Exhibit No:	
Issues:	*Revenues, ECWR AAO, Bad Debt Expense, Pension Expense, Prepaid Pension, OPEBs, Income Taxes*
Witness:	*Paul R. Harrison*
Sponsoring Party:	*MOPSC Staff*
Type of Exhibit:	*Direct Testimony*
Case No.:	*GR-2006-0422*
Date Testimony Prepared:	*October 13, 2006*

MISSOURI PUBLIC SERVICE COMMISSION
UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

PAUL R. HARRISON

MISSOURI GAS ENERGY
CASE NO. GR-2006-0422

Jefferson City, Missouri
October 2006

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-2006-0422

AFFIDAVIT OF PAUL R. HARRISON

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Paul R. Harrison, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 30 pages to be presented in the above case; that the answers in the foregoing Direct 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.

Paul R. Harrison

Paul R. Harrison

Subscribed and sworn to before me this 5th day of October 2006

Ashley M. Harrison

NOTARY PUBLIC STATE OF MISSOURI NOTARY SEAL

ASHLEY M. HARRISON
My Commission Expires
August 31, 2010
Cole County
Commission #06898978

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PAUL R. HARRISON

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DIRECT TESTIMONY

OF

PAUL R. HARRISON

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

Q. Please state your name and business address.

A. Paul R. Harrison, P. O. Box 360, Jefferson City, Missouri 65102.

Q. By whom are you employed and in what capacity?

A. I am a Utility Regulatory Auditor for the Missouri Public Service Commission (PSC or Commission).

<u>BACKGROUND OF WITNESS</u>

Q. Please describe your educational background.

A. I graduated from Park College, Kansas City, Missouri, where I earned a Bachelor of Science degree in Accounting and Management in July of 1995. I also earned an Associate degree in Missile Maintenance Technology from the Community College of the Air Force in June 1990. In addition, I graduated from the Non-Commission Officer (NCO) Leadership School in July 1977, the NCO Academy in March 1983 and the Senior NCO Academy in February 1992. These professional military education schools trained and prepared Non-Commissioned Officers for increased levels of responsibility as Supervisors and Managers in the United State Air Force (USAF).

Q. Please describe your work background prior to working at the Commission.

A. Prior to coming to work at the Commission, I was the manager for Tool Warehouse Inc. for four and one-half years. As the manager, I supervised eight sales representatives and managed merchandise and inventory in excess of $1.5 million.

Prior to that, I was in the USAF for 23 years. During my career in the USAF, I was assigned to many different duty positions with varying levels of responsibility. I retired from active duty on May 1, 1994, as Superintendent of the 321st Strategic Missile Wing (SMW) Missile Mechanical Flight. In that capacity, I supervised 95 missile maintenance technicians and managed assets valued in excess of $50 million.

Q. Please describe your duties while employed by the PSC.

A. My duties at the Commission include performing audits of the books and records of regulated public utilities under the jurisdiction of the PSC, in conjunction with other Commission Staff (Staff) members. Acting in that capacity, I am also required to prepare testimony and serve as a Staff expert witness on cases involving the accounting issues that I am assigned.

Q. Have you previously filed testimony before this Commission?

A. Yes. Schedule 1, attached to this testimony, lists the cases in which I filed testimony, the issues that I have worked and the small informal cases that I have completed.

PURPOSE OF TESTIMONY

Q. Did you make an examination and analysis of the books and records of Missouri Gas Energy (MGE or Company) in regard to matters raised in this case?

A. Yes, in conjunction with other members of the Staff. I specifically examined information provided by the Company in response to Staff data requests, portions of the Company's general ledger, other Company financial and statistical reports, as well as workpapers supplied by MGE to support its case filing. I also examined Company's Annual Reports and other information contained on the Company's website.

Q. What is the purpose of your direct testimony?

A. The purpose of my testimony is to sponsor and discuss the following Income Statement adjustments, which appear on Accounting Schedule 10, Adjustments to Income Statement. I am also sponsoring the Income Tax adjustments, which are supported on Accounting Schedule 11, Income Tax:

Residential Growth:	S-1.1
SGS and LGS Growth:	S-2.1 and S-3.1
Weather Normalization	S-1.2, S-2.2, S-3.2
Gross Receipt Taxes	S-1.3, S-2.3, S-3.3, S-7.1 S-9.1 and S-9.4
Unbilled Revenues:	S-1.4,
PGA Revenues:	S-1.5, S-2.5 and S-3.5
ACA Costs	S-1.6, S-2.6 and S-3.6
TOP Costs	S-1.7
Remove refund/PEPL Deferral	S-1.8, S-2.9 and S-3.8
W/O unpostable cash report	S-1.9
Remove Company Use Gas	S-2.8
Remove daily balancing not in CSS	S-3.4
Remove credit adj. not in CSS	S-9.2
Remove ISRS revenue not in rates	S-9.3
Contract Demand	S-2.7 and S-3.7

Remove Purchase	S-10.1
Rate Code 48 Gas Costs	S-2.4
ECWR AAO	S-36.1
Bad Debt Expenses:	S-36.2
Pension Expense	S-52.9 and S-52.12
FAS 106 Expense	S-52.10 and S-52.11
Rents	S-55.1
Mo. Franchise Taxes	S-63.1
Income Taxes	S-65.1
Kansas City Tax	S-67.1
Gross Receipts Expense	S-62.1

Q. What knowledge, skill, experience, training or education do you have in these matters?

A. I have performed duties as a Utility Regulatory Auditor within the Auditing Department at the Commission since January 18, 2000. In addition to acquiring general knowledge of these topics through my education, I've acquired experience in prior rate cases before the Commission as well as through formal and informal training.

Q. Please describe the formal training for your position that you have received.

A. I attended the National Association Regulatory Utilities Commissioner's (NARUC) Water Rate School in San Diego, California in May of 2000. I also attended NARUC's "On The Missouri" 2003 seminar conducted in Jefferson City, Missouri in January 2003.

Q. Please describe the informal training for your position that you have received.

A. I have successfully completed each of my assigned issues, as listed in Schedule 1, and have had the opportunity to interact with other auditors concerning these and other issues that involved the Auditing Department of the Commission.

I have attended in-house training classes, reviewed Auditing Department position papers, training manuals and technical manuals pertaining to the accounting issues in this and other cases.

I have reviewed the Commission's Report and Orders, testimony and transcripts of cases filed by this and other utilities within the jurisdiction of this Commission.

EXECUTIVE SUMMARY

Q. Please summarize your direct testimony in this proceeding.

A. The Company’s test year revenues, like its expenses, must be annualized and normalized in order to develop a cost of service that is representative of the Company’s ongoing operations. I am sponsoring the Staff’s adjustments related to additional revenues from customer growth through June 30, 2006.

The Staff is recommending a normalized level of bad debt expense based upon a five year average of the Company’s actual bad debt write-offs for this case.

The Staff is proposing to include in rates for this case an amortization of costs incurred by the Company relating to the Commission approved Emergency Amendment to the Cold Weather Rule, (ECWR) 4 CSR 240-13.055.

The Staff is recommending that the ERISA minimum method agreed upon in the last case (GR-2004-0209) continue to be used in this case to determine MGE’s pension expense, along with the “tracker” mechanism also agreed to in MGE’s last rate proceeding.

The Staff's OPEBs expense amount is based on the use of the market-related value of assets and a five-year amortization of the five-year average balance of unrecognized Financial Accounting Standard No. 106 gains and losses.

The Staff's calculation of current and deferred income taxes is based on the Company's adjusted operating results for its gas operations. I calculated the Staff's level of current and deferred income taxes, as well as the amount of Alternative Minimum Tax Credit that is included in this case.

REVENUES

Q. Please give a general description of MGE's service territory in the state of Missouri.

A. MGE's service territory covers much of the western side of Missouri. The Company's customers are segregated into three different regions, Joplin (including Monett), St. Joseph and Kansas City (including Kansas City North, Independence, Lee's Summit, and Warrensburg territories). Each region serves four classes of customers: residential, general service (small and large), large volume and transportation customers.

Q. What type of customer is in the Small General Service (SGS) and Large General Service (LGS) rate classifications?

A. Each rate class includes both commercial and industrial customers. The distinction between SGS and LGS is in the volumes used by the customer, not how the gas is used.

Q. Do MGE's current tariffs specify commercial and industrial customer classes?

A. No. Unless a commercial or industrial customer qualifies for the Large Volume Service rate schedule, MGE's current tariff requires these customers to be classified under either SGS or LGS rate schedule. However, for purposes of recording income statement entries by account in the Staff's Exhibit Manipulation System, SGS and LGS rate class revenues are characterized as either commercial or industrial customer revenues.

Q. What is the basis for pricing the Staff's revenue adjustments?

A. All revenue adjustments in the Staff's cost of service were priced on the margin (the total rate excluding Purchased Gas Adjustment (PGA) gas cost rate) included in the Company's tariffs.

Q. Please provide a general discussion of the Staff's annualization of revenues, including the Staff witnesses who performed the various revenue analyses.

A. The Company's test year revenues, like its expenses, must be annualized and normalized in order to develop a cost of service that is representative of the Company's ongoing operations. In the area of revenues, the following Staff members have performed certain analyses or annualizations:

Staff Member	Area of Analysis or Adjustment
Curt Wells	Thirty-year weather normalization
James A. Gray	Normalized usage per customer through regression analysis
Henry E. Warren	Allocation of SGS normal volumes to rate blocks through regression analysis
Anne E. Ross	Transportation, flex rate, large volume service customer annualizations
Thomas M. Imhoff	Miscellaneous revenues
Paul R. Harrison	Residential, SGS and LGS customer growth annualizations and revenue adjustments

The majority of the Company's revenues are affected by weather. Staff Witness Curt Wells of the Energy Department, Economic Analysis Section, has developed normalized weather based on a 30-year analysis. Mr. Well's normalized weather calculations were then given to Staff witness James A. Gray of the Energy Department, Tariff/Rate Design Section. Mr. Gray used Mr. Well's 30-year normalized weather calculations to develop normal gas usage per hundred cubic feet (Ccf) by customer class and also by month for the Staff's test year.

Q. Please describe and discuss the types of adjustments the Staff developed to determine annualized revenues.

A. In general, the Staff's annualized revenues reflect the effects of the following conditions:

1. Normalized weather
2. Customers switching customer classes (rate switching)
3. Customer load changes
4. Customer growth or loss

Staff Witness Anne E. Ross of the Energy Department, Economic Analysis Section analyzed the transportation, flex rate and large volume service customer classes by individual customer. Through her analysis, Ms. Ross can determine if customers have switched rate classes, came onto the system as a new customer or reduced demand on the system by a significant amount. If any of the three circumstances occurred during the test year, Ms. Ross developed an adjustment in Ccfs from the Company's records.

I am sponsoring the application of the adjustments that were developed by Mr. Gray to determine normalized gas usage by customer class. Mr. Gray will sponsor the methodology supporting the adjustments and I will sponsor the development of the revenue adjustments and their relationship to the Staff's cost of service calculation. Please refer to Mr. Gray's testimony for a more detailed discussion of these areas.

I have also developed the revenue adjustments to reflect customer growth. The test year used by the Company and the Staff in this proceeding was the twelve months ending December 31, 2005, with an update period through June 30, 2006. The Staff used the customer numbers as of June 30, 2006,` to annualize revenues for residential, SGS and LGS rate class. I have calculated the customer growth adjustments to reflect the increases in customers through June 30, 2006. These adjustments were again based on normal gas usage per customer as developed by Mr. Gray. A more complete discussion of the Staff's customer growth adjustments is included later in this direct testimony.

Q. Why is it appropriate to adjust revenues for normalized weather?

A. Because a principal use of natural gas is for space heating, temperature levels experienced during any 12-month period could have a significant impact on the Company's revenues. If the overall temperature were very cold during the period, the Company's revenue would be overstated in relation to normal weather. Conversely, if the overall temperature were very warm during the period, the Company's revenues would be understated in relation to normal weather. Therefore, the Staff uses normalized revenues for weather to eliminate the effects of above and/or below-normal temperature during the test year.

Q. What methodology did the Staff use to normalize weather?

A. Staff witness Wells performed the weather normalization computations. Because the Company's service territory covers much of the western side of Missouri, the

Company's customers were segregated into two weather regions (Kansas City and Springfield).

Q. Please describe the Staff's adjustments relating to weather normalization.

A. Staff witness Gray developed the monthly weather normalized Ccf sales per customer for the customer classes during the Staff's test year. Generally, these classes consist of residential, small and large general service-heating customers. The weather normalized Ccf sales per customer were developed for each of the three regions for each customer class. In addition, Staff witness Henry E. Warren used the same time period to develop the breakdown of usage between the various rate blocks for the general service customer class.

Mr. Gray adjusted the actual monthly sales from the test year to reflect normalized weather. The totals were then priced on the margin to develop the Staff's weather normalization adjustments.

Q. Please explain what adjustments were made to the test year ending December 31, 2005 per book revenues.

A. The Staff made several adjustments to the Company's per book revenues. Adjustments S-1.3, S-2.3, S-3.3, S-7.1 and S-9.1 remove the test year gross receipt taxes from the operating revenues. Gross receipt taxes are not operating revenues for the Company. The Company acts merely as a collecting agent and remits the taxes to the appropriate taxing entities. The Staff also made adjustment S-62.1 to remove gross receipt taxes from the Taxes Other Than Income Taxes line item of the expense portion of the income statement. Gross receipt taxes are reported as both a revenue and expense item on the Company's books. Therefore, both revenue and expense adjustments are necessary to eliminate this item.

Staff adjustment S-1.4 eliminates unbilled revenues from the test year. The unbilled revenue adjustment is made to reflect the Company's revenues on a billed basis for the test year. In the Staff's test year, there are gas sales to customers relating to either usage periods outside the test year, or gas usage that has not yet been recognized on the bills; this can occur at both the beginning and end of the test year. To recognize this usage, utilities generally book an unbilled adjustment to revenues. The purpose of the adjustment is to reflect an estimate of what the actual revenues are for that month. For purposes of a rate case, the adjustment for unbilled revenues must be eliminated from the Company's books in order to reflect revenues during the test year on a billed basis.

Q. Please explain adjustments S-1.1, S-2.1 and S-3.1 and how the Staff annualized gas-operating revenues for the residential, SGS and LGS class customers.

A. Adjustment S-1.1 applies to the annualization of residential customer revenues, which contains two components, the base charge and the commodity charge. The base charge is the minimum monthly charge that MGE assesses to a customer for supplying the gas service. The monthly base charge revenue is calculated by multiplying the base charge by the Staff's monthly level of customers. The Staff's annualized base charge revenue is the sum of the twelve monthly base charge revenues. The commodity charge is the rate MGE charges a customer for each Ccf of gas usage. Residential and LGS customers have only one commodity charge rate block, while SGS customers have two commodity charge rate blocks. For SGS customers, block one represents usage of 0 through 600 Ccf and block two represents usage over 600 Ccf by month. Please refer to the testimony of Staff Witness Warren for a discussion of this area and the assignment of Ccf usage between blocks.

To annualize the residential commodity charge revenues, the monthly level of annualized customers were multiplied by the Staff's normal usage per customer based on normal weather, to derive monthly usages. Please refer to Staff Witness Gray's direct testimony for the development of normal usage per customer based on normal weather. The residential normal monthly usages were then multiplied by the commodity charge to determine the monthly commodity charge revenues. For SGS customers, the Staff allocated the normal monthly usages to each of the Company's rate blocks and then multiplied the blocked usage by the appropriate block commodity charge. The sum of each rate block for each of the twelve months was the Staff's annualized commodity revenue. The total annualized revenue for the SGS and LGS rate class was calculated by adding the annualized base charge revenues to the annualized commodity charge revenue adjustments S-2.1 and S-3.1.

Q. Why is it necessary to distribute the customers through a 12-month period for the purpose of annualizing gas revenues?

A. Generally, customer levels are higher in the winter months and decrease during the summer months. Likewise, normal usage per customer is greater in the winter months than in the summer months. Distributing customers through the 12-month period enables the Staff to more accurately annualize revenues to reflect seasonal impact on usage.

Q. Did the Staff use this methodology for growth annualization in all three regions of the Company?

A. Yes, the Staff used the same methodology. Overall, the Company has been experiencing steady growth in customers up through the test year, except for the St. Joseph district. The number of customers at any given point in time, except for the ending months of 2001 and 2003, has been higher than the same period in the preceding year since 1997.

Q. Please explain how the Staff annualized SGS and LGS revenues.

A. Small and large general service customers have two commodity charges covering different periods (November through March and April through October) of the year. In addition, small general service customers have two usage rate blocks as discussed earlier in my testimony.

To annualize the commodity charge revenues, the monthly level of customers by customer class was multiplied by the Staff's normal usage per customer, based on normal weather. The large general service normal monthly usages were then multiplied by the seasonal commodity charge to determine the monthly commodity charge revenues. For small general service customers, the Staff allocated normal monthly usages to the Company's rate blocks.

Q. Please describe the phenomenon of customers switching customer classes or rate switching.

A. Customers switching customer classes, or rate switching, can occur for several reasons. The nature of a customer's operations may have changed and another customer class is now more appropriate. The customer may find it to be economical to switch to another customer class. Finally, the customer may decide to procure its own gas, which would also make a rate switch necessary. Please refer to Staff witness Ross for further discussion of this area.

PURCHASED GAS ADJUSTMENTS

Q. Please explain what adjustments were made to test year ending December 31, 2005 per book revenues for purchased gas.

A. Adjustments S-1.5, S-2.5 and S-3.5 are line item adjustments to adjust revenues to reflect MGE's test year per book expense for gas purchases. Gas purchase expenses are estimated and assessed to ratepayers through MGE's PGA Clause. The PGA Clause provides MGE an estimating methodology for recovering purchased gas expense, which is subsequently trued-up through the Actual Cost Adjustment (ACA) mechanism. Therefore, purchased gas expense and revenues generally are netted to equal zero for purposes of rate cases. Adjustments S-1.5 and S-2.5 and S-3.5 eliminate PGA revenues for the test year from the appropriate revenue accounts, and adjustment S-10.1 eliminates the purchased gas expense portion from the books.

Q. Please explain adjustments S-1.7.

A. Adjustments S-1.7 remove the take-or-pay portion of the PGA revenues.

Q. Please explain adjustments S-1.6, S-2.6 and S-3.6.

A. Adjustments S-1.6, S-2.6 and S-3.6 adjust the PGA revenue for the ACA true-up mechanism.

Q. Please explain adjustments S-1.8, S-2.9 and S-3.8.

A. Adjustment S-1.8, S-2.9 and S-3.8 remove the refund/Panhandle Eastern Pipeline Company deferral from the cost of service to derive the appropriate actual test year margin results.

Q. Please explain adjustments S-2.7 and S-3.7.

A. Adjustments S-2.7 and S-3.7 remove contract demand credits from commercial and industrial revenues to derive the appropriate test year margin results.

Q. Please explain adjustment S-2.4.

A. Adjustment S-2.4 adds the Succession Rate Code 48 costs (the "Company use" gas costs) to commercial small general service gas sales.

Q. Please explain adjustment S-1.9.

A. Adjustment S-1.9 removes the W/O unpostable cash report entry from the cost of service to derive the appropriate actual test year margin results.

Q. Please explain adjustment S-2.8.

A. Adjustment S-2.8 removes the gas used by the Company from the cost of service to derive the appropriate actual test year margin results.

Q. Please explain adjustment S-9.3.

A. Adjustment S-9.3 removes the Infrastructure System Replacement Surcharge revenue not in included in base rates from the cost of service to derive the appropriate actual test year margin results.

Q. Please explain adjustment S-3.4.

A. Adjustment S-3.4 removes the daily balancing not in MGE's Customer Service Software (CSS) from the cost of service to derive the appropriate actual test year margin results.

Q. Please explain adjustment S-9.2.

A. Adjustment S-9.2 removes the credit adjustment not in CSS from the cost of service to derive the appropriate actual test year margin results.

ECWR ACCOUNTING AUTHORITY ORDER

Q. Please provide the history of MGE's Emergency Cold Weather Rule (ECWR) Accounting Authority Order (AAO) pertaining to ECWR costs in this case.

A. On December 13, 2005, in Case No. GX-2006-0181, the Commission approved an Emergency Amendment to the Cold Weather Rule, 4 CSR 240-13.055. The amendment contained special provisions only applicable to providers of natural gas services to residential customers. The rule was effective from January 1, 2006 through March 31, 2006.

Q. Please explain the ECWR amendment for the Cold Weather Rule.

A. This amendment provided additional repayment plans for residential users of natural gas for heating purposes which allowed numerous customers that were unable to pay eighty (80) percent of preexisting bills, under the previous Cold Weather Rule, to be reconnected to receive gas service.

This amendment stated that from January 1, 2006, through March 31, 2006, a gas utility shall restore service upon initial payment of fifty (50) percent or $500 whichever is lesser, of the preexisting arrears, with the deferred balance to be paid at a later date. Between January 1, 2006, and April 1, 2006, any customer threatened with disconnection could retain service by entering into a payment plan as described in the ECWR.

Q. Did MGE apply for an AAO to recover the costs associated with the ECWR?

A. Yes. On August 7, 2006, Missouri Gas Energy (MGE) filed its Motion for an AAO in this rate case docket concerning the Emergency Cold Weather Rule. On September 21, 2006, the Commission issued an Order Granting Motion for MGE's AAO. In the Order, the Commission stated that MGE is authorized to maintain on its books a regulatory asset representing the costs of complying with the 2005 Cold Weather Rule (4 CSR 240-13.055(14)) as such costs are defined in the rule. The Commission further ordered that the parties will advise the Commission on this issue in testimony and briefing.

Q. Please describe MGE's ECWR costs.

A. Per the response to Staff Data Request No. 52.8, the Company identified an amount of $901,331 incurred from January to March 2006 that it believes was associated with the ECWR amendment. In its response, the Company identified 11,554 customers that took advantage of the ECWR and were reconnected to receive gas service. Of the 11,554 customers that were reconnected, 2,976 of them have subsequently either been disconnected or scheduled to be disconnected. The $901,331 represents the difference between the amount that the Company could have collected from these customers under the old cold weather rule and the amount that they actually collected under the ECWR.

The customers that were either disconnected or scheduled to be disconnected are either accounts that were connected under terms of the ECWR and were subsequently disconnected and written off or customers who have broken ECWR pay agreements, have been issued final bills and are scheduled for disconnection.

Q. What rate treatment is the Staff proposing for the ECWR AAO that was approved by the Commission?

A. Based on the Staff's review of the Commission's Report and Order Case No. GX-2006-0181, the Company's workpapers and responses to data requests concerning this matter in this proceeding, the Staff has verified that the costs MGE is seeking recovery of related to the ECWR are accurately quantified and were incremental to the issuance by the Commission of the ECWR. The Staff has proposed adjustment S-36.1 to amortize these costs over a three-year period.

BAD DEBT EXPENSE

Q. Please explain adjustment S-36.2.

A. Adjustment S-36.2 reflects the Staff's recommended normalized level of bad debt expense to be included in this case.

Q. What adjustments did the Staff perform in its analysis of the Company's actual bad debt write-offs for the test year?

A. The Staff adjusted the test year per book balance in the bad debt expense account to reflect the average of the Company's actual bad debt write-offs for the last five years ending June 30, 2006.

Q. Why does the Staff propose a five-year normalization adjustment for bad debt expense in this case?

A. MGE's level of bad debt write-offs over the last five years has been very volatile. This suggests that the balance for this expense in any twelve-month period may not be a reasonable representation of an ongoing level of expense for this item. Based on the Staff's analysis, the Staff believes that use of the five-year average level of actual bad debt write-offs is appropriate in this proceeding.

Staff Witness Anne M. Allee of the Procurement and Analysis Department will address the Company's proposal to reflect a portion of its bad debt expense through the PGA mechanism in her direct testimony.

PENSION EXPENSE

Q. What level of pension expense is the Staff proposing in this case?

A. The Staff is proposing that MGE continue the method that was agreed to in the "*Corrected* Partial Non-unanimous Stipulation and Agreement as to Alternative Minimum Tax, Depreciation, Accounting for Net Cost of Removal, Accounting for Pension Expenses, Revenues, Bad Debts and May 1, 2004 Union Wage Increase Issues" (2004 Stipulation) from

MGE's last rate case (Case No. GR-2004-0209). In that case, the Staff proposed to change the method of calculating pension expense from the Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions* (FAS 87) method which, for several years in the past had resulted in a significant pension credit (negative expense), to a minimum funding method designed to ensure the pension fund is adequate to meet current and future pension obligations. This method is referred to as the Employee Retirement Income Security Act of 1974 minimum (ERISA minimum) method. The provisions of Title I of ERISA, which are administered by the U.S. Department of Labor, were enacted to address public concern that funds of private pension plans were being mismanaged and abused. ERISA was the culmination of a long line of legislation concerned with the labor and tax aspects of employee benefit plans.

Q. Please explain the provisions of the Stipulation and Agreement in MGE's last rate case that pertained to treatment of pension expense.

A. In the 2004 Stipulation, the parties agreed to the following provisions regarding the accounting treatment for pension expense:

> MGE's rates include a $0 annual provision for jurisdictional pension costs. The Company is authorized to reflect pension cost equal to ERISA minimum and record the difference between the ERISA minimum and the annual provision for pension cost as a regulatory asset or liability. This regulatory asset and/or liability is intended to track the difference between the provision for the ERISA minimum contribution included in cost of service in this case, and the Company's actual ERISA minimum made after the effective date of rates established in this case. This regulatory asset and /or liability will be included in rate base in the Company's next rate case and amortized over a five (5) year period. The Company is authorized to make such additional entries as are appropriate under FAS 71 to reflect that rates in this case are not based upon FAS 87 pension expense calculation. The Company is authorized to adjust its calculation of the MGE ERISA minimum, and the allocations to MGE pension-related assets and costs,

to reflect the exclusion of Southern Union Company's total company actual contributions that are in excess of the ERISA minimum.

Q. How are ERISA minimum contributions used to determine an annual level of pension cost for ratemaking purposes?

A. The Staff performs an analysis of the actual fund contributions required under ERISA regulations. If the annual contributions have been relatively stable in regard to the amount of the contribution required, then use of the most recent contribution may be appropriate for setting the annual level of pension cost to be included in cost of service. However, if there has been significant annual volatility (fluctuations) in the level of contributions from year to year in the annual fund contributions, then use of a multi-year average may be appropriate for determining a normalized level of pension expense for ratemaking purposes.

Q. What level of pension expense is the Staff recommending for MGE's pension expense in this proceeding?

A. The Staff is recommending that the ERISA minimum amount of $8,198,546 be included in rates in this case, along with the "tracker mechanism" established in the last MGE rate case proceeding. The Staff used the $25,127,127 projected cash contributions for calendar years 2006-2008 that are reflected in a letter from MGE's actuary, Rudd and Wisdom. The Staff is recommending a normalized level of $7,059,236 based upon a three year average of the $25.1 million total contribution amount referenced above. Added to this amount is the annual amortization amount associated with the prepaid pension asset of $1,139,310 that was included in rates in MGE's previous case, Case No. GR-2004-0209. The total pension cost to be included in this case is $8,198,546.

Q. What is a "tracker" mechanism?

A. For ratemaking purposes, a tracker mechanism is an ongoing comparison of the amount of an expense actually incurred by a utility to the amount of the same expense reflected in the utility's rates. In MGE's last rate proceeding, the 2004 Stipulation provided that the difference between the amount of MGE's actual pension expenses and the amount of pension expense included in its rates (both measured on a minimum ERISA basis) would be booked as a regulatory asset/liability, and amortized to expense in MGE's next rate proceeding.

While tracker mechanisms are generally not appropriate for use in setting rates, trackers for pension expenses are an exception because of the significant possible cash flow implications to utilities if their minimum ERISA pension funding requirements are materially different from their pension expense recovery levels in rates.

Q. Why does the Staff's pension expense recommendation in this case take into account projected pension funding levels for the years 2007-2008?

A. The Staff normally does not advocate use of projected revenue, expense and rate base amounts to set rates, because such projections are not known and measurable. However, in this case, the Staff recommends that such projections be used to set the level of pension expense in this proceeding as MGE's actuarial estimates indicate that there will be a large and significant increase in the amount of the Company's minimum ERISA pension contributions in 2007-2008 above the funding requirements in the test year, update period and true-up periods for this case. This recommendation, however, is explicitly contingent upon continued use of a tracker mechanism for MGE's pension expenses as a result of this case. Continued use of a pension tracker mechanism will serve to protect customers by ensuring they will receive credit in future rate cases for any excessive amounts of pension expense included in rates in this case, in the event MGE's current estimates of future minimum ERISA pension contributions for 2007-2008 turn out to be overstated.

Q. If a pensions tracker mechanism does not result from this case, what would be the Staff's alternative recommendation for pension expense in this proceeding?

A. In that event, the Staff would recommend that MGE receive $4,016,500 of pension expense rate recovery in this case, based upon the total level of its minimum ERISA contributions for the test year, update period and true-up period in this case.

PREPAID PENSION ASSET

Q. Please explain the prepaid pension asset calculated under FAS 87.

A. FAS 87 provides the Generally Accepted Accounting Principles (GAAP) method used for recognizing the annual pension cost liability for financial reporting purposes for business entities. The previously-discussed ERISA regulations address funding requirements for the same pension plan liability. Annual differences between FAS 87 expense amounts and minimum ERISA funding requirements occur because the actuarial methods used assign cost differently over the service lives of employees. Annual differences between pension cost under FAS 87 for financial reporting and cash contributions to the fund are accounted for as either a prepaid pension asset (cash contribution exceeds FAS 87 accrual) or an accrued liability (FAS 87 accrual exceeds cash contribution).

Q. Please explain the regulatory implications of the prepaid pension asset.

A. With regard to major utility companies in Missouri, the existence of prepaid pension assets has resulted primarily from negative pension expense amounts under FAS 87 previously used to set rates in this jurisdiction, compared to zero minimum ERISA contribution levels experienced by utilities in the 1990s and early years of this decade. As discussed previously, a negative pension expense reduced cash flow to the utility. The excess of fund assets over the pension liability in prior years could not be withdrawn and used to offset the negative cash flow that resulted from reflecting a negative pension cost under FAS 87 in setting rates. The prepaid pension asset, in effect, represents a cash flow benefit (reduction in rates), which, in theory, should reverse over the service life of the employees used to accrue pension cost. In other words, there should not be any permanent difference between the recognition of the pension liability for financial reporting over the service life of employees and the funding of the same liability over the long term.

Q. How has the prepaid pension asset been treated in rates since the 2004 Stipulation changed the method used to determine MGE's pension expense for ratemaking purposes from FAS 87 to the minimum ERISA approach?

A. MGE's prepaid pension asset is in effect the opposite of the accumulated deferred income tax reserve. Deferred income taxes represent income tax paid through rates that exceed the Company's current income tax liability. The deferred taxes represent a cash flow benefit to the utility and are returned to customers over the life of the assets generating the accelerated tax deductions used in calculating current income tax. The prepaid pension asset represents the accumulated reduction in rates that has occurred as a result of reflecting negative pension cost in rates under FAS 87 for MGE from the mid-1990s to 2004. As long as FAS 87 ratemaking for pensions was maintained for MGE, the prepaid pension asset was considered to be a temporary timing difference that would reverse over time. With a change in pension cost determination to the minimum ERISA funding requirement in MGE's 2004 rate proceeding, the only mechanism to reverse the prepaid pension asset was to amortize the balance over a reasonable period of time. The Staff believes the appropriate time frame for amortizing MGE's prepaid pension asset is the number of years that FAS 87 was in effect for ratemaking purposes.

MGE adopted FAS 87 for ratemaking purposes in Case No. GR-96-285. The rates for that case went into effect in February 1997. Therefore, the accumulation period for the prepaid pension asset was from February 1997 through December 31, 2003, (the ending point of the update period in Case No. GR-2004-0209), or a period of seven years.

Q. Please explain adjustment S-52.11.

A. This adjustment amortizes MGE's prepaid pension asset established in the last case as discussed above. This adjustment also incorporates a five-year amortization to expense of the amount of minimum ERISA pension contribution that exceeded the level of minimum ERISA pension expense included in rates in MGE's last rate case, per the operation of the pensions expense tracker mechanism agreed to in the 2004 Stipulation..

OPEBS - FAS 106

Q. Please explain adjustments S-52.10 and 52.11.

A. This adjustment annualizes OPEB expense calculated under Financial Accounting Standard No. 106 *Employers' Accounting for Postretirement Benefits Other than Pensions* (FAS 106) for MGE's employees. OPEB expense reflects MGE's current liability to provide retiree medical payments to its current employees as well as its retired employees.

Q. How did the Staff determine the level of OPEB expense to include in this case?

A. The Staff used the FAS 106 costs as reflected in a letter from MGE's actuary, Rudd and Wisdom, dated December 31, 2005. This letter provides the level of FAS 106 OPEB expense booked by the Company for the test year ended December 31, 2005.

In addition, the Staff made no adjustment to MGE's $2.6 million amortization on its books of the Transition Benefit Obligation (TBO amortization). This obligation or liability was assumed by MGE upon its acquisition of its Missouri gas properties from Western Resources, Inc. in 1994. This liability of $43 million dollars reflects MGE's liability for medical payments to retirees of the former owner of MGE's gas distribution properties, Western Resources, Inc. This liability is being amortized over a period of approximately 16 years and will be fully amortized in December 2012.

Q. Does this FAS 106 expense level reflect the five-year rolling average amortization of gains and losses agreed to by the Staff and MGE in MGE's last rate case, Case No. GR-2004-0209?

A. Yes, it does.

RENTS

Q. Please describe adjustment S-55.1

A. Adjustment S-55.1 offsets the MGE Broadway parking lot lease expense for rent received from Broadway Ford.

MISSOURI FRANCHISE TAXES

Q. Please describe adjustment S-.63.1

A. The adjustment to annualize state franchise tax payments was included in MGE's accounting schedules filed in this proceeding as adjustment H-16, State Franchise Tax. The Staff adjusted the test year amount of state franchise tax expense to the actual amount paid by MGE to the state in the test year.

INCOME TAXES

Q. Please explain adjustment S-65.1.

A. Adjustment S-65.1 adjusts current income tax expense from the level included in the Company's books and records to the annualized amount calculated on Accounting Schedule 11, Income Tax.

Q. Please describe Accounting Schedule 11, Income Tax.

A. Accounting Schedule 11 reflects the Staff's calculation of current income taxes based on the Company's adjusted operating results for its gas operations.

Q. Please describe how the current income tax component of the total income tax expense is calculated on Accounting Schedule 11, Income Tax.

A. The Current Income Tax component (Line 28) is calculated by taking the Net Operating Income Before Taxes (NOIBT) amount from Accounting Schedule 9, Income Statement, and adjusting for additions to and deductions from NOIBT that appear on Accounting Schedule 11, lines 2 through 7. This amount (Net Taxable Income) is then multiplied by the appropriate federal and state income tax rates, giving consideration to the fact that federal income taxes are deductible for state income tax purposes, and state income taxes are deductible for federal income tax purposes.

Q. Please explain why Interest Expense, line 4 of Accounting Schedule 11, is subtracted from NOIBT to arrive at Net Taxable Income and how it was calculated.

A. Interest expense is recorded below-the-line on MGE's income statement and is not reflected in the Staff's calculation of Net Operating Income on Accounting Schedule 9. When an item is booked below-the-line, it is not included in the calculation of net operating income. An item booked below-the-line is generally included in "other operating revenues and expenses." Since the Staff's revenue requirement is based on the amount of net operating income, an item booked below-the-line will have no impact on the revenue requirement. If a cost is booked below-the-line and is not recovered elsewhere, it will be borne by the shareholders and not the ratepayers.

For ratemaking purposes, the Company recovers interest expense through the weighted cost of debt portion of the overall rate of return on rate base. However, interest expense is a deduction for tax purposes and must be reflected in the calculation of income tax expense. The tax deduction for interest expense was calculated by multiplying the Rate Base amount on Accounting Schedule 2 by the Staff's calculated weighted cost of debt, which is sponsored by Staff witness David Murray of the Financial Analysis Department. This method is known as "interest synchronization" because the interest expense used in the calculation of income tax expense is matched (synchronized) with the interest expense the ratepayers are required to provide the Company in rates (rate base multiplied by the weighted cost of debt). Interest synchronization has been consistently used by the Staff and adopted by the Commission in numerous past orders.

Q. Are you sponsoring any items in the Staff's Rate Base, as depicted within Accounting Schedule 2?

A. Yes. I am sponsoring the line items: Deferred Income Taxes-Direct Plant; Deferred Income Taxes-Allocated Plant; Deferred Income Taxes, GO-92-185; Deferred Income Taxes, GO-94-234; Deferred Income Taxes, GO-97-301; Deferred Income Taxes SLRP, GR-98-140; Deferred Income Taxes GR-2001-292; and Deferred Income Taxes, Year 2000 AAO.

The first two items represent the portion of MGE's December 31, 2005, balance of the accumulated deferred income tax reserve related to prior depreciation tax timing differences that is appropriate to include for ratemaking purposes in this proceeding. The last five-rate base items relate to deferred taxes associated with past Accounting Authority Order deferrals authorized by the PSC. Four of these items relate to Service Line Replacement Program (SLRP) deferrals, with the last deferral item relating to Year 2000 (Y2K) costs.

Q. Please explain why accumulated deferred income taxes are an offset to rate base.

A. MGE's deferred tax reserve represents, in effect, a prepayment of income taxes by MGE's customers. As an example, because MGE is allowed to deduct depreciation expense on an accelerated basis for income tax purposes, depreciation expense used for income taxes is considerably higher than depreciation expense used for ratemaking cost of service purposes. This results in what is referred to as book-tax timing difference and creates a deferral of income taxes to the future. The net credit balance in the deferred tax reserve represents a source of cost-free funds to MGE. Therefore, MGE’s rate base is reduced by the deferred tax reserve balance to avoid having customers pay a return on funds that are cost free to the Company. The most significant book-tax timing difference is caused by the differences between accelerated tax depreciation and book depreciation. Generally, deferred income taxes associated with all book-tax timing differences which are created through the ratemaking process should be reflected in rate base.

Q. Please explain why deferred taxes associated with the SLRP and Y2K programs are included within Accounting Schedule 2.

A. The SLRP deferred tax line I am sponsoring relates to the fact that the Company was previously allowed to currently deduct SLRP expenses for income tax purposes that were being deferred for financial reporting purposes. The Company’s past SLRP program is discussed in the direct testimony of Staff witness Joan C. Wandel. The Y2K deferred tax line I am sponsoring relates to the fact that MGE was previously allowed to currently deduct Y2K related costs for income tax purposes that were deferred for financial reporting purposes. Both of these situations gave rise to tax timing differences. Normalization of these tax-timing differences means the MGE's customers are required to pay in rates amounts associated with income taxes on the tax-timing difference items to the Company prior to when the Company will pay the income taxes to taxing authorities. Recognizing a rate base deduction for SLRP and Y2K deferred taxes gives customers appropriate credit for providing funds to the utility to use for corporate purposes for a period of time before payment to taxing authority.

Q. Please explain adjustment S-67.1 and identify why the Staff is proposing the Kansas City earnings tax be calculated as an operating expense instead of reflecting it in the composite effective tax rate along with federal and state income taxes.

A. Adjustment S-67.1 for the Kansas City, MO earnings tax apportionment calculation is derived from Southern Union Company's (Southern Union's) annual gross receipts, instead of MGE's stand-alone earnings. (Southern Union is MGE's parent company.) In response to Staff Data Request No.94.1, the amount of the Kansas City earnings tax in recent years varied dependant upon the fluctuation of the gross receipts earned by Southern Union. The Staff believes this tax should be normalized by using a five-year average of payments to Kansas City.

Q. Please explain the rate base component Alternative Minimum Tax Credit (AMT Credit).

A. The AMT Credit is directly related to, and in fact, is an offset to deferred income taxes. As a result of certain Internal Revenue Service (IRS) regulations, over the past several years Southern Union has been what is referred to as an “AMT taxpayer.” IRS regulations reduce or eliminate certain corporate tax benefits used to reduce taxable income if a company's regular income tax falls below a certain threshold. One of the major tax benefits reduced is accelerated tax depreciation. While the deferred tax reserve is set up to reflect the full income tax effect of book-tax depreciation timing differences, the tax effect of the amount of accelerated tax depreciation which is not allowed to be deducted on the current year's tax return is recorded as an AMT tax credit. The AMT credit is a reduction in accumulated deferred income taxes and has the effect of increasing MGE's rate base.

Q. How was the amount of MGE’s AMT credit calculated?

A. MGE does not file a separate tax return from that of its parent, Southern Union. Instead, Southern Union calculates its tax liability, including the AMT credit amount, on a consolidated basis, which includes MGE’s financial results. To ensure that non-jurisdictional financial impacts do not influence Missouri rates, the Staff calculated the AMT credit amount for MGE in this rate case on a stand-alone MGE basis.

Q. Does this conclude your direct testimony?

A. Yes, it does.

CASE PROCEEDING/PARTICIPATION

PAUL R. HARRISON

COMPANY	CASE NO.	TESTIMONY/ISSUES
Missouri Gas Energy	**GR-2006-0422**	**Case in Progress** **Direct**– Revenues; Purchased Gas Adjustments; Bad Debt Expense; ECWR AAO Bad Debt: Rent; Pensions & OPEBS; Income Taxes; Franchise Taxes; Manufactured Gas Plant, and Case Reconciliation
Empire Electric Company	**ER-2006-0315**	**July 2006** **Rebuttal-** Storm Damage Tracker
Empire Electric Company	**ER-2006-0315**	**June 2006** **Direct-** Tree Trimming Expense and Construction Over-Run Costs
Missouri Pipeline & Missouri Gas Company LLC	**GC-2006-0378**	**Case in Progress** Plant in Service, Depreciation Reserve, Depreciation Expense, Transactions & Acquisition Costs and Income Taxes
New Florence Telephone	**TC-2006-0184**	**Case in Progress** Plant in Service; Depreciation Reserve; Depreciation Expense; Plant Overage; and Materials & Supplies
Cass County Telephone	**TC-2005-0357**	**July 2006** Plant in Service; Depreciation Reserve; Depreciation Expense; Plant Overage; Plant Held for Future Use and Missouri Universal Service Fund

COMPANY	CASE NO.	TESTIMONY/ISSUES
Cass County Telephone & New Florence Telephone Fraud Investigation Case	**TO-2005-0237**	**May 2006** Fraud Investigation case involving Cass County Telephone and New Florence Telephone
Missouri Gas Energy	**GR-2004-0209**	**June 2004** **Surrebuttal** - Revenues and Bad Debt Expense **True-Up** - Revenues; Bad Debt Expense
Missouri Gas Energy	**GR-2004-0209**	**May 2004** **Rebuttal** - Revenues; Bad Debt Expense; and Manufactured Gas Plant **Litigated- Manufactured Gas Plant**
Missouri Gas Energy	**GR-2004-0209**	**April 2004** **Direct** – Revenues; Purchased Gas Adjustments; Bad Debt Expense; Medical Expense; Rents; and Income Taxes
Union Electric Company d/b/a AmerenUE (Gas)	**GR-2003-0517**	**October 2003** **Direct** – Corporate Allocations; UEC Missouri Gas Allocations; CILCORP Allocations; Rent Expense; Maintenance of General Plant Expense; Lease Agreements; and Employee Relocation Expense
Union Electric Company d/b/a AmerenUE	**EC-2002-1**	**June 2002** **Surrebuttal** - Coal Inventory; Venice Power Plant Fire; Tree Trimming Expense; and Automated Meter Reading Service

COMPANY	CASE NO.	TESTIMONY/ISSUES
Laclede Gas Company	**GR-2002-356**	**June 2002** **Direct** - Payroll; Payroll Taxes; 401k Pension Plan; Health Care Expenses; Pension Plan Trustee Fees; and Clearing Account: **True- Up** – Payroll; Payroll Taxes; and Clearing Accounts
Union Electric Company d/b/a AmerenUE (2nd period, 3rd EARP)	**EC-2002-1025**	**April 2002** **Direct** - Revenue Requirement Run; Plant in Service; Depreciation Reserve; Other Rate Base items; Venice Power Plant Fire expenditures; Tree Trimming Expense; and Coal Inventory
2nd Complaint Case, Union Electric Company d/b/a AmerenUE New Test Year ordered by the Commission.	**EC-2002-1**	**March 2002** **Direct** - Materials and Supplies; Prepayments; Fuel Inventory; Customer Advances for Construction; Customer Deposits; Plant in Service; Depreciation Reserve; Venice Power Plant Fire Expenditures; Tree-Trimming Expense; Automated Meter Reading Expense; Customer Deposit Interest Expense; Year 2000 Computer Modification Expense; Regulatory Advisor's Consulting Fees; and Property Taxes **Deposition – April 11, 2002**
1st Complaint Case, Union Electric Company d/b/a AmerenUE	**EC-2002-1**	**July 2001** **Direct** - Materials and Supplies; Prepayments; Fuel Inventory; Customer Advances for Construction; Customer Deposits; Plant in Service; Depreciation Reserve; Power Plant Maintenance Expense; Tree-Trimming Expense; Automated Meter Reading Expense; Customer Deposit Interest Expense; Year 2000 Computer Modification Expense; Computer Software Expense; Regulatory Advisor's Consulting Fees; Board of Directors Advisor's Fees and Property Taxes. **Deposition – November 27 2001**

COMPANY	CASE NO.	TESTIMONY/ISSUES
Union Electric Company d/b/a AmerenUE (2nd period, 2nd EARP)	**EC-2001-431**	**February 2001** Coal Inventory
Union Electric Company d/b/a AmerenUE (Gas)	**GR-2000-512**	**August 2000** **Direct** - Cash Working Capital; Advertising Expense; Missouri PSC Assessment; Dues and Donations; Automated Meter Reading Expenses; Computer System Software Expenses (CSS); Computer System Software Expenses (Y2K); Computer System Software Expenses (EMPRV); Generation Strategy Project Expenses; Regulatory Advisor's Consulting fees; Board of Directors Advisor's fees
SUMMARY OF SMALL RATE CASES WORKED		
Big Island Water & Sewer	**WA-2006-0480** **SA-2006-0482**	**In Progress** Certificate of Necessitate Application Case Lead Auditor
Aqua Missouri Water and Sewer	**QS-2005-0008** **QW-2005-009** **QS-2005-0010** **QW-2005-0011**	**October 2006** Plant In Service; Depreciation Reserve, Depreciation Expense, Rate Base; Revenues and Expenses Lead Auditor
Lake Region Water and Sewer Certificate Case	**WA-2005-0463**	**October 2006** Certificate of Necessitate Application Case Lead Auditor
Tri-State Utility Inc.	**WA-2006-0241**	**May 2006** Certificate of Necessitate Application Case Lead Auditor

COMPANY	CASE NO.	TESTIMONY/ISSUES
Osage Water Company Environmental Utilities Missouri American Water	**WO-2005-0086**	**February 2005** Rate Base; Cost of Service; Income Statement Items; Pre-Post Sale of OWC, Sale of EU Assets to MAWC
North Suburban Water & Sewer	**WF-2005-0164**	**December 2004** Sale of All Stocks of Lake Region Water & Sewer to North Suburban Water & Sewer, Value of Rate Base Assets, Acquisition Premium Lead Auditor
Mill Creek Sewer	**SR-2005-0116**	**December 2004** Plant In Service: Rate Base: Revenues: and Expenses. 2nd update December 2004 1st update September 2003 Filled October 2002 Lead Auditor
Roark Water and Sewer	**WR-2005-0153** **SR-2005-0154**	**September 2004** Plant In Service: Rate Base: Revenues: and Expenses. 2nd Update September 2004 1st Update October 2003 Filed February 2003 Lead Auditor
Osage Water Company	**WT-2003-0583** **SR-2003-0584**	**December 2003** Cost of Service; All Expenses related to Osage Water; Plant in Service; Depreciation Reserve & other Rate Base Items

SUMMARY OF NON-CASE RELATED AUDITS

January 2006 – Environmental Utilities and Osage Water Company Audit Concerning Provision of Service to Eagle Woods Subdivision and Disconnect Notice

COMPANY	CASE NO.	TESTIMONY/ISSUES
November 2004 - Internal Audit of Public Service Commission (PSC) Fixed Assets, Physical Inventory Control Process and Location of Assets		