

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

In the Matter of Missouri Gas Energy's Tariffs)	
to Implement a General Rate Increase for)	Case No. GR-2004-0209
Natural Gas Service)	Tariff No. YG-2004-0624

Dissenting Opinion of Chairman Steve Gaw

I respectfully dissent from the Report and Order issued by the majority in this proceeding. In general, I am concerned with the majority's decision regarding the following issues: (1) Short-Term Debt; (2) Long-Term Debt Cost; (3) Return on Equity; (4) Capacity Release / Off-System Sales; (5) Incentive Compensation; (6) Legislative / Lobbying; (7) Gas Purchasing / Reliability Plan Reporting; Legislative / Lobbying Time Reporting / Response Time to Commission Referred Customer Complaints; (8) Class Revenue Responsibility; and (9) Experimental Energy Efficiency Programs including PAYS. Furthermore, I harbor concerns about the impact of this decision on the ability of residential ratepayers to pay their gas bills this winter. This is especially true since it is widely recognized that gas costs, which are in addition to the rates approved by the majority, are expected to be at or near record levels this winter.

I. Short-Term Debt

Although I agree with the majority's decision to utilize the actual consolidated capital structure of Southern Union, I disagree with decision to exclude short-term debt from the Southern Union capital structure.

It is undisputed that Southern Union routinely carries a short-term debt balance. During the test year, Southern Union maintained a short-term debt balance

that comprised approximately 7.5% of the Southern Union capital structure.¹ By looking solely at a specific snapshot in time (April 30, 2004), the majority has neglected to reflect the reality of the Company's capital structure.

As the Company has repeatedly informed the Commission, "[f]or MGE to have any realistic chance of actually achieving its Commission-authorized earnings level, the ratemaking process must reasonably reflect MGE's operating reality."² As shown by OPC, the majority's decision to eliminate short-term debt from the consolidated capital structure does not "reflect MGE's operating reality." By eliminating the cheapest source of capital available to the Company, MGE's revenue requirement is arbitrarily inflated.

II. Long-Term Debt Cost

I am concerned about the exclusion of the Panhandle debt in the determination of long-term debt cost. Specifically, the majority has adopted a consolidated capital structure of Southern Union. This capital structure includes the capital components of the entire company including its wholly owned subsidiary Panhandle Eastern Pipeline. Nevertheless, while the majority included the debt of Panhandle Eastern when determining the appropriate capital mix, it excluded this debt in its determination of the long-term debt cost. Arguably, a more appropriate view of the cost of capital should reflect all sources of capital that influence its cost.

III. Return on Equity

In its Report and Order, the majority adopts a Return on Equity of 10.5%. I believe that the majority's decision ignores the clear weight of the evidence in this matter as well as the economic conditions that currently exist.

The majority discredits the recommendations of Staff (8.52% - 9.52%) and Office of Public Counsel (9.01% - 9.34%) based primarily on a survey of regulatory

¹ Allen Direct at Schedule TA-4.

² MGE Initial Brief at 5 (emphasis added).

decisions from around the country. Despite its claims that the Commission does not believe it is appropriate to unthinkingly mirror the national average, the Commission bases its dismissal of Staff and Public Counsel's recommendations upon this national average. Specifically, the majority claims that the national average for 2002 and 2003 was 11% and that the average for the first quarter of 2004 was 11.1%.

As Staff witness Murray indicated, MGE's claims regarding the national average is not relevant. First, any reference to the 2002 and 2003 is clearly outdated. As the record indicates, since the beginning of 2002, the Federal Reserve has reduced the discount rate by 40%.³ Over the same period, the prime interest rate has been reduced from 4.75% to 4.00%.⁴ It is unquestionable that the current costs of capital are much less than those experienced in 2002 and 2003. As such, any references to such survey results should be summarily dismissed.

There are similar problems with MGE's claims that the average for the first quarter of 2004 was 11.1%. As Staff Witness Murray indicates, the survey referenced by MGE does not necessarily reflect return on equity decisions issued by state public utility commissions during that period. Rather, it is merely a recitation of the currently authorized return on equity for the survey companies at that point in time. As such, it may reflect return on equity decisions that are many years old. For instance, Murray noted that one decision included in the survey was over 10 years old.⁵ As he notes, these return on equity decisions are "hardly relevant to today's low cost of capital environment."⁶ I have no problems with the Commission considering decisions of other utility commissions. That said, however, the Commission should be fully informed as to the timing and circumstances of those decisions.

³ Murray Direct at Schedule 2-2.

⁴ Murray Direct at Schedule 3-1.

⁵ Murray Surrebuttal at page 4.

⁶ Murray Surrebuttal at page 4.

Of particular interest, I note that, because of Southern Union's practice of not paying dividends, all parties agreed that South Jersey Gas Company was an appropriate proxy for Southern Union. Interestingly, the New Jersey Board of Public Utilities issued a decision on July 8, 2004 for South Jersey Gas Company. As reflected in that decision, the appropriate return on equity for this Southern Union proxy was 10.0%. Clearly, this decision better reflects the current economic conditions faced by Southern Union and highlights the reasonableness of Staff's return on equity calculation.

IV. Capacity Release / Off-System Sales

In its Report and Order, the majority decided to eliminate capacity release revenues from consideration of rates in this proceeding. Instead, prompted by MGE's claims that future capacity release revenues are uncertain, the majority has shifted those revenues to the PGA / ACA process. In order to give the Company an incentive to maximize its efforts to realize these revenues, the majority has also adopted MGE's proposed sharing grid. Under this sharing grid, MGE is permitted to share, to various extents, in all future capacity release revenues.

As an initial matter, it should be stated that I would have preferred that capacity release revenues be treated in the context of the base rates established in this proceeding. The very nature of Missouri regulation provides utilities, such as MGE, an incentive to maximize revenues and minimize expenses. Recognizing that the Commission is not permitted to engage in retroactive ratemaking, utilities are permitted to keep, until the next time that rates are changed, any increase in revenues or decrease in expenses. In this way, because rates established in 2001 were based upon a projected level of capacity release revenues of \$1,200,000, MGE has been permitted to profit to the extent that it could exceed that amount. Furthermore, if it was not able to meet this level of revenues, MGE shareholders

would suffer the shortfall. As is clearly evident, the current Missouri regulatory process works and provides adequate incentives for utilities to maximize its realized revenues.

That said, if it is determined that the capacity release revenues should be included in the PGA process, I believe that it is inappropriate to implement a sharing grid that allows MGE to share in the first block of revenues. It is reasonable that some level of revenues is attainable by a gas utility without exercising any expertise. I do not believe that a utility should be provided an incentive for exercising such an elementary degree of skill. This is "low hanging fruit" that can be reaped by virtually anyone. The true expertise, and need for incentive, is needed as the utility reaches higher in the tree for more revenues. At these levels, incentive becomes truly important and I believe that the utility should truly be rewarded.

Instead of a careful consideration of the incentives implicit in a sharing grid, the majority merely accepted MGE's proposed sharing grid. The MGE proposal merely serves to shift risk from the Company to the ratepayer. Under the current system, MGE faced a revenue shortfall if it did not reach the amount of capacity revenues built into rates. Under the new sharing proposal, MGE is permitted to engage in the amount of capacity release sales that it desires. At any point in time, MGE can unilaterally decide that it no longer wants to devote resources to these transactions. In such a situation, Missouri ratepayers will no longer benefit, but MGE is not penalized. For this reason, the current system is superior for providing MGE with incentives while not saddling ratepayers with the risk that MGE will no longer engage in such activities.

V. Incentive Compensation

In its Report and Order, the majority excludes all incentive compensation awards associated with financial performance. While I would concur with this

decision, the majority allows MGE to recover costs associated with incentive compensation awards related to customer service. It is my opinion that the majority has rewarded MGE for inferior customer service by allowing it to establish and recover incentive compensation awards based upon goals that are less than industry average.

As pointed out by the Office of Public Counsel, a study conducted by Theodore Barry and Associates indicates that the industry average speed of answer was 60 seconds. Since the Company's incentive compensation program establishes a call answer target that is longer than 60 seconds, I would not allow MGE to recover these incentive compensation awards.

The majority erroneously places the burden upon Public Counsel to demonstrate that the 1998 Theodore Barry analysis is still reflective of industry average. Instead, MGE should have been required to meet the burden of proving that these costs were just and reasonable. The burden should be on MGE to show that its customer service has reached a level that deserves ratepayer support of the incentive compensation program. Although the study is six years old, it is recognized to be the most recent study. Clearly, since MGE was unable to produce any evidence demonstrating that its customer service incentive compensation awards were beneficial to the public, it should not be allowed to reward employees for inferior customer service. The Commission should only be rewarding utilities based on a showing of extraordinary customer service. The majority decision rewards mediocrity.

VI. Legislative / Lobbying

In the last litigated MGE proceeding, the Commission considered the issue of disallowance of legislative / lobbying expenses. Based upon the recommendation of

Staff, the Commission disallowed costs of the Public Affairs and Community Relations Department as lobbying expenses. As the Commission noted in that case:

MGE should keep time records that would at least show the time expense spent by staff members on regulated or recoverable activities. This would give the Commission competent documentary evidence indicating the respective amount of time spent on the various activities assigned to the Public Affairs and Community Relations Department. Lacking such competent evidence, the Commission must disallow any expense that is not support by competent and substantial evidence.⁷

Despite the Commission's stern warning in the last proceeding, MGE again failed to maintain documentary evidence indicating the "respective amount of time spent on the various activities assigned to the Public Affairs and Community Relations Department." Overlooking its past warning and against the advice of Staff, the majority allows the inclusion of 50% of the salary of MGE's Legislative Liaison. Interestingly, the majority admits "MGE did not provide any detailed information about the amount of time Snider spends lobbying". The majority further notes that "[t]he problem is that there is no way to really know how much of the time of Snider, Oglesby, and Hack is spent lobbying."

I believe that MGE has been on notice for over six years that it should maintain documentary evidence to show the legitimacy of the costs in question. Given MGE's blatant disregard of the Commission's warning, I believe that it is highly inappropriate to then reward MGE by including any portion of the costs in question.

VII. Gas Purchasing / Reliability Plan Reporting; Legislative / Lobbying Time Reporting / Response Time to Commission Referred Customer Complaints

In its testimony, Staff requests that the Commission order MGE to submit certain plans or to adopt certain guidelines. Each of these proposals, if adopted, would have assisted the Commission in fulfilling its statutory obligation in ensuring that MGE offers safe and adequate service at just and reasonable rates.

⁷ Missouri Gas Energy, 7 MoPSC 3d 394 at 412 (emphasis added).

First, Staff asks that MGE be required to submit a Gas Purchasing / Reliability Plan. Recognizing that MGE has recently replaced its entire gas supply department, the Commission needs assurances that the new department at MGE is fulfilling this duty. Staff notes that similar gas purchasing / reliability plans are voluntarily provided by other Missouri gas companies. Reflecting a continuation of its non-cooperative attitude, MGE states that it should not be required to file such a plan and instead proposes that Staff obtain such information through the Commission's formal discovery rules.

As expressed in my dissent in Case No. GC-2004-0507, I am also concerned about MGE's decision to replace its entire gas procurement department. In light of such changes, I believe that it is imperative that this Commission takes a proactive approach to guarantee that ratepayers do not suffer as a result of this management decision. This Commission has a responsibility to ensure that MGE provides safe and adequate service.

Second, reflecting its ongoing difficulty in assessing the extent that MGE employees are engaged in legislative and lobbying efforts, Staff requests that MGE be required to keep documentation sufficient to allow Staff to eliminate these costs from regulated rates. Despite the frustration expressed by the majority when deciding the issue of legislative / lobbying costs ("the problem is that there is no way to really know how much of the time of Snider, Oglesby and Hack is spent lobbying"; "the Commission must make adjustments based on the limited information that is available"; "the Commission's inability to determine the exact amount of time that they spend in lobbying must be laid solely to MGE's failure to properly account for their time."), the Commission fails to take steps to address this problem. Instead, the Commission further perpetuates the problem that has existed since MGE came into

existence. I believe that a definite problem exists and that Staff's proposal should be adopted to ensure that the problem does not continue.

Finally, the Staff makes another proposal in an attempt to address another lingering problem with MGE. Specifically, Staff asks that the Commission order MGE to respond to Commission forwarded customer complaints / inquiries within 3 business days. In the event that such a matter involves an interruption of service, the response should be forwarded within 24 hours. Again, Staff notes that other companies have been more cooperative and have voluntarily adopted Staff's proposal. This Commission should ensure that customer complaints are handled in an expeditious manner.

VIII. Class Revenue Responsibility

After determining the appropriate revenue requirement for MGE, it is necessary to determine how any increase should be allocated among the various customer classes. In my opinion, the current rate revenue percentage is still reasonable and should have been used for the allocation of any increase. Shifting burdens to residential ratepayers on top of the rate increase in this case as well as the increase in the cost of natural gas will impose a severe hardship on many residential customers especially those living on limited income.

IX. Experimental Energy Efficiency Programs including PAYS

In the Report and Order, the majority expresses an interest in the PAYS program, but declines to implement such a program in the context of this proceeding. I believe that the Commission should further its efforts to advance programs similar to PAYS to help achieve more energy efficiency. Inevitably, while the Commission would seek to address this matter in a subsequent proceeding, MGE will claim that the Commission cannot implement such a program without funding. Such funding can only come in the context of a rate proceeding.

During my questioning of MGE witnesses, I was distressed at the Company's seeming lack of interest on this issue. I have a great interest in programs such as PAYS and believe that the implementation of such programs is reflective of an efficient management. Furthermore, I would consider appropriate incentives for companies with effective programs. I would hope that the Company would revisit its position on this program and present the Commission with definite proposals as soon as possible.

Respectfully submitted,



Steve Gaw
Chairman

Dated at Jefferson City, Missouri,
on this 26th day of September, 2004.