

Exhibit No.:	_____
Issue(s):	Deferral of Operations and Maintenance and Capital Related Costs/ Deferral of Margin Revenue
Witness/Type of Exhibit:	Lafferty/Rebuttal
Sponsoring Party:	Public Counsel
Case No.:	GU-2011-0392

REBUTTAL TESTIMONY

OF

SHAWN LAFFERTY

Submitted on Behalf of the Office of the Public Counsel

MISSOURI GAS ENERGY

CASE NO. GU-2011-0392


November 1, 2011


In the Matter of the Application of Missouri)
Gas Energy for the Issuance of an)
Accounting Authority Order Relating to its)
Natural Gas Operations and for a)
Contingent Waiver of the Notice)
Requirement of 4 CSR 240-4.020(2))

AFFIDAVIT OF SHAWN LAFFERTY

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.


Shawn Lafferty
Public Utility Accountant III


Jerene A. Buckman
Notary Public

My Commission expires August 23, 2013.

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SHAWN LAFFERTY
MISSOURI GAS ENERGY
CASE NO. GU-2012-0392

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**REBUTTAL TESTIMONY
OF
SHAWN LAFFERTY**

**MISSOURI GAS ENERGY
CASE NO. GU-2011-0392**

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Shawn Lafferty, PO Box 2230, Jefferson City, Missouri 65102-2230.

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

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

Q. WHAT IS THE NATURE OF YOUR CURRENT DUTIES AT THE OPC?

A. Under the direction of the OPC Chief Public Utility Accountant, Mr. Ted Robertson, I am responsible for performing audits and examinations of the books and records of the public utilities operating within the state of Missouri.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND OTHER QUALIFICATIONS.

A. I graduated in May, 1984 from The University of Iowa in Iowa City, Iowa, with a Bachelor of Business Administration Degree in Accounting. In November of

1 1984, I took and passed the Uniform Certified Public Accountant Examination,
2 and I obtained Certified Public Accountant (CPA) certification from the state of
3 Missouri in 1985. My CPA certificate number is 10203. I am not currently a
4 licensed CPA. After graduation I spent over 6 years in public accounting working
5 for both regional and national CPA firms. I joined Sprint in 1991 and held a
6 series of progressive financial and product management / operations positions
7 over 18 plus years. I joined the Office of Public Counsel in November, 2010.
8

9 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE MISSOURI PUBLIC
10 SERVICE COMMISSION ("COMMISSION" OR "MPSC")?

11 A. Yes. I previously submitted testimony in Case No. ER-2011-0004.
12

13 **II. PURPOSE OF TESTIMONY**

14 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

15 A. The purpose of my testimony is to express Public Counsel's concerns and
16 recommendations to the Commission regarding Missouri Gas Energy's ("MGE"
17 or "Company") request that the Commission issue an Accounting Authority Order
18 ("AAO"). The requested AAO would permit MGE to defer to a regulatory asset:

- 19 1. Alleged incremental costs (net of insurance or other proceeds) incurred by
20 MGE related to the May 22, 2011 Joplin tornado.

2. Alleged loss from the tornado of fixed cost recovery (margin revenue)
provided by the Company's distribution rates.

III. ACCOUNTING AUTHORITY ORDER

Q. WHAT IS AN AAO?

A. Under historical test year ratemaking, revenue and costs are rarely considered from earlier than the test year to determine a reasonable revenue requirement. Certain test year items may be normalized (such as rate case expense given such expenses tend to significantly fluctuate on an annual basis) or annualized (such as payroll expense to reflect changes in staffing or wage rates effective at the end of the test year) to determine test year income. However, the Commission has in certain circumstances allowed for unique treatment of extraordinary items.

Q. WHAT ARE EXTRAORDINARY ITEMS?

A. The Commission requires gas companies to keep all accounts in conformity with the Uniform System of Accounts ("USOA") as Prescribed by the Federal Energy Regulatory Commission ("FERC"). FERC general instruction No. 7 defines extraordinary items as "events and transactions of significant effect which are abnormal and significantly different from the ordinary and typical activities of the company, and which would not reasonably be expected to recur in the

1 foreseeable future". Instruction No. 7 further states "to be considered
2 extraordinary, an item should be more than approximately 5% of income,
3 computed before extraordinary items. Commission approval must be obtained to
4 treat an item of less than 5%, as extraordinary." In the past, the Missouri
5 Commission has granted AAOs for utilities to defer costs in a number of
6 circumstances that arise as a result of extraordinary events.

7
8 Q. HAS THE COMMISSION PREVIOUSLY STATED ITS CRITERION FOR
9 GRANTING AN AAO?

10 A. Yes. Mr. Mike Noack, in his direct testimony on pages 12-13, cites the standard
11 for granting an AAO as documented in Case No. GU-2005-0095. Further, the
12 MPSC Staff ("Staff"), in its memorandum (attachment A) to its recommendation
13 to approve in part and deny in part MGE's application for an AAO provides
14 additional deferral authorization standards. Since both documents are on record,
15 in the interest of brevity, I will not repeat those standards herein.

16
17 **IV. DEFERRAL OF OPERATIONS AND MAINTENANCE EXPENSE (O&M) AND**
18 **CAPITAL RELATED COSTS**

19 Q. WHAT AMOUNT OF O&M AND CAPITAL RELATED COSTS HAS THE
20 COMPANY INCURRED?

1 A. As of July 28, 2011 (the latest information available to OPC) MGE indicated that
2 it had incurred approximately \$1.042M (million) in operations and maintenance
3 expense and \$99.5K (thousand) in capital related costs pertaining to the tornado.
4 In schedule MRN-2 attached to Mr. Mike Noack's direct testimony, he provided
5 the Company's estimated gross costs that could potentially be incurred and
6 subject to deferral. The schedule reflects estimated O&M expenses totaling
7 \$1.318M and capital related costs totaling \$6.667M. However, the Company's
8 estimate represents costs that may never be incurred. Also, the incurrence of
9 such costs could span several years.

10
11 Q. DOES THE COMPANY EXPECT TO RECEIVE INSURANCE PROCEEDS
12 WHICH WOULD OFFSET COSTS?

13 A. Yes. Mr. Noack states in his direct testimony on page 5 that ". . . MGE expects
14 that a significant amount of these costs" (i.e., O&M and capital costs) "will be
15 recovered through insurance, but the timing and amount of that recovery is
16 uncertain."

17
18 Q. WHAT LEVEL OF NET OPERATING INCOME WAS CALCULATED AND
19 APPROVED IN THE MOST RECENT MGE RATE CASE?

20 A. The most recent MGE rate case was Case No. GR-2009-0355. The case test
21 year ended December 31, 2008, was updated through April 30, 2009 and had a

1 true-up through September 30, 2009. In response to OPC data request No.1101,
2 Mr. Noack provided a schedule which indicated that the adjusted test year net
3 operating income was \$37.4M. Including the Commission approved rate
4 increase pursuant to that rate case, net operating income totaled \$47.4M.
5

6 Q. ABSENT THE ALLEGED LOST MARGIN REVENUE, DO MGE'S CURRENT
7 ESTIMATED O&M AND CAPITAL RELATED COSTS MEET THE
8 EXTRAORDINARY THRESHOLD OF 5% OF INCOME AS DEFINED BY FERC?

9 A. Costs would need to total approximately \$2.37M (5% of \$47.4M) based upon the
10 level of operating income calculated per the most recent rate case in order to
11 meet the 5% threshold defined by FERC.

12
13 Exactly how much plant infrastructure the Company will need to replace and
14 when they will need to replace it is dependent upon when and if customer
15 structures that were destroyed as a result of the tornado are rebuilt, and if they
16 are rebuilt in the immediate storm damaged area, other parts of Joplin or
17 elsewhere. Further, the Company has indicated it anticipates significant recovery
18 of the costs through insurance proceeds. Based upon these circumstances,
19 OPC cannot truly discern whether such costs will ultimately meet the
20 extraordinary threshold as defined by FERC general instruction No. 7, but it
21 certainly seems unlikely.
22

1 Q. ARE THE STAFF AND COMPANY IN AGREEMENT IN THEIR
2 RECOMMENDATION THAT THE COMMISSION AUTHORIZE MGE TO ALLOW
3 DEFERRAL OF O&M EXPENSES AND CAPITAL-RELATED COSTS
4 ASSOCIATED WITH THE EVENTS OF THE MAY 22, 2011 TORNADO?

5 A. Yes. Staff and the Company both agree that the Commission should authorize
6 MGE to defer incremental tornado-related O&M expenses and incremental
7 capital-related costs incurred as a result of the Joplin tornado on May 22, 2011.
8

9 Q. DOES PUBLIC COUNSEL OPPOSE THE RECOMMENDATION THAT THE
10 COMMISSION SHOULD AUTHORIZE DEFERRAL OF COSTS ASSOCIATED
11 WITH THE JOPLIN TORNADO?

12 A. No, but with one additional condition. Since Public Counsel cannot discern at
13 this time whether such costs will truly be material to MGE's financial position,
14 OPC recommends the Commission condition recovery on the Company filing a
15 general rate case proceeding within two years from the time of the tornado, or
16 May 22, 2013.
17

18 Q. ARE STAFF AND THE COMPANY IN AGREEMENT ON ALL ASPECTS OF
19 STAFF'S RECOMMENDATION REGARDING THE DEFERRAL OF
20 INCREMENTAL O&M EXPENSE AND INCREMENTAL CAPITAL COSTS?

1 A. No. In its recommendation, Staff has described several conditions on which their
2 recommendation is based. MGE has not indicated that is supportive of two of
3 those conditions.

- 4 • Staff has recommended that MGE ratably amortize all costs to which it is
5 authorized to defer over a ten-year (120 month) period. MGE has
6 recommended a five-year amortization for such costs.

- 7 • Staff has recommend amortization begin, as of January 1, 2012 so that
8 the ten year amortization period concludes on December 31, 2021. MGE
9 has recommended that the amortization should commence with the
10 effective date of rates approved by the Commission in the first rate case
11 following Case No. GR-2009-0355
12

13 Q. DOES OPC HAVE ANY OPINION OR RECOMMENDATION REGARDING THE
14 CONDITIONS THAT APPEAR TO BE IN DISPUTE REGARDING THE
15 DEFERRAL OF COSTS?

16 A. Yes. Public Counsel's opinion for Commission consideration is as follows:

- 17 • Amortization period: OPC supports Staff's recommendation. A ten-year
18 amortization period appears to be appropriate given the majority of costs
19 to be deferred (subject to future audit) are capital related. According to
20 the estimates in Mr. Noack's testimony, 85.3% of the costs subject to
21 deferral are capital related. However, as noted previously, many

1 uncertainties exist as to the ultimate amount of unreimbursed capital and
2 O&M costs the Company will actually incur.

- 3 • When to begin amortization: In regard to when amortization of deferred
4 costs should commence, Public Counsel is not opposed to either the Staff
5 or Company position. Once the appropriate amount of deferred costs
6 authorized for recovery is determined by the Commission in the next rate
7 case, Public Counsel believes the Company should be allowed to recover
8 those costs in rates; but ratepayers should not be expected to fund any
9 excess amount of authorized deferred costs. Public Counsel believes this
10 objective can be reasonably managed during the ratemaking process.
11 Therefore, Public Counsel is less concerned about the commencement
12 date for amortization of authorized deferred costs.

13
14 **V. DEFERRAL OF THE LOSS OF ANY MARGIN REVENUE FROM ALLEGED**
15 **LOST SALES**

16 Q. IN REGARD TO THE ALLEGED LOSS OF MARGIN REVENUE, WHAT IS MGE
17 PROPOSING?

18 A. MGE is proposing to defer to a regulatory asset, the loss of margin revenues due
19 to an estimated 3,000+ customers that had structures severely damaged or
20 destroyed and will not be ready for service in the foreseeable future, if service is
21 restored at all.

1
2 Q. HAS MGE PROVIDED ESTIMATES OF ITS ALLEGED LOSS OF MARGIN
3 REVENUE?

4 A. Yes. On pages 9-10 of Mr. Mike Noack's direct testimony he states:

5 "Attached as Schedule MRN-3 is a spreadsheet consisting of two pages.
6 Page 1 of the schedule calculates the loss of fixed cost recovery on a
7 monthly basis of \$94,285 for residential ("RS") and small general service
8 ("SGS") customers or \$1,131,420 annually. Page 2 of the schedule
9 calculated the loss of fixed cost recovery from transportation customers to
10 be \$36,000 annually".
11

12 Q. DOES MR. NOACK'S TESTIMONY REFLECT HOW THE ESTIMATED MARGIN
13 REVENUE LOSS WAS CALCULATED?

14 A. Yes. Mr. Noack attached to his testimony Schedule MRN-3, which provides
15 active bill counts by Customer Class (Residential, SGS and LGS or large gas
16 service) for the months of April –September 2010 compared to those same
17 months in 2011 for the Joplin area. The difference between the September 2011
18 active bill counts relative to September 2010 bill counts for the RS and SGS
19 customer classes is then multiplied by the corresponding fixed monthly charge
20 for each class. In addition, Schedule MRN-3 provided the 2010 revenue for two
21 large volume transportation customers which apparently are no longer being
22 served.
23

1 Q. DOES OPC BELIEVE THE COMMISSION SHOULD GRANT MGE'S REQUEST
2 FOR AN AAO TO DEFER THE ALLEGED LOST MARGIN REVENUE?

3 A. No. OPC recommends the Commission deny MGE's request to defer any
4 alleged lost margin revenue.
5

6 Q. WHY DOES OPC BELIEVE MGE'S REQUEST TO DEFER LOST MARGIN
7 REVENUE SHOULD BE DENIED?

8 A. OPC does not believe the recovery of lost margin revenue is appropriate based
9 upon the following reasons:

- 10 • There is no historical basis or precedent for recovery of revenue in prior
11 AAOs.
- 12 • Shareholders incur business risk when investing in a regulated utility and
13 are compensated for that risk in the form of a premium on the return on
14 equity.
- 15 • The enormous difficulty and inconsistency in tracking lost revenues.
- 16 • The alleged lost revenue does not appear to have had a material impact
17 on the Company's financial operations.
18

19 Q. WHY DOES OPC BELIEVE THERE IS NOT A HISTORICAL BASIS OR
20 PRECEDENT FOR ALLOWING DEFERRAL OF MARGIN REVENUE IN THE
21 AAO?

1 A. To Public Counsel's knowledge the MPSC has never authorized the deferral of
2 alleged lost revenues pursuant to an AAO, regardless of the rate design used to
3 establish rates and the type of costs those rates are intended to recover. To date
4 the MPSC has granted AAO accounting treatment primarily for one time outlays
5 (expense) or capital caused by infrequent, unpredictable events of an unusual
6 and extraordinary nature that are outside the control of the utility or the
7 Commission. These incremental costs associated with the extraordinary event
8 are accumulated and deferred on the balance sheet and subject to future
9 recovery according to Commission authorization.

10
11 Q. HAVE OTHER PARTIES TO THIS CASE FOUND ANY EVIDENCE OF A
12 HISTORICAL PRECEDENT TO ALLOW LOST MARGIN REVENUE?

13 A. No. In Staff's Recommendation to the Commission filed on August 19, 2011,
14 Staff noted the following on page 6 of the Official Case File Memorandum.

15 "MGE's request to defer and obtain the opportunity to seek subsequent
16 recovery of lost revenues associated with an extraordinary event is
17 unprecedented in this jurisdiction. Though many prior natural disasters in
18 Missouri (for example, floods, wind, and ice storms) resulted in a loss of
19 customer load by the affected utility for a period of time, at no time in the
20 past have these utilities included lost revenues (or "loss of fixed cost
21 recovery") as a financial item for which deferral treatment was requested.²"

22
23 ² (Staff footnote): "Staff was unable to find a similar request for lost
24 revenues in other states in a survey of cases for the last 25 years. Staff
25 invited MGE to alert it and the Commission to any request it may have
26 overlooked, or from a further time period."
27

1 Q. HAS MGE BEEN ABLE TO PROVIDE ANY EVIDENCE OF AN AAO BEING
2 GRANTED FOR LOST MARGIN REVENUE?

3 A. No. On page 13 of Mr. Noack's direct testimony he states "In researching
4 previous cases, I have not come across a Commission decision that mentioned a
5 company's request to defer lost revenues."
6

7 Q. HISTORICALLY, FOR WHAT PURPOSES HAS THE COMMISSION GRANTED
8 AAOS TO UTILITIES?

9 A. **Historically, AAOs have enabled a utility to potentially recover those**
10 **extraordinary costs that would not normally be accounted for in regulatory**
11 **ratemaking process.** Thus such deferrals are sometimes warranted. However,
12 the loss (or gain) of margin revenues is part of a normal rate case, and should
13 not be afforded extraordinary treatment.
14

15 Q. DO INVESTORS IN A REGULATED UTILITY INCUR RISK?

16 A. Yes. In a typical rate case, the authorized rate of return on equity set by the
17 Commission, when coupled with costs of the other capital the Company has
18 raised, determines the weighted average cost of capital (WACC). WACC is
19 multiplied by the rate base, to provide the overall return on investment on which
20 the Company and its shareholders have an opportunity to earn, but not a

1 guarantee to earn. Investors in a regulated utility invest in the Company with the
2 realization there are risks to their investment.

3
4 Q. ARE INVESTORS COMPENSATED FOR TAKING THIS RISK?

5 A. Yes. Equity investors demand a premium over debt investors to compensate for
6 the risk that is involved in owning a specific investment security. In theory, the
7 investor's required return on equity is the return an investor must earn in order to
8 be willing to make an initial or continued investment in the equity securities of a
9 particular company. This equity risk premium is based upon a company's
10 financial risk (based upon the Company's capital structure) and general business
11 risk.

12
13 Business risk encompasses all the operating factors that collectively increase the
14 probability that future earning flows accruing to investors may not be realized,
15 because of the fundamental nature of the firm's business. Many factors influence
16 business risk, including: demand for services, sales volatility, availability of
17 product and service substitutes, the Company's relative degree of fixed vs.
18 variable costs, the revenue mix among customer types, regulatory policies,
19 operating and capital investment cost uncertainty, general market risk, etc.
20 Investors in utilities are well aware that weather – including severe weather
21 events – can affect utilities' earnings and thus the investor's return.

1 Q. DOES PUBLIC COUNSEL BELIEVE THE ALLEGED FORGONE REVENUE

2 THE COMPANY SEEKS TO RECOVER IS A RISK INVESTORS BEAR?

3 A. Yes. OPC believes the alleged forgone revenue the Company seeks to defer
4 and recover is a business risk for which investors are adequately compensated in
5 the form of return on equity, which is significantly higher than the rate earned on
6 a risk-free investment.

7
8 Q. DOES OPC BELIEVE LOST MARGIN REVENUE CAN BE REASONABLY
9 ESTIMATED?

10 A. No. Efforts to estimate the amount of lost revenue are speculative at best and
11 numerous issues arise. One such issue is accurate tracking of and accounting
12 for individual customers for which the Company seeks lost revenue. For
13 example, some customers may have intended to move from the Joplin area and
14 the storm may or may not have hastened that departure. Yet MGE seeks to
15 recover this "lost revenue" even though this is normal customer loss.

16
17 Furthermore, in response to MPSC Data Request No. 008, MGE has stated that
18 normal customer growth should not be considered in the deferral. Yet given
19 Joplin's reasonably close proximity to the borders of Kansas and Oklahoma and
20 its reputation as a commuter commercial hub for that area, customers may seek
21 permanent housing in those locations, but still be treated as "lost revenue" for
22 which the Company seeks recovery.

1
2 Q. CAN MGE ACCURATELY TRACK INDIVIDUAL CUSTOMERS FOR WHICH IT
3 SEEKS LOST REVENUE?

4 A. No. In response to OPC Data Request No. 1107, MGE responded that if a
5 customer re-establishes service within MGE service territory under a different
6 name / social security number, MGE would not be able to offset the "lost
7 revenue" for which it seeks recovery.
8

9 Q. ARE THERE ADDITIONAL PROBLEMS WITH ATTEMPTING TO QUANTIFY
10 THE NUMBER OF CUSTOMERS LOST AND CORRESPONDING ESTIMATED
11 LOSS OF MARGIN REVENUE?

12 A. Yes. On page 10 of Mr. Noack's direct testimony, he explains how he estimated
13 the lost revenue:

14 "The amount of lost fixed cost recovery was determined by estimating the
15 number of fewer customers served in the RS and SGS classes and
16 multiplying that number by the fixed monthly charge, including the ISRS
17 rate element. The number of fewer customers was estimated by
18 comparing the number of active bills in 2011 to number of active bills for
19 the same months of 2010 for MGE's billing Town Codes of 501 – Joplin
20 and 515 – Duquesne. As shown on page 1 of Schedule MRN-3 April 2011
21 was only 169 customers less than 2010 while May (the month of the
22 tornado) had 1,047 fewer customers than in 2010. June through
23 September customer numbers were lower in 2011 by over 3,000
24 customers peaking at 3,227 fewer customers in September 2011."
25

26 However, OPC reviewed meter counts for the Southern Region provided in
27 Company work papers in support of its filing for an increase in rates per Rate

1 Case No. GR-2009-0355. The monthly meter counts were for the years 2005 –
2 2008. Over that time frame, same-month year over year meter count
3 comparisons for the residential class indicated changes ranging from negative
4 461 meters to positive 1,039 meters. For small gas service, the changes ranged
5 from negative 377 to positive 179 meters. Same year inter-month meter count
6 swings were just as volatile. For the residential class inter-month change in
7 counts ranged from negative 1,103 to positive 1,381. For the SGS class, inter-
8 month change in counts ranged from negative 313 to positive 471.

9
10 Given the alleged loss in customers is not static, (i.e., some customers will
11 reconnect to the system during the re-building process) normal customer growth
12 and loss, difficulties in tracking individual customers and the historical volatility in
13 month to month and year over year billed customers, obtaining a reasonable
14 estimate of any loss becomes nearly impossible.
15

16 Q. IS IT POSSIBLE THAT OPERATING REVENUES HAVE INCREASED?

17 A. Yes. Joplin has experienced many visitors to the area to assist with recovery
18 efforts. Gas usage at hotels, motels, extended stay commercial housing units or
19 other commercial establishments may have experienced increases over normal
20 usage trends. Furthermore, revenue may have increased in other regions within
21 MGE's territory.
22

1 Q. IS IT POSSIBLE THAT OPERATING COSTS HAVE DECREASED?

2 A. Yes. Although on page 7 of Mr. Noack's testimony he states that the loss of
3 customers has not resulted in lower costs for MGE, Public Counsel questions
4 that premise. For example, one would expect if they were fewer customers
5 served by MGE that some incremental costs could potentially decline such as:

- 6 • Postage for billing
- 7 • Billing stock expense
- 8 • Overtime for repair and maintenance personnel
- 9 • Overtime or temporary help in the contact centers
- 10 • Expense associated with meter reading

11
12 Q. IS THE COMPANY'S CURRENT ALLEGED LOST MARGIN REVENUE AN
13 EXTRAORDINARY ITEM?

14 A. No. The Company's current estimate of annual lost revenue is \$1,067,420
15 (\$1,131,420 for RS and SGS customers and \$36,000 for Large Volume
16 Transportation customers). As stated previously, the net operating income
17 reflected in the true-up test year for the last rate case, (the last MPSC audit) after
18 the test year rate increase is included, totaled \$47,422,866. Therefore the
19 estimated revenue loss represents approximately 2.25% of MGE's net operating
20 income per the prior rate case after the effects of the rate change are included.
21 The above figure assumes that the revenue loss is static, which it is not as some

1 customers will return to the system over relatively short periods of time. Under
2 FERC definition, the lost revenue alone would not be an extraordinary item.
3

4 Q. DOES THAT RAISE QUESTIONS AS TO WHETHER THE OVERALL EVENT IS
5 IN FACT AN EXTRAORDINARY ITEM?

6 A. Yes. Although as stated previously, OPC will not oppose Staff's
7 recommendation to grant an AAO for the deferral of O&M expenses and capital
8 costs, one does question whether the event is truly an extraordinary item as
9 defined by the FERC.

10
11 On page 2-3 of MGE's Reply to Staff's Recommendation, MGE states the
12 following:

13 "In this *Reply*, MGE wishes to focus the Commission on the key area of
14 disagreement that it has with Staff's analysis, as well as make clear that if
15 the Commission accepts *Staff's Recommendations* as written, granting an
16 AAO which excludes fixed cost recovery provided through MGE's
17 distribution rates will provide little assistance to MGE from the impact of
18 this natural disaster. It is MGE's belief, based on ongoing discussions
19 with insurers, that potential insurance payments may cover facilities
20 replacement costs, lost gas costs, and incident response costs incurred by
21 MGE due to the tornado."
22

23 Thus, if the incremental costs of the tornado are going to be reimbursed, and the
24 estimated margin revenue loss is 2.25% of the last audited year net operating
25 income, the event may not be extraordinary if a 5% threshold is used.
26

1 Q. DOES PUBLIC COUNSEL BELIEVE THAT DENYING MGE'S REQUEST FOR
2 ALLEGED LOSS OF MARGIN REVENUE WILL HAVE AN ADVERSE EFFECT
3 ON THE COMPANY'S ABILITY TO ATTRACT CAPITAL FOR ITS
4 OPERATIONS AT A REASONABLE RATE?

5 A. No. MGE is a division of Southern Union Company ("SUG"). This Commission
6 has consistently found that the appropriate capital structure to use in establishing
7 rates for MGE is that of its parent company, SUG.

8
9 On February 25, 2011 Southern Union Company (SUG) issued its 2011 Financial
10 Outlook which called for adjusted earnings per share between \$1.75 and \$1.95
11 and free cash flow prior to dividends of \$234M - \$289M. Despite the events of
12 May 22, SUG reaffirmed that guidance during its second quarter earnings
13 release on August 9.

14
15 The Company has not needed to announce any reduction in dividends to
16 investors in order to conserve cash to help pay for any of the costs or alleged lost
17 margin revenue. As a matter of fact on June 16, 2011 Energy Transfer Equity
18 and SUG announced that Energy Transfer Equity would acquire Southern Union
19 for \$7.9B (billion).

20
21 A subsequent bidding war ensued, with the most recent price tag per the Second
22 Amended Merger Agreement dated July 19, 2011 valued at \$9.4B. The price
23 represents a potential premium of over 56% compared to SUG's closing stock

1 price on the day prior to the merger announcement. Clearly, the market values
2 SUG's revenue stream and business model despite the business risks involved
3 and regardless of the outcome of this proceeding. This would suggest that the
4 market does not believe SUG (and its underlying MGE division) should have any
5 problem earning sufficient returns or raising sufficient capital to meet the
6 standard of providing safe and reliable service to customers while providing an
7 adequate return for investors.
8

9 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

10 A. Yes.
11