Exhibit No.:	_____
Issues:	Cash Working Capital
Witness:	Robert L. O'Brien
Sponsoring Party:	Missouri Gas Energy
Case No.:	GR-2009-
Date Testimony Prepared:	April 2, 2009

MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NO. GR-2009-

DIRECT TESTIMONY OF

ROBERT L. O'BRIEN

Jefferson City, Missouri

April 2009

MISSOURI GAS ENERGY

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ROBERT L. O'BRIEN

CASE NO. GR-2009-____

April 2009

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Robert O'Brien and my business address is 1753 Via Mazatlan, Rio Rico, Arizona 85648.

Q. BY WHOM ARE YOU EMPLOYEED AND WHAT IS YOUR POSITION?

A. I am the sole member of O'Brien Innovative Regulatory Solutions, LLC.

Q. PLEASE DESCRIBE YOUR ROLE IN THIS PROCEEDING.

A. I have been retained to provide a cash working capital ("CWC") study to determine the CWC required by Missouri Gas Energy ("MGE" or "Company") for the test year in this proceeding.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE AND EDUCATIONAL BACKGROUND THAT RELATE TO YOUR PRESENTATION IN THIS PROCEEDING.

A. I formed O'Brien Innovative Regulatory Solutions in January 2008 on my retirement from Black & Veatch Corporation ("B&V"). Prior to January 2008, I was employed by B&V in its separate operating sector of the Enterprise Management Solutions as a Principal Consultant since January 2005 when B&V acquired R.J. Rudden Associates ("Rudden") where I was employed as a Vice President since January 2000. In my positions with B&V and Rudden, I have provided services to clients in the areas of Strategic Planning, State Regulatory Operations, Financial Planning, Administrative Cost Allocations, Rate Case Preparation, Rate Case Management and Rate Case Model Design. Prior to joining Rudden, I was employed by Citizens Communications Company (formerly Citizens Utilities Company) ("Citizens") from 1975 to 1999, holding the positions of Vice President, Strategic Planning and Regulatory Affairs for Citizens' Public Utilities Sector (1997 to 1999) and Vice President, Corporate Regulatory Affairs (1978 to 1997) and Manager of Special Studies (1975 to 1978). From 1967 to 1975, I was employed as a controller by companies in the Printing, Educational, Financial and Communications industries. Prior to 1967, I was employed by Ernst & Young and attained the status of Senior Auditor after four years, including two years work experience during the 5-year work-study program at the University of Cincinnati. I graduated from the University in 1965 with a Bachelor of Business Administration with a major in Accounting. I am a Certified Public Accountant.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE STATE OR FEDERAL REGULATORY COMMISSIONS?

A. Yes, I have testified or presented testimony in over 200 proceedings before the state regulatory commissions in Arizona, California, Colorado, Hawaii, Idaho, Illinois, Indiana, Montana, Nevada, Ohio, Pennsylvania, Tennessee, Vermont and West Virginia for utility operations of electric, natural gas, communications, water and sewer utility companies. I have presented testimony in company specific proceedings for general rate increases, commission ordered rate reviews, purchased energy pass through proceedings, initial certification proceedings, acquisitions and sales of utility companies, disaster relief requirements and recovery of acquisition premiums. I have testified on the subjects of all rate base elements including deferred income taxes and cash working capital and on revenues, rate design and rate of return. In addition, I have testified regarding all operating expenses including income taxes. Finally, I have testified in generic proceedings related to income taxes, purchased energy pass through clauses and changes in regulation of the communications and electric industries.

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

A. I am presenting testimony and exhibits supporting the CWC rate base component for the Company. As shown on MGE Schedule RLO-1, the appropriate amount of CWC for the test year is $20,105,085 as shown on line 18 of page 1.

Q. ARE YOU SPONSORING ANY SCHEDULES?

A. Yes, I am. In addition to my prepared testimony, I am co-sponsoring schedule MGE Schedule RLO-1 with Company witness Noack. Mr. Noack is responsible for the pro forma test year expense amounts used to determine the pro forma CWC used as a component of rate base, while I am responsible for the determination of the revenue and expense lag days for each of the components as summarized on MGE Schedule RLO-1, page 1.

Q. WHAT IS CASH WORKING CAPITAL AND WHY IS IT SIGNIFICANT TO THE DETERMINATION OF RATE BASE?

A. The term Cash Working Capital refers to the net amount of funds required to pay for goods and services to provide utility service between the time those goods and services are paid for by the utility and the time the utility collects its revenue from the customers who received those services. The determination of the net amount of CWC is normally made using what is commonly referred to as a lead/lag study.

Q. PLEASE DESCRIBE A LEAD/LAG STUDY.

A. A lead/lag study analyses the collection period between the time the utility provides service to its customers and the time the utility receives the actual cash payments from customers for that service. This is commonly referred to as the revenue lag. The lead/lag study also analyzes the payment lag between the time goods or services are used to provide service to customers and the time the utility must pay for those services. For example, a gas utility will purchase gas to

deliver to its customers and will have to pay for that gas on terms agreed to with the supplier of the gas provided to customers, which is normally referred as a payment lag for that component. Assuming that the revenue lag is 50 days and the payment lag for the purchased gas is 45 days, this one component would result in a lead of 5 days. This means that the utility must pay the provider of the service 5 days before the utility receives payment from its customers for the use of that component of the service. In this instance, the Company would include an appropriate amount as an addition to rate base for that component. The payment lag for each expense element is examined and compared to the revenue lag to determine if the Company has a positive or negative CWC requirement which will be included in the rate base for the test year.

Q. WHAT REVENUE AND EXPENSE AMOUNTS ARE USED TO DETERMINE THE LEAD OR LAG OF EACH COMPONENT OF THE CWC?

A. As I will describe, historic revenue and expense amounts are used to determine the actual revenue lag days and payment lag days for each of the components. These lag days are then used with the test year pro forma expense amounts to determine the overall CWC requirement for the test year to be included in the determination of rate base.

Q. PLEASE DESCRIBE THE PROCESS YOU USED TO DETERMINE THE OVERALL CWC.

A. First, I had discussions with Company personnel and provided a list of data and information required for the completion of the CWC study. I also reviewed the last CWC study performed for the Company and then proceeded to develop a preliminary CWC. During the course of my review and preparation of the CWC study, I spoke with various Company personnel to clarify certain data provided and also requested additional data where needed and made any changes to the CWC calculations during this process.

Q. WHEN DID THE COMPANY LAST HAVE A CWC STUDY PERFORMED?

A. The last CWC study was performed and presented in Case No. GR-2006-0422.

Q. HOW DID YOU USE THE DATA PRESENTED IN THAT CWC STUDY?

A. I used it as a guide to check the consistency of the revenue lag-days and payment lag-days resulting from my calculations and in certain instances used certain data after determining Company processes had not changed significantly over this three year period, the lag-days were within a range of what I am familiar with and the element was not a significant component of the CWC overall.

Q. **WHAT WERE THE ELEMENTS THAT YOU ADOPTED FOR YOUR CWC STUDY?**

A. I used the payment lag associated with the customer payments to the Company in the revenue lag and the bank float associated with the payment lag associated with

the Company's payment for services using checks. In addition, I used the payment lag days for several of the other tax expense elements that will be discussed in connection with those expenses.

Q. PLEASE DESCRIBE THE PAYMENT LAG ASSOCIATED WITH THE REVENUE LAG CALCULATION.

A. This is the time between when the Company receives the payment from a customer and the time those payments are available to the Company in the form of cash. The Company can receive payments in the form of checks, electronic transfers, credit card payment or payments through authorized agents. Based on the analysis conducted with Company personnel and records in Case No. GR-2006-0422, it was determined that the payment lag component of the revenue lag was 0.96 days. I have accepted this payment lag for the current CWC since it is within the range of time I am familiar with for this component and I do not believe an additional review would produce a significantly different amount.

Q. PLEASE DESCRIBE THE BANK FLOAT COMPONENT OF THE VARIOUS EXPENSE LAG DAY CALCULATIONS.

A. This refers to the time between when a check payment is reflected on the Company's accounting records and when that payment actually clears the bank and results in a reduction in the Company's cash. Again, as with the payment lag associated with the revenue lag, I have accepted the number of float days for payments made by check. The 7.67 days is within the range I have experienced in

other CWC studies. I think it is reasonable to use that lag day calculation for the determination of payment lag-days when payment is made by check. When payments are made by wire transfer, there is no lag since the funds are expended when the wire transfer is made.

Q. PLEASE DESCRIBE THE SUMMARY OF THE CWC REQUIREMENT OF $19.8 MILLION SHOWN ON PAGE 1, LINE 18 OF SCHEDULE RLO-1.

A. The revenue lag, which is calculated on page 2, is shown on line 1 while the payment lags associated with the operating and maintenance ("O&M") expenses are shown on lines 2 to 8. The net working capital requirement for the O&M expense is shown on line 11. Other expenses, such as income and other taxes, interest expense and preferred dividends are summarized on lines 12 to 17 with a total CWC requirement shown on line 18. Lines 19 to 23 show the total pro forma test year O&M expense and the net amount of O&M expense used in the CWC after the removal of uncollectible expense.

Q. PLEASE DESCRIBE THE CALCULATIONS OF THE EXPENSE WEIGHTED DOLLAR DAYS ON LINES 3 TO 6 OF MGE SCHEDULE RLO-1.

A. The weighted dollar days are the result of multiplying the test year expenses for each category in column 2 by the number of (lead)/lag days for the category in column 3. The total weighted dollar days on line 7 is used to determine the

average O&M expense lag days shown on line 8. Each of the expense payment (lead)/lag days will be described in connection with the calculations shown on page 3.

Q. PLEASE DESCRIBE HOW THE REVENUE PAYMENT LAG WAS CALCULATED.

A. As shown on page 2, lines 2 to 20, an account receivable turnover lag was calculated using the monthly revenue for the year ended December 31, 2008 and the average of the thirteen months of accounts receivable balances. This calculation, as shown on line 19, resulted in a turnover ratio of 13.02 which was used to determine the average collection day lag of 28.03 days as shown on line 20. This collection lag was increased by the recording and billing day lag of 4.37 days shown on line 21, the customer payment lag of 0.96 days shown on line 22 and finally the service period lag on line 23. The resulting number of revenue lag days for MGE is 48.57 days as shown on line 24.

Q. IS THE TURNOVER RATIO METHOD A REASONABLE PROCEDURE TO DETERMINE THE COLLECTION DAY LAG?

A. Yes, it is. It measures the outstanding accounts receivables to sales (customer billings) and provides a collection day factor that, in my experience, provides an accurate measurement of the collection lag days. As an example, the collection lag days from the 2006 CWC study was 27.07 which is very close to the current 28.03 collection lag days provided by the turnover ratio procedure.

Q. WHAT ARE THE FUNCTIONS INCLUDED IN THE RECORDING, BILLING AND MAILING LAG?

A. These functions include the activities between the meter reading and the date that the customer revenue billing amount is recorded as an account receivable on the Company's accounting records. This would reflect the period after the service period and before the revenue is reflected in the accounts receivable.

Q. HOW WAS THE AVERAGE FOR THESE LAG DAYS DETERMINED?

A. The Company provided a listing showing the actual meter reading dates, billing dates and mailing dates for each meter reading route for each day of 2008. The number of days between the meter reading day and the billing date were determined and used as the base for the average lag-days for these activities which is the 4.37 days shown on line 21. The Company included the customer revenue in its accounts receivable on the billing date and therefore the mailing date, which was normally the following day was not used since that day would be included in the collection lag.

Q. WHAT IS THE SERVICE PERIOD MIDPOINT?

A. This reflects the calculation of the date at the middle of the service period that is used to measure the base for determining when customers received service to be compared to the date payment is made for that service. Since billing is normally made for a month of service, it is common to use the midpoint of the service

period to measure the period between when service is provided until the payment date for that service. The 15.21 days reflects the average number of days per month during a 365 day year.

Q. WHAT IS THE REVENUE LAG PERIOD RESULTING FROM THESE CALCULATIONS?

A. As shown on line 24, there are 48.57 lag-days for the revenue collection. This is brought forward to page 1 on line 1 and is used in the calculations on pages 6 to 11 to determine the CWC requirement for each component.

Q. PLEASE DESCRIBE THE EXPENSE LAG CALCULATIONS ON PAGE 3.

A. Page 3 summarizes the calculations of the expense payment lags for the O&M expenses such as the payroll, payroll taxes, employee benefits, purchased gas and other O&M expenses.

Q. HOW WAS THE PAYMENT LAG FOR PAYROLL DETERMINED?

A. The Company pays its employees on a bi-weekly schedule which creates a seven-day period from the midpoint of the fourteen day service period to the end of that work period. The Company's employees are paid on the Friday following the Saturday ending the service period which adds six days to the end of the service period. This would result in a total payment lag for payroll of thirteen days. However, the Company uses a payroll administrator for the actual payments to employees and provides cash to the administrator on Wednesday instead of Friday

which reduces the payment lag by two days. This service period and payment schedule results in an eleven-day lag in the payment for the service provided by the Company's employees.

Q. ARE THE LAG DAYS FOR THE PAYMENT OF WITHHOLDING TAXES AND FICA EXPENSE THE SAME AS THOSE FOR THE PAYROLL?

A. Yes, they are. The Company provides funds to the administrator for the payment of the payroll withholding taxes and the FICA expense at the same time payment is made for the payroll. As such those items have the same eleven-day payment lag period.

Q. HOW IS THE PAYMENT LAG OF 11 DAYS USED IN THE CALCUALTION OF THE CWC?

A. The payroll lag days calculated on lines 1 to 3 of 11 days, as shown on line 4, is shown on page 1, column 3, line 3 and multiplied by the pro forma test year expenses to determine the weighted dollar days in column 4 which is included with the other O&M weighed dollar days to determine the O&M expense lag days on line 8 and the net revenue lag days on line 9.

Q. **WHAT ARE THE EXPENSE PAYMENT LAGS FOR THE EMPLOYEE BENEFIT COMPONENTS?**

A. The expense and benefit components, which are shown on page 3, lines 5 to 7, column 3, are calculated on pages 10 and 11. The lag days for the 401k match, as shown on line 8, are the same as the lag days for the payroll since payments are made by the Company on the same schedule as payments for payroll are made.

Q. PLEASE DESCRIBE THE CALCULATIONS ON PAGES 10 and 11.

A. Payment dates, service periods, payment amounts and weighted (lead) lag dollars for each benefit category are shown in columns 1 to 5 with the average payment (lead) lag days shown in column 6. Except for the pension payments, which are made by electronic transfer, all other benefit lag days are increased by the check clearing lag as shown in column 7. The total of these payment lag days is shown in column 8 and brought forward to MGE Schedule RLO-1, page 3.

Q. **PLEASE EXPLAIN HOW THE GAS COST PAYMENT LAG DAYS WERE DETERMINED.**

A. The gas cost payment lag days were calculated using actual payment lag days for all gas purchase transactions for the year ended December 31, 2008. The monthly results of these calculations are shown on page 5 and result in a payment lag of 34.23 days as shown on line 14. In each instance, the midpoint of the month the gas commodity was provided was used as the service date and, since these payments are made electronically, there is no additional check clearing lag added.

Q. HOW WERE THE PAYMENT LAG DAYS FOR THE OTHER O&M EXPENSES DETERMINED?

A. The payment lag days for the other O&M expenses, summarized on lines 13 to 17, reflect a sample of actual payments for the months of March 2008, June 2008 and October 2008 which are summarized on page 4. The average lag days for these data, 22.61 payment lag days as shown on line 14, is added to the average lag days to reflect the service period lag of 15.21 days and the check clearing lag days of 7.67 for a total payment lag days for other O&M expense of 45.49 as shown on line 17 of page 3 and also on line 10 of page 4.

Q. PLEASE DESCRIBE THE PROCEDURES USED TO CALCULATE THE MONTHLY PAYMENT LAG DAYS SHOWN ON PAGE 3, LINES 1 TO 6.

A. I selected three months in 2008 and obtained a listing of cash disbursements for those months. I then removed all amounts over $100,000 and under $1,000, charges for commodity purchases, employee benefits and other accounts which are addressed in other sections of the CWC study and then removed non-expense accounts from that total listing. This provided a listing of payments for each month selected which were used for the other disbursements payment lag.

Q. DO YOU THINK THIS IS A REASONABLE APPROACH TO DETERMINE THE PAMENT LAG DAYS FOR THE OTHER DISBURSEMENTS?

A. Yes. I think this provides a broad sample of the Company's payments and the result is, while in the high end, in the range of other disbursement payment lags I have experienced in other CWC studies.

Q. PLEASE EXPLAIN THE CALCULATIONS ON LINES 8 TO 11 ON PAGE 1 OF MGE SCHEDULE RLO-1.

A. These calculations convert the payment lags for the O&M expenses shown on lines 3 to 7 to a CWC amount to determine the CWC component for the O&M expense. The 33.25 payment lag days on line 8 represents the weighted average payment lag days for the O&M expenses shown on lines 3 to 7. These lag days are subtracted from the revenue lag days on line 1 and the difference, 15.32 lag days, reflects the number of days the Company pays for O&M expense before it collects its revenue from its customers. This 15.32 lag day amount is then multiplied by the average daily expense for the O&M expense to determine that the Company has a CWC requirement of $25.2 million for the O&M expense as shown on line 11.

Q. PLEASE DESCRIBE THE CALCULATION FOR THE INTEREST EXPENSE REDUCTION TO CWC.

A. This calculation, shown on page 6, reflects the fact that the composite interest expenses payment lag is greater than the revenue collection lag and therefore results in the reduction to CWC. Lines 1 to 3 on page 6 reflect the components of the synchronized interest expense which is used to determine the pro forma

interest expense per day of $50,289 as shown on line 7. The payment lag days of 82.40 reflects the fact that most of the Company's long-term debt interest is paid twice a year while some debt has monthly or other periods for the payment of interest. Since this payment lag is greater than the revenue collection lag, there is a lead where the Company has collected its revenue from customers before it must pay its interest expense. Using the payment and collection lag days on lines 6 and 7 respectively, the CWC lead for interest expense is 33.83 days which, at $50,289 per day, results in a reduction to CWC of $1,701,277 which is shown on line 6 of page 1.

Q. HOW IS THE CALCULATION OF THE PREFERRED DIVIDEND PAYMENT LAG AND CWC AMOUNT MADE?

A. The basic calculation would follow the same procedures used in the calculation of the interest expense CWC component. The main difference is that the preferred stock dividends are paid quarterly which results in a significantly lower number of payment lag days than the interest expense component. However, since there are no preferred dividends, there is no working capital component included in the CWC amount for the test year.

Q. HOW WAS THE CWC COMPONENT FOR THE GROSS RECEIPTS TAX CALCULATED?

A. The CWC reduction of $1,492,674 shown on line 8 of page 1 is calculated on page 8, lines 1 to 10. The gross receipt tax payments for the year 2008 were

obtained from the Company and sorted into common service periods as shown in column 1 on lines 1 to 3 which reflects the mid-point of those service periods. The payment lag days for each of those service periods are shown in column 3 and the weighed payment lag days are shown in column 5. Line 5 represents the average gross receipts lag days of 53.21 payment lag days. When this payment lag is increased by the check clearing lag of 7.67 days and difference, a lead of 12.31 days reflects that the Company collects its revenue from customers before it pays the gross receipts taxes. These lead days are used to determine the reduction to the CWC of $1,492,674 which is included on page 1, line 14.

Q. PLEASE DESCRIBE THE CALCULATION OF THE PAYMENT LAG DAYS AND RESULTING CWC AMOUNT FOR THE PROPERTY TAXES SHOWN ON LINE 15 OF MGE SCHEDULE RLO-1.

A. The calculation, shown on MGE Schedule RLO-1, page 8, lines 13 to 23 follows the same procedures described for the determination of the gross receipts tax component of the CWC. The result of the calculation for the property taxes, shown on lines 19 and 23 is a CWC lead of 141.41 days and $3,485,615 respectively.

Q. **HOW WAS THE CWC AMOUNT FOR FEDERAL & STATE INCOME TAX EXPENSE DETERMINED?**

A. The calculations, shown on page 9, lines 1 to 12 reflect the dates when estimated payments are required for Federal and state income taxes. These quarterly

payment dates are used to determine the CWC requirement of $206,432 for the Federal income tax and $32,440 for the state income tax. The total amount of $238,872 is shown on page 1, line 16.

Q. PLEASE DESCRIBE THE CALCULATIONS FOR THE OTHER TAXES COMPONENT OF CWC SHOWN ON LINE 17 OF PAGE 1 OF MGE SCHEDULE RLO-1.

A. These calculations are shown on page 9, lines 13 to 24 with the $1,362,632 CWC requirement shown on line 25 also reflected on page 1, line 17. The corporate franchise taxes are paid once annually on April 15th for the current year which, when compared to the midpoint of the year of July 1 results in a payment lead of 77 days. This is reduced by the check clearing lag of 7.67 days and the resulting lead is added to the revenue collection lag of 48.57 days for total lag days of 117.90 as shown on page 9, line 15, column 9 and a CWC requirement of $94,966 as shown in column 10. As shown on page 9, columns 1 to 3, the same payment lag days were used as determined in the CWC study submitted in Case No. GR-2006-0422 after I confirmed that there were no changes in the payment requirements for the three other taxes which included the sales tax, lines 16 to 18, use tax, lines 19 to 21 and the federal unemployment insurance expense on lines 22 to 24.

Q. WHY IS IT REASONABLE TO USE THE PAYMENT LAGS FROM CASE NO. GR-2006-0422 FOR THE PAYMENT LAGS IN THIS PROCEEDING FOR THE OTHER TAXES MENTIONED ABOVE?

A. Because these taxes are paid on set schedules established by the taxing authorities which have not charged in the three years since Case No. GR-2006-0422 and the Company procedures for payment of those taxes have not changed, I believe the average payment lag days would not change. Therefore, I used the days used in the last filing.

Q. WHAT IS THE OVERALL CWC REQUIRED FOR THE TEST YEAR BASED ON YOUR STUDY?

A. The CWC requirement for inclusion in the rate base for the test year is $20,105,085 as shown on MGE Schedule RLO-1, page 1, line 18.

Q. DOES THIS COMPLETE YOUR TESTIMONY AT THIS TIME?

A. Yes, it does.