover, it is important to recognize that the bill impacts provided by MGE are the only accurate bill impact information available to the Commission. During cross examination, Mr. Rush admitted to the inaccuracies contained in his bill impact calculations and, accordingly, his calculations cannot be relied upon.<sup>59</sup> Staff witness Scheperle's only bill impact calculation was for a L&P Space Heating customer using 1000 kWh in the summer and 1500 kWh in the winter based on MGE's recommendation to eliminate Space Heating.<sup>60</sup> Rather than a 19% bill impact portrayed by Mr. Scheperle, this L&P customer would experience a 5% bill increase.<sup>61</sup> Mr. Scheperle contends that MGE's recommendations result in rate shock, but he does not provide any Space Heating bill impact calculations for MPS if Space Heating is eliminated. Mr.

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<sup>58</sup> Exh. 630, Cummings Surrebuttal, page 23, lines 11 – 18 and Surrebuttal Schedule FJC-2. Additional discussion of the KCPL-Kansas 2010 rate case is provided in Exh. 628, Cummings Direct, page 30, line 3 – page 31, line 15 and Exh. 630, Cummings Surrebuttal, page 14, line 11 – page 15, line 13.

<sup>59</sup> Transcript, Volume 19, page 1013, line 13 – page 1015, line 11.

<sup>60</sup> Exh. 268, Scheperle Direct, page 8, lines 6 – 9.

<sup>61</sup> Exh. 630, Cummings Surrebuttal, page 26, lines 1 – 17 and Surrebuttal Schedule FJC-3.

Scheperle did provide a comparison of current General Use and current Space Heating bills at various usage levels, but he explains that these tables do not represent bill impacts associated with MGE's recommendations.<sup>62</sup> Finally, Staff did not provide bill impact calculations associated with MGE's alternative recommendation to freeze the availability of Space Heating services.

#### **IV. SUMMARY**

MPS' and L&P's current Residential rates are structured to inappropriately promote and incentivize the use of electricity over other resources for space heating. MPS' and L&P's rates price electricity under the Residential Space Heating rate schedules below cost (at a discount) and require GMO's other Residential customers to pay a share of the cost to serve these Space Heating customers.

Not correcting this situation and requiring an across the board equal percentage rate increase would cause Residential Space Heating rates to continue to move further away from the actual cost to serve these customers, would send misleading price signals to customers and would represent a decision to inefficiently favor electricity over natural gas and other space heating energy sources.

MGE has provided two recommendations in order to address this issue:

(1) MGE's first recommendation is that the Commission adjust current MPS and L&P Residential rates on a revenue-neutral basis to remove the existing seasonal inequities in the collection of revenue in relation to cost and the inequities in the collection of winter revenue among customers taking service on different rate schedules. This recommendation results in

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<sup>62</sup> Exh. 3011, Scheperle Surrebuttal, page 3, line 17 – page 5, line 5, as clarified by Transcript, page 1058, line 18 – page 1060, line 12.



*reduced* bills for Residential General Use customers (which represent approximately sixty-five percent (65%) of MPS' Residential customers and sixty-two percent (62%) of L&P's Residential customers) and increased bills for MPS' and L&P's Residential Space Heating customers through the elimination of this subsidy. Staff also recognizes that L&P Residential Space Heating services are underpriced, but its revenue-neutral adjustment recommendation only partially corrects the inequities in the collection of current Residential revenue; and,

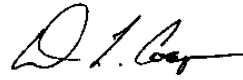
(2) After the removal of these inequities on a revenue-neutral basis, MGE recommends that the Residential Space Heating rates for MPS and L&P be eliminated. In the alternative, MGE recommends the Commission freeze the availability of Space Heating rates using tariff language to simplify the future elimination of these rates. Moreover, MGE recommends that any Residential rate increase that may be awarded in this case should be assigned to Residential rates in a way that preserves the movement to cost-based rates.

It is important for the Commission to consider the impact of not acting. This is especially true given GMO's recommendation to continue the historical pattern of moving Space Heating rates further and further away from the cost to serve these customers. While there are impacts associated with bringing the Space Heating rates in line with cost now, those impacts are less than they will be in the future, if nothing is done. "Kicking the can down the road" will only result in larger and more painful customer impacts in the future.

WHEREFORE, MGE respectfully requests that the Commission consider this Initial

Brief and, thereafter, issue such orders as it should find to be just and reasonable.

Respectfully submitted,



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ATTORNEYS FOR MISSOURI GAS ENERGY

## CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been sent by electronic mail this 28<sup>th</sup> day of November, 2012, to:

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