Exhibit No.:	
Issues:	*FAS 106/OPEBs; Bad Debt Expense*
Witness:	*Keith D. Foster*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Surrebuttal Testimony*
Case No:	*GR-2009-0355*
Date Testimony Prepared:	*October 14, 2009*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

KEITH D. FOSTER

MISSOURI GAS ENERGY,
a Division of Southern Union Company

CASE NO. GR-2009-0355

Jefferson City, Missouri
October 2009

** **Denotes Highly Confidential Information** **

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Q. Please state your name and business address.

A. Keith D. Foster, 200 Madison Street, Suite 440, Jefferson City, Missouri 65101.

Q. Are you the same Keith D. Foster who participated in the preparation of the Staff's Cost of Service Report, filed August 21, 2009, and rebuttal testimony, filed September 28, 2009, for this case?

A. Yes.

Q. What is the purpose of your surrebuttal testimony?

A. My surrebuttal testimony addresses the rebuttal testimonies of Missouri Gas Energy, a Division of Southern Union Company (MGE or Company) witnesses John A. Davis and Michael J. Muth regarding FAS 106/OPEBs, and the Office of the Public Counsel (OPC) witness Russell W. Trippensee regarding Bad Debt Expense.

FAS 106/OPEBs

Q. What is MGE's recommended level of rate recovery for FAS 106/OPEBs expense in this case?

A. MGE is recommending $3,544,883 of rate recovery which includes $2,664,792 for the Transition Benefit Obligation (TBO) amortization and $880,091 for FAS 106 ongoing costs. (These amounts, and any others that follow in this section, are total Company numbers; i.e., they include both the capital and expense components of MGE's FAS 106 expense.)

Q. What is the TBO?

A. The TBO amortization is a liability assumed by MGE upon its acquisition of Missouri gas properties from Western Resources, Inc. in 1994. MGE assumed a total liability of $43 million for medical benefits to retirees of Western Resources, Inc. This liability is amortized over a period of approximately 16 years and will be fully amortized in December 2012.

Q. Where did the Company obtain its recommended amount of FAS 106 ongoing cost recovery of $880,091?

A. The Company used the FAS 106 cost recovery amount reflected in a letter from MGE's actuary, Rudd and Wisdom, Inc., dated February 23, 2009, that provides an actuarial valuation of the level of FAS 106 ongoing expense applicable to the year ending December 31, 2008. This Highly Confidential letter and its attached actuarial valuation were provided in response to Staff Data Request No. 0007, and are also attached as Schedule MJM-1 to Mr. Muth's Highly Confidential rebuttal testimony.

Q. Does the Staff disagree with this amount for the ongoing FAS 106 expense component?

A. Yes. The actuary's assumption of the use of the "corridor approach" or "corridor method" advocated by FAS 106 is inconsistent with Staff's prior treatment of the rate allowances for MGE and other Missouri utilities. Please see the Highly Confidential Schedule MJM-1 attached to Mr. Muth's rebuttal testimony, pages 4 and 5, ***Missouri PSC***

Gain/Loss Amortization Method, for Mr. Muth's discussion of the use of the "corridor method."

Q. In his rebuttal testimony, what did MGE witness Davis assert the Company uses as the basis of booking the liability for its FAS 106 obligations?

A. Mr. Davis states the Company uses what he calls "proper amounts" from the actuarial reports prepared by the Company's actuary.

Q. Does Staff believe the Company is using the "proper amounts" from the actuarial reports in establishing its annual FAS 106 liability?

A. No. The amounts booked by MGE for FAS 106 liability are not computed using the accounting method advocated by the Staff (and approved by the Commission) over many years in multiple cases to calculate FAS 106 expense for MGE. Specifically, Staff's standard approach for annualizing FAS 106 Expense is to <u>not</u> use the "corridor approach."

Q. Please explain what the "corridor approach" is and how it relates to the calculation of FAS 106 expense.

A. The "corridor approach" is an option under FAS 106 which, if used, limits the recognition of unrecognized gains and losses to an amount that exceeds 10% of the greater of the plan's projected benefit obligation or the market value of the assets in the plan's fund.

Q. Why do unrecognized gains and losses occur in the context of FAS 106/OPEBs, and why is it important to reflect these gains and losses in the rate process?

A. The primary reason that gains and losses occur in the context of OPEBs is that funds invested in a trust will often earn significantly more or less investment income due to fluctuations in the financial market than previously assumed by the actuary in calculating FAS 106 expense. The Staff believes that FAS 106 gains and losses should be reflected in rates on a normalized basis because the gains and losses directly affect the amount of assets available to pay future OPEBs costs.

Q. Why is it inappropriate to use the "corridor approach" for ratemaking purposes?

A. In a competitive environment, the price of a good or service is limited to a large degree by what a company's competitors are charging for a similar good or service. Using the "corridor approach" in a non-regulated environment will not have a direct impact on the price of a good or service because of the market's control of the price.

However, for a regulated utility that by its nature is monopolistic, using the "corridor approach" directly affects the price of the utility service. A method which totally ignores all or a significant part of the ongoing gains and losses occurring under FAS 106 is not appropriate for valuing OPEBs expense for ratemaking purposes.

Q. If the "corridor approach" is not used, then what is the Staff's approach to reflecting ongoing OPEBs gains and losses in rates?

A. The Staff is recommending that the total unrecognized gains and losses balance be subject to amortization in calculating FAS 106 expense. Differences that occur between actual results and expected results need to be reflected on a timely basis to accurately determine the level of OPEBs costs to be included in the cost of service. Under the "corridor approach" proposed by MGE, a substantial amount, if not all, of the Unrecognized Net Gain/Loss balance is ignored in calculating FAS 106.

Q. Has the Commission ever accepted the Company's position on use of the "corridor approach" to set rates for FAS 106?

A. No. The use of the "corridor approach" in setting rates for pension expense and OPEBs expense was specifically rejected by the Commission in Case Nos. GR-96-285, MGE; and ER-97-394, UtiliCorp United, Inc.

Q. Did MGE's actuary perform a calculation of the accumulated unrecognized net gain/loss balance in the manner prescribed by the Staff?

A. Yes. Starting on page 13 of the actuarial report (Highly Confidential Schedule MJM-1) attached to MGE witness Muth's Highly Confidential rebuttal testimony shows the Unrecognized Net Gain/Loss using the "Missouri PSC Method" alongside the "SFAS 106 Method" used by MGE as the basis for its recovery request in this case. The actuarial report uses this procedural comparison in further calculations to determine the net annual periodic postretirement benefit cost for 2008 using both methods, reflected side-by-side within the actuarial report.

Q. Which OPEBs cost valuation from Mr. Muth's actuarial report did Staff use for this case?

A. The amount listed under "Missouri PSC Method" of ** ________ ** was used as the starting point by the Staff for its FAS 106 recommendation. However, the Staff made an adjustment to this amount to impute additional trust investment income as an offset in the FAS 106 calculation to reflect the contributions MGE should have made to its OPEBs trusts (plus imputed interest) under a full funding policy. Please see the Staff's Cost of Service Report, page 93, for a discussion of the need for this adjustment. This adjustment is different than the "catch up" calculation sponsored by Staff.

Q. What is the Staff's "catch up" calculation?

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A. This is the Staff's calculation of the amount of the prospective contribution MGE should make to its OPEB trust funds in order to make its customers whole for the Company's prior underfunding of ratepayer FAS 106 rate allowances. Please see the Staff's Cost of Service Report, pages 94-95, for a discussion of the need for this "catch up" adjustment.

Q. How did Staff compute the "catch up" contribution?

A. Staff used the "FAS 106 Analysis" spreadsheet provided by MGE in response to Staff Data Request No. 0126 as the basis for calculating the "catch up" adjustment. Starting with January 1997 and ending with May 2009, this spreadsheet provides, for each month, the total amount of MGE's actual funding of FAS 106 and the amount of FAS 106 expense recognized on MGE's financial statements. Staff computed the annual difference between the expensed amounts and the FAS 106 funding and ran a cumulative total to determine if and when the cumulative expensed amount exceeded the funding, which then represented the underfunded FAS 106 obligation. The underfunding began to occur in mid-2003. Therefore, starting with 2003, Staff took the cumulative underfunded amount for each year, added to it the prior year's year-end amount, divided the sum by two (for an average mid-year balance), and computed 7.00% interest which was then added to the new cumulative balance. Interest was calculated to determine the imputed interest for potential earnings that were lost by not having the underfunded amounts invested in an external funding mechanism.

Q. Why did Staff not use the FAS 106 amounts included in MGE's rates to compare to the Company's trust fund contributions for purposes of its catch-up calculation?

A. These amounts are not available.

Q. In Mr. Davis' testimony he states that "it is not at all clear how much the Company has received in rates" to determine the actual FAS 106 amounts included in all prior rate cases. Do you have any comment on this?

A. Yes, I do. MGE's Data Request No. 0319 asked for the Staff's opinion on what annual amounts were included in rates for FAS 106 benefit amounts for each rate case starting with case GR-2001-292. Such amounts are not readily determinable, because the amounts included in rates in prior cases for MGE's OPEBs cost were determined through settlements, and those amounts are not spelled out anywhere in the record of those cases. However, if one were to assume that the amount of OPEBs expense included in rates in the three prior MGE rate cases were equal to the Staff's recommended level of expense, the amount of the "catch up" contribution would be higher under that assumption.

Q. Does Staff recommend revising the "catch up" contribution at this time based on the Staff's prior rate recommendations for MGE's OPEBs expense?

A. No.

Q. Why not?

A. Because of the ways OPEBs issues were resolved in those cases, it may not be accurate to assume that the Staff's recommended level of expense was the amount reflected in MGE's ordered rates. Therefore, the Staff stands by our original computation as presented in the Staff Report – Cost of Service as being based upon verifiable data.

Q. On page 3 of his testimony, Mr. Davis alleges that "in most years, MGE's actual earnings fell short of its Commission-authorized level such that all of its costs, including SFAS costs, were being under-recovered to some degree" and that Staff has ignored this in its catch-up calculation. Do you care to comment?

A. Yes. Any shortfall in earnings by MGE below the level authorized by the Commission is going to be reflected in a lower Return on Equity (ROE) result. If, and only if, a utility's positive ROE is eliminated in entirety will it be possible for the company to fail to recover all of its expenses in rates. To the extent that MGE has earned positive ROEs in prior periods, even if those values were less than its authorized ROE, this means the Company has been fully recovering its expenses in rates, including FAS 106 expenses. Mr. Davis has not claimed, and the Staff is otherwise not aware of, any allegations that MGE's actual earnings were negative in any year since 2003, or even in its entire history of operating in this State.

BAD DEBT EXPENSE

Q. What is OPC's position in this case regarding the appropriate level of bad debt expense to include in the revenue requirement?

A. Based upon the rebuttal testimony of Mr. Trippensee, it appears OPC has increased the five-year average bad debt expense to be included in its revenue requirement recommendation from $9,212,500 as presented on page 9 of his direct testimony to $9,685,323 as presented on page 2 of his rebuttal testimony, an increase of $472,823. Note that these amounts are exclusive of a reduction Mr. Trippensee proposes to make for the Emergency Cold Weather Rule (ECWR) Accounting Authority Order (AAO) amortization.

Q. Why did the amount of OPC's five-year bad debt expense increase?

A. Mr. Trippensee reports on page 8 of his rebuttal testimony that OPC had requested and then analyzed additional bad debt write-offs from MGE through July 31, 2009. This is three months worth of additional write-offs over and above what Staff reviewed in its audit of MGE and reflected in its proposed normalization of bad debts based on a three-year average ending April 30, 2009.

Q. Has Staff similarly updated its proposed adjustment for bad debts as OPC has done?

A. No. Bad debt expense is included as a true-up item in this case, and the Staff will revisit its proposed bad debt adjustment during the true-up audit.

Q. Mr. Trippensee's testimony also addresses reducing MGE's adjusted level of bad debt expense determined in this case by the amount of the Emergency Cold Weather Rule (ECWR) bad debt deferral amortization recorded by MGE in the test year. Please comment.

A. The ECWR AAO is an amortization of bad debt expense incurred in the past, specifically related to the ECWR in effect from January 1 to March 31, 2006, and neither the Staff nor the Company has included this amortization in their revenue requirement recommendations. The Staff is not persuaded at this point that there has been any "double-counting" of the ECWR amortization and MGE's booked write-offs in the three-year period used to develop the Staff's bad debt normalization. Therefore, the Staff still believes its recommended level of bad debts in this case is an appropriate ongoing level to be included in MGE's rates.

Q. Does this conclude your surrebuttal testimony in this case?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy and Its Tariff Filing to Implement a General Rate Increase for Natural Gas Service	))))	Case No. GR-2009-0355

AFFIDAVIT OF KEITH D. FOSTER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Keith D. Foster, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 9 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Keith D. Foster

Subscribed and sworn to before me this 14th day of October, 2009.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 08, 2012
Commission Number: 08412071

Notary Public