Exhibit No.:	____________
Issue:	Gas Storage Inventory; Pension Expense; Legislative Activities; Incentive Compensation; Bad Debt Expense; Late Payment Fee; Cost of Removal/Salvage; Capacity Release/Off-system Sales; Low-income Programs; Proposed Reporting Requirements
Witness:	Michael R. Noack
Type of Exhibit:	Rebuttal Testimony
Sponsoring Party:	Missouri Gas Energy
Case No.:	GR-2004-0209
Date Filed:	May 24, 2004

MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

REBUTTAL TESTIMONY

OF

MICHAEL R. NOACK

ON BEHALF OF MISSOURI GAS ENERGY

Jefferson City, Missouri

May 2004

REBUTTAL TESTIMONY OF MICHAEL R. NOACK
ON BEHALF OF
MISSOURI GAS ENERGY

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REBUTTAL TESTIMONY OF MICHAEL R. NOACK
ON BEHALF OF
MISSOURI GAS ENERGY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Michael R. Noack. My business address is 3400 Broadway, Kansas City Missouri, 64111.

Q. DID YOU SUBMIT DIRECT TESTIMONY IN THIS PROCEEDING BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION ("COMMISSION") ON BEHALF OF THE MISSOURI GAS ENERGY ("MGE" OR "COMPANY") OPERATING DIVISION OF SOUTHERN UNION COMPANY ("SOUTHERN UNION")?

A. Yes I did.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. In my rebuttal testimony I will:

1. Provide schedules showing the Company's revenue deficiency following changes made as a result of the prehearing conference held from May 3 through 6, 2004;
2. Explain MGE's understanding concerning the agreed-upon true-up procedure to be used in this case;
3. Rebut the direct testimony of Commission Staff ("Staff") witness Allee regarding the rate base amount for gas storage inventory;

4. Rebut the direct testimony of Staff witness Hyneman regarding the accounting for actual pension expense that may be incurred in the future in excess of the $0 ERISA minimum being used for rate making purposes in this case;
5. Rebut the direct testimony of Staff witness Hyneman regarding rate recoverability of certain internal payroll costs associated with individuals with responsibility for legislative activities;
6. Rebut the direct testimony of Staff witnesses Eaves and Hyneman regarding rate recoverability of financially-based incentive compensation;
7. Rebut the direct testimony of Staff witness Harrison regarding the appropriate level of bad debt expense to be included in rates on a going forward basis;
8. Rebut the direct testimony of Staff witness Imhoff regarding the Staff proposal to reduce MGE's late payment charge from the current level of 1.5% to the Staff's proposed level of 0.5%;
9. Rebut the direct testimony of Staff witness Hyneman regarding accounting for cost of removal/salvage expense in excess of the rate case amount;
10. Rebut the direct testimony of Staff witness Allee and Office of Public Counsel ("Public Counsel") witness Busch proposing to include in the calculation of distribution rates revenues associated with capacity release and off-system sales;
11. Rebut the direct testimony of Staff witness Ross, Public Counsel witness Meisenheimer and City of Kansas City witness Jackson regarding a number of low-income programs; and

12. Rebut the testimony of Staff witnesses Allee, Bernsen and Hyneman regarding certain proposed reporting requirements.

1. MGE'S Revenue Deficiency after Discussions held during the Prehearing Conference

Q. PLEASE DESCRIBE THE REVENUE DEFICIENCY SCHEDULES ATTACHED TO YOUR REBUTTAL TESTIMONY.

A. During the prehearing conference held from May 3 through May 6, 2004, a number of discussions took place among the parties concerning the issues in this case. Many of these discussions focused on differences between the revenue deficiency presented in MGE's updated direct testimony (filed on January 30, 2004) and the revenue requirement presentation of the Staff (filed on April 15, 2004). These discussions resulted in changes to MGE's revenue deficiency calculation as well as changes to the calculation of Staff's revenue requirement. Included in MGE's changes is MGE's adoption of the update approach taken by the Staff; that is, the revenue requirement for the test year as filed by MGE (twelve months ending June 30, 2003) is updated for known and measurable changes occurring through December 31, 2003. MGE's depreciation expense is now calculated on the basis of the rates recommended in the June 2000 Black & Veatch Report, which was first provided to the Staff in June 2000, with the cost of removal/salvage component removed. MGE's evidence now supports a revenue deficiency of $41,880,775, as shown in Rebuttal Schedule MRN-1.

2. True-up Procedure

Q. DOES MGE CONTINUE TO RECOMMEND A TRUE-UP IN THIS CASE THROUGH APRIL 30, 2004?

A. Yes. The true-up was discussed among the parties during the prehearing conference and, based on those discussions, I understand that both MGE and the Staff recommend a true-up through April 30, 2004, covering the following items:

Gas prices used to compute the value of gas in storage
All other rate base components (excluding cash working capital expense and revenue lags)
Revenue for customer growth
Payroll – Employee levels, current wages and benefits
Rate case expense
Depreciation and amortization expense
FAS 106 OPEB expense
Related income taxes
Bad debt expense
Medical expense

As I understand the true-up process, a party's methodology is not to change for the true-up mechanism. I am not aware of any objections to the true up or the true up process agreed to by MGE and the Staff.

3. Gas Storage Inventory

Q. PLEASE DESCRIBE THIS ISSUE.

A. This issue concerns the price of gas to be applied to agreed-upon volumes of gas storage inventory for purposes of establishing an appropriate rate base amount for this item. The Staff has used a price of $4.59/MMBtu calculated on the basis of a three-year historical average, while MGE has proposed a price of $5.35/MMBtu calculated by reference to the NYMEX forward strip, as of December 31, 2003, for the storage injection months of April through October 2004. The Staff's price is unreasonable for reasons I will explain.

Q. WHAT ARE THE AGREED-UPON VOLUMES?

A. 10,464,628 MMBtu.

Q. PLEASE EXPLAIN HOW GAS STORAGE INVENTORY VOLUMES AND PRICE ARE USED IN THE RATE SETTING PROCESS INTHIS CASE?

A. A reasonable price is multiplied by a number representing reasonable volumes to measure the amount of money the Company has deployed for purposes of gas storage inventory. This amount is then included in rate base.

Q. IF AN UNREASONABLE GAS PRICE IS USED IN THIS CALCULATION, WILL MGE BE HARMED?

A. Yes. Using the unreasonably low price recommended by the Staff would cause MGE to suffer an immediate earnings shortfall due to the fact that the amounts the Company would necessarily incur for gas storage inventory would exceed the amount of such costs recognized in rates. The table below indicates the magnitude of the difference in revenue requirement between Staff and MGE on this issue.

	Storage Volume	Price Per MMBtu	Rate Base Amount
Staff Witness Allee	10,474,628	$ 4.59	$ 48,078,543
MGE	10,474,628	$ 6.14	$ 64,318,406
Rate Base Reduction using Staff's Method	-		$(16,239,863)
Resulting Reduction in Revenue Requirement using Staff's Recommended Rate of Return		6.830%	$ (1,800,314)
Resulting Reduction in Revenue Requirement using MGE's Recommended Rate of Return		9.354%	$ (2,465,614)

Q. HAS WITNESS ALLEE, OR ANY OTHER INDIVIDUAL OR INDIVIDUALS ON THE STAFF, UNDERTAKEN ANY ANALYSIS TO ASCERTAIN WHETHER THE FACTS AND CIRCUMSTANCES AFFECTING THE COST OF MGE'S STORAGE INVENTORY IN EXISTENCE DURING THE THREE YEAR PERIOD ENDING DECEMBER 31, 2003, ARE LIKELY TO BE REASONABLY REFLECTIVE OF THE FACTS AND CIRCUMSTANCES TO BE IN EXISTENCE ON AND AFTER OCTOBER 2, 2004, WHEN THE RATES FROM THIS CASE ARE GOING TO BE IN EFFECT?

A. That was the exact question asked in MGE DR 0004 to witness Allee. Her response, which is attached as Rebuttal Schedule MRN-2, indicated that she had evaluated the term of MGE's storage contracts, but had not done any analysis with respect to natural gas prices on a forward-looking basis with the exception of monitoring the current prices.

Q. WITNESS ALLEE'S RESPONSE MENTIONS THAT STAFF CONTINUES TO MONITOR CURRENT NATURAL GAS PRICES. WAS ANY ADJUSTMENT MADE BY STAFF TO GAS PRICES TO REFLECT CURRENT GAS PRICES?

A. No. Only a historical average was used.

Q. WHY IS THE $4.59/MMBTU PRICE PROPOSED BY THE STAFF UNREASONABLE?

A. As shown in the rebuttal testimony of MGE witness John Hayes, natural gas is unavailable at a price of $4.59/MMBtu for the period April-October 2004. In fact, the April strip settled at $5.365/MMbtu, the May strip settled at $5.935/Mmbtu and according to market conditions as of April 30, 2004, the NYMEX strip for the June-October 2004 time period is $6.5404/MMBtu. Since gas prices are a recommended true-up item, it is this price ($6.5404/MMBtu), adjusted for a basis differential of between $.30 and $.40/MMBtu, that MGE recommends for use in calculating an appropriate allowance for gas storage inventory in the true-up of this case. That means $6.1404/MMBtu should be used in the calculation.

Q. ARE THERE OTHER REASONABLE ALTERNATIVES TO USING THE JUNE-OCTOBER 2004 NYMEX STRIP PRICES, AS OF APRIL 30, 2004, TO PRICE THE STORAGE INVENTORY?

A. Yes. It would also be reasonable to use a forward looking price calculated by averaging the forward NYMEX strip for the 2004 and 2005 injection seasons or a forward looking price calculated by averaging the forward NYMEX strip for the 2004, 2005 and 2006 injection seasons. As shown in the rebuttal testimony of MGE witness John Hayes, the forward looking two-year average is $6.1643/MMBtu while the forward looking three-year average is $5.8988/MMBtu. Both of these would also need to be reduced for the basis differential, producing prices of $5.7643 (two-year forward average) or $5.4988 (three-year forward average).

Q. ARE THERE METHODS OTHER THAN THE THREE-YEAR AVERAGE OF HISTORICAL GAS COSTS AVAILABLE TO COMPUTE A VALUE OF THE GAS STORED IN INVENTORY?

A. Yes. Attached, as Rebuttal Schedule MRN-3 is a document supplied by witness Allee in response to MGE data request number 0003 which asked for all written policies, procedures or other documents relied upon in preparing her recommendation. The document entitled "Natural Gas Storage Position Paper" lists ways in which the Staff should compute a ***reasonable*** level of inventory in rate base. The first method listed is to use a five-year average of actual injection prices in order to smooth out any abnormally high or low gas prices that would otherwise be included in inventory. Depending on the circumstances of the case, this method has sometimes been modified. The position paper goes on to describe an alternative method:

> "If the 5 year average does not represent a reasonable estimate of injection prices, the more traditional 12 month ending approach might be used."

Q. DID STAFF TO YOUR KNOWLEDGE USE A MODIFIED METHOD OR USE THE 12-MONTH APPROACH SINCE THE AVERAGE DOES NOT REPRESENT AN ESTIMATE OF THE FUTURE?

A. Staff used a three-year average instead of a five-year average of gas costs but did not to my knowledge based on witness Allee's response to MGE DR 0004 explore the 12-month ending approach.

Q. WHAT IS MGE'S PROPOSAL?

A. It is MGE's proposal to use the average NYMEX strip adjusted for any basis difference to price the inventory. As an alternative, the Commission might look at the average price of storage for the 12 months ending April 30, 2004 that was $5.68/Mmbtu. The detail of the $5.68 is attached as Rebuttal Schedule MRN-4.

4. Pension Expense

Q. PLEASE DESCRIBE THIS ISSUE.

A. The Staff has recommended that the amount of pension expense to be included in MGE's revenue requirement should be based on ERISA minimum funding levels. This new Staff position represents a significant change from the methodology used, at the recommendation of the Staff, to calculate pension expense in prior MGE rate proceedings. MGE generally believes this new approach may be reasonable, so long as supplemental language—to be discussed later—is adopted. MGE is concerned, however, about the Staff's failure to follow a consistent approach for calculating pension expense from rate case to rate case.

Q. HOW WAS PENSION EXPENSE CALCULATED IN PRIOR MGE RATE PROCEEDINGS?

A. In prior proceedings a 5 year average was used, at the Staff's recommendation, for determining the unrecognized net gain/loss to be amortized over five years in calculating MGE's direct FAS 87 costs for financial reporting and rate making purposes. As a result of using that formula, the level of pension expense in the last case was a negative $2,200,000.

Q. WHAT WOULD MGE'S PENSION EXPENSE BE ACCORDING TO THE CALCULATION METHODOLOGY USED IN PRIOR MGE RATE CASES?

A. Approximately $3,950,000.

Q. WHAT IS MGE'S PENSION EXPENSE ACCORDING TO THE CALCULATION METHODOLOGY RECOMMENDED BY THE STAFF IN THIS RATE CASE?

A. $0.

Q. WHY ARE YOU CONCERNED ABOUT THE STAFF'S CHANGE IN METHODOLOGY?

A. The rationale advanced by the Staff for the change in its approach—to mitigate volatility in expense levels caused by financial performance of pension assets—has been a problem with the Staff's prior method from the outset. That is, the Staff's prior method was subject to this volatility. This was pointed out to the Staff in prior cases. However, the Staff has only recently been willing to acknowledge this problem. Perhaps it's nothing more than coincidence, but it should be pointed out that this change in Staff method comes at a time when the prior Staff method would generate positive pension expense for ratemaking purposes in this case. In the past, the Staff's method had generated negative expense for ratemaking purposes. The Commission should not sanction changing calculation methodologies from case to case simply to achieve the lowest possible revenue requirement.

Q. WHAT LANGUAGE SHOULD BE ADOPTED AS A SUPPLEMENT TO THE STAFF'S RECOMMENDED PENSION EXPENSE CALCULATION METHODOLOGY?

A. In order to protect against the possibility of earnings degradation due to pension funding requirements caused by matters (e.g., the financial performance of pension assets) largely beyond the Company's control, MGE requests that the Commission include in its order in this case language similar to language adopted by the Commission in other LDC rate proceedings (such as Aquila, Inc. in Case No. GR-2004-0072) as follows:

> MGE's rates include a $0 annual provision for jurisdictional pension cost. Company is authorized to reflect pension cost equal to the ERISA minimum and record the difference between the ERISA minimum and the annual provision for pension cost, including a provision for carrying costs associated with any such difference, 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 contributions 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 FAS71 to reflect that rates do not include FAS87 in cost of service. 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.

5. Legislative Activities

Q. PLEASE DESCRIBE THIS ISSUE.

A. MGE disagrees with the Staff's proposal—made by way of the direct testimony of Staff witness Hyneman—to disallow certain internal payroll costs involving legislative responsibilities and activities of certain MGE employees. In particular, the Staff proposes to disallow 100 % of the payroll costs of MGE employee Paul Snider and 10% each of the payroll costs of MGE employees Jim Oglesby and Rob Hack.

Q. WHY DOES MGE DISAGREE WITH THIS STAFF DISALLOWANCE?

A. First, as discussed in the rebuttal testimony of MGE witness Jim Oglesby, awareness of, and involvement in, the legislative process is a fundamental responsibility of operating a business affected with the public interest such as MGE's natural gas local distribution operations. Expenses associated with a reasonable level of internal resources involved in the legislative process are clearly a legitimate cost of doing business. In fact, the Staff has made no claim that MGE devotes excessive internal resources to this fundamental responsibility. Moreover, MGE has excluded from cost of service in this case, the expenses associated with all outside, contract lobbyists in addition to dues paid to the Missouri Energy Development Association. The Staff's proposal, which is apparently based on the belief that the cost of all legislative activities should be disallowed from rates because no benefits from such activities accrue to the ratepayers, is unfounded. MGE's exodus from the legislative process would effectively nullify the Company's ability to be aware of and involved in aspects of such process that impact customers and employees, as well as shareholders. For example, legislation passed in 2002, known as the Experimental School Transportation Program, has benefits for customers only. It does not directly benefit shareholders. It would not be responsible for MGE to simply ignore the legislative process. Therefore, it is reasonable for MGE to assign responsibility for legislative activities to various individuals at various levels within the Company, including the chief operating officer level, the officer level and the staff level.

Second, the evidence is irrefutable that Mr. Snider's responsibilities are not limited to legislative matters. For example, Mr. Snider's job description (attached hereto as Rebuttal Schedule MRN-5) clearly demonstrates that he has responsibility for media relations as well as special projects in addition to his legislative responsibilities. As a practical matter, the Missouri General Assembly meets for roughly three days per week for about four months per year and then meets "full time" for the last two weeks of the session. Therefore, even if Mr. Snider worked on legislative matters for the entirety of the legislative session (which he does not), the percentage of his time devoted to legislative activities would fall well short of even fifty percent (50%).

Third, if the Commission is inclined to adopt the Staff's recommendation that the cost of all legislative activities must be disallowed from rates, then the Commission itself needs to examine the costs it incurs associated with legislative activities, costs that are ultimately passed on to utility customers. It is clear from a review of job descriptions as well as the Commission's time reporting records that various Commission personnel are involved in the legislative process and that commission personnel devote substantial time to legislative activities. (See Rebuttal Schedules MRN-6 and 7, attached hereto). It is also clear that effectively all of the Commission's costs are recovered through utility assessments, which are funded by utility customers.

Q. WHAT IS MGE'S RECOMMENDATION?

A. It is MGE's recommendation that there be no disallowance of salary for Mr. Snider, for Mr. Oglesby or for Mr. Hack.

6. Incentive Compensation

Q. PLEASE DESCRIBE THIS ISSUE.

A. MGE disagrees with the Staff's proposal to disallow incentive compensation paid at the divisional level and at the corporate level that is awarded on the basis of achieving financial objectives. Staff witness Eaves and Staff witness Hyneman apparently believe that achieving financial objectives a) is not significantly driven by the interests of ratepayers, and b) does not benefit utility operations as a whole.

Q. WHY DOES MGE DISAGREE WITH THE STAFF'S RECOMMENDED DISALLOWANCE OF INCENTIVE COMPENSATION THAT IS FINANCIALLY BASED?

A. As shown in the rebuttal testimony of MGE witness Deborah Hayes, at-risk, incentive compensation is a practice observed by the vast majority of for-profit companies. MGE achieving its financial objectives is significantly driven by ratepayer interests and benefits utility operations as a whole.

Q. PLEASE EXPLAIN HOW CUSTOMER INTERESTS SIGNIFICANTLY DRIVE MGE ACHIEVING FINANCIAL OBJECTIVES.

A. To the extent any utility, including MGE, is able to achieve earnings it deems reasonable, it will be less likely to make filings, such as this one, seeking to implement general rate increases. Moreover, cost savings and efficiencies generated between rate cases should reduce the magnitude of a subsequent rate increase request to the benefit of customers. Financially based incentive compensation opportunities cause employees to seek out efficiencies that will help improve the bottom line and increase the likelihood of an award of incentive compensation.

Q. DO YOU HAVE DATA, IN ADDITION TO WHAT IS CONTAINED IN YOUR DIRECT TESTIMONY, SHOWING HOW MGE MEASURES UP TO OTHER GAS DISTRIBUTION COMPANIES IN TERMS OF PRODUCTIVITY?

A. Rebuttal Schedule MRN-8, which is a copy of Appendix 5 from the "2000-2002 Performance Benchmarks for Natural Gas Utilities", shows that the 50 natural gas utilities in the study had an average of 512 customers per employee. Based on December 31, 2003 data, MGE has a ratio of 759 customers per employee. (This includes divisional employees and an allocated number of corporate employees.)

Q. DID STAFF UNDERTAKE AN ANALYSIS TO ASCERTAIN HOW MGE'S COMPENSATION PRACTICES COMPARE TO PRACTICES IN THE MARKET?

A. No. Per witness Eaves' response to MGE DR 0027 to Staff (attached as Rebuttal Schedule MRN-9), neither witness Eaves nor any other individuals on the Commission Staff undertook such a study.

Q. DOES WITNESS EAVES BELIEVE THAT INCENTIVE COMPENSATION CAN HAVE A POSITIVE EFFECT ON EMPLOYEES?

A. Yes. In response to MGE DRs 0028 and 0029 to the Staff (attached as Rebuttal Schedules MRN-10 and MRN-11), witness Eaves believes that not only can incentive compensation affect the morale and/or job satisfaction of employees, but also can effect the behavior of employees.

7. Bad Debt Expense

Q. PLEASE DESCRIBE THIS ISSUE.

A. MGE disagrees with Staff witness Harrison's use of a five-year average to compute a normalized level of bad debt write-offs amounting to $6,135,570, with no recognition of any increased bad debts to result from the Commission's newly promulgated denial of service rule. MGE, on the other hand, recommends the use of a three-year average, producing a normalized level of $8,424,470, and proposes to add $750,000 to that amount in recognition of the increased bad debts to result from the Commission's newly promulgated denial of service rule.

Q. WHY DOES MGE DISAGREE WITH THE STAFF'S FIVE-YEAR AVERAGE METHODOLOGY?

A. Use of a five-year average includes the calendar years 1999 through 2003. In two of these years, 1999 and 2000, natural gas prices were significantly lower than natural gas prices are now and are also significantly lower than natural gas prices are projected to be for the next two or three years. The bottom line is that the factors influencing MGE's bad debts during the years 1999-2003 are not reasonably reflective of the factors likely to be prevailing during the period when the rates resulting from this case are going to be in effect.

Q. HAS STAFF WITNESS HARRISON, OR ANY OTHER REPRESENTATIVE OF THE STAFF, UNDERTAKEN ANY ANALYSIS TO ASCERTAIN WHETHER THE FACTS AND CIRCUMSTANCES AFFECTING MGE'S UNCOLLECTIBLE EXPENS/BAD DEBT LEVELS DURING THE FIVE YEAR PERIOD ENDING DECEMBER 31, 2003 WILL BE REASONABLY REFLECTIVE OF THE FACTS AND CIRCUMSTANCES LIKELY TO BE IN EXISTENCE DURING THE TIME PERIOD ON AND AFTER OCTOBER 2, 2004, WHEN THE RATES FROM THIS CASE ARE GOING TO BE IN EFFECT?

A. No such analysis has been undertaken by the Staff according to Staff witness Harrison's response to MGE data request number 0140, attached hereto as Rebuttal Schedule MRN-12.

Q WHAT FACTORS INFLUENCE BAD DEBT EXPENSE FOR A NATURAL GAS LOCAL DISTRIBUTION COMPANY LIKE MGE?

A. The primary factors influencing bad debt expense for MGE are: 1) revenue levels (including number of customers, use per customer and PGA rate); 2) collection tools available to the Company; and 3) the state of the economy (primarily the unemployment rate).

Q. PLEASE DESCRIBE THE FACTORS INFLUENCING MGE'S BAD DEBT EXPENSE DURING THE FIVE-YEAR PERIOD 1999 THROUGH 2003.

A. The table below shows values for the years 1999 through 2003 as well as the five-year and three-year average for those values:

	1999	2000	2001	2002	2003	5 YR Avg	3 YR AVG
Kansas City, Mo Unemployment Rate	3.10%	3.20%	4.40%	5.70%	5.90%	4.46%	5.33%
Average PGA (per Mcf)	$ 4.14	$ 4.97	$ 7.76	$ 4.90	$ 6.15	$ 5.58	$ 6.27
Average Number of Customers	492,428	498,990	500,141	503,045	506,807	500,282	503,331
Average Sales per Residential Customer (Mcf)	87.9	88.3	91.0	86.8	86.1	88.0	88.0

Q. IS IT POSSIBLE TO OBTAIN MORE CURRENT MEASURES OF SUCH FACTORS OR TO MAKE FORECASTS OF SUCH FACTORS INTO THE FUTURE?

A. Yes. As of March 31, 2004, unemployment in Kansas City, Missouri was 5.5%, higher than both the three and the five-year averages. MGE's PGA rate as of April 30, 2004 was approximately $0.75 per Ccf (or $7.50 per Mcf) also higher than both the three and the five-year averages; it is not expected to decrease for the foreseeable future. The average use per residential customer flowing from the Staff's estimate of normal use is 912 Ccf/customer/year (or 91.2 Mcf/customer/year); the average use per residential customer flowing from MGE's estimate of normal use is 876 Ccf/customer/year (or 87.6 Mcf/customer/year).

Q. DO YOU HAVE INFORMATION ON ANY OTHER FACTORS INFLUENCING MGE'S BAD DEBTS?

A. Yes. Southern Star Central Gas Pipeline ("SSCGP"), which used to be known as the Williams pipeline, provides interstate transportation and storage service to MGE representing approximately 67% of MGE's total interstate transportation and storage costs, filed a rate case with the Federal Energy Regulatory Commission on April 29, 2004. It is my understanding that SSCGP's proposed rates will likely take effect five months after filing, on a subject to refund basis. Our initial estimates indicate that this will translate into an increase in MGE's PGA rate of approximately $0.03/Ccf or about 4%. This increase in MGE's PGA rate will likely take effect on or about November 1, 2004.

In addition, the Commission has recently promulgated a denial of service rule by way of Case No. AX-2003-0574. The effect of this new rule will be to nullify certain sections of MGE's existing tariff found on Sheet No. 19 in Section 3.02. Specifically, the nullified provision is boldfaced in the following excerpt:

> Company shall not be required to commence supplying gas service if at the time of application, the applicant, **or any member of applicant's household (who has received benefit from previous gas service),** is indebted to Company for such gas service previously supplied at the same premises or any former premises until payment of such indebtedness shall have been made. This provision cannot be avoided by substituting an application for service at the

> same or at a new location signed by some other member of the former customer's household or by any other person acting for or on behalf of such customer.

MGE has consistently made use of this tariff authority in attempting to collect amounts owed. Nullification of this collection tool on a going forward basis will increase MGE's bad debts by an amount estimated to be $750,000 annually.

Q. WHAT CONCLUSIONS DO YOU REACH ON THE BASIS OF ALL OF THIS INFORMATION?

A. A three-year average, adjusted for $750,000 in additional bad debt to result from the elimination of a previously available collection tool, is a more reasonable measure of ongoing bad debt expense than the simple five-year average used by the Staff, which considering the current measures of the factors that influence bad debt expense, is clearly inadequate.

Q. HAS MGE CONSISTENTLY HAD IN RATES A LEVEL OF BAD DEBTS THAT IS BELOW WHAT HAS BEEN EXPERIENCED?

A. Yes. As is shown on Schedule G-3 of my direct testimony, actual bad debt expense per books from July 1, 1995 through June 30, 2003 was $44,567,834. The amount of bad debt expense allowed in rates for the same time period was $31,850,570 for an under collection of $12,717,264. Using an average of 5 years to compute the normal level of bad debts, with no recognition of increased bad debt expense to result from the elimination of a previously available collection tool, will only increase this shortfall on a going forward basis.

8. Late Payment Fee

Q. PLEASE DESCRIBE THIS ISSUE.

A. The Staff, by way of the direct testimony of Tom Imhoff, has proposed that MGE's late payment charge be reduced from 1.5% to 0.5%. MGE disagrees with this proposal.

Q. WHY SHOULD MGE'S LATE PAYMENT CHARGE REMAIN AT 1.5%?

A. In my opinion, the late payment charge should provide at least some incentive for customers to pay their bills on time. Although assessing a late payment charge of 1.5% on a delinquent balance for the first month of delinquency provides only a modest incentive for customers to pay on time, I believe that reducing this amount to 0.5% will provide almost no incentive for customers to pay on time.

Q. SHOULD THIS CHARGE BE THOUGHT OF AS A FINANCE CHARGE?

A. No, not in my opinion. First, MGE does not compound this 1.5%; it is applied only to the portion of the bill, which is one month overdue. It is not applied to past due amounts from previous months' bills. It should be thought of more like the late payment fee which credit cards charge in addition to finance charges if your bill is paid late. I suppose an alternative could be to charge a simple flat amount per bill if it is delinquent, however MGE is not proposing to do this.

Q. HOW LONG, ON AVERAGE, DO MGE'S CUSTOMERS PRESENTLY TAKE TO PAY THEIR GAS BILLS?

A. According to the cash working capital analysis of the MGE and Staff, MGE's customers take approximately 25 days to pay their gas bills.

Q. WOULD YOU EXPECT THIS LENGTH OF TIME TO INCREASE IF THE STAFF'S PROPOSAL TO REDUCE THE LATE PAYMENT CHARGE TO 0.5% WERE ADOPTED?

A. Yes.

Q. WHAT IMPACT WOULD THAT HAVE ON MGE?

A. It would increase MGE's cash working capital requirement. I estimate that for every additional day the average payment time is increased, cash working capital requirements would increase by approximately $1,150,000. Absent a corresponding adjustment to the cash working capital allowance, MGE's shareholders would be funding this extended payment time. If a corresponding adjustment to the cash working capital allowance were made, MGE's customers would be funding this extended payment time. Neither of these alternatives is a reasonable result in my opinion.

Q. HAS ANY SUCH IMPACT BEEN REFLECTED IN THE CASH WORKING CAPITAL REQUIREMENT USED BY THE STAFF IN THIS CASE?

A. No.

Q. DOES MGE CURRENTLY COMPOUND THE 1.5% LATE PAYMENT FEE?

A. No.

9. Accounting for Cost of Removal/Salvage Expense in Excess of Rate Case Amount

Q. PLEASE DESCRIBE THIS ISSUE.

A. For purposes of this case MGE has agreed to the net cost of removal/salvage expense methodology proposed by the Staff. Furthermore, there is no disagreement between MGE and the Staff as to the amount of net cost of removal/salvage expense to include in rates--$771,039. The issue on which MGE and the Staff disagree relates to future accounting treatment on the Company's books of actual cost of removal/salvage expense in excess of the rate case amount.

Q. HOW DOES THE STAFF PROPOSE THAT MGE ACCOUNT FOR ANY SUCH EXCESS COST OF REMOVAL/SALVAGE EXPENSE?

A. Because the Staff testimony is silent on the point, I am uncertain what the Staff proposes in this regard. However, as I understand it, absent express language from the Commission authorizing otherwise, MGE would be required to book actual cost of removal/salvage expense regardless of whether it exceeds the rate case amount.

Q. IS BOOKING ACTUAL COST OF REMOVAL/SALVAGE EXPENSE IN EXCESS OF THE RATE CASE AMOUNT REASONABLE?

A. No. Similar to the Staff position on accounting for actual ERISA minimum pension expense in excess of the rate case amount, accounting for cost of removal/salvage in this fashion could cause the Company to suffer earnings degradation as a result of matters entirely beyond the Company's control.

Q. WHAT DOES MGE PROPOSE AS AN ALTERNATIVE?

A. MGE requests that the Commission include in its order in this case the following language:

> "The provision for jurisdictional net cot of removal of $771,039 is to be recorded as an annual expense for rate making purposes. MGE shall book for its gas operations, actual levels of annual net cost of removal as an expense up to the amount listed above. For any actual amount of annual net cost of removal that exceeds this amount, MGE will record the difference in its accumulated depreciation reserve. This methodology will represent full recovery of all of MGE's annual net cost of removal expenditures. This methodology will be reviewed in MGE's next rate case in which its retail gas distribution rates are under review to determine whether the methodology will be continued."

10. Capacity Release/Off-system Sales

Q. PLEASE DESCRIBE THIS ISSUE.

A. MGE disagrees with the proposal, made by both the Staff and Public Counsel, to include in the calculation of MGE's distribution rates revenues derived from capacity release/off-system sales.

Q. WHY DOES MGE DISAGREE WITH THESE STAFF AND PUBLIC COUNSEL PROPOSALS?

A. First, because capacity release/off-system sales revenues relate to capacity and commodity costs that are recovered through the purchased gas adjustment ("PGA") mechanism in MGE's tariff, it is more appropriate that such revenues be handled through that mechanism. Second, as explained in the rebuttal testimony of MGE witness John Hayes, changes in market conditions have occurred and will occur in the future affecting the level of revenues MGE may be able to generate by way of capacity release such that past performance is not a reasonable or reliable indicator of future performance.

Q. PLEASE EXPLAIN MORE FULLY WHY YOU BELIEVE IT IS MORE APPROPRIATE TO HANDLE CAPACITY RELEASE/OFF-SYSTEM SALES REVENUES THROUGH THE PGA MECHANISM.

A. In Case No. GR-2002-348, an actual cost adjustment ("ACA") proceeding applicable to the time period July 1, 2001 through June 30, 2002, the Staff has proposed to disallow approximately $1.2 million in capacity costs based on the Staff's allegation that MGE has "excess" capacity under contract. As part of its rationale for its proposed disallowance the Staff stated that "Pursuant to MGE's most recent rate case, Case No. GR-2001-292, if this excess capacity were released in the capacity release market, the Company keeps all revenues associated with this capacity released." (Staff Recommendation, Case No. GR-2002-348, filed December 19, 2003). It is unfair to capture revenues for the benefit of customers on the one hand (i.e., including an amount of capacity release revenues in distribution rates in Case No. GR-2001-292) and then to propose disallowing recovery of associated costs for the same time period (through the ACA process in Case No. GR-2002-348). Treating capacity release/off-system sales revenues through the same process pursuant to which the associated costs are recovered—the PGA mechanism—will help to avoid this kind of regulatory problem. In addition, a revenue sharing approach implemented through the PGA mechanism will accurately apportion revenues generated by these items because the revenues shared will be based on known and audited results based on actual experience rather than a forecast of the future based on past experience.

Q. DOES THE COMPANY PROPOSE AN ALTERNATIVE TO THE STAFF AND PUBLIC COUNSEL PROPOSALS TO INCLUDE CAPACITY RELEASE/OFF-SYSTEM SALES REVENUES IN DISTRIBUTION RATES?

A. Yes. To address the shortcomings MGE has identified with the Staff and Public Counsel proposals and still appropriately credit customers with capacity release/off-system sales revenues, MGE proposes that the Commission order in this case include the following language:

> "MGE shall be authorized to implement, through its PGA mechanism, a revenue sharing grid pursuant to which revenues generated by capacity release and off-system sales (net of revenues from off-system sales made for "system protection" purposes) shall be shared between MGE and its customers as follows:
>
> First $300,000—15% to MGE and 85% to customers
>
> Second $300,000—20% to MGE and 80% to customers
>
> Third $300,000—25% to MGE and 75% to customers
>
> Above $900,000—30% to MGE and 70% to customers.
>
> Any excess capacity disallowance resulting from an actual cost adjustment ("ACA") proceeding shall be offset by capacity release revenues before application of the above sharing grid and before any shareholder funding may be required."

Compliance tariff sheets would then incorporate this concept into MGE's PGA clause for implementation.

11. Low-Income Programs

Q. PLEASE DESCRIBE THIS ISSUE.

A. A number of proposals have been made regarding low-income programs. The specific programs addressed include: A) low-income weatherization mentioned in the direct testimonies of MGE, the City of Kansas City and the Public Counsel; B) experimental low-income rate mentioned in the direct testimonies of the Staff and the Public Counsel; and C) "PAYS" mentioned in the direct testimony of the Public Counsel.

Q. WHAT IS MGE'S GENERAL POSITION WITH RESPECT TO LOW-INCOME PROGRAMS?

A. MGE understands that many customers have difficulty paying their gas bills, particularly in light of the current extended period of sustained high natural gas commodity prices. In an effort to be responsive to customers having such difficulty, MGE has an extensive track record of activity.

MGE has had in place for years employees—called customer advisors—whose primary responsibility is to help connect customers in need of energy assistance with providers of energy assistance.

MGE has been involved in the low-income weatherization program, in partnership initially with the City of Kansas City and later with other service providers, for years.

MGE was also the first energy utility in Missouri to implement a low-income rate, called the experimental low-income rate, as a result of the settlement of an MGE general rate proceeding in 2001.

In light of this extended history, MGE has come to the general conclusion that its involvement in low-income activities must be focused on matters that can be shown to provide demonstrable benefits to MGE's body of customers as a whole and which do not require significant administrative undertakings by MGE. MGE is in the business of operating a natural gas distribution system with the objective of generating a profit; MGE is not a social service agency.

Q. WHAT CONCLUSIONS DO YOU REACH WHEN APPLYING THIS GENERAL POSITION TO THE SPECIFIC LOW-INCOME PROPOSALS IN THIS CASE?

A. MGE believes that the low-income weatherization program has been shown to provide demonstrable benefits to MGE's body of customers as a whole. In addition, the low-income weatherization program does not require significant administrative activities on the part of MGE. MGE also understands that the waiting list for this program is lengthy, showing high demand for this program. As a consequence, MGE believes it is reasonable to provide additional funding for the low-income weatherization program. MGE has suggested an additional $160,000 (current funding is $340,000 per year) while the City of Kansas City and the Public Counsel have suggested differing amounts of additional funding. MGE believes any additional funding should be allocated in accordance with current funding proportions (i.e., $250,000 is presently administered by the City of Kansas City and $90,000 is administered throughout the balance of MGE's service territory).

MGE believes the experimental low-income rate program cannot yet be characterized as either a success or a failure primarily because it is unclear whether the low-income rate offering had any material impact on the payment practices of the participating customers. It has, however, required significantly more in the way of administrative undertakings by

MGE than MGE originally anticipated. As a consequence, MGE is willing to continue the experimental low-income program—unmodified—through July of 2006 or until funding runs out, whichever occurs first. Based on current subscription levels MGE believes funding already in hand is adequate to continue the program—unmodified—through that period. MGE is not willing to make the modifications to the program suggested by the Public Counsel and the Staff, primarily because of the additional administrative requirements and costs associated with those modifications.

MGE is unwilling to implement the PAYS program mentioned by Public Counsel witness Meisenheimer. MGE does not understand what is being proposed in the way of a PAYS program and is concerned that it may involve substantial administrative undertakings and costs by MGE. Perhaps more importantly though, it is MGE's understanding that the Commission has recently opened a case (Case No. GW-2004-0452) to examine potential energy efficiency initiatives. Until that case runs its course and the Commission reaches some sort of policy conclusion regarding energy efficiency programs, MGE believes it is premature to implement a program such as PAYS.

12. Proposed Reporting Requirements

Q. STAFF WITNESS ALLEE HAS RECOMMENDED THAT THE COMMISSION ORDER MGE TO SUBMIT PERIODIC RELIABILITY REPORTS AND GAS SUPPLY PLANS, STAFF WITNESS BERNSEN HAS RECOMMENDED THAT THE COMMISSION ORDER MGE TO RESPOND TO STAFF-FORWARDED COMPLAINTS/INQUIRIES WITHIN CERTAIN TIME PERIODS AND STAFF WITNESS HYNEMAN HAS RECOMMENDED THAT THE COMMISSION ORDER MGE OR SOUTHERN UNION TO TRACK TIME SPENT ON CERTAIN ACTIVITIES. DO YOU AGREE WITH THESE RECOMMENDATIONS?

A. No. There is no indication that what the Staff is proposing is factually unique to MGE. As such, it certainly appears to me to be an attempt to impose a general requirement on MGE without following the process used for setting state regulations. As I understand it, general requirements for utilities, such as those being recommended by the Staff here, should be set out in proposed rules or regulations. If the Commission deems any such requirements reasonable or appropriate, they should be enacted by following the process used to set state regulations and imposed uniformly on all similarly situated companies. If there is a problem that is factually unique to MGE, then a complaint should be filed.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, at this time.

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-2004-0209

AFFIDAVIT OF MICHAEL R. NOACK

STATE OF MISSOURI)
) ss.
COUNTY OF JACKSON)

Michael R. Noack, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, to be presented in the above case; that the answers in the foregoing Rebuttal 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.

Michael R. Noack

MICHAEL R. NOACK

Subscribed and sworn to before me this 24th day of MAY 2004.

Kim W. Henzi

Notary Public

My Commission Expires: Feb. 3, 2007

Kim W. Henzi
Notary Public - Notary Seal
State of Missouri
Jackson County
My Commission Expires Feb. 3, 2007