

EXHIBIT

Exhibit No.:

Issue(s):

Safety Line Replacement Program/
Former Manufactured Gas Plant Remediation/
Uncollectible Expense/
Kansas Property Tax AAO/
Oklahoma Property Tax Expense/
Unrecovered Revenue Deficiency

Witness:

Ted Robertson

Type of Exhibit:

Direct

Sponsoring Party:

Public Counsel

Case Number:

GR-2006-0422

Date Testimony Prepared:

October 13, 2006

DIRECT TESTIMONY

OF

TED ROBERTSON

Submitted on Behalf of
the Office of the Public Counsel

FILED²

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Missouri Public
Service Commission

MISSOURI GAS ENERGY

Case No. GR-2006-0422

October 13, 2006

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My commission expires January 31, 2010.

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**DIRECT TESTIMONY
OF
TED ROBERTSON**

**MISSOURI GAS ENERGY
CASE NO. GR-2006-0422**

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Ted Robertson, P. O. Box 2230, Jefferson City, Missouri 65102.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Office of the Public Counsel of the State of Missouri ("OPC" or "Public Counsel") as a Public Utility Accountant III.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND OTHER QUALIFICATIONS.

A. I graduated from Southwest Missouri State University in Springfield, Missouri, with a Bachelor of Science Degree in Accounting. In November, 1988, I passed the Uniform Certified Public Accountant ("CPA") Examination, and obtained CPA certification from the State of Missouri in 1989. My Missouri CPA license number is 2004012798.

Q. WHAT IS THE NATURE OF YOUR CURRENT DUTIES WHILE IN THE EMPLOY OF THE PUBLIC COUNSEL?

Direct Testimony of
Ted Robertson
Case No. GR-2006-0422

1 A. Under the direction of the OPC Chief Public Utility Accountant, Mr. Russell W.
2 Trippensee, I am responsible for performing audits and examinations of the books and
3 records of public utilities operating within the State of Missouri.
4

5 Q. HAVE YOU RECEIVED SPECIALIZED TRAINING RELATED TO PUBLIC
6 UTILITY ACCOUNTING?

7 A. Yes. In addition to being employed by the Office of the Public Counsel since 1990, I
8 have attended the NARUC Annual Regulatory Studies Program at Michigan State
9 University, and I have also participated in numerous training seminars relating to this
10 specific area of accounting study.
11

12 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE MISSOURI PUBLIC
13 SERVICE COMMISSION?

14 A. Yes, I have. Please refer to Schedule No. TJR-1, attached to this direct testimony, for a
15 listing of cases in which I have previously submitted testimony before the Missouri
16 Public Service Commission ("MPSC" or "Commission").
17

18 Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

19 A. The purpose of this direct testimony is to address the Public Counsel's positions
20 regarding the determination of an appropriate level of costs associated with Missouri Gas
21 Energy's ("MGE" or "Company") Safety Line Replacement Program ("SLRP"), Former
22 Manufactured Gas Plant Remediation ("FMGP"), Uncollectible Expense ("Bad Debt"),

1 Kansas Property Tax Accounting Authority Order ("AAO"), Oklahoma Property Tax
2 Expense, and Unrecovered Cost of Service Revenue Deficiency.
3

4 **II. SAFETY LINE REPLACEMENT PROGRAM**

5 Q. WHAT IS THE ISSUE?

6 A. The issue concerns the determination of the appropriate level of Safety Line Replacement
7 Program costs to include in the development of rates for the instant case. The SLRP
8 costs were accumulated and deferred pursuant to several Accounting Authority Orders
9 authorized by the Commission.
10

11 Q. PLEASE DESCRIBE THE SAFETY LINE REPLACEMENT PROGRAM.

12 A. The safety line replacement program required all gas companies to establish a gas main
13 and line replacement program. It was mandated by Commission Rule 4 CSR 240-40.030.
14

15 Q. WHAT IS AN ACCOUNTING AUTHORITY ORDER?

16 A. An accounting authority order is an accounting mechanism that permits deferral of costs
17 from one period to another. The items deferred are booked as an asset rather than as an
18 expense, thus improving the financial picture of the utility in question during the deferral
19 period. During a subsequent rate case, the Commission determines what portion, if any,
20 of the deferred amounts will be recovered in rates. An AAO allows an utility to increase
21 reported earnings for the financial period in which the deferral occurs and subsequently

1 recover those earnings in a future period to the extent the deferred amounts are included
2 in future rates.
3

4 Q. WHAT HAPPENS WHEN A COST IS DEFERRED?

5 A. When a cost (expense) is deferred, it is removed from the income statement and entered
6 on the balance sheet (e.g., Account 186, Miscellaneous Deferred Debits), pending the
7 final disposition of these costs at some future time, usually a rate case. The Federal
8 Energy Regulatory Commission Uniform System of Account No. 186, Miscellaneous
9 Deferred Debits states:
10

11 A. This account shall include all debits not elsewhere provided for,
12 such as miscellaneous work in progress, construction certificate,
13 application fees paid prior to final disposition of the application as
14 provided for in gas plan instruction 15A, and unusual or
15 extraordinary expenses not included in other accounts which are
16 in process of amortization, and items the final disposition of
17 which is uncertain.
18

19 B. The records supporting the entries to this account shall be so kept
20 that the utility can furnish full information as to each deferred
21 debit included herein.
22
23

24 Q. PLEASE EXPLAIN THE TERMS "RETURN OF" AND "RETURN ON."

25 A. If an expenditure is recorded on the income statement as an expense it is compared dollar
26 for dollar to revenues. This comparison is referred to as a "return of" because a dollar of
27 expense is matched by a dollar of revenue in the determination of revenue requirement.

1 "Return on" occurs when an expenditure is capitalized within the balance sheet because it
2 increased the value of a balance sheet asset or investment. This capitalization is then
3 included in the rate base calculation, which is a preliminary step in determining the
4 earnings the company achieves on its total regulatory investment.

5
6 Q. IS IT TRUE THAT THE SAFETY LINE REPLACEMENT PROGRAM DEFERRED
7 CARRYING COST AND DEPRECIATION EXPENSE ARE NOT ACTUALLY
8 FUNDED BY THE COMPANY?

9 A. Yes. The carrying cost and depreciation expense associated with the SLRP deferral are
10 not actually dollars of investment funded by the Company, they are merely paper
11 accounting entries on the financial books of the Company. Neither the carrying cost nor
12 the depreciation expense causes the Company to make any actual outlay of cash (i.e. an
13 expenditure).

14
15 Q. IF THE SAFETY LINE REPLACEMENT PROGRAM DEFERRAL BALANCE IS
16 INCLUDED IN RATE BASE WOULD THAT PERMIT THE COMPANY TO EARN A
17 RETURN ON AMOUNTS FOR WHICH THERE WAS NO ACTUAL INVESTMENT
18 MADE BY THE COMPANY?

19 A. Yes. In fact, allowing the Company to earn a return on the SLRP deferrals has the same
20 effect of allowing it to earn a return on a return. Stated another way, the Company,
21 absent the recording of the deferrals, would have experienced lower equity returns in
22 financial periods prior to the effective date of the new rates. Inclusion of deferral

1 balances in rate base would result in deferred earnings from prior period being multiplied
2 by the overall cost of capital and collected from future customers.

3
4 Q. DOES AN ACCOUNTING AUTHORITY ORDER INSULATE THE COMPANY
5 FROM THE EFFECTS OF REGULATORY LAG?

6 A. Yes. An AAO insulates the Company's shareholders from a significant majority of the
7 risks associated with regulatory lag that may occur if the SLRP construction projects are
8 completed and placed in service before the operation of law date of a general rate
9 increase case.

10
11 Q. PLEASE EXPLAIN THE CONCEPT OF REGULATORY LAG.

12 A. This concept is based on the difference in timing of a decision by management and the
13 Commission's recognition of that decision and its effect on the rate base/rate of return
14 relationship in determination of a utility's revenue requirement. Prudent management
15 decisions which reduce the cost of service without changing revenues result in a change
16 in the rate base/rate or return relationship. This change increases the profitability of the
17 firm in the short-run, and until such time when the Commission reestablishes rates which
18 properly match the new level of service cost. Regulated utilities are allowed to retain
19 cost savings resulting in excess profits during the lag period between rate cases. When
20 faced with escalating costs (i.e., expenses or investments), which will change the rate
21 base/rate of return relationship adversely with respect to profits, regulatory lag places

1 pressure on management to minimize the change in the relationship by filing an
2 application for a rate increase.
3

4 Q. HAS THIS COMMISSION RULED THAT IT IS NOT REASONABLE TO PROTECT
5 SHAREHOLDERS FROM ALL REGULATORY LAG?

6 A. Yes. In Missouri Public Service Company, Case Nos. EO-91-348 and EO-91-360, the
7 Commission stated:
8

9 Lessening the effect of regulatory lag by deferring costs is beneficial to a
10 company but not particularly beneficial to ratepayers. Companies do not
11 propose to defer profits to subsequent rate cases to lessen the effects of
12 regulatory lag, but insist it is a benefit to defer costs. Regulatory lag is a
13 part of the regulatory process and can be a benefit as well as a detriment.
14 Lessening regulatory lag by deferring costs is not a reasonable goal
15 unless the costs are associated with an extraordinary event.
16

17 Maintaining the financial integrity of a utility is also a reasonable goal.
18 The deferral of costs to maintain current financial integrity though is of
19 questionable benefit. If a utility's financial integrity is threatened by high
20 costs so that its ability to provide service is threatened, then it should
21 seek interim rate relief. If maintaining financial integrity means
22 sustaining a specific return on equity, this is not the purpose of
23 regulation. It is not reasonable to defer costs to insulate shareholders
24 from any risks.
25
26

27 Q. SHOULD RATEPAYERS BE REQUIRED TO PROVIDE THE COMPANY WITH AN
28 EFFECTIVE GUARANTEED RETURN ON THE SLRP CONSTRUCTION
29 EXPENDITURES JUST BECAUSE THE COMPANY'S MANAGEMENT CHOOSES
30 NOT TO EXERCISE ITS PLANNING AND OPERATING RESPONSIBILITIES?

1 A. No. Ratepayers should not be required to fund such a return. Planning and operation of
2 the Company's construction projects are a fundamental responsibility of Missouri Gas
3 Energy's management. Only management has complete access to the data and resources
4 necessary to fulfill these responsibilities, and as such, management should be able to
5 implement a SLRP construction program that minimizes the effects of regulatory lag on
6 the Company's finances.

7
8 To the extent regulatory lag moves against the Company, the Commission has already
9 decided, as mentioned earlier, that lessening regulatory lag by deferring costs is not a
10 reasonable goal. Therefore, even though the Commission has determined the costs to be
11 extraordinary, the actual effect of the accounting variance is to protect the Company from
12 adverse financial impact caused by the regulatory delay period over which it has
13 considerable control, and to afford it the opportunity to recover these charges. Thus, in
14 order that the Company not benefit disproportionately, Public Counsel believes that the
15 recovery of the costs deferred should be shared by both shareholders and ratepayers.

16
17 Q. HAS PUBLIC COUNSEL DETERMINED AN APPROPRIATE LEVEL OF SAFETY
18 LINE REPLACEMENT PROGRAM ACCOUNTING AUTHORITY ORDER COSTS
19 TO INCLUDE IN THE DEVELOPMENT OF THE INSTANT CASE RATES?

20 A. Yes. Public Counsel has calculated the unamortized SLRP deferral and the annual
21 amortization pursuant to the terms ordered by the Commission. For example, in MGE
22 Case No. GR-98-140, the Commission ordered that guaranteeing the Company a "return

1 of' and "return on" the unamortized SLRP deferral is not a fair allocation of regulatory
2 lag resulting from the ongoing construction project. Therefore, consistent with that
3 Commission decision, Public Counsel recommends that any adjustment to its rate base so
4 that it can earn a "return on" the unamortized SLRP deferral be denied.

5
6 While I continue to believe that an amortization period of 20 years or longer is more
7 appropriate, OPC is firmly committed to and in agreement with the Commission's
8 decision to disallow any addition to rate base of the unamortized SLRP deferral. This
9 view is based on the fact that OPC believes management is responsible for planning and
10 operating the activities of the Company. If management is unable to or chooses not to
11 implement processes and procedures which would limit the effect of regulatory lag on its
12 finances, the Company should not be protected by the Commission with an effective
13 guarantee of earnings. In order that ratepayers and shareholders both share in the effect
14 of regulatory lag, the Public Counsel is recommending that the Company be allowed to
15 earn a "return of" the SLRP deferred balance, but not a "return on" the SLRP deferred
16 balance.

17
18 Q. WHAT IS THE VALUE OF THE UNAMORTIZED SAFETY LINE REPLACEMENT
19 PROGRAM DEFERRAL, AND ITS ANNUAL EXPENSE AMORTIZATION, AS
20 DETERMINED BY THE PUBLIC COUNSEL?

21 A. Public Counsel has determined that the June 30, 2006 balance for the unamortized SLRP
22 deferral is approximately \$10,353,310, and that the annual expense amortization

1 associated with the total gross SLRP deferrals, based on a ten year amortization period, is
2 approximately \$3,204,805.
3

4 Q. IS PUBLIC COUNSEL PROPOSING AN ADJUSTMENT TO THE COMPANY'S
5 BOOKED ANNUAL SAFETY LINE REPLACEMENT PROGRAM EXPENSE
6 AMORTIZATION?

7 A. No. My review of the Company's general ledger indicates that the utility actually
8 expensed \$3,204,805 of the unamortized SLRP deferral during the twelve months ended
9 June 2006 so no adjustment is necessary.
10

11 Q. DOES THE PUBLIC COUNSEL ALSO SUPPORT A RATE BASE REDUCTION FOR
12 ACCUMULATED DEFERRED INCOME TAXES ASSOCIATED WITH THE
13 SAFETY LINE REPLACEMENT PROGRAM COSTS DEFERRED?

14 A. Yes. The SLRP deferred income taxes are a creation of the federal income tax laws and
15 are a cost free source of capital to the Company. Public Counsel recommends that the
16 SLRP deferred income tax balance be included as a reduction in the determination of the
17 Company total rate base because it is a cost free capital made available to the Company
18 by virtue of it having various tax deductions that lower the amount of income taxes
19 actually paid to the IRS, the benefit of which is not flowed through directly to customers
20 as a reduction in the income tax. To my knowledge, all prior Commission orders, and
21 regulatory theory, require that the Company not be allowed to earn a return on the SLRP
22 accumulated deferred income tax balance.

1
2 Q. WHAT IS THE BALANCE OF THE SAFETY LINE REPLACEMENT PROGRAM
3 ACCUMULATED DEFERRED INCOME TAX THAT SHOULD BE UTILIZED AS A
4 REDUCTION TO RATE BASE?

5 A. The balance by which MGE's rate base should be reduced is shown in Schedule B-1,
6 attached to the update direct testimony of Company witness, Mr. Michael R. Noack.
7 Schedule B-1 identifies the current balance, as of June 30, 2006, as \$3,554,392.
8

9 Q. PLEASE SUMMARIZE PUBLIC COUNSEL'S RECOMMENDATIONS REGARDING
10 THE SAFETY LINE REPLACEMENT PROGRAM ACCOUNTING AUTHORITY
11 ORDER COSTS.

12 A. Public Counsel's recommendations on this issue concern both expense and rate base
13 treatment of the SLRP associated costs. That is, in order for ratepayers and shareholders
14 to both share in the effects associated with SLRP related regulatory lag, Public Counsel
15 recommends that the Company be allowed to earn a return of the unamortized SLRP
16 deferred balance via an expense amortization included in the development of the instant
17 case rates. It is the Public Counsel's request that the Commission authorize the utilization
18 of the amortization expense level I previously identified in this testimony. However,
19 regarding rate base, it is my recommendation that the Company not be allowed to include
20 the unamortized SLRP deferred balance as an addition to rate base because the
21 adjustment, were it to be authorized, would allow the utility to earn a return on the
22 balance. Public Counsel believes that the utility should not be allowed to earn a return on

1 the unamortized SLRP deferred balance if fair and equal regulatory treatment of the costs
2 is to be achieved. Lastly, Public Counsel believes that the accumulated deferred income
3 tax balance associated with the SLRP AAOs should continue to be utilized as a reduction
4 to the Company's rate base because the tax balance represents a cost free source of funds
5 provided by ratepayers to the utility.
6

7 **III. FORMER MANUFACTURED GAS PLANT REMEDIATION**

8 Q. WHAT IS THE ISSUE?

9 A. This issue concerns the level of remediation costs for former manufactured gas plant to
10 include in the Company's cost of service in the instant case.
11

12 Q. WHAT ARE FORMER MANUFACTURED GAS PLANT REMEDIATION COSTS?

13 A. FMGP remediation costs can be defined as all investigations, testing, land acquisition (if
14 appropriate), cleanup and/or litigation costs, and expenses or other liabilities, excluding
15 personal injury claims, specifically relating to former gas manufacturing facility sites,
16 disposal sites, or sites to which hazardous material may have migrated, as a result of the
17 operation or decommissioning of the former gas manufacturing facilities.
18

19 Q. WHY IS THE COMPANY POTENTIALLY LIABLE TO INCUR FORMER
20 MANUFACTURED GAS PLANT CLEANUP EXPENDITURES?

21 A. To deal with the contamination and cleanup problems presented by abandoned and/or
22 inactive hazardous waste sites, Congress in 1980 enacted the Comprehensive

1 Environment Compensation and Liability Act ("CERCLA" or "Superfund"). CERCLA
2 provided funding and enforcement authority to the Environmental Protection Agency
3 ("EPA") to enable it to respond to hazardous substance releases and to enable the EPA to
4 undertake or regulate the cleanup of those hazardous sites where owners/operators were
5 either without resources or unwilling to implement such cleanups.

6
7 In 1986 CERCLA was amended by the Superfund Amendments and Reauthorization Act
8 ("SARA") which intensified Superfund activities and set a goal of achieving "permanent"
9 solutions at Superfund sites. CERCLA imposes strict, joint and several liability on
10 present or former owners or operators of facilities where substances have been or are
11 threatened to be released into the environment.

12
13 Potentially responsible parties ("PRP") included owners of contaminated land from point
14 of contamination to date, operators (which is interpreted as any party that had possession,
15 control, or influence over the premises during the same period), transporters and
16 generators of the contaminants regardless of whether they directly released such
17 substances into the environment.

18
19 Q. MISSOURI GAS ENERGY IS A POTENTIALLY RESPONSIBLE PARTY FOR HOW
20 MANY FORMER MANUFACTURED GAS PLANT SITES?

21 A. MGE has identified that it currently has ownership interests in six (6) FMGP sites that
22 could require potential responsibility for cleanup efforts. In addition to the currently

1 owned sites, Company has identified fourteen (14) facilities it does not own which may
2 or may not involve it as a potentially responsible party under the Superfund statute
3 (source: MGE Response to MPSC Staff Data Request No. 7.1).
4

5 Q. WHAT IS THE DOLLAR AMOUNT THAT MISSOURI GAS ENERGY HAS
6 BOOKED IN ITS FINANCIAL RECORDS FOR FORMER MANUFACTURED GAS
7 PLANT REMEDIATION COSTS DURING THE TEST YEAR?

8 A. It is my understanding that the expenses it has incurred during the test year, though
9 immaterial, are recorded on the financial books of its parent; thus, none of the actual
10 costs incurred has been included by MGE in this rate case. However, Company has
11 proposed to include an adjustment which adds \$500,000 of expense in the test year
12 associated with what it identifies as an "Environmental Response Fund" (source:
13 Michael R. Noack updated direct testimony Schedule H-25).
14

15 Q. IS PUBLIC COUNSEL OPPOSED TO INCLUDING FORMER MANUFACTURED
16 GAS PLANT REMEDIATION COSTS IN MISSOURI GAS ENERGY'S COST OF
17 SERVICE?

18 A. Yes.
19

20 Q. PLEASE EXPLAIN WHY.

21 A. Public Counsel's opposition to the inclusion of the former manufactured gas plant
22 remediation costs in Missouri Gas Energy's cost of service is based on several reasons.

1 For example, MGE and Western Resources Inc. (WRI) have already recognized and
2 accepted that they, their insurers and potentially other PRP's are responsible for the costs
3 of the FMGP remediation (WRI is the former owner of the Missouri gas utility assets).
4 Pursuant to the terms of the *Environmental Liability Agreement* attached to the
5 *Agreement for Purchase of Assets* between Southern Union Company and Western
6 Resources Inc., the companies have agreed to share the liability for payment of any costs
7 associated with any FMGP remediation that might occur subsequent to Southern Union
8 Company buying the Missouri gas utility assets.

9
10 Also, Public Counsel believes that the costs should not be included in customer's rates
11 because, 1) to my knowledge, none of the manufactured gas plants are currently in
12 operation. Therefore, these sites are not used and useful in providing service to current
13 customers. If current customers are required to pay for the cost of service not recovered
14 from past customers (e.g., past rates were set too low), the result is intergenerational
15 inequity, and possibly retroactive ratemaking will occur, 2) present customers should not
16 be required to pay for past deficits of the Company in future rates, 3) the investigation
17 expenditures associated with potential superfund sites are essentially a non-recurring cost
18 of operation. Public Counsel believes that shareholders are compensated for this
19 particular business risk through the risk premium inherent to the equity portion of the
20 Company's weighted average rate of return, 4) shareholders, not ratepayers, receive the
21 benefits of any gains or losses (i.e., below-the line treatment) of any sale or removal from
22 service of Company-owned land or investment. Since it is the shareholder who receives

1 the benefit associated with the gain, or the loss, on an investment's disposal, it is the
2 shareholder who should bear the responsibility for any legal liability that arises at a later
3 date related to the investment, 5) the liability for the remediation costs are not incurred
4 because of the gas service Missouri Gas Energy provides to its current customers.
5 Missouri Gas Energy is a potentially responsible party because it either owns the
6 property now or its predecessor owned the property at sometime in the past, and 6)
7 automatic recovery of the remediation costs from Missouri Gas Energy's customers may
8 reduce the incentive for the Company to seek partial or complete recovery of the costs
9 from other past owners of the plant sites or Company insurers.

10
11 **IV. UNCOLLECTIBLE EXPENSE**

12 **Q. WHAT IS THE ISSUE?**

13 **A.** The issue concerns the appropriate amount of bad debt expense to include in the
14 determination of rates for the instant case.

15
16 **Q. WHAT IS THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE?**

17 **A.** Public Counsel believes that the bad debt expense authorized in this case should be based
18 on a normalized level of cost. Therefore, Public Counsel recommends that the test year
19 per book balance in the uncollectible account be adjusted to represent an average of the
20 actual bad debt write-offs for the last five years.

1 Q. WHY IS OPC PROPOSING A FIVE YEAR NORMALIZATION ADJUSTMENT IN
2 THIS CASE?

3 A. MGE's level of bad debt write-offs over the last ten (10) years has been very volatile.
4 By using a five year average for the normalized annual amount, abnormal levels of bad
5 debt write-offs can be appropriately leveled for rate purposes.

6
7 Q. WHAT ARE THE BAD DEBT WRITE-OFFS AND AUTHORIZED RATE CASE
8 ALLOWANCES FOR THE LAST TEN YEARS?

9 A. The following is a table that compares MGE's annual bad debt expense write-offs and
10 authorized rate allowances for the twelve months ended June 1997 through 2006.

11
12 Bad Debt Expense

	Net	Rate
<u>June</u>	<u>Write-Offs</u>	<u>Allowance</u>
1997	\$ 2,978,126	\$3,409,662
1998	\$ 6,570,664	\$3,409,662
1999	\$ 4,156,361	\$4,325,000
2000	\$ 3,381,016	\$4,325,000
2001	\$ 7,819,418	\$4,325,000
2002	\$ 9,168,320	\$4,323,292
2003	\$ 5,646,546	\$4,323,292
2004	\$ 8,174,818	\$4,323,292
2005	\$11,059,738	\$7,042,000
2006	\$ 9,317,740	\$7,042,000

27
28 Q. WHAT IS THE ADJUSTMENT PROPOSED BY PUBLIC COUNSEL?

29 A. Due to the volatility shown in the amount of the annual write-offs for the periods shown
30 in the above table it would appear that a normalization of the annual bad debt expense

1 level would be appropriate. Public Counsel recommends an average of the most recent
2 five years (i.e., \$8,673,432) be included as the normalized level of bad debt expense for
3 rate purposes. Since the amount actually booked for the twelve months ended June 2006
4 is \$8,210,455, an adjustment of \$462,978 to increase the book expense is necessary (i.e.,
5 \$8,673,432 less \$8,210,455) to achieve the normalized level of annual bad debt expense I
6 recommend.

7
8 **V. KANSAS PROPERTY TAX AAO**

9 **Q. WHAT IS THE ISSUE?**

10 **A.** The issue pertains to Company's deferral of expenses to pay property taxes on natural gas
11 held in storage in the State of Kansas. Pursuant to an Accounting Authority Order
12 authorized in MGE Case No. GU-2005-0095, effective September 18, 2005, the
13 Commissioned stated the following:

14
15 **Summary**

16 The report and order grants Missouri Gas Energy an Accounting Authority
17 Order to permit it to defer its expenses incurred to pay property taxes on
18 natural gas held in storage in the state of Kansas. Missouri Gas Energy will
19 be allowed to defer taxes paid for tax years 2004, 2005, and 2006. The
20 company will be required to begin amortization of the deferred amounts at
21 the beginning of the month following a final judicial determination of the
22 legality of the Kansas property taxes. Amortization must occur over a five-
23 year period.
24
25

26 **Q. WHAT IS THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE?**

1 A. In addition to continuing to believe that the Commission's authorization of the AAO was
2 inappropriate due to the fact that the costs to be deferred were not both "known" and
3 "measurable" (as acknowledged by the Commission on page fifteen (15) of the AAO Order),
4 Public Counsel believes that the threshold of a final judicial resolution of the costs, as
5 described on pages 7, 10, 11, 17 and 18 in the AAO Order, has had the effect of
6 inappropriately extending the timeframe of the AAO originally authorized.

7
8 Q. WHY DOES PUBLIC COUNSEL BELIEVE THE AAO TIMEFRAME HAS BEEN
9 INAPPROPRIATELY EXTENDED?

10 A. As anticipated in the AAO Order (i.e., page 7), the appeal to the Kansas Board of Tax
11 Appeals ("BOTA") by approximately one hundred and nine (109) separate taxpayers (i.e.,
12 not just MGE) was finalized on or about July 19, 2006 when it issued an *Order Denying*
13 *Reconsideration*. Earlier, on or about June 22, 2006, BOTA had issued an *Order Nunc Pro*
14 *Tunc* which determined that the taxation of the natural gas in storage is not appropriate
15 because it is merchants' inventory, which is exempt under K.S.A. 79-201m. On page seven
16 of the BOTA's *Order Nunc Pro Tunc*, it states:

17
18 The parties have stipulated that the Taxpayers are merchants of natural gas
19 and that gas they delivered to interstate pipelines for redelivery qualifies as
20 inventory. Based on these stipulations and the ruling herein, the Board finds
21 that the subject natural gas is exempt from ad valorem taxation pursuant to
22 K.S.A. 79-201m.
23
24

1 This Commission was led to believe a final judicial resolution would be decided in mid-2006
2 (see page seven (7) of the AAO Order), but the BOTA ruling, even though it favored the
3 utilities, was subsequently appealed to a higher judicial authority.
4

5 Q. WAS THE ISSUE APPEALED TO THE KANSAS SUPREME COURT?

6 A. Yes. Company's response to OPC Data Request No. 1000 provided documents that show
7 subsequent to the BOTA's decision exempting the natural gas in storage from taxation the
8 Director of Property Valuation of the Kansas Department of Revenue filed a *Motion To*
9 *Transfer To Supreme Court* and a *Notice Of Appeal/Petition For Judicial Review* of the
10 BOTA's adverse rulings to the Court of Appeals of the State of Kansas. To my knowledge,
11 that is where the issue currently resides and a decision in the matter is pending.
12

13 Q. SHOULD MGE BE ALLOWED TO CONTINUE TO DEFER, FOR FUTURE
14 RECOVERY, KANSAS PROPERTY TAX EXPENSE FOR WHICH IT HAS NOT
15 ACTUALLY INCURRED AN EXPENDITURE?

16 A. No. It is the Public Counsel's belief that the expense Company has deferred pursuant to the
17 AAO, along with the related liability, should be removed (reversed) from MGE's balance
18 sheet. This recommendation is based on the fact that the purpose of an AAO is not to allow
19 the utility unfettered deferral of costs which it may or may not ever incur.
20

21 The Commission authorized MGE to defer Kansas property tax expense for three years,
22 2004, 2005, and 2006 (see page eighteen (18) of the AAO Order); however, the expenses at

1 issue in the Kansas case only relate to property taxes for the years 2004 and 2005. Calendar
2 year 2006 property taxes are not even an issue; yet, this Commission authorized MGE to
3 defer the expense even after recognizing that it, and the alleged property tax expense for
4 years 2004 and 2005, were not both "known" and "measurable." Public Counsel asserts that
5 utilization of the AAO process in this instance results in an inappropriate aberration of the
6 original purpose of an AAO.

7
8 Q. WHY DOES PUBLIC COUNSEL BELIEVE THIS AAO TO BE AN ABERRATION OF
9 THE AAO PROCESS?

10 A. The Commission test for allowing deferral of costs via an AAO has historically been for an
11 event found to be extraordinary, unusual and unique, and not recurring. Though the
12 Commission apparently believed and authorized, over OPC's objections, that the AAO at
13 issue was based on the results of that test, one important fact has yet to be addressed. That
14 fact is that the "costs" the Commission allows MGE to defer have never actually been
15 incurred or paid by MGE; whereas, to my knowledge, in all other AAOs preceding this one,
16 costs supporting the deferral were actually incurred. Because MGE's has neither incurred
17 nor paid any monies whatsoever, the alleged property tax expenses continue to be
18 "unknown." Public Counsel believes that since the costs are not both "known" and
19 "measurable," the AAO should be discontinued and the deferrals associated with it removed.

20
21 Q. DOES PUBLIC COUNSEL BELIEVE THERE IS A BETTER WAY TO ACCOUNT FOR
22 THE ALLEGED KANSAS PROPERTY TAX EXPENSE?

1 A. Yes. Since the date of the expected final judicial resolution has passed, and it is not certain
2 when the final judicial resolution will occur or if the tax will ever result in an actual
3 expenditure by MGE, Public Counsel believes the best way to account for the alleged
4 property tax expense is to discontinue the AAO. In the event that the final judicial resolution
5 actually goes against the utilities, Company could, if its management deemed necessary,
6 seek emergency rate relief from the Commission for the actual expenditures incurred.
7 Otherwise, the Company can seek recovery of the expense in its next general rate case
8 subsequent to the date of the final judicial decision. Under either scenario the aberration of
9 the AAO process caused by the current Kansas property tax AAO will cease and the
10 Company will continue to have avenues available for possible future recovery of any actual
11 Kansas expenditures incurred on a going forward basis.

12
13 **VI. OKLAHOMA PROPERTY TAX EXPENSE**

14 Q. WHAT IS THE ISSUE?

15 A. Company has an ongoing dispute within the State of Oklahoma similar to that occurring in
16 the State of Kansas regarding the right of the taxing authorities to assess property tax on gas
17 stored within their jurisdiction. Currently the issue is on appeal to the Oklahoma Supreme
18 Court after the utility won a Woods County District Court final ruling in the favor of the
19 utility's claim that the gas is exempt from taxation. Company is seeking a refund of
20 approximately \$66,000 from Woods County, Oklahoma and \$1.1 million from Grant
21 County, Oklahoma (source: MPSC Staff Data Request No. 54.28).

1 Q. IS OKLAHOMA PROPERTY TAX INCLUDED IN MGE'S TEST YEAR IN THE
2 INSTANT CASE?

3 A. Yes. According to Company response to MPSC Staff Data Request No. 108, during the test
4 year the utility paid approximately \$218,521 for property tax related to gas storage in the
5 State of Oklahoma.

6
7 Q. WHAT IS THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE?

8 A. Public Counsel recommends that this Commission disallow the Oklahoma property tax
9 expense in the determination of rates in the instant case. I find it ironic that on one hand, for
10 the State of Kansas property tax, MGE sought and obtained an AAO to defer for future
11 recovery from Missouri ratepayers property tax expense on gas storage which it has not paid
12 and may not ever pay, while on the other hand it seeks to include in rates property tax
13 expense on gas storage in the State of Oklahoma, which it has paid, but may be refunded. If
14 the Oklahoma property tax costs are included in MGE's rates, and the Company ultimately
15 prevails in the courts, Missouri ratepayers will not benefit from the refunds even though they
16 are the source which actually funded the total (possibly excessive) costs. That is, MGE's
17 owners would reap an unwarranted benefit because Company would be under no obligation
18 to channel the refunds back to the Missouri ratepayers.

19
20 **VII. UNRECOVERED REVENUE DEFICIENCY**

21 Q. WHAT IS THE ISSUE?

1 A. Company has alleged it is incurring an unrecovered revenue deficiency related customer
2 usage revenues that were authorized by the Commission in MGE Case No. GR-2004-0209.

3
4 Q. IS IT THE COMPANY'S POSITION THAT IT SHOULD BE ALLOWED TO RECOVER
5 THE ALLEGED REVENUE SHORTFALL IN FUTURE PERIODS?

6 A. Yes. On page twenty-one (21), of the direct testimony of Mr. Michael R. Noack, MGE
7 Director of Pricing and Regulatory Affairs, he states Company has calculated the
8 unrecovered revenue deficiency for year 2006 and proposes to amortize the amount over five
9 (5) years beginning with the effective date of the rate change in the instant case.

10
11 Q. WHAT IS THE PUBLIC COUNSEL'S POSITION REGARDING THE ALLEGED
12 UNRECOVERED REVENUE?

13 A. It is the Public Counsel's position that any unrecovered revenue deficiency, fact or fiction, is
14 not a recoverable cost in the current general rate case. Commission authorization of a
15 general rate increase is not a guarantee of recovery of a defined level of revenues. It
16 represents nothing more than the Commission's permission for the utility to have the
17 "opportunity" to earn the revenue requirement authorized. If the utility is not able to earn
18 that authorized level of revenue, the utility has no right to seek additional funds from future
19 ratepayers to compensate the utility. Likewise, future ratepayers have no right to pay lower
20 rates if previous rates resulted in earnings above the level used by the Commission to set
21 those rates.

1 Q. IS THE COMMISSION REQUIRED TO GUARANTEE A UTILITY THAT IT WILL
2 EARN ITS AUTHORIZED REVENUE REQUIREMENT?

3 A. No. In its determination of rates that are fair and reasonable to ratepayers, the Commission
4 must authorize rates that allow a utility the opportunity to make enough money to meet
5 reasonable expenses, pay interest on its debts, and provide a reasonable return to
6 stockholders. The Commission does not, nor is it required to, "guarantee" the utility that its
7 actual earnings achieved will equal the revenue requirement authorized. It is up to the
8 utility's management to operate the company so as to capitalize on the opportunity presented
9 to it by the Commission.

10
11 Q. WOULD COMMISSION AUTHORIZATION OF RECOVERY OF UNRECOVERED
12 REVENUE DEFICIENCIES REPRESENT RETROACTIVE RATEMAKING?

13 A. Yes. Setting rates is a legal requirement aimed at giving a utility the opportunity to earn
14 a fair and reasonable return on its investment after recovering its prudently incurred
15 expenses. Rates are determined using a revenue requirement that includes operating
16 expenses, depreciation, taxes plus the return on rate base. Company's position is intended
17 only to insulate stockholders from risks associated with the operation of the utility. That
18 position is inconsistent with the fundamental ratemaking concept that the development of
19 a utility's cost of capital requires it to bear some risk in order to have the opportunity to
20 earn returns in excess of the returns provided by risk-free investments (interestingly, Mr.
21 Noack's proposal contains no reduction in MGE's return on equity for the reduction in
22 risk that would be achieved if it were to be authorized by the Commission). In addition,

1 Commission authorization of the Company's request would only benefit shareholders
2 because, as identified by Mr. Noack, it would guarantee MGE full recovery of any
3 revenue requirement authorized by the Commission. It is also likely, in my opinion, that
4 it could lead to less incentive for management to manage the costs of the operation.
5

6 Q. WHAT IS RETROACTIVE RATEMAKING?

7 A. Retroactive ratemaking is the setting of future rates which permit a utility to recover past
8 losses or which require it to refund past excess profits collected under a rate that did not
9 perfectly match expenses plus rate of return with the rate actually established.

10 Essentially, it is the recovery in future rates of an expense or liability which occurred or
11 accrued in a prior period (see *St. ex rel. Utility Consumers Council of Missouri v. Public*
12 *Service Commission*, 585 S.W.2d 41, 47-49 (Mo. Banc 1979).
13

14 Q. WHAT IS THE REGULATORY IMPACT OF THE PROHIBITION ON
15 RETROACTIVE RATEMAKING?

16 A. Past expenses of a utility can be used as a basis for determining what rate is reasonable to
17 be charged in future in order to avoid future excess profits or future losses, but such
18 expenses cannot be used to set future rates to recover for past profits or losses due to
19 imperfect matching of rates with expenses.
20

21 Q. WOULD COMPANY'S PROPOSAL VIOLATE THE PROHIBITION AGAINST
22 RETROACTIVE RATEMAKING?

Direct Testimony of
Ted Robertson
Case No. GR-2006-0422

1 A. Yes. It is my understanding, based on counsel's opinion, that if the Commission were to
2 authorize the Company's request it would lead to the creation of a process whereby the
3 final result would be retroactive ratemaking treatment of previously incurred costs which
4 is illegal in the State of Missouri. Company's proposal violates the retroactive ratemaking
5 prohibition because it requests the Commission to authorize, in the current case,
6 amortization of an alleged revenue deficiency directly associated with costs incurred in a
7 prior period.

8
9 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

10 A. Yes, it does.

**CASE PARTICIPATION
OF
TED ROBERTSON**

<u>Company Name</u>	<u>Case No.</u>
Missouri Public Service Company	GR-90-198
United Telephone Company of Missouri	TR-90-273
Choctaw Telephone Company	TR-91-86
Missouri Cities Water Company	WR-91-172
United Cities Gas Company	GR-91-249
St. Louis County Water Company	WR-91-361
Missouri Cities Water Company	WR-92-207
Imperial Utility Corporation	SR-92-290
Expanded Calling Scopes	TO-92-306
United Cities Gas Company	GR-93-47
Missouri Public Service Company	GR-93-172
Southwestern Bell Telephone Company	TO-93-192
Missouri-American Water Company	WR-93-212
Southwestern Bell Telephone Company	TC-93-224
Imperial Utility Corporation	SR-94-16
St. Joseph Light & Power Company	ER-94-163
Raytown Water Company	WR-94-211
Capital City Water Company	WR-94-297
Raytown Water Company	WR-94-300
St. Louis County Water Company	WR-95-145
United Cities Gas Company	GR-95-160
Missouri-American Water Company	WR-95-205
Laclede Gas Company	GR-96-193
Imperial Utility Corporation	SC-96-427
Missouri Gas Energy	GR-96-285
Union Electric Company	EO-96-14
Union Electric Company	EM-96-149
Missouri-American Water Company	WR-97-237
St. Louis County Water Company	WR-97-382
Union Electric Company	GR-97-393
Missouri Gas Energy	GR-98-140
Laclede Gas Company	GR-98-374
United Water Missouri Inc.	WR-99-326
Laclede Gas Company	GR-99-315
Missouri Gas Energy	GO-99-258
Missouri-American Water Company	WM-2000-222
Atmos Energy Corporation	WM-2000-312
UtiliCorp/St. Joseph Merger	EM-2000-292
UtiliCorp/Empire Merger	EM-2000-369
Union Electric Company	GR-2000-512
St. Louis County Water Company	WR-2000-844
Missouri Gas Energy	GR-2001-292
UtiliCorp United, Inc.	ER-2001-672
Union Electric Company	EC-2002-1
Empire District Electric Company	ER-2002-424

Schedule TJR-1.1

**CASE PARTICIPATION
OF
TED ROBERTSON**

<u>Company Name</u>	<u>Case No.</u>
Missouri Gas Energy	GM-2003-0238
Aquila Inc.	EF-2003-0465
Aquila Inc.	ER-2004-0034
Empire District Electric Company	ER-2004-0570
Aquila Inc.	EO-2005-0156
Aquila, Inc.	ER-2005-0436
Hickory Hills Water & Sewer Company	WR-2006-0250
Empire District Electric Company	ER-2006-0315
Central Jefferson County Utilities	WC-2007-0038
Missouri Gas Energy	GR-2006-0422