

Exhibit No.: \_\_\_\_\_  
Issue: Return on Equity/Earnings  
Variability; Amortization of  
Property Tax Refunds;  
Amortization of Unrecovered  
Cost of Service; Low-Income  
Weatherization Funding;  
Environmental Response Fund;  
Infinium Software Amortization;  
Emergency Cold Weather Rule  
AAO; Seasonal Disconnect Fee;  
Historical Earnings and O&M  
Expenses; Miscellaneous Tariff  
Issues; Updated Revenue  
Deficiency  
Witness: Michael R. Noack  
Type of Exhibit: Surrebuttal Testimony  
Sponsoring Party: Missouri Gas Energy  
Case No.: GR-2006-0422  
Date Testimony Prepared: December 11, 2006

MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NO. GR-2006-0422

SURREBUTTAL TESTIMONY

OF

MICHAEL R. NOACK

Jefferson City, Missouri

December 2006

**SURREBUTTAL TESTIMONY OF MICHAEL R. NOACK  
ON BEHALF OF  
MISSOURI GAS ENERGY  
GR-2006-0422**

**INDEX TO TESTIMONY**

	<u>Page Number</u>
Return on Equity/Earnings Variability	2
Amortization of Property Tax Refunds	5
Amortization of Unrecovered Cost of Service	5
Low-Income Weatherization Program Funding	9
Environmental Response Fund	10
Infinium Software Amortization	17
Emergency Cold Weather Rule AAO	19
Seasonal Disconnect Fee	20
Historical MGE Earnings Analysis and O&M Cost Comparisons	20
Unopposed Tariff Changes	24
MGE's Updated Revenue Deficiency	24

**SURREBUTTAL TESTIMONY OF MICHAEL R. NOACK  
ON BEHALF OF  
MISSOURI GAS ENERGY  
GR-2004-0209**

1   **Q.    PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2   A.    My name is Michael R. Noack, 3420 Broadway, Kansas City, Missouri.

3

4   **Q.    ARE YOU THE SAME MICHAEL R. NOACK WHO PREVIOUSLY SUBMITTED**  
5       **DIRECT, UPDATED DIRECT AND REBUTTAL TESTIMONY IN THIS**  
6       **PROCEEDING?**

7   A.    Yes.

8

9   **Q.    WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

10  A.    I will address:

- 11           • 1) the rebuttal testimony of OPC witness Trippensee related to return on equity with
- 12           an emphasis on earnings variability;
- 13           • 2) the Staff's proposed amortization of property tax refunds as a reduction to revenue
- 14           requirement;
- 15           • 3) the rebuttal testimony of Staff witness Oligschlaeger related to unrecovered cost of
- 16           service amortization;
- 17           • 4) the rebuttal testimony of Staff witness Ross and City of Kansas City witness
- 18           Jackson related to low-income weatherization program funding;

- 5) the rebuttal testimony of Staff witness Harrison and OPC witness Robertson related to the environmental response fund;
- 6) the rebuttal testimony of Staff witness Mapeka and OPC witness Robertson related to amortization of Infinium software costs;
- 7) the absence of OPC rebuttal testimony related to the amortization of deferred costs incurred due to compliance with the emergency cold weather rule;
- 8) the rebuttal testimony of Staff witness Ensrud related to the seasonal disconnect fee;
- 9) the rebuttal testimony of Staff witness Oligschlaeger related to the historical MGE earnings analysis and annual operating and maintenance (“O&M”) cost per customer comparisons;
- 10) certain unopposed changes proposed by MGE in a number of tariff sheets; and
- 11) MGE’s updated revenue deficiency.

**1. Return on Equity/Earnings Variability**

**Q. ON PAGE 6 OF HIS REBUTTAL TESTIMONY, OPC WITNESS TRIPPENSEE STATES THAT THE IMPACT OF A FIXED RESIDENTIAL DELIVERY CHARGE ON THE COMPANY IS THAT “. . . THE RISK OF EARNINGS VARIABILITY WILL BE VIRTUALLY ELIMINATED FOR THESE CUSTOMER CLASSES AND GREATLY REDUCED FOR ITS MISSOURI JURISDICTIONAL OPERATIONS”. DO YOU AGREE?**

1 A. No. This statement implies that the residential class volumetric revenue stream represents  
2 the only material driver of MGE's earnings variability. This is simply and demonstrably  
3 untrue. Many variables contribute significantly to MGE's earnings variability. Forexample:

- 4 • As is shown in Schedule G-3 Page 1 of 2 of my direct testimony, bad debt expense  
5 actually experienced by MGE can vary significantly from one year to another as well  
6 as from the amount of bad debt expense which is included in rates. In fiscal year  
7 ending June 30, 2001, MGE experienced actual bad debt write-offs of more than  
8 \$12.6 million. MGE and the Staff recommend for purposes of this case that  
9 \$8,628,073 of bad debt expense should be included in calculating customer rates.  
10 Based on actual experience, therefore, at least \$4 million of earnings variability may  
11 occur for MGE in the future related to bad debts alone.

- 12 • Property tax expense is also an item that can vary considerably from year to year; if  
13 MGE's earnings improve after this rate case, one likely result is that MGE's property  
14 tax liability will increase because those improved earnings will serve to reduce or  
15 eliminate the economic obsolescence (i.e., MGE's chronic earnings shortfalls) that  
16 produced the property tax refunds for tax years 2002-2005. As a result, it is quite  
17 possible that MGE will experience earnings variability in the future of \$1 million or  
18 more related to the difference between actual property tax liability going forward and  
19 the amount of property taxes included in rates in this case. In fact, property tax  
20 expense for 2004 was \$9.3 million or \$800,000 higher than the amount included in  
21 rates in Case No. GR-2004-0209.

- 1           • It is also undeniable that MGE can lose customers and suffer revenue losses relative  
2           to the revenue levels assumed for rate setting purposes as a result. This has occurred  
3           recently as a direct result of action taken by the Commission when it expanded the  
4           service territory of Trigen-Kansas City allowing Trigen to provide steam service to  
5           hospital customers whose primary space heating needs has formerly been served by  
6           MGE. (See, Case No. HA-2006-0294)
- 7           • As indicated in the surrebuttal testimony of MGE witness Helfrich, MGE has a  
8           number of former manufactured gas plant sites that may require remediation in the  
9           future. The costs associated with these projects can be significant and represent  
10          another possible cause of significant earnings variability for MGE in the future.
- 11          • MGE has also experienced, and is likely to continue to experience, increases in other  
12          types of expenses, such as wages and salaries, health care premiums, expense for  
13          postage stamps, property and general liability insurance premiums, etc.

14          In conclusion, although I agree (and, in fact, proved in my direct testimony) that the  
15          volumetric revenue stream produced by the residential class under MGE's current rate  
16          structure has been a primary driver of MGE's chronic earnings shortfalls over at least the past  
17          decade, there are many other material cost-of-service elements that have contributed to  
18          MGE's past earnings shortfalls and – even with the straight fixed-variable rate structure  
19          proposed by MGE and endorsed by the Staff for the residential customer class – will  
20          continue to contribute to earnings variability for MGE in the future.

1                                    **2. Amortization of Property Tax Refunds**

2    **Q. PLEASE DESCRIBE THIS ISSUE.**

3    A. MGE opposes the Staff's proposal to include in cost of service, through a 5-year  
4       amortization, property tax refunds MGE received in 2005 attributable to tax years 2002, 2003  
5       and 2004. Under the Staff's proposal, one-fifth of this \$5.5 million refund, or approximately  
6       \$1.1 million would be used to *reduce* MGE's revenue requirement.

7  
8    **Q. WHAT IS THE BASIS OF MGE'S OPPOSITION TO THE PROPERTY TAX**  
9       **REFUND AMORTIZATION?**

10   A. The Staff's proposed amortization of property tax refunds should be rejected because it  
11       constitutes prohibited retroactive ratemaking. In addition, no accounting authority order was  
12       ever issued in time to preserve these refunds for the subsequent ratemaking treatment the  
13       Staff now proposes.

14  
15                                    **3. Amortization of Unrecovered Cost of Service**

16   **Q. PLEASE DESCRIBE THIS ISSUE.**

17   A. The Staff opposes MGE's proposal to include in cost of service, through a 5-year  
18       amortization, the difference between MGE's actual revenues for the period January 1, 2006  
19       through June 30, 2006 and the level of revenues for that period assumed in MGE's last rate  
20       proceeding. MGE's actual revenue levels during the first six months of 2006 fell short of the  
21       revenue levels assumed in Case No. GR-2004-0209 because extraordinarily warm weather  
22       caused actual customer usage to fall well short of the customer usage levels assumed in that

1 rate case. Under MGE's proposal, one-fifth of this \$15.6 million difference, or  
2 approximately \$3.125 million, would be included in MGE's revenue requirement.

3  
4 **Q. WHAT IS THE BASIS OF THE STAFF'S OPPOSITION TO THE UNRECOVERED**  
5 **COST OF SERVICE AMORTIZATION?**

6 A. According to the rebuttal testimony of Staff witness Oligschlaeger (on page 4), MGE's  
7 proposed unrecovered cost of service amortization should be rejected because it constitutes  
8 prohibited retroactive ratemaking. Mr. Oligschlaeger also opines, on pages 6 and 7 of his  
9 rebuttal testimony, that the warm weather experienced during the first six months of 2006 is  
10 not an extraordinary event justifying special accounting treatment for this revenue shortfall.  
11 Finally, Mr. Oligschlaeger suggests on page 7 of his rebuttal testimony that there are  
12 alternatives to the unrecovered cost of service amortization that MGE can take to address  
13 concerns about ratemaking assumptions used by the Commission relating to average gas use  
14 by customers.

15  
16 **Q. PLEASE COMMENT ON THE STAFF'S POSITION THAT MGE'S PROPOSED**  
17 **UNRECOVERED COST OF SERVICE AMORTIZATION CONSTITUTES**  
18 **PROHIBITED RETROACTIVE RATEMAKING.**

19 A. I cannot disagree with Mr. Oligschlaeger's assertion that MGE's proposed unrecovered cost  
20 of service amortization constitutes retroactive ratemaking. Whether it is prohibited is a  
21 question perhaps answered by a lawyer, but the answer to that question may be affected by  
22 whether the item is viewed as "extraordinary" which I will address later. It is notable,



1       however, that Mr. Oligschlaeger's opposition to MGE's proposed unrecovered cost of  
2       service amortization is virtually identical to my opposition to the Staff's proposed  
3       amortization of property tax refunds.

4  
5       **Q.    HOW IS THE STAFF'S OPPOSITION TO YOUR UNRECOVERED COST OF**  
6       **SERVICE AMORTIZATION VIRTUALLY IDENTICAL TO YOUR OPPOSITION**  
7       **TO THE STAFF'S PROPOSED AMORTIZATION OF PROPERTY TAX REFUNDS?**

8       A.   Mr. Oligschlaeger on page 5 of his rebuttal testimony at lines 1 through 6 states the  
9       following:

10           Allowing a utility to recoup past losses in forward-looking rates is a significant  
11           disincentive to utility efficiency, in that such a practice would presumably reduce a  
12           utility's desire to avoid such financial losses in the first place. Similarly, allowing  
13           utility customers to derive the past benefit of utility gains in forward-looking rates  
14           would also be a significant disincentive to utility efficiency, in that such a practice  
15           would presumably reduce a utility's desire to achieve the financial gains in the first  
16           place.

17  
18       So while asking the Commission to disallow the amortization of the Unrecovered Cost of  
19       Service on the grounds that it constitutes illegal retroactive ratemaking and is also ill-advised  
20       from a ratemaking perspective, Staff turns right around and asks the Commission to allow an  
21       adjustment which would offset property tax expense with the past benefits of the utility  
22       gains realized from property tax refunds for the years 2002 through 2004.

23  
24       **Q.    PLEASE RESPOND TO MR. OLIGSCHLAEGER'S OPINION THAT WARM**  
25       **WEATHER DURING THE FIRST SIX MONTHS OF 2006 DOES NOT**  
26       **CONSTITUTE AN EXTRARODINARY EVENT.**

1 A. As to Mr. Oligschlaeger's contention that warmer than normal weather during the first six  
2 months of 2006 and the resulting \$15.6 million revenue shortfall does not constitute an  
3 extraordinary event, I disagree wholeheartedly. A six month revenue shortfall of \$15.6  
4 million is a staggering sum. MGE's total operating and maintenance expenses for the test  
5 year (unadjusted) were \$71.1 million. The revenue shortfall amounts to 22% of total O&M  
6 expenses. There are no budget cuts that MGE can make and still maintain safe and adequate  
7 service to customers which will make up for the revenue shortfall experienced. Taken as a  
8 percent of net operating income before interest expense, the revenue shortfall amounts to  
9 35%. As a point of reference, the threshold for extraordinary items defined in the uniform  
10 system of accounts is 5% of income. This issue points out the necessity of the proposed SFV  
11 rate design or some other meaningful weather and conservation normalization clause to  
12 enable MGE to have a meaningful opportunity to earn its authorized rate of return.

13  
14 **Q. PLEASE RESPOND TO MR. OLIGSCHLAEGER'S ASSERTION REGARDING**  
15 **ALTERNATIVES TO MGE'S PROPOSED UNRECOVERED COST OF SERVICE**  
16 **AMORTIZATION.**

17 A. Any alternatives that exist on a prospective basis would do nothing to compensate MGE for  
18 the massive revenue and earnings shortfall it has already experienced in the first half of 2006.

1                                    **4. Low-income Weatherization Program Funding**

2    **Q.    DO YOU AGREE WITH STAFF WITNESS ROSS'S PROPOSAL THAT MGE**  
3           **PARTICIPATE WITH KANSAS CITY POWER & LIGHT COMPANY ("KCPL") IN**  
4           **AN EVALUATION OF THE PROGRAM?**

5    A.    Yes. MGE agrees with Ms. Ross's proposal (found on page 5 of her rebuttal testimony)  
6           which, as I understand it, is that MGE should increase total program funding by \$120,000  
7           annually and that \$20,000 of that amount should be used to participate with KCPL in an  
8           evaluation of the program. The revenue deficiencies shown in Surrebuttal Schedule MRN-4  
9           appended hereto include \$120,000 in increased costs for low-income weatherization funding.

10  
11  
12   **Q.    DO YOU AGREE WITH CITY OF KANSAS CITY WITNESS JACKSON'S**  
13           **RECOMMENDATION TO INCREASE LOW-INCOME WEATHERIZATION**  
14           **PROGRAM FUNDING PROVIDED TO THE CITY OF KANSAS CITY BY \$250,000**  
15           **ANNUALLY? PLEASE EXPLAIN YOUR ANSWER**

16   A.    No. MGE's position on this proposal is in no way based on a lack of faith by MGE in either  
17           the merits of the program or in the City of Kansas City's administration of the program; both  
18           the program itself and the City of Kansas City's administration of the program (which applies  
19           to a significant portion – but not the entirety – of the program in MGE's service territory) are  
20           solid and beneficial to MGE and its customers. Instead, this view is based on my opinion  
21           that funding for this program should be increased more gradually than Mr. Jackson proposes  
22           (i.e., MGE's proposed increase of \$120,000 annually for the entirety of the program

1 throughout MGE's service territory vs. Kansas City's proposed increase of \$250,000  
2 annually for that portion of the program administered by the City of Kansas City). If the  
3 Commission determines otherwise, MGE will of course comply.

4  
5 **5. Environmental Response Fund**

6 **Q. PLEASE DESCRIBE THIS ISSUE.**

7 A. Both the Staff (by way of the testimony of Mr. Harrison) and OPC (by way of the testimony  
8 of Mr. Robertson) oppose MGE's proposal to implement a mechanism to address the  
9 ongoing regulatory and ratemaking treatment of costs associated with former manufactured  
10 gas plant ("MGP") sites. The basis of their opposition can be paraphrased as follows:

- 11 a. OPC and the Staff allege that the asset purchase agreement pursuant to which  
12 Southern Union acquired the Missouri property from Western Resources, Inc., in  
13 1994 somehow disclaims rate recoverability of MGP costs (Harrison Rebuttal,  
14 pp. 5-6; Robertson Rebuttal, pp. 12-18);
- 15 b. the Staff alleges that MGP costs are not known and measurable (Harrison  
16 Rebuttal, p. 6) and OPC alleges that MGP costs may be potentially recoverable  
17 from other entities (Robertson Rebuttal, pp. 18-21);
- 18 c. the Staff alleges that the environmental response fund proposed by MGE could  
19 constitute single-issue and retroactive ratemaking (Harrison Rebuttal, p. 6);
- 20 d. the Staff alleges that the environmental response fund proposed by MGE is flawed  
21 in that it provides automatic rate recovery of MGP costs and therefore reduces the

1 incentive for MGE to seek recovery of costs from other entities (Harrison Rebuttal, p.  
2 6);

3 e. OPC witness Robertson alleges that the “used and useful” principle precludes  
4 recovery of MGP costs (Robertson Rebuttal, p. 21); and

5 f. OPC alleges that customers have already reimbursed the company for MGP costs  
6 (Robertson Rebuttal, p. 20).

7 I will discuss and refute each of these allegations in turn below.

8  
9 **a. The 1994 Asset Purchase Agreement Does Not Preclude Rate Recovery of MGP Costs**

10 **Q. DOES THE 1994 ASSET PURCHASE AGREEMENT BETWEEN SOUTHERN**  
11 **UNION AND WESTERN RESOURCES PRECLUDE RATE RECOVERABILITY**  
12 **OF MGP COSTS?**

13 A. No. In fact the asset purchase agreement specifically requires Southern Union to seek  
14 rate recovery of MGP costs before it may seek recovery from Western Resources.  
15 (Harrison Rebuttal, Schedule 1-5, section (iii)). Moreover, if Southern Union had agreed  
16 to forego recovery of MGP costs from Missouri customers any such agreement most  
17 certainly would have been reflected in the Stipulation and Agreement approved by the  
18 Commission in the course of authorizing Southern Union’s acquisition of the Missouri  
19 property. No such agreement is reflected in that document and no party has made any  
20 allegation that Southern Union has made any such agreement.

1       **b. MGP Costs Need Not Be Known and Measurable to be Included in Rates**

2       **Q.     DO YOU AGREE THAT MGP COSTS MUST BE KNOWN AND MEASURABLE**  
3       **TO BE INCLUDED IN RATES?**

4       A.     No. The environmental response fund proposed by MGE as contained in my direct  
5       testimony would segregate all revenues—including a share of any contributions toward  
6       MGP costs the Company is able to obtain from other entities—collected for these costs  
7       into an interest bearing trust account. To the extent that monies in the account are not  
8       spent, any such amounts can be credited to the benefit of customers when the  
9       Commission deems it appropriate. However, it must be recognized that approximately  
10      \$9.9 million has been spent by MGE on MGP activities since February 1994, and as  
11      explained in the rebuttal testimony of MGE witness Helfrich, MGE continues to believe  
12      that additional MGP costs may need to be incurred in the future.

13  
14      **c. Sound Policy Reasons Support Implementation of an Environmental Response Fund**

15      **Q.     DO YOU AGREE WITH STAFF WITNESS HARRISON THAT THE**  
16      **ENVIRONMENTAL RESPONSE FUND PROPOSED BY MGE COULD**  
17      **CONSTITUTE PROHIBITED SINGLE-ISSUE AND RETROACTIVE**  
18      **RATEMAKING?**

19      A.     No. The Environmental Response Fund proposed by MGE is essentially a tracking  
20      mechanism designed to ensure that shareholders and customers are neither benefited nor  
21      disadvantaged by a mismatch between MGP costs included in rates and MGP costs  
22      actually incurred. Although not a traditional ratemaking mechanism in Missouri, a

1 tracking mechanism is appropriate for MGP costs because although the incurrence of  
2 such costs is certain, the precise timing and amount of such costs is not presently known.  
3 Many jurisdictions have adopted similar mechanisms for the regulatory and ratemaking  
4 treatment of MGP costs, presumably for those very reasons. I did a search using Lexis-  
5 Nexis to find regulatory jurisdictions which over the past 10 years had made findings  
6 allowing environmental costs in rates either through a surcharge, rider, PGA or simply as  
7 an expense to be included in rates. Schedule MRN-1 is a list of 24 states where  
8 environmental costs have been included in some fashion in rates with some states having  
9 adopted mechanisms for the regulatory treatment of MGP costs similar to the  
10 Environmental Response Fund proposed by MGE. The environmental response fund  
11 proposed by MGE is essentially an accounting authority order, as Staff witness Harrison  
12 appears to recommend at page 7 of his rebuttal testimony, with the added feature of  
13 funding. Funding serves the beneficial purposes of mitigating rate shock in the event  
14 significant MGP costs are incurred in the future and also promotes intergenerational  
15 equity concepts by spreading cost recovery over a wider base of customers. Therefore,  
16 because of the specific design features of the Environmental Response Fund proposed by  
17 MGE, I do not believe it constitutes prohibited single-issue or retroactive ratemaking.

1       **d. The Environmental Response Fund Provides Appropriate Incentives for MGE to**  
2       **Minimize Cost Recovery from Customers**

3       **Q.     STAFF WITNESS HARRISON ALLEGES THAT THE ENVIRONMENTAL**  
4       **RESPONSE FUND PROVIDES AUTOMATIC RECOVERY OF MGP COSTS**  
5       **AND THEREFORE REDUCES THE INCENTIVE FOR MGE TO SEEK**  
6       **RECOVERY OF SUCH COSTS FROM SOURCES OTHER THAN**  
7       **CUSTOMERS. DO YOU AGREE?**

8       A.    No. Mr. Harrison apparently ignores three critical features of MGE's proposal that  
9       provide very real incentives for MGE to minimize cost recovery from customers. First,  
10       sub-paragraph (a) includes the following requirement: "The Company will use best  
11       efforts to satisfy its obligation to minimize the Environmental Response Costs charged to  
12       the fund consistent with applicable regulatory requirements and sound environmental  
13       policies and to minimize litigation costs that may arise." (Noack Direct, Schedule H-25,  
14       page 2 of 2) Second, the sharing between customers and shareholders of contributions  
15       and/or recoveries obtained from other parties toward MGP costs as proposed in sub-  
16       paragraph (a) provides the Company with an opportunity to generate benefits for  
17       shareholders and customers from successful pursuit of such contributions. Successful  
18       pursuit of such contributions provides benefits to both the Company and its customers, so  
19       a sharing of such contributions is entirely appropriate. Third, sub-paragraph (c)  
20       specifically provides that the right to review costs charged to the environmental response  
21       fund is retained. All of these items make sure that the Company will use its best efforts  
22       to minimize MGP costs sought to be recovered from customers.



1  
2 **Q. HAS THE MISSOURI PUBLIC SERVICE COMMISSION EVER ENDORSED A**  
3 **PLAN OF REIMBURSEMENT OF ENVIRONMENTAL COSTS AND A**  
4 **SHARING OF INSURANCE PROCEEDS BETWEEN CUSTOMER AND**  
5 **SHAREHOLDER?**

6 A. Yes. The stipulation and agreement in FERC Docket No. RP93-109-000 called for  
7 Williams Natural Gas Company (now Southern Star Central) to recover annual  
8 environmental costs of \$1,700,000 and to continue to split insurance recoveries between  
9 customer and shareholder on a 90% customer and 10% shareholder basis. On February  
10 16, 2001, a document entitled "Comments of the Missouri Public Service Commission in  
11 support of Stipulation and Agreement" was filed with FERC. The cover letter and the  
12 Comments are attached as Surrebuttal Schedule MRN-2.

13 **e. The "Used and Useful" Principle Does Not Preclude Recovery of MGP Costs**

14 **Q. OPC WITNESS ROBERTSON ALLEGES THAT THE "USED AND USEFUL"**  
15 **PRINCIPLE PRECLUDES RECOVERY OF MGP COSTS. DO YOU AGREE?**

16 A. No. My understanding is that only used and useful items are to be included in rate base  
17 on which a return may be earned for purposes of calculating revenue requirements. MGP  
18 costs are not rate base items, but expense items, and as such I do not believe the used and  
19 useful concept has any applicability to determining their recoverability through rates.  
20  
21  
22

1       **f. Customers Have Not Already Reimbursed the Company for MGP Costs**

2       **Q.     OPC WITNESS ROBERTSON ALLEGES THAT CUSTOMERS HAVE**  
3               **ALREADY REIMBURSED THE COMPANY FOR MGP COSTS THROUGH**  
4               **THE RETURN ON EQUITY INCLUDED BY THE COMMISSION IN**  
5               **CALCULATING PAST RATES. DO YOU AGREE?**

6       A.     No. This allegation makes no sense at all. If true, one could also say that electric utilities  
7               should not be permitted to recover extraordinary costs caused by extreme weather events  
8               such as ice storms because past equity returns compensated the utility for such risks.  
9               Such an argument is clearly nonsense. As a matter of fact, Through June 30, 2006, the  
10              Company has expended approximately \$9.9 million in MGP costs since 1994 that have  
11              not been borne by customers.

12  
13       **Q.     DO YOU HAVE ANY OTHER COMMENTS TO MAKE?**

14       A.     Yes. As mentioned earlier in my testimony, I have identified 24 states where  
15               environmental costs have been included in some fashion in rates. Further, my research  
16               has not revealed that any regulatory jurisdiction has adopted a policy prohibiting recovery  
17               of MGP costs through rates, which is precisely the policy OPC is asking the Commission  
18               to adopt. The request which MGE has made in this case is very similar to a plan  
19               approved in Massachusetts in 1990. Attached as Schedule MRN-3 is the order approving  
20               a settlement in the generic case involving the ratemaking treatment of the costs of  
21               investigating and remediating matters associated with the manufacture of gas during the  
22               period 1822-1978. The order addresses most of the concerns of both OPC witness

1 Robertson and Staff witness Harrison. In addition to setting up a mechanism to recover  
2 costs, the Order also approves a sharing mechanism between customers and shareholders  
3 of 50/50 of net insurance proceeds.  
4

5 **6. Infinium Software Amortization**

6 **Q. STAFF WITNESS MAPEKA PROPOSES (ON PAGE 6 OF HER REBUTTAL**  
7 **TESTIMONY) TO INCLUDE IN COST OF SERVICE A 5-YEAR AMORTIZATION**  
8 **OF REMAINING INFINIUM SOFTWARE COSTS. HOW DO YOU RESPOND?**

9 A. MGE finds this proposal to be an acceptable alternative to the 3-year amortization I proposed  
10 in direct testimony. It is important to note that neither MGE nor the Staff propose to include  
11 the remaining Infinium software costs in rate base. Thus, if the joint proposal of MGE and  
12 the Staff is adopted, MGE would not be permitted to earn a return on the remaining Infinium  
13 software costs, but would be limited to recovering, over a five-year period, the costs  
14 expended by MGE for that software.  
15

16 **Q. OPC WITNESS ROBERTSON PROPOSES (ON PAGES 22-25 OF HIS REBUTTAL**  
17 **TESTIMONY) TO DISALLOW RECOVERY OF ALL REMAINING INFINIUM**  
18 **SOFTWARE COSTS. PLEASE RESPOND.**

19 A. The first reason advanced by Mr. Robertson is that “. . . the Company’s proposed treatment  
20 of this issue [i.e., amortization of the remaining Infinium software costs] . . . violates the  
21 regulatory ‘used and useful’ standard.” (Robertson Rebuttal, page 23, lines 1-2). His  
22 reliance on this standard is misplaced, however, for at least two reasons.

1  
2 First, as demonstrated by the material quoted by Mr. Robertson on lines 19-22 of page 23 of  
3 his rebuttal testimony, the “used and useful” standard applies to determinations of whether  
4 particular property should or should not be included in rate base and provided an opportunity  
5 on which to earn a return. As stated above, neither MGE nor the Staff has proposed to  
6 include the remaining Infinium software costs in rate base.

7  
8 Second, because MGE continues to make use of the Infinium software, albeit on a somewhat  
9 limited basis for time-entry purposes only, it remains “used and useful”. However, because  
10 the Infinium software is being used for such a limited purpose, MGE has not proposed to  
11 include those costs in rate base.

12  
13 **Q. DO YOU HAVE ANY OTHER COMMENTS ON OPC WITNESS ROBERTSON’S**  
14 **OPPOSITION TO THE AMORTIZATION OF REMAINING INFINIUM**  
15 **SOFTWARE COSTS?**

16 A. Yes. The kind of regulatory treatment being requested is not a new concept in regulation.  
17 This was the normal regulatory treatment for telephone companies especially in the 1980’s  
18 and 1990’s when switching equipment went digital and significant assets remained on the  
19 books without any residual or salvage value to the utility. The only way to recover those  
20 costs was to amortize the retirements over some period of time, usually the number of years  
21 remaining to be depreciated. One case of note where the Missouri Commission granted such

1 accounting and rate treatment was Case No. TR-98-343 Mid Missouri Telephone Company.  
2 In that case, the Commission approved a 5 year amortization of the extraordinary retirement.

3  
4 One additional point to make is that the cost allocated to MGE for the Oracle and PowerPlant  
5 software systems is \$2.6 million dollars while the Infinium software system allocated cost to  
6 MGE was \$6.8 million dollars and is a much more functional system as would be expected  
7 by technology advancements. Consequently, the decision to switch to Oracle as opposed to  
8 continuing to use Infinium was sound from both a dollars and cents and a functionality  
9 perspective, and further supports the reasonableness of the Infinium software amortization  
10 proposed by MGE and the Staff.

11  
12 **7. Emergency Cold Weather Rule AAO**

13 **Q. DID OPC OFFER ANY REBUTTAL TESTIMONY ON THIS ISSUE?**

14 A. No.

15  
16 **Q. DO YOU KNOW OPC'S POSITION, OR THE BASIS OF OPC'S POSITION, ON**  
17 **THIS ISSUE?**

18 A. No, not at this time.

1 8. Seasonal Disconnect Fee

2 **Q. DO YOU HAVE ANY COMMENTS ON THE REBUTTAL TESTIMONY OF STAFF**  
3 **WITNESS ENSRUD REGARDING THE SEASONAL DISCONNECT FEE ISSUE?**

4 A. Yes. On page 2 of his rebuttal testimony, Staff witness Ensrud apparently agrees, at least for  
5 purposes of this case, with MGE's proposal to limit the seasonal disconnect fee structure to  
6 those customers who have voluntarily disconnected service. Therefore, I believe that MGE's  
7 proposed seasonal disconnect fee, as modified in my rebuttal testimony (on page 13), is no  
8 longer the subject of any party's opposition in this proceeding.

9  
10 9. Historical MGE Earnings Analysis and O&M Cost Comparisons

11 **Q. ON PAGES 9-13 OF HIS REBUTTAL TESTIMONY STAFF WITNESS**  
12 **OLIGSCHLAEGER DISCUSSES THE HISTORICAL MGE EARNINGS ANALYSIS**  
13 **YOU PRESENTED ON SCHEDULE G-4 OF YOUR DIRECT TESTIMONY. WHAT**  
14 **CONCLUSION DOES MR. OLIGSCHLAEGER REACH?**

15 A. Although offering some mild criticism of my analysis, which I will address later, Mr.  
16 Oligschlaeger does not disagree with the central point of the analysis, namely that MGE's  
17 actual earnings have consistently fallen short of its Commission-authorized return levels.  
18 Specifically, Staff witness Oligschlaeger acknowledges MGE's consistent historical earnings  
19 shortfalls when he states on pages 12-13 of his rebuttal testimony:

20 Q. Your last point notwithstanding, **do you disagree that MGE has had a**  
21 **tendency to underearn** in its short history to date?

22  
23 A. **No.** Given the fact that MGE has added much plant in service to its rate base  
24 in recent years, and the nature of the ratemaking process in Missouri, **that**  
25 **phenomenon is not unexpected.**

1  
2 (emphasis supplied)  
3  
4

5 **Q. WHAT CRITICISMS HAS MR. OLIGSCHLAEGER OFFERED REGARDING**  
6 **YOUR ANALYSIS OF MGE'S HISTORICAL EARNINGS?**

7 A. In concluding that I have understated MGE's actual earnings levels, Staff witness  
8 Oligschlaeger offers three technical criticisms of the analysis:

- 9 1. my use of "end of period" rate base amounts versus annual average rate base;  
10 2. my omission of deferred income taxes as an offset to rate base;  
11 3. my elimination of the property tax refunds received in 2005 for tax years  
12 2002, 2003 and 2004 rather than spreading the impact of those refunds over  
13 the appropriate tax years.

14 Interestingly, Mr. Oligschlaeger provided no alternative analysis of MGE's historical  
15 earnings levels.  
16

17 **Q. HOW DO YOU RESPOND TO THESE CRITICISMS?**

18 A. I do not disagree with Mr. Oligschlaeger; however, incorporating those changes in the  
19 analysis does not significantly change the overall results, as can be seen on Surrebuttal  
20 Schedule MRN-5.  
21

1 **Q. REFERRING BACK TO SURREBUTTAL SCHEDULE MRN-5, HAS MGE HAD**  
2 **RATE INCREASES GO INTO EFFECT DURING THE PERIOD COVERED ON**  
3 **MRN-5?**

4 A. Yes. MGE had increased rates take effect on March 21, 1997 in case number GR-96-285,  
5 September 2, 1998 in case number GR-98-140, August 6, 2001 in case number GR-2001-  
6 0292 and October 2, 2004 in case number GR-2004-0209.

7  
8 **Q. DID MGE EARN THE COMMISSION-AUTHORIZED RETURN IN THE FISCAL**  
9 **YEAR IMMEDIATELY FOLLOWING ANY OF THE ABOVE MENTIONED RATE**  
10 **INCREASES?**

11 A. No.

12  
13 **Q. ON PAGES 8-9 OF HIS REBUTTAL TESTIMONY STAFF WITNESS**  
14 **OLIGSCHLAEGER DISCUSSES THE OPERATING AND MAINTENANCE**  
15 **(“O&M”) COST COMPARISON BETWEEN MGE AND CERTAIN OTHER**  
16 **MISSOURI GAS UTILITIES YOU PRESENTED ON SCHEDULE G-1 OF YOUR**  
17 **DIRECT TESTIMONY. WHAT CONCLUSION DOES MR. OLIGSCHLAEGER**  
18 **REACH?**

19 A. Although offering some criticism of my analysis, which I will address later, and some  
20 historical perspective that is not particularly relevant to a comparison of recent O&M costs,  
21 Mr. Oligschlaeger does not disagree with the central point of the analysis, namely that



1 MGE's O&M costs are lower than peer companies in the State. Specifically, Staff witness  
2 Oligschlaeger acknowledges MGE's consistently lower O&M costs when he states:

3 Q. Do you agree with Mr. Hack's conclusion that MGE's O&M expenses are  
4 lower than Laclede Gas Company's (Laclede's), AmerenUE's and Aquila  
5 Inc's (Aquila's) gas O&M expenses, when measured on a per customer  
6 basis?  
7

8 A. I do not disagree with the data shown on page 10 of Mr. Hack's direct  
9 testimony [which is drawn from Noack Direct, Schedule G-1]. \* \* \*  
10  
11

12 **Q. MR. OLIGSCHLAEGER INDICATES, ON PAGES 9-10 OF HIS REBUTTAL**  
13 **TESTIMONY, THAT CAUTION SHOULD BE USED WHEN MAKING DIRECT**  
14 **COST COMPARISONS BETWEEN DIFFERENT UTILITIES. HOW DO YOU**  
15 **RESPOND?**

16 A. I agree. No two companies are identical. However, the fact remains that the Missouri gas  
17 operations of Laclede, AmerenUE and Missouri Public Service (also known as "Aquila") are  
18 all subject to the regulatory authority and regulatory requirements of the Missouri Public  
19 Service Commission just like MGE's operations. Moreover, while the operations of these  
20 companies are not identical, they are subject to many similar economic conditions since all of  
21 the operations about which the comparison is being made are located within the State of  
22 Missouri. Moreover, Laclede, AmerenUE and Missouri Public Service, like MGE, have filed  
23 and processed requests for general rate increases in the recent past. In addition, the analysis  
24 compares O&M cost performance over a period of several years, not just one or two years,  
25 which eliminates the chance that MGE's significant advantage from an O&M cost  
26 perspective is being driven by an extraordinary or non-recurring item. As a consequence of

1 these factors, I believe it is reasonable to conclude that MGE consistently outperforms  
2 Laclede, AmerenUE and Missouri Public Service, in terms of O&M cost, from the analysis  
3 contained in Schedule G-1 in my direct testimony.  
4

5 **10. Unopposed Tariff Changes**

6 **Q. IN ITS TARIFF FILING WHICH INITIATED THIS PROCEEDING, DID MGE**  
7 **PROPOSE CHANGES TO A NUMBER OF TARIFF SHEETS THAT HAVE NOT**  
8 **BEN MENTIONED OR OPPOSED BY ANY OF THE PARTIES?**

9 A. Yes. Tariff sheet nos. 24.3, 61.2, and R-34, all of which were included in the filing made by  
10 MGE on May 3, 2006, have not been mentioned or opposed by any party.  
11

12 **11. MGE's Updated Revenue Deficiency**

13 **Q. HAVE YOU PREPARED AN UPDATED REVENUE DEFICIENCY FOR MGE**  
14 **INCOPORATING CHANGES IN POSITION ADOPTED IN THE COMPANY'S**  
15 **SURREBUTTAL TESTIMONY?**

16 A. Yes. MGE's current revenue deficiency stands at \$37,533,421, as reflected in Surrebuttal  
17 Schedule MRN-4 page 1 of 2. This reflects MGE's revenue deficiency as shown in my  
18 rebuttal testimony (based on an 11.75% return on equity, which included a 15 basis point  
19 upward adjustment to return on equity due to the absence of any protection for MGE from  
20 the vagaries of the weather) with one change – the addition of \$20,000 in low-income  
21 weatherization program funding recommended by Staff witness Ross and agreed to by MGE.

22 However, if the Commission adopts the straight fixed-variable rate design

1 recommended by MGE and endorsed by the Staff for the residential class, MGE's  
2 recommended return on equity would be reduced by 25 basis points – to 11.50%, as  
3 explained in the surrebuttal testimony of MGE witness Hanley – producing a revenue  
4 deficiency of \$36,449,902 as shown in Surrebuttal Schedule MRN-4 page 2 of 2. Neither of  
5 these revenue deficiencies includes costs for Natural Gas Conservation programs.

6  
7 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

8 A. Yes, at this time.  
9  
10  
11  
12

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.

)  
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Case No. GR-2006-0422

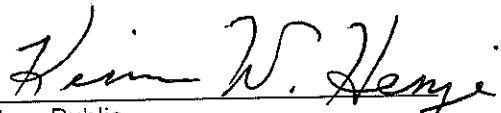
AFFIDAVIT OF MICHAEL R. NOACK

STATE OF MISSOURI            )  
  )  
COUNTY OF JACKSON        )       ss.

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

  
MICHAEL R. NOACK

Subscribed and sworn to before me this 11<sup>th</sup> day of December 2006.

  
Notary Public

My Commission Expires: Feb. 3, 2007

