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Manufactured Gas Plants
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MISSOURI PUBLIC SERVICE COMMISSION

**REGULATORY REVIEW DIVISION
UTILITY SERVICES - AUDITING**

SURREBUTTAL TESTIMONY

OF

KAREN LYONS

**MISSOURI GAS ENERGY
A Division of Laclede Gas Company**

CASE NO. GR-2014-0007

Jefferson City, Missouri
April 2014

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KAREN LYONS
MISSOURI GAS ENERGY
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1 2. Page 1 of Mr. Buck’s rebuttal testimony on the billing lag and
2 collection lag portion of the revenue lag for Cash Working Capital (CWC) and the
3 income tax and pension expense lags.

4 I will also respond to MGE witness Michael R. Noack with respect to a proposal at page 15 of
5 his rebuttal testimony wherein he supports a tracker for the costs related to the remediation
6 costs for MGE’s manufactured gas plant (MGP) sites.

7 **KANSAS PROPERTY TAXES**

8 Q. Please summarize MGE’s position regarding Kansas property taxes.

9 A. On page 9 of MGE witness Glenn W. Buck’s rebuttal testimony, he presents
10 two proposals regarding how the Kansas property taxes should be treated in this rate case.
11 The first proposal is “to include an allowance in rates for this expense item, but make that
12 allowance subject to a true-up with any difference subject to return to or recovery from
13 customers in the Company’s next rate case through an accounting authority order.” The
14 second MGE proposal would “...renew the Company’s AAO with the proviso that
15 amortization of expenses would not begin until the effective date of rates in the next general
16 rate proceeding.”

17 Q. Is the position of MGE different than what was requested in its direct filing?

18 A. Yes. In its direct filing, MGE requested recovery of Kansas property taxes
19 assessed by the state of Kansas for MGE gas storage facilities located in Kansas for the period
20 of 2009 through 2013. MGE’s proposal included an annual amortization for Kansas property
21 taxes assessed for the period of 2009-2013 amortized over a 5-year period and an annualized
22 level of Kansas property taxes representing an ongoing level of expense.

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1 Q. Please summarize Staff's recommendation with regard to MGE's request for
2 recovery of Kansas property taxes.

3 A. Staff recommends that the existing Accounting Authority Order (AAO) for the
4 Kansas property taxes be renewed using the same language that has been approved by the
5 Commission in Case Nos. GU-2005-0095 and Case No. GR-2009-0355. A detailed
6 background of this issue is provided on pages 116-119 in Staff's Cost of Service report filed
7 on January 29, 2014.

8 Q. Has MGE disputed the assessment of property taxes with the state of Kansas?

9 A. Yes. Prior to 2009, MGE succeeded in overturning the Kansas legislation in
10 the courts system. However, in 2009, Kansas passed a new law to allow for assessment of all
11 gas being stored and held for resale in Kansas. MGE appealed the new legislation and on
12 December 6, 2013, the Kansas Supreme Court issued an order holding MGE responsible for
13 Kansas property taxes for gas held in storage at sites physically located in the state of Kansas
14 and remanded the issue back to the Court of Taxing Appeals (COTA) for a final decision.

15 Q. Is MGE appealing the Kansas Supreme Court decision?

16 A. Yes. MGE witness Glenn W. Buck states in his rebuttal testimony on page 8:

17 Now that the Kansas Supreme Court has issued an adverse
18 ruling against the Company and its participating plaintiffs, the
19 only action available is to seek review at the U.S. Supreme
20 Court. Notice of such an appeal has been filed and we should
21 know if the Court will hear it sometime in the spring or fall
22 session.

23 Q. Has MGE paid Kansas property taxes as of the true up period in this case,
24 December 31, 2013?

25 A. No. MGE has not paid for any property taxes to the state of Kansas. Although
26 MGE has received assessments for the state of Kansas and, based on the assessments,

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1 estimated the taxes to record in a deferred asset, the actual property taxes for which MGE can
2 potentially be held responsible have not been paid by MGE. In addition, it is still unclear
3 when, or if, MGE will ultimately be held responsible for the property taxes since MGE is still
4 appealing the legality of the tax. Since a final decision has not yet been made in the courts
5 and MGE has not received actual property tax bills from the state of Kansas, the disputed
6 property taxes are not known and measurable.

7 Q. Has the Commission approved an AAO for the Kansas property taxes?

8 A. Yes. The Commission granted MGE an AAO in Case No. GU-2005-0095 and
9 again in a Stipulation and Agreement (the 2009 Stipulation) approved by the Commission
10 in Case No. GR-2009-0355. In the 2005 AAO case, the Commission ordered MGE to
11 defer the costs in a regulatory asset with the amortization to begin the following month
12 after a final decision was made in the courts. On page 18 of the Report and Order in Case No.
13 GU-2005-0095, the Commission ordered the following:

14 That Missouri Gas Energy, a division of Southern Union
15 Company, is granted an Accounting Authority Order whereby
16 the company is authorized to record on its books a regulatory
17 asset, which represents the expenses associated with the
18 property tax to be paid to the state of Kansas pursuant to Senate
19 Bill 147 for tax years 2004, 2005, and 2006. **Missouri Gas
20 Energy may maintain this regulatory asset on its books until
21 the beginning of the month after the final judicial resolution
22 of the legality of that tax. Thereafter, Missouri Gas Energy
23 shall commence amortization of the deferred amounts, with
24 the amortization to be completed over a five-year period
25 (emphasis added).**

26 In the 2009 MGE rate case, the Company agreed to an AAO relating to the Kansas property
27 taxes under the same conditions as ordered by the Commission in the 2005 AAO case. On
28 February 10, 2010, the Commission approved the following AAO language included in the
29 Stipulation and Agreement in Case No. GR-2009-0355, pages 4-5:

1 MGE shall be granted the following accounting authority order
2 (AAO): That Missouri Gas Energy, a division of Southern
3 Union Company, (“MGE”) is granted an Accounting Authority
4 Order whereby the company is authorized to record on its books
5 a regulatory asset, which represents the expenses associated
6 with the property tax to be paid to the state of Kansas in relation
7 to natural gas in storage pursuant to House Substitute for Senate
8 Bill No. 98 for 2009 and subsequent years based on assessments
9 from Kansas taxing authorities. **Missouri Gas Energy may**
10 **maintain this regulatory asset on its books until the**
11 **beginning of the month after the final judicial resolution of**
12 **the legality of that tax. Thereafter, Missouri Gas Energy**
13 **shall commence amortization of the deferred amounts, with**
14 **the amortization to be completed over a five-year period.** If
15 MGE files a general rate case prior to that final resolution,
16 ratemaking treatment of the deferral may be considered within
17 that case. If MGE is allowed ratemaking treatment providing a
18 return of any AAO funds for Kansas Property Tax, there shall
19 be no return on the Kansas Property Tax AAO funds included in
20 rates. The Commission shall include language in its Order
21 stating that the grant of this AAO does not in any way control
22 how the Commission will treat this deferral for ratemaking
23 purposes in subsequent rate cases, except there shall be no rate
24 base treatment of deferred amounts as provided above
25 (emphasis added).

26 Staff continues to believe the proper ratemaking treatment of these yet-to-be-paid property
27 taxes is what the Commission ordered in the 2005 AAO case and what MGE agreed to in its
28 2009 rate case stipulation. Staff recommends that the existing AAO for the Kansas property
29 taxes be renewed using the same language that has been approved by the Commission in the
30 2005 and 2009 cases. In particular, that any amortization of the property taxes begin the
31 month after the final court decision is issued.

32 Q. Did MGE agree to a time when the amortization of the deferral for property
33 taxes should begin in Case No. GR-2009-0355?

34 A. Yes. While MGE did initially recommend in Case No. GU-2005-0095 the
35 amortization not start until the effective date of rates in the case where the property tax matter
36 was resolved, most recently it agreed in the 2009 rate case to the same amortization as ordered

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1 by the Commission in Case No. GU-2005-0095 which, as noted above, provided for the
2 amortization to start the month after the final court decision. Staff's proposed treatment for
3 the Kansas property taxes in this case is consistent with both Case No. GR-2009-0355, (MGE
4 agreed-to deferral treatment) and the 2005 AAO case ordered by the Commission (Case No.
5 GU-2005-0095).

6 Q. Why does Staff disagree with MGE's recommendation to begin the
7 amortization on the effective date of rates in MGE's next rate case?

8 A. Extending the amortization to the effective date of rates in MGE's next rate
9 causes a mismatch of revenues and expenses and does not consider events that are likely to
10 occur that will cause a significant decrease in expense. Any decrease in expense could offset
11 the increase in property taxes if, in fact, MGE will have to pay those taxes.

12 In rate cases Staff analyzes both a utility's test year revenue and expense and makes
13 adjustments to account for fluctuations or changes in the utility's cost of service. These
14 adjustments are made to ensure that expenses are properly matched to revenues. This is
15 referred to as the "matching principle". Although AAO's by nature distort the matching
16 principle, starting the amortization as soon as possible minimizes the mismatch of revenues
17 and expense and will ensure timely recognition of the property tax expense in MGE's
18 financial statements.

19 When rates are set in a rate case, it is assumed that the new level of revenues will be
20 sufficient to cover a utility's total cost of service until rates are changed. This assumption
21 may hold true even if certain costs increase above the level currently reflected in rates because
22 an increase in expense can be offset either by increased revenues from customer growth or
23 favorable weather conditions, or decreases in other expenses from events such as operational

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1 efficiency or employee reductions. The purpose of an AAO is to allow a utility the
2 opportunity to recover costs that are considered extraordinary and material and otherwise
3 would have to be expensed when incurred. When an amortization of an AAO deferral
4 expense begins outside of a rate case, it is assumed that the utility is recovering this expense
5 in the revenues generated from its customers. If the utility believes it is not recovering its
6 costs, it can choose to file a rate case to recover those costs. Consequently, the amortization
7 period granted by the Commission in an AAO should not be tied to a rate case.

8 Q. Is Staff aware of any operational efficiencies that will result in costs savings
9 for MGE in the future?

10 A. Yes. Typically Staff cannot predict the level of costs savings that may or may
11 not occur following a rate case. However, in the case of Laclede Gas and MGE there will be
12 significant costs savings in the future as a result of the Laclede Gas acquisition of MGE on
13 September 1, 2013. The potential costs savings may be achieved through improved
14 efficiency, consolidation of operations, economies of scale and savings in customer service.

15 Q. Has the Commission recognized the importance of starting an amortization of
16 an AAO as soon as possible?

17 A. Yes. Staff's recommendation of starting the amortization beginning the month
18 after the final court decision is consistent with the standards the Commission has used and
19 continues to use in its determination of whether or not to grant an AAO and if granted when
20 the amortization should begin. The Commission ordered in Case No. GU-2005-0095:

21 MGE argues that the deferral should be allowed to continue
22 until it is in a position to file its next rate case because otherwise
23 it will not be able to recover the full amount of the deferred
24 expenses from its customers in rates. That argument is not
25 compelling because an AAO is not a guarantee that the

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1 company will be able to recover all of its deferred expenses in
2 rates.

3 Q. At page 7 of Mr. Buck’s rebuttal testimony, he indicates it is not appropriate to
4 begin amortizing the Kansas property taxes the month following the court decision. Why is
5 the Company opposed to such treatment?

6 A. MGE indicates that the timing of the court decision “...could cause a sizable
7 financial detriment to MGE.”

8 Q. Does Staff agree that the timing of the court decision could cause a sizable
9 financial detriment to MGE?

10 A. Yes. It is possible the timing of the court decision could result in a financial
11 impact to MGE. However, as discussed above, the Commission recognized that an AAO is
12 not a guarantee to recover all of the deferred costs. It is also possible that MGE could
13 experience increase in revenues or a decrease in other expenses that would offset all or part of
14 any unrecovered costs.

15 Q At page 8 of Mr. Buck’s rebuttal testimony, he discusses his view about the
16 nature of property taxes. Please comment.

17 A. MGE believes these are taxes similar to income taxes in that the taxes are
18 imposed by governmental entities and therefore the Company does not have any control over
19 the amounts, and that these property taxes are gas taxes because they are taxes on gas supply.
20 Staff does not believe any form of property taxes is similar to income taxes. Income taxes
21 vary directly with the level of income generated by a company’s operations. With each dollar
22 increase of income there is a direct relationship to the amount of income taxes owed to federal
23 and state taxing authorities. Not so with property taxes. Property taxes are assessed by local

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1 and state governments using a variety of methods to base property values as well as a variety
2 of methods to calculate tax rates applied to the assessed property values.

3 Q. Mr. Buck addresses the period in the 1980s where tax rates declined. Does this
4 relate to the assessment of Kansas property taxes?

5 A. No. There is no relation to what was done in the 1980s regarding the reduction
6 of the federal income tax rates. These income tax rates were directly responsible for the
7 significant decrease in income tax expense. It is my understanding that the Commission
8 opened an investigative docket to require the utilities under its jurisdiction to provide
9 information relating to the decrease in cost structure resulting from the reduction to the
10 income tax rates. On November 3, 1986, the Commission issued an Order Establishing
11 Docket to investigate the revenue effects upon Missouri utilities of the Tax Reform Act of
12 1986, Case No. AX-87-48. Both MGE (then operating as KPL Gas Service) and Laclede Gas
13 supplied documentation relating to this request by the Commission. I have personally
14 reviewed MGE's and Laclede Gas' submissions in Case No. AX-87-48.

15 The decrease in income tax rates was substantial. The marginal federal tax rate
16 declined from 46 percent to 34 percent, which caused a substantial decrease to the utilities'
17 income tax expenses. At the time of the reduction in federal tax rates in 1987, utility rates in
18 Missouri reflected the higher tax rate. Most of the companies voluntarily reduced utility rates
19 in the state to reflect the lower tax rates. To the extent some of the companies did not reduce
20 rates on their own, Staff did a series of rate reviews which resulted in additional rate
21 reductions. These were earnings reviews that looked at all material cost elements along with
22 income tax reduction from the lower federal tax rates. One earnings review led to a complaint

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1 case filed with the Commission that resulted in a litigated rate case where all elements of the
2 cost of service were examined along with the significant federal tax rate reduction.

3 Mr. Buck's inference that property taxes relate in any way to what took place in the
4 1980s regarding the reduction to the federal tax rate is simply misplaced. MGE witness Buck
5 would also have the Commission believe that property taxes are similar to income taxes in
6 that the Company does not have any control over the expense. The fact that the state of
7 Kansas has attempted to assess MGE property taxes since approximately 2000 and MGE has
8 yet to pay for any Kansas property taxes clearly shows that MGE has had some degree of
9 control over property tax expense.

10 Moreover, utility companies challenge property tax assessments and property
11 valuation frequently. There are opportunities to request local and state taxing authorities to
12 reconsider the amounts charged for property taxes in any given year. Adjustments can be
13 made that reduce the property tax amounts from the original assessment billings. Property
14 taxes are more discretionary than the federal income taxes.

15 Q. Did Staff review any documents to support the property tax estimate MGE is
16 currently deferring in the regulatory asset?

17 A. Yes. Prior to Staff filing its Cost of Service report on January 29, 2014, MGE
18 had not provided any support for the balance of the regulatory asset or the annualized level of
19 property taxes requested in its direct filing. In March 2014, MGE provided Staff copies of the
20 assessments from the state of Kansas. In addition, MGE also provided Staff estimated levies
21 for each of the counties in the state of Kansas that MGE currently stores gas. Staff also
22 reviewed information the Company developed to support the expected property tax amounts
23 should Kansas prevail in assessing property taxes on the storage gas.

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1 Q. Based on the documentation received from MGE, was Staff able to estimate an
2 amount of Kansas property taxes that MGE is requesting recovery in this case?

3 A. Yes. Staff was able to estimate the taxes using the assessments (based on gas
4 volumes and the price of gas), and using the estimated tax levies. Staff's analysis resulted in a
5 balance of approximately \$7.9 million for the period of 2009-2013. However, since MGE is
6 still appealing the legality of the tax and MGE has not paid any property tax to the state of
7 Kansas the actual amount of property taxes that MGE potentially will pay is still unknown.

8 Q. Does MGE agree with this balance?

9 A. Yes. MGE witness Buck states on page 7 of his rebuttal testimony, "While
10 MGE has been fighting the tax since 2009. The balance has grown to nearly \$8 million."

11 Q. Does MGE recommend an alternative proposal for recovery of the Kansas
12 property taxes?

13 A. Yes. The Company recommends two alternatives. The first alternative
14 described by Mr. Buck on page 9 of his rebuttal testimony states:

15 First, given the fact that this issue has been decided by the
16 highest court in a state, leaving only the very slim prospect of a
17 U.S. Supreme Court reversal as a means of further avoiding this
18 tax, the Company proposes to include an allowance in rates for
19 this expense item, but make that allowance subject to a true-up
20 with any difference subject to return to or recovery from
21 customers in the Company's next rate case through an
22 accounting authority order. We believe that the Commission
23 should include both the amortization and the ongoing costs in
24 rates in this proceeding subject to this treatment. If the
25 Company and its allies lose at the U.S. Supreme Court, there
26 will be no further effect on rates, other than a reconciliation of
27 how actual tax expense compared to the allowance made in
28 rates. Similarly, if the Company and its allies prevail at the
29 Supreme Court, the Company agrees to refund such amounts
30 collected, with interest at our short-term debt rate, back to
31 customers. This amortization can begin either with the adoption
32 of new rates in our next rate proceeding, or sooner, at the

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1 Commission's discretion, by directing MGE to flow it back to
2 customers through the PGA.

3 MGE's second alternative described by Mr. Buck on page 9 of his rebuttal testimony states:

4 The second alternative would be to renew the Company's AAO
5 with the proviso that amortization of expenses would not begin
6 until the effective date of rates in the next general rate
7 proceeding.

8 Q. Does Staff agree with MGE's alternative recommendations to renew the
9 Company's AAO with the provision that the amortization of the Kansas property taxes would
10 not begin until the effective date of rates in MGE's next rate case?

11 A. No. As discussed above, the Commission has ruled on the deferral
12 treatment of these taxes on two separate occasions, once in its Report and Order in Case No.
13 GU-2005-0095 and most recently in approving the 2009 Stipulation in MGE's last rate case
14 (Case No, GR-2009-0355). The language addressing the treatment of the Kansas property
15 taxes in the Commission Report and Order in Case No. GU-2005-0095 and the 2009
16 Stipulation is identical. Staff recommends the deferral treatment ordered by the Commission
17 in MGE's 2005 AAO and 2009 rate case be continued for the protested Kansas property
18 taxes. Staff further recommends that this regulatory asset be maintained until a final decision
19 is made in the courts. Once MGE receives a final court decision, the deferral treatment
20 should be discontinued until the beginning of the month after the final judicial resolution of
21 the legality of that tax. MGE would then commence amortization of the deferred amounts in
22 the month following the decision, with the amortization to be completed over a five-year
23 period. Should MGE file a general rate case prior to that final resolution, ratemaking
24 treatment of the deferral may be considered within that case. Finally, the Commission should
25 include language in its Order in this case stating that the grant of the continuation of the AAO
26 does not in any way control how the Commission will treat this deferral for ratemaking

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1 purposes in subsequent rate cases, except there shall be no rate base treatment of deferred
2 amounts.

3 Q. Does Staff agree with MGE's first proposal to include an allowance for Kansas
4 property taxes subject to refund in MGE's cost of service in this case?

5 A. Absent Commission approval of Staff's recommendation to renew MGE's
6 existing AAO for the Kansas property taxes, Staff would not be opposed to including an
7 allowance subject to refund in MGE's cost of service in this case. Staff would suggest
8 a \$3 million amount based on the accumulated deferred property tax level to date. The
9 \$3 million Staff recommends includes the deferred property tax and an on-going level of
10 property taxes that the Company would pay annually.

11 Q. If the Kansas property taxes are not known and measurable, why would Staff
12 recommend an allowance for these unpaid and unquantified costs?

13 A. The circumstances surrounding the Kansas property taxes are very unique and
14 unusual. The cost exposure to the Company regarding the deferred amounts in particular
15 could be substantial. In addition, MGE has been fighting the payment of these taxes for many
16 years for the benefit of the Company and its customers. To the extent MGE prevails in the
17 courts, this decision will have a significant cost benefit for the Company and customers for
18 many years. Therefore, Staff is willing to consider a unique approach to allow MGE cost
19 recovery should it lose the court decision and to have a mechanism to protect customers'
20 collected amounts if the Company prevails.

21 Staff has been working with the Company to develop a proposal to identify an amount
22 for the protested Kansas property taxes. Staff has included this amount in Staff's Accounting
23 Schedules filed on April 3, 2014 to address a portion of these property taxes that are currently

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1 being deferred on the MGE books that relate to prior years' property taxes and a portion for
2 on-going property taxes.

3 Q. In the event MGE is successful with its current appeal, does Staff agree that
4 any allowance included in rates should be refunded in the PGA as MGE proposes in its first
5 alternative proposal?

6 A. No. Staff opposes the inclusion of Kansas property tax expense, including a
7 potential refund to the ratepayers, in the purchase gas adjustment (PGA). Property taxes are
8 not gas costs and therefore should not be included in the PGA. Please see surrebuttal
9 testimony in this case of Staff witness David M. Sommerer for further explanation.

10 Q. In the event MGE is successful with its current appeal, does Staff agree that
11 any refund should include interest at MGE's short term debt rate as suggested at page 9 of Mr.
12 Buck's rebuttal testimony?

13 A. No. If an allowance is included in MGE's cost of service for Kansas property
14 taxes and MGE ultimately prevails in the court system, any amounts collected from the
15 ratepayers should be refunded using the same return as the Infrastructure System Replacement
16 Surcharge (ISRS) overall rate of return determined in this rate case. MGE customers should
17 be properly compensated for the funds they supply to the utility in advance. Typically,
18 ratepayers are compensated for funds provided to the utility in advance through Cash
19 Working Capital in a rate case. The overall rate of return is applied to customer supplied
20 funds and is used to offset the utility's rate base. MGE's recommendation to use the short
21 term debt rate is typically the lowest interest rate experienced by a utility.

22 Q. Has the Commission recognized that customers should be compensated for
23 funds supplied in advance with the overall rate of return?

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1 A. Yes. In MGE's last rate case, Case No. GR-2009-0355, MGE customers
2 supplied funds for energy efficiency programs. The funds supplied by the customers were not
3 used by the Company. MGE recommended that an interest rate equal to its short term debt
4 should be applied to the unspent funds. Instead, the Commission ordered MGE to apply the
5 overall cost of capital determined in that case to any unspent amounts.¹

6 Q. If the Commission allows MGE an allowance in its cost of service, what is
7 Staff's recommendation to refund the funds collected in the event MGE is successful in the
8 court system?

9 A. Staff recommends that MGE track the amounts collected for property taxes,
10 and, to the extent that the property taxes are not paid, MGE will refund the amounts collected,
11 including interest (based on the ISRS rate of return established in this case), using a
12 special tariff.

13 Q. Please summarize Staff's recommendation regarding the treatment of Kansas
14 property taxes.

15 A. Staff recommends that the existing AAO for the Kansas property taxes be
16 renewed using the same language that has been approved by the Commission in Case No.
17 GU-2005-0095 and Case No. GR-2009-0355. MGE should be commended for their efforts in
18 opposing the validity of these taxes. Consequently, Staff is not opposed to an alternative
19 recovery mechanism that includes an allowance in MGE's cost of service and allows
20 ratepayer funds collected through rates including interest (based on the ISRS rate of return
21 established in this case) to be returned through a special tariff in the event MGE prevails in
22 the court system.

¹ Case No. GR-2009-0355 Commission Report and Order, page 63.

1 **CASH WORKING CAPITAL**

2 Q. Please summarize Staff's position related to the revenue lag (billing and
3 collection lags) and the pension and income tax expense lags included on the cash
4 working capital schedule of Staff's Accounting schedules filed on January 29, 2014 and
5 February 14, 2014.

6 A. It is Staff's understanding that an agreement was reached between MGE and
7 Staff on Cash Working Capital. Specifically, the billing and collection lags as part of the
8 overall revenue lag and the pension and income tax expense lags were agreed to by MGE and
9 Staff. Staff has reflected the results of this agreement for cash working capital and provided
10 the impacts to the Company. As of this surrebuttal filing, MGE has not indicated any further
11 disagreement with the changes made to Staff's updated revenue requirement.

12 Despite the agreed-upon changes to cash working capital, MGE's witness Buck
13 addressed this matter at page 1 of his rebuttal testimony. Mr. Buck states that the Company
14 would like to reserve the right to file supplemental rebuttal testimony on these issues.
15 Mr. Buck made the following remarks regarding cash working capital:

16 It is my understanding that the Company and Staff have come to
17 an agreement on Cash Working Capital but the Company
18 reserves the right to file supplemental rebuttal testimony on the
19 billing lag and collection lag portions of the overall revenue lag
20 used in the computations as well as the income tax and pension
21 expense lags at a future time if necessary.

22 Staff would also like to reserve the right to file supplemental testimony on Cash Working
23 Capital at a future time should the Company file any supplemental rebuttal testimony relating
24 to the billing and collection lags, income tax and pension expense lags.

1 **MANUFACTURED GAS PLANTS**

2 Q. Please summarize MGE's position relating to remediation costs for MGE's
3 manufactured gas plant sites.

4 A. MGE witness Michael R. Noack recommends in his rebuttal testimony
5 (page 15), that a tracker is an appropriate mechanism to handle recovery of remediation
6 costs related to MGE's manufactured gas plants. Staff disagrees that a tracker is the
7 appropriate ratemaking mechanism to recover these costs. During the course of the audit of
8 MGE, Staff reviewed MGE's manufactured gas plant actual remediation costs for the period
9 of 1994 through August 2013. In addition, Staff met with MGE personnel to get a better
10 understanding of how the costs were treated, a historical overview of how these costs came
11 about, and the remediation status of each of the manufactured gas plant sites. Based on these
12 discussions and Staff's analysis, a normalized level of remediation costs based on the test year
13 (12 month period ended April 30, 2013) was included in Staff's accounting schedules filed on
14 January 29, 2014. Including a normalized level of remediation costs as part of MGE's cost of
15 service is the appropriate recovery method for these costs and consistent with how these costs
16 have been treated in past rate cases by Staff.

17 Q. Why does MGE suggest a tracker for remediation costs related to the
18 manufactured gas plants?

19 A. MGE witness Michael R. Noack states the following in his Rebuttal Testimony
20 on pages 15-16:

21 Q. Do you believe that a tracker or other form of
22 adjustment mechanism is appropriate to handle recovery of
23 environmental costs?

24 A. Yes. If there is a concern about the possible variability
25 of the environmental costs and insurance recoveries, a tracker is
26 a good alternative to address net cost recovery. This approach

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1 would account for the costs in a way that would reduce the
2 chances that the Company would either under or over-recover
3 its environmental costs. Such an approach would also mitigate
4 the significance of the estimated amount used for the purpose of
5 setting rates.

6 Q. Prior to the rebuttal testimony filed by Mr. Noack's in this case, has MGE
7 recommended a tracker for remediation costs in any testimony in this case or in discussions
8 with Staff throughout this case?

9 A. No. MGE did not recommend a tracker for recovery of remediation costs in its
10 direct testimony and there were no discussions between Staff and MGE during the course of
11 the rate case that would suggest MGE was seeking a tracker for recovery of these costs.

12 Q. Do you agree with MGE's witness Mr. Noack that actual incurred remediation
13 costs have varied over the years?

14 A. Although these costs fluctuated over the period of 1994-2008, the actual costs
15 incurred for the period of 2009 through August 2013 have not significantly varied. Prior to
16 the 2009 rate case, MGE received insurance recoveries that covered a large majority of the
17 remediation costs incurred by MGE.² In Case No. GR-2009-0355, Staff included a
18 normalized level of remediation costs for MGE's manufactured gas plants net of insurance
19 and third party recoveries.³ As a result of discussions with MGE personnel, Staff understands
20 that the opportunity to recover remediation costs through insurance proceeds has been
21 exhausted. However, the normalized level of costs included in MGE's cost of service in Case
22 No. GR-2009-0355 was representative of the actual costs MGE incurred since the effective
23 date of rates in that case (February 2010 through August 2013).

² Case No. GU-2007-0480, Staff Witness Paul R. Harrison Rebuttal Testimony, pages 9-10.

³ Case No. GR-2009-0355, Staff Cost of Service Report, pages, 110-111.

Surrebuttal Testimony of
Karen Lyons

1 Q. Did Staff include a normalized level of manufactured gas plant remediation
2 costs in MGE's current rate case?

3 A. Yes. During Staff's review of MGE's actual historical remediation costs, Staff
4 concluded the costs did not show a significant fluctuation for the period of 2009 through
5 August 2013 and that the test year level (12 months ended April 30, 2013) of actual costs
6 incurred is representative of an ongoing level.

7 Q. Does MGE agree with Staff's normalized level of remediation costs included
8 in MGE's cost of service?

9 A. It is Staff's understanding that MGE agrees with Staff's recommendation of
10 normalized remediation costs included in MGE's cost of service. However Mr. Noack states
11 on page 15 of his rebuttal testimony that Staff included a normalized level of manufactured
12 gas plant remediation costs based on a three-year average. This is incorrect. Staff used a
13 normalized level of these costs based on the test year (12 month period ended April 30, 2013),
14 and not a three-year average as Mr. Noack states in his rebuttal testimony.

15 Q. What is a tracker?

16 A. A tracker is a rate recovery mechanism that is intended to result in deferral of
17 certain financial impacts on utility books, with the deferral amount eligible for recovery in a
18 subsequent rate proceeding. Using this type of rate mechanism allows certain cost increases
19 and decreases to be "tracked" so those cost changes may be included in a future rate case.

20 Q. For what kind of costs would a tracker be an appropriate cost
21 recovery mechanism?

22 A. Typically, trackers have been granted for costs showing significant fluctuation
23 and up-and down volatility over time; new costs for which there is little or no historical

Surrebuttal Testimony of
Karen Lyons

1 | experience; and costs for which accurate estimation is difficult such as pensions or for
2 | operation and maintenance expenses for a new power plant addition; and costs imposed upon
3 | utilities by Commission rule, such as the Commission's vegetation management program and
4 | infrastructure inspections.

5 | Q. Does MGE's manufactured gas plant remediation costs meet the criteria for
6 | a tracker?

7 | A. No. During Staff's review of MGE's actual historical remediation costs, Staff
8 | concluded the costs did not show a significant fluctuation and Staff was able to determine a
9 | normalized level. As discussed above, Staff included an amount for remediation costs in
10 | MGE's cost of service in the 2009 rate case based on historical data. Staff's level of
11 | remediation costs in the 2009 case was an accurate reflection of remediation costs actually
12 | incurred by MGE over the last three years. Upon review of MGE's historical actual
13 | remediation costs in MGE's current rate case, Staff concluded the costs did not fluctuate and
14 | that the test year level (12 months ended April 30, 2013) of actual costs incurred is
15 | representative of an ongoing level.

16 | Q. Mr. Noack indicates at page 16 of his rebuttal testimony that Commission
17 | rules allow for MGE's proposed treatment of manufactured gas costs. Do you agree with
18 | this assessment?

19 | A. I agree that the Commission's rules allow for certain environmental costs to be
20 | recovered for electric and water companies. However, there are significant rules and
21 | reporting requirements associated with the implementation of these rules. To date, it is my
22 | understanding that no utility has requested cost recovery under these rules.

Surrebuttal Testimony of
Karen Lyons

1 Q. Please summarize Staff's position regarding the use of a tracker for MGE's
2 manufactured gas plant remediation costs.

3 A. A tracker has been approved by the Commission in the past for costs that
4 fluctuate, costs that are difficult to estimate, and for costs imposed upon utilities by
5 Commission rule. The actual remediation costs incurred by MGE for manufactured gas plants
6 have not fluctuated over the last three years and there are several years of historical data to
7 accurately determine an appropriate level of costs to represent an ongoing level of costs.
8 Consequently, it is Staff's recommendation that a tracker for MGE's manufactured gas plant
9 remediation costs is not an appropriate mechanism for cost recovery.

10 Q. Does this conclude your surrebuttal testimony?

11 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

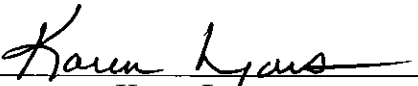
OF THE STATE OF MISSOURI

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

AFFIDAVIT OF KAREN LYONS

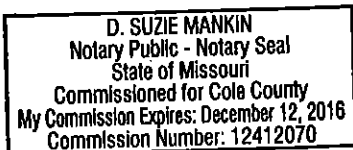
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

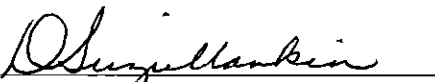
Karen Lyons, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 21 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.



Karen Lyons

Subscribed and sworn to before me this 3rd day of April, 2014.





Notary Public