BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

STAFF'S BRIEF

COMES NOW the Staff of the Missouri Public Service Commission (Staff) and respectfully submits as follows:

On July 13, 2006, the Commission issued its Order Regarding Procedural Schedule, Test-Year and True-Up Hearing. The Commission directed that all Briefs brief the issues in the same order as presented in the List of Issues. On November 14, 2006, the Staff filed, on behalf of the parties, a Joint List of Issues, Calendar of Issues, Order of Witnesses, and Order of Cross-Examination (Issues List). This document was prepared and filed by Staff after consultation with the other Parties.

Staff's Brief follows the Issues List and addresses each issue as discussed below:

On May 2, 2006, Missouri Gas Energy (MGE), a division of Southern Union Company, filed tariff sheets with the Missouri Public Service Commission (Commission) to implement a general rate increase for natural gas service in an annual amount of $41,651,345.

Introduction and Policy

In his direct testimony, MGE COO Robert Hack asserts that MGE is currently providing its customers with high quality service at very reasonable prices (Exhibit 104, Oligschlaeger Rebuttal, p. 7, lines 17-22). This is certainly a desirable situation. However, Mr. Hack also criticizes selected ratemaking techniques used by the Commission in the past to set rates for

MGE. Mr. Hack seems to believe that such techniques have stopped MGE from earning its authorized rate of return. Mr. Hack should certainly realize that no utility can reasonably expect to have its positions carry the day on every issue in every rate case. Utilities take the risk that rates filed by them will be inadequate or excessive each time they seek rate approval. *State ex rel. Utility Consumers Counsel of Missouri, Inc. v. Public Service Commission of Missouri,* 585 S.W.2d 41, 59 (Mo Banc 1979). It is clear that MGE recognizes this process and this case clearly shows this.

In Missouri, the traditional ratemaking process gives a utility an opportunity to recover its costs and earn a reasonable return on its investment. If a utility's costs increase above the level upon which rates were set, then all other things being equal, a utility's earnings will decline (Exhibit 104, Oligschlaeger Rebuttal, p. 13, lines 5-8). If the decline in earnings were significant enough, the utility would expect to file for rate relief to have an opportunity to file for rate relief to have an opportunity to restore its earnings to a reasonable level (Exhibit 104, Oligschlaeger Rebuttal, p. 13, lines 5-10).

Staff approaches each case with an open mind. Staff followed that approach in this case. Staff's positions and recommendations on each issue in the List of Issues are discussed in this Prehearing Brief.

I. COST OF CAPITAL

a. Capital Structure and costs of capital other the common equity

What is the appropriate capital structure (i.e., the relative proportions of long-term debt, short-term debt, preferred equity and common equity) to use in calculating MGE's cost of service? What cost of long-term debt, short-term debt and preferred stock should be applied to the capital structure?

Staff Witness David Murray ably described the proper approach for determining a utility company's cost of capital:

> Q. Please describe the approach for determining a utility company's cost of capital?
>
> A. The total dollars of capital for the utility company are determined as of a specific point in time. This total dollar amount is then apportioned into each specific capital component; i.e. common equity, long-term debt, preferred stock and short-term debt. A weighted cost for each capital component is determined by multiplying each capital component ratio by the appropriate embedded cost or by the estimated cost of common equity component. The individual weighted costs are summed to arrive at a total weighted cost of capital. This total weighted average cost of capital (WACC) is synonymous with the fair rate of return for the utility company.
>
> Q. Why is a total WACC synonymous with a fair rate of return?
>
> A. From a financial viewpoint, a company employs different forms of capital to support or fund the assets of the company. Each different form of capital has a cost and these costs are weighted proportionately to fund each dollar invested in the assets.
>
> Assuming that the various forms of capital are within a reasonable balance and are valued correctly, the resulting total WACC, when applied to rate base, will provide the funds necessary to service the various forms of capital. Thus, the total WACC corresponds to a fair rate of return for the utility company.

(Murray Direct, p. 17, lines 6-23). However, the cost of common equity must be determined by expert analysis.

Staff recommends that the appropriate capital structure to use for the determination of the cost of capital is Southern Union's actual capital structure, on a consolidated basis, as of the end of Staff's test year in this proceeding, December 31, 2005 (Exhibit 101, Murray Direct, p. 18, lines 1-7). MGE is a division of Southern Union. Staff believes that Southern Union's capital structure as of the true-up period may be the most appropriate capital structure. In his True-Up Testimony, Staff Witness updated and corrected the proper capital structure of Southern Union as of the end of the test year ending December 31, 2005: 41.36 percent common equity, 5.40 percent preferred stock, 52.03 percent long-term debt and 1.20 percent short-term debt (Exhibit 103A, Murray True Up Direct, p. 2, lines 2-12). Staff's analysis for Southern Union's Capital

Structure as of October 31, 2006 showed a capital structure of: 36.06 percent common stock, 4.71 percent preferred stock, 55.92 percent lon-term debt and 3.30 short-term debt (Exhibit 103A, Murray True-Up Direct, p. 3, lines 1-3). This capital structure is reasonable for purposes of estimating MGE's ROR in this case (Exhibit 103A, Murray True-Up Direct, p. 3, lines 4-8). This capital structure is less leveraged than Southern Union's historical capital structure even when its primary operations were natural gas distribution (Exhibit 103A, Murray True-Up Direct, p. 3, lines 6-8).

Staff recommended that the embedded cost of long-term debt for Southern Union as of December 31, 2005 was 7.70 percent, the embedded cost of short-term debt was 3.98 percent and the embedded cost of preferred stock was 7.76 percent (Exhibit 101, Murray Direct, p. 20, line 17 through p. 21, line 5; Schedule 22). The true-up numbers, as of October 31, 2006, were: an embedded cost of long-term debt of 7.649 (Exhibit 103A, Murray True-Up Direct, p. 3, lines 9-21); cost of short-term debt was 5.25 percent (Exhibit 103A, Murray True-up Direct, p. 4, lines 15-16); and the embedded cost of preferred stock was 7.76 percent (Exhibit 103A, Murray True-Up Direct, p. 4, lines 8-11).

The overall Rate of Return declined slightly to 7.94-8.15% (Exhibit 103A, Murray True-Up Direct, p. 5, lines 1-6). This decline is attributable to several factors. The first factor is that the common equity ratio decreased slightly since the test year; the second factor was that the cost of long-term debt decreased slightly; and even though the short-term debt increased slightly, it now makes up a larger percentage of the capital structure and since the cost of this debt was still below the overall ROR, this decreased the ROR as compared to the test year (Exhibit 103A, Murray True-Up Direct, p. 5 lines 1-13). This continues to be based on an ROE of 8.65%-9.25% (Exhibit 103A, Murray True-Up Direct, p. 5, lines 1-13).

b. Return on Equity

What is the appropriate return on equity to use in calculating MGE's cost of service?

Staff's expert, David Murray, determined MGE's cost of common equity (ROE) at 8.65% to 9.25%, performing a comparable company analyzing six comparable companies using the discounted cash flow (DCF) model. (Exhibit 101, Murray Direct, p. 21, lines 9-10; p. 37, lines 21-23). Murray also used the capital asset pricing model to test the reasonableness of his DCF estimates (Exhibit 101, Murray Direct, p. 21, lines 15-16). Murray states, "I continue to believe that the DCF model is the most reliable model to use when estimating a utility company's cost of common equity." (Exhibit 101, Murray Direct, p. 4, lines 3-4).

The centerpiece of this case is the rate design, discussed below. Staff and MGE propose a common-sense rate design in which fixed costs are collected through fixed rate elements. Public Counsel strenuously opposes this rate design, as is discussed in detail later in this brief. Public Counsel also argues that, if Staff's rate design is adopted, then MGE's ROE must be reduced in order to reflect the fact that MGE's shareholders will face significantly less risk. However, Public Counsel has not adduced competent evidence in support of its position. Rather, Public Counsel relies upon the lay analysis of Russell Trippensee. Trippensee presented a result based upon an utterly unorthodox methodology that the Commission should not even have received, much less rely upon. Section 490.065.3, RSMo, provides:

> The facts or data in a particular case upon which an expert bases an opinion or inference may be those perceived by or made known to him at or before the hearing and **must be of a type reasonably relied upon by experts in the field in forming opinions or inferences upon the subject and must be otherwise reasonably reliable.**

For these reasons, Staff urges the Commission to adopt its return on equity recommendation.

II. INCOME STATEMENT-REVENUES

a. Weather Normalization

What is the appropriate measure of normal weather to be used in calculating 1) MGE's revenue requirement and 2) the billing determinants to be used in establishing MGE's volumetric rate elements?

The appropriate measure of normal weather to be used in calculating MGE's revenue requirement and the billing determinants to be used in establishing MGE's volumetric rate elements is a 30 year period (Exhibit 108, Wells Rebuttal, p. 1, lines 26-27; Exhibit 107, Wells Direct, p. 4, lines 8-16). Even MGE's witness on this issue, Mr. Feingold, agrees that *normal* weather is established by the 30 year average. (Tr. 673, lines 15-16). Staff recommends, specifically, use of the National Oceanic and Atmospheric Association (NOAA) three decade time period to calculate normal weather (Exhibit 108, Wells Rebuttal, p. 2, lines 6-8). The current thirty year period used by NOAA is January 1, 1971, through December 31, 2000 (Exhibit 108, Wells, Rebuttal, p. 2, lines 9-10). NOAA recalculates a 30-year normal at the end of each decade to deal with changes in measurement conditions and changes in the climate itself (Wells Rebuttal, p. 2, lines 14-15). NOAA's goal is to have a stable normal for a weather variable while reflecting change in weather patterns (Exhibit 108, Wells Rebuttal, p. 2, lines 15-16).

Mr. Feingold's 10 year period does not meet these tests for reliability, ignores past Commission cases, is inconsistent with international meteorological convention, and ignores the purpose of adjusting volumes to normal HDDs in Missouri PSC rate cases (Exhibit 108, Wells Rebuttal, p. 2-6). Staff's recommendation of 30 year normals meets all of these criteria and should be utilized by the Commission.

MGE's purpose in suggesting a 10 year average is obvious: If the base volumes are set based on warmer weather, MGE can generate more revenue when the weather is normal or colder than normal. (Tr. 671, lines 15-20). Additionally, MGE proposes that the 10 year average be a moving one, subject to frequent changes in weather. (Exhibit 11, Feingold Direct, p. 6-13). The Commission has already rejected that proposal and should do so again. A moving average would "needlessly cause frequent rate changes based upon the introduction of new data every year." (Tr. 672, lines 21 to 25).

Should the Commission allow MGE to use a 10 year average for normal weather while KCPL uses 30 years? No. The Commission should maintain consistency among Missouri's utilities rather than allowing each to choose the normal that augments revenues.

III. INCOME STATEMENT-EXPENSES

a. Property Tax Refunds

What is the proper treatment of $5,554,068 in property tax refunds received by MGE during the test year?

Staff recommends that MGE amortize the $5,554,068 in property tax refunds MGE received during the test year as an offset to property tax expense over a five-year period. The company has incorrectly suggested that Staff's proposed treatment of the property tax refunds is retroactive ratemaking. Appellate courts have addressed and defined retroactive ratemaking, and Missouri's Supreme Court has been quite explicit: in the *UCCM* case, it set forth the standard that the Commission can only consider past excess recoveries to determine what rate a utility should charge in the future to eliminate excess charges in the future.[1] The key to the prohibition

[1] "[T]o direct the commission to determine what a reasonable rate would have been and to require a credit or refund of any amount collected in excess of this amount would be retroactive ratemaking. The commission has the authority to determine the rate to be charged, § 393.270. In so determining it may consider past excess recovery insofar as this is relevant to its determination of what rate is necessary to provide a just and reasonable return in the

against retroactive ratemaking is that the Commission may not re-determine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of its property without due process.

Staff's proposal is not retro-active ratemaking. The $5 million property tax refund pertaining to the property taxes for 2002, 2003, and 2004 was received during the test year. Staff proposes that rather than ignoring that test year event, the Commission should take it into account as one of the factors used to determine the cost of service in setting future-looking rates. (Tr. 852.)

Under the test year concept, Staff takes a snapshot of the company's incoming revenues and outgoing expenses, and works with those to determine the appropriate rates. (Tr. 852.) Property taxes and refunds are both part of that mix. The company suggests the Commission should simply ignore the refund. Staff believes it is reasonable for the ratepayers to share in the benefit that they paid for – they paid for the taxes initially, as those were built into the revenue requirement (Tr. 861-62); they paid more for taxes than the company ultimately paid, taking into account the refunds (*Id.*); they paid the litigation expenses for the company to recoup to the overpayments (Tr. 859); and although everything the company did may have been reasonable and prudent, the ratepayers still should be entitled to share in a portion of the returns. By spreading out the impact of the refunds on rates over five years, and not reducing rate base by the unamortized balance of refunds, the Staff has appropriately allowed both the Company and its

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future, and so avoid further excess recovery, See *State ex rel. General Telephone Co. of the Midwest v. Public Service Comm'n*, 537 S.W.2d 655 (Mo. App. 1976). It may not, however, redetermine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of his property without due process. See *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe R. Co.*, 284 U.S. 370, 389-90, 52 S.Ct. 183, 76 L.Ed. 348 (1932); *Board of Public Utility Commissioners v. New York Telephone Co.,* 271 U.S. 23, 31, 46 S.Ct. 363, 70 L.Ed. 808 (1926); *Lightfoot v. City of Springfield*, 361 Mo. 659, 236 S.W.2d 348, 353 (1951)." *State ex rel. Util. Consumers Council of Mo., Inc. v. Pub. Serv. Comm'n,* 585 S.W.2d 41, 58 (Mo. 1979).

ratepayers a share of the benefits of the property tax refunds received by MGE and booked during the test year.

b. Unrecovered Cost of Service Amortization

Should MGE recover $15.6 million in rates amortized over five year for alleged revenue loss due to lower customer gas use for the period January through June, 2006?

This proposed adjustment consists of a five-year amortization of an alleged revenue deficiency caused by a shortfall in actual average gas use by customers for the months of January–June 2006, compared to the average customer gas use assumed when rates were last set by the Commission for MGE in Case No. GR-2004-0209 (Exhibit 104, Oligschlaeger Rebuttal, p. 2, line 20 through p. 3 line 2). MGE claims to have experienced a total loss of revenues of approximately $15.6 million from January through June of 2006 due to lower customer gas usage than assumed in MGE's last rate case (Exhibit 104, Oligschlaeger Rebuttal, p. 3, lines 5-8). MGE proposes to amortize this alleged loss over five years with an approximate $3.125 million of additional rate relief (Exhibit 104, Oligschlaeger Rebuttal, p. 3, lines 8-10).

This proposal violates fundamental ratemaking principles in that ratemaking should be a forward-looking and prospective process (Exhibit 104, Oligschlaeger Rebuttal, p. 3, lines 21-23). Utilities should bear the financial risk that its actual incurred cost of service may exceed the levels presumed in rates until the time that its rates are changed by the Commission to reflect the utility's higher cost of service (Exhibit 104, Oligschlaeger Rebuttal, p. 3, line 23 through p. 4, line 2). On the other hand, customers should bear the financial risk that a utility's incurred cost of service may be lower than the levels presumed in its rates, until the time that its rates are changed by the Commission to reflect the utility's lower cost of service (Exhibit 104, Oligschlaeger Rebuttal, p. 4, lines 2-5).

This proposal is retroactive ratemaking, which is the setting of rates to allow a utility to recover the specific costs of past events incurred by the utility so as to make utility shareholders "whole" or conversely, it is the setting of rates to reimburse customers related to past over-earnings of a utility so as to make the customers "whole" (Exhibit 104, Oligschlaeger Rebuttal, p. 4, lines 6-13). See also *State ex rel Utility Consumers' Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41, 59 (Mo. Banc 1979). Such instances are contrary to ratemaking practices, which seek to allow a utility to recover a normal ongoing level of costs (Exhibit 104, Oligschlaeger Rebuttal, p. 4, lines 10-13). MGE has admitted repeatedly that its proposal is retroactive ratemaking (Exhibit 104, Oligschaleger Rebuttal, p. 4, lines 19-20). This confession was made by MGE in testimony (Exhibit 7, Noack Surrebuttal, p. 6, lines 19-21); in its Prehearing Brief (p. 37); in its opening statement at hearing on this issue (Tr. 866, lines 4-7); and at the hearing during testimony (Tr. 876, lines 19-22; Tr. 879, lines 7-25).

Retroactive ratemaking is prohibited in Missouri. *State ex rel Utility Consumers' Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41, 59 (Mo. Banc 1979). Accordingly, the Commission should overrule MGE's attempt to engage in retroactive ratemaking. Despite MGE's protestations to the contrary, this issue must be decided on its merits alone and the disposition of this issue does not depend on any other issue. On that basis, MGE's attempt to recover past cost of service should also be denied.

Likewise, MGE's alternative rate request for an AAO to defer the alleged impact of warmer than normal weather on its past earnings levels also constitutes illegal retroactive ratemaking since it is an attempt to use future rates to recover past expenses and it does not even meet the criteria for an AAO (Tr. 878, lines 12-25). An AAO is appropriate only when events occur during a period which are extraordinary, unusual, unique and nonrecurring. These types of

costs have traditionally been associated with extraordinary losses due to storm damage or outages, conversions or cancellations. *In the Matter of the Application of Missouri Public Service for the issuance of an accounting authority order relating to its purchase power commitments,* 1MPSC 3d, 200, 204-5 (1991). See also Report and Order, Case No. GU-2005-0095, (September 18, 2005, p. 11-14). MGE conceded in testimony that such a request for an AAO, that weather is not ordinarily an extraordinary event since weather every year will be warmer than normal, colder than normal or be exactly normal (Tr. 878, lines 12-25). Fluctuations in weather patterns are a risk that the Company faces. See, *State ex rel. Utility Consumers Council of Missouri Inc. v. Public Service Commission,* supra at 59. Furthermore, allegedly warmer than normal or colder weather is not an extraordinary event suitable for the granting of an AAO (Tr. 994, lines 8-21).

Accordingly, MGE's requests should be denied.

c. Rate Case Expense

What is the appropriate amount and treatment of rate case expense, including amortization of prior rate case expense, in this case?

MGE seeks to recover of the unamortized portion of the rate case expense allowed in MGE's previous rate case (Mapeka Surrebuttal, p. 17, lines 17-19; Noack Rebuttal, p. 9-10). Staff does not agree that the Report and Order in GR-2004-0209 authorizes MGE to engage in retroactive ratemaking in this case. It simply is retroactive ratemaking to allow recovery of unamortized rate case expense from a prior rate case in the present case. *State ex rel Utilities Consumer Council of Missouri v. Public Service Commission of Missouri*, 585 S.W.2d 41, 59 (Mo. Banc 1979).

The Commission has dealt with similar issues before and specifically rejected the position advocated by MGE herein. See *Missouri Cities Water*, Case Nos. WM-82-147, WM-82-192, WR-83-14, and SR-83-15, 26 Mo. P.S.C. (N.S.) 1, 8-9 (May 2, 1983).

The Staff's position on this issue is reasonable, in that MGE and other utilities can over-recover as well as under-recover rate case expense in its rates. In order to over-recover this item, all the utility must do is stay out of the rate case process longer than the normalization period for rate case expense assumed in the previous rate case (Tr. 1057-1058). In that event, it would be totally improper to attempt to give back the rate case expense over-recovery to customers when the utility in question does come in for a rate case. It is likewise equally inappropriate to make a utility whole for an under-recovery of past rate case expense when it chooses to seek a rate change sooner than what was assumed in its prior rate proceeding.

Accordingly, the Commission should overrule MGE's attempt to engage in retroactive ratemaking.

d. Depreciation Expense

What are the appropriate average service lives and net salvage values associated with MGE's plant to set the depreciation rates to be used in calculating MGE's cost of service?

On January 3, 2007, MGE and Staff filed a Partial Nonunanimous Stipulation and Agreement with the Commission. No Party objected and the Commission approved the Stipulation on January 30, 2007.

e. Low Income Weatherization/Natural Gas Conservation

What is the appropriate level of low-income weatherization funding to be used in calculating MGE's cost of service and how should such funding be allocated among the geographic regions of MGE's service territory?

Should funding for natural gas conservation programs be included in MGE's cost of service?

Staff supports MGE's proposal to increase the low-income weatherization by $100,000 and proposes that an additional $20,000 be allocated to evaluate the program's effectiveness in reducing low-income customers' natural gas usage and bills (Exhibit 105, Ross Rebuttal, p. 5, lines 16-20).

MGE has proposed a $45,000 educational program (Exhibit 107, Ross Surrebuttal, p. 10, line 1). The money will be used to pay for educational activities consisting of an on-line energy audit program, as well as other educational activities designed to increase customers' knowledge of energy efficiency (Exhibit 107, Ross Surrebuttal, p. 10, lines 1-4). Staff supports this proposal.

The second proposal is $705,000 for a water-heating rebate program (Exhibit 107, Ross Surrebuttal, p. 10, line 5). Staff supports this program and notes that water-heating is a significant part of a household's energy usage and that helping customers with the purchase of an energy efficient model would help many households (Exhibit 107, Ross Surrebuttal, p. 10, lines 5-12). Staff supports putting the $750,000 for the education and water-heater rebate program in Revenue Requirement as well as the $100,000 increase for low-income weatherization funding.

Staff further anticipates that many of the details of the program's actual implementation would be worked out via a collaborative effort by interested Parties. MGE would be part of this effort, Staff would certainly be part of this effort and OPC would participate as it could (Tr. 960,

line 6, through p. 961, line 11). Staff provided information answering Commission questions about energy efficiency and energy audits (Exhibits 106A and 106B; Tr. 979-980). This is the type of information that the Parties would review as they develop the details of the plan.

Staff therefore requests that the Commission issue an Order approving the gas conservation proposals in this case.

f. Environmental Response Fund

Should the environmental response fund proposed by MGE be adopted and what, if any, level of environmental costs should be used in calculating MGE's cost of service?

MGE's proposal to establish an Environmental Response Fund (ERF) should be rejected. MGE makes this exceptional proposal to establish a tracking mechanism to pre-collect $500,000 from consumers annually for unknown and unmeasurable costs related to clean-up of manufactured gas plants (MGP). (Tr. 910, lines 5-7.) Mr. Helfrich admits that it is not possible at this time to determine the cost of investigation or clean-up of these sites. (Tr. 897, lines 1-3)

These gas plants have not served customers for more than fifty (50) years (Tr. 900, lines 10-12). Besides proposing to include expenses related to property that has not served customers for more than fifty years, MGE proposes to establish this fund **before** MGE has incurred any expenses. (Tr. 913). If MGE actually incurs costs, then that is the time for MGE to request inclusion of ERF costs in rates.

Perhaps the most peculiar part of this extraordinary proposal is that fifty (50) percent of any applicable insurance proceeds and/or contributions from Westar Energy and/or contributions from other potential responsible parties, less costs of obtaining such, would be credited to shareholders. (Exhibit 120, Harrison Rebuttal, p. 32, lines 1-9). In other words, ratepayers would pay for all expenses yet only half of any recoveries would go to the fund. This is despite

the fact that MGE's current management accepted responsibility for MGP sites when it purchased Western Resources (Tr. 903, lines 7-11.)

Notably, the purchase agreement only requires MGE **seek** to recover these costs from Missouri ratepayers in order for MGE to collect from Western Resources (Tr. 904, lines.23-25). With its filing in this case, MGE has complied with that requirement, and that alone is sufficient to satisfy the terms of the purchase agreement. This Commission should deny MGE's request to include these unknown and unmeasurable costs in rates.

g. Infinium Software Amortization

Should the unrecovered cost associated with MGE's Infinium software be included in rates through an amortization and, if so, over what period should this cost be amortized?

The Infinium software system is an intangible asset that MGE was using for a number of functions in its day to day operations until 2005, when the Company reclassified this asset as non-utility plant. However, the software is still currently being used by MGE for time entry purposes (Exhibit 124, Mapeka Rebuttal, p. 6, lines 1-3; Tr. 1253, lines 22-24). Staff recommends a five year amortization on the unrecovered portion of the Infinium software amortization (Exhibit 124, Mapeka Rebuttal, p. 6, lines 17-18). Staff further notes that MGE made an adjustment to remove the plant investment in the Infinium system out of MGE's rate base (Tr. 1266, lines 15-20; Tr. 1267, lines 3-9). This means that MGE will not earn a return on this plant (Tr. 1266, lines 16-20; Tr. 1277, line 24 through p. 1278, line 4).

Southern Union Company switched to the use of the Oracle software system in 2005 which caused MGE to discontinue use of the Infinium software (Exhibit 124, Mapeka Rebuttal, p. 6, lines 21-23). Staff believes that it is more efficient for Southern Union and MGE to use the same software to perform financial consolidations and providing consistent reports for the

organization and it is less costly than for Southern Union and MGE to maintain two general ledger systems (Exhibit 124, Mapeka Rebuttal, p. 6, line 21 through p. 7, line 4). Furthermore, the changeover to the new Oracle system from the Infinium software has clearly led to significant savings in allocated software costs to MGE from Southern Union (Tr. 1271, line 15 through p. 1272, line 6). For these reasons, Staff proposes a five year amortization for this matter (Exhibit 124, Mapeka Rebuttal, p. 7, lines 6-8).

MGE concurs with Staff's proposal on this issue (Exhibit 7, Noack Surrebuttal, p. 17, lines 6-17). Staff recommends that the Commission rule in favor of Staff's recommendation on this issue.

h. Emergency Cold Weather Rule AAO Recovery Mechanism

What is the proper rate treatment for costs deferred under the Emergency Cold Weather Rule AAO Recovery Mechanism?

On December 13, 2005, in Case No. GX-2006-0181, the Commission approved an Emergency Amendment to the Cold Weather Rule, 4 CSR 240-13.055. The amendment only applied to providers of natural gas services to residential customers. The rule was effective from January 1, 2006 through March 31, 2006. (See also, Exhibit 119, Harrison Direct, p. 16, lines 1-5).

On August 7, 2006, MGE filed a Motion for an AAO in this case regarding the Emergency Cold Weather Rule. On September 21, 2006, the Commission issued an Order Granting an AAO. The Commission specified that MGE is authorized to maintain on its books a regulatory asset representing the costs of complying with the Emergency Cold Weather Rule 4 CSR 240-13.055(14). The Commission further ordered the Parties to advise the Commission

on this issue in testimony and briefing. (See also Exhibit 119, Harrison Direct, p. 16, lines 16-23).

Pursuant to this Order, Staff verified that the costs which MGE is seeking to recover were accurately quantified and were incremental under the Rule (Exhibit 119, Harrison Direct, p. 17, lines 14-21). The amount sought by MGE is $901,331 (Exhibit 119, Harrison Direct, p. 17, lines 7-9). Staff proposed an adjustment to amortize these costs over a three-year period. (Exhibit 119, Harrison Direct, p. 17, 20-21).

Like MGE (Exhibit 7, Noack Surrebuttal, p. 19, lines 13-18), Staff is unaware of any prefiled testimony by OPC or any other Party opposing Staff's position on this matter. While OPC did state some opposition (Tr. 43, line 22 through Tr. 44, line 9), in opening statement, to the proper rate treatment for costs deferred under the Emergency Cold Weather Rule AAO Recovery Mechanism as proposed by MGE, such opposition in an opening statement is not evidence. *Thompson v. Brown & Williamson Tobacco, Co.,* 207 S.W.3d 76, 120 (Mo. App. 2006).

Furthermore, OPC's assertions regarding this issue in its opening statement (Tr. 43-44) are directly refuted by Mr. Harrison's testimony. Mr. Harrison explained the derivation of MGE's ECWR costs as follows:

> …The Company identified an amount of $901,331 incurred from January to March 2006 that it believes was associated with the ECWR amendment. In its response, the Company identified 11,554 customers that took advantage of the ECWR and were reconnected to receive gas service. Of the 11,554 customers that were reconnected, 2,976 of them have subsequently either been disconnected or scheduled to be disconnected. The $901,331 represents the difference between the amount that the Company could have collected from these customers under the old cold weather rule and the amount that they actually collected under the ECWR.
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> The customers that were either disconnected or scheduled to be disconnected are either accounts that were connected under terms of the ECWR and were subsequently disconnected and written off or customers who have

broken ECWR pay agreements, have been issued final bills and are scheduled for disconnection.

(Exhibit 119, Harrison Direct, p. 17, lines 2-13).

From the foregoing, it is clear that Mr. Harrison correctly verified that the costs MGE is seeking recovery of are related to the ECWR and were accurately quantified and were incremental to the issuance of the ECWR by the Commission. MGE identified 2,976 customers, who enrolled under the ECWR and then were disconnected or scheduled for disconnection. These customers had incremental costs to MGE associated with the ECWR, in the amount verified by Mr. Harrison.

The Commission should issue an Order consistent with Staff's position on this issue.

IV. CCOS, Rate Design and Miscellaneous Tariff Language

a. What is the appropriate rate design for the Residential Class?
b. What is the appropriate rate design for the Small General Service Class?
c. What is the appropriate rate design for the Large Volume Service Class?
d. What is the appropriate rate design for the Large General Service Class?

Rate Design / Rate Structure for Residential Class

For the Residential class, Staff recommends recovering the non-gas, or margin, costs in a fixed monthly charge, a Delivery charge (Exhibit 105, Ross Direct, p. 4, lines 16-18). Staff believes that customers within the Residential class are homogeneous with respect to cost factors related to the utility's actual cost of serving them, and that it is unfair to collect these costs from customers through a volumetric charge (Exhibit 105, Ross Direct, p. 3, line 21 through p. 4, line 12; Rebuttal, p. 3, lines 6-17). Volumetric charges collect an inordinate, unfair share of the Residential class's cost-of-service from higher-use customers (typically space- and/or water-heating) and smaller customers – for example, those using gas for cooking or fireplace logs – pay less than the cost required to serve them (Exhibit 105, Ross Direct, p. 3, line 4 through p. 4, line 12; Exhibit 105.5, Rebuttal, p. 3, lines 14-21; Exhibit 106, Surrebuttal, p. 5, lines 6-11). The

subsidy flowing from higher- to lower-use households is especially harmful to the space-heating customers during the winter months because winter is when space-heating customers buy most of their gas for the year (Exhibit 106, Ross Surrebuttal, p. 5, lines 8-9). As a result of concentrating so much gas purchasing in such a short buying period, the volumetric charge requires customers to pay most of their non-gas margin costs during the four month winter heating season. (Exhibit 106, Ross Surrebuttal, p. 5, lines 8-9). When these customers need help the most, during the winter, they are paying the most for their gas. Staff's fixed Delivery Charge proposal corrects this unfairness.

Staff's cost recovery mechanism has other benefits for space-heating customers. The fixed Delivery charge reduces the volatility of a customer's bill from year to year, as well as a portion of the seasonal volatility experienced by space-heating customers. The fixed Delivery charge sends the correct price signals to customers, and may reduce the number of "limited use" customers who request gas service only for cooking or gas fireplaces (Exhibit 105.5, Ross Rebuttal, p. 4, lines 5-14). By approving Staff's proposed rate design, those customers opting to use gas for limited purposes will pay the true cost of delivery, which is the same cost of delivering gas to higher-use, space-heating customers.

One major customer benefit is the alignment of the objectives of the utility's shareholders with the interests of its customers. Because the utility's revenues would no longer depend on maximizing gas deliveries, the interests of its customers and shareholders will not be opposed. (Exhibit 105, Ross Direct, p. 8, lines 4-19; Rebuttal, p. 2, line 22 through p. 3, line 12). As a condition of the Commission's approval of the Delivery Charge, and the accompanying opportunity it provides the Company for achieving greater revenue stability, the Company will commit to implementing conservation and efficiency programs that will educate customers about

conservation measures, and help them purchase energy-saving equipment (Exhibit 105, Ross Direct p. 16, lines 8-15; Surrebuttal, p. 6, lines 1-5; p. 10, lines 1-20).

At hearing, MGE witness Michael Noack testified that the Delivery Charge frees the company from its dependence on volumetric sales and that the adoption of the Delivery Charge would put the company in the position to promote conservation because to do so does not affect the company's bottom line and its ability to earn a return on its investment. "We would like to help customers lower their bill. With this rate design, we can." (Tr. Vol. 8, p. 948 lines 13-14 and lines 23-25; Tr. 949 lines 18-20). In further support of MGE's commitment to conservation programs, Mr. Noack offered at hearing to add another $130,000 or $140,000 of ratepayer dollars *above* what the Company originally proposed, as discussed elsewhere in this Brief. These added funds are to be collected from seasonal disconnects. MGE derived the *additional* $140,000 from OPC witness Meisenheimer's study which calculates the dollar amount that *would* have been collected under Staff's proposed Delivery Charge using last year's actual number of seasonal disconnects. (Tr. 946, lines 21 to Tr. 947, line 6)

In further support of the Company's commitment to energy conservation programs, Mr. Rob Hack testified at hearing that MGE would meet with other parties, such as Staff, OPC, and the City of Kansas City, to review and discuss the implementation of energy conservation programs. Even so, MGE intends to assess the impact of these programs and remains open to considering other programs offered up by the parties as more information about them becomes available (Tr. 643, line 25 to Tr. 644, line 20).

Failure of OPC's Traditional Rate Design either Saddles Customers with Overpayment or Yokes MGE with Undercollection of its Non-gas Costs

OPC witness Meisenheimer acknowledged MGE currently collects 55% of its cost of service in a fixed customer charge and relies on collecting the other 45% of its non-gas costs in a

volumetric charge. In the same breath, she agreed there is a need to promote conservation in MGE's service territory; which, under OPC's "status quo" rate design, degrades MGE's ability to recover its non-gas costs (Tr. 529, line 25 to Tr. 530, line 14). OPC tirelessly urges the Commission to adopt the "status quo" rate design, yet Public Counsel offers *no* energy conservation proposals or programs for MGE customers (Tr. 960, lines 8-15). "Just say no" defines Public Counsel's approach to rate design. Solutions to the serious financial problems facing both ratepayers and MGE are left to Staff and the Company to develop.

Because 45% of all non-gas costs are recovered in a volumetric charge, only in a "normal" winter can the Company earn its revenue requirement without customers overpaying. For MGE to maximize return on its investment - the private property it has dedicated to public service - MGE *must sell more* gas to its customers. The more sold, the better for MGE shareholders. Likewise, colder-than-normal winters create a windfall for MGE shareholders, while siphoning dollars from Missouri ratepayers when they need help the most. Because, with a volumetric charge, customers underpay their cost of service in warmer-than-normal winters, the Company bears this loss, unable to earn its authorized return. OPC remains content to "bet on the come," betting warmer-than-normal winters are here to stay and believing customers really benefit when MGE cannot earn its authorized return. And, if OPC's bet plays out, the consumer "wins" and the Company "loses." But at what longer-term cost? The Company must file another rate case to earn its authorized return, and the process starts all over again. At the end of the day, customers pay rate case expenses and incur the risk of a new rate increase. The "status quo" rate design embraced by Public Counsel has outlived its usefulness in an era of unprecedented high natural gas prices. For all the reasons discussed above, OPC's traditional

two-part rate design is a demonstrable policy failure, and the time to correct its many inequities is now.

By adopting Staff's proposed fixed Delivery Charge, the Commission will (1) insure that all customers pay the Commission-determined price for their gas service – no more, no less, (2) lower winter bills of most space- and water-heating customers, (3) send the correct price signals to customers for them to make energy investment decisions, (4) eliminate disincentives for MGE to promote energy-saving programs aimed at helping customers reduce their gas use, and (5) eliminate the need to implement and administer complex, hard to understand and hard to explain weather and conservation adjustment mechanisms as may be permitted under future rules enabling Senate Bill 179.

b. What is the appropriate rate design for the Small General Service (SGS) Class?

Staff recommends the small customers in the SGS class pay the same fixed delivery charge as is proposed for the residential class because both classes are similar in usage, service equipment, and cost of service. (Exhibit 105, Ross Direct, p. 16, lines 17-20). In support, Staff recommends that small general service customers be studied more closely to determine the appropriate SGS class split (Exhibit 105, Ross Direct, p. 16, line 21 through p. 17, line 6).

c. What is the appropriate rate design for the Large Volume Service Class?

Staff recommends the current rate structure for the LVS-Sales and Transportation be continued (Exhibit 105, Ross Direct, p. 1, lines 26-27).

d. What is the appropriate rate design for the Large General Service Class?

Staff recommends the current rate structure for the LGS be continued (Exhibit 105, Ross Direct, p. 1, lines 27-28).

e. Seasonal Disconnects

Should the seasonal disconnect tariff language proposed by MGE (on Sheet No. R-31) be approved?

The Staff believes MGE should be given an opportunity to demonstrate the effectiveness of a seasonal disconnect program. Funds generated by the seasonal disconnect charge should be considered as revenue, (Tr. 1113, lines 13-18), and not placed into a special weatherization fund like MGE proposes (Tr. 1086, lines 2-8).

Seasonal disconnects are usually customers who disconnect from service for a month or more, generally in the summer, and these customers then generally reconnect during the heating period (Exhibit 125, Ensrud Direct, p. 5, lines 24-26). Seasonal disconnect customers shift costs to customers who remain connected to the system for the entire year (Exhibit 125, Ensrud Direct, p. 6, lines 1-3). These customers currently avoid paying the Customer Charge as well as the current Commodity Charge. Staff believes such conduct is intentional and harms other customers on the system by shifting fixed costs (Exhibit 125, Ensrud Direct, p. 6, lines 6-8).

Staff proposes a minor change to MGE's proposal. First, MGE would charge the traditional reconnection charge of $45. Additionally, Staff's proposal would permit MGE to accumulate the number of customer charges that a customer avoided when service was disconnected (Exhibit 125, Ensrud Direct, p. 7, lines 17-22).

Staff is willing to accept MGE's $45.00 traditional reconnection fee proposal (Exhibit 126, Ensrud Rebuttal, p. 1, lines 20-22) plus MGE's proposal to recapture up to seven-months of foregone Customer Charges.

V. **<u>Miscellaneous</u>**

b. Should the Kansas Property Tax AAO be continued past the expiration date ordered by the Commission in Case No. GU-2005-0095?

In Case No. GU-2005-0095, the Commission granted MGE authority to defer property taxes billed to it by Kansas taxing authorities for gas held in storage until a final decision on the legality of such taxation was issued in Kansas (Exhibit 122, Mapeka Direct, p. 26, lines 11-13). The deferral authority granted by the Commission to MGE applied to property taxes billed in Kansas for tax years 2004, 2005 and 2006 (Exhibit 122, Mapeka Direct, p. 26, lines 15-17). Staff recommends that the Commission, in the Report and Order in this case, grant MGE the authority to continue deferring these costs through the end of tax year 2007 or until a final decision is obtained in the Kansas courts, whichever occurs first (Exhibit 122, Mapeka Direct, p. 26, lines 15-18). MGE, at that time, will be ready to either amortize the deferred costs to expense or write-off the deferred amount as needed (Exhibit 122, Mapeka, p. 26, lines 18-20). This issue has no revenue requirement impact in this case (Tr. 1291, lines 9-18).

WHEREFORE, Staff respectfully submits Staff's Brief and requests the Commission to issue a Report and Order in this case consistent with Staff's positions.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile, or electronically mailed to all counsel of record this 15th day of February 2007.

/s/ Robert V. Franson