Exhibit No.:	
Issues:	*Overview*
	Revenue Requirement
	True-up Allowance for Changes
Witness:	*Cary G. Featherstone*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Direct Testimony*
Case No.:	*GR-2014-0007*
Date Testimony Prepared:	*January 29, 2014*

MISSOURI PUBLIC SERVICE COMMISSION

REGULATORY REVIEW DIVISION
UTILITY SERVICES - AUDITING

DIRECT TESTIMONY

OF

CARY G. FEATHERSTONE

MISSOURI GAS ENERGY
DIVISION OF LACLEDE GAS COMPANY

CASE NO. GR-2014-0007

Jefferson City, Missouri
January 2014

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DIRECT TESTIMONY

OF

CARY G. FEATHERSTONE

MISSOURI GAS ENERGY

CASE NO. GR-2014-0007

Q. Please state your name and business address.

A. Cary G. Featherstone, Fletcher Daniels State Office Building, 615 East 13th Street, Kansas City, Missouri.

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

A. I am a Regulatory Auditor with the Missouri Public Service Commission ("Commission").

CREDENTIALS

Q. Please describe your educational background.

A. I graduated from the University of Missouri at Kansas City in December 1978 with a Bachelor of Arts degree in Economics. My course work included study in the field of Accounting and Auditing.

Q. What job duties have you had with the Commission?

A. I have assisted, conducted, and supervised audits and examinations of the books and records of public utility companies operating within the state of Missouri. I have participated in examinations of electric, industrial steam, natural gas, water, sewer and telecommunication companies. I have been involved in cases concerning proposed rate increases, earnings investigations, and complaint cases as well as cases relating to mergers and acquisitions and certification cases.

Q. Have you previously testified before this Commission?

A. Yes. Schedule 1 attached to this testimony contains a list of rate cases in which I have submitted testimony. In addition, I also identify in Schedule 1 other cases where I directly supervised and assisted Commission Staff ("Staff") in audits of public utilities, but where I did not testify.

Q. With reference to Case No. GR-2014-0007, have you examined and studied the books and records of Missouri Gas Energy regarding its natural gas operations?

A. Yes, with the assistance of other members of the Commission Staff.

Q. What knowledge, skill, experience, training and education do you have with regard to Missouri Gas Energy's general rate increase tariff filing that is the subject of Case No. GR-2014-0007?

A. I have acquired knowledge of the ratemaking and regulatory process through my employment with the Commission. I have participated in numerous rate cases, complaint cases, merger cases and certificate cases, and filed testimony on a variety of topics. I have also acquired knowledge of these topics through review of Staff work papers from prior rate cases filed before this Commission relating to Missouri Gas Energy ("MGE," which I may also refer to as "Company") and its natural gas operations.

I have also participated in numerous electric rate cases. I have previously examined generation and generation-related topics; and conducted and participated in several construction audits involving plant and construction records, specifically the costs of construction projects relating to power plants. I have also been involved in the fuel and fuel-related areas for power plant production, purchased power and off-system sales on numerous occasions.

In particular, I have been involved in several natural gas rate cases involving MGE or its predecessor companies, the Gas Service Company and KPL Gas Service.

For this rate case, I reviewed selected testimony, work papers and responses to data requests from past MGE and Laclede Gas Company (Laclede Gas) rate cases. I conducted and participated in interviews of Company personnel relating to this rate case. Over the years I have had many discussions with the Company regarding a variety of regulatory topics, including MGE's rate case & regulatory activities, depreciation matters, and merger, acquisition and sale transactions.

EXECUTIVE SUMMARY

Q. Please summarize your testimony.

A. Staff witness Kim Cox and I sponsor Staff's Cost of Service Report and Accounting Schedules in this rate proceeding that are being filed concurrently with this and Ms. Cox's direct testimony. Staff's Cost of Service Report supports Staff's recommendation of the amount of the rate revenue increase for MGE based on information through the period ending September 30, 2013 using actual historical information, and the rate revenue increase recommendation that Staff expects it will find after true-up to be appropriate for MGE in this rate case. Staff prepared its revenue requirement results based on actual results through the September 30, 2013 update period. Staff will further update the case for MGE to include actual results for the true-up period ending December 31, 2013. The rate revenue recommendation being filed for the period ending September 30, 2013 is found in Staff's separately filed Accounting Schedules.

I present an overview of the results of Staff's review of MGE's revenue requirement started in response to MGE's general rate increase request made on September 16, 2013.

Several members of the Commission's Staff participated in Staff's examination of MGE's books and records for all the relevant and material components that make up the revenue requirement calculation. These components can be broadly defined as (1) capital structure and return on investment, (2) rate base investment and (3) income statement results, including revenues, operating and maintenance expenses, depreciation expense, and the taxes related to MGE's financial results, including income taxes. I provide an overview of the Staff's work on each of these broadly defined components.

Q. Based on its review of the test year ending April 30, 2013 updated through September 30, 2013, what is Staff's recommendation concerning MGE's revenue requirement?

A. Staff recommends a return on equity ("ROE") range of 7.90 percent to 8.90 percent, with a mid-point of 8.40 percent, which yields the rate of return range of 5.65 percent to 6.18 percent. Using this range of overall rate of return, Staff's MGE revenue requirement calculation, which is based on MGE actual costs through September 30, 2013 and updated for part of the true-up through December 31, 2013, indicates a range between a negative \$3.3 million to a positive \$1.4 million based on current MGE rates.

The parties agreed and the Commission authorized a true-up through December 31, 2013. Staff will perform the true-up audit and make a recommendation regarding the revenue requirement based on actual results for the December 31, 2013 in a Supplemental Direct filing on February 14, 2014. Staff has been able to incorporate part of the true-up components in its direct filing for plant and reserve, payroll and some other elements of the cost of service. However, there are other elements of the true-up that needs updated through December 31, 2013 that will be addressed in the supplemental filing.

Q. What are the major drivers for Staff's estimate of MGE's revenue requirement in this case?

A. The following is a non-exhaustive list:

- Rate of return
- Acquisition savings since the September 1, 2013 close date
- Operational Costs such as property insurance, maintenance costs, payroll and payroll related costs
- Property Taxes
- Uncollectibles (Bad Debts Expense)

OVERVIEW OF MISSOURI GAS ENERGY FILING

Q. What is the purpose of your direct testimony?

A. With Ms. Cox, I present an overview of the results of Staff's review of MGE's revenue requirement in response to MGE's general rate increase request made on September 16, 2013. I provide an overview of the Staff's work on each component of the revenue requirement calculation Staff used for determining an appropriate revenue requirement for MGE in this case. Ms. Cox provides an overview of the work performed by members of the Commission's Tariff, Safety, Economic & Engineering Analysis (TSEEA) department who contributed to Staff's calculation of MGE's revenue requirement. I identify the work performed by assigned members of the Commission's Utility Services Department who contributed to the revenue requirement. Several members of Staff had specific assignments relating to different components of Staff's revenue requirement calculation for MGE. The members of Staff who contributed to the Staff's Cost of Service Report are identified in the report to the sections for which they are responsible and verify, and their credentials are included in an appendix to the report. Results for the different revenue requirement calculation components are contained in Staff's Accounting Schedules. Using historic financial information from MGE's actual operations through the update period ending September 30, 2013 to develop a comprehensive revenue requirement, Staff applies annualization and normalization ratemaking techniques to make adjustments to reflect the costs of its ongoing operations in the future.

Staff refers to the revenue requirement model it uses as "Exhibit Model System" or "EMS," and refers to its EMS modeling results based on various inputs as "EMS runs." Staff estimates a utility's revenue requirement based on the work product of members of the Regulatory Review Division of the Commission. Staff's EMS run results that support its revenue requirement for MGE make up the Accounting Schedules that are separately filed as an exhibit in the case. The Accounting Schedules, along with Ms. Cox's direct testimony and my direct testimony, and the Staff's Cost of Service Report and supporting schedules present and support Staff's revenue requirement for MGE.

Q. Why did Staff review MGE's books and records and calculate a revenue requirement for MGE in this case?

A. On September 16, 2013, MGE filed tariff sheets designed to implement an increase in its natural gas retail rate revenues in Missouri, exclusive of gross receipts, sales, franchise and occupational fees or taxes, of $23.4 million. The Commission assigned the filing Case No. GR-2014-0007. If implemented on an equal percentage basis, this represents a 4.9 percent increase in existing MGE rates. In this case, MGE is requesting that $6.3 million of revenues relating to the Infrastructure System Replacement Surcharge (ISRS) be included in permanent rates. Since the Company is currently collecting this amount as a surcharge, the net effect of its proposed rate increase would be $17.0 million.

On December 6, 2013, MGE filed for a new ISRS request in the amount of $1.58 million (Case No. GO-2014-0179). MGE is requesting this amount be included in any amount the Commission determines is appropriate for this rate case.

MGE based its rate increase request on a proposed rate of return on equity of 9.70 percent applied to a 51.55 percent equity capital structure based on the capital structure of its parent, The Laclede Group.

MGE's Cost of Capital

Type of Capital	**Ratio**	**Cost of Capital**	**Weighted Cost of Capital**
Long-Term Debt	48.450%	4.35%	2.108%
Common Equity	51.55%	9.70%	5.000%
Total	100.00%		**7.108%**

Source: Laclede Gas work papers

Staff reviewed MGE's books and records, and calculated a revenue requirement for MGE, to independently evaluate MGE's rate increase request.

BRIEF HISTORY OF MISSOURI GAS ENERGY

Q. Please provide a brief overview of MGE.

A. MGE is a regulated local natural gas distribution utility serving approximately 500,000 customers and generally operates in 155 western Missouri communities including the cities of Kansas City, St. Joseph, Warrensburg and Joplin.

MGE is an operating division of Laclede Gas Company (Laclede Gas). Laclede Gas is a wholly owned subsidiary of The Laclede Group, Inc. ("Laclede Group").

MGE was purchased by Laclede Group on September 1, 2013 from Energy Transfer Equity, L.P. ("Energy Transfer" or "ETE"). The Commission authorized the Laclede Group acquisition of MGE on July 17, 2013 in Case No. GM-2013-0254 when it approved a Unanimous Stipulation and Agreement dated July 2, 2013.

Energy Transfer purchased Southern Union Company ("Southern Union") including MGE on March 26, 2012 and was approved by the Commission in Case No. GM-2011-0412.

Southern Union purchased MGE—the Missouri natural gas operations of KPL Gas Service—from Western Resources, now Westar Energy, in late 1994. This acquisition was approved by the Commission in Case No. GM-94-40. Originally, Western Resources acquired this distribution system in 1983 when it was called The Gas Service Company.

Q. What is Laclede Group?

A. Laclede Group is a public utility holding company incorporated in October 1, 2001. It has wholly-owned subsidiaries—Laclede Gas provides regulated natural gas utility services and Laclede Energy Resources, Inc. ("LER") that provides non-regulated natural gas marketing services. Laclede Pipeline Company is also a wholly owned subsidiary of Laclede Group that operates a pipeline under the jurisdiction of Federal Energy Regulatory Commission (FERC).

Laclede Gas provides natural gas to approximately 628,000 residential, commercial and industrial customers (based on September 30, 2012) in parts of ten counties in the eastern side of Missouri, and primarily in and around the city of St. Louis. Laclede Gas is also under the jurisdiction of the Commission.

STAFF FINDINGS AND RECOMMENDATIONS FOUND IN STAFF'S COST OF SERVICE REPORT AND STAFF'S ACCOUNTING SCHEDULES

Q. Did Staff only review MGE's books and records to calculate a revenue requirement for MGE?

A. No. Staff also interviewed MGE personnel, as well as reviewing MGE's responses to data requests issued in this and other cases. Staff also reviewed the minutes of meetings of Laclede and Laclede Gas's Boards of Directors. Staff reviewed the books and records of MGE, including: the general ledger, plant ledgers and various other documents, including the FERC Form 1, for the last several years.

Q. Which members of Staff were assigned to this case?

A. Several Staff experts from the Regulatory Review Division were assigned to this case. Their names follow with a brief description of their contribution to the Staff's Cost of Service Report:

Utility Services Department

Financial Analysis Unit--

- Zephania Marevangepo -- Rate of Return and Capital Structure.

Engineering and Management Services Unit--

John A. Robinett -- Depreciation Rates.

Auditing Unit--

- Cary G. Featherstone -- Overall Revenue Requirement Results
- V. William Harris -- Maintenance, Injuries and Damages and Property Insurance Costs
- Karen Lyons -- Revenues and Uncollectible Revenues (Bad Debts); Cash Working Capital and Rate Case Expense.
- Keith Majors -- Income Taxes, Deferred Income Taxes, Deferred Income Tax Reserve; Payroll and Payroll related Costs, Payroll Taxes and Incentive Compensation, Pensions and Other Post-Retirement Employment Benefits, Corporate Costs
- Matthew R. Young -- Plant in Service, Accumulated Depreciation Reserve, Depreciation Expense; material and supplies, prepayments, advertising and miscellaneous expenses

<u>Tariff, Safety, Economic & Engineering Analysis (TSEEA) department</u>

Kim Cox -Overall Revenue Requirement Results

- Michelle Bocklage - Weather Normalization
- Michael J. Ensrud - Interest on Customer Deposit
- Henry E. Warren – Large Volume Adjustment
- Seoung Joun Won - Weather

Each of these Staff experts' work product was used as a direct input to the various adjustments contained in Staff's Accounting Schedules and revenue requirement recommendation.

Q. Would you provide an overview of how the Staff assigned to this case worked together to arrive at Staff's revenue requirement recommendation and true-up estimate?

A. All of the Staff members assigned to this case are, by education, training and experience, experts at performing their regulatory responsibilities as members of the Commission Staff. These regulatory experts rely on the work of each other to develop Staff revenue requirement recommendations regarding filings public utilities make before the Commission. The work of each Staff member is an integral part of the Staff's Cost of Service Report, including Staff's Accounting Schedules, which contain the results of their collective efforts in Staff's findings and recommendations. Ms. Cox and I relied on these findings and recommendations to develop Staff's ultimate recommendations in this direct filing. Many of the individual sections presented include references indicating reliance on the work of other contributing experts.

Ms. Cox and I relied on the work product of every Staff expert assigned to this case. Each Staff expert provided the results of their review and analysis as inputs to the revenue requirement calculation, and is identified in the sections of the report submitted by that expert. An affidavit, credentials, and the qualifications of each Staff expert are included in the Report attached as Schedule 1. Each Staff expert assigned to the MGE rate case will provide work papers supporting the findings and recommendations to both Companies and to other parties as the Commission has ordered in setting the procedural schedule in this case. Finally, each Staff expert assigned to this rate case will be available to answer Commissioner questions and to be cross-examined by any party who wishes to conduct cross-examination regarding information on how Staff's findings and recommendations were developed and presented in Staff's Cost of Service Report, including Staff's Accounting Schedules.

Q. What is your overall responsibility in this case?

A. I am one of two project coordinators assigned to identify the work scope for the case, make Staff assignments, and supervise and oversee all work product development. I specifically supervised all areas of the audit work assigned to and the responsibility of the Auditing Unit. I worked closely with other Staff experts assigned to this rate case. I worked with the depreciation and rate of return experts as well as the TSEEA experts assigned to revenues and fuel costs.

I have overall responsibility to ensure the revenue requirement calculation using the Staff's computer model is timely completed. This involves all aspects of the elements making up the revenue requirement recommendation. To this end, I, along with those under my direct supervision, either developed directly, or was provided with, the information used to support the Staff's revenue requirement recommendations for MGE.

Q. Please provide examples of how information from Staff experts was used to develop Staff's revenue requirement recommendation for MGE.

A. Staff expert Zephania Marevangepo's recommendations from his capital structure and rate of return analyses were provided as inputs to the revenue requirement calculation and appear as part of Accounting Schedule 12. His findings are also in Staff's Cost of Service Report, along with his schedules.

Staff expert John A. Robinett provided the results of his depreciation analysis, which also are reflected in Staff's Cost of Service Report, and in Accounting Schedule 5.

Staff expert Karen Lyons worked closely with members of the **TSEEA** and together they are sponsoring the revenue adjustment results.

Other Staff members contributed to the development of the revenue requirement as specifically identified in the Cost of Service Report being filed concurrent with Staff's direct testimony, exhibits and Accounting Schedules.

Q. Did Staff develop its revenue requirement recommendation for MGE in this rate case any differently than it has done so in the past for MGE rate cases and for other utilities?

A. No. Staff developed its revenue requirements for MGE consistently with how Staff has developed revenue requirements for other utilities, and the inputs provided by the various Staff experts assigned to the MGE rate case are reasonable.

Based on my extensive experience as a regulatory auditor, my many years of experience as a project coordinator in numerous rate cases, the effect of the inputs provided by the various Staff experts assigned to these rate cases, Staff's overall revenue requirements for MGE as presented in this testimony and the Staff's Cost of Service Report, including the Accounting Schedules, are all reasonable.

Q. Does this January 23, 2014 filing by Staff present all of Staff's direct case?

A. No. Staff is scheduled to file its class cost of service and rate design recommendation for MGE on February 7, 2014.

<u>Test Year, Known & Measurable Period and True-Up Period</u>

Q. What is a test year?

A. A test year is an historical year from which actual information is used as the starting point for determining an annual revenue requirement to see if any shortfall or excess of earnings exist. Adjustments are made to that information so that, as adjusted, it reflects the normal annual revenues and operating costs of the rate-regulated utility. Those normal annual revenue and operating costs to provide utility service on an ongoing basis form the basis for determining what the utility's rates need to be to give it the opportunity to collect in the future sufficient revenues both to pay for those ongoing costs and to earn a reasonable profit. In determining ongoing revenues and costs to develop the utility's revenue requirement, the first step is to identify the test year costs levels, which serve as the starting point for making all the adjustments to arrive at the revenue requirement recommendation. The Commission concisely stated the purpose of using a test year in its Order in KCPL's 1983 general rate case, Case No. ER-83-49:

> The purpose of using a test year is to create or construct a reasonable expected level of earnings, expenses and investments during the future period in which the rates, to be determined herein, will be in effect. All of the aspects of the test year operations may be adjusted upward or downward to exclude unusual or unreasonable items, or include unusual items, by amortization or otherwise, in order to arrive at a proper allowable level of all of the elements of the Company's operations. The Commission has generally attempted to establish those levels at a time as close as possible to the period when the rates in question will be in effect.

Q. Is the test year important?

A. Yes. It is important to synchronize and capture—"match"—all revenues and costs in the test year, and more importantly the update period, in order to develop a relationship between the various components of the ratemaking process and keep those relationships properly aligned. The starting point of this analysis is to select a test year for the utility. To determine the proper level of utility rates, Staff examines the major elements of the utility's operations within the test year. These include rate base items such as plant in service, accumulated depreciation, deferred income tax reserves, fuel stocks, material and supplies, and other investment items. Also essential in this process is a review of the utility's revenues and expenses, making adjustments through the annualization and normalization processes. These items include: payroll, payroll related benefits, payroll taxes, operation and maintenance costs for non-payroll related costs such as material and equipment costs, small tool costs, and outside vendor costs for equipment repairs. Depreciation expense and taxes, including federal, state, local and property taxes, are all considered in setting rates.

It is important to maintain a representative relationship between rate base, revenues and expenses at a point in time near to when new prospective rates become effective in order for a public utility to have an opportunity to earn a fair and reasonable return. An attempt is made in the regulatory process to set rates to properly reflect the levels of investment and expenses necessary to serve the retail customer base which provides revenues to the utility.

Q. What is the test year in this case?

A. The ordered test year is the twelve months that ended April 30, 2013. The April 30, 2013 test year was chosen by the Company, agreed to by Staff, and approved by the Commission in its November 13, 2013, *Order Adopting Recommended Procedural Schedule*.

Staff made annualization, normalization and disallowance adjustments to the test year results when the unadjusted results did not fairly represent MGE's most current annual level of existing revenue and operating costs.

Q. What update period did the Commission order in this case?

A. The update period in the MGE rate case is the period ending September 30, 2013.

Q. What is the significance of the update period?

A. The update period (sometimes also known as the "known and measurable period") is critical to the development of new rates. New rates from general rate cases such as this one normally take about eleven months from the time the case is filed until the new rates take effect. A utility's revenue requirement based on the historical test year may change significantly while its case is being processed. To better match new rates with the utility's ongoing revenue requirement, the Commission orders update and true-up periods. Test year information is updated to reflect changes through the update cut-off date—in this case September 30, 2013—and major changes through the true-up date—in this case December 31, 2013.

Selecting a "known and measurable date" or "known and measurable period" is even more important than selection of a test year in synchronizing and capturing—"matching"—all revenues and expenses as this updated information will, along with the results of the true-up, form the basis for changing rates. Just as with the test year, a proper determination of revenue requirement is dependent upon a consideration of all material components of the rate base, return on investment, current level of revenues, along with operating costs, ***at the same point in time***. This ratemaking principle is common to all rate cases and common to how the Commission has established rates using all material and relevant cost component to develop the revenue requirement calculation. The September 30, 2013 date for the known and measurable period was chosen to enable the parties and Staff an update period that provides sufficient time to obtain actual information from MGE upon which to perform analyses and make calculations regarding various components to the revenue requirement and still base the revenue requirement recommendation used for proposing new prospective rates on very recent information.

In Case No. ER-83-49, regarding the need for a true-up, the Commission stated that it would not "consider a true-up of isolated adjustments, but will examine only a package of adjustments designed to maintain the proper revenue-expense-rate base match at a proper point in time." [26 Mo P.S.C. (N.S.) 104, 110 (1983)] This concept of developing a revenue requirement calculation based on a consideration of all relevant factors has been a long-standing approach to ratemaking in this state, and is the approach Staff is following in the MGE rate case.

The update cutoff date of September 30, 2013, is as close to the Staff's direct filing date of January 23, 2014 that is reasonable to allow Staff to file a direct case based on information as near to Staff's direct filing date as possible.

Q. What is the true-up period?

A. The true-up period in this case is the period ending December 31, 2013. Staff will examine material changes that may occur from the time of the update period of September 30, 2013 through December 31, 2013. The true-up will include updates for plant and depreciation reserve, any inventory changes, deferred taxes, the annualization amounts for cash working capital, payroll and payroll related benefits, property taxes and any related income tax effects.

<u>Revenue Requirement Ratemaking Adjustments</u>

Q. Does Staff make any adjustments to the utility's accounting information to determine its revenue requirement for setting rates?

A. Yes. The ratemaking process includes making adjustments to that information so that it reflects the normal, on-going operations of the utility. This process generally uses four different types of adjustments to reflect changes determined to be reasonable and appropriate. Staff makes annualization, normalization, disallowances, and *pro forma* adjustments to base its recommendation regarding the revenue requirement recommendation.

Q. What is an annualization adjustment?

A. An annualization adjustment is made to a cost or revenue shown on the utility's books to reflect a full year's impact of that cost or revenue. Examples are employee pay raises during the test year and employees starting their employment during the updated test year. Both require annualization adjustments so that the full annual salary of that employee is reflected in the updated test year. If not annualized, the utility's payroll would be understated since the increased payroll cost to the utility due to such employees will continue into the future. Another example is new customers that start taking service during or at the end of the updated or trued-up test year. Their usage needs to be annualized to reflect a full 12 months of revenues from those new customers. If the utility's revenues from these customers are not normalized, then the utility's revenues will be understated causing its revenue requirement to be overstated and its new rates to be too high.

In this case Staff annualized revenues, payroll costs, fuel costs and other accounting information.

Q. What is a normalization adjustment?

A. A normalization adjustment is made to revise an actual cost to reflect the cost at a normal, on-going level. Utility revenues and costs that were incurred in the test year that are determined not to be typical or abnormal generally are adjusted to remove the effects of those abnormal or unusual events. For example, some utility revenues and costs vary with weather (i.e., higher or lower temperatures); therefore, adjustments are made to normalize these items. Unusually hot or cold weather significantly affect revenues received from those customers that are weather sensitive, impacting the overall level of revenues that may result in a distortion to the level of test year revenues and costs. Because utility rates are set using normalized inputs, adjustments to test-year input levels must be made when it is determined that unusual or abnormal events, such as weather effects, cause unusually high or low results. To adjust these results, temperatures during the test year are compared to normal annual daily temperatures that are based on actual temperature measurements taken over a substantial period of time, many times for a 30-year time horizon. Weather-sensitive revenues are adjusted in the test year to reflect normal weather temperatures. The resulting weather-normalized sales volumes are also used as the basis for the utility's fuel and purchased power costs, so that they too reflect normal weather temperatures.

Maintenance and operation costs relating to production equipment may also be normalized. If unusual events like major maintenance or major weather related events have occurred during the test year, then accounts where the costs associated with them may be adjusted to reflect a normal level. If normalization adjustments are not made, the utility revenues and costs, which both directly impact earnings, would be either too high or too low to reflect the utility's future ongoing revenues and costs. For example, warmer than normal weather in the winter will negatively impact a gas utility's revenues since the demand for gas for heating is decreased relative to a "normal" year. Staff proposes adjustments to normalize the costs and revenues of events that are expected to vary from the "normal" year.

In this case, Staff based on an examination of actual historical events, has made both a weather adjustment for revenues and normalized non-payroll operation and maintenance expenses.

Q. What is a disallowance?

A. A disallowance is an adjustment to remove an item from the utility's revenue requirement. Typically a disallowance is made to remove a cost because the cost is not expected to recur, it was not necessary for providing utility service, it provided no benefit to ratepayers or it was imprudent. One example of costs that are disallowed are certain advertising costs. While some advertising costs benefit ratepayers and should be included in rates, others do not and should be disallowed. In this case Staff disallowed certain of MGE's advertising costs.

Q. What is a *pro forma* adjustment?

A. This type of adjustment is made to reflect increases and decreases to a utility's revenue requirement caused by the implementation of a rate increase or decrease. *Pro forma* adjustments are made because of the need to reflect the impact of items and events that occur subsequent to the test year. These items and events may significantly impact the revenue, expense and the rate base relationship, and should be recognized to address the objective of forward-looking rates. Caution must be taken when making *pro forma* adjustments to ensure that all material items and events subsequent to the test year are examined to avoid failing to recognize offsetting adjustments. In addition, some post-test year items and events may not have occurred yet—be known— and / or may not have been sufficiently measured—be measurable. As a result, quantification of some *pro forma* adjustments may be more difficult than others. A true-up audit that considers a full range of items and events that occur subsequent to the test year and update period attempts to address the maintenance of a proper relationship between revenues, expenses and investment, as well as address the difficulty in making *pro forma* adjustments.

The most common example of a *pro forma* adjustment is the grossing up of a net income deficiency for income tax purposes. This involves calculating the revenue requirement before income taxes. If rates need to be adjusted to increase utility revenues, then those revenues need to be factored up for income taxes. This is necessary because every additional revenue dollar collected in rates is subject to income tax.

Revenue Requirement Calculation

Q. In the context of determining rates for public utilities, what is "revenue requirement"?

A. "Revenue requirement" is the amount of the annual revenues that a utility's rates should be designed to allow it to collect each year. General natural gas rates in Missouri are based on actual historical information. The revenue requirement is calculated using the key elements decided by the Commission such as rate of return and capital structure on the investment together with the costs to provide a particular utility service. This difference between the revenue requirement from a cost of service calculation and revenues based on existing rates identifies any revenue shortfall (denoting a need to increase rates) or excess (denoting a need to decrease rates).

Q. How did Staff determine MGE's revenue requirement?

A. Staff reviewed all the material and relevant components making up the revenue requirement of MGE, which include rate of return and capital structure, rate base investment, and revenues and expenses, and sought to maintain the relationship in time between each of these components through the update period through September 30, 2013. It will continue to do so through the true-up period ending December 31, 2013.

Q. How does each of these components interrelate?

A. The ratemaking process for regulated utilities is a process whereby the Commission makes rate decisions regarding how utilities charge customers for utility services using a prescribed formula. This interrelationship may be seen through the following formula:

Revenue Requirement = Cost of Providing Utility Service

Or

RR = O + (V-D)R; where,

RR = Revenue Requirement

O = Operating Costs (Payroll, Maintenance, etc.) Depreciation and Taxes

V = Gross Valuation of Property Required for Providing Service (including plant and additions or subtractions of other rate base items)

D = Accumulated Depreciation Representing Recovery of Gross Depreciable Plant Investment.

V-D = Rate Base (Gross Property Investment less Accumulated Depreciation = Net Property Investment)

R = Rate of Return Percentage

(V-D)R = Return Allowed on Rate Base (Net Property Investment)

This formula is the traditional rate of return calculation this Commission relies on to set just and reasonable rates. The result is the total revenue requirement for a utility. The difference between that total amount of revenues the utility would bill the number of annualized, normalized test year customers under existing rates is the incremental change in revenues that rates need to be adjusted to allow the utility the opportunity to earn the revenue requirement the Commission authorizes, including the Commission-authorized return on rate base investment. The revenue requirement calculation allows for the recovery of the proper level of utility costs, including income taxes.

ORGANIZATION OF STAFF'S COST OF SERVICE REPORT

Q. How is Staff's Cost of Service Report organized?

A. It is organized by each major revenue requirement category as follows:

I. Executive Summary
II. Background of Rate Case
III. Background of Missouri Gas Energy
IV. True-Up Recommendation
V. Rate of Return
VI. Rate Base
VII. Income Statement – Revenues & Expenses
VIII. Appendices

These categories have several subsections which identify in detail the specific elements of Staff's revenue requirement recommendation for MGE.

OVERVIEW OF STAFF'S FILING, FINDINGS AND RECOMMENDATIONS

Q. Please identify the findings of Staff's review of MGE's rate increase request.

A. Staff conducted a review of MGE's September 16, 2013 rate increase filing and has identified the following areas in its findings and recommendations.

Overall Revenue Requirement

Q. How did Staff determine its revenue requirement for MGE?

A. Staff identified many areas impacting MGE's revenue requirement. Because of the potential changes relating to the MGE acquisition by Laclede Gas, plant additions and other cost changes, the initial revenue requirement developed as of the September 30, 2013 update case will change for the December 31, 2013 true-up.

The December 31, 2013 true-up in this rate case will include various changes to costs. Staff will perform the true-up audit and make a new recommendation regarding the revenue requirement at that time based on actual costs.

There are other costs that will likely change and, therefore, materially affect Staff's current calculation of MGE's revenue requirement. Those other costs include plant costs, payroll and payroll-related benefits, such as pensions and medical costs.

Rate of Return

The rate of return Staff used to calculate its revenue requirement recommendation for MGE in this case is based on Laclede Group's capital structure and corporate results. Staff witness Zephania Marevangepo, of the Commission's Financial Analysis Department, determined that the appropriate rate of return on equity is in a range of 7.9 percent to 8.9 percent with a mid-point of 8.4 percent which results in an overall rate of return on investment of 5.65 percent to 6.18 percent with a mid-point of 5.92 percent.

Mr. Marevangepo examined the Company's capital structure and cost of money and provided the Staff's proposed rate of return which it used to calculate its revenue requirement recommendation for MGE in this case.

Staff's Recommended Cost of Capital

Type of Capital	**Ratio**	**Embedded Cost**	**Weighted Cost of Capital Using Common Equity of 7.90%**	**Weighted Cost of Capital Using Common Equity of 8.40%**	**Weighted Cost of Capital Using Common Equity of 8.90%**
Common Equity	53.08%	-----	4.19%	4.46%	4.72%
Long-Term Debt	46.92%	3.12%	1.46%	1.46%	1.46%
Total	100%		5.65%	5.92%	6.18%

Rate Base

Plant-in-Service and Accumulated Depreciation Reserve are reflected in the rate base as of September 30, 2013. All plant additions and retirements were included in the revenue requirement calculation as of September 3, 2013. Staff will reflect plant additions and retirements through the end of the true-up period, December 31, 2013 in its true-up audit.

Cash Working Capital has been included in rate base using a lead-lag study developed by Staff over the last several rate cases. This has been updated to reflect changes in this case.

Purchased Gas Inventories, Material & Supplies and Prepayments were included as of the September 30, 2013. These items will be re-examined in the true-up.

Prepaid Pension Asset is calculated through September 30, 2013.

Accumulated Deferred Income Taxes Reserves were included as an offset to rate base as of September 30, 2013. Deferred tax reserves will be updated for the true-up.

Other rate base components for customer deposits and customer advances for construction are included through end of the update period of September 30, 2013.

INCOME STATEMENT

Revenues

Staff annualized and normalized revenues through September 30, 2013 to reflect an annual level of weather normalized revenues on a Missouri jurisdictional basis. Revenues will be trued-up through December 31, 2013.

Expenses

Payroll, payroll related benefits, and payroll taxes were annualized through September 30, 2013. Payroll will be updated in the true-up to as of December 31, 2013.

Operations and Maintenance costs, other than payroll costs, were included in the case either at its value as of end of the test year /update period or based upon multi-year averages.

Depreciation Expense was annualized based on depreciation rates approved by the Commission. The depreciation rates were applied to Staff's recommended plant values as adjusted plant-in-service jurisdictional amounts, resulting in total annualized Missouri jurisdictional depreciation expense. Depreciation will be updated for December 31, 2013 plant levels included in the true-up.

Staff calculated Income Taxes based on the results of the revenue requirement calculation as of September 30, 2013. The income tax expense amount will be trued-up as of December 31, 2013. Deferred income tax reserve will also be trued-up as of December 31, 2013 from the level reflected as of April 30, 2013.

ALLOWANCE TO THE REVENUE REQUIREMENT

Q. What is the revenue requirement estimate Staff is submitting with its direct filing?

A. Staff is filing its revenue requirement for MGE based on the April 30, 2013 test year results updated for known and measurable changes through September 30, 2013 to include an estimate for the revenue requirement impacts of anticipated true-up results through December 31, 2013. Staff has made an estimate designed to cover an expected or anticipated increase to the overall revenue requirement being recommended in this case due to events in the true-up period. This estimate is being used to consider the additional revenue requirement that is expected to be in effect as of the true-up ending period of December 31, 2013.

The Commission authorized the use of updating the revenue requirement through the end of December 31, 2013, primarily to address changes through this period. The amount for the allowance to the revenue requirement is identified on Schedule 1 of Staff's Accounting Schedules filed concurrent with this testimony.

Q. Does this conclude your direct testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy, Inc.'s Filing of Revised Tariffs to Increase its Annual Revenues for Natural Gas	)))	Case No. GR-2014-0007

AFFIDAVIT OF CARY G. FEATHERSTONE

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Cary G Featherstone, 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 26 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.

Cary G. Featherstone

Subscribed and sworn to before me this 29th day of January, 2014.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin
Notary Public