Exhibit No.:
Issues: *Policy and Load Attrition*
Witness: *Mark L. Oligschlaeger*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Rebuttal Testimony*
Case No.: *GR-2004-0209*
Date Testimony Prepared: *May 24, 2004*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

Jefferson City, Missouri
May 2004

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Tariffs to Implement a General Rate Increase for Natural Gas Service	)))	Case No. GR-2004-0209

AFFIDAVIT OF MARK L. OLIGSCHLAEGER

STATE OF MISSOURI COUNTY OF COLE	)))	ss.

Mark L. Oligschlaeger, being of lawful age, on his oath states: that he has participated in the preparation of the following rebuttal testimony in question and answer form, consisting of 22 pages to be presented in the above case; that the answers in the following rebuttal testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Mark L. Oligschlaeger
Mark L. Oligschlaeger

Subscribed and sworn to before me this 21st day of May 2004.

Toni M Charlton
Notary

TONI M. CHARLTON, NOTARY SEAL, NOTARY PUBLIC, STATE OF MISSOURI

TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

TABLE OF CONTENTS

REBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

REBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

Q. Please state your name and business address.

A. Mark L. Oligschlaeger, P.O. Box 360, Suite 440, Jefferson City, MO 65102.

Q. Are you the same Mark L. Oligschlaeger who has previously filed direct testimony in this proceeding for the Staff?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address certain policy matters raised by Missouri Gas Energy (MGE or Company) witness James Oglesby in his direct testimony. I will also briefly comment on the test year/matching implications of the Company's proposed "load attrition" adjustment sponsored by Company witness F. Jay Cummings in his direct testimony in this proceeding.

POLICY

Q. Please summarize Mr. Oglesby's testimony on policy matters.

A. In his direct testimony, Mr. Oglesby makes a claim that MGE is currently providing its customers with high quality service at very reasonable prices. However, Mr. Oglesby also criticizes a number of the ratemaking techniques utilized by the Commission in the past to set rates for MGE, on the grounds that such techniques have impaired the Company's ability to earn its authorized rate of return. Finally, Mr. Oglesby recommends that the

Commission "reward" MGE for its management efficiency be increasing its authorized rate of return by 25 basis points in this proceeding.

Q. Will you be addressing Mr. Oglesby's claim that MGE provides a high quality of service to its customers?

A. No. Staff witness Deborah Ann Bernsen will be addressing this claim in her rebuttal testimony. The Staff's position in this proceeding is that MGE is not providing above-average customer service at this time.

Q. Is it the current Commission policy to adjust allowed rates of return on account of positive or negative management efficiency?

A. No, per the Commission's Report and Order in Case No. TC-89-14, et al., which is discussed in more detail in Ms. Bernsen's rebuttal testimony. However, the Commission did order use of the low-end of the Staff's recommended range of return on equity values in MGE's rate case, Case No. GR-96-285, on account of poor customer service performance.

Q. What evidence does Mr. Oglesby present in his direct testimony to justify his claim that MGE provides utility service on a very cost effective basis?

A. Mr. Oglesby provides analyses that purport to compare MGE's performance in the areas of operation and maintenance (O&M) expense per customer for the years 1998-2002 to other Missouri local distribution companies (LDCs), and MGE's annual residential rate level per customer to other Missouri LDCs for the year 2002 only. Both the comparative O&M and rate analyses reflected in Mr. Oglesby's direct testimony are based upon work actually performed by Company witness Michael R. Noack.

Q. What conclusion has the Staff reached concerning MGE's claims that its residential customer rate levels are lower than other Missouri LDCs?

A. Staff witness Anne E. Ross of the Energy Department – Economic Analysis section has performed an analysis of MGE's current residential rate levels compared to other Missouri LDCs, and has verified that MGE's current margin rates are lower than the other LDCs that Mr. Oglesby compares MGE to at page seven of his direct testimony. However, Ms. Ross performed a further analysis of what the impact of MGE's current rate increase request would be on these comparative rate levels. This analysis is included in Ms. Ross' rebuttal testimony.

Q. What does Ms. Ross' testimony show?

A. This testimony shows that, if MGE's current rate increase request and proposed rate design were to be granted in full, then almost all of MGE's current rate advantage over Laclede Gas Company, the next lowest LDC depicted in Mr. Oglesby's testimony, would be eliminated. In other words, MGE is effectively seeking to eliminate in this rate increase case the comparative rate advantage it argues justifies the extraordinary rate treatment it also desires in this rate proceeding in the form of a rate of return adder.

Ms. Ross also shows that, if MGE's proposed rate increase and rate design were to be adopted in full by this Commission, MGE's resulting residential rates would be higher than those of Atmos Energy Corporation (Atmos), a Missouri LDC not included in Mr. Oglesby's rate comparison.

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

A. I do not disagree with the data shown at page 7 of Mr. Oglesby's direct testimony. However, one must be cautious when making direct cost comparisons between different utilities. Each utility faces unique circumstances that may cause different cost levels from other regional utilities of its type. For example, both AmerenUE and Aquila are primarily electric utilities in Missouri, with their natural gas operations being a relatively small percentage of their total business in this state. This fact alone may make direct gas O&M cost comparisons between AmerenUE and Aquila on one hand, and MGE (a 100% gas utility) on the other, not particularly meaningful.

Laclede is on the surface more like MGE than AmerenUE or Aquila, in that both are entirely gas utilities that serve, among other areas, Missouri's two largest cities. Even in this case, however, there may be significant differences between Laclede's service territory and MGE's that may cause differences in comparative cost levels. MGE has not performed the detailed analysis of Laclede and MGE necessary to determine whether the two companies are truly comparable enough to justify MGE's conclusions regarding its cost levels compared to Laclede's. Laclede has not had an opportunity to present its view on this matter. It is not likely that Laclede would agree that the MGE management outperforms its management.

The remainder of this section of testimony will largely focus on the O&M cost relationship over time of MGE and Laclede, given their nominal similarities.

Q. Did you do any further research on the relationship between MGE's O&M levels to those of other Missouri LDCs?

A. Yes, I did. MGE purchased its Missouri gas properties from Western Resources, Inc. (Western) in early 1994. Since MGE assumed Western's existing rates in Missouri when it purchased its Missouri property, I was curious whether Western had a similar cost advantage over the other Missouri LDCs that MGE depicts that it had in Mr. Oglesby's testimony for the years 1998-2003. Therefore, I reviewed the Federal Energy Regulatory Commission Form 2 (Annual Report) numbers on O&M costs for Western, Laclede, AmerenUE and Aquila for the years 1992 and 1993, the period before MGE's purchase of its Missouri properties. I also reviewed the same data for the same companies for the year 1994-1997 (substituting MGE for Western), as well as 2003 information for those utilities whose 2003 Annual Report was available as of the time of this filing (only MGE and Laclede).

Schedule 1 to this rebuttal testimony provides this comparative cost data for these Missouri gas utilities for the years 1992-2002, and for MGE and Laclede for 2003. The O&M per customer data for the LDCs for the years 1998-2002 is identical to that shown on page seven of Mr. Oglesby's direct testimony.

Q. What did the O&M data for the years 1992-1995 show?

A. My analysis shows that Western had a small cost advantage over Laclede in the O&M area in the years 1992 and 1993. For 1993, for example, Western's O&M level per customer was at 97% of Laclede's. My analysis further showed that most of MGE's current comparative cost advantage over Laclede was achieved by the end of 1995, after the first two years MGE operated its Missouri properties. In 1994, MGE's level of O&M per customer was at 78% of Laclede's; in 1995, 74%.

Q. Why did MGE show a significant reduction in O&M expenses compared to Western in 1994 and 1995?

A. Western was a combination electric and gas utility. The electric properties represented a majority of that company's business. Western had acquired its Missouri gas properties as a "white knight" in a friendly takeover to prevent these properties being acquired by UtiliCorp United, Inc. (now Aquila) in a hostile acquisition. MGE instituted a cost reduction program in 1994 for its new Missouri properties. It should be noted that one reason for this effort was that MGE had paid a significant premium (acquisition adjustment) to Western for the

Missouri property, for which it was forbidden in the Stipulation And Agreement in Case No. GM-94-40 from seeking direct cost recovery of in Missouri. Further, under the terms of the same Stipulation And Agreement, MGE was under a three-year rate moratorium that started in February 1994. Therefore, achieving significant cost reductions was the only way MGE could earn an indirect return of and a return on the premium it paid Western for its current Missouri property.

Q. After 1995, did MGE accomplish further cost reductions relative to Laclede?

A. Only to a minor degree. For the years 1996 through 2001, MGE's O&M per customer levels ranged from 70% to 77% of Laclede's. Schedule 1 shows that MGE showed a further improvement in this area relative to Laclede in 2002 (61%) and 2003 (67%), but that improvement appears to relate entirely to increasing O&M expense levels for Laclede, not O&M reductions by MGE.

Q. What is the significance of the fact that most of MGE's improvement in its relative position on O&M costs occurred in the first years of operation of MGE in Missouri?

A. As it relates to MGE's arguments that it should be "rewarded" for its management efficiency compared to other Missouri LDCs, there are two significant points to make regarding MGE's cost efficiencies in the mid-1990s:

1) MGE is effectively asking the Commission to reward it currently for actions it largely took ten years or so in the past; and

2) MGE's cost-cutting efforts at that time had certain detrimental impacts on its customers.

Q. In regard to your first point, why shouldn't MGE be rewarded for actions it took in the distant past?

A. To the extent that the Commission chooses to implement a policy of allowing rate "rewards" to utilities, such rewards should only be based on real and measurable current improvements in productivity and efficiency, not on status quo current performance.

Q. In regard to your second point, why do you believe that MGE's cost reduction efforts after it took over its Missouri properties had detrimental impacts on MGE's customers?

A. In the 1996-97 time frame, MGE experienced significant customer service problems that were addressed by the Commission in the 1996 and 1998 rate cases. The Staff believes that these problems were caused, in part, by staffing reductions in certain parts of MGE's operations. In fact, some of the Commission's actions in those cases are part of what Mr. Oglesby characterizes as "punishments" in his direct testimony. My point here is simply that the cost reductions MGE brought about in the mid-1990s had some detrimental impacts on its customers.

Q. Did MGE ever have the opportunity to benefit from the cost reductions it implemented after it purchased the Missouri properties from Western?

A. Yes. MGE was able to entirely keep the benefits of these cost reductions for a period of time under the three-year rate moratorium agreed to in Case No. GR-94-40.

Q. In its O&M analysis, does MGE compare itself to all major Missouri LDCs?

A. No. MGE for some reason chose to omit Atmos. Atmos purchased the former United Cities Gas Company properties in Missouri in 2000.

Q. How large is Atmos, compared to the other four Missouri LDCs MGE cited in its O&M comparison?

A. In terms of O&M costs, Atmos is only slightly smaller than Aquila, the smallest of the utilities included in MGE's comparison.

Q. Have you examined Atmos' recent O&M expense levels per customer in Missouri?

A. Yes, I did. Rebuttal Schedule 2 shows this information for the years 2002 and 2003, based upon filed Annual Reports. This data shows that, on a per customer basis, Atmos' O&M levels were less than MGE's in 2003.

Q. Mr. Oglesby states in his testimony at page 11 that MGE "has never earned" its authorized rate of return. What is the basis for this statement?

A. This statement is based upon an analysis performed by Mr. Noack. Mr. Noack attached a copy of this analysis to his "Updated Test Year Direct Testimony" filed in January 2004 as Schedule G-4. I have attached the same copy of this analysis to my testimony as Rebuttal Schedule 3 for easy reference.

Q. What is the nature of Mr. Noack's rate of return analysis?

A. Mr. Noack takes the per book revenue and expense numbers for MGE for its fiscal years ending in June 1996 through June 2003, and compares the resulting net operating income amounts to the last rate base amount reflected in its rates, updated for the change in net plant in service (gross plant in service, less depreciation reserve) since the time of its last rate proceeding. The resulting earned rate of returns demonstrate, according to Mr. Oglesby, that MGE has never earned its authorized rate of return for any of the fiscal years examined.

Q. Do you agree with the conclusion Mr. Oglesby draws from Mr. Noack's analysis?

A. Not based upon the analysis presented in Schedule 3. There are several fundamental problems with how this analysis purports to measure MGE's past annual earnings.

Q. What is one problem with Mr. Noack's analysis?

A. One problem is that Mr. Noack compares net operating income (NOI) amounts derived from a 12-month period to an "end-of-period" rate base amount. Such a methodology will always understate the earned rate of return because the calculation in effect assumes that a company is underearning if the company has not earned 12 months of return on investment that has actually been in service less than twelve months. If one wants to calculate an accurate earnings number for a 12-month period, one should compare 12 months of net operating income to an average rate base for the 12-month period examined. Conversely, if one desires to use an end-of-period rate base to compare to NOI, then one should adjust the revenues and expenses to an end-of-period perspective.

The year-end rate base technique is used in the traditional Missouri ratemaking process in order to set forward-looking rates and reduce regulatory lag. This method has never been endorsed by the Commission as a measurement to calculate the rate of return earned under the existing rates. In fact, when the Commission has implemented earnings sharing programs for Southwestern Bell Telephone Company and for Union Electric Company in the past, the annual earnings measurements have been based on average annual investment, not year-end investment.

As long as rate base is increasing over time (which is true of MGE), comparison of 12 months of NOI to an end-of-period rate base will only serve to mathematically understate the true earned rate of return of the utility.

Q. Can you provide an example of how MGE's year-end rate base approach to presenting its past earnings results bias those results downward?

A. Yes. Assume a utility's annual NOI is $ 1 million, that its average rate base for the year is $10 million, and its period-ending rate base is $11 million. Further, assume the utility's authorized rate or return is 10%.

Measured as a comparison of its annual earnings to its average rate base over the same 12-month period, this utility's rate of return would have been 10% ($1 million/$10 million). Alternatively, under MGE's approach, one would apply the annual NOI of $1 million to the end-of-period rate base of $11 million, and calculate an annual rate of return of 9.09%. This example shows how MGE's presentation of its earnings results in Mr. Noack's analysis is biased downwards because the NOI amounts are not properly matched with the rate base amounts. MGE's method of calculating its earned rate of return is flawed and consistently results in an understated return.

Q. What other problems exist with Mr. Noack's analysis?

A. A fundamental problem is that none of MGE's revenue or expense numbers in this analysis are normalized, as would be done in a rate proceeding. For example, the revenue amounts shown on MGE's analysis will be impacted by weather conditions. Warmer than normal weather, all other things being equal, will tend to produce earnings levels below the authorized rate of return for a gas utility. Yet, any resulting earnings deficiency should not lead a utility to file for rate relief, because the abnormally warm weather's impact on earnings will be normalized (eliminated) for purpose of setting rates. Weather is obviously not under human control, and variations in earnings due to weather fluctuations in no way are indicative of flaws or problems in the regulatory process used in Missouri. To the extent weather was warmer than normal for the period of time covered in MGE's earnings analysis, that fact alone may go a long way toward explaining why MGE had difficulty earning its authorized rate of return during these years.

Q. Do you have any further comments on MGE's earnings analysis?

A. Yes. As previously mentioned, Mr. Noack simulates the growth in MGE's rate base over time by inputting in his analysis the increase in net plant since the time of MGE's last rate proceeding in determining each fiscal year's earnings result for the Company.

Q. Is this an appropriate method to simulate MGE's growth in rate base over time?

A. No. The Staff acknowledges that the trend of increase or decrease in net plant over time will almost always be the primary driver of the increase or decrease over time in total rate base. However, Mr. Noack's approach totally ignores an offset to rate base that almost always serves to reduce rate base over time: deferred income taxes. While this item is smaller in value than net plant in utility rate base, it is still a significant and material rate base item, and for almost all utilities the balance of deferred income taxes grows larger over time. For a valid simulated rate base calculation, MGE should have offset the increase over time in deferred income taxes against the increase in net plant shown on my Schedule 3.

Q. How has MGE's deferred income tax balance changed since the mid-1990s?

A. In MGE's first Missouri rate case, No. GR-96-285, the deferred tax offset balance in rate base was valued at approximately $9 million. In the current rate proceeding, MGE's deferred tax offset is valued at more than $64 million. To reiterate, growth in the Company's deferred income tax balance over time serves to reduce its revenue requirement, all other things being equal.

Q. What is the impact of MGE's omission of deferred income tax growth on its earnings analysis?

A. This omission serves to understate MGE's true earnings levels.

Q. How often has MGE filed for rate relief in its history?

A. MGE has filed rate cases in March 1996 (Case No. GR-96-285); October 1997 (Case No. GR-98-140); November 2000 (Case No. GR-2001-292); and the current rate case in November 2003.

Q. What does this rate case filing history have to do with MGE's earnings deficiency analysis?

A. For a company that claims to have "never earned" its authorized rate of return, it is surprising that MGE has filed for rate relief so seldom. For each of the last two rate proceedings, MGE waited a full three-years period between filings.

Q. Why hasn't MGE filed rate cases more often, given its allegations of consistent poor earnings?

A. Two possibilities suggest themselves. One, that MGE's actual earnings were not far enough below the authorized level set by the Commission to justify filing a rate case, or that MGE perceived that its cost of capital had declined since its last rate case, and its current earnings were adequate. Second, MGE may have realized that when its per book revenues and expenses reflecting underearnings were appropriately normalized and annualized, a rate case was not justified.

Q. Having made these points concerning MGE's earnings analysis, do you disagree that MGE has had a tendency to underearn in its short history to date?

A. No. Given the fact that MGE has added much plant in service to its rate base in recent years, and the nature of the ratemaking process in Missouri, that phenomenon is exactly what would be expected to happen.

Q. Please explain.

A. In Missouri, the traditional ratemaking process gives a utility an opportunity to recover its costs and earn a reasonable return on its investment. To the extent a utility's costs increase above the level upon which rates were set, all other things being equal, the utility's earnings will then decline. If the decline in earnings were significant enough, the utility would be expected to file for rate relief to have the opportunity to restore its earnings to a reasonable level.

Q. Has MGE's costs increased over the time depicted in Mr. Noack's earnings analysis?

A. Yes, especially its capital costs. In particular, note that in Schedule 2 net plant in service is shown as increasing from approximately $360 million in 1996 to approximately $525 million in 2003. (As mentioned previously, the increase in net plant should be offset by the increase in deferred income taxes, in order to depict more accurately MGE's capital cost growth over time.). This increase in net plant over a seven-year period may be assumed to be a key driver in both MGE's alleged earnings deficiencies over that time, and in MGE's decisions to seek periodic rate relief from the Commission.

Q. How do increases in net plant over time affect a utility's earnings?

A. Net plant increases affect utility earnings in two primary ways:

1) depreciation expense begins to accrue on the plant in service additions when they are placed into service, and the increase in expense drives down earnings, all other things being equal; and

2) the plant addition is added to rate base, which in turn increases the utility's required rate base return, all other things being equal.

Both of these phenomena can significantly impact a utility's rate of return over time, until rates are changed to reflect inclusion of the plant additions in rates.

Q. Does under-earning by utilities due to the addition of plant in rate base point out the need for changes in the regulatory process in Missouri?

A. No. This type of under-earning does not represent a flaw or defect in Missouri's regulatory process; it is exactly how the regulatory process is intended to work. When a utility's costs increase; its earnings will decline. MGE's sizeable increase in net plant over that period inevitably caused it to experience earnings pressure.

Q. Has the Commission provided some measure of earnings protection to MGE on account of its past plant additions?

A. Yes. For plant expenditures associated with the Service Line Replacement Program (SLRP), the Commission has had a past policy of granting Accounting Authority Orders (AAOs), which served to protect the earnings of MGE from earnings detriment associated with SLRP plant additions until rates could be adjusted to include the SLRP additions in rates. AAOs allow this protection by authorizing the deferral of depreciation expense and carrying charges on SLRP additions, which otherwise would have detrimentally impacted earnings. Especially in the 1990s, SLRP additions were a significant part of total MGE plant additions.

Q. Are you aware of any other recent developments that will affect how MGE is prospectively affected by plant additions?

A. Yes. In 2003, legislation was passed that gave MGE and other Missouri gas and water utilities the ability to have their rates changed on a single-issue basis for certain types of plant additions. This legislation is commonly known as the Infrastructure System Replacement Surcharge (ISRS) law. MGE applied for a single-issue ISRS rate increase of approximately

$3 million earlier this year, which was granted by the Commission in accordance with the ISRS law.

Q. Will ongoing use by MGE of the opportunities afforded by the ISRS law mitigate some of the earnings declines attributable to net plant additions shown in MGE's earnings analysis?

A. Yes.

Q. Mr. Oglesby provides a number of his own reasons in direct testimony as to why he believes MGE has not been able to earn its authorized rate of return, among them rate design issues, treatment of bad debt expenses in rates, the Commission's "traditional" disallowances, and alleged inequity in how the Commission has "punished" MGE by some of the Commission's actions in the past. Do you agree with Mr. Oglesby's arguments?

A. No. I will address Mr. Oglesby's points on bad debt expense, traditional disallowances and "punishments." Other Staff witnesses will address Staff policy on rate design in rebuttal testimony.

Q. What does Mr. Oglesby allege in the area of uncollectibles/bad debts?

A. Mr. Oglesby alleges that MGE has seriously under-recovered its bad debt costs in its recent rate levels, and presents a calculation that purports to show an average under-recovery of this item of $1.5 million annually for the last five years.

Q. Do you agree with the numbers used by Mr. Oglesby for bad debts in his testimony?

A. No. Mr. Oglesby's chart on page 14 of his direct testimony compares the bad debt expense recognized by MGE on its books on an accrual basis to the bad debt expense included in rates, which is not based upon an accrual calculation but on a multi-year average of actual bad debt write-offs. For purposes of comparing the adequacy of MGE's rate levels for bad debts with its actual costs, it would be more appropriate to compare MGE's actual uncollectible write-offs to the level used to set rates.

Q. Why has there been a shortfall in MGE's recovery of bad debt expense?

A. The fault is not in how the Commission has set rates for this item in the past; the problem is that MGE experienced a very high level of bad debts in the winter of 2000-2001. The Staff believes these bad debt levels were in part attributable to a combination of high gas costs and colder than normal temperatures that winter. As can be seen in the chart in Mr. Oglesby's testimony at page 14, the level of bad debts for fiscal year 2001 (the 12 months ending June 2001) was far in excess of the level incurred by the Company in any other recent 12-month period.

Q. Did MGE enjoy a benefit from the cold weather during the winter of 2000-2001 that gave rise in part to the increased level of uncollectibles?

A. Yes. The abnormally cold weather also increased MGE's sales of gas, and hence its revenues.

Q. How should rates be set to account for "spikes" in bad debts, such as what occurred in 2000 and 2001?

A. Given the inherent volatility and uncertainty in levels of cost for uncollectibles, it is usually appropriate to use a multi-year average of this expense for purposes of setting rates. The Staff for bad debts generally uses a five-year average, and that is what has been recommended in this case.

When a multi-year average is used to set rates for an item, and a utility incurs an unusually high level of the expense in a test year, the averaging technique will serve to "normalize" the abnormally high level downward. "Under-recovery" of the expense is the natural and normal result. Then, if the levels of the expense (in this case, bad debts) decline to a more normal level in subsequent years after the spike, then the averaging technique should provide the utility with rate levels above the level of expense actually incurred for that item, because the abnormally high year is a part of the multi-year average. (This process happens in reverse for a utility than incurs an abnormally low level of uncollectibles in a given year.)

Q. How does the Staff's recommended level of uncollectibles compare to MGE's recent level of bad debts?

A. The Staff's recommended level of bad debts in this proceeding ($6.1 million) is above MGE's test year amount of write-offs, and in addition is above the level of write-offs incurred by MGE in all but one of the last seven years.

Q. Does the Staff believe that its recommended level of bad debts to include in rates has "some reasonable likelihood of being achieved" (Oglesby direct, page 17, line 1)?

A. Yes.

Q. What are Mr. Oglesby's points in his direct testimony concerning so-called "traditional disallowances?"

A. Mr. Oglesby complains that the Commission's traditional disallowances harm the Company's ability to earn its authorized rate of return, and prevents the Company from recovering in rates necessary costs. He further implies that the Commission should imply a different standard in these ratemaking areas for MGE since it is allegedly a low-cost company (Oglesby direct; page 14, line 28 to page 15, line 5).

Q. What types of costs does Mr. Oglesby include in the category of traditional disallowances?

A. Mr. Oglesby states that charitable contributions, certain types of advertising, lobbying costs, and Customer and Government Relations Department (CGR Dept.) costs all fall into this category.

Q. What do these categories of costs have in common?

A. They all have in common that the Commission's policy is to treat these types of costs as being inherently assignable to utility shareholders, not customers. That is because the Commission does not believe customers should bear the burden of costs that do not benefit them (institutional advertising), or would convert captive customers into involuntary contributors to charitable causes or political concerns. CGR Dept. costs fall into both categories.

Q. Why shouldn't the Commission take into account MGE's claim that it has lower overall O&M expense levels than other LDCs when considering treatment of these items in rates?

A. Because treating ratepayers as involuntary contributors, or passing on costs to them in rates that are not intended to benefit them, is not made any fairer by pointing to alleged lower levels of total costs incurred by MGE compared to other gas utilities.

Q. Is it true that MGE has no choice but to incur the costs associated with traditional disallowances?

A. The Staff believes that MGE has no obligation to incur these costs in its role as a public utility. Furthermore, MGE can take into account that the Commission will assign these costs to shareholders in determining what level of expenditure in each of these areas it should make. MGE can choose to increase its earned return by discontinuing these activities that are not required to provide service to its customers.

Q. Does the Commission's policy of disallowing rate recovery of these categories of costs make it more difficult for MGE to earn its authorized rate of return?

A. Yes. Any time a utility chooses to incur costs and book expenses that it knows the Commission has a policy of disallowing, the Company's per book earned returns will be reduced as opposed to the alternative of not incurring those costs at all. However, the Staff does not believe these particular elements of expense have a material impact on the Company's earned rate of return.

Q. Please explain why.

A. I attempted to quantify the Staff's proposed adjustments in this proceeding to disallow costs in all of the areas of traditional disallowances cited by Mr. Oglesby. (I only included Staff disallowance amounts in the category of lobbying costs that were greater than the Company's own adjustments to eliminate certain lobbying costs from the case.) My analysis indicated that these adjustments totaled no more than $215,000. This compares to a total difference between the Staff's and the Company's direct cases of $44.5 million.

While the traditional disallowances question is important in terms of appropriate Commission policy, it is not particularly important in terms of the dollar impact associated with these items for ratemaking purposes.

Q. Please describe Mr. Oglesby's statements concerning Commission "punishment" and "rewards" in his direct testimony.

A. Mr. Oglesby lists a number of actions the Commission took regarding MGE, most of which occurred in the 1990s, and describes them as "punishments." Then, he implies that fairness requires the Commission to be as equally willing to "reward" MGE for good behavior as it was formerly willing to "punish" it.

Q. Do you agree with how Mr. Oglesby has characterized this matter?

A. No. I disagree with his use of the word "punishment" to characterize the former Commission actions Mr. Oglesby seems to deplore. Most, if not all, of these "punishments" were in actuality prudence disallowances. A standard part of traditional regulation has been the concern that utilities not act in an imprudent manner in providing utility service, and if they do so that they do not reap financial benefits from such behavior. The fact that the Commission has, on occasion, found that MGE has acted in an imprudent manner in no way requires the Commission to go beyond the normal risk/reward mechanisms in traditional regulation to somehow reward the Company for merely performing in a manner consistent with its obligations to its customers.

Q. Please summarize your rebuttal testimony on policy matters.

A. The Company, in Mr. Oglesby's direct testimony, claims that its performance in customer service matters and management efficiency is of such high quality that it deserves favorable rate treatment, in the form of an upward 25 basis point adjustment in its authorized rate of return.

The Staff opposes the Company's proposal. First, the Commission's policy is that rate of return adjustments are not an appropriate means of recognizing management efficiency, either for good or for ill. The Staff agrees with this Commission policy. Second, the Staff believes that MGE's current level of customer service cannot be deemed to be truly of a high quality (refer to the testimony of Staff witness Bernsen). Third, the Staff believes that the Company has not presented any evidence in this proceeding showing any relevant or meaningful evidence of superior management efficiency, either considering MGE in isolation or in comparison to other Missouri LDCs.

LOAD ATTRITION

Q. What is the importance in the ratemaking process of the "matching" principle?

A. The matching principle, as it applies to ratemaking, requires all of the components of the ratemaking process (revenues, expenses, rate base, rate of return) be measured at a consistent point in time. If this is not done, the result will be the setting of a skewed level of rates, and an increase in the likelihood that the utility will either underearn or overearn in the period rates will be in effect.

Q. How does the Commission enforce the principle of matching in its rate case policies?

A. The Commission orders use of a particular test year early in the rate case process, and expects all parties to adhere to that test year. The Commission also normally orders use of a test year update period, and may order a true-up period to end at a definite point in time as well.

Q. Are there any issues between the parties to this proceeding regarding appropriate matching of revenue requirement components?

A. With one exception, there do not appear to be issues among the parties regarding allegations of improper matching of revenue requirement components.

Q. What is that exception?

A. That exception is the Company's proposed "load attrition" adjustment. Staff witness Daniel I. Beck provides rebuttal testimony in this proceeding that the Company's calculation of the load attrition adjustment is measured out to September 2004.

Q. What cut-off should be observed for measurement of adjustments in this case?

A. The Commission's ordered test year ends in June 2003; the test year update period ends in December 2003; and the proposed true-up period in this case ends in April 2004. At this stage of the proceeding, most adjustments were measured at a point no later than the end of December 2003, the update period. If the Commission orders a true-up audit, it is assumed that MGE's revenue requirement components will be measured at a point no later than the end of April 2004.

Q. What is the Staff's position on the Company's proposed load attrition adjustment?

A. For the reasons given in Staff witness Beck's rebuttal testimony, the Staff opposes this adjustment. In addition, the Staff also opposed the load attrition adjustment because, as proposed by MGE, it is out-of-period and not properly matched with other elements of MGE's revenue requirement.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

Missouri Gas Energy
Comparison of FERC Form 2 Information
MGE, LACLEDE, AMERENUE AND MoPUB

YEAR	1992 Western Resources	Laclede Gas Co.	AmerenUE	MoPub	1993 Western Resources	Laclede Gas Co.	AmerenUE	MoPub
EXPENSES								
Operating	$ 12,859,310	$ 22,937,356	$ 4,852,503	$ 1,605,874	$ 15,251,260	$ 26,019,378	$ 4,453,542	$ 1,794,394
Maintenance	$ 9,317,203	$ 14,029,547	$ 2,838,088	$ 881,754	$ 9,904,240	$ 15,237,040	$ 3,113,156	$ 828,435
Customer Account	$ 14,302,979	$ 21,783,570	$ 3,199,716	$ 1,167,311	$ 17,379,692	$ 23,148,172	$ 3,174,737	$ 1,107,894
Customer Service & Information	$ 655,678	$ 350,414	$ 197,144	$ 148,237	$ 322,928	$ 554,620	$ 186,495	$ 151,415
Sales	$ 519,426	$ 2,954,364	$ 264,016	$ 100,518	$ 1,098,173	$ 3,015,548	$ 266,141	$ 134,977
Administrative & General	$ 29,066,203	$ 24,262,689	$ 4,087,934	$ 3,653,087	$ 28,311,831	$ 26,955,250	$ 5,871,596	$ 4,274,223
Joint & Common	-	-	-	-	-	-	-	-
Total Expenses	$ 66,720,799	$ 86,317,940	$ 15,439,401	$ 7,556,781	$ 72,268,124	$ 94,930,008	$ 17,065,667	$ 8,291,338
Total Customers	458,624	574,367	111,667	39,935	455,696	579,419	113,212	40,496
Annual O&M Per Customer	145	150	138	189	159	164	151	205

	1994 Missouri Gas Energy	Laclede Gas Co.	AmerenUE	MoPub	1995 Missouri Gas Energy	Laclede Gas Co.	AmerenUE	MoPub
Operating	$ 10,269,940	$ 25,419,989	$ 4,140,332	$ 1,738,061	$ 11,719,081	$ 25,405,194	$ 4,129,168	$ 1,569,017
Maintenance	$ 9,726,733	$ 16,792,226	$ 2,910,258	$ 778,288	$ 7,592,133	$ 15,949,359	$ 2,785,127	$ 754,014
Customer Account	$ 16,197,162	$ 22,359,431	$ 3,113,277	$ 1,269,541	$ 13,134,932	$ 26,016,346	$ 3,212,344	$ 1,365,232
Customer Service & Information	$ 509,854	$ 541,553	$ 180,922	$ 136,161	$ 672,361	$ 449,490	$ 177,853	$ 88,460
Sales	$ 582,053	$ 3,134,835	$ 205,372	$ 204,395	$ 679,561	$ 3,386,181	$ 172,379	$ 1,280,529
Administrative & General	$ 19,891,209	$ 31,945,401	$ 6,097,558	$ 3,772,365	$ 16,654,057	$ 23,815,472	$ 5,696,732	$ 3,839,058
Joint & Common	$ 5,990,633	-	-	-	$ 5,990,633	-	-	-
Total Expenses	$ 63,167,584	$ 100,193,435	$ 16,647,719	$ 7,898,811	$ 56,442,758	$ 95,022,042	$ 16,173,603	$ 8,896,310
Total Customers	466,716	584,029	114,910	40,937	472,489	590,178	116,607	41,406
Annual O&M Per Customer	135	172	145	193	119	161	139	215

Schedule 1-1

Missouri Gas Energy

Comparison of FERC Form 2 Information

MGE, LACLEDE, AMERENUE AND MoPUB

1996

	Missouri Gas Energy	Laclede Gas Co.	AmerenUE	MoPub
Operating	$ 10,989,553	$ 26,211,416	$ 3,781,917	$ 1,486,899
Maintenance	$ 7,728,684	$ 16,484,983	$ 2,925,845	$ 585,751
Customer Account	$ 15,203,814	$ 26,008,684	$ 3,009,254	$ 1,432,226
Customer Service & Information	$ 566,850	$ 597,681	$ 131,485	$ 43,726
Sales	$ 928,407	$ 3,397,531	$ 181,255	$ 297,791
Administrative & General	$ 19,213,962	$ 26,817,840	$ 6,608,146	$ 4,943,791
Joint & Common	$ 5,990,633	-	-	-
Total Expenses	$ 60,621,903	$ 99,518,135	$ 16,637,902	$ 8,790,184
Total Customers	475,491	597,933	118,541	42,796
Annual O&M Per Customer	127	166	140	205

1997

	Missouri Gas Energy	Laclede Gas Co.	AmerenUE	MoPub
Operating	$ 12,218,392	$ 27,572,561	$ 5,245,015	$ 1,883,637
Maintenance	$ 8,110,593	$ 16,472,169	$ 2,154,993	$ 803,612
Customer Account	$ 21,418,753	$ 29,162,016	$ 2,979,876	$ 1,364,912
Customer Service & Information	$ 563,766	$ 725,669	$ 140,345	$ 70,441
Sales	$ 827,663	$ 3,580,208	$ 127,164	$ 295,769
Administrative & General	$ 14,199,176	$ 28,294,449	$ 6,378,645	$ 5,920,603
Joint & Common	$ 5,990,633	-	-	-
Total Expenses	$ 63,328,976	$ 105,807,072	$ 17,026,038	$ 10,338,974
Total Customers	480,077	605,688	120,473	44,185
Annual O&M Per Customer	132	175	141	234

1998

	Missouri Gas Energy	Laclede Gas Co.	AmerenUE	MoPub
Operating	$ 12,355,944	$ 28,345,124	$ 4,718,817	$ 2,492,512
Maintenance	$ 7,937,127	$ 16,999,438	$ 2,935,837	$ 875,562
Customer Account	$ 13,174,246	$ 26,265,211	$ 3,917,614	$ 1,731,663
Customer Service & Information	$ 382,979	$ 675,791	$ 325,723	$ 59,312
Sales	$ 1,317,503	$ 3,803,770	$ 264,676	$ 199,432
Administrative & General	$ 15,621,521	$ 25,950,439	$ 8,638,896	$ 3,082,259
Joint & Common	$ 5,990,633	-	-	-
Total Expenses	$ 56,779,953	$ 102,039,773	$ 20,801,563	$ 8,440,740
Total Customers	485,926	613,422	123,952	45,575
Annual O&M Per Customer	117	166	168	185

1999

	Missouri Gas Energy	Laclede Gas Co.	AmerenUE	MoPub
Operating	$ 12,596,580	$ 28,704,072	$ 5,405,588	$ 1,892,307
Maintenance	$ 8,816,834	$ 17,656,652	$ 3,431,715	$ 812,227
Customer Account	$ 10,274,313	$ 26,910,883	$ 4,162,105	$ 1,486,060
Customer Service & Information	$ 389,930	$ 571,834	$ 213,173	$ 61,134
Sales	$ 1,310,139	$ 3,642,056	$ 163,821	$ 34,793
Administrative & General	$ 17,393,460	$ 22,779,452	$ 7,551,555	$ 4,715,667
Joint & Common	$ 5,990,633	-	-	-
Total Expenses	$ 56,771,889	$ 100,264,949	$ 20,927,957	$ 9,002,188
Total Customers	492,069	618,918	125,311	49,929
Annual O&M Per Customer	115	162	167	180

Schedule 1-2

Missouri Gas Energy

Comparison of FERC Form 2 Information

MGE, LACLEDE, AMERENUE AND MoPUB

2000

	Missouri Gas Energy	Laclede Gas Co.	AmerenUE	MoPub
Operating	$ 12,352,128	$ 28,201,478	$ 6,540,071	$ 2,448,541
Maintenance	$ 9,419,193	$ 16,937,422	$ 3,136,282	$ 789,155
Customer Account	$ 13,830,337	$ 25,819,702	$ 4,608,923	$ 1,580,243
Customer Service & Information	$ 405,692	$ 578,896	$ 220,793	$ 83,124
Sales	$ 1,059,863	$ 3,427,126	$ 170,771	$ 23,480
Administrative & General	$ 16,410,430	$ 27,954,095	$ 8,793,928	$ 4,977,336
Joint & Common	$ 5,990,633	-	-	-
Total Expenses	$ 59,468,276	$ 102,918,719	$ 23,470,768	$ 9,901,879
Total Customers	498,988	624,149	126,962	46,657
Annual O&M Per Customer	119	165	185	212

2001

	Missouri Gas Energy	Laclede Gas Co.	AmerenUE	MoPub
Operating	$ 12,686,682	$ 30,828,659	$ 6,310,853	$ 2,557,992
Maintenance	$ 10,855,324	$ 17,182,505	$ 3,286,438	$ 831,990
Customer Account	$ 23,214,541	$ 31,626,011	$ 6,798,371	$ 1,568,026
Customer Service & Information	$ 442,736	$ 756,499	$ 345,314	$ 109,399
Sales	$ 434,475	$ 3,540,264	$ 153,207	$ 15,650
Administrative & General	$ 16,197,727	$ 33,839,651	$ 10,652,252	$ 5,292,938
Joint & Common	$ 6,934,982	-	-	-
Total Expenses	$ 70,766,467	$ 117,773,589	$ 27,546,435	$ 10,375,995
Total Customers	499,782	625,035	127,970	46,234
Annual O&M Per Customer	142	188	215	224

2002

	Missouri Gas Energy	Laclede Gas Co.	AmerenUE	MoPub
Operating	$ 10,624,433	$ 31,758,020	$ 6,793,585	$ 2,615,481
Maintenance	$ 8,371,137	$ 15,693,756	$ 2,740,299	$ 1,041,715
Customer Account	$ 14,302,689	$ 29,050,704	$ 6,650,967	$ 2,220,139
Customer Service & Information	$ 476,258	$ 770,124	$ 531,489	$ 116,038
Sales	$ 188,016	$ 3,564,350	$ 155,620	$ 62,612
Administrative & General	$ 18,089,426	$ 40,194,759	$ 17,379,822	$ 5,568,067
Joint & Common	$ 6,934,982	-	-	-
Total Expenses	$ 58,986,941	$ 121,031,713	$ 34,251,782	$ 11,624,052
Total Customers	502,639	626,169	124,907	46,099
Annual O&M Per Customer	117	193	274	252

2003 ***From EFIS***

	Missouri Gas Energy	Laclede Gas Co.	AmerenUE	MoPub
Operating	$ 11,895,326	$ 29,167,121	-	-
Maintenance	$ 10,396,402	$ 16,922,006	-	-
Customer Account	$ 17,703,698	$ 34,212,997	-	-
Customer Service & Information	$ 488,539	$ 812,807	-	-
Sales	$ 213,032	$ 3,702,206	-	-
Administrative & General	$ 23,498,256	$ 49,582,448	-	-
Joint & Common	$ 6,934,982	-	-	-
Total Expenses	$ 71,130,235	$ 134,399,585	-	-
Total Customers	498,091	627,302	-	-
Annual O&M Per Customer	143	214	-	-

Atmos Energy

Comparison of FERC Form 2 Information

	2002 Atmos Energy	2003 Atmos Energy
Operating	$ 2,731,281	$ 2,099,217
Maintenance	$ 977,626	$ 540,007
Customer Account	$ 170,946	$ 922,174
Customer Service & Information	$ 39,462	$ 33,411
Sales	$ 18,811	$ 9,942
Administrative & General	$ 5,142,953	$ 4,480,374
Joint & Common	-	-
Total Expenses	$ 9,081,079	$ 8,085,125
Total Customers	$ 64,491	59,710
Annual O&M Per Customer	141	135

SCHEDULE 2

Schedule 2

Missouri Gas Energy
COMPARISON OF ACHIEVED RATE OF RETURN VS. AUTHORIZED RATE OF RETURN

Description	6/30/1996 (000)	6/30/1997 (000)	6/30/1998 (000)	6/30/1999 (000)	6/30/2000 (000)	6/30/2001 (000)	6/30/2002 (000)	6/30/2003 (000)	Cumulative (000)
Net Sales Margin	$ 119,106	$ 121,390	$ 123,759	$ 130,859	$ 125,088	$ 141,971	$ 136,311	$ 144,483	
Operating Expenses excluding Uncollectible Expense	(50,688)	(48,037)	(47,390)	(49,273)	(49,638)	(51,176)	(46,693)	(53,967)	
Uncollectible Expense	(3,906)	(9,443)	(4,470)	(2,585)	(1,697)	(12,654)	(3,211)	(6,602)	
Corporate Allocated Expenses from GR-98-140	(5,612)	(5,612)	(5,991)	(5,991)	(5,991)	(5,991)	(6,935)	(6,935)	
Taxes Other than Income Taxes	(6,406)	(5,730)	(7,084)	(7,341)	(8,267)	(9,263)	(10,759)	(9,983)	
Depreciation & Amortization	(14,806)	(16,344)	(19,131)	(21,740)	(22,439)	(22,986)	(20,015)	(22,691)	
Income Taxes	(6,843)	(5,732)	(6,763)	(7,999)	(4,972)	(5,821)	(8,553)	(6,449)	
Total Operating Expenses	88,261	90,898	90,829	94,929	93,004	107,891	96,166	106,627	
Net Operating Income	$ 30,845	$ 30,492	$ 32,930	$ 35,930	$ 32,084	$ 34,080	$ 40,145	$ 37,856	
Net plant from most recent rate case	$ 359,290	$ 359,290	$ 431,152	$ 431,152	$ 431,152	$ 431,152	$ 503,192	$ 503,192	
Net Plant Balance at 6/30/XX	360,288	384,986	440,251	460,145	478,794	491,271	505,412	525,495	
Increase in plant since most recent rate case	$ 998	$ 25,696	$ 9,099	$ 28,993	$ 47,642	$ 60,119	$ 2,220	$ 22,303	
Total rate base from most recent case updated for annual plant increases	$ 349,040	$ 373,738	$ 427,318	$ 447,212	$ 465,861	$ 478,338	$ 504,650	$ 524,733	
Achieved Rate of Return	8.84%	8.16%	7.71%	8.03%	6.89%	7.12%	7.95%	7.21%	
Authorized Rate of Return	10.54%	9.46%	9.46%	9.40%	9.40%	9.40%	9.03%	9.03%	
Date Rates Went into Effect	1-Feb-94	1-Feb-97		2-Sep-98			6-Aug-01	6-Aug-01	
Return Deficiency	-1.70%	-1.30%	-1.75%	-1.37%	-2.51%	-2.28%	-1.08%	-1.82%	
Earnings Deficiency	$ (5,944)	$ (4,864)	$ (7,494)	$ (6,108)	$ (11,707)	$ (10,883)	$ (5,425)	$ (9,528)	$ (61,953)
Revenue Deficiency	$ (9,682)	$ (7,923)	$ (12,207)	$ (9,950)	$ (19,070)	$ (17,728)	$ (8,837)	$ (15,520)	$ (100,916)

* - High end of Staff recommendation implicit in the settlement

Schedule 3