BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Tariff Sheets Designed to Increase Rates for Gas Service in the Company's Service Area.	))))	**Case No. GR-96-285**

REPORT AND ORDER

Issue Date: January 22, 1997

Effective Date: February 1, 1997

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APPEARANCES

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ADMINISTRATIVE LAW JUDGE: **Thomas H. Luckenbill, Deputy Chief.**

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REPORT AND ORDER

Procedural History

On March 1, 1996, Missouri Gas Energy (MGE or Company), a division of Southern Union Company (Southern Union), submitted to the Commission tariff sheets reflecting increased rates for gas service provided to customers in the Missouri service area of the Company. The proposed tariff sheets are designed to produce an annual increase of approximately 13.04 percent ($34,019,650) in the Company's revenues.

On March 8, 1996, the Commission issued an order and notice relating to the tariff sheets. In that order and notice the Commission did not suspend the tariff sheets because they bore an effective date of February 1, 1997.

On March 11, 1996, the Company filed a cover letter accompanied by substitute tariff sheets. The cover letter states that the tariff sheets filed therewith are identical to the tariff sheets filed on March 1, 1996 except for the proposed effective date. The substitute tariff sheets bear a proposed effective date of April 3, 1996.

By order issued March 13, 1996, the Commission suspended these tariffs for a period of 120 days from April 3, 1996 plus an additional six months to

February 1, 1997. The Commission also established an intervention deadline of April 8, 1996.

On March 14, 1996, the Office of the Public Counsel (OPC) filed a request for local public hearings with the Commission. On April 19, 1996, OPC filed an amended request for local public hearings with the Commission.

By order issued March 21, 1996, the motion filed by MGE for a protective order was granted. By order issued April 26, 1996, the Commission established a procedural schedule. By order issued May 2, 1996, the Commission established the test year to be the 12-month period ending September 30, 1995, as updated through May 31, 1996.

By order issued on May 3, 1996 the Commission granted the applications to intervene of the following parties: Summit Builders, Inc., JKL Development, Inc./Patterson Peters Development, Inc., Winterset Park, Inc., Patterson and Peters land Company, Inc., Parker-Jones Development, Inc., Longhorn Asset Management, Inc., Jim Robertson Plumbing, Inc., Maple Tree Development, Inc., MDM Development, Inc., Baldwin Properties Inc., Savannah Development, Inc., Terra Land Development Company, Acuff-Lutz homes Inc., Aartic Investments, Inc., Peterson Companies, Cumberland Properties, Inc., and Hunt Midwest Real Estate Development Inc. The Commission ordered that these parties would be denominated as the Kansas City Area Real Estate Developers (Developers) for purposes of this proceeding.

By order issued May 3, 1996, the Commission required Midwest Gas Users Association (MGUA) to file a complete and final list of those entities that intend to participate under the auspices of MGUA and granted intervention to the City of Kansas City, Missouri (Kansas City); County of Jackson, Missouri (JACOMO); University of Missouri-Kansas City (UMKC); Central Missouri State University (CMSU); Local No. 53, International Brotherhood of Electrical Workers, AFL-CIO (Union); Gas Service Retirees' Association of Missouri (GSRA); Williams Natural Gas Company (WNG); Riverside Pipeline Company, L.P. and Mid-Kansas Partnership (Riverside/Mid-Kansas); Kansas City Power & Light Company KCPL); St. Joseph Light & Power Company (SJLP); Mountain Iron & Supply Company (Mountain Iron); UtiliCorp United Inc., d/b/a UtiliCorp Energy Services (UtiliCorp); and MGUA.

By order issued May 9, 1996, the Commission granted the application of the City of St. Joseph, Missouri to participate out of time, without intervention.

By order issued May 24, 1996, the Commission amended the test year to the 12-month period ending March 31, 1996, updated through May 31, 1996.

Pursuant to the order of the Commission, local hearings were convened on August 27, 1996 at St. Joseph, Missouri and Kansas City, Missouri. On August 29, 1996, a local hearing was convened in Joplin, Missouri.

By order issued July 26, 1996, the Commission extended direct testimony relating to issues other than rate design to August 9, 1996, extended direct testimony on rate design to August 19, set rebuttal for September 26-27, and required MGE to provide all response to data requests of the Commission Staff (Staff) and OPC by July 30, 1996.

By order issued August 30, 1996, the Commission directed that a true-up hearing be held on December 12, 1996

By order issued October 15, 1996, the Commission withheld ruling on a motion by OPC to dismiss the case until after the evidentiary hearing. *See* Section II.A., *infra*. In the same order, the Commission granted the motion to file supplemental direct testimony filed by the OPC and granted the motion to file supplemental direct testimony and revised schedules filed by the Staff. The Commission held an evidentiary hearing which commenced on October 21, 1996 and continued to October 25, 1996, and reconvened on October 30, 1996 and adjourned on October 31, 1996. On December 12, 1996, the Commission held a true-up hearing in this proceeding.

By order issued November 26, 1996, the Commission denied motions by MGE, the Staff and OPC to extend the dates and limits for the reply brief.

On December 17, 1996, the Commission issued an order regarding a request for outstanding "uncollectibles" information and amending the procedural schedule in Case No. GC-97-33 (a pending Staff complaint against MGE). In that order the Commission created a project team under the Executive Secretary's office to investigate the practices of MGE related to the use of alleged threatened or actual disconnection to encourage payment from customers. The report from that investigation is to be filed no later than January 31, 1997, in Cases No. GC-97-33 and GO-95-177. Case No. GO-95-177 is a Staff investigation into the billing practices of MGE.

I. Stipulations and Agreements

A. Stipulation and Agreement Relating to an Experimental Weatherization Program

On October 30, 1996, MGE, the Staff, OPC and the City of Kansas City filed a Stipulation And Agreement in this proceeding relating to an Experimental Weatherization Program. On October 31, 1996, the Commission issued a notice to the parties indicating that they had until November 6, 1996 to indicate whether they objected to the terms of the agreement under 4 CSR 240-2.115. No party has indicated any objection to the agreement.

The agreement provides that the Company will provide $250,000 annually for this program so long as the Commission will include a $250,000 amount specifically for the program in the revenue requirement in this case. The agreement further provides that the program should continue for a period of at least two years from February 1, 1997. MGE's obligation to provide the $250,000 annual payment ceases when that amount is no longer reflected in the rate level authorized by the Commission. The agreement provides that the program funds will be administered by the City of Kansas City, Missouri under a written contract between MGE and the City. MGE and the City will consult with Staff and OPC prior to execution of the contract and its submission to the Commission. While it is experimental, the program will be limited to existing low income (as defined by the Office of Management and Budget (OMB)), MGE residential customers located within Clay, Platte and Jackson Counties, Missouri.

The program is intended to assist customers through conservation, education and weatherization in reducing use of energy and reduce the level of bad debt expense experienced by energy companies.

On January 3, 1997, the parties to the Stipulation And Agreement filed an amendment to it. Under the amendment, the date for the award of contract provided for in paragraph 9 of the proposed tariff is extended from February 1, 1997 until May 1, 1997.

The Commission has reviewed the agreement and the portion of transcript relating to the agreement. The Commission is concerned about this proposal because the revenue requirement impact of $250,000 is spread to all of MGE's customers. The program will directly benefit low income customers in Platte, Clay and Jackson Counties only. Despite the fact that some degree of cross-subsidization occurs under this program, the Commission finds that implementation of the agreement between MGE and the City, with active consultation by OPC, and particularly the Commission's Staff, will be worthwhile insofar as this is an experimental program. However, prior to implementation of a program such as this on a permanent basis, evidence demonstrating that the program benefits <u>all</u> MGE's ratepayers must be produced to justify the revenue requirement impact.

Given the above caveat, the Commission will approve the Stipulation And Agreement (Attachment A) and the amendment thereto (Attachment B).

The Stipulation And Agreement provides that approval thereof disposes of the issues in Case No. GC-96-402. Thus, the Commission will order that Case No. GC-96-402 be closed.

B. Stipulation and Agreement on Cost of Service and Related Revenue Shifts

On October 30, 1996, the Staff, OPC, MGUA, UMKC and JACOMO filed a Stipulation And Agreement relating to cost of service and related revenue shifts. (Attachment C). On October 31, 1996, the Commission issued a notice to the parties indicating that they had until November 6, 1996 to indicate whether they objected to the terms of the agreement under 4 CSR 240-2.115. No party has indicated any objection to the agreement.

If approved by the Commission, this Stipulation And Agreement would resolve issues IV.A.1., Allocation of Costs for Services, Meters and Regulators; IV.A.2., Allocation of Costs for Mains; IV.A.3., Class Cost of Service Results; and VI.B.4., Class Rate Increases. Under the proposed Stipulation And Agreement, if the increase in MGE's revenue requirement in the instant case were $6,096,685, the residential customers would bear $6,054,328 of such increase. (Ex. 159, p. 3, ll. 5-8, Sch. 1). This would mean that residential ratepayers would fund 99.31 percent of the revenue requirement increase. Under the proposed Stipulation And Agreement, if the increase in MGE's revenue requirement in the instant case were $10,096,685, the residential customers would bear $7,983,216 of such increase. (Ex. 159, Sch. 2). This would mean that residential ratepayers would fund 79.07 percent of the revenue requirement increase. Under the proposed

Stipulation And Agreement, if the increase in MGE's revenue requirement in the instant case were $15,040,320, the residential customers would bear $10,290,789 of such increase. (Ex. 159, Sch. 2). This would mean that residential ratepayers would fund 68.42 percent of the revenue requirement increase.

This situation occurs because the Stipulation And Agreement calls for a revenue shift to the Residential class. At a revenue requirement increase in the amount of $6,096,685, an amount of $1,788,727 is shifted on to residential ratepayers. The amount of the shift declines as the revenue requirement increases. If the revenue requirement increase is greater than $6,096,685, then the revenue shift to the residential class decreases by one-fifth of the revenue requirement increase above $6,096,685, but not beyond the point where the shift to the residential class becomes zero. The shift to the residential class becomes zero at a revenue requirement increase in the amount of $15,040,320.

The Commission finds that it would be poor public policy to force residential ratepayers to fund more than their previously allocated share of MGE's revenue requirement. The Commission does not understand why the share allocated to residential ratepayers of MGE's total revenue requirement should change with varying revenue requirement results from the instant case.

The Commission shall reject the Stipulation And Agreement and finds that the revenue requirement increase shall be allocated among the customer classes on the same basis as current revenues (i.e., 68.22 percent for Residential; 0.01 percent for Unmetered Gas Lights; 21.22 percent for Small General Service; 2.65 percent for Large General Service; and 7.90 percent for Large Volume Service), as reflected in the compliance filing by Staff on January 17, 1997. The basis of the rejection of the agreement is that no compelling evidence has been produced to justify the residential shift as proposed in the Stipulation And Agreement. In addition, the Commission is not inclined to increase the proportionate share of MGE's revenue requirement borne by residential customers in the face of poor service complaints heard in public testimony. See, *infra*, IV.5.

II. Pending Motions

A. Motion to Dismiss on Basis that MGE Failed to Comply With Capital Structure Condition in Case No. GM-94-40

On September 27, 1996, Public Counsel filed a motion to dismiss this case on the basis that Southern Union failed to comply with a capital structure requirement to which it had agreed in Case No. GM-94-40. In that case, this Commission approved the acquisition by Southern Union of all Missouri properties previously owned by Western Resources, Inc. (WRI) except for that portion of WRI's system in and around Palmyra, Missouri. The stipulation and agreement entered into by the parties was approved by the Commission and provided:

> Southern Union agrees not to implement a general increase in non-gas rates until Southern Union has attained a total debt to total capital ratio which does not exceed Standard and Poor's Corporation's Utility Financial Benchmark ratio for the lowest investment grade investor-owned natural gas distribution company at the time a general rate increase case is filed. Southern Union agrees to attain this total debt to total capital ratio within three years of the closing date of the subject transaction in order to be in compliance with this Unanimous Stipulation and Agreement.

The dispositive issue is whether the trust-originated preferred securities ("TOPrS") issued by Southern Union Financing Company I (SUFI) is to be considered debt or equity. The TOPrS issued by SUFI is backed by a note that Southern Union issued to SUFI. The dividends on the TOPrS can be deferred for a period up to five years. If the dividends are not paid at the end of five years, then the trustee can call the note against Southern Union. The interest paid by Southern Union to SUFI on the note is tax deductible to Southern Union.

The Commission finds that the TOPrS issued by Southern Union Financing Company I constitutes the creation of equity, not debt, with respect to Southern Union. Therefore, Southern Union has demonstrated compliance with the Stipulation And Agreement in GM-94-40, and it is entitled to implement a general rate increase in this case. The Commission finds the Staff's testimony, as well as MGE's testimony, persuasive which shows that Southern Union complied with the intent of the capital structure requirement from GM-94-40. (Ex. 76, p. 28, l. 14; p. 29, l. 10).

By its order issued January 7, 1997, the Commission has taken official notice of a press release issued October 21, 1996 by the Federal Reserve Board and the public contents of an internal Federal Reserve Board memorandum dealing with preferred shares of this type. (Attachment D). The press release announced that the Federal Reserve Board has allowed bank holding companies to treat these kinds of preferred securities as equity, and the memorandum sets forth the technical reasons supporting the decision.

On January 14, 1997, OPC filed an Objection And Response To Order Taking Official Notice Of Documents, arguing that the Commission erred by taking official notice of the press release and the memorandum. On January 17, 1997, MGE filed a reply to OPC's objection.

The Commission did not err by taking official notice of the Federal Reserve Board documents. First, these are public records. Second, the treatment of the TOPrS securities as debt or equity is a technical matter within the Commission's specialized knowledge, and the Commission is empowered by statute to determine financial issues of the companies it regulates. *See* Section 393.200, R.S.Mo. (1994). Third, the Commission gave parties a reasonable opportunity to show that taking notice of the documents would not be proper. Even without considering the Federal Reserve documents, the Commission would have reached the same conclusion based on Staff's and MGE's testimony in this proceeding.

B. MGE's Motion For Variance From Protective Order

On October 17, 1996 MGE filed a Motion For Variance From Protective Order. MGE states that certain requests were made of MGE at the local public hearings in this proceeding to provide additional information regarding some of the customers who testified at the local public hearings. MGE states that it does not wish to send customer-specific highly confidential information to other parties, since the customers involved did not indicate that they wanted the details of their bills distributed to other parties. MGE requests a waiver from the terms of the protective order which would allow it to refrain from providing copies of the highly confidential portion of the summary report to the other parties in this proceeding. The Commission finds that MGE's motion is reasonable and will grant it.

C. MGE's Motion For Admission of Supplement to Exhibit

On January 3, 1997, MGE filed a motion for admission of a Supplement to Exhibit 111. The Supplement relates to testimony given at local public hearings. No party has filed a response to the motion.

The Commission finds that the motion is reasonable and will order that the Supplement to Exhibit 111 be received into the record.

D. MGE's Motion For Admission of Revised True-Up Reconciliation

On January 6, 1997, MGE filed a Motion For Admission Of Late-Filed Exhibit. MGE attached a revised reconciliation dated January 3, 1997 to the motion. MGE recites the fact that there have been unreconciled revenue differences existing at the evidentiary hearing in October, 1996, and at the true-up hearing in December, 1996. MGE states that it believes it has located the source of the discrepancy. MGE suggests that it supplied certain erroneous information in responding to a data request regarding bills and usage in the Small General Service class.

On January 7, 1997, Staff filed a response to MGE's motion, requesting that the Commission deny MGE's motion on the basis that to grant it would be the same as reopening the record and this would violate 4 CSR 240-2.110(10).

On January 9, 1997, OPC filed a response to MGE's motion. OPC concurs with Staff that it is too late in the proceeding to admit MGE's revised reconciliation.

On January 10, 1997, MGE filed a reply to Staff and OPC. MGE requests that the Commission order Staff to perform an expedited audit on the new MGE material to determine its accuracy.

On January 10, 1997, Staff filed a revenue requirement scenario. General note no. 3 states that if the Commission accepts MGE's position on the unreconciled difference matter, then the revenue requirement calculations are correct as shown.

The Commission will deny MGE's motion and not allow the revised true-up reconciliation into the record at this late stage in this proceeding.

III. Late-filed Exhibits

Exhibits 113, 114, 115, 116, 117, 120, 163, 163HC, 164, 171, 172, 173, 174, 179 and 179HC were filed after the close of the evidentiary hearing in this case. These were filed at the direction of the bench. Counsel were afforded a ten-day period in which to file an objection to the admission of these exhibits.

On December 2, 1996, Riverside/Mid-Kansas filed a motion to strike a portion of late-filed Exhibit 172. Riverside/Mid-Kansas requests that the portion beginning with page 3, line 7, through the bottom of page 4, be stricken, because it goes beyond the information requested by Commissioner Crumpton.

On December 10, 1996, MGE filed a response to the motion to strike. MGE argues that all of late-filed Exhibit 172 is responsive to Commissioner Crumpton's request.

The Commission finds that all of Exhibit 172 is responsive to Commissioner Crumpton's request. The Commission will deny the motion to strike.

The Commission has received no objections to the receipt of the late-filed exhibits other than the objection of Riverside/Mid-Kansas discussed above.

Late-filed Exhibits 113, 114, 115, 116, 117, 120, 163, 163HC, 164, 171, 172, 173, 174, 179 and 179HC shall be received into the record.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact.

I. Revenue Adjustments

A. Weather Normalization Adjustment

This issue concerns the appropriate period of time to use for the purpose of establishing "normal" temperatures in the context of setting rates for MGE. MGE advocates the use of ten years of data ending March 31, 1996. Staff advocates the use of 30 years of data (1961 through 1990). Public Counsel agrees with the Staff on this issue.

MGE witness Cummings maintains that the ten-year average of Heating Degree Days (HDD) compiled by the National Oceanographic and Atmospheric Administration (NOAA) better reflects the temperatures experienced in recent years and is not influenced by several consecutive cold winters which occurred many years ago and have not repeated themselves. (Ex. 9, p. 8). Dr. Cummings performed an analysis where he calculated the median temperatures over the last ten and fifteen years and he concluded that the ten-year measure is more representative of recent years' temperatures than the use of the 1961-1990 measure. (Ex. 9, p. 9). The reason for this result is that there were some winters with extremely cold temperatures a number of years ago that are reflected in the 30-year measure, and these extremes have not repeated themselves in the last decade. (Ex. 9. p. 10).

Staff maintains that the Commission should use the 30-year measure of normal temperatures published by NOAA, which are based on properly adjusted monthly Heating Degree Day data from the FAA weather stations at Kansas City International Airport and the Joplin Airport. Staff argues that the 30-year average is the more proper measure of "normal weather" rather than the ten-year moving average proposed by the Company. NOAA's 30-year normal averages are compiled independently of the regulatory process and are set for a period of ten years at a time after each decade of data can be analyzed. The calculations of "normals" are done only once every ten years because they require a substantial effort and commitment of NOAA's resources. The published normals used by Staff remain the same for those ten years until another decade's worth of data is collected and analyzed by NOAA.

Staff believes that the 30-year period utilized by NOAA is necessary to constitute a normal period. This period is long enough to compensate for shorter-term cycles that may be present in the data, while not being so long that historical conditions which are no longer relevant might influence the calculations of normals. Staff maintains that the use of a ten-year moving average as proposed by MGE results in great fluctuations of "normals" which has no place in setting rates on a forward-looking basis.

The Commission finds that NOAA's 30-year normals is the more appropriate benchmark. The ten-year moving average would needlessly cause frequent rate changes based on the introduction of new data every year. If one takes MGE's argument to its logical extreme, the Commission would use the most recent year's experience in MGE's service territory and re-set rates each year. This could lead to serious financial problems for MGE if its rates were set after a record-setting cold year. In addition, the data upon which Staff's recommendation is based has gone through the processes established by NOAA to ensure the best data possible. This safeguard is not present in MGE's approach.

B. Economic Development Discounts

OPC maintains that the Commission must impute the full level of revenues based on the Large Volume contract rate. OPC bases this position on the tariff language contained on MGE's Sheet 74, which states:

> Prior to any determination of the Company's revenue requirement for rate making purposes before the Commission, test year revenues shall first be adjusted to the level corresponding to that which would be produced under the standard Large Volume contract rate schedule with respect to the customers qualified for service hereunder.

OPC maintains that this language precludes Staff and MGE from making their recommended adjustment that has the effect of having ratepayers fund approximately 25 percent of the amount of economic development discounts.

This issue is the extent to which MGE's shareholders should bear the cost associated with discounted rates which MGE offers under MGE's economic development rider. The cost associated with discounted rates means the amount of revenue forgone by MGE by not charging the full tariffed rate, assuming that the customer would have had the same usage even if MGE had charged the full tariffed rate. In this particular matter, MGE has agreed with Staff that the shareholders will absorb approximately 75 percent of the cost, leaving about 25 percent or $9,500 to be borne by the ratepayers.

The Commission finds that the language of Tariff Sheet 74 does not preclude such an adjustment to test year revenues after those revenues are adjusted to the standard large volume contract rate. The Commission finds that test year revenues in this rate case should reflect the assumption by Southern Union's shareholders of 75 percent of the forgone revenue resulting from discounts from the maximum tariffed rate for customers served under the economic development rider. Given the economic benefits which accrue to the customer base as a whole, it is proper for the ratepayers to shoulder 25 percent of the forgone revenue resulting from discounts from the maximum tariffed rate for customers served under the economic development rider.

C. Delayed Payment Revenue

Delayed payment revenue is the amount of revenue collected by MGE as a result of some customers not paying their bills on time and incurring the two percent late payment fee. The issue appears to be whether the Commission should assume a direct relationship between the authorized revenue requirement and delayed payment revenue.

MGE's position is that there is a direct relationship between the revenue requirement and delayed payment revenue. The Staff's position is that no such direct relationship exists. The Commission finds that MGE has met its burden of proof on this issue. The Commission finds MGE witness Cummings' testimony to be particularly persuasive on this point. Dr. Cummings testified in rebuttal testimony:

> Once the authorized overall revenue increase is determined, 0.3098 percent of the authorized increase should be presumed to be recovered through delayed payment revenue, thus serving as an offset to the amount that must be recovered through base rates. The rate of 0.3098 percent is the portion of the Company's revenue that was derived from late payment charges for the year ending March 31, 1996. For example, if a $30 million revenue increase is authorized, monthly base rates should be designed to recover $29,907,060, or 99.6902 percent of the authorized total revenue increase. (Ex. 9, pp. 3-4).

The Staff has not submitted persuasive testimony to counter the proposition that delayed payment revenue would remain a constant 0.3098 percent of the Company's revenue. Therefore, the Commission finds that MGE's position is correct on this issue.

D. Flex Revenue

Staff and OPC have recommended an adjustment of $97,543 which represents the difference between the full-tariffed rate and the actual decreased or "flex" rates charged to seven customers to provide natural gas service. MGE requests that the ratepayers pay for the difference, arguing that keeping these seven large-volume customers as revenue contributors benefits all ratepayers. If the Commission found in favor of Staff and OPC on this issue, the effect would be to force the shareholders of MGE to fund the "discounts" provided to these customers.

MGE's tariff provides:

> The Company may from time to time at its sole discretion reduce its charge for transportation service by any amount down to the minimum transportation charge for customers who have alternative energy sources, which on an equivalent BTU basis, can be shown to be less than the sum of the Company's transportation rate and the cost of natural gas available to the customer.

> Such reductions will only be permitted if, in the Company's sole discretion, they are necessary to retain or expand services to an existing customer, to re-establish service to a previous customer or to acquire new customers.
>
> The Company will reduce its transportation rate on a case by case basis only after the customer demonstrates to the Company's satisfaction that a feasible alternative energy source exists.
>
> If the Company reduces its transportation charge hereunder, it may, unless otherwise provided for by contract, upon 2 days notice to the customer, further adjust that price within the rates set forth above.

This language makes it clear that MGE has the authority to flex down charges for certain customers but the tariff does not affect ratemaking treatment.

The Commission recognized the regulatory problem inherent with "flex" provisions in its decision in Case No. GR-95-160. In that case, the Commission stated:

> The Commission is fully aware of the obstacles faced by the natural gas utility industry in a post-636 competitive environment. In order to provide a reasonable opportunity to respond to competitive pressure, within the bounds of the regulatory structure, the Commission will reject the tariff proposal of the Staff and allow United Cities to file a substitute tariff in accordance with the following standards.
>
> The Commission will allow United Cities to negotiate and perform transportation contracts with rate flex sufficient to retain economically worthwhile customers on the system, without causing subsidization by the remainder of the rate-payers.
>
> United Cities may flex its tariffed transportation rate to meet competition, but must recover all variable costs plus a reasonable contribution to its fixed costs during the course of the contract. United Cities executes and performs under such contracts at its own risk. All transportation contracts will be thoroughly examined and reviewed in any subsequent rate case or PGA/ACA proceeding to determine whether the contract meets the above standard.
>
> United Cities will be expected to show substantial and competitive evidence of imminent by-pass by the transportation customer and will, in addition, be required to show that the contracted rate satisfies the requirement to collect no less than the variable costs attributable to the particular transportation customer plus reasonable contribution.

> The Commission would emphasize that transactions involving non-regulated affiliates will be scrupulously reviewed for determination as to whether all parties acted at arms [sic] length, and rates were flexed down no further than required to meet the relevant competition. Comparison of the affiliates' contract terms with terms contemporaneously available in the market will be probative of the arms [sic] length nature of actions. The Commission's review will be conducted with the understanding that the Company bears the burden of proof with regard to the prudency [sic] of its actions and that inappropriate transactions will result in the imputation of revenue to United Cities.
>
> The Commission would not that, upon prima facie showing by another party that a transportation contract was flexed down below the full tariffed rate, United Cities will be required to show by full, complete, substantial and competent evidence that the arrangement 1) was necessary to avoid imminent bypass, 2) recovers variable costs plus a reasonable contribution to fixed costs, and 3) in instances involving affiliates, was at arms [sic] length and flexes rates no lower than necessary to meet relevant competition.

The Commission will apply this standard to MGE in future rate cases. The Commission will clarify, however, that the avoidance of "imminent by-pass" includes the loss of a customer because of a competitive alternative.

The facts of the current case present a difficult decision to the Commission. On the one hand, MGE has no current information showing an analysis of why it was necessary to flex down in order to retain these seven customers on the system. On the other hand, Staff has assumed that these seven customers would remain on MGE's system and pay the full tariffed rate and consume the same amount of gas if MGE had charged the full tariffed rate. MGE bears the burden to prove that its proposed rate increase is justified. However, the Staff is trying to apply a standard to MGE previously unknown to it. Given these facts the Commission will order that the revenue requirement set in this case reflect 50 percent of the proposed adjustment. Since 100 percent of the proposed adjustment is $97,543, the Commission will order an adjustment of $48,771.50. This will result in shareholders and ratepayers sharing equally the forgone revenue that would have been collected from the seven customers on an equal basis.

In its next rate case, MGE should provide a current analysis of why it was necessary to flex down to retain the customers. Staff should review that analysis and make its own determination of whether the flexdown was necessary to retain the customers. Staff should also verify that the flexdown arrangement recovers the variable costs associated with serving the customers along with a reasonable contribution to fixed costs.

E. Other Revenue Adjustments

It appears from the hearing memorandum that the Commission's decision on issue I.A. (Weather Normalization) will resolve this category.

II. Expense Adjustments

A. Starting Point

The briefs are silent on this matter. The hearing memorandum and MGE testimony state that MGE accepts the expenses included in Staff's September 13, 1996 accounting run as its starting point for purposes of updating the Company's initial filing to the Commission ordered test year in this case. (Ex. 52, p. 3).

The Commission does not discern a contested issue based on the hearing memorandum and briefs.

B. Payroll

The hearing memorandum states that the Staff believes this is no longer a contested issue.

C. Payroll Taxes

The hearing memorandum states that the Staff believes this is no longer a contested issue.

D. Pensions and Benefits

1. Medical Costs - Active Employees

The hearing memorandum states that MGE accepts Staff's pro forma expense based on actual claims paid, as corrected based on the update to Staff Data Request No. 285. (Ex. 34, pp. 8-9, Ex. 35, pp. 17-22). Thus, there does not appear to be a controversy regarding this issue.

2. Medical Costs - Retirees

a. Recognition of Gains and Losses

The parties disagree regarding the appropriate method for amortizing actuarial gains and losses with respect to pension and postretirement benefits other than pensions (OPEBs) under Financial Accounting Standards 106 (FAS 106) and 87 (FAS 87). Although this is an issue of first impression for the Commission, the Commission has approved three settlements where the treatment recommended by Staff in this proceeding was used.[1]

The Staff recommends that gains and losses under FAS 87 and FAS 106 be amortized to expense over five years. MGE advocates use of a "corridor" approach, where up to 10 percent of the unrecognized net gain/loss balance is ignored (not amortized) in calculating FAS 87 and FAS 106.

The Commission finds that MGE should recognize gains or losses in its pension and OPEB accounts, and amortize those gains/losses over five years. The

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[1]United Cities Gas Company, GR-95-160; The Empire District Electric Company, ER-95-279; and Laclede Gas Company, GR-96-193.

Commission does not accept the corridor approach recommended by MGE. The Commission finds MGE's "consistency" argument not persuasive since the recommendations of Staff and MGE are each allowed by the Financial Accounting Standards Board, and since this Commission has never addressed this issue before for any utility and certainly not for MGE, it is absurd for MGE to argue that rejection of its position would be inconsistent. In fact, adoption of MGE's position would be inconsistent with the treatment of other Missouri utilities. In addition, although Section 386.315, R.S.Mo. relates to the Commission's treatment of FAS 87 and FAS 106 expenses, the statute does not require that the Commission give utilities the most liberal ratemaking treatment possible and adopt the most anti-ratepayer construction of the Financial Accounting Standards. As pointed out by the Staff, MGE does not have the competitive price pressures of other firms that must abide by the FAS standards. MGE, so far, enjoys the benefit of a monopoly for the provision of natural gas service to a large area of Missouri. MGE's attempt to shield the gains in its pension investments by use of the corridor approach is not warranted, and Staff's position will be adopted.

b. <u>COLI Amortization</u>

The Commission approved MGE's use of a COLI program to fund a portion of its OPEB costs in docket GO-94-255. (3 MPSC3d 203 (1994)). The COLI program provided a method of financing OPEB costs based on combining the growth in value of whole-life insurance policies on employees, loans against such policies, and deduction of interest on such loans for income tax purposes. The federal government has now ended the income tax deductions for these programs, which eliminates their viability as a funding mechanism for OPEB expenses.

The Staff and MGE agree that the program should be concluded. MGE proposes to amortize these costs to rates over a three-year period, and to accumulate interest on the unamortized balance, for an annual expense of $465,924. (Ex. 37, p. 3).

OPC contends that the COLI costs should be amortized over 197 months to be consistent with the historical treatment of COLI as part of the FAS 106 cost. (Tr. 182, ll. 10-17). This would result in the amortized expense related to COLI at an annual level of no more than $133,000 rather than the $466,000 proposed by MGE. (Ex. 44, p. 16, ll. 13-16).

Staff proposes that this expense should be amortized over a period of five years, for an annual expense of $249,274. Staff maintains that its proposal is consistent with typical PSC treatment for other unanticipated events, for which accounting authority orders are granted. Staff maintains that the elimination of the tax provisions which drove COLI is an unanticipated event and should be treated like any such similar occurrence. Staff maintains that a five-year amortization without accrual of interest adequately balances between the ratepayers and the shareholders the unanticipated expense of concluding the COLI program.

The Commission finds that it is reasonable for the expenses related to the conclusion of the COLI program to be amortized over a five-year period as recommended by Staff.

3. Pensions

MGE and Staff differ on whether to use the "corridor" approach for unrecognized pension plan losses or to amortize them over five years. MGE proposes the corridor approach while the Staff recommends a five-year amortization.

For the reasons stated above in Section II.D.2., the Commission finds Staff's position to be the most reasonable.

4. Long Term Disability

MGE decided to not pursue this issue. (Tr. 166).

E. Injuries and Damages

This issue involves determining the level of workers' compensation, automobile liability and general liability expense for the purpose of establishing MGE's rates. MGE's position is that the test year expense level should include the total amount of losses which have been incurred by it. This amount includes not only paid losses, but also amounts which MGE has accrued to pay losses which have occurred, but for which payment is yet to be made. MGE witness Wilson testifies that the "vast majority" of such claims are known and the total amount of the loss payments are measurable. Using historical loss experience, MGE believes it can reliably determine the losses for the coming year. (Ex. 46, pp. 7-8).

MGE's approach to this issue is not tenable because it would include paid losses, as well as incurred but not paid losses. MGE's proposal is also not appropriate is because it assumes that WRI's experience is valid for estimating MGE's likely experience. The Commission is not inclined to assume that WRI and MGE are so similar that WRI's expense experience should affect the level of injuries and damages expenses for MGE. Also, MGE relies on Southern Union's loss history from Texas in estimating the level of losses MGE will have in Missouri. The reliance on this data is not appropriate because loss experience is influenced by the legal system in various states and, for natural gas companies, the level of activity in the area of safety line replacements.

The Commission finds that the approach utilized by Staff is the most reasonable one presented because it relies on the actual historical experience of MGE while operating in the State of Missouri.

F. Fleet Leases

Based on the true-up reconciliations (Exhibits 177 and 178), the Commission determines that the parties have resolved this issue.

G. Reorganization Costs

MGE proposes that the costs of the permanent elimination of employee positions be amortized over three years. MGE maintains that ratepayers will experience a benefit by the elimination of these employee positions because payroll expense has been reduced in this case. (Ex. 34, p. 10; Ex. 52, p. 7).

Staff is opposed to increasing cost of service for a three-year amortization of severance packages given to employees terminated through a corporate reorganization, because this treatment would constitute retroactive ratemaking and Southern Union's shareholders have already been compensated through reduced payroll expenditures resulting from the terminations. (Ex. 26, p. 2).

OPC maintains that MGE's three-year amortization of severance payments incurred to reduce the number of employees should be eliminated from the prospective cost of service because MGE has already recovered these costs from the savings resulting from the reduction in the number of employees. In fact, OPC's evidence shows that the savings to MGE from the time the severance occurred to the time the rates in this case go into effect are greater than the accrued costs of the severance. (Ex. 42, pp. 23-25).

The Commission finds that MGE's position is based upon fallacious reasoning. It is appropriate that prospective rates will be set on recently available payroll expense. MGE overlooks the substantial cash flow savings that it has achieved by terminating the employees. OPC's evidence shows that Southern Union's shareholders have already received more than the severance costs in terms of reduced payroll. The rates that MGE has been charging are premised on a payroll level higher than that which it currently has, so it has profited by the decreased number of employees.

MGE's position would have the Commission assume that minimization of payroll is the paramount goal of providing utility service. This assumption is wrong. It is essential that MGE provide the best possible utility service per dollar spent by ratepayers. As with any business there is a marginal benefit to ratepayers for the last dollar spent to provide service. The Commission has not seen evidence in this proceeding to suggest that MGE has achieved a proper balance between marginal costs and marginal revenues for the ratepayers of Missouri.

The Commission finds that MGE's shareholders have already received monetary compensation through the reduction in payroll expense. The Commission will not allow MGE to charge ratepayers the costs associated with employee severances where MGE has already recovered those costs.

The Commission finds that the position of Staff and OPC is most reasonable on this issue.

H. Advertising

Staff and MGE are in agreement regarding the amount of advertising expenditures made by MGE to be included in rates. However, OPC believes more of the advertising expenses incurred by MGE during the test year should be excluded from rates. Specifically, Staff and MGE agree that $16,629 of MGE's advertising expenses should be excluded from rates, but OPC believes that $48,074 should be excluded, a difference of $31,445. (Ex. 174).

The controversial advertising expenditures are broken into six distinct groups by OPC. The first item for which OPC proposes disallowance are charges from Smith Grieves & Company relating to billing inserts for the Neighbors Helping Neighbors Program. OPC classified this advertisement as institutional and proposes disallowance of $4,957.69 of associated cost.

MGE argues that the Neighbors Helping Neighbors program provides a direct benefit to ratepayers and thus, should be allowed in rates.

The Commission finds that the advertising costs associated with the Neighbors Helping Neighbors program should be allowed in rates. With cutbacks of federal funding to help low income users of natural gas programs like Neighbors Helping Neighbors are increasingly important. Because it is in the interest of all ratepayers generally to assist low income users of natural gas, the Commission will allow gas utilities to pass through a reasonable level of costs to the ratepayers to subsidize the existence of programs designed to benefit low income users of natural gas.

The second item for which OPC recommends disallowance is a duplicate charge from Smith Grieves & Company in the amount of $4,546.57. Staff failed to remove this duplicate charge but Staff witness O'Keefe, during cross-examination, admitted that the duplicate charge should be removed. (Tr. 304, ll. 2-18).

The Commission finds that the revenue requirement set in this case should reflect removal of the duplicate charge in the amount of $4,546.57 from Smith Grieves & Company.

The third item for which OPC recommends disallowance is the cost of advertising for the public relations manager in the amount of $833.45. The Commission finds that such cost should be allowed in rates because this position is no longer in the Community Relations Department. (Tr. 319).

The fourth item for which OPC recommends disallowance is the cost of brochures, folders, brochure holders and laser sheets from TNT, Inc. in the amount of $16,862.93. OPC recommends disallowance of seven-eighths of the

TNT, Inc. costs because seven of the advertisements were promotional in nature, while one related to safety. (Ex. 55, p. 25, ll. 25-30).

Staff had excluded four-fifths of the TNT, Inc. advertisements and left in the cost of service the advertisement holders. (Ex. 55, p. 25. ll 22-25). However, during cross-examination, Staff witness O'Keefe stated that OPC's proposed seven-eighths adjustment was correct and should be adopted. (Tr. 308, ll. 3-8).

The Commission finds in favor of OPC on this issue because seven-eighths of the cost of brochures, folders, brochure holders and laser sheets from TNT, Inc. are promotional in nature.

OPC recommends a disallowance in the amount of $5,035.57 which reflects the cost associated with various advertisements for the Missouri Restaurant Association, the Home Builders Association, the purchase of promotional t-shirts, the cost of printing and shipping pocket calendars embossed with MGE's name, and charges for 300 reprints of "Cooking for Profit." OPC contends that all of these advertisements seek to encourage the use of natural gas or enhance MGE's corporate image.

The Commission finds that the $5,035.57 amount should not be allowed in rates because these expenses are incurred to encourage use of gas over electricity or to promote MGE's corporate image. The Commission has to consider the energy market in making these decisions. The Commission will not encourage gas and electric companies to compete by passing those costs on to ratepayers. Since these companies are still subject to rate base/rate of return regulation in Missouri, it does not make sense to pass these types of expenses through to ratepayers. Shareholders, not ratepayers, must bear the expense of advertisements designed to increase sales of energy resources.

Finally, OPC recommends that the Commission disallow $7,059.53 of charges for Chuck Denton, an advertising consultant who deals with home builders associations, developers, and realtors. OPC maintains that his activities are promotional in nature. OPC points out that in response to a data request, Denton wrote that he was involved in setting up potential ads and material for Lennox Corporation open house and review of possible poster boards or banner for background for MGE floor display in future showcase.

The Commission finds that Denton was primarily engaged in promotional activities and therefore will disallow the expenses associated with his services.

I. Dues and Donations

MGE, Staff and OPC each have different opinions about the appropriate level of dues and donations in this case. OPC argues that the dues and donations made by MGE to various organizations do not provide a direct benefit to rate-payers and should therefore be disallowed. OPC points out that the direct benefit test comes from a previous decision of this Commission. ***In re Kansas City Power & Light Co.***, 24 Mo. P.S.C. (N.S.) 386, 400 (1986). In that case, the Commission stated:

> The rule has always been that dues to organizations may be allowed as operating expenses where a direct benefit can be shown to accrue to the ratepayers of the company. Conversely, where that sort of benefit does not appear, disallowance of the dues is required.

After carefully considering the positions of MGE, Staff and OPC, the Commission finds that the Staff's recommendation is the best alternative. Staff proposed the elimination of $53,289 for certain non-American Gas Association (AGA) dues and donations, and an additional adjustment of $53,947 to disallow those portions of AGA dues attributable to lobbying, governmental affairs and marketing. The Staff recommendation includes dues to local chambers of commerce, professional organizations like the American Institute of Certified Public Accountants, and a donation for safety equipment to the Western Missouri Fire Chiefs Association. The evidence shows that the Staff exercised sound judgment concerning the nature of each expenditure. In reviewing AGA dues, the Staff compared the expenditures itemized by the National Association of Regulatory Utility Commissioners (NARUC) audit of the AGA with the standards traditionally used by this Commission to derive a ratio for allowable expense. (Ex. 39HC, pp. 8-9). Overall, Staff's position is the most reasoned, and does not unduly emphasize the quantification of direct benefits, which OPC's analysis does.

J. Community Leadership Department

The issue presented for decision is what portion of the expense booked to MGE's Community Leadership Department should be recovered in rates. MGE believes the entire cost should be allowed in rates. OPC believes that none of the cost should be allowed in rates. Staff recommends that the Commission allow 50 percent of the cost in rates.

Staff's review of the Community Leadership Department records indicate that a substantial portion of the department's functions are not properly chargeable to ratepayers. (Ex. 38HC), pp. 13-17). Some functions which are not properly chargeable to ratepayers include promotion of MGE's corporate image, legislative contacts, civic functions, and charitable activities. On the other hand, Staff identified several functions which are normally chargeable to ratepayers. These above-the-line functions include safety presentations and customer service contacts. Staff maintains that MGE's records were far from comprehensive for purposes of conducting a thorough audit. Balancing the material reviewed by Staff, Staff recommends that the Commission allow

50 percent of the department's test year expense in its revenue requirement. (Ex. 38HC, p. 26).

The Commission finds that 50 percent of the test year expenses of the Community Leadership Department should be allowed in MGE's revenue requirement. A significant part of the functions of the Community Leadership Department relate to promoting the corporate image of MGE or encouraging greater use of natural gas. Therefore, it would be inappropriate to charge ratepayers with 100 percent of the expenses of the Community Leadership Department. At the same time, however, it appears that some of the functions conducted by the department, such as safety training and education, will provide benefits to ratepayers and are properly chargeable to ratepayers.

K. <u>Corporate Costs</u>

1. <u>Executive Salaries</u>

MGE contends that 100 percent of the salaries of George Lindemann, Chief Executive Officer and Chairman of the Board, and Jack Brennan, Assistant Secretary and Vice Chairman of the Board, should be included in the calculation of corporate costs allocated to MGE for ratemaking purposes. MGE witness Janet M. Simpson testified that Lindemann and Brennan are heavily involved in the day-to-day activities of Southern Union Company. According to Simpson, they are in continuous contact with the executive officers of the company in Austin relating to matters of long term and short term strategic planning. Simpson further testified that they are actively involved in establishing and maintaining contacts with bankers, rating agencies and financial analysts. Simpson contends that based on the nature and extent of their involvement, Lindemann and Brennan function as executive officers rather than geographically removed directors.

Staff presents testimony relating to several data requests that it submitted to MGE concerning the time spent by Lindemann and Brennan working as directors or officers of Southern Union Company. Staff testifies that MGE did not provide appointment calendars for 1995 and 1996 but, instead, MGE states "calendars were not retained" by Lindemann and Brennan. Staff further testifies that in addition to their function as directors/officers of Southern Union, Lindemann and Brennan are officers/directors/employees of Activated Communications, a company controlled by Lindemann that is headquartered in New York City. While at Activated Communications' office in New York City, or while at Lindemann's residence in Florida, these individuals are geographically remote from Southern Union's corporate headquarters in Austin, Texas, and the MGE headquarters in Kansas City, Missouri.

The Commission finds that 50 percent of that portion of the salaries allocated through Southern Union of Lindemann and Brennan should be excluded from MGE's revenue requirement because MGE has not provided sufficient documentation to establish that 100 percent of the activities of Lindemann and Brennan performed for Southern Union provide a benefit to Missouri ratepayers.

The Commission is concerned with the state of the record on this issue. This evidence leaves many unanswered questions regarding the services that Lindemann and Brennan provide to benefit MGE's ratepayers. For instance, how much of their time is spent working for Southern Union? How much is spent working on MGE matters? There appears to be no evidence on jurisdictional allocation between Texas operations and Missouri operations. Does Activated Communications provide services to Southern Union?

Under Section 393.150(2), R.S.Mo. (1994), MGE bears the burden to show that proposed increased rates are just and reasonable. This means that MGE must keep auditable records to show that Lindemann and Brennan provided services to

MGE which services benefited Missouri ratepayers. It is not sufficient to request the increase in revenue requirement with no supporting documentation. However, given the supported positions in this record the Commission will rule in favor of Staff's position.

2. Executive Office Lease Expense

MGE contends that the lease costs associated with office space used by George Lindemann and Jack Brennan should be included in the calculation of corporate costs allocated to MGE for ratemaking purposes.

Staff and OPC recommend that the Commission remove the cost of the New York City office space from the corporate costs allocated to MGE because it is an unnecessary, additional expense that MGE would not otherwise incur if its top executive officers, Lindemann and Brennan, maintained an office at the Austin, Texas headquarters of Southern Union.

The Commission finds that MGE failed to prove the necessity of the expense for the New York City office. Thus, the Commission will not allow MGE's revenue requirement to reflect this expense.

3. Incentive Compensation

MGE recommends that the Commission adopt the adjustment proposed by Staff which reflects a four-year average of incentive compensation paid. (Ex. 35, pp. 26-29). OPC believes that the Southern Union incentive compensation plan should be excluded from the cost of service. OPC contends that the incentive compensation plan relates primarily to shareholder-related goals such as increasing profits or net income. (Ex. 42, pp. 25-27; Ex. 43, pp. 13-14).

OPC witness Effron testified at pages 13 and 14 of his rebuttal testimony as follows:

> Q. . . . To the extent that the incentive compensation program relates to controlling costs, which is arguably a ratepayer oriented goal, should the incentive compensation be included in the cost of service?
>
> A. As a general rule, I would agree that if the incentive compensation is related to customer oriented goals, then it should not be excluded from the cost of service. But, and this is a big but, if one of the nominally customer oriented goals of the incentive compensation program is reducing expenses, then that incentive compensation should be included in the cost of service only to the extent that the intended cost containment can be achieved without compromising customer service. If employees are rewarded for reducing costs, without regard to the quality of service, then the employees have an incentive to reduce costs, even if it means compromising the quality of service. Unless the Company can demonstrate that cost reductions pursuant to which incentive compensation has been awarded were achieved while <u>maintaining the quality of service</u>, then the incentive compensation should be excluded from the cost of service. In fact, based on the testimony of OPC witnesses Trippensee and Kind, any cost reductions which the Company has been able to achieve have been realized at the expense of the quality of service. In these circumstances, it would be inappropriate to include any incentive compensation related to expense reductions in the cost of service. [Emphasis added].

The Commission finds that the quality of service is provided by MGE has declined precipitously during the last three years. (Ex. 81, pp. 7-8, Sch. 2). Nevertheless, MGE is requesting the Commission to have ratepayers pay for an incentive compensation program that ratepayers may have already paid for in terms of a reduction in the quality of service that ratepayers receive.

The Commission finds that the costs of MGE's incentive compensation program should not be included in MGE's revenue requirement because the incentive compensation program is driven at least primarily, if not solely, by the goal of shareholder wealth maximization, and it is not significantly driven by the interests of ratepayers. (Tr. 461-462, 508-512).

4. Stock Option Compensation

MGE granted a limited number of its employees stock options as part of their compensation. Alleging that the cost of these stock options is $431,573, MGE requested that they be included in its cost of service.

The Staff removed this cost on the basis that these are very speculative and not appropriate for ratemaking purposes. In addition, Staff argues that since neither Southern Union nor MGE records an expense on its books associated with the stock options, it is not appropriate to charge MGE ratepayers for the options. (Ex. 59, pp. 17-22).

The effect of granting stock options to employees is to align the interests of shareholders and employees. The interest of shareholders is to maximize shareholder wealth. To maximize shareholder wealth, the firm must maximize revenues and minimize costs.

Minimization of cost while maintaining an appropriate level of quality of service is an appropriate goal. MGE has argued in this proceeding that since it wants to maximize revenue it will maintain service quality at an appropriate level. The Commission does not agree with this argument by MGE because MGE enjoys a monopoly service territory in the State of Missouri. MGE does not have to compete with other suppliers of natural gas to provide service to residential and small business customers. (Tr. 1137-1138). Thus, MGE's argument that its goal of maximizing revenue ensures appropriate quality of service is fallacious. Furthermore, that argument will remain fallacious until the market for natural gas is truly competitive. Having said all that, the Commission finds that the Staff's position on the stock option compensation issue is correct because there is not a sufficient connection between benefits to Missouri ratepayers and benefits to MGE's shareholders to justify the cost of a program that brings the interests of MGE's shareholders and MGE's employees into alignment.

L. Amortization Period for Safety Program Deferrals

MGE's position is that a three-year amortization period is warranted for safety line replacement program costs. MGE contends that a prolonged delay in recovery of these costs denies shareholders a timely cash return of and on their investment. (Ex. 34, p. 15, ll. 3-7). MGE recommends that the Commission increase amortization expense from the Staff's September 13, 1996 accounting run to reflect a three-year amortization period of the Company's deferrals. (Ex. 61, p. 17, ll. 10-13).

Staff and OPC recommend that the safety line replacement program deferrals be amortized over 20 years rather than three years. (Ex. 64, pp. 8-11; Ex. 66, pp. 11-12; Ex. 42, pp. 27-32).

The Commission finds that a 20-year amortization is appropriate because the line replacements should last at least 20 years. However, the Commission does find that MGE's objection to Staff's argument that MGE is "trying to change the deal" on this issue as agreed to in the merger case, GM-94-40, is well taken. The rights and obligations from an earlier matter (GR-93-240) which Southern Union agreed to assume in the merger case were subject to a variety of typical settlement agreement conditions, including a proviso that the parties were not "deemed to have approved or acquiesced in any ratemaking principle or any method of cost determination or cost allocation . . . ." Therefore, MGE was free to assert that the amortization period for safety program deferral was altered.

The Commission's finding in favor of a 20-year amortization on this issue is not to be construed as an indication that the Commission is not concerned about the safety of gas lines. To the contrary, the Commission takes very seriously its obligation to ensure the safety of gas lines. The Commission had to choose between two extreme positions in this case. It would be helpful to have other proposals in between the extremes presented herein.

M. Depreciation and Amortization Other Than Safety Program

MGE recommends that the Commission authorize the use of a 10 percent depreciation rate with respect to the portion of the costs booked to Account 391 that relates to computer hardware and software. (Ex. 34, p. 14; Ex. 35, pp. 35-38). The Staff maintains that MGE has failed to conduct a thorough depreciation study and that MGE is attempting to improperly select a few assets from a large category of assets for rapid depreciation. The evidence shows that MGE had hired Black & Veatch to conduct a depreciation study of all accounts in 1995. The study specifically indicated that the Account 391 depreciation rates were too low and failed to recognize the actual life of computer equipment. (Ex. 67, p. 12). The study concluded that overall depreciation expense should decrease. However, Staff and MGE agreed that there would be no change in depreciation rates in this rate case. (Ex. 67, p. 12).

The Commission finds MGE's proposal that computer hardware and software be depreciated at a rate of 10 percent per year is appropriate because technology is advancing at such a rapid pace that an owner will frequently find computer hardware and software to be obsolete ten years or less after the date of acquisition.

N. Acquisition Savings

MGE proposes an adjustment that adds expenses to rate base equal to 50 percent of achieved, ongoing savings resulting from Southern Union's acquisition of Missouri properties from Western Resources, Inc. These acquisition savings involve: labor and associated taxes, benefit savings, purchased gas savings, MIS savings, lease cost savings (building and vehicle) and financial savings. (Ex. 34, p. 16). MGE asserts that the basis of the adjustment is the unanimous stipulation and agreement from Case No. GM-94-40.

MGE contends that the stipulation and agreement allows MGE to request recovery of the benefits resulting from the acquisition. MGE contends that an equal sharing of these ongoing savings between customers and shareholders is a reasonable ratemaking approach and is consistent with the terms of the stipulation and agreement. (Ex. 34, pp. 16-17).

MGE quantified the purported identifiable annual savings it has already generated at $14,748,912. (Ex. 34, pp. 16-18, and Sch. DND-1-H, p. 5 of 6). MGE states that more than $5,420,000 of these savings has already been realized and flowed through to its ratepayers by the Purchased Gas Adjustment (PGA) Clause. For producing these tangible savings, MGE is requesting that the Commission provide MGE with some tangible recognition. The recognition requested is in the form of adding an amount equal to one-half of these identified, achieved and ongoing savings as an expense for ratemaking purposes. (Ex. 34, p. 16). MGE maintains that Missouri ratepayers have experienced a benefit in terms of decreased natural gas costs. MGE maintains that it has acquired gas supplies at a lower cost than its predecessor (WRI) because MGE tends to bid supply contracts where WRI tended to negotiate its contracts. (Tr. 747-748).

MGE further argues that it has lowered its cost of capital, which is reflected in rates, from what customers would have experienced if WRI had not sold the properties. MGE states that it has achieved this lower cost of capital through refinancing higher cost debt and issuing tax deductible preferred stock. (Ex. 9, p. 18).

Staff's position is that the acquisition savings proposal should not be implemented. Staff argues that the proposal "imputes" expenses to ratepayers which were not actually incurred by MGE. MGE witness Cummings directly admits in his rebuttal testimony that the "imputed expenses are not current costs of providing utility service." (Cummings Rebuttal, Ex. 9, p. 22). MGE's witness

Dively testified at the hearing that no part of MGE's acquisition savings adjustment proposal represents actual costs of providing service. (Tr. 670-671).

Staff points out that the stipulation and agreement from Case No. GM-94-40 merely allows MGE to seek recovery of the benefits from acquisition rather than guaranteeing such recovery.

In sum, the Staff recommends that the Commission reject MGE's proposal because it does not represent appropriate or proper ratemaking policy because the alleged savings are not adequately quantified by MGE; the proposal is not fair and equitable; utilities other than MGE have also downsized without expecting any sharing of related savings; the alleged cost reductions benefited MGE at least up until any rate changes resulting from this proceeding; the proposal represents the equivalent of an incentive plan without any safeguards; the proposal shifts risks of MGE's cutbacks and related cost reductions to its customers; the proposal represents an attempted recovery of the acquisition premium from Case No. GM-94-40; and the proposal would take MGE off of cost of service ratemaking (cost-based rates). (Ex. 72, pp. 4-5). The Staff further argues that adoption of MGE's proposal would reward the Company for providing a lower quality of service while at the same time requesting ratepayers to pay higher than cost-based rates.

The Commission finds that MGE's acquisition savings adjustment should be rejected in total because adoption of this adjustment would be contrary to the provision of natural gas service based on the costs of providing such service and because MGE's experimental gas cost incentive mechanism already rewards MGE's shareholders for making financially sound gas procurement decisions.

O. Street Cut Referendum Fees

The City Council of Kansas City, Missouri, passed an ordinance in April 1996 which, if implemented, would have imposed higher costs on MGE and other utilities which are required to occasionally dig holes (i.e., street cuts) in the city streets. (Ex. 55, p. 30). MGE estimated the increased costs to its customers resulting from the ordinance to be approximately $1,200,000 annually. (Tr. 792-793). In May 1996 MGE started a referendum petition drive to place the ordinance passed by the City Council on the ballot for a public vote. (Ex. 55, p. 30). The petition requested the City Council to either repeal the ordinance or put it on the ballot and let the voters in Kansas City determine whether it should be implemented. (Ex. 88, p. 5; Tr. 790). The City Council rescinded the ordinance. (Tr. 800). MGE requests that the revenue requirement reflect an $18,466 amount which reflects the test period portion of expenses used to help encourage reconsideration of the ordinance. MGE points out that the total expenditure for this effort was approximately $100,000, but only $18,466 fell into the test year period so that is what MGE requests in the revenue requirement.

Staff contends that this would be a nonrecurring expense and not material. OPC contends that this is an inappropriate lobbying expenditure by MGE.

The Commission finds that this type of activity by a natural gas utility has the potential of providing a direct benefit to ratepayers. In this particular case, it appears that MGE's efforts did, in fact, have a substantial direct benefit to ratepayers. The Commission finds that MGE's request that its expenditures during the test year period on the street cut referendum issue be included in its revenue requirement in this rate case is reasonable.

1. Lobbying Expense

OPC proposes an adjustment in the amount of $4,971, which represents an imputed level of lobbying expenses to represent the services MGE provides to a political action committee (PAC). The PAC is known as Missouri Gas Energy Citizens for Responsible Energy. (Ex. 55, p. 47, ll. 10-13). OPC states that MGE incurs direct costs in relation to the PAC.

MGE states that whatever costs it incurs in relation to the PAC are de minimis. (Ex. 53, p. 9, ll. 8-15). The services performed by MGE in relation to the PAC are: (1) withholding employee contributions from payroll checks; and (2) completion of a quarterly report to the State of Missouri.

The Commission finds in favor of MGE on this issue because the proposed adjustment of $4,971 actually equaled the amount of voluntary contributions for the test period made by MGE employees. OPC has not quantified the amount.

P. Weatherization Program and Its Costs

This issue was resolved by the Stipulation And Agreement filed by the parties on October 30, 1996. Please see section I.A. of the Procedural History for the discussion about this Stipulation And Agreement

Q. Property Tax Expense

MGE contends that the most current known and measurable plant balances should be used to calculate an ongoing level of property tax expense. Thus, MGE used May 31, 1996 plant balances in the annualization of property tax expense. (Ex. 53, pp. 4-6).

Staff's position is that the actual property tax assessment date of January 1, 1996 should be used to determine property taxes for revenue requirement purposes. (Ex. 71, pp. 6-8).

The Commission finds Staff witness Featherstone's testimony persuasive where he states:

> MGE will not accrue a property tax expense for any of the plant additions through May 31, 1996 identified in the Rebuttal Testimony of Mr. Kelly until January of 1997. This accrual will only be an estimate for which the Company will not know the actual amount of property tax payments until late in 1997, when the tax bills are distributed by the taxing authorities, usually in November or December of that year.

(Ex. 73, p. 4).

The Commission finds that MGE's proposal would require waiting until the end of 1997 to account for an item of expense for inclusion in this case because this would be a violation of the test year, updated test year or true-up concepts. (Ex. 73, pp. 5-8). Staff's recommendation will be adopted.

R. <u>Uncollectible Expense</u>

The Company accepts Staff's recommended uncollectible expense ratio, but the Company believes that the ratio should be used to compute uncollectible expense relating to revenue from Large Volume Sales and Transportation customers. MGE also believes the ratio should be used to compute uncollectible expense relating to the Company's additional revenues as reflected in the Commission-determined revenue deficiency.

As discussed under issue I.C., Delayed Payment Revenue, the Commission agrees with MGE insofar as the uncollectible expense should be adjusted to reflect additional revenues resulting from the instant rate case. The only remaining issue is whether the uncollectible expense ratio should be applied to Large Volume Sales and Transportation revenue.

Staff maintains that Large Volume Sales and Transportation customers do not normally create bad debt expense. It is reasonable to assume that Large Volume Sales and Transportation customers would not cause the creation of bad debt expense. In order for MGE to prevail, it would have to show that Large Volume Sales and Transportation customers do, in fact, cause the creation of bad debt expense. MGE argues that while it is true that uncollectible accounts are fewer in the Large Volume class, the critical point is that the revenues from Large Volume customers were included in the development of the 1.02 percent uncollectible factor. If revenue from Large Volume customers is excluded from the calculation, the percentage of uncollectible accounts (net chargeoffs) becomes 1.06 percent of revenue from Residential, Small General Service and Large General Service customers. MGE maintains that the 1.02 percentage must be applied to all revenues, including Large Volume Sales, or a mismatch will occur in the calculation of the appropriate amount of uncollectible expense for inclusion in cost of service.

MGE's argument seems persuasive on its face. However, since MGE did not provide any evidence showing the calculation of 1.02 percent or 1.06 percent to be the appropriate level of the bad debt expense, the argument fails. In fact, MGE relies, again, on the Staff's calculation of the bad debt expense factor to be 1.02 percent. Staff witness Larry Cox stated that MGE's records and production of information was so deficient that he was not able to do a thorough examination to calculate the uncollectible expense factor. Thus, MGE's position that Large Volume Sales customers' and Transportation customers' revenue should be included with regard to the uncollectible expense factor is completely without merit. The Commission finds that the Staff's approach is the more reasonable approach on this issue.

S. Income Tax

1. Adjustment to Tax Calculation for Equity Portion of SLRP Carrying Cost Deferrals

MGE's position is based on an accounting authority order issued by the Commission in Case No. GO-94-234. In that order the Commission authorized MGE to defer and book to Account No. 182.3 depreciation expense, property taxes and carrying costs at 10.54 percent for certain costs. However, Ordered Paragraph 3 of that same order was quite clear that nothing in the order was to be considered a finding of the Commission in relation to ratemaking treatment. (Commission Order, Case No. GO-94-234, p. 4).

Staff asserts that the actual carrying costs incurred by MGE are reflected by applying the allowance for funds used during construction (AFUDC) rate. (Exhibit 67, p. 9).

The Commission finds that Staff's position is more reasonable on this issue because the order upon which MGE's position is based specifically provides that ratemaking treatment to be afforded the deferred amounts is reserved. Furthermore, MGE makes no claim that 10.54 percent is an accurate reflection of its actual financing costs during the deferral period. (Tr. 916). The Commission is of the opinion that MGE's revenue requirement in this rate proceeding should reflect actual carrying costs and that the AFUDC rate proposed by the Staff is reflective of actual carrying costs.

2. Adjustment to Tax Calculation for Fifty Percent of Acquisition Savings

As discussed in issue II.N., Acquisition Savings, the Commission rejects MGE's proposal to recognize acquisition savings in rate base. Therefore, there are no income tax consequences associated with the alleged cost reductions resulting from Southern Union's acquisition. (Ex. 64, p. 13). Thus, this issue has become moot.

T. Other Polsinelli, White Charges

This is an issue between MGE and OPC. OPC maintains that MGE's revenue requirement should reflect the elimination of $22,056 in legal fees incurred by MGE in a Kansas Pipeline Partnership (KPP) rate case before the Kansas Corporation Commission. OPC maintains that MGE has failed to show a connection between the KPP rate case and the provision of utility services to MGE's Missouri ratepayers.

MGE's witness Kevin J. Kelly has testified that MGE and KPP have negotiated a contract under which MGE purchases gas, the cost of which is passed directly on to MGE ratepayers. This evidence by MGE appears to be uncontroverted. Therefore, the Commission finds that MGE has demonstrated a strong connection between the KPP rate case before the Kansas Corporation Commission and MGE's rates applicable to Missouri ratepayers. Thus, the Commission finds that the $22,056 of legal fees incurred by MGE for this Kansas rate case should be included in the revenue requirement of MGE.

U. Loaned Executive

This issue was settled between MGE and OPC prior to conclusion of the evidentiary hearing.

III. Rate Base

A. Safety Program Deferrals

1. Carrying Cost Rate

MGE's position is that the Commission should apply a carrying cost rate of 10.54 percent because the Commission issued an accounting authority order on September 28, 1994, in Case No. GO-94-234 which mentioned carrying costs at 10.54 percent. That order provides that "MGE is authorized to defer and book to Account No. 182.3, beginning February 1, 1994 and continuing through January 31, 1997, depreciation expense, property taxes, and carrying costs at 10.54 percent, on the costs incurred to repair or replace facilities located in mobile home parks, replace MGE-owned and customer-owned service and yard lines. . . ." That order also provides that nothing in the order "is to be considered a finding of the Commission of the reasonableness of the expenditures involved herein, or of <u>the value for ratemaking purposes</u> of the expenditures and property herein involved, . . . and <u>the Commission reserves the right to consider the ratemaking treatment to be afforded these expenditures in any later proceeding</u>." [Emphasis added]. MGE argues that not only did the Company rely on this accounting authority order for preapproval of the 10.54 percent carrying cost rate, but that, implicitly, the financial community at large must be able to rely upon accounting authority orders. (Ex. 61, p. 7).

The Commission finds that MGE has taken the application of accounting authority orders well beyond their intended purpose. Accounting authority orders allow utilities to book certain expenses in certain ways. However, accounting authority orders have no direct ratemaking impact. It seems redundant for the Commission to elaborate on this point since the accounting authority order itself from Case No. GO-94-234 states that the order is not to be considered a finding of the Commission regarding values for ratemaking purposes. Since MGE has based its position on the Commission's order from GO-94-234, which by its very terms does not have a ratemaking impact, MGE's position on this issue is not persuasive. The Commission finds in favor of the Staff on this issue because the Staff's proposal shows a carrying cost which is more reflective of the actual carrying cost associated with the gas safety line replacements. (Ex. 65).

2. Period Through Which Deferrals Are Computed

MGE contends that the Commission's order in Case No. GO-94-234 requires it to compute deferrals through January 31, 1997 on safety-related plant for ratemaking purposes. (Ex. 34, pp. 14-15; Ex. 61, pp. 10-13).

Staff's position is that safety program deferrals should be cut off at May 31, 1996, the end of the updated test year in this case. Staff states that it has updated these deferrals through October 31, 1996 under the Commission's true-up order. (Ex. 175, p. 2). OPC contends that deferrals of safety line replacement plant included in rate base should be computed at the same date used for other plant-related components of rate base. (Ex. 42, pp. 5-8). In essence, the Commission has already decided this issue in two respects. First, the true-up order issued in this case is quite clear insofar as safety-related plant in service is to be trued-up through October 31, 1996. Second, the Commission's order in GO-94-234, upon which MGE places so much reliance, states very clearly that the accounting authority order does not have any effect upon ratemaking issues. Thus, the Commission finds that the Staff's position is correct.

3. Dismantling Costs, and

4. Unamortized Balance of Deferrals from Case No. GO-94-234

At a conceptual level, these issues are identical to issue III.A.2. MGE places undue reliance on Case No. GO-94-234 in that the order in GO-94-234 is an accounting authority order which specifically reserved ratemaking treatment.

The Commission in its true-up order in this case specified true-up through October 31, 1996. The Staff has correctly trued-up these balances through October 31, 1996. Staff's approach is consistent with cost of service/historical test year ratemaking principles, and the Commission finds that the Staff's approach is correct. (Ex. 65).

B. Offset for Rate Base Reductions Eliminated by Purchase

The unanimous stipulation and agreement in the acquisition case, Case No. GM-94-40, in which Missouri Gas Energy acquired the Missouri gas properties of WRI, contains the following language:

> Southern Union [i.e., MGE] agrees to use an additional offset to rate base in any Southern Union filing for a general increase in non-gas rates in Missouri completed in the next ten years to compensate for rate base deductions that have been eliminated by this transaction. The amount of the offset for the first year shall be $30.0 million. The amount shall reduce by $3.0 million per year on each anniversary date of the closing of the subject transaction.

(Ex. 71, p. 4; *see also* p. 6, para. 8, Unanimous Stipulation And Agreement in Case No. GM-94-40).

MGE argues that the stipulation and agreement is silent as to the precise nature of the rate base reduction eliminated by the transaction. MGE argues that instead of the two-year amortization proposed by the Staff and OPC, which would reduce rate base by $24 million, the appropriate amortization period for purposes of this case is two years and four months, which would reduce rate base by $23 million.

The Commission finds that Staff and OPC correctly interpreted and applied the stipulation and agreement from GM-94-40 wherein it states: "The amount shall reduce by $3.0 million per year on each anniversary date of the closing of the subject transaction." (Ex. 71, pp. 5-6).

IV. Capital Structure and Rate of Return

A. Required Capital Structure to Implement Rates

Please see the Commission's discussion of this issue at pages 12 through 14 (Motion to Dismiss on Basis that MGE Failed to Comply With Capital Structure Condition in Case No. GM-94-40).

B. Capital Structure

MGE, OPC and the Staff agree that MGE's capital structure is as follows: common equity - 33.13 percent; long term debt - 54.12 percent; preferred stock - 12.75 percent. OPC's agreement to this capital structure is conditioned on the assumption that the Commission will determine that the preferred stock should be treated as equity, which, of course, is the subject of OPC's motion to dismiss the case as well as issue IV.A.

C. Cost of Debt

MGE, Staff and OPC agree that the cost of long term debt for purposes of this case is 8.21 percent. (Ex. 90, pp. 26-28; Ex. 91, p. 2; Ex. 78, Sch. 2; Ex. 99). Riverside/Mid-Kansas claim that the cost of debt is 7.739 percent. The difference between the two proposals stems from the fact that MGE's proposed cost of debt includes losses on reacquired debt recorded in Account No. 189. These reacquired debt costs are associated with high cost debt that was outstanding prior to the acquisition of Missouri properties. Since these costs were not incurred in financing the acquisition of the Missouri properties, these costs should not be considered in determining the cost of debt for MGE's Missouri operations. (Ex. 105, p. 12).

The Commission finds that Southern Union incurred the reacquisition debt costs recorded in Account No. 189 in an effort to lower its overall cost of capital. This cost may legitimately be passed through to ratepayers. (Ex. 91, p. 18).

D. Cost of Preferred Stock

MGE, Staff and OPC agree that the appropriate cost of preferred stock for purposes of this rate case is 10 percent. (Ex. 90, pp. 28-29; Ex. 91; Ex. 76, Sch. 13; Ex. 99).

E. Rate of Return on Common Equity

MGE's position is that it should be authorized to earn a rate of return on common equity of 12.25 percent. (Ex. 90, pp. 30-71, 75-76). MGE witness Fairchild's recommendation is based on the results of two analyses. First, the constant growth discounted cash flow model was applied to a group of 19 other gas local distribution companies (LDCs). Second, risk premium methods based on leading studies for utilities in the academic and trade literature were also applied. Dr. Fairchild testifies that, taken together, these analyses implied that the cost of equity for MGE is in the range of 11.5 to 12.5 percent. Dr. Fairchild testifies that he selected a rate of return on common equity for MGE above the midpoint of 11.5 to 12.5 percent (he selected 12.25 percent) based on two considerations. First, the range gives approximately equal weight to the discounted cash flow analysis, which tends to be biased downward because investors expect near-term growth rates to be lower than longer-term growth as LDCs prepare for a more competitive industry. Second, Dr. Fairchild testifies that this cost of equity range does not recognize flotation costs incurred in connection with sales of common stock. (Ex. 90, pp. 6-7).

OPC recommends that Southern Union be authorized a 10.75 percent return on equity. (Ex. 99, pp. 14-33). OPC witness Burdette testifies that MGE should be allowed a return on common equity of 10.75 percent. This return on equity was determined using the discounted cash flow method applied to a group of nine comparable companies and supported by a capital asset pricing model analysis and a market-to-book ratio analysis. (Ex. 99, p. 14).

Staff recommends a return on equity range of 11.30 to 12.35 percent from a financial analysis viewpoint. However, Staff believes that the Commission has the power to consider poor customer service when determining a reasonable return on equity. (Ex. 76, pp. 32-49; Ex. 78, pp. 4-10; Ex. 81, all).

The Commission takes very seriously its obligation to ensure that MGE provides safe and adequate service under reasonable terms and conditions. After hearing the many serious customer complaints at local public hearings in St. Joseph, Kansas City and Joplin, Missouri, and after reviewing the testimony provided by the Office of the Public Counsel and the Commission's Consumer Services Department, the Commission has grave reservations about whether MGE is providing an adequate level of service quality to Missouri customers.

The number of customer complaints has increased substantially since Southern Union acquired the Missouri properties from WRI in February of 1994. For the fiscal year ending June 30, 1996, the Commission's Consumer Services Department received 941 complaints relating to MGE operations. In contrast to that number, during fiscal year 1993 (the last full fiscal year that WRI operated the territory) there were 540 customer complaints. This represents an increase in the number of customer complaints received by the Commission's Consumer Services Department of 74 percent. (Ex. 81, pp. 7-8).

The Commission finds that the appropriate return on equity for purposes of establishing MGE's revenue requirement in this case is 11.30 percent. This is the low end of the range of acceptable return on equity figures provided by the Staff. (Ex. 76, pp. 32-49; Ex. 79, pp. 4-10).

1. Increased Residential Customer Charge

OPC contends that Southern Union's return on equity should be adjusted downward by 25 basis points because the customer charge is being increased from $9.05 to $15.00 in this case. OPC witness Burdette testifies that with the proposed increased customer charge, 69.74 percent of MGE's nongas residential revenues would not vary with gas usage, leaving only 30.26 percent variable with gas usage. (Ex. 100, pp. 25-26, Sch. MB-1-R). With the current $9.05 customer charge, Burdette concludes that since MGE's revenues will be less variable as a result of the increased customer charge, the reduced risk should be reflected in a lower authorized return on equity. In making this analysis, Burdette assumes a $9.05 customer charge, the margin residential revenue requirement, billing determinants, and rates from MGE witness Dittemore's direct testimony. MGE's position is that the adjustment proposed by OPC is not based on competent and substantial evidence in that the theory is based on an assumption that MGE's current customer charge produces a percent of nongas revenues comparable to OPC's group of "comparable" LDCs. MGE states that the recommendation is based on a conclusory allegation that a reduction in the variability of MGE's earnings through a higher customer charge would make those earnings less risky, which, in turn, justifies a reduction in the authorized return on equity.

The Commission finds that OPC has failed to carry its burden of proof on this issue. At page 25, lines 23 through 22, Burdette admits that in calculating the portion of MGE's revenues that do not vary with gas usage, it was assumed, along with the $9.05 customer charge, that the marginal residential revenue requirement, billing determinants and rates from Dittemore's direct testimony would be used. The revenue requirement resulting from this order is significantly less than that which MGE proposed in its testimony. Therefore, an analysis which assumes the revenue requirement used by MGE fails. Thus, the Commission declines to adopt the 25 basis point downward adjustment proposed by OPC because of the increased customer charge.

F. Adjustment for Weather Normalization Clause

This adjustment is premised on the assumption that the Commission will adopt MGE's proposed weather normalization clause. As discussed in that section of this Report And Order, MGE has not convinced the Commission that the adoption of a weather normalization clause is in the interests of ratepayers. Since the weather normalization clause is rejected by this Report And Order, this particular issue which is premised on the adoption of the weather normalization clause thereby becomes moot.

V. Customer Service Issues

As stated previously, the Commission has serious concerns as to whether MGE is providing an adequate level of service. This matter has been addressed in other sections of this Report And Order where appropriate.

VI. Class Cost of Service and Rate Design

A. Class Cost of Service Study

1. **Allocation of Costs for Services, Meters and Regulators,**
2. **Allocation of Costs for Mains,**
3. **Class Cost of Service Results, and**
4. **Class Rate Increases**

These four issues were addressed in Section I.B., *infra*.

B. Rate Design

1. Miscellaneous Service Charges

MGE proposes that miscellaneous service charges be more closely aligned with the costs of providing these services. (Ex. 30, pp. 4-5; Ex. 31, pp. 2-3).

OPC recommends that the charges currently reflected on MGE's tariff be maintained and MGE's request to change these tariffed rates be denied because MGE has failed to provide a complete set of work papers to support the proposed changes. (Ex. 19, pp. 11-12).

The Staff contends that MGE's collection, disconnect, reconnect and request for meter reading charges should be maintained at the current tariffed rate because the Company could not provide Staff with documentation to quantify or substantiate the proposed charges. (Ex. 23, pp. 3-4).

The Commission will deny MGE's proposal to modify miscellaneous service charges because MGE has failed to adequately substantiate the proposed changes.

2. Customer Charges

The issue is what the Commission should set as the monthly customer charge for MGE's customers. The current charge is $9.05 per month which was approved by the Commission in 1993. MGE's cost study filed with its direct testimony identified a monthly customer cost of $18.21. (Tr. 1826). Although MGE identified costs at that level, MGE witness Gillmore testified that he used his judgment to recommend an increase in the monthly charge to $15.00 rather than $18.21 given the magnitude of an increase from $9.05 up to $18.21. (Tr. 1901).

OPC recommended a monthly residential customer charge of $9.75. (Tr. 1911-1915). The Staff recommends that the monthly residential customer charge be set at $9.81. Staff has developed its customer charges based on direct costs for the provision of a meter, regulators, service line, meter reading and billing that are traditionally collected through the customer charge, and believes that the Commission should follow that approach in this case and order the residential customer charge at $9.81 per month.

The Commission finds that the residential customer charge should remain at $9.05 per month. The customer charge for Small General Service customers should be increased from $9.05 to $11.05 per month. This result brings MGE closer to the practice of other Missouri gas companies. (Ex. 171). The customer charge for Large General Service should remain at $65.80 per month. The customer charge for Large Volume Service should remain at $409.30 per month. The Commission finds that the resulting percentage contribution to revenue requirement should remain at 68.22 percent from Residential Service, 0.01 percent from Unmetered Gas Lights, 21.22 percent from Small General Service, 2.65 percent from Large General Service, and 7.9 percent from Large Volume Service, as reflected in Staff's filing on January 17, 1997.

The increased revenue requirement for Residential, Large General Service and Large Volume Service will be recovered through variable use charges (i.e., commodity charge for Residential and Large General Service customers, sales charge for Large Volume Service taking sales gas, and contract demand charge for Large Volume Service customers who are transporting gas). The commodity charge is referred to as the "energy charge" on the residential bills, and is not to be confused with the wholesale cost of the natural gas commodity. These charges are shown at pages 25, 28, 31, 42 and 44 of MGE's tariff. The increased revenue requirement for Small General Service will be recovered primarily from the increased monthly customer charge and the remainder of its revenue requirement increase will be from the commodity charge.

3. Overrun Penalties

See issues VII.K. and VII.L.

4. Class Rate Increases

See issues VI.B.2., *infra*.

VII. Tariff Issues

A. Weather Normalization Clause

MGE proposes a weather normalization clause (WNC) which would reduce the impact of temperature variations on its revenue stream. Through the WNC the volumes of gas for which customers are charged are adjusted to reflect "normal" weather, as defined in this case. During a month that is colder than normal, the volumes of gas would be reduced to a normalized level. On the other hand, during a month that is warmer than normal, the volumes charged would be increased.

Staff and OPC are against approval of the WNC because it has the effect of changing the per-unit rate a customer pays for actual usage. (Ex. 28, pp. 4-5). Staff witness Hubbs quotes from a previous Commission decision regarding a similar proposal by MGE (Case No. GT-95-429). The Report And Order in that case stated:

> Approval of the WNC tariff would result in a de facto change in MGE's rates. Under the weather normalization clause a customer would pay for more gas than he actually used in an unusually warm month. In that month, the customer would have paid an effective per-unit rate for his actual usage greater than MGE's current tariffed rate. In an unusually cold month the customer would pay for less gas than he actually used. In that month, the customer would have paid a lower per-unit rate for his actual usage than MGE's current tariffed rate.

(Ex. 28, p. 4).

Staff also maintains that approval of the WNC would constitute single-issue ratemaking. Hubbs testified that approval of the WNC would allow MGE to change, in an uncertain amount, the maximum rate approved for MGE's services, and that allowing MGE to modify actual usage would change the effective maximum rate the Commission sets for MGE in this proceeding. (Ex. 28, pp. 5-6). These changes would occur outside the context of a rate case. Thus, the Commission's concerns expressed in Case No. GT-95-429 about single-issue ratemaking are still valid, according to Hubbs.

Staff goes on to state that if the Commission were to allow MGE to have the weather normalization clause, it should not be mandatory but should be allowed at the customer's option and should be further conditioned as set forth in Dr. Proctor's rebuttal testimony.

It is clear to the Commission that approval of the WNC proposed by MGE would benefit MGE insofar as the variability of its revenues resulting from weather changes would be reduced, thus reducing MGE's business risk. The WNC would shift virtually all weather-related risk onto ratepayers. In the event that the Commission would authorize a WNC similar to the one proposed herein, the Commission would seriously consider a downward adjustment to return on equity as proposed by OPC. Also, there may be other conditions that would have to be implemented along with the WNC. The Commission notes that ratepayers already bear a substantial amount of risk associated with wholesale gas price changes under MGE's Experimental Gas Cost Incentive Mechanism. On balance, the Commission finds that the WNC would be a detriment to ratepayers because weather-related risks would be assumed by ratepayers, and ratepayers are already able to levelize their payments by entering into a levelized payment plan. The Commission finds that approval of the WNC would be a de facto abdication of the Commission's responsibility to set rates. The fact that the WNC technically adjusts volumes rather than rates does not cure this fundamental problem. Thus, the Commission will not approve the WNC.

B. Gas Safety Project Rider

MGE proposes a gas safety project rider (GSPR) to recognize gas safety program expenditures in the cost of service on a more expedited basis than through a traditional rate case mechanism. MGE maintains that this benefits customers through smaller and less sharp rate changes, and benefits shareholders through a more timely recognition of these expenditures in cash earnings. MGE also proposes an incentive regulation rider (IRR) to replace, on an experimental basis, traditional rate cases. The two riders are a package. The IRR issue is listed as issue VII.C. in this Report And Order.

MGE proposes a GSPR which would cause rates to be adjusted annually to reflect depreciation, property taxes, and return on the safety plant additions. The GSPR is prompted by the Commission's enactment of extensive changes to its gas safety rules in 1989, five years before Southern Union acquired its Missouri gas properties from WRI. MGE currently spends more than $20 million per year on safety line replacements. Due to the magnitude of these costs and the fact that they reflect replacement of existing pipes and not addition of new customers, timely rate recognition is essential to the financial well-being of MGE.

The Staff points out that the Commission has approved accounting authority orders for MGE's as well as WRI's safety plant additions. MGE is seeking rate recovery of those amounts in this proceeding. In addition, MGE wants to replace the accounting authority order process with the GSPR. Under the GSPR proposal, rates will automatically increase annually following a 45-day Staff review period, to reflect the revenue requirement impact of safety plant additions completed by March 31 of each year. (Ex. 80, pp. 5-6). The GSPR annual rate change would reflect only the revenue requirement impact of the gas safety program and would not reflect the impact of any revenue requirement changes related to other facets of MGE's operations. (Ex. 80, p. 6). Under the proposal, the Staff would look only at the prudence of the gas safety plant expenditures and the accuracy of MGE's calculations in deriving the proposed GSPR rate increase amount during the 45-day review period. (Tr. 1401-1402). If the expenditures were found to be prudently incurred and MGE's calculations found to be correct, rates would be automatically increased.

Staff, as well as OPC, argue that this would be unlawful single-issue ratemaking insofar as it would be the isolated examination of the prudence of the gas safety expenditures. They maintain that the GSPR ignores revenue requirement changes in other rate base items, including nonsafety plant additions, depreciation accruals, deferred income taxes, contributed plant, cash working capital, as well as changes in the levels of revenues and nonsafety expenses incurred by the Company. (Ex. 80, p. 7). Staff maintains that all of these events or transactions with potential revenue requirement impact must be examined when considering a rate change based on safety expenditures to determine if the actual revenue requirement of MGE has changed since the last time rates were set for the Company. According to Staff, 45 days to examine the rate impact is not sufficient for a reasonably comprehensive review of all the relevant ratemaking factors. (Ex. 80, p. 7).

The Commission will reject the GSPR because it would constitute unlawful single-issue ratemaking. ***State ex rel. Utility Consumers Council v. Public Serv. Comm'n***, 585 S.W.2d 41, 49 (Mo. en banc 1979). In addition, the Commission will reject the GSPR because 45 days is not sufficient time for the Staff and Commission to conduct a thorough review of all relevant factors relating to gas safety investments by the Company, and the Commission foresees the need for suspensions of GSPR adjustments with drawn-out, fully litigated cases similar to the current ACA process. For all of the above reasons, the Commission will reject MGE's proposal for a gas safety project rider.

C. Incentive Regulation Rider

MGE proposes an incentive regulation rider (IRR) which would replace the traditional ratemaking process used by the Commission for gas corporations. Under the IRR, MGE would share earnings with customers on a 50/50 basis where MGE's return on equity is between 12.80 percent and 14.80 percent. MGE would share earnings with customers on a 75-percent-to-customers-and-25-percent-retained-by-Company basis where MGE was achieving a return on equity in excess of 14.80 percent.

Staff recommends that the Commission reject MGE's IRR proposal for numerous reasons. Staff points out that incentive regulation has been approved by the Commission for Southwestern Bell Telephone Company and Union Electric Company. However, at the time of approval of incentive regulation for those companies, each company had been achieving an adequate level of earnings to support their operations for some time prior to implementation of incentive regulation. Obviously, as shown in this case, MGE does not believe that its earnings are adequate. Staff witness Oligschlaeger testified that:

> [T]he root problem with MGE's incentive regulation proposal is that MGE is trying to reconcile its desire for incentive regulation with the fact that it is an increasing cost utility that will require periodic rate increases on account of its gas safety program, among other things. The need for frequent rate increase intuitively does not tie into the normal conception of incentive ratemaking, wherein a utility's ability to increase rates is generally restricted as part of the incentive "bargain". MGE has tried to make the pieces fit together by proposing to enhance its abilities to raise rates on an annual basis to cover increasing costs through the GSR while availing itself of the opportunity to gain the benefits of incentive regulation through the IRR. The difficulty is that making incentive regulation "workable" for an increasing cost company in essence means skewing incentive regulation against the interests of its customers, as MGE's proposals in this proceeding show.

(Ex. 80, p. 18).

Another concern expressed by Staff concerns the auditability of MGE's operations under the IRR. (Ex. 50, p. 11). Under the IRR, reports would need to be filed on a timely basis, meetings with Company personnel would need to be conducted in a timely fashion, and MGE's books and records would need to be completed accurately and on time; based on the difficulty Staff experienced during the audit for this case, these matters pose a significant concern. (Ex. 50, p. 11). Staff is also concerned about Commission approval of an incentive regulation plan for a company which has a poor customer service record, as shown in this case, and believes that these problems need to be corrected before the Commission considers giving the Company the ability to retain excess profits as an incentive to perform better. (Ex. 50, pp. 11-12).

As stated before, the Commission has serious concerns about the adequacy of the service provided by MGE to ratepayers. As pointed out by Staff witness Proctor, the danger with allowing a local distribution company to recover margin costs through an incentive mechanism is that the quality of service to customers could be substantially decreased as the local distribution company cuts its costs in an effort to make additional profits. (Ex. 107, p. 3). The Commission will not approve this type of incentive regulation for nongas costs for MGE, which could exacerbate the customer service problems of MGE.

D. Economic Development Rider

This issue concerns the "prospective tariff language" aspect of the economic development rider (EDR). The issue is whether there should be changes made to the existing tariff language. MGE filed a proposed tariff seeking to reduce the percentage amount of the existing discounts. The changes would be as follows: In the first year, from 50 percent to 30 percent; in the second year, from 40 percent to 25 percent; in the third year, from 30 percent to 20 percent; and in the fourth year, from 20 percent to 15 percent. The 10 percent amount in the fifth year would remain unchanged. There have been no new customers added to the EDR since December 1994. (Ex. 23, p. 6; Tr. 1609). Gillmore of MGE testified that recent changes in the gas industry, in his opinion, have made EDRs serve very little, if any, purpose. (Ex. 31, p. 3). Gillmore commented that it was MGE's original intention to eliminate the EDR entirely, but he agreed to keep it in place as a result of requests from local governments who view it as important to their efforts to attract new industry. (Tr. 1602). MGE states that since its shareholders are financing 75 percent of the discounts (if Staff and MGE's position on issue I.B. prevails), then MGE believes that those shareholders should have a very significant voice in being able to set the level of discounts that they are funding. (Ex. 9, p. 6).

The Commission finds that MGE's position on this issue is reasonable. Therefore, the Commission will approve tariffs reflecting the changes proposed by MGE.

E. Curtailment Plan

See issues VII.K. and VII.L.

F. Facilities Extensions

This issue involves how much developers will be required to pay for main extensions to new developments. There is no revenue requirement impact associated with the issue in this case. However, it presents a question as to what type of tariff language will be approved for future situations. The resolution of this issue will have an impact on future rates. MGE's proposal contemplates a case-by-case analysis to be done in order to calculate the cost to be charged to developers for facilities extensions.

The Developers want MGE to have an extension rule with specific dollar amounts per foot of pipe so it is easy for the Developers to calculate how much they have to pay, and how much they may get back as a refund when customers move into the new homes. (Ex. 123, p. 6; Ex. 125, p. 11). The Developers' position is apparently quite similar to the current procedure, which resulted from a recent settlement in a complaint case (GC-96-287).

MGE maintains that the current policy causes customers who are currently on the system to cross-subsidize residential customers in new subdivisions.

MGE has not provided evidence to substantiate its claim that the current procedure implemented pursuant to the settlement of GC-96-287 causes cross-subsidization to the benefit of new residential subdivisions. The Commission finds that MGE's proposal to determine the investment by real estate developers and main extensions by an "analysis" under Section 9.03 would grant too much discretion in MGE in calculating investments to be made by real estate developers. Since MGE has not provided sufficient evidence to justify modification of the facilities extension tariffs from the status quo, the Commission will not approve the facilities extension tariffs. The Commission would reconsider whether to approve a facilities extension tariff that modifies the per-foot charges for extensions if the proposal is supported by competent and substantial evidence as to the per-foot charges.

With respect to the revisions and clarifications suggested by Staff, the Commission suggests that MGE and Staff carefully discuss the terms of a proposed facilities extension tariff prior to the filing thereof.

G. Large General Service (LGS)

The issue identified as "1)" at page 56 of the Hearing Memorandum has been resolved. MGE acknowledged that the applicable section should continue to allow for monthly usage up to 3,000 mcf on this rate. (Ex. 32, p. 22).

The remaining issues relating to LGS appear below.

1. Whether to Offer Transportation Service to LGS Customers Without Electronic Gas Metering (EGM)

Transportation customers take on the responsibility of acquiring their own gas supplies and having them transported over one or more interstate pipelines to the MGE distribution system. Sales customers, on the other hand, do not have that responsibility because the local distribution company ensures that supplies are available for such customers. MGE proposes that LGS customers moving to transportation would not have to install electronic gas measurement (EGM) devices. Electronic gas meters allow usage measurement to be done remotely at practically any time and for the data to be available on a computer bulletin board for MGE and the customer to access. This is in contrast to a gas meter without an EGM attachment where a human being must be dispatched to read and report back what is observed on the dials. The current tariffed rate for

EGM installation is approximately $5,000. MGE has stated that it believes that a requirement for EGM for LGS customers would likely make transportation service uneconomical for them. (Ex. 32, p. 23).

Staff is opposed to MGE offering transportation without requiring EGM. (Ex. 20, pp. 11-16). MGE continues to support the Commission's decision to require EGM for Large Volume Service (LVS) customers. MGE contends that the use of EGM is not necessary for LGS customers because LVS customers make up approximately 30 percent of the throughput on the MGE system, while the LGS class represents less than 5 percent of MGE's purchases for resale. (Ex. 70, p. 7). Langston testified that the LGS class is a "very small class of customers that has very little impact on MGE's overall operations and represents an ideal test category for MGE to utilize in developing alternatives for further unbundling activities. At this time, we do not think that the lack of EGM will present a problem, but we won't know unless we try it, at least on an experimental basis." (Ex. 70, p. 8).

MGE did not propose making transportation services available to LGS customers as a test or experiment. However, MGE witness Langston said that MGE is not opposed to the Commission treating this as an experiment for a three-year period. (Tr. 1578-1579).

Staff opposes the proposal without the requirement of EGM because of the detrimental impacts which will accrue to MGE's sales customers by the elimination of accountability and protections afforded by EGM. Staff witness Hubbs testified that without EGM for the LGS class, MGE will not have the ability to assign and bill upstream costs to the transportation customers who are responsible for causing MGE to incur interstate pipeline costs and penalties, and that without EGM equipment, MGE will have no effective method to assign such costs and penalties to the appropriate customers. (Ex. 28, p. 12).

The Commission will not approve transportation for LGS customers without EGM at this time as a result of the risk of unfair allocation of upstream costs and penalties to other transportation customers.

2. Whether to Require a Warning to Transportation Customers

Staff witness Hubbs has recommended that a warning be required in every transportation contract. Hubbs is concerned primarily with smaller and less knowledgeable potential customers in the LGS class. (Ex. 28, p. 17).

The Commission will not require this warning because the Commission will not approve LGS customers' use of transportation service at this time.

3. Standby Sales Service

This item has become moot because the Commission is not authorizing MGE's proposal to provide transportation services to the LGS class.

4. Whether to Incorporate LVS Transportation Tariff Provisions into LGS Tariff Sheets

This item, shown at page 162 of the Staff's initial brief, has become moot because the Commission is not authorizing MGE's proposal to provide transportation services to the LGS class.

5. Whether to Implement Balancing Provisions for LGS Transportation Customers

This item has become moot because the Commission is not authorizing MGE's proposal to provide transportation services to the LGS class.

H. Large Volume Service (LVS)

1. Imputation of Revenues for Customer Charges Relating to LVS Meters

MGE is not collecting customer charges on 70 meters of Large Volume customers in cases where those meters were installed for the convenience of the Company.

This practice, begun by WRI, is based on an interpretation of the following tariff provision:

> When more than one meter or metering facility is set at a single address or location for customer's convenience, a separate customer charge will be applicable for each meter or metering facility.

(Ex. 33, p. 3). MGE maintains that where the meter is set for MGE's convenience rather than the customer's convenience, it is not appropriate that MGE charge for those meters.

The Staff would have the Commission impute revenues on these 70 meters even though MGE is not collecting that money.

The Commission finds that MGE's interpretation of the tariff is reasonable and will rule in favor of MGE on this issue.

2. Costs of LVS Customer Switching Between Transportation and Sales Service

Staff is opposed to the elimination of the currently tariffed provision that prohibits an LVS customer from switching from transportation to sales service without payment of certain costs. Staff recommends that this provision as quoted on page 21 of Hubbs's rebuttal testimony be maintained, and MGE concurs in its reply brief.

The Commission finds that the provision as quoted on page 21 of Hubbs's rebuttal testimony should be maintained to ensure that customers switching from transportation to sales service pay appropriate costs.

3. Reduction of Commodity Portion of "Minimum Transportation Charge" from $0.075 per mcf to $0.005 per mcf

MGE's witness Dennis Gillmore conducted a study through which he determined that MGE should be allowed to reduce the commodity portion of the minimum transportation charge as low as $0.005 per mcf.

Staff witness Hubbs testified that the current commodity flex rate is approximately one-fourth of the commodity rate the Commission has previously determined is needed to recover the cost of service for this class, and that the Company's proposal of $0.005 per mcf is less than 2 percent of the currently effective, Commission-approved commodity rate and that, in his opinion, the Company's proposal would be the same as giving the service away. (Ex. 28, pp. 24-25).

The Commission finds that MGE has made a showing that its tariff should be amended to allow it to reduce the commodity portion of the "Minimum Transportation Charge" to $0.005 per mcf and the Staff did not convincingly rebut MGE's position. The Commission recognized the regulatory problem inherent with flexdown provisions in its decision in Case No. GR-95-160. (See Section I.D., Flex Revenue, of this Report And Order).

The Commission will apply the standard established in GR-95-160 to MGE in future rate cases. The Commission will clarify, however, that the avoidance of "imminent by-pass" includes the loss of a customer because of a competitive alternative.

In MGE's next rate case, MGE should provide a current analysis of the necessity to flex down to retain the customers. Staff should review that analysis and make its own determination of whether the flex down was necessary to retain the customers. Staff is also expected to verify that the flex down arrangement recovers the variable costs associated with serving the customers along with a reasonable contribution to fixed costs.

As part of its compliance filing, MGE's tariffs shall reflect the three-pronged standard adopted by the Commission in Case No. GR-95-160 and reiterated here. The tariff shall reflect that any special contract arrangements: (1) were necessary to avoid imminent bypass; (2) recover variable costs plus a reasonable contribution to fixed costs; and (3) in instances involving affiliates, was at arm's length and flexes rates no lower than necessary to meet relevant competition.

I. <u>Sales and Transportation Contracts</u>

MGE proposes that a single form of contract be used rather than two forms. MGE states the use of one form does not preclude a customer from taking sales service, transportation service or both. MGE proposes a reduction in the notice requirement from one year to 180 days with regard to customer switches from sales to transportation service

Staff adeptly demonstrates that one effect of MGE's proposal would be the imposition of a maximum daily firm sales requirement which would limit the availability of gas before sales customers incur charges for unauthorized service. (Ex. 28, p. 27). In addition, Staff states that MGE's proposed modification of Section 1.5 of the current tariff would allow MGE to waive metering and telephone line installation charges at its discretion. *Id.*

The Commission will not approve MGE"s proposal to eliminate its "form of contract" on tariff sheets 32 and 35 on the basis of Staff's argument.

J. Standby Sales Service

The Commission will not authorize MGE to provide this service because MGE has not demonstrated that it can purchase the additional upstream capacity needed to provide the service. (Ex. 28, p. 29).

K. As-Available Sales Service, and
L. Unauthorized Use Charges

MGUA, UMKC/JACOMO/CMSU, and Mountain Iron are all transporters of natural gas. These parties have expressed concerns about MGE's proposal in this case. During the course of the hearing MGE witness Langston and Staff witness Hubbs prepared a document marked Exhibit 156 which has been received into the record. Exhibit 156 reflects agreement by Staff and MGE on the issues of the Curtailment Plan (issue 7.5), As-Available Sales Service (issue 7.11), and Unauthorized Use Charges (issue 7.12).

The Commission has reviewed the portions of transcript relating to Exhibit 156 and finds that the contents of Exhibit 156 reflect a reasonable resolution of issues 7.5, 7.11 and 7.12. (Tr. 1514-1550, 1562-1567).

MGUA has asserted that MGE has misapplied its own tariff provisions. If MGUA or any other transporter believes that it has been harmed by a misapplication of MGE's tariffs, such transporter may file a complaint with the Commission. In fact, Mountain Iron has filed such a complaint (Case No. GC-96-372).

M. Financing Advance for Construction

MGE states that this issue has been resolved. To implement the resolution, MGE will submit, as part of its compliance tariffs, tariff language which is similar to that contained in the direct testimony of Staff witness Flowers. (Ex. 83, pp. 14-15; Tr. 1707-1708).

No Party has stated opposition to Staff's proposed tariff language. This issue has been resolved.

N. Service Initiation Charge

MGE has proposed to levy a service initiation charge in the amount of \$20.00. MGE contends that it has provided documentation of the costs. (Ex. 31, Sch. DSG-1). MGE asserts that it costs MGE \$27.49 to perform the services necessary for a connection or reconnection of service.

OPC maintains that MGE failed to provide support for the proposed charges despite numerous data requests from OPC.

Staff recommends that the Commission reject MGE's proposal to levy a \$20.00 service initiation charge. Staff witness Flowers testified that no other Missouri utility companies have such a charge and that MGE was unable to explain to Staff how this proposed charge was determined. Also, Staff witness Flowers testified that if the Commission decides to approve a service initiation charge, then the monthly customer charge should reflect removal of these costs because these costs are "presumably now recovered from the customer charge." (Ex. 83, p. 17).

The Commission has reviewed Schedule DSG-1 attached to Gillmore's rebuttal testimony. The Commission finds that this schedule does not provide adequate support for implementation of the \$20.00 service initiation charge. Thus, this proposal is rejected.

O. Clarification of Definitions

MGE states that this issue has been resolved and to implement the resolution, the Commission should order MGE to file, as part of its compliance tariff filing, a sheet containing the text of Exhibit 160.

Staff witness Flowers states that MGE's proposed definitions of customers needed clarification. (Ex. 83, p. 18). Staff states that it is willing to accept Exhibit 160 in resolution of the issue, and, since no other party took a position on this issue, this should resolve the matter.

The Commission finds that this matter has been resolved and MGE should file, as part of its compliance tariff filing, a sheet containing the text of Exhibit 160.

P. Levelized Payment Plan

MGE states that this issue has been resolved and to implement the resolution, the Commission should order MGE to file as a part of its compliance tariff filing a sheet containing the text of Exhibit 161. (Tr. 1709).

Staff states that it is willing to accept Exhibit 161 in resolution of this issue.

JACOMO/CMSU/UMKC support the position of the Commission Staff. No other party expressed a position on this issue.

The Commission finds that this matter has been resolved and MGE should file, as part of its compliance tariff filing, a sheet containing the text of Exhibit 161.

Q. Unbundling of Transportation Services

MGE states that no further unbundling of services beyond what it has proposed in this case is appropriate at this time.

MGUA opposes unbundling under the terms proposed by MGE. MGUA maintains that all transportation customers should be provided access to the system on a nondiscriminatory basis. In this proceeding, MGE has argued that EGM is not needed for LGS customers that transport their own gas. MGUA argues that if EGM is not required for LGS customers, then perhaps EGM should not be required for any transportation customers.

The EGM issue was fully litigated in GO-94-318 (Phase I), and in that decision the Commission explained why it agreed with Staff that EGM should be required for transportation customers.

JACOMO/CMSU/UMKC maintain that the cost of providing transportation service should be broken down into its components. They argue that transportation customers should be allowed to purchase only the services that they request and not be required to buy a bundle of services, many of which are unneeded, in order to get the services they desire.

Staff's position is that no party to this proceeding, including MGE, has proposed unbundling of services with sufficient particularity to enable the Commission to order unbundling based on the record before it. Staff opposes unbundling of transportation services based on the record in this case.

The Commission will not authorize the implementation of unbundling as proposed by MGE because MGE's proposal is not supported by adequate evidence of sufficient safeguards for affected customer classes. MGE argues that the Commission should authorize transportation for LGS customers without the balancing benefits of EGM because LGS volumes are smaller than LVS volumes. The Commission will not adopt MGE's proposal based on the record before it.

Furthermore, to achieve the Commission's approval MGE's proposal must include evidence of sufficient safeguards for affected customer classes.

R. Disputed Bill Provision

MGUA, JACOMO/CMSU/UMKC and Mountain Iron contend that the Commission should order MGE to implement a "disputed bill" provision for transportation customers. MGE opposes inclusion of this language for several reasons, arguing that there has never been a demonstrated need for this type of provision.

The Commission has mandated a set procedure for bill disputes involving residential customers (4 CSR 240-13), which is reflected in the tariffs of every gas, water, electric and sewer company regulated by the Commission. MGE maintains that transportation customers do not need the level of protection afforded residential customers because they are capable of "fending for themselves." (Ex. 32, p. 22). MGE further argues that the ability of transportation customers to file a complaint against MGE before the Commission with respect to disputes gives MGE an incentive to resolve disputes. MGE references actions it took in connection with a pending complaint case filed by Mountain Iron (GC-96-372). MGE further argues that if the Commission favors disputed bill provisions for nonresidential customers, it should consider it on an industry-wide basis by proposing an amendment to 4 CSR 240-10.040 so all interested parties have an opportunity to comment. MGE points out that the proposed language requires submission of disputes for private arbitration.

Staff agrees with MGE that commercial and industrial customers already have adequate protection in this regard. (Ex. 31, p. 18).

The Commission finds that it would not be appropriate to order MGE to implement a disputed bill provision for nonresidential customers because MGUA's proposal contemplates tariff language that permits submission of these disputes for private arbitration, which would cause a conflict between the Commission's complaint jurisdiction (Section 386.390, R.S.Mo. (1994) and 4 CSR 240-2.070) and the tariff provisions. If this type of requirement is appropriate, it should be promulgated through a formal rulemaking procedure, not in a company-specific rate case.

S. Payment of Interest on Customer Funds Held by Company

JACOMO/CMSU/UMKC recommend that the Commission require MGE to amend its tariff to require MGE to pay interest on refunds due to overcharges. JACOMO/CMSU/UMKC argue that if MGE realized it may have to pay interest on over-charges, it may be more inclined to resolve bona fide disputes more expeditiously. They contend that without a disputed bill provision or a require-ment to pay interest, customers are not on a level playing field when it comes to resolving bona fide disputes. Mountain Iron supports JACOMO/CMSU/UMKC on this issue.

MGE maintains that there is no evidence of any intentional overcharges to warrant JACOMO/CMSU/UMKC's proposal. MGE further contends that a requirement that MGE pay interest on refunds due to overcharges will increase the cost of service ultimately borne by the body of ratepayers.

Staff took no position on this issue.

The Commission finds that the evidence does not support a conclusion that overcharges have occurred with regard to CMSU. The Commission finds that the record before it does not justify implementation of interest charges on overcharges.

T. Refund of Costs of Electronic Meters

JACOMO/CMSU/UMKC and Mountain Iron propose that the Commission order MGE to change its tariff to provide a refund of EGM charges in the event that tariff changes make it uneconomical for a customer to continue transportation service. These parties argue that transportation customers who rely on MGE's previous tariff should not be penalized because MGE decides to change the tariff and, therefore, these transportation customers should receive a refund.

MGE states that the Commission has already turned back attempts in Case No. GO-94-318 to eliminate the requirement of EGM. MGE states that the potential transportation customer makes a business decision as to whether to take transportation service or be a sales customer of MGE. The $5,000 cost of EGM is not held by MGE. These funds are spent to cover the meter installation costs for that customer. MGE states that if the Commission were to rule that after the equipment is installed, MGE will have to refund these amounts when a customer switches back to sales service, it will be an expense for MGE not presently reflected in costs and to the extent MGE is allowed to recover the expense in future rates, it will have to be borne by other customers.

Staff states that no party has alleged that MGE charged more than allowed under its approved tariff. Staff maintains that the imposition of a required refund would be of questionable validity and could be construed as a prohibited retroactive adjustment.

The Commission reiterates that EGM for transportation customers is an essential component of a properly functioning market with regard to multiple entities using MGE's system to transport gas because EGM provides data to MGE to ensure that transporters are in balance.

Certain classes of natural gas customers may decide to be a transportation or sales customer. The cost to install EGM is properly borne by the transportation customers for whom the EGM equipment is necessary. The Commission finds in favor of MGE and Staff on this issue.

U. Shipper Trading

The Commission fails to discern any proposed benefit to MGE or its gas users by implementation of a shipper trading proposal similar to that stated in the Hearing Memorandum.

Implementation of the proposal would violate the burner-tip balancing agreement between Williams Natural Gas Company (WNG) and MGE. Furthermore, as demonstrated by MGE witness Gillmore, implementation of this proposal would result in system control being transferred from MGE to a group of shippers. The system control must remain in the hands of MGE. (Ex. 32, p. 31.) Approval of Mountain Iron's shipper trading idea would be, in all probability, an abdication by the Commission of its duty to ensure safe and adequate service by gas corporations. Section 393.130.1, R.S.Mo. (1994). Finally, the Commission sees no competent and substantial evidence in the record to support the shipper trading idea.

For all these reasons, the Commission will not order implementation of the shipper trading idea.

VIII. Certificated Areas

MGE has committed to file tariff sheets with metes and bounds descriptions and maps showing certificated service areas in the State of Missouri by February 28, 1997. (Tr. 1738-1739). This commitment by MGE adequately addressed Staff's concern on this issue. (Staff Initial Brief, p. 183).

The Commission finds that this issue is resolved by virtue of MGE's commitment to file the requested tariff sheets by February 28, 1996.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law.

Missouri Gas Energy, a division of Southern Union Company, is an investor-owned public utility engaged in the provision of natural gas service in the state of Missouri and, therefore, subject to the jurisdiction of the Missouri Public Service Commission under Chapters 386 and 393, R.S.Mo.

IT IS THEREFORE ORDERED:

1. That pursuant to the findings of fact and conclusions of law in this Report And Order, the proposed tariff sheets filed by Missouri Gas Energy, a division of Southern Union Company, on March 1, 1996 are hereby rejected.

2. That pursuant to the findings of fact and conclusions of law in this report And Order, the proposed substitute tariff sheets filed by Missouri Gas Energy, a division of Southern Union Company, on March 11, 1996 are hereby rejected.

3. That Missouri Gas Energy, a division of Southern Union Company, is hereby authorized to file, in lieu of the rejected tariff sheets, for approval of the Commission, tariff sheets designed to increase gross revenues, exclusive of any applicable license, occupation, franchise, gross receipts taxes, or other similar fees or taxes, by the amount of $7,527,513 for natural gas service rendered in its Missouri service area on an annual basis over its current revenues.

4. That the tariffs sheets to be filed pursuant to this Report And Order shall become effective for natural gas service rendered on and after February 1, 1997.

5. That the Stipulation And Agreement filed by Missouri Gas Energy, the City of Kansas City, Missouri, the Office of the Public Counsel and the Commission's Staff on October 30, 1996, relating to an experimental weatherization program and the Amendment thereto filed on January 3, 1997 are hereby approved. (Attachments A and B, respectively).

6. That Case No. GC-96-402 be closed pursuant to the terms of Attachment C.

7. That the Stipulation And Agreement filed by the Midwest Gas Users Association, University of Missouri-Kansas City, Central Missouri State University, Jackson County, Missouri, the Office of the Public Counsel and the Commission's Staff on October 30, 1996, relating to class cost of service and related revenue shifts, is not approved.

8. That the Motion For Variance From Protective Order filed by Missouri Gas Energy, a division of Southern Union Company, on October 17, 1996 is hereby granted.

9. That the Supplement to Exhibit 111 filed by Missouri Gas Energy, a division of Southern Company, on January 3, 1997, be received into the record.

10. That the Motion For Admission Of Late-Filed Exhibit filed by Missouri Gas Energy, a division of Southern Company, on January 6, 1997, be denied.

11. That late-filed Exhibits 113, 114, 115, 116, 117, 120, 163, 163HC, 164, 171, 172, 173, 174, 179 and 179HC be received into the record.

12. That the completed Revenue Requirement Scenario filed on January 10, 1997 shall be received into the record as Exhibit 180 (Attachment E).

13. That those motions and objections not specifically ruled on in this order are hereby denied or overruled.

14. That this Report And Order shall become effective on the 1st day of February, 1997.

BY THE COMMISSION

Cecil I. Wright

Cecil I. Wright
Executive Secretary

(S E A L)

Zobrist, Chm., McClure, Kincheloe, Crumpton and Drainer, CC., concur and certify compliance with the provisions of Section 536.080, R.S.Mo. (1994).

Dated at Jefferson City, Missouri, on this 22nd day of January, 1997.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Missouri Gas Energy's tariff sheets designed to increase rates for gas service in the Company's service area.	)))	Case No. GR-96-285

Stipulation and Agreement

The undersigned parties have reached agreement on the following general principles of settlement to resolve the issue denominated as Experimental Weatherization Program in the Hearing Memorandum in this proceeding and to provide for the dismissal with prejudice of the complaint of the Office of the Public Counsel in GC-96-402.

I. REVENUE COMMITMENT

The Company is agreeable to providing $250,000 annually for this program so long as the Commission will include a $250,000 amount specifically for the program in the revenue requirement in this case. As long as that amount is included in the rate level authorized for Missouri Gas Energy, MGE will provide that amount to the City of Kansas City annually. The stipulation and agreement will contain a provision that reads substantially as follows:

> The parties agree that the Commission should include a $250,000 amount for the experimental weatherization program in Case No. GR-96-285. So long as that amount is included in the rate level authorized for MGE, MGE will provide that amount to the City of Kansas City annually (the program funds) for the weatherization grant and loan program. The parties agree that the program should

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continue for a period of at least two years from February 1, 1997. MGE's obligation to provide the $250,000 annual payment ceases when that amount is no longer reflected in the rate level authorized by the Commission.

II. PROPOSED TARIFF

EXPERIMENTAL WEATHERIZATION PROGRAM

Description and Availability: In accord with this tariff, and pursuant to the terms and conditions of a stipulation and agreement (pertaining to the experimental weatherization program) filed and approved in Case No. GR-96-285, the Company will provide $250,000 annually (the program funds) for an experimental residential weatherization grant and loan program, including energy education, primarily for lower income customers. The program will be administered by the City of Kansas City, Missouri pursuant to a written contract between the City and MGE which will take effect after it is approved by the Commission. MGE and the City will consult with Staff and Office of the Public Counsel prior to execution of the contract and its submission to the Commission. While it is experimental, the program will be limited to existing low-income to middle-income (as defined by the Office of Management & Budget (OMB)), Missouri Gas Energy (MGE) residential customers within Clay, Platte, and Jackson Counties in Missouri.

Purpose: This program is intended to assist customers through conservation, education and weatherization in reducing their use of energy and to reduce the level of bad debts experienced by the Company.

Terms and Conditions: Unless specifically exempted in any of the following terms and conditions the following terms and conditions, at a minimum, shall be included in any agreement between MGE and the City of Kansas City concerning administration of the program.

1. The program will offer a combination of grants and interest rate subsidies based upon the eligible customer's income and family size. The program will be primarily directed to lower income customers with high usage and/or bad debts.

2. The total amount of loans and grants offered to a customer will be determined by the cost-effective improvements that can be made to a customer's residence, which shall not exceed $3,000, and is expected to average $1,750.

3. Program funds cannot be used for administrative costs except those incurred by the City of Kansas City that are directly related to qualifying and assisting customers under this program. The amount of reimbursable administrative costs per participating household shall not exceed $300 for each participating household.

4. Loans to customers under this program will be administered by participating banks. In no event shall a customer's performance with respect to a loan under this paragraph be used as a basis for receiving or continuing utility service from the Company. The Company shall not be required to buy back or otherwise pursue collection on the non-performing loans.

5. The City of Kansas City and the Company both agree to consult with Staff and Public Counsel (and any other party agreeable to Company, Staff, Public Counsel and the City) during the term of the program.

6. A Program participant's bill will not be calculated using an estimated meter read. If the Company regularly experiences difficulties obtaining regular meter reads, the Company will install on the meter and utilize a remote reading attachment. Notwithstanding the general terms and conditions for gas service, tariff sheet numbers R-41 and R-42, Section 5.05, the attachments shall be installed with an initial installation cost as specified in those sheets to be recovered by the Company from program funds. The currently approved amount is $50. The initial installation cost will be a deduction to any payment due the City of Kansas City pursuant to the aforesaid agreement. The Company shall not utilize program funds to recover other costs of remote meter reading devices. The Company will provide documentation to the City of Kansas City on any such installations.

7. This program will continue until the effective date of an order of the Commission in the Company's next general rate case, unless otherwise ordered by the Commission. With the primary assistance of the City of Kansas City, the Company shall submit a report on the program to the Staff, and Public Counsel on or before April 15, 1998 and on the same date in 1999 and for each succeeding year in which the program continues. Each report will address the progress of the program, and provide an accounting of the funds received and spent on the program by the City. The report shall be subject to audit by the Commission Staff and Public Counsel. To the extent that $250,000 exceeds the total cost expended by the City on the program, the amount of the excess shall be "rolled over" to be utilized for the weatherization program in the succeeding year, excepting that if there is an excess

at the time the program terminates, the amount of excess shall be transmitted to MGE. MGE thereafter shall credit the amount of the excess to its refund account under the experimental gas cost incentive mechanism and flow that excess back to ratepayers under that mechanism. To the extent that there is any "excess" resulting from the supplemental payments by the Company of the $140,000 referred to herein, those amounts shall be refunded in the same manner.

Each of the above-referenced reports shall contain the following information about each home weatherized. The party responsible for the preparation of the information is designated in parentheses by each item. KC refers to the City of Kansas City and MGE refers to the Company.

A. Demographics

1. Customer name (KC, to be verified by MGE)
2. MGE account number (MGE)
3. Home and work phone number (KC, to be verified by MGE)
4. Street address, city, county, zip (KC, to be verified by MGE)
5. Gross monthly income (KC)
6. Type of income (social security, wages, other) (KC)
7. Family size (KC)
    a. Number of elderly over 60 (KC)
    b. Number of disabled (KC)
    c. Number of children under 5 (KC)

8. Type of dwelling unit (KC)

9. Number of rooms (KC)

B. Gas Usage (MGE)

1. Actual usage history two years prior to weatherization (reported monthly). (MGE)

2. Identify actual monthly usage after weatherization for at least 24 months. (MGE)

C. Payment History (MGE)

1. Billed dollars (MGE)

2. Arrears dollars (MGE)

3. Payment history, including payment history codes (D, R, N, L, P, etc.) (MGE)

D. Weatherization Cost for Each Program Participant (KC)

1. Initial visit date (KC)

2. Audit date (KC)

3. Write bid date (KC)

4. Complete bid date (KC)

5. Award bid date (KC)

6. Weatherization date (KC)

7. Technical assistance (KC)

8. Installer cost (KC)

9. Supplemental funding for contract costs (Sources specified) (KC)

10. Total costs of D. (KC)

E. Education (KC)

1. Specify and describe education program (KC)

2. Report education provided to individual participants (KC)

F. Contractor Invoices (KC)

8. MGE will grant City access to program-required customer information in connection with the preparation and submission of these reports to the extent participants consent to the provision of the information. The Company, with data or reports provided by the City of Kansas City, shall also submit a report to Staff and Public Counsel reporting weatherization activity each quarter.

This report will be due on the tenth calendar day of the second month following the quarter for which weatherization activity is being reported. The first quarter subject to this reporting requirement shall be the quarter beginning April 1, 1997.

Each quarter update report shall contain:

A. Total homes weatherized at beginning of quarter and during quarter;

B. Total homes in progress at end of quarter;

C. Expenditures per program participant; and

D. Total monies spent on program.

9. An independent consultant selected by the City of Kansas City, and the Company, with concurrence of Public Counsel and Staff, will evaluate the cost effectiveness of the Program. The consultant's services shall be governed by a written contract and the scope of work in the contract will include, but will not be limited to, those matters listed below:

A. Impact of energy usage

1. Weatherization measures

2. Education

B. Impacts of weatherization and education

1. Changes in energy usage (gas and electric) and corresponding energy costs.

2. Changes in comfort , safety, etc.

3. Changes in bad debt expense, collection expense, etc.

The Company will award the contract, with consent of the City, the Staff and Public Counsel, on or before February 1, 1997 unless such deadline is extended by the Commission for good cause shown. If a decision as to the awardee for the contract is not finalized by February 1, 1997, or the date to which the award date has been extended, the Commission may, at its option select the consultant.

The Company, with the assistance of the City of Kansas City, shall continue to collect data for this group of participants and any additional participants of the plan for 24 months after termination of the experimental weatherization program. At that point, the Company, with the assistance of the City of Kansas City, will provide weather normalized gas usage for each participant of the program. The Company shall utilize the weather normalization method utilized by the Commission in Case No. GR-96-285.

10. MGE will provide the City or the consultant on a timely basis all information within its possession, custody or control that is necessary for the preparation of the reports and studies required by the contract between the City and MGE or MGE and the consultant. MGE will retain final responsibility for submittal of the report(s), required for submittal under this tariff but is not responsible for any failure of the City of Kansas City to provide data in the possession of the City. MGE shall provide appropriate notices to the City of Kansas City as to the applicable deadlines for the reporting to the Commission and provide copies of such reminder letters to Staff and Public Counsel.

11. MGE and City Agreement: Staff, Public Counsel, the City and MGE agree that any controversy, complaint, claim or dispute arising out of or relating to the agreement between the City and MGE shall be settled by compulsory arbitration before the Commission. Staff, Public Counsel, the City or MGE may file a request for such arbitration in accord with Commission rules or an agreed upon procedure. If no procedure is provided in the rules or agreed to within 30 days of the request, then the same shall be governed by the rules of the American Arbitration Association. Pending the outcome of the arbitration, and unless otherwise ordered by the Commission, MGE may withhold from the City so much of the program fund

installment(s) owed under the agreement that are relevant to the dispute, or otherwise so much of the program funds that will protect MGE's interests.

III. Dismissal of the Complaint

The parties agree that in return for the following promise by MGE, the Public Counsel shall dismiss its complaint in GC-96-402 with prejudice: MGE agrees to augment the monthly amount as provided by in the tariff sheet by contributing additional monthly payments in equal amounts over 36 months for a total supplemental payment of $140,000. The consultant contract payments will then be deducted from the total program amount.

IV. Representation by City of Kansas City

The City of Kansas City represents that it will timely provide the information and reports set forth in the tariff, the contract between the City and MGE, and in this agreement.

V. Other Provisions

This Stipulation and Agreement has resulted from extensive negotiations among the signatories and the terms hereof are interdependent. In the event the Commission does not approve and adopt this Stipulation and Agreement in its entirety, then this Stipulation and Agreement shall be void and no signatory shall be bound by any of the agreements or provisions hereof. None of the signatories to this Stipulation and Agreement shall have been deemed to have approved or acquiesced in any ratemaking or procedural principle, any method of cost determination or cost allocation, or any service or payment standard, and none of the signatories shall be prejudiced or bound in any manner by the terms of this Stipulation and Agreement in this or any other proceeding, except as otherwise expressly specified herein.

Respectfully submitted,

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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Missouri Gas Energy's tariff sheets designed to increase rates for gas service in the Company's service area.	)))	Case No. GR-96-285

AMENDMENT TO STIPULATION AND AGREEMENT

The interested parties to the issue denominated as Experimental Weatherization Program in the Hearing Memorandum in this proceeding entered into and filed with the Commission a Stipulation and Agreement to resolve this issue and to provide for the dismissal with prejudice of the complainant of the Office of the Public Counsel in GC-96-402.

Paragraph 9 of the Proposed Tariff included within the Stipulation and Agreement provided that a consultant would be retained by MGE by February 1, 1997. It is been agreed by the parties to the Stipulation and Agreement that the date for the award of contract provided for in paragraph 9 of the Proposed Tariff should be extended until May 1, 1997.

Therefore, the Stipulation and Agreement is hereby amended to extend the date of award of the consultant contract in Paragraph 9 of the Proposed Tariff from February 1, 1997 to May 1, 1997.

All other provisions of the agreement shall remain unchanged.

Respectfully submitted,

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ATTORNEY FOR THE OFFICE OF THE PUBLIC COUNSEL

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 3rd day of January, 1997.

FILED

OCT 30 1996

MISSOURI
PUBLIC SERVICE COMMISSION

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Missouri Gas Energy's tariff sheets designed to increase rates for gas service in the Company's Missouri service area.	))))	Case No. GR-96-285

Stipulation and Agreement

The undersigned parties have reached agreement on the following general principles of settlement to resolve the issues of Cost of Service and the related revenue shifts which resolves issues 6.1.1 Allocation of Costs for Services, Meters, and Regulators; 6.1.2 Allocation of Costs for Mains; 6.1.3 Class Cost of Service Results; and 6.2.4 Class Rate Increases as delineated in the Hearing Memorandum filed in this proceeding. This Stipulation does not include Issue 6.2.2 Customer Charges. The parties reserve the right to cross examine witnesses on the issues settled in this Stipulation and Agreement for the limited purpose of the use of those costs in the customer charges and not to question witnesses on the settled issues.

<u>COST OF SERVICE CLASS REVENUE SHIFT</u>

The parties agree that the cost of service class revenue shift issue will be settled in the following manner:

a. If the Commission determines that the revenue requirement increase should be at the Staff's midpoint ($6,096,685) in the revised reconciliation from October 18, 1996 then prior to any rate increase the following class revenue shifts will be made: $1,788,727 will be shifted to the residential class and the sum of the revenues for all other classes combined will decline by this amount. Any revenue shifts from the other classes made possible by the increase to the residential class will be spread among the non-residential classes so that their class revenue requirements decrease by equal percentages.

b. If the Commission determines that the revenue requirement increase should be some amount greater than $6,096,685 then the revenue shift to the residential class will decrease by one fifth of the revenue requirement increase above $6,096,685 to, but not beyond, the point where the shift to residential class becomes zero. If the Commission determines that the revenue requirement increase should be some amount less than $6,096,685 then the revenue shift to the residential class will increase by one fifth of the difference between the Commission determined revenue requirement and $6,096,685 to, but not beyond, the point where the revenue requirement change becomes zero.

c. In the event that the Commission determines that MGE did not meet the condition specified in paragraph 7 of the Stipulation and Agreement approved in Case No. GM-94-40 for filing a rate case, then no class revenue shift shall be made in this docket. This agreement reflects the rate impact concerns shared by all of the undersigned parties.

OTHER PROVISIONS

This Stipulation and Agreement has resulted from extensive negotiations among the signatories and the terms hereof are interdependent. In the event the Commission does not approve and adopt this Stipulation and Agreement in its entirety, then this Stipulation and Agreement shall be void and no signatory shall be bound by any of the agreements or provisions hereof. None of the signatories to this Stipulation and Agreement shall have been deemed to have approved or acquiesced in any ratemaking or procedural principle, any method of cost determination or cost allocation, or any service or payment standard, and none of the signatories shall be prejudiced or bound in any manner by the terms of this Stipulation and Agreement in this or any other proceeding, except as otherwise expressly specified herein.

In the event the Commission accepts the specific terms of this Stipulation And Agreement, the parties waive their respective rights to cross-examine witnesses and to present oral argument and written briefs pursuant to Section 536.080.1 RSMo 1994; their respective rights to the reading of the transcript by the Commission pursuant to Section 536.080.2 RSMo 1994; and their respective rights to judicial review pursuant to Section 386.510 RSMo 1986. In the event that the Commission does not accept this Stipulation and Agreement, the undersigned parties believe it would be appropriate to conduct cross-examination and to brief this issue in order to develop a full record on which the Commission can base its decision.

Respectfully submitted,

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MISSOURI STATE UNIVERSITY AND JACKSON COUNTY, MISSOURI

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 30th day of October, 1996.

Penny G Baker

FEDERAL RESERVE press release

For immediate release October 21, 1996

The Federal Reserve Board today approved the use of certain cumulative preferred stock instruments in Tier 1 capital for bank holding companies.

These instruments, which are marketed under a variety of proprietary names such as MIPS and TOPRS, are issued out of a special purpose subsidiary that is wholly owned by the parent company. The proceeds are lent to the parent in the form of a very long-term, deeply subordinated note.

Bank holding companies seeking to issue such securities should consult with their District Federal Reserve Bank. Such arrangements, which give rise to minority interest upon consolidation of the subsidiary with the parent holding company, normally will be accorded Tier 1 capital status. Minority interest in consolidated subsidiaries generally qualifies as Tier 1 capital under the Board's current capital adequacy guidelines for bank holding companies.

To be eligible as Tier 1 capital, such instruments must provide for a minimum five-year consecutive deferral period on distributions to preferred shareholders. In addition, the intercompany loan must be subordinated to all subordinated debt and have the longest feasible maturity.

(more)

The amount of these instruments, together with other cumulative preferred stock a bank holding company may include in Tier 1 capital, is limited to 25 percent of Tier 1. Like other preferred stock includable in capital, these instruments require Federal Reserve approval before they may be redeemed.

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MISSOURI GAS ENERGY

CASE NO. GR-96-285

REVENUE REQUIREMENT

SCENARIO RECONCILIATION

Jefferson City, Missouri
January 10, 1997

General Notes

1. The value of each rate base issue has been calculated using grossed-up for tax rates of return based on the various rates of return specified in the Commission scenario request. The grossed-up rates are 11.50%, 11.79%, 12.08%, and 12.31% based on OPC's recommended ROE, Staff's low end, Staff's midpoint and MGE's ROE, respectively.

2. The value of Item #30 Rate of Return is calculated using MGE's rate base and the grossed-up rates of return noted in footnote 1 above.

3. Starting from a Company position of $34,390,502 allows for recovery in rates of $659,137 in what has previously been referred to as unreconciled differences. Each party's position regarding this issue is discussed in recently filed motions before the Commission. If the Commission accepts Staff's position, $659,137 must be removed from the revenue deficiency on all revenue requirement calculations shown on the Scenario sheet. If the Commission accepts MGE's position, the revenue requirement calculations are correct as shown.

MGE Notes to Response to Commission Revenue Requirement Scenario

1. The Staff has provided the Commission with two alternatives on the carrying cost rate, alternatives which affect items 22 and 25.

    a. The first alternative is the Company's AFUDC rate. The revenue requirement impact is shown on the attached scenario sheet in items 22 and 25. This recommendation would require MGE to write-off $5,990,333 of previously reported earnings.

    b. A second alternative is to use the Company's approved rate of return in this case and the AFUDC rate on a going-forward basis.

    As stated in Staff's initial brief, "In the alternative, if the Commission wishes to avoid a major write-off by MGE, but otherwise agrees with Staff's position on this issue, the Staff recommends the Commission order the Company's approved rate of return in this case as the deferred carrying charge for the construction in this proceeding and the Company's AFUDC rate as the deferred carrying charge on a prospective basis" (Staff Initial Brief, pp. 101-102).

    The following table provides quantification of the revenue deficiency effect of Staff's alternative recommendation. The table shows the alternative adjustment that would be appropriate for lines 22 and 25 in the Scenario sheet attached. In addition, the line "Required earnings write-off" is the amount of MGE's previously reported earnings that would have to be written off depending on which carrying cost rate is approved by the Commission.

			Alternative Carrying Cost Rates (Underlying ROE in parenthesis)			
			9.28%	9.46%	9.64%	9.78%
		AFUDC	(10.75%)	(11.3%)	(11.83%)	(12.25%)
Revenue Effects of Differences between Company's Current Position and Scenario						
Item 22	Income Tax adjustment-Nondeductible SLRP	Scenario Sheet	(245,699)	(254,805)	(263,941)	(271,048)
Item 25	Carrying Cost	Scenario Sheet	(146,630)	(128,784)	(109,878)	(94,475)
Required Earnings write-off		(5,990,333)	(1,729,064)	(1,517,645)	(1,306,229)	(1,141,785)

2. MGE agrees with OPC Notes 1 and 2.

OPC Notes to Response to Commission Revenue Requirement Scenario

1. Item #32 - Advertising.
Footnote B. The correct amount of duplicate Smith Grieves is $4,546.57, not $4957.69.

Footnote D. The Commission Scenario calls for excluding 7/8ths of $16,862.93 expense for TNT, Inc. charges. The OPC adjustment recommended disallowance of 7/8ths of $19,271.91, which is $16,862.93. If the intent was to adopt OPC's recommendation, the revenue requirement should be reduced by $2,614.

OPC recommended disallowance (Scenario footnote D)	$19,272
Multiply by 7/8ths	87.5%
Net disallowance	$16,863
Amount previously removed by Staff and MGE	($14,249)
Net decrease in revenue requirement	$2,614

Footnote E. The revenue requirement should be further reduced by only $872.93 because Staff has previously removed $4,162.64 of the $5,035.57.

OPC believes the correct amount of Item #32-Advertising in the Scenario should be: $15,094 as shown below:

Footnote B	($ 4,547)
Footnote D	($ 2,614)
Footnote E	($ 873)
Footnote F	($ 7,060)
Total Item 32	($15,094)

2. Item #35 - Polsinelli & White Charges. Of the $22,056.11 at issue MGE agreed that $11,509.26, which was related to its investigation of an appliance financing program, should be excluded from the revenue requirement (Tr. p.910 lines 2-13). Therefore, Public Counsel believes the Scenario should reflect a reduction for the appliance financing program investigation. Thus, $10,546.85 was the remaining issue, of which only $4,039.58 dealt with the KPP monitoring.

Staff Notes to Response to Commission Revenue Requirement Scenario

1. The Company starting point of $34,390,502 is more than the Company's request in its original revenue requirement filing.

2. The scenario showing Staff's midpoint return on equity is based on 11.83% as requested by the ALJ. Staff had previously used 11.80% as its midpoint return on equity in all revenue requirement filings in this case.

3. Staff received the Company's workpapers supporting their calculations in MGE Note 1 above on January 10, 1997 and has not had sufficient time to verify these calculations.

4. The Staff agrees with OPC's position in OPC Notes 1 and 2 above.

	CASE NO. GR-96-285				
	REVENUE REQUIREMENT SCENARIO				
		Revenue Requirement	Revenue Requirement	Revenue Requirement	Revenue Requirement
Issue No.		ROE of 10.75% OPC	ROE of 11.30% Staff Low	ROE of 11.83% Staff Mid	ROE of 12.25% MGE
	Company's Request	$34,390,502	$34,390,502	$34,390,502	$34,390,502
1	Injuries and Damages	($604,087)	($604,087)	($604,087)	($604,087)
2	FAS 106 FAS 87 Gain/Loss Amortization	$36,679	$36,679	$36,679	$36,679
3	Amortization of COLI abandonment	($235,654)	($235,654)	($235,654)	($235,654)
4	Uncollectibles	($74,958)	($74,958)	($74,958)	($74,958)
5	Reorganization Costs	($303,470)	($303,470)	($303,470)	($303,470)
6	Executive Salary-Corporate	($54,775)	($54,775)	($54,775)	($54,775)
7	Executive Lease Space-Corporate	($81,609)	($81,609)	($81,609)	($81,609)
8	Stock Options-Corporate	($431,573)	($431,573)	($431,573)	($431,573)
9	Property Taxes	($151,485)	($151,485)	($151,485)	($151,485)
10	Dues and Donations	($67,838)	($67,838)	($67,838)	($67,838)
11	American Gas Association Dues	($48,321)	($48,321)	($48,321)	($48,321)
12	Street Cut Fees	$0	$0	$0	$0
13	Depreciation on Corporate Plant	$0	$0	$0	$0
14	Amortization Period for Safety Program Deferrals	($7,511,038)	($7,511,038)	($7,511,038)	($7,511,038)
15	Acquisition Savings	($7,374,456)	($7,374,456)	($7,374,456)	($7,374,456)
16	Community Relations Department	($218,391)	($218,391)	($218,391)	($218,391)
17	Weather Normalization Adjustment	($1,968,472)	($1,968,472)	($1,968,472)	($1,968,472)
18	Growth Adjustment (different Weather Normalization)	($5,300)	($5,300)	($5,300)	($5,300)
19	Economic Development Discounts	$0	$0	$0	$0
20	Delayed Payment Revenue (See 20.1 Below)	$107,746	$107,746	$107,746	$107,746
21	Large Volume Customer Flex Rate Adjustment	($48,772)	($48,772)	($48,772)	($48,772)
22	Income Tax adjustment - Nondeductible SLRP	($1,468,315)	($1,468,315)	($1,468,315)	($1,468,315)
23	Income Tax adjustment - Nondeductible Savings	($2,297,425)	($2,297,425)	($2,297,425)	($2,297,425)
24	Unbilled Meters	$0	$0	$0	$0
25	Carrying Cost Rate-Gross of deferred taxes	**($558,221)**	**($572,298)**	**($586,375)**	**($597,540)**
26	Deferral Period-Gross of deferred taxes	**($288,162)**	**($295,428)**	**($302,695)**	**($308,458)**
27	Dismantling Costs-Gross of deferred taxes	**($28,835)**	**($29,562)**	**($30,290)**	**($30,866)**
28	Unamortized Deferrals Case No. GO-92-185	**$10,801**	**$11,074**	**$11,346**	**$11,562**
29	Rate Base Reductions Eliminated by Purchase	**($258,750)**	**($265,275)**	**($271,800)**	**($276,975)**
30	Rate of Return	($2,898,254)	($1,860,607)	($822,961)	$0
31	Uncollectible Gross up Difference	($347,241)	($347,241)	($347,241)	($347,241)
32	Advertisements	($17,560)	($17,560)	($17,560)	($17,560)
33	Dues and Donations	$0	$0	$0	$0
34	AGA Dues	$0	$0	$0	$0
35	Polsinelli & White Charges	$0	$0	$0	$0
36	Community Relations Dept Costs	$0	$0	$0	$0
37	Political Action Committee	$0	$0	$0	$0
38	Incentive Compensation-Corporate	$0	$0	$0	$0
39	Economic Development Discounts	$0	$0	$0	$0
40	Rate of Return	$0	$0	$0	$0
41	Amortization of COLI abandonment	$0	$0	$0	$0
	Revenue Requirement	$7,202,767	$8,212,092	$9,221,413	$10,021,911
20.1	*Delayed payment @ .003098% Revenue Requirement*	($22,314)	($25,441)	($28,568)	($31,048)
	Net Revenue Requirement	$7,180,452	$8,186,650	$9,192,845	$9,990,863