Exhibit No.: ______________
Issue(s): Bad Debt Expense & PGA/Bad Debt
Witness/Type of Exhibit: Trippensee/Rebuttal
Sponsoring Party: Public Counsel
Case No.: GR-2009-0355

REBUTTAL TESTIMONY

OF

RUSSELL W. TRIPPENSEE

Submitted on Behalf of the Office of the Public Counsel

MISSOURI GAS ENERGY

Case No. GR-2009-0355

September 28, 2009

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-2009-0355

AFFIDAVIT OF RUSSELL W. TRIPPENSEE

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Russell W. Trippensee, of lawful age and being first duly sworn, deposes and states:

1. My name is Russell W. Trippensee. I am the Chief Public Utility Accountant for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony.

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

Russell W. Trippensee

Russell W. Trippensee

Subscribed and sworn to me this 28th day of September 2009.

NOTARY PUBLIC
NOTARY SEAL
STATE OF MISSOURI

SHYLAH C. BROSSIER
My Commission Expires
June 8, 2013
Cole County
Commission #09812742

Shylah C. Brossier

Shylah C. Brossier
Notary Public

My commission expires June 8, 2013.

REBUTTAL TESTIMONY

OF

RUSSELL W. TRIPPENSEE

THE COMPANY

CASE NO. GR-2009-0355

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. Russell W. Trippensee. I reside at 1020 Satinwood Court, Jefferson City, Missouri 65109, and my business address is P.O. Box 2230, Jefferson City, Missouri 65102.

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

A. I am the Chief Utility Accountant for the Missouri Office of the Public Counsel (OPC or Public Counsel).

Q. ARE YOU THE SAME RUSSELL W. TRIPPENSEE WHO HAS FILED DIRECT TESTIMONY IN THIS CASE?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. To address the Staff Report Cost of Service with regard to the position taken on Bad Debt Expense, page 98 and 99 of the report. Keith Foster is listed as the Staff Expert on this issue. Certain comments regarding Mr. Foster's recommendation will also address Missouri Gas Energy's (MGE or Company) witness Michael Noack's recommendation regarding bad debt expense. I will also update Public Counsel's position on this issue. A change in OPC's recommended amount has been made to reflect new data available which provided seven more months of actual experience with write-offs of customer accounts for lack of payment by or on behalf of the customer.

I will also outline and explain Public Counsel's opposition to Missouri Gas Energy's proposal to include a portion of bad debt expense along with property taxes on gas in storage in the Purchased Gas Adjustment clause. Finally OPC also opposes a bad debt tracker mechanism which is the third option MGE proposes for addressing bad debt costs. The Company's proposals regarding bad debts is set out in Michael Noack's direct testimony beginning on page 12, line 17 and continues through line 1 on page 15.

BAD DEBT EXPENSE

Q. WHAT IS PUBLIC COUNSEL'S POSITION ON THE APPROPRIATE LEVEL OF BAD DEBT EXPENSE TO INCLUDE IN REVENUE REQUIREMENT?

A. Based on the updated data through July 2009, Public Counsel recommends that $9,298,066 be included in the revenue requirement as the appropriate amount of bad debt. This recommendation is calculated based on an analysis of the actual net write-offs as reflected in the balance sheet account, Accumulated Provision for Uncollectible Accounts, account 144 and recognition of the Cold Weather Rule (CWR) Accounting Authority Order amortization. These two components are $9,685,323 related to the analysis of account 144 and a reduction of $387,256 related to the monies received via the CWR amortization but were not reflected in account 144.

Q. DID BOTH STAFF AND MGE EXCLUDE THE CWR AMORTIZATION MONIES FROM THEIR RESPECTIVE ANALYSIS?

A. Yes.

Q. WHY IS IT APPROPRIATE TO INLCUDE THESE MONIES RECEIVED?

A. Simply stated, if the Commission fails to recognize these monies, the ratepayers will have paid MGE approximately $1,161,769 since the rates in Case No. GR-2006-0422 for costs that were asserted at that time to be an impact of the CWR on actual write-offs of bad debts. However, the subsequent accounting treatment of these monies was not used to reduce the actual net write-offs on the Company's financial records. It is these records that are analyzed and used in the determination of bad debt expense for regulatory purposes. Any failure to recognize these monies turns the regulatory asset created by the Commission for the CWR into a regulatory gift of ratepayers' monies to the Company.

Q. DO ALL THE PARTIES TO THIS CASE USE AN ANALYSIS OF THE ACCUMULATED PROVISION FOR UNCOLLECTIBLE ACCOUNTS, ACCOUNT 144, TO MAKE THEIR RECOMMENDATION FOR THE APPROPRIATE LEVEL OF BAD DEBT EXPENSE?

A. Yes. Mr. Noack states that "The adjustment was computed by taking the averaging bad debt write-offs for 2006 – 2008 and comparing that average to the bad debt expense recorded in 2008", page 12, lines 11 – 13 of his direct testimony. Similarly the Staff Report Cost of Service states "The Staff's adjustment, therefore, represents the difference between a three-year average of uncollectible accounts and the test year level of bad debt expense recorded on the Company's books and records", Staff Report page 99, lines 1 – 3. Public Counsel also analyzed the uncollectible accounts in making its recommendation of $9,685,323 as the appropriate level of bad debt expense excluding the CWR AAO recognition.

Q. FROM YOUR ANSWER, SHOULD THIS COMMISSION INFER THAT THERE IS A DIFFERENCE BETWEEN "UNCOLLECTIBLE ACCOUNTS" AND "BAD DEBT EXPENSE"?

A. Yes. The proper use of the term "uncollectible accounts" refers to account 144 which is a balance sheet account. A proper reference to "bad debt expense" is a reference to account 904 which is an income statement account. Entries to record bad debt expense in account 904 which impacts the financial income statement are not on a customer specific basis. Account 904 is used to record monthly estimates (an accrual) of a utilities inability to subsequently collect the total revenues billed to all customers in that month. Account 144, the Accumulated Provision for Uncollectible Accounts is the account where the utilities actual inability to collect revenues from specific customers (the cash transaction) is recorded. The opportunity during a regulatory proceeding to look at actual experience is why the regulatory process analyzes account 144 to determine the actual amount of revenues that are not collected from customers. While some people use either bad debt or uncollectible interchangeably, this usage is incorrect as explained previously.

Q. YOU USED THE TERM BAD DEBT WRITE-OFFS, PLEASE EXPLAIN THE RELATIONSHIP OF THAT TERM TO UNCOLLECTIBLE ACCOUNTS AND BAD DEBT EXPENSE.

A. Bad debt write-off refers to the process where a utility determines that an individual customer's account will not be collected. The balance of the account receivable (a balance sheet account that was debited when the customer was originally billed) related to that customer is credited and account 144 is debited. This journal entry reflects that the utility no longer expects to collect the monies and thus reduces both its accounts receivable and its accumulated reserve for uncollectible accounts.

Q. WHAT WAS THE PURPOSE OF THE ACCOUNTING AUTHORITY ORDER RELATED TO THE COLD WEATHER RULE?

A. The purpose was to reflect expected increases in actual uncollectible accounts resulting from the CWR reducing the minimum amount of payment on a customer's unpaid bill in order for that customer to again receive gas service. The assertion was that this reduction would cause the utility to receive a lower actual payment to be applied against the accounts receivable related to that customer and therefore would incur higher write-offs in the future.

Q. IS IT RELEVANT TO THE DETERMINATIO OF BAD DEBT EXPENSE FOR RATEMAKING PURPOSES WHETHER OR NOT MGE ACTUALLY INCURRED HIGHER WRITE-OFFS AS A RESULT OF THE COLD WEATHER RULE CHANGES FOR RATEMAKINE PURPOSES?

A. No. The Company tracks all customer accounts and if an individual account must be written off, the write-off occurs. The reason for the write-off of an individual customer's account is not relevant so long as there is no reason to believe the write-off occurred because of an imprudent action by the utility. The regulatory process as previously discussed analyzes the actual amounts written off in the rate-setting process.

Q. WHY IS IT THEN NECESSARY TO ADJUST THE ANALYSIS OF THE ACTUAL WRITE-OFFS TO REFLECT THE COLD WEATHER RULE AMORTIZATION?

A. As previously stated, the normal financial record keeping process used by utilities records payments related to individual customer accounts and any resulting write-offs. The AAO granted by the Commission and its reflection in the rate determination in Case No. GR-2006-0422 resulted in increased rates for the general body of ratepayers to reflect the payment in base rates for expected write-offs of individual customers.

The financial record keeping system of MGE (or any utility under the Uniform System of Accounts) does not reflect these CWR AAO monies in account 144, Accumulated Provision for Uncollectible Accounts. Thus monies were received for the write-offs but the receipt was not recognized in account 144. In contrast, payments by customers or other customer assistance sources on accounts that have been written off are applied to account 144. The term net write-offs refers to this process of netting actual write-offs and subsequent payments related to the accounts that were actually written off.

Q. DID PUBLIC COUNSEL VERIFY THAT THE AAO ASSOCIATED WITH THE COLD WEATHER RULE WAS RECORDED ON MGE'S FINANCIAL RECORDS IN A MANNER THAT DID NOT IMPACT ACCOUNT 144?

A. Yes. During the three year period since the rates from GR-2006-0422 went into effect, the recording of the amortization did not impact the Accumulated Provision for Uncollectible Accounts, account 144. I have attached OPC Data Request 1206 to my rebuttal testimony as Schedule RWT-2. This schedule contains the Company's response to a request for the accounting entries related to the CWR amortization during the period. A review of the response clearly indicates that no entries were made to account 144.

Q. DID PUBLIC COUNSEL REVIEW THE STAFF POSITION IN CASE NO. GR-2009-0422?

A. Yes. The Staff witness in the case on bad debt expense was Paul R. Harrison. I have reviewed his testimony from that case along with his work papers related to bad debt expense. I have attached the relevant portions of his direct testimony on bad debt expense and CWR to my rebuttal testimony as Schedule RWT-3.

Q. HOW DID MR. HARRISON CALCULATE HIS RECOMMEDATION FOR BAD DEBT EXPENSE?

A. Mr. Harrison analyzed data from July 1998 through June 2006. He utilized a five year average actual net write-offs for the years ending July 2002– June 2006 to recommend a level of bad debt expense, $8,628,073 be included in the revenue requirement determination.

Q. DID MR. HARRISON MAKE AN ADJUSTMENT TO THIS AMOUNT WITH RESPECT TO THE COLD WEATHER RULE ACCOUNTING AUTHORITY ORDER?

A. No.

Q. IS IT PUBLIC COUNSEL'S UNDERSTANDING THAT THE PARTIES ULTIMATELY AGREED TO MR. HARRISON'S RECOMMENDATION WITH REGARD TO THE LEVEL OF BAD DEBT EXPENSE THAT DID NOT TAKE INTO CONSIDERATION THE CWR AMORTIZATION?

A. Yes.

Q. WAS THE COLD WEATHER RULE AMORTIZATION ADDED TO THE REVENUE REQUIREMENT DETERMINATION IN THAT CASE IN ADDITION TO MR. HARRISON'S RECOMMENDATION REGARDING BAD DEBT EXPENSE?

A. Yes.

Q. PLEASE EXPLAIN WHY PUBLIC COUNSEL HAS UPDATED ITS RECOMMENDED AMOUNT OF BAD DEBT EXPENSE BASED ON AN ANALYSIS OF THE ACTUAL NET WRITE-OFFS?

A. The section of the Staff Report related to bad debt expense, page 98, line 14 to page 99, line 4, asserted that actual net write-offs were trending upward based on data as of April 30, 2009. This assertion was not consistent with the information OPC had analyzed as of December 31, 2008. When this inconsistency was discussed between the parties, OPC requested additional information from MGE through July 31, 2009.

An analysis of this additional data indicated that Staff's use of data ending April 30, 2009 and use of only three annual periods had provided an incorrect interpretation of the actual trends related to net write-offs. Public Counsel believes that Staff's analysis was impacted by the abnormally high level of write-offs that occurred in April 2009 that effectively skewed the result. The net write-offs for April were over 67% higher than any April in the previous five years thus the inclusion of April as an end point taken together with the use of only three annual periods (years ending April 2007, 2008, & 2009) created a trend line with only three data points of which one was significantly impacted by an abnormal month.

Q. WHAT DID PUBLIC COUNSEL'S ANALYSIS OF THE ADDITIONAL DATA THROUGH JULY 31, 2009 REVEAL?

A. Public Counsel found that the trend over either a three or four year period showed a slightly decreasing trend in actual net write-offs. Use of a five year analysis resulted in a slightly increasing trend. The end point of each of the three trend lines was under $10 Million per year. These trend lines were developed after Public Counsel updated its analysis used in the filing of the direct testimony which had reviewed data from January 2003 through December 2008 to include the additional seven months of data. Public Counsel calculated rolling twelve month totals over this 79 month period and calculated trends based on those data points.

Q. WHY DID PUBLIC COUNSEL USE ROLLING TWELVE MONTHS TOTALS IN DEVELOPMENT OF ITS TREND ANALYSIS?

Q. The use of rolling twelve months averages eliminates the impact of choosing periods based on the selection of a single month that has abnormal levels and thus create a false impression with regard to any trend. The rolling twelve month data produces twelve times more data points over the same period thus significantly reducing the impact of any abnormal levels contained in the data and thus should provide a trend line that is more representative of actual experience.

Q. PLEASE EXPLAIN PUBLIC COUNSEL'S REVISED RECOMMENDATION FOR BAD DEBT EXPENSE EXCLUSIVE OF THE COLD WEATHER RULE AAO IMPACT.

A. Public Counsel calculated a three, four and five-year average of the rolling twelve month totals that corresponded to the trend periods analyzed. The following table reflects those averages:

Five-year average	$ 9,609,526
Four-year average	9,729,640
Three-year average	9,716,802

Public Counsel utilized an average of these three numbers to give more weight to the data from the most recent periods in order to recognize that the three and four-year trend lines have been going down (declining slope). OPC included the five-year average so as to include five years of data to provide consistency with the five-year period used by Staff witness Harrison in the prior case.

BAD DEBT EXPENSE IN THE PURCHASE GAS ADJUSTMENT CLAUSE

Q. PLEASE EXPLAIN MGE'S PROPOSAL AS YOU UNDERSTAND IT.

A. The Company proposes to adjust the PGA to reflect alleged uncollectible revenues based on a computation that compares annual net write-offs multiplied by the ratio of gas revenues to total revenues and then subtract a specific amount that MGE alleges is contained in base rates. The result of this calculation is then divided by 12 and the result is added or subtracted from the actual gas costs included in the PGA / Actual Gas Cost Adjustment (ACA) process.

Q. DOES PUBLIC COUNSEL SUPPORT MGE'S PROPOSAL?

A. No.

Q. PLEASE SET OUT THE REASONS PUBLIC COUNSEL OPPOSES THE PROPOSAL AS PRESENTED IN THIS CASE?

A. Public Counsel believes the proposal has several problems, specifically;

1. Uncollectible Expense is not a gas cost and as such should not be included in the PGA/ACA process.

2. The proposal constitutes single issue ratemaking without consideration of all other relevant factors.

3. The proposal constitutes retro-active ratemaking which counsel has advised is prohibited in the state of Missouri.

4. The proposal reduces the incentive to implement appropriate collection processes with respect to bills rendered thus placing additional risk on other customers' rates to reflect increased bad debt costs.

Q. YOU ASSERT THAT UNCOLLECTIBLE EXPENSE IS NOT A GAS COST. CAN YOU POINT TO ANY AUTHORITATIVE SOURCE THAT SUPPORTS YOUR POSITION?

A. Yes. MGE is required to maintain it books and records in conformance with the Uniform System of Accounts (USOA) as set out by the Federal Energy Regulatory Commission (FERC). A review of the USOA proves without any ambiguity that the FERC does not classify uncollectible expense as a gas cost. USOA account 904 has the following definition for uncollectible expense;

> This account shall be charged with amounts sufficient to provide for losses from uncollectible utility revenues. Concurrent credits shall be made to account 144, Accumulated Provision for Uncollectible Accounts—Credit. Losses from uncollectible accounts shall be charged to account 144.

USOA account 144 has the following definition;

> This account shall be credited with amounts provided for losses on accounts receivable which may become uncollectible, and also with collections on accounts previously charged hereto. Concurrent charges shall be made to account 904, Uncollectible Accounts, for amounts applicable to utility operations, and to corresponding accounts for other operations. Records shall be maintained so as to show the write-offs of accounts receivable for each utility department.

These definitions clearly do not define uncollectible expense as a gas cost. An estimate of a utilities inability to collect revenue is recorded as uncollectible expense and thus earnings are reduced in that period in which the revenues are recorded. At the same time, a reserve account is set up, USOA account 144, to account for the actual failure to receive cash from the customer for the billed revenues.

The failure to receive the cash does not change uncollectible expense (the failure to collect revenues) into gas costs as MGE asserts. Gas costs are also addressed in the USOA and found in accounts 800 through 813. A review of the USOA definitions of these respective categories of gas costs does not contain any reference to revenues or uncollectible expense. MGE's continued efforts to redefine gas cost are in conflict with the USOA and Generally Accepted Accounting Principles. I am aware of no GAAP that would require that the expense reflecting payments to third party vendors be increased to reflect a company's inability to collect revenue from its own customers.

Q. IS THERE ANOTHER DISTINCTION BETWEEN GAS COST EXPENSE AND UNCOLLECTIBLE EXPENSE?

A. Yes. Uncollectible expense does not require MGE to pay a third party that provides goods or service, whereas MGE does pay third parties for its gas costs. Uncollectible expense is simply a journal entry on the Company's financial records that at no time represents the outflow of cash or other assets to a third party. Outside of its gas acquisition policies and procedures, a utility has been deemed to have minimal if any control over the actual cost of gas and the resulting payments to third parties. In contrast, a utility has operational control over its policies and procedures to collect bad debts. MGE even discusses in the testimony the incentive it maintains to collect it revenue with the approximately 30% portion of bad-debt write-offs it proposes to exclude from the PGA process. (Noack direct testimony, page 13, line 20)

The Commission has recognized the value of incentives and that prudence review are not a good substitute for the company's own desire to improve its bottom line.

> Although the Fund would be subject to audit by Staff and Public Counsel and they could seek a prudence adjustment, the need for a prudence adjustment is difficult to prove and is not a good substitute for the company's own desire to prudently minimize its costs to improve its bottom line.
>
> (MPSC, Report and Order, GR-2006-0422, page 19, issued March 22, 2007)
>
> The Fund would be subject to audit by Staff and Public Counsel and they could seek a prudence adjustment if necessary. But the need for a prudence adjustment is difficult to prove and is not a good substitute for the company's own desire to prudently minimize its costs to improve its bottom line.
>
> (MPSC, Report and Order, GR-2004-0209, page 38, issued September 21, 2004)

Q. PLEASE EXPLAIN WHY MGE'S PROPOSAL WOULD CONSTITUTE SINGLE ISSUE RATEMAKING.

A. MGE is proposing to change the PGA tariff in a manner that allows rates charged to customers to fluctuate based on the increase or decrease in bad debt write-offs without considering all other relevant factors. Absent consideration of all other relevant factors, it cannot be determined if the resulting rates will result in a just and reasonable return on equity.

Q. WOULD CHANGES IN UNCOLLECTIBLE EXPENSE HAPPEN IN A VACUUM WITH RESPECT TO OTHER POSSIBLE CHANGES IN THE OPERATIONS OF THE UTILITY?

A. No. The overall cost of service is made up of a multitude of factors. Isolating or focusing on only one component, such as uncollectibles, fails to look at all relevant factors in determining the overall cost of service. Other factors may have changed that have a corresponding decrease or increase on the overall cost of service. Unless all factors are analyzed, it is not appropriate to single out one specific event. The effect of singling out a normal on-going cost for special treatment without consideration of all relevant factors is commonly referred to as single-issue ratemaking.

Q. DOES UTILITY REGULATORY THEORY ANTICIPATE THAT THERE WILL BE CHANGES IN THE COST COMPONENTS THAT MAKE UP THE OVERALL COST OF SERVICE?

A. Yes, I believe that would be a fair characterization. Rate of Return regulation anticipates overages and underages with respect to any specific cost component, the level of customers, sales and the resulting revenues. However, the critical point to recognize is that the determination as to whether rates are adequate or not is the measurement of the rate of return on equity, not an individual cost component, level of customers, or level of sales. It should also be noted that the courts have found that the regulatory process also provides the stockholder the opportunity, <u>not a guarantee</u>, to earn a rate of return. That opportunity involves business risk. Absent risk, authorized returns would reflect a risk-free return such as U.S. government securities (T-bills).

Any event such as an abnormally cool summer or warm or cold winter could have a significant impact on revenues and thus earnings. Other significant impacts could occur from any event such as a significant change in the economy in the normal course of utility operations that had a material impact on earnings. Other cyclical costs that are normalized for ratemaking treatment but expensed on the utilities financial records include tree-trimming expenses for electric utilities, tank painting for water utilities, and over-time hours for all types of utilities. All of these events are part of the normal business risks faced by a utility. The traditional regulatory process has procedures, which are normally used in ratemaking proceedings, which address these variable factors, and provides the utilities with an opportunity but not a guarantee to earn its rate of return.

Q. SHOULD THE FINANCIAL IMPACT OF A CHANGE IN BAD DEBT EXPENSE AND THE RESULTING IMPACT ON EARNINGS HAVE AN IMPACT ON WHETHER OR NOT BAD DEBT EXPENSE SHOULD RECEIVE SPECIAL CONSIDERATION AS IS IMPLICIT IN AN AAO?

A. No. The financial impact argument could be made for other expense categories as they can also have dramatic changes when measured as a percentage of change. A change in a single category of expense, investment, revenue, or customer levels without a change in any other of the components of the overall cost of service will impact earnings. The result is that the relationship between all the cost of service components has been altered to a degree that the level of earnings is no longer appropriate. The time period from the change in earnings until a change in rates occurs is referred to as regulatory lag. It must be recognized that regulatory lag can provide both for retention by the utility of earnings above a reasonable level and a period where earnings, while positive, are not at the authorized level. Regulatory Lag is the term that refers to the period between the imbalance occurring and the time rates are adjusted to reflect the imbalance. Regulatory Lag is an integral part of the incentive procedures built into the regulatory process to ensure customers have just and reasonable rates and utilities operate in a prudent manner.

Q. HAS THIS COMMISSION ADDRESSED REGULATORY LAG?

A. Yes. This Commission has held that it is **not** reasonable to protect shareholders from all regulatory lag. In Missouri Public Service Company, Cases Nos. EO-91-358 and EO-91-360, the Commission stated:

> Lessening the effect of regulatory lag by deferring costs is beneficial to a company but not particularly beneficial to ratepayers. Companies do not propose to defer profits to subsequent rate cases to lessen the effects of regulatory lag, but insist it is a benefit to defer costs. Regulatory lag is a part of the regulatory process and can be a benefit as well as a detriment. <u>Lessening regulatory lag by deferring costs is not a reasonable goal unless the costs are associated with an extraordinary event</u>.
>
> Maintaining the financial integrity of a utility is also a reasonable goal. The deferral of costs to maintain current financial integrity though is of questionable benefit. If a utility's financial integrity is threatened by high costs so that its ability to provide service is threatened, then it should seek interim rate relief. If maintaining financial integrity means sustaining a specific return on equity, this is not the purpose of regulation. <u>It is not reasonable to defer costs to insulate shareholders from any risks.</u> <u>If costs are such that a utility considers its return on equity unreasonably low, the proper approach is to file a rate case so that a new revenue requirement can be developed which allows the company the opportunity to earn its authorized rate of return. Deferral of costs just to support the current financial picture distorts the balancing process used by the Commission to establish just and reasonable rates.</u> Rates are set to recover ongoing operating expenses plus a reasonable return on investment. Only when an extraordinary event occurs should this balance be adjusted and costs deferred for consideration in a later period (Emphasis added).

Q. YOU DISCUSSED OTHER EXPENSES THAT COULD HAVE AN IMPACT ON EARNINGS IF THEY EXPERIENCED CHANGES. CAN YOU PROVIDE ANY EXAMPLES?

A. Cost of living adjustments for employees can have a significant impact on the payroll costs incurred by a utility. These payroll increases will cause a decrease in earnings if all other factors of the utilities operations remain unchanged. However other factors do not remain unchanged and thus regulators should look at all relevant factors and the resulting rate of return before changing rates. Another example that went in the opposite direction with regard to earnings impact was changes in federal income tax rates such as the reduction that occurred in 1986 and had a material impact on utility's earnings. I would note that the significant reduction in the tax rate due to the Tax Reform Act of 1986 did not result in AAOs or expense trackers being implemented despite the increased earnings created by the 25% drop in the federal corporate tax rate.

Q. PLEASE DEFINE THE TERM "COST" AS USED IN YOUR TESTIMONY.

A. I use the term "cost" to refer to each component of the total revenue requirement of the utility. Cost includes all expenses along with the earnings and interest expense associated with the rate base. The total revenue requirement is also called the overall cost of service.

Q. WHAT IS AN EXPENSE?

A. Expense is the use of assets and services in the creation of revenue during a specified period. Expenses are recorded on the income statement and are subtracted from revenues in order to determine net income (earnings) for the period

Q. WOULD THE INCREASED REVENUES DUE TO A COLDER THAN NORMAL WINTER OR CUSTOMER GROWTH ALSO INCREASE THE FUNDS AVAILABLE TO OFFSET INCREASED EXPENSE (AND THEREFORE MAINTAIN OR INCREASE EARNINGS) AS IT RELATES TO NOT ONLY UNCOLLECTIBLES BUT ALSO OTHER SPECIFIC EXPENSES?

A. Yes. Based on regulatory practices, a certain level of each expense plus return on equity makes up each dollar of revenue. The expected revenue received is based on a normalized level of gas sales. To the extent a colder winter would generate more sales and therefore more revenue, the utility would recover revenues sufficient to provide funds to pay increased expenses and provide greater earnings than anticipated. To single out one factor, such as uncollectibles, without looking at all offsetting factors, such as increased revenues, would constitute single issue ratemaking.

Rate of Return Regulation is not cost recovery regulation. Utilities are dynamic entities that are constantly changing and face constantly changing operating environments. Rate of return regulation looks at the relationship of all relevant factors and determines if the resulting return is appropriate. A cost component could change 100% and earnings may or may not be impacted, just as new investments may or may not generate sufficient revenues to maintain earnings. Only a review of all relevant factors can make that determination.

Q. IF FINANCIAL IMPACT IS THE ONLY CONSIDERATION, WOULD THAT OPEN A FLOODGATE OF OPPORTUNITY FOR A UTILITY TO MANAGE ITS EARNINGS THROUGH THE USE A TRACKER MECHANISM AS PROPOSED BY MGE IN THIS CASE?

A. Yes. An event such as an abnormally cool summer or warm or cold winter would have a significant impact on revenues and thus earnings. Other significant impacts could occur from any event in the normal course of utility operations that had a material impact on earning such as the impact of an annual cost of living adjustment for payroll. Other cyclical costs that are normalized for ratemaking treatment but expensed on the utilities financial records include tree-trimming expenses for electric utilities, tank painting for water utilities, and over-time hours for all types of utilities. All of these events are part of the normal business risks faced by a utility. The traditional regulatory process has procedures, which are normally used in ratemaking proceedings, which address these variable factors, and provides the utilities with an opportunity but not a guarantee to earn its rate of return.

Q. IS THE PROPOSAL BY MGE RETROACTIVE RATEMAKING IN PUBLIC COUNSEL'S OPINION?

A. Yes. MGE is proposing to single out a past expense (and the resulting decrease in earnings) and factor that amount into a rate that is effective in the future. This treatment perfectly describes retroactive ratemaking.

Q. IS IT YOUR UNDERSTANDING THAT RETROACTIVE RATEMAKING IS PROHIBITED IN MISSOURI?

A. Yes. As stated by the Missouri Supreme Court:

> [p]ast expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses, but under the prospective language of the statutes, Sections 393.270(3) and 393.140(5) they cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses.
>
> State ex rel. Utility Consumers Council v. Public Service Commission, 585 S.W.2d 41, 59 (Mo. Banc 1979) (citations omitted)

Q. HAS THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES APPROVED A RESOLUTION IN OPPOSITION TO THE TREATMENT OF BAD DEBT EXPENSE IN PURCHASE GAS ADJUSTMENT CLAUSES?

A. Yes. I have attached that resolution as Schedule RWT-4 to my rebuttal testimony.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.