

Exhibit No.: _____
Issues: Revenue Deficiency
Witness: Michael R. Noack
Sponsoring Party: Missouri Gas Energy
Case No.: GR-2006-
Date Testimony Prepared: May 1, 2006

MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NO. GR-2006-

DIRECT TESTIMONY OF

MICHAEL R. NOACK

Jefferson City, Missouri

May 2006

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CASE NO. GR-2006-_____

MAY 2006

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CASE NO. GR-2006-_____

MAY 2006

1

2 **Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS**
3 **ADDRESS?**

4 A. My name is Michael R. Noack and my business address is 3420 Broadway,
5 Kansas City, Missouri 64111.

6

7 **Q. WHO ARE YOU EMPLOYED BY?**

8 A. I am employed by Missouri Gas Energy (MGE), a division of Southern Union
9 Company (Company), as Director of Pricing and Regulatory Affairs.

10

11 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**
12 **EXPERIENCE.**

13 A. I received a Bachelor of Science in Business Administration with a major in
14 Accounting from the University of Missouri in Columbia in 1973. Upon
15 graduation, I was employed by Troupe Kehoe Whiteaker & Kent (TKWK), a
16 Certified Public Accounting Firm in Kansas City, Missouri. I spent
17 approximately 20 years working with TKWK or firms that were formed from
18 former TKWK employees or partners. I was involved during that time in public
19 utility consulting and financial accounting, concentrating primarily on rate cases
20 for electric and gas utilities and financial audits of independent telephone
21 companies across the United States. In 1992, I started Carleton B. Fox Co. Inc. of

1 Kansas City which was an energy consulting company specializing in billing
2 analysis and tariff selection for large commercial and industrial customers. In July
3 of 2000 I started my employment with MGE. Presently I hold in good standing, a
4 Certified Public Accountant certificate in the state of Kansas and am a member of
5 the Kansas Society of Certified Public Accountants.

6
7 **1. EXECUTIVE SUMMARY**

8 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
9 **PROCEEDING?**

10 A. The purpose of my testimony is to support MGE's requested revenue increase of
11 \$41,651,345, or 6.8%.

12
13 The revenue deficiency is supported by Schedules A through H, which are
14 attached to this testimony. I will be responsible for sponsoring most of the
15 adjustments made to the test year ending December 31, 2005 and which support
16 the revenue deficiency. Other MGE witnesses providing direct testimony are
17 Russell Feingold, supporting revenue adjustments and a weather normalization
18 clause; Ronald Amen supporting rate design and cost of service allocation;
19 Michael Adams supporting the cash working capital requirement; Carlton A.
20 Ricketts, discussing customer service; Frank Hanley, supporting the capital
21 structure and the cost of capital shown in Schedule F; Thomas J. Sullivan,
22 supporting depreciation rates; and Robert J. Hack, providing policy testimony.

1 **Q. WHY DOES MGE NEED TO FILE FOR A GENERAL RATE INCREASE?**

2 A. Simply stated, MGE is not achieving its authorized rate of return. There are three
3 primary reasons for not achieving the authorized rate of return.

- 4 1. Plant in service has increased approximately \$50 million.
- 5 2. Operating expenses as adjusted are significantly higher
- 6 3. Usage per customer is significantly lower than the level rates were
- 7 set at in GR-2004-0209
- 8

9

10 **2. ADMINISTRATIVE MATTERS**

11 **Q. MR. NOACK, WOULD YOU PLEASE SUMMARIZE THE DIFFERENT**
12 **SECTIONS OF SCHEDULES ATTACHED TO YOUR DIRECT**
13 **TESTIMONY?**

14 A. Schedule A summarizes the revenue deficiency at December 31, 2005.
15 Schedule B summarizes and supports the various rate base components.
16 Schedule C summarizes and supports plant in service.
17 Schedule D summarizes and supports Reserve for Depreciation.
18 Schedule E summarizes and supports the various working capital components.
19 Schedule F summarizes the rate of return.
20 Schedule G is a comparison of statistical information
21 Schedule H summarizes & supports the operating income statement &
22 adjustments.

23

24 **Q. WHAT IS THE TEST YEAR USED IN THIS DETERMINATION OF**
25 **MGE'S REVENUE REQUIREMENT?**

1 A. The test year is the twelve months ending December 31, 2005 adjusted for known
2 and measurable changes.

3
4 **Q. WILL MGE BE REQUESTING THAT THE TEST YEAR BE UPDATED?**

5 A. Yes. MGE expects to update the test year through June 30, 2006. This is
6 consistent with the process used in the last two MGE rate cases. This will provide
7 a relatively current time period of actual experience on which to base rates for the
8 future while at the same time allowing the Commission staff and other parties to
9 audit this actual experience.

10
11 **Q. IS MGE REQUESTING A “TRUE-UP” PROCESS?**

12 A. MGE requests a “true-up” through October 2006 in order to mitigate regulatory
13 lag and update the following significant cost components:

14 **RETURN:**

15 Capital Structure and related costs (unless a hypothetical capital structure
16 is adopted)

17
18 **RATE BASE:**

19 Plant in Service
20 Depreciation Reserve
21 Deferred Taxes
22 Working Capital Components including Materials and Supplies, Natural
23 Gas Storage Inventory and Prepaid Pensions

24
25 **INCOME STATEMENT:**

26 Revenue for Customer Growth
27 Payroll, Employee Levels and Current Wage Levels
28 Pension Costs
29 Injuries and Damages
30 Rate Case Expense

1 Depreciation and Amortization Expense
2 Property Taxes
3 Related Income Tax Effects
4

5 **3. REVENUE DEFICIENCY**

6 **Q. MR. NOACK, WOULD YOU PLEASE EXPLAIN THE SCHEDULES**
7 **ATTACHED TO YOUR TESTIMONY?**

8 A. Yes. Schedule A is a summary of the MGE revenue deficiency for the test year
9 ended December 31, 2005. The schedule summarizes the rate base, rate of return,
10 required net operating income, adjusted net operating income and, finally, the
11 revenue deficiency. The net revenue deficiency shown on Schedule A is
12 \$41,651,345, or approximately 6.84%.

13
14 Schedule A-1 is the summary of net operating income per books for the test year
15 ending December 31, 2005, a summary of the adjustments made to operations
16 and, finally, the as adjusted net operating income.

17
18 Schedule A-2 is a summary income tax computation both per books and as
19 adjusted for the twelve months ending December 31, 2005.

20
21 **Q. MR. NOACK, WOULD YOU PLEASE DESCRIBE SCHEDULE B, THE**
22 **CALCULATION OF RATE BASE?**

23 A. Schedule B summarizes the requested rate base of MGE at December 31, 2005.
24 Total rate base of \$581,203,364 consists of net plant of \$557,312,682, SLRP

1 Deferrals net of accumulated amortization of \$11,955,712, Working Capital of
2 \$99,028,330, and total rate base net offsets of \$87,093,361.

3
4 **Q. WOULD YOU PLEASE DESCRIBE THE SCHEDULES SUPPORTING**
5 **SCHEDULE B?**

6 A. Schedule B-1 is the summary of SLRP Deferrals net of accumulated amortization
7 and associated deferred taxes. The SLRP program requires significant costs to be
8 incurred which MGE was allowed to defer, before the advent of the infrastructure
9 system replacement surcharge ("ISRS") rate, pursuant to six separate Accounting
10 Authority Orders (AAOs).

11
12 **Q. WOULD YOU PLEASE DISCUSS EACH OF THE PREVIOUS AAOS,**
13 **WHICH HAVE GIVEN RISE TO THE ACCUMULATED DEFERRALS**
14 **INCLUDED IN MGE'S RATE BASE AT DECEMBER 31, 2005?**

15 A. The first AAO (Case No. GO-92-185) allowed the deferral of carrying costs,
16 depreciation and property taxes on safety related plant investments for the period
17 July 1, 1991 through October 15, 1993.

18
19 The second AAO (Case No. GO-94-133) covered the period from October 15,
20 1993 through February 1, 1994.

1 The third AAO (Case No. GO-94-234) allowed MGE to defer depreciation
2 expense, property taxes and compute carrying costs at a rate of 10.54% for the
3 period from February 1, 1994 through October 31, 1996.

4
5 The fourth AAO (Case No. GO-97-301) allowed MGE to defer depreciation,
6 property taxes and carrying costs from February 1, 1997 through May 31, 1998 or
7 the date at which the true-up ended and also seek rate recovery in Case No. GR-
8 98-140 of those regulatory assets recorded from November 1, 1996 through
9 January 31, 1997.

10
11 The fifth AAO was granted in the report and order issued in Case No. GR-98-140
12 and allowed MGE to begin deferring costs on September 3, 1998 and allowed
13 them to continue July 31, 2001.

14
15 The sixth and most recent AAO to date was granted in the report and order issued
16 in Case No. GR-2001-292 and allows MGE to defer costs from July 1, 2001
17 through the test year or true-up period in this case.

18
19 **Q. WHAT AMOUNT OF SLRP DEFERRALS HAVE YOU INCLUDED IN**
20 **RATE BASE AT DECEMBER 31, 2005?**

21 A. Schedule B-1 details the total unamortized SLRP deferrals of \$11,955,712 and
22 associated deferred taxes of \$4,062,133 at December 31, 2005.

1 **Q. PLEASE EXPLAIN THE OTHER COMPONENTS INCLUDED IN RATE**
2 **BASE?**

3 A. Generally there are three types of costs and related approaches considered in
4 developing rate base. The first type of cost and approach relates to amounts that
5 are included in rate base in compliance with Commission Orders. The
6 Commission had included the SLRP Accounting Authority Orders (AAOs), which
7 I described above, in rate base in cases prior to Case No. GR-98-140.

8
9 The second type of cost and approach relates to amounts that fluctuate monthly
10 due to many variables. Adjusting any one of these costs at a date specific may not
11 provide a reasonable basis for determining an appropriate level of on-going cost
12 of service. Specifically, a thirteen-month average has been utilized to more
13 accurately reflect the on-going nature of these fluctuating balances.

14
15 The third type of cost and approach relates to actual test period amounts which are
16 adjusted for known and measurable changes that have occurred or will take place
17 prior to rates being placed into effect. These adjustments minimize the effects of
18 regulatory lag. The objective is to establish rates prospectively, synchronizing the
19 cost of service with the revenue stream so that MGE in fact has a reasonable
20 opportunity to earn its authorized rate of return.

21
22 **Q. PLEASE DESCRIBE COSTS, WHICH ARE AFFORDED A THIRTEEN-**
23 **MONTH AVERAGE.**

1 A. The rate base items afforded a thirteen month average are material and supplies
2 inventory, prepayments, natural gas in storage, as well as the rate base offsets of
3 customer deposits and customer advances. Schedules B-2 and B-3 show the
4 monthly amounts related to customer deposits and customer advances,
5 respectively. Schedule E provides a summary of all working capital components
6 with the monthly amounts for Materials and Supplies, Prepayments and Natural
7 Gas in Storage being shown on Schedules E-1, E-2 and E-3 respectively.

8
9 **Q. HAVE YOU ALSO INCLUDED A CASH WORKING CAPITAL**
10 **COMPONENT OF RATE BASE AT DECEMBER 31, 2005?**

11 A. Michael Adams is sponsoring testimony supporting cash working capital in rate
12 base in the amount of \$13,353,691.

13
14 **Q. HAVE YOU INCLUDED ANY OTHER WORKING CAPITAL**
15 **COMPONENTS IN YOUR RATE BASE?**

16 A. Schedule E-5 includes the net prepaid pension asset in the working capital
17 component of rate base.

18
19 **Q. PLEASE EXPLAIN YOUR SCHEDULE OF PLANT IN SERVICE.**

20 A. Schedule C, page 1 of 2 summarizes the various categories of plant investment
21 including the direct plant MGE accounts for on its books; completed construction
22 not classified; joint and common plant accounted for on Southern Union
23 Company's books that is allocated to MGE; and any adjustments. There are two

1 adjustments included in the December 31, 2005 plant in service balance. The first
2 eliminates from rate base the investment in inactive services. This adjustment,
3 while not having a direct effect on rate base since the retirement decreases both
4 plant and accumulated depreciation by the same amount, does decrease
5 depreciation expense for the test year. The second adjustment eliminates the
6 balance of the accounting software system which is included on MGE's books but
7 was replaced by a new accounting software system in 2005.

8
9 **Q. PLEASE DESCRIBE THE ADJUSTMENTS TO OPERATING INCOME,**
10 **WHICH YOU ARE SPONSORING, ON SCHEDULE H.**

11 A. Schedule H, consisting of 25 schedules, details all of the adjustments made to cost
12 of service. The first two pages of schedule H detail the operating income
13 statement summarized by the uniform system of accounts. It shows the test year
14 balances per books at December 31, 2005, a summary of the proforma
15 adjustments to each account and finally the adjusted balance at December 31,
16 2005. The next six pages detail each adjustment individually by FERC account
17 number.

18
19 Schedules H-1 and H-2 are the revenue adjustments and are being sponsored by
20 MGE witness Feingold.

21
22 Schedule H-3 removes purchased gas costs from the operating income statement.
23 These expenses should not be included in the determination of the cost of service.

1 Purchased gas costs are recovered through the PGA mechanism and not base
2 rates.

3
4 **Q. PLEASE EXPLAIN THE PAYROLL RELATED ADJUSTMENTS.**

5 A. Proforma payroll and the related payroll adjustment is detailed by account number
6 on schedule H-4. The adjustment takes into consideration the employee levels at
7 December 31, 2005 and the level of wages known and measurable as of April 1,
8 2006. The proforma level also includes overtime, which was based on actual
9 overtime hours worked during the test year. Dividing total proforma payroll
10 charged to operating expenses by total proforma payroll developed a payroll
11 expense ratio. This payroll expense ratio was subsequently applied to the
12 proforma levels of employee benefits, payroll taxes and injuries and damages.

13
14 A separate adjustment has been proposed on Schedule H-22, which normalizes
15 MGE incentive compensation and bonuses based on an average three-year period
16 2003 through 2005.

17
18 Payroll taxes on schedule H-6 are adjusted for the payroll annualization.

19
20 **Q. WHAT IS INCLUDED IN YOUR ADJUSTMENT TO EMPLOYEE**
21 **BENEFITS?**

22 A. The adjustment to employee benefits on Schedule H-5 normalizes all expenses
23 representing employee benefits paid on behalf of employees. Included in these

1 benefits is the FAS 87 pension expense, which represents the ERISA minimum
2 payment necessary for 2005 and which will be made in 2006.

3
4 Other benefits expense costs include insurance, FAS 106 post retirement benefit
5 costs, 401k costs and other miscellaneous employee benefit costs charged to
6 account 926. These proforma costs were then multiplied by the payroll expense
7 ratio to arrive at the adjustment to operating expenses.

8
9 **Q. WHAT ADJUSTMENT HAVE YOU MADE TO PROPERTY INSURANCE**
10 **AND INJURIES AND DAMAGES?**

11 A. Schedule H-7 normalizes the property insurance and injuries and damages by
12 taking a three-year average of workmen's compensation claims paid and auto and
13 general liability claims paid and adding that average to the insurance premiums
14 paid during the test year. In addition an additional accrual of \$1,500,000 or
15 \$500,000 per year has been included in order to reserve for damages which are
16 probable due to accidents occurring in the last part of 2005. The test year payroll
17 expense to capital ratio is then applied to the normalized injuries and damages
18 cost in order to compute the normalized test year operating expense.

19
20 **Q. PLEASE EXPLAIN SCHEDULE H-8.**

21 A. Schedule H-8 increases administrative and general expenses to properly assign or
22 allocate joint and common corporate functions to MGE. These functions support
23 the ongoing operations of MGE and include accounting, taxes, shareholder

1 relations, treasury, human resources, environmental and legal. Joint and common
2 costs allocated to MGE for the test year total \$3,559,811 for account 923. This
3 compares to the amount allowed in MGE's last rate case, Case No. GR-2004-0209
4 of \$4,325,651 for account 923.

5
6 **Q. HAVE YOU PROPOSED AN ADJUSTMENT TO UNCOLLECTIBLE**
7 **EXPENSE?**

8 A. Yes. I have increased bad debt expense or uncollectible expense by \$1,772,614.

9
10 **Q. WHAT IS THE BASIS FOR YOUR ADJUSTMENT AND PLEASE**
11 **EXPLAIN HOW YOU COMPUTED THE ADJUSTMENT?**

12 A. The adjustment was computed by taking the averaging bad debt write-offs for
13 2004 and 2005 and comparing that average to the bad debt expense recorded in
14 2005. The average write-offs of \$8,881,391 when compared to the actual expense
15 of \$7,108,777 results in an adjustment of \$1,772,614.

16
17 **Q. WHY WERE ONLY TWO YEARS USED IN THE COMPUTATION OF**
18 **THE AVERAGE BAD DEBT WRITE-OFFS?**

19 A. I initially looked at the 3 and 4 year average of bad debt write-offs, but because of
20 the cost of gas and the levels of the PGA in the last two years, the years 2002 and
21 2003 are really not comparable to what has occurred in 2004 and 2005. The
22 average PGA levels for 2002 and 2003 were \$0.46896 and \$0.68155 per Ccf
23 respectively and the percent of revenue written off was 1.42% and 1.15%. In

1 2004 and 2005 the PGA has increased dramatically to an average level of
2 \$0.77128 in 2004 and \$0.86829 in 2005. At the same time the percent of revenue
3 written off has risen to 1.58% in 2004 and 1.45% in 2005. In other words, it is
4 not enough to just look at the average level of bad debt write-offs. Both the level
5 of gas costs which drives the dramatic increase in recorded gross revenues and the
6 percent of revenue actually written off must be factored into any formula for
7 normalizing the level of bad debt expense.

8
9 **Q. ARE THERE ANY OTHER ALTERNATIVES AVAILABLE FOR THE**
10 **COMMISSION TO CONSIDER WHEN DEALING WITH THE**
11 **UNPREDICTABLE NATURE OF THE BAD DEBT EXPENSE?**

12 A. In my opinion there are. As one alternative, the Commission can separate the bad
13 debt write-offs into two pieces; the gas cost piece and the distribution piece.

14
15 The gas cost portion of the bad debt is a risk the Company should not have to
16 bear. The purchased gas adjustment ("PGA") clause is meant to be the
17 mechanism by which the Company is reimbursed for the gas cost including the
18 commodity, storage, transportation costs and other costs of acquiring the gas
19 which is delivered to end use customers. MGE's tariff sheet no. 14 describes the
20 various costs that should included in the current cost of gas but also states that the
21 costs are not solely limited to just those costs:

22 Current Cost of Gas (CCG) - A per Ccf factor to reflect the current
23 estimate of the annualized cost of various natural gas services
24 purchased by the Company, including but not limited to firm and
25 interruptible gas supply, gathering, processing and treating

1 services, firm and interruptible transportation service, storage
2 services, gas price volatility mitigation instruments, including but
3 not limited to financial instruments and any service which bundles
4 or aggregates these various services.

5
6 The rising cost of natural gas has outstripped the traditional way of recovering bad
7 debt. MGE should be allowed to use the PGA mechanism to recover unpaid gas
8 costs. Concerns about the Company not having an incentive to keep unpaid bills
9 down which may be voiced are groundless because MGE will still have about 30
10 percent of any unpaid bill that represents distribution charge at risk and would still
11 try to collect that balance along with the gas cost portion of that unpaid bill. If a
12 customer wants gas service their bill needs to be paid. The gas cost portion of all
13 bad debt recoveries would then be credited back to the customers through the
14 PGA mechanism.

15
16 Another alternative would be for the Commission to permit MGE to defer the gas
17 portion of bad debt expense in a way similar to the tracking mechanisms in place
18 for the over/under recovery of pension expense and cost of removal. Currently
19 MGE is allowed to recover a set amount of pension expense and cost of removal
20 in rates. If at the end of the year, MGE has either over or under collected those
21 costs from ratepayers, the difference is recorded in a deferred asset/liability
22 account and amortized to rates in the subsequent rate filing. Using that same
23 mechanism, MGE would be allowed to include in rates \$6,786,361 of bad debts
24 associated with gas costs and \$2,095,030 related to non gas costs. If at the end of
25 the year, MGE's actual bad debt expense associated with gas costs is \$7,086,361,
26 then MGE would be allowed to defer the difference and include amortization of

1 the deferral over 3 years in the next rate case. The non-gas portion of \$2,095,030
2 would not be included in this mechanism and remain at risk for MGE.

3
4 **Q. IF MGE WERE ALLOWED TO PASS THROUGH THE GAS PORTION**
5 **OF BAD DEBTS THROUGH THE PGA, WHAT WOULD THE**
6 **ADJUSTMENT TO BAD DEBTS AMOUNT TO?**

7 A. Instead of an adjustment of \$1,772,614 the adjustment only attributable to the
8 non-gas portion of bad debts would be \$418,142.

9
10 **Q. HAS MGE FILED PROPOSED TARIFF LANGUAGE TO APPLY TO THE**
11 **INCLUSION OF THE GAS PORTION OF BAD DEBTS IN THE PGA?**

12 A. Yes. Schedule H-9, pages 2 of 3 and 3 of 3 contain suggested tariff language to
13 include in the PGA.

14
15 **Q. PLEASE EXPLAIN THE ADJUSTMENT TO REGULATORY**
16 **COMMISSION EXPENSE.**

17 A. This adjustment on Schedule H-10 first normalizes rate case expense along with
18 the cost of the appeal of Case No. GR-2004-0209 and the remaining unamortized
19 balance of the rate case expense approved in GR-2004-0209 over a three-year
20 period, and the 2005 depreciation study over a five-year period, annualizes the
21 NARUC and MPSC assessments based on invoices received in June 2005.

22
23 **Q. WHAT IS THE PURPOSE OF SCHEDULE H-11?**

1 A. Schedule H-11 computes interest on the average thirteen-month balance of
2 residential customer deposits at an interest rate of 8.25% or 1% over the prime
3 rate as of December 31, 2005, consistent with MGE's tariff Sheet No. R-14 and
4 on the average thirteen-month balance of commercial customer deposits at the
5 statutory interest rate of 3.00%.

6
7 **Q. HAVE YOU PROPOSED AN ADJUSTMENT TO DEPRECIATION**
8 **EXPENSE?**

9 A. Schedule H-12 details the adjustment to depreciation expense based upon the
10 level of plant investment at December 31, 2005. The adjustment being proposed
11 on schedule H-12 is a two part adjustment with the first part of the adjustment
12 being made to annualize depreciation expense based on the year end levels of
13 plant using the current depreciation rates approved by the Commission in Case
14 No. GR-2004-0209. The second part of the adjustment uses the depreciation rates
15 recommended by MGE witness Sullivan.

16
17
18 **Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO AMORTIZATION**
19 **EXPENSE.**

20 A. Schedule H-13 details the proforma amortization expense. The adjustment
21 consists of three parts. The first part annualizes the amortization of all leasehold
22 improvements and miscellaneous intangible plant at December 31, 2005. The
23 second part of the adjustment computes SLRP amortization based upon the ten-

1 year amortization period, which the Commission determined in Case No. GR-98-
2 140. The third part of the adjustment amortizes the unamortized cost of the
3 infinium software over a three year period.
4

5 **Q. PLEASE EXPLAIN SCHEDULES H-14 and H-15 RELATING TO THE**
6 **VARIOUS CLEARING ACCOUNTS.**

7 A. These adjustments normalize the amounts included in the test year expense
8 accounts relating to dollars charged from clearing accounts.
9

10 **Q. PLEASE EXPLAIN THE FUNCTION OF CLEARING ACCOUNTS.**

11 A. Clearing accounts are specific accounts required by the uniform system of
12 accounts. They serve as a clearinghouse for various costs that are incurred for a
13 similar function. For example, the TWE account accumulates various costs
14 relating to vehicles and major work equipment including payroll, benefits, taxes,
15 and insurance as well as the cost of tires, oil, and repairs and depreciation and/or
16 vehicle lease expense. Similarly, the stores load account accumulates costs
17 relating to managing the inventory and purchasing function, and the paid time off
18 account accumulates the payroll and related costs of vacations, sick leave, etc. By
19 accumulating varied but related costs into one account these costs can more easily
20 and consistently be charged back to other expense and capital accounts. At the
21 end of the year these clearing accounts should have a balance of \$0.
22

1 **Q. WHY IS IT NECESSARY TO REFLECT ADJUSTMENTS RELATING TO**
2 **THESE ITEMS IN A RATE CASE?**

3 A. There are two reasons. First, timing differences routinely occur relating to the
4 amounts charged into and cleared out of clearing accounts. For any given twelve-
5 month test year period, the total amounts charged into the clearing account
6 typically do not exactly equal the amounts cleared out. For ratemaking purposes,
7 it is necessary to normalize this process so that test year expense accounts are
8 adjusted to the level that would have existed absent the timing difference. The
9 second reason is that in the ratemaking process, adjustments are made to the direct
10 expense portion of many of the items typically charged into a clearing account.
11 As discussed above, these items include payroll and payroll related costs such as
12 benefits, taxes, etc. and in the case of the TWE account, depreciation and lease
13 expense. While the adjustment relating to the direct expense portion of each of
14 these items is accounted for and discussed on other Schedules, Schedules H-14
15 and H-15 adjust the portion of these items that are charged into and cleared out of
16 clearing accounts. These adjustments enable test year clearing to be adjusted
17 consistently with the remainder of the case.

18
19 **Q. PLEASE EXPLAIN SCHEDULE H-16.**

20 A. Schedule H-16 adjusts Missouri State Franchise Tax to the actual level of tax on
21 the filed franchise tax return.

22
23 **Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO PROPERTY TAXES.**

1 A. Schedule H-17 synchronizes ad valorem taxes with plant in service excluding
2 intangible plant and corporate allocated plant at December 31, 2005. The property
3 tax rate is based on the 2005 actual property tax rate.

4
5 **Q. WHAT IS THE STATUS OF THE ACCOUNTING AUTHORITY ORDER**
6 **AUTHORIZED IN CASE NO. GU-2005-0095?**

7 A. Currently, MGE has deferred a total of \$3,422,206 of Kansas property taxes for
8 the 2004 and 2005 tax years. The case is still ongoing and a decision from the
9 Kansas courts does not appear to be forthcoming any time soon. Based upon the
10 order of the Commission, MGE currently will be allowed to defer one more year
11 (2006) of property taxes on gas in storage before amortization of the balance must
12 begin.

13
14 **Q. DO YOU ANTICIPATE A FINAL COURT DECISION TO BE**
15 **RENDERED BY THE END OF 2006?**

16 A. No. Because the decision has already been delayed for at least one year beyond
17 our initial expectations, MGE is requesting the Commission to continue the
18 deferral until MGE concludes its next general rate proceeding before the
19 amortization begins.

20
21 **Q. PLEASE EXPLAIN SCHEDULE H-18.**

22 A. Schedule H-18 annualizes the postage costs to reflect the postage increase which
23 went into effect in early 2006.

1

2 **Q. PLEASE EXPLAIN SCHEDULES H-19.**

3 A. Schedule H-19 annualizes rent expense and MGE's share of operating expenses,
4 taxes and maintenance at the headquarters building.

5

6 **Q. PLEASE EXPLAIN THE ADJUSTMENTS MADE ON SCHEDULES H-20.**

7 A. Schedule H-20 normalizes MGE incentive compensation and bonuses paid based
8 on a three-year period 2003 through 2005. The payroll expense ratio is then
9 applied to the normalized level in order to calculate the amount, which should be
10 charged to expense.

11

12 **Q. PLEASE EXPLAIN THE UNRECOVERED COST OF SERVICE**
13 **ADJUSTMENT ON SCHEULE H-21**

14 A. Schedule H-21 calculates the revenue deficiency suffered in January, February and
15 March 2006 due to the shortfall in actual average usage per customer when
16 compared to the average usage used in the GR-2004-0209 rate design and
17 amortizes this shortfall over a three year period.

18

19 **Q. WHAT IS THE BASIS FOR REQUESTING RECOVERY OF THIS COST**
20 **OF SERVICE SHORTFALL?**

21 A. In GR-2004-0209, MGE requested a weather normalization clause or a weather
22 mitigation rate design similar to Laclede in order have a more realistic opportunity
23 to recover the allowed cost of service. MGE also requested the use of more recent

1 weather data so as to more accurately reflect customer usage. Finally, MGE
2 proposed an attrition adjustment to normalized sales volumes in recognition of the
3 consistently declining average per-customer usage that has been experienced on
4 MGE's system. None of these proposals was adopted in Case No. GR-2004-
5 0209, and in the first three months of 2006, average per-customer residential
6 usage fell 27.36% short of the usage assumed when MGE's rates were set in Case
7 No. GR-2004-0209. That shortfall can only be recovered if the Commission
8 approves this adjustment. To the extent it is deemed necessary to grant MGE an
9 accounting authority order ("AAO") to reflect in future rates this revenue shortfall
10 that has been caused in significant part by the extraordinarily warm weather
11 experienced so far in 2006 in MGE's service territory, MGE hereby requests such
12 an AAO.

13
14 **Q. PLEASE EXPLAIN SCHEDULES H-22 AND H-23?**

15 A. H-22 annualizes the number of collectors schedule to work during the 2006 test
16 year while H-23 eliminates non-recurring or non-utility activity from cost of
17 service.

18
19 **Q. PLEASE EXPLAIN SCHEDULE H-24.**

20 A. Weatherization of customers' homes provides a tangible benefit that continues on
21 into the future, akin to an investment that yields continuing returns. Also, the
22 providers of low-income weatherization services, including the City of Kansas
23 City and the Economic Security Corporation in Joplin, have long waiting lists of

1 eligible customers requesting weatherization improvements. The additional
2 funding will provide assistance to about another 30 homes annually.

3
4 **Q. PLEASE EXPLAIN SCHEDULE H-25.**

5 A. Schedule H-28 requests annual funding of \$500,000 to set aside to cover the clean
6 up costs associated with former manufactured gas plant ("FMGP") sites and other
7 environmental clean up costs.

8
9 **Q. WILL SENATE BILL 179 ACCOMPLISH THE SAME RESULT AS THIS**
10 **PROPOSED FUNDING MECHANISM IF RULEMAKING LANGUAGE**
11 **CAN BE WORKED OUT AND APPROVED?**

12 A. Yes, but to date little progress has been made toward developing consensus on
13 this type of rule.

14
15 **Q. HOW DOES THE COMPANY PROPOSE TO RECOVER SUCH COSTS?**

16 A. FMGP costs can be significant, as shown by MGE's experience during the test
17 year. And although MGE fully expects to continue to incur FMGP-related costs
18 in the future, it is difficult to pinpoint when or how much because of the site-
19 specific nature of FMGP-related costs. Therefore, MGE proposes the creation of
20 an Environmental Response Fund for the recovery of FMGP-related costs, to be
21 funded initially at a level of \$500,000 per year by way of a discrete rate element
22 included in the basic service charge or delivery charge of all customer classes.
23 MGE's proposed Environmental Response Fund, attached hereto as Schedule H-

1 25 page 2, will ensure appropriate regulatory review of FMGP-related cost
2 recovery while at the same time ensuring that the Company neither over- nor
3 under-recovers FMGP-related costs.
4

5 **4. MISCELLANEOUS MATTERS**

6 **Q. HAVE YOU PREPARED ANY OTHER SCHEDULES IN THIS FILING?**

7 A. Yes. Section G contains schedules which compare some of MGE's statistics
8 related to operations and maintenance ("O&M") expense per customer and annual
9 residential margin bills with other reasonably comparable LDC's regulated in
10 Missouri and also compares MGE's actual uncollectible expense with the level
11 allowed by the Commission in the last three rate cases.
12

13 The first schedule, Schedule G-1 compares MGE's O&M expense per customer
14 for the years 1998 through 2004 with the O&M expense per customer for the
15 same period for Laclede, AmerenUE and the Missouri Public Service ("MoPub")
16 division of Aquila. As shown by Schedule G-1, MGE is consistently much lower
17 than the other utilities shown on the schedule.
18

19 Schedule G-2 is a comparison of annual residential bills on the basis of margin
20 rates (monthly customer charge plus volumetric delivery rates). The schedule
21 shows that MGE is considerably lower-priced than these companies. The
22 comparison is based on the average residential usage MGE used to set rates in
23 Case No. GR-2004-0209.

1
2 **Q. PLEASE CONTINUE.**

3 A. Schedule G-3 compares the actual bad debt expense included in MGE's net
4 operating income with the rate case allowance. The comparison is for each fiscal
5 year from 1996 through 2005. For the ten years shown on the schedule, MGE has
6 realized a shortfall of \$16,998,067 in expense recovery or \$1,699,807 per year on
7 average.

8
9 **Q. DO YOU HAVE ANY INFORMATION COMPARING MGE'S ACTUAL**
10 **ACHIEVED EARNINGS TO MGE'S COMMISSION-AUTHORIZED**
11 **RETURNS?**

12 A. Yes. Schedule G-4 shows that in each fiscal year from 1996 through 2005,
13 MGE's achieved rate of return was below the return authorized by the
14 Commission in the most recent previous case. In 2005, MGE's per books
15 achieved return was close to the return authorized in Case No. GR-2004-0209
16 only because MGE was able to favorably resolve a series of property tax appeals
17 related to a number of preceding years. Absent that non-recurring event, pursuant
18 to which MGE received property tax refunds and adjustments in 2005 of
19 \$8,309,218, MGE's achieved return for 2005 would have been 7.49%, well short
20 of the return authorized in Case No. GR-2004-0209. Taken a step further, over
21 the ten and one-half year period shown on Schedule G-4, MGE has realized an
22 earnings deficiency of about \$98 million, which equates to a revenue deficiency of
23 over \$160 million.

1 5. TARIFF CHANGES

2

3 **Q. WOULD YOU PLEASE SUMMARIZE THE TARIFF CHANGES BEING**

4 **REQUESTED BY MGE?**

5

6 A. MGE is filing twenty-two (22) tariffs sheets where there is either a language or

7 rate change.

8

9 Tariff sheets 25, 28, 31 and 42 contain the new rates being requested for each of

10 the tariff classes. In addition tariff sheets 28 and 31 contain a change where a

11 Standby Facilities Charge is being proposed so that MGE may bill a customer

12 who has changed rate classes from a large volume customer to either a small

13 general service customer or a large general service customer but for whatever

14 reason has requested that MGE not remove the large meter in place to serve the

15 customer at the LV level but rather leave it in place as insurance in case large

16 volumes of gas are needed to be delivered by MGE sometime in the future. Under

17 the current SGS or LGS rate that customer is not paying the proper level of

18 customer charge for the customer related facilities in place. This standby charge

19 will properly assess the costs of the facilities to the customer requesting them.

20

21 Rate sheet 39 which is an Unmetered Gaslight Service schedule corrects the

22 delayed payment charge from 1.5% to 0.5%.

23

1 **Q. IS MGE REQUESTING A CHANGE TO THE TRANSPORTATION**
2 **PROVISIONS OF ITS TARIFF?**

3 A. Yes. Tariff sheet 61.2 has been changed to include firm transportation costs in the
4 monthly cash out computation. Currently if a customer or agent is either over or
5 under nominated in a current month, they are cashed out based on a formula
6 which only includes gas costs and not the cost to transport the gas to MGE's
7 system. This change which also shows on sheet 24.3 of the Purchased Gas Cost
8 Adjustment, corrects this deficiency in the cash out process.

9

10 **Q. HAVE YOU ALSO MADE SOME CHANGES TO MGE'S GENERAL**
11 **TERMS AND CONDITIONS FOR GAS SERVICE?**

12 A. Yes. Sheet numbers R-6, R-7, R-8, R-9 and R-10 contain some minor changes to
13 the definitions contained in the general terms and conditions.

14

15 Sheets R-14 and R-15 contain minor changes to the customer deposit terms and
16 conditions to include language to compare four (4) times the average bill to two
17 (2) times the largest bill, whichever is smaller for computing the amount of the
18 deposit.

19

20 **Q. PLEASE EXPLAIN YOUR CHANGE TO SHEET NO. R-31?**

21 A. The change to sheet R-31 allows MGE to collect the basic service charges a
22 customer who disconnects and reconnects at the same premise within a period of
23 seven (7) months would have paid but for the disconnection.

1

2 **Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?**

3 **A. Yes it does.**

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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)
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Case No. GR-2006-_____

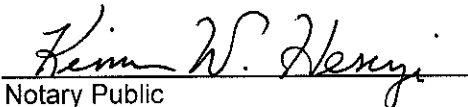
AFFIDAVIT OF MICHAEL R. NOACK

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 Direct Testimony in question and answer form, to be presented in the above case; that the answers in the foregoing Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.


MICHAEL R. NOACK

Subscribed and sworn to before me this 26th day of APRIL 2006.


Notary Public

My Commission Expires: Feb. 3, 2007

