Exhibit No.:	
Issues:	*Revenue Requirement; Corporate Allocations; Income Taxes; Miscellaneous Rate Base Components; Miscellaneous Income Statement Adjustments*
Witness:	*Charles R. Hyneman*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Direct Testimony*
Case No.:	*GR-2001-292*
Date Testimony Prepared:	*April 19, 2001*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

FILED 2
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Missouri Public
Service Commission

DIRECT TESTIMONY

OF

CHARLES R. HYNEMAN

MISSOURI GAS ENERGY,
A DIVISION OF SOUTHERN UNION COMPANY

CASE NO. GR-2001-292

Jefferson City, Missouri
April 2001

DIRECT TESTIMONY

OF

CHARLES R. HYNEMAN

MISSOURI GAS ENERGY,

A DIVISION OF SOUTHERN UNION COMPANY

CASE NO. GR-2001-292

Q. Please state your name and business address.

A. Charles R. Hyneman, 3675 Noland Road, Suite 110, Independence, Missouri 64055.

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Public Service Commission (Commission) as a Regulatory Auditor.

Q. Have you previously filed testimony before the Commission?

A. Yes. Schedule 1, attached to this testimony, lists the cases in which I have filed testimony before the Commission.

Q. With respect to Case No. GR-2001-292, have you made an examination of the books and records of Southern Union Company (Southern Union) and its operating division Missouri Gas Energy (MGE)?

A. Yes, with the assistance of other members of the Commission Staff (Staff).

Q. What are your principal areas of responsibility in this case?

A. As lead auditor, I am responsible for the preparation of the Staff Accounting Schedules, which include the Staff's recommendation for MGE's revenue requirement in this case. Other areas of responsibility include the overall level of corporate costs allocated to MGE from Southern Union's corporate headquarters in Austin, Texas. These costs include corporate expenses (payroll, non-payroll and insurance), plant in service, depreciation reserve and deferred income taxes. My non-corporate cost areas of responsibility for MGE include income taxes, deferred income taxes (excluding accounting deferrals), miscellaneous rate base components and miscellaneous income statement adjustments.

Q. Please list the Staff witnesses who are sponsoring the individual Staff Accounting Schedules.

A. See below:

Schedule 1	Revenue Requirement	Charles R. Hyneman
Schedule 2	Rate Base	Leslie L. Lucus
Schedule 3	Total Plant in Service	Leslie L. Lucus
Schedule 4	Adjustments to Total Plant	Leslie L. Lucus
Schedule 5	Depreciation Expense	Leslie L. Lucus
Schedule 6	Depreciation Reserve	Leslie L. Lucus
Schedule 7	Adjustments to Depreciation Reserve	Leslie L. Lucus
Schedule 8	Cash Working Capital	Graham Vesely
Schedule 9	Income Statement	Charles R. Hyneman
Schedule 10	Adjustments to Income Statement	Charles R. Hyneman
Schedule 11	Income Tax	Charles R. Hyneman

Q. Please describe Accounting Schedule 1, Revenue Requirement.

A. Line 14 of Accounting Schedule 1, Revenue Requirement reflects the Staff's recommended revenue increase for MGE as a result of its audit of MGE's financial records for the test year ended December 31, 2000. MGE's Net Operating Income requirement is calculated by multiplying its net investment in plant and other assets (rate base) by the rate of return recommended by Staff witness David Murray of the Financial Analysis Department. MGE's adjusted jurisdictional net operating income from Accounting Schedule 9, Income Statement, is subtracted from this amount to arrive at the additional income needed to earn the recommended rate of return (line 5). Finally, the additional current income tax expense required as a result of the additional income (line 9) is added to the additional income needed which results in the total recommended revenue increase.

Q. What Rate Base components are you sponsoring?

A. I am sponsoring the following rate base components found on Accounting Schedule 2, Rate Base:

Prepayments
Customer Advances for Construction
Customer Deposits
Deferred Taxes on Direct Plant
Deferred Taxes on Allocated Plant
Alternative Minimum Tax Credit
Rate Base Offset per GM-94-40

Q. Please describe the rate base component for Prepayments.

A. Prepayments represent shareholder-invested funds that are required to be paid prior to the period when the related expense is recognized in the income statement. The amount of prepayments included in Accounting Schedule 2, Rate Base, represents a 13-month average of prepaid corporate insurance expenses and postage expense allocated or directly assigned to MGE. All insurance policies are recorded on the books of Southern Union and are allocated or directly assigned to the individual divisions and subsidiaries.

Q. Please describe the rate base component for Customer Advances for Construction (Customer Advances).

A. Customer advances are recorded as liabilities because they represent an obligation to repay the advanced funds once the customers, on whose behalf the construction was made, meet certain contractual requirements. The amount of customer advances for construction included on Accounting Schedule 2, Rate Base, represents a 13-month average of end of month account balances.

Q. Please describe the rate base component of Customer Deposits.

A. Customer deposits represent funds collected from customers as security against future bad debt expense should a customer fail to pay for utility service. Similar to customer advances, these funds are available for MGE to use until the funds are repaid, either after a specified period of time or upon satisfaction of certain requirements. The Staff used a December 2000 ending balance of customer deposits instead of a 13-month average because of a noticeable decrease over time in both residential and commercial/industrial customer deposits.

Q. Please describe the Deferred Income Tax components of Rate Base.

A. Staff Accounting witness Mark L. Oligschlaeger is sponsoring the Deferred Income Tax components related to MGE's service line replacement program (SLRP) accounting authority orders granted in Case Nos. GO-94-234, GO-97-301 and GR-98-140, as well as the Year 2000 (Y2K) AAO in Case No. GO-99-258. I am sponsoring the line item for Deferred Income Taxes related to MGE's Direct Plant and Corporate Plant allocated from Southern Union. These amounts represent the portion of MGE and corporate allocated deferred income tax reserve that is appropriate to be included in rate base.

Q. Did the Staff make any adjustment to MGE's proposed level of deferred taxes to include in rate base in this Case?

A. Yes. The workpapers supporting MGE's calculation of deferred income taxes used an incorrect effective tax rate. In response to Staff Data Request No. 136, MGE provided a workpaper showing the calculation of individual book-tax timing differences deferred at an effective tax rate (combined federal and state) of 37.15 percent. The Staff's calculation of MGE's deferred tax balances for direct plant, allocated plant and accounting authority order (AAO) amortizations reflects an effective tax rate of 38.61 percent. MGE provided the calculation of its 38.61 percent effective tax rate in response to Staff Data Request No. 11. The effective tax rate includes the federal, state, and Kansas City income tax rates. The Staff agrees with MGE's calculation of its 38.61 percent effective tax rate as reflected in its response to Staff Data Request No. 11.

Q. Please explain why accumulated deferred income taxes are an offset to rate base.

A. MGE's deferred tax reserve represents, in effect, a prepayment of income taxes by MGE's customers. As an example, because MGE is allowed to deduct depreciation expense on an accelerated basis for income tax purposes, depreciation expense used for income taxes is considerably higher than depreciation expense used for ratemaking cost of service purposes. This results in what is referred to as a book-tax timing difference and creates a deferral of income taxes to the future. The net credit balance in the deferred tax reserve represents a source of cost-free funds to MGE. Therefore, the rate base is reduced by the deferred tax reserve balance to avoid having customers pay a return on funds that are cost-free to the Company. While the most significant book-tax timing difference is caused by the differences between accelerated tax depreciation and book depreciation, generally, deferred income taxes associated with all book-tax timing differences which are created through the ratemaking process should be reflected in rate base.

Q. Please explain the rate base component Alternative Minimum Tax Credit (AMT Credit).

A. The AMT Credit is directly related to, and in fact, is an offset to deferred income taxes. As a result of certain Internal Revenue Service (IRS) regulations, over the past several years Southern Union has been what is referred to as an "AMT taxpayer." IRS regulations reduce or eliminate certain corporate tax benefits used to reduce taxable income if a company's regular income tax falls below a certain threshold. One of the major tax benefits reduced is accelerated tax depreciation. While the deferred tax reserve is set up to reflect the full income tax effect of book-tax depreciation timing differences, the tax effect of the amount of accelerated tax depreciation which is not allowed to be deducted on the current year's tax return is recorded as an AMT tax credit. The AMT credit is a reduction in accumulated deferred income taxes and has the effect of increasing MGE's rate base. The AMT credit will eventually "turn around" and reduce income taxes paid in the future.

Q. Please explain the rate base component "Rate Base Offset per GM-94-40."

A. In Case No. GM-94-40, the Commission approved Southern Union's purchase of the Missouri gas properties of Western Resources, Inc. (Western Resources). In the Stipulation And Agreement to that case, there were several agreements reached among the parties and approved by the Commission. One agreement related to the elimination of deferred taxes caused by the sale and transfer of the Missouri properties to Southern Union. Southern Union agreed to use as an offset to rate base an amount relating to these deferred taxes in future rate proceedings for a period of ten years.

The following language appears at page 6 of the Unanimous Stipulation And Agreement regarding the deferred taxes:

> Southern Union agrees to use an additional offset to rate base in any Southern Union filing for a general increase in non-gas rates in Missouri completed in the next ten years to compensate for rate base deductions that have been eliminated by this transaction. The amount of the offset for the first year shall be $30.0 million. <u>The amount shall reduce by $3.0 million per year on each anniversary date of the closing of the subject transaction.</u> [paragraph 8 of Unanimous Stipulation And Agreement in Case No. GM-94-40, emphasis added]

Q. How was the Rate Base Offset from Case No. GM-94-40 calculated in this case?

A. The $21 million balance in Accounting Schedule 2, Rate Base, represents a reduction of $3 million each year since the close of the sale transaction in February 1994.

Q. Please list the adjustments to Accounting Schedule 9, Income Statement, that you are sponsoring in this case.

A. I am sponsoring the following adjustments to Accounting Schedule 9, Income Statement. These adjustments are individually listed on Accounting Schedule 10, Adjustments to Income Statement:

Adjustment No.	Description
S-41.6	Amortize database credits
S-45.2	Capitalize costs charged to expense
S-45.7	Remove costs of second holiday party
S-45.8	Capitalize costs to refinish office equipment
S-47.4	Reflect MGE adjustment H-25 non-regulated costs

S-47.5	Remove nonrecurring costs
S-47.6	Adjust per hour legal costs
S-47.8	Transfer legal costs to corporate allocation model
S-52.2	Remove cost of abandoned project as nonrecurring
S-53.1	Recognize Broadway Ford parking lot rent
S-55.1	Adjust interest on customer deposits
S-56.2	Include a five-year average of net salvage
S-59.1	Annualize current income tax expense
S-60.1	Amortize deferred ITC from Case No. GM-94-40
S-62.1	Include corporate allocated payroll costs
S-63.1	Include corporate allocated non-payroll costs
S-63.2	Remove MGE's allocated SGA dues
S-63.3	Adjust AGA dues for government relations costs
S-63.4	Remove former manufactured gas plant costs
S-63.5	Miscellaneous corporate allocation adjustments
S-63.6	Remove allocated costs of New York office
S-63.7	Adjust corporate allocated legal costs
S-63.8	Capitalize computer-related equipment
S-63.9	Capitalize computer-related equipment
S-66.1	Depreciation expense clearing
S-66.2	Depreciation expense clearing

Also, adjustments S-21.1, S-26.1, S-30.1, S-34.1, S-36.1, S-41.2, S-45.5 and S-52.4 remove 50 percent of MGE's meals and entertainment charges incurred in the test year. Adjustments S-32.1, S-41.3, S-44.1, S-44.2, S-45.6 and S-47.7 remove payments made to former MGE employees under employee severance agreements.

Q. Please describe Accounting Schedule 9, Income Statement.

A. Accounting Schedule 9, Income Statement, contains the Staff's adjusted gas revenues, expenses and net income for MGE for the test year ended December 31, 2000.

Q. Please explain Accounting Schedule 10, Adjustments to Income Statement.

A. Accounting Schedule 10 contains a listing of the specific adjustments that the Staff has made to the unadjusted test year income statement to derive the Staff's adjusted net income. A brief explanation for each adjustment and the name of the Staff witness sponsoring the adjustment is listed in Accounting Schedule 10.

Non Corporate Income Statement Adjustments

Q. Please describe adjustments S-21.1, S-26.1, S-30.1, S-34.1, S-36.1, S-41.2, S-45.5 and S-52.4

A. These adjustments remove 50 percent of MGE's meals and entertainment (M&E) charges incurred in the test year. The Staff's review of the documentation supporting these expenses reveals that certain employee meals charged to MGE were excessive and that the documentation of these meal charges was inadequate and not in compliance with Company policy. A similar adjustment is made to corporate M&E charges and is discussed later in my testimony.

The Internal Revenue Code (IRC) Section 274 only allows a tax deduction for 50 percent of M&E expenses as legitimate business expenses. The IRS requires that all business meals that are considered lavish or extravagant must first be subtracted from the meal cost before the 50 percent reduction is applied. While the Staff's review indicated that some of the Company's M&E expenses could be considered as "lavish and extravagant" from a reasonable cost ratemaking standard, the Staff's M&E adjustments did not adopt this stricter standard.

Q. Please describe adjustments S-32.1, S-41.3, S-44.1, S-44.2, S-45.6 and S-47.7.

A. These adjustments remove payments made to former MGE employees under contractual employee severance agreements. The Staff reviewed the severance agreements related to payments to former MGE employees made in the test year. It is the

Staff's opinion that the severance agreements are primarily shareholder protection contracts and provide no current benefit other than to protect the Company's shareholders and the image of the Company.

Q. Please describe adjustment S-41.6.

A. This adjustment removes test year cost of database software and 300,000 meter search credits and amortizes this cost over its estimated useful life of three years. The useful life is based on the number of credits used each year.

Q. Please describe adjustment S-45.2.

A. This adjustment removes outside vendor costs to install a sink and a water heater in an MGE facility. The Staff believes this cost should be capitalized instead of expensed in the current period. Staff Accounting witness Lucus is sponsoring Plant adjustment P-18.2, which capitalizes this cost to Plant account 390.1, Structures.

Q. Please describe adjustment S-45.7.

A. This adjustment removes the cost of a second holiday party. The Staff has already included in MGE's cost of service a large holiday party held for all MGE employees at the downtown Kansas City airport.

Q. Please describe adjustment S-45.8.

A. This adjustment removes outside vendor costs incurred to refinish office furniture. The Staff believes this cost should be capitalized instead of expensed in the current period. Staff Accounting witness Lucus is sponsoring Plant adjustment P-20.2, which capitalizes this cost to Plant account 391, Office Furniture and Equipment.

Q. Please describe adjustments S-47.4 and S-47.5.

A. Adjustment S-47.4 removes non-regulated costs and adjustment S-47.5 removes nonrecurring legal and outside vendor costs from account 923, Outside Services Employed.

Q. Please describe adjustment S-47.6.

A. This adjustment reduces the test year level of expense paid to Flesichman & Walsh, L.L.P. (Fleischman & Walsh), a Washington, D.C. law firm who represents MGE before the Federal Energy Regulatory Commission (FERC). Aaron I. Fleischman, the Senior Partner of Fleischman & Walsh, has been a member of Southern Union's Board of Directors since February 1990. The Staff determined that the per-hour fees paid to Fleischman & Walsh are excessive compared to MGE's other legal costs. The Staff adjusted this fee to $300 per hour, which is the highest per hour rate paid by MGE for all of its outside legal costs incurred in the test year.

It is also the Staff's understanding that Southern Union did not solicit competitive bids for its FERC legal counsel. While MGE may pay its FERC counsel whatever it chooses, the Staff believes it is prudent and reasonable for MGE to periodically solicit bids for this legal service to determine if it can obtain equal quality legal service at a lower cost. MGE's decision to award this work to Fleischman & Walsh on a recurring basis without soliciting competitive bids, especially considering the relationship between the two firms and the significance of this annual cost, requires these costs to be closely scrutinized.

Q. Please describe adjustment S-47.8.

A. This adjustment removes certain legal costs from MGE's income statement and transfers them to the corporate allocation model, where, because they apply to the corporation as a whole, are more properly reflected.

Q. Please describe adjustment S-52.2.

A. This adjustment removes the nonrecurring site survey costs of an abandoned project to build a fire training school.

Q. Please describe adjustment S-53.1.

A. This adjustment recognizes revenue received from Broadway Ford for rental of MGE's parking lot spaces as an offset to lease expense.

Q. Please describe adjustment S-55.1.

A. This adjustment annualized interest on customer deposits at 9.5 percent for residential deposits and 3 percent for commercial and industrial deposits consistent with interest rate paid by MGE in the test year.

Q. Does the Staff have a concern about the interest rate MGE is currently paying on its commercial and industrial deposits?

A. Yes. MGE's Tariff Sheet No. R-14 requires an interest rate of 9.5 percent on all customer deposits. MGE, however, cites 4 CSR 240-10 (4) as its authority to pay 3 percent on commercial and industrial deposits. This is an apparent contradiction that needs to be resolved. The Staff anticipates that this issue will be discussed at the prehearing conference in May 2001.

Q. Please describe adjustment S-56.2.

A. This adjustment includes a five-year average of net salvage costs for gas plant retired from service, consistent with the Staff's method used to calculate depreciation rates in this Case. This issue is discussed in the testimony of Staff witness Paul W. Adam of the Engineering and Management Services Department.

Q. Please explain adjustments S-66.1 and S-66.2.

A. These adjustments eliminate depreciation expense on transportation equipment charged to maintenance expense. Since the Staff's depreciation expense annualization includes an annual level of depreciation on transportation plant, this adjustment is necessary to avoid this expense from being duplicated – included in maintenance expense and depreciation expense.

Q. Please explain adjustments S-59.1 and S-60.1.

A. Adjustment S-59.1 adjusts current income tax expense and adjustment S-60.1 adjusts deferred income tax expense from the level included in the Company's books and records to the annualized amount calculated on Accounting Schedule 11, Income Tax.

Q. Please describe Accounting Schedule 11, Income Tax.

A. Accounting Schedule 11 reflects the Staff's calculation of current and deferred income taxes based on the Company's adjusted operating results for its gas operations.

Q. Please describe how the current income tax component of the total income tax expense is calculated on Accounting Schedule 11, Income Tax.

A. The Current Income Tax component (Line 28) is calculated by taking the Net Operating Income Before Taxes (NOIBT) amount from Accounting Schedule 9 and adjusting for additions to and deductions from NOIBT that appear on Accounting Schedule 11, lines 2 through 7. This amount (Net Taxable Income) is multiplied by the appropriate federal and state income tax rates, giving consideration to the fact that federal income taxes are deductible for state income tax purposes, and state income taxes are deductible for federal income tax purposes.

Q. Please explain why Interest Expense, line 5 of Accounting Schedule 11, is subtracted from NOIBT to arrive at Net Taxable Income and how it was calculated.

A. Interest expense is recorded below-the-line on MGE's income statement and is not reflected in the Staff's calculation of Net Operating Income on Accounting Schedule 9. When an item is booked below-the-line, it is not included in the calculation of net operating income. An item booked below-the-line is generally included in "other operating revenues and expenses." Since Staff's revenue requirement is based on the amount of net operating income, an item booked below-the-line will have no impact on the revenue requirement. If a cost is booked below-the-line and is not recovered elsewhere, it will be borne by the shareholders and not the ratepayers.

For ratemaking purposes, the Company recovers interest expense through the weighted cost of debt portion of the overall rate of return on rate base. However, interest expense is a deduction for tax purposes and must be reflected in the calculation of income tax expense. The tax deduction for interest expense was calculated by multiplying the rate base on Accounting Schedule 2 by the Staff's calculated weighted cost of debt, which is sponsored by Staff witness Murray of the Financial Analysis Department. This method is known as "interest synchronization" because the interest expense used in the calculation of income tax expense is matched (synchronized) with the interest expense the ratepayers are required to provide the Company in rates (rate base multiplied by the weighted cost of debt). Interest synchronization has been consistently used by the Staff and adopted by the Commission in numerous past orders.

Q. Please explain why Preferred Stock Dividends are subtracted from NOIBT on Accounting Schedule 11, Income Tax.

A. Southern Union has issued and has outstanding a class of preferred stock in which the dividend payments are tax deductible to Southern Union in the same manner as interest expense on bonds. The preferred stock is included in the capital structure and cost of capital proposed by Staff witness Murray in his direct testimony. The Company recovers the cost of the dividends on this preferred stock through the weighted cost of preferred stock component of the overall rate of return. Since the dividends are deductible and are not listed as a deduction on Accounting Schedule 9, Income Statement, they must be included as a subtraction from NOIBT to arrive at Net Taxable Income. The amount of the tax deduction for preferred stock dividends is calculated by multiplying the rate base amount on Accounting Schedule 2, Rate Base by the Company's weighted cost of preferred stock.

Q. Please describe the Amortization of Investment Tax Credit (ITC) on Line 30 of Accounting Schedule 11, Income Tax.

A. As discussed earlier, on July 9, 1993, Southern Union entered into an Agreement for the Purchase of Assets with Western Resources. In the agreement, Southern Union purchased Western Resources' Missouri gas operations, which are now operated under the name of Missouri Gas Energy.

In Case No. GM-94-40, the Commission approved the purchase subject to the terms of a Stipulation And Agreement (Stipulation). Among other things, that Stipulation provided that Southern Union agrees to reduce regulatory income tax expense by $296,363 in any Southern Union general non-gas rate increase case completed within ten years of the closing date of the transaction. The purpose of this amortization is to compensate Missouri ratepayers for the ITC that was eliminated as a result of the acquisition.

Q. Please explain COLI Amortization on line 3 of Schedule 11.

A. The COLI Amortization on line 3 of Schedule 11, Income Tax, must be added back in determining taxable income because it is not deductible for calculating current income tax under IRS regulations.

Corporate Allocations

Q. Please describe the Staff's audit of Southern Union's proposed corporate allocation to MGE.

A. The Staff has reviewed and analyzed Southern Union's proposed allocation of corporate plant and expenses to MGE. Based on the Staff's audit, responses to Staff data requests, and the results of interviews with several corporate employees and executive officers, the Staff is proposing several adjustments to the proposed level of costs allocated to MGE. These adjustments are discussed below.

Q. What amount of Southern Union corporate costs is MGE proposing to include in rates in this case?

A. MGE's updated December 31, 2000 filing includes $8,372,922 in MGE allocated and directly assigned expenses. This amount is calculated after the application of a 79.2495 percent expense/capital ratio (expense factor) and can be found on

Schedule H-8 of MGE witness Noack's Updated Test Year Direct Testimony, and is shown below.

	Payroll	NonPayroll	Total
Corporate Costs	$17,198,098	$11,661,204	$28,859,302
% to MGE	37.182%	35.765%	36.61%
MGE allocated	$6,394,591	$4,170,677	$10,565,268
Exp Factor	79.2495%	79.2495%	79.2495%
MGE Expense	$5,067,681	$3,305,241	$8,372,922

Also, while not included in Southern Union's cost allocation model, all insurance premiums are paid out of the corporate headquarters in Austin Texas and allocated to the divisions and subsidiaries. MGE is being allocated approximately $716,952 in insurance premiums before applying the expense factor.

Q. What amount of corporate plant is Southern Union proposing to allocate to MGE?

A. Southern Union is proposing to allocate $11,791,245 in corporate plant to MGE with $11,049,549 consisting of computer and software related plant, which Southern Union refers to as IT (Information Technology) plant. Southern Union maintains substantially all of the Company's computer hardware, software and network plant on its corporate books. While the hub of Southern Union's computer network is at MGE's headquarters in Kansas City (referred to as the KC Data Center), all IT hardware, software, and employees are assigned to corporate. Plant adjustments P-29.1, P-30.1, P-31.1, P-32.1, P-33.1 and P-34.1 found on Accounting Schedule 4, Adjustments to Total Plant add Southern Union's proposed level of allocated corporate plant to MGE's plant in service for rate purposes.

Q. Is the Staff proposing any adjustments to Southern Union's proposed level of allocated plant to MGE?

A. Yes. Plant adjustment P-29.2 removes from Southern Union's proposed plant allocation a mainframe computer formerly used with billing and customer records software. The Staff learned in a meeting with Company personnel that this computer in no longer being used and has been replaced by a computer that is recorded as operating lease and not capitalized to plant in service. Adjustment P-29.3 removes the capitalized software costs for a project that was abandoned. Adjustments P-29.4 and P-29.5 capitalize the purchase of computer or computer related equipment. These costs were also removed form the level of corporate overhead expenses allocated to MGE.

Q. Are you sponsoring any Depreciation Reserve adjustments related to corporate allocated plant?

A. Yes. Reserve adjustments can be found on Accounting Schedule 7, Adjustments to Depreciation Reserve. Adjustments R-29.1, R-40.1, R-41.1, R-42.1, R-43.1, R-44.1 and R-45.1 add the depreciation reserve for Southern Union's proposed plant allocation to MGE. Adjustment R-29.2 removes the depreciation reserve for the mainframe computer that was removed in Staff Plant adjustment P-29.2.

Q. Please provide a brief history of Southern Union.

A. Southern Union was founded in 1929 in Texas. In early 1990, the Company was purchased in a cash transaction by the shareholders of Metro Mobile CTS, Inc. (Metro Mobile). After the purchase, Southern Union was reorganized with a new group of shareholders and a new Board of Directors. Mr. George Lindemann, the then Chairman and Chief Executive Officer (CEO) of Metro Mobile, became the Chairman and CEO of Southern Union. Mr. Lindemann and his family control about 28 percent of Southern Union's common stock. Southern Union's recent growth to approximately

1.6 million customers makes the Company one of the top ten natural gas utilities in the United States as measured by number of customers. The Company's goal of serving 3 million customers will make it one of the largest natural gas utilities in the nation, if achieved.

Southern Union's primary business is the sale and distribution of natural gas through its five operating divisions. In addition to the MGE division, which serves approximately 491,000 customers, Southern Union's Texas division, Southern Union Gas Company, serves approximately 523,000 customers in various cities throughout Texas, including El Paso, the Gulf Coast, the Rio Grande Valley and south Central and north Texas. The Florida division, South Florida Natural Gas, serves approximately 5,000 customers in the vicinity of New Smryna Beach. The Pennsylvania division, PG Energy, was acquired by Southern Union in November 1999, and serves about 154,000 gas distribution customers in central and northeastern Pennsylvania, including the cities of Scranton, Wilkes-Barre and Williamsport. The New England division serves approximately 286,000 customers in Rhode Island and Massachusetts. This division consists of three separate companies which Southern Union acquired in September 2000. These companies were Providence Energy Corporation, Valley Resources, Inc. and Fall River Gas Company.

In addition to its natural gas distribution divisions, Southern Union has several energy-related, non-utility subsidiaries. These subsidiaries are involved in natural gas marketing, electric power marketing, intrastate pipeline transportation service, propane sales and distribution, and international (Mexico) activities.

Q. Has Southern Union engaged in significant acquisition activities since Mr. Lindemann acquired the Company in 1990?

A. Yes. A brief summary of Southern Union's merger and acquisition activities since 1990 is discussed below.

During 1991, Southern Union acquired the natural gas transmission and distribution facilities serving an area in south Texas and the natural gas distribution facilities serving the city of Andrews, Texas. Also in 1991, Southern Union acquired Brazos River Gas Company, a natural gas distribution company in north Texas. In November 1991, Southern Union sold the assets of its Arizona gas utility operations for approximately $46 million. The Arizona gas operations served 62,000 customers.

During 1992, Southern Union acquired the natural gas distribution facilities in Nixon, Texas for $415,000. In May 1993, Southern Union acquired the natural gas distribution facilities of Berry Gas Company in Texas for $274,000.

On July 9, 1993, Southern Union entered into an Agreement for the Purchase of Assets with Western Resources for the Missouri gas properties now operated as MGE. Southern Union acquired 472,000 customers in the Kansas City, Joplin and St. Joseph, Missouri service areas. The purchase was consummated on January 31, 1994 and Southern Union paid Western Resources approximately $400 million. As a result of this acquisition, Southern Union became one of the top 15 gas utilities in the United States as measured by number of customers. Also in July 1993, Southern Union acquired the natural gas distribution facilities serving the city of Eagle Pass, Texas, for approximately $2 million. On September 30, 1993, Southern Union acquired Rio Grande Valley Gas

Company for approximately $31 million. Rio Grande then served 74,000 customers in south Texas.

On May 1, 1996, Southern Union consummated the sale of various operations for $15,900,000. The operations included certain gas distribution operations in the Texas and Oklahoma Panhandles, and Western Gas Interstate Company, a wholly owned subsidiary. On August 30, 1996, Southern Union purchased certain propane distribution operations in El Paso, Texas and on June 30, 1997, acquired propane operations located in and around Alpine Texas. These acquisitions added 3,600 customers to the Company's customer base.

On July 23, 1997, Southern Union acquired a 43 percent equity ownership in a natural gas distribution company in Piedras Negras, Mexico for $2.7 million. This system is across the U.S. – Mexico border from the Company's Eagle Pass, Texas service area.

Effective December 31, 1997, Southern Union acquired Atlantic Utilities Corporation (Atlantic) and subsidiaries for approximately $23 million. Atlantic is operated as South Florida Natural Gas, a natural gas division of Southern Union and Atlantic Gas Corporation, a propane subsidiary of the Company.

On February 1, 1999, Southern Union submitted a proposal to the Board of Directors of Southwest Gas Corporation (Southwest) to acquire all of Southwest's outstanding common stock. Southwest then had a pending merger agreement with ONEOK, Inc. Southwest's Board of Directors rejected Southern Union's offer. There are several lawsuits pending over Southern Union's efforts to acquire Southwest. In the

12 months ended June 30, 2000, Southern Union spent $10,363,000 on its attempt to acquire Southwest and the related litigation.

Southern Union extended its utility operations into the northeast United States when it acquired Pennsylvania Enterprises, Inc (now operating as PG Energy) in November 1999 for $500 million. This acquisition added 154,000 natural gas customers in central and northeastern Pennsylvania, including Scranton, Wilkes-Barre and Williamsport. In addition to its natural gas operations, PG Energy distributes propane to retail and commercial customers and markets electricity and natural gas.

In September 2000, Southern Union extended its reach into the northeast by acquiring Providence Energy Corp. (ProvEnergy), Fall River Gas Company (Fall River Gas), and Valley Resources Inc. (Valley Resources) (the New England acquisition).

ProvEnergy serves about 181,000 customers in Providence, Newport, and other Rhode Island cites, as well as North Attleboro and Plainville, Mass. ProvEnergy offers retail marketing of natural gas and other energy products, market retail fuel-oil, and provides heating, ventilating and air conditioning and electricity services. Fall River Gas, located in southeastern Massachusetts, serves approximately 48,000 residential, commercial, and industrial natural gas customers. Valley Resources supplies natural gas and propane to approximately 66,000 residential, commercial and industrial customers in northeastern and eastern Rhode Island. Valley Resources' operations include the sale of propane and appliances, as well as the sale, installation and design of natural gas conversion systems and facilities. According to Southern Union's 2000 Annual Report to Shareholders (Annual Report), the "assimilation of these New England companies will create one large contiguous operation that will enhance service to our customers and streamline operations."

Q. Has Southern Union recently made significant investments in other companies?

A. Yes. At page 9 of its 2000 Annual Report, Southern Union describes its policy of embracing new technologies:

> Southern Union is harnessing the power of the most advanced technologies in the marketplace to provide our customers with exciting new services that will save them both time & money. By strategically partnering with companies that are creating breakthrough technological applications, we will bring added services and enhanced conveniences to our customers, along with new revenue opportunities and greater efficiencies.

Southern Union had an approximate $400,000,000 (market value) investment in Capstone Turbine Corporation (Capstone) on August 31, 2000 with a cost basis of only $10,625,000. Capstone has developed a microturbine fueled by natural gas or propane that produces electricity and creates less pollution than conventional systems.

Southern Union also holds a $2,586,000 equity interest in PointServe, Inc. (PointServe), a business-to-business online scheduling solution for Internet 'portals seeking to enrich the consumer value of their site, and service industries seeking to harness the power of the Internet.

Southern Union has a $3,000,000 equity interest in Servana.com (Servana). Based in Austin, Texas, Servana partners with utility companies to deliver comprehensive e-commerce solutions to the customer's home. Servana is positioning itself to be the dominant utility-based home-service portal, leveraging the utility's brand name and reputation in the utility's service territory. In its Securities and Exchange

Commission (SEC) Form 10-K, Annual Report filed on September 28, 2000, Southern Union describes how Servana and PointServe will operate.

> For example, a new resident who moves to Austin, Texas and needs to establish gas service will be able to access Southern Union's website, schedule service through PointServe, and register for a variety of other services (i.e., electric, pest control, lawn service, etc.)

As of June 30, 2000, Southern Union had a $2,000,000 equity interest in Advent Networks, Inc. (Advent), headquartered in Austin, Texas. According to its most recent SEC Form 10-K, Southern Union intends to make an additional investment of up to approximately $2,500,000 in Advent. Advent is developing a next generation UltraBand platform which is expected to deliver digital broadband services 50 times faster than digital subscriber lines (DSL) or cable modems.

Q. What is Southern Union's business approach and its strategic direction?

A. Mr. Pete Kelley, Southern Union's President and Chief Operating Officer (COO) filed testimony before the Massachusetts Department of Public Utilities which included a description of the Company's strategic direction. Mr. Kelley stated that Southern Union's business approach emphasizes efficient operations, high quality customer service, sales activities that focus on improved utilization of gas distribution systems, and growth through cost-effective system expansions and strategic acquisitions. Mr. Kelley also stated that Southern Union adopted this business approach in early 1990 when Southern Union was acquired by shareholders of Metro Mobile CTS, Inc.

In its 1999 Annual Report, Southern Union stated that its strategic plan is "to increase the scale of its operations and the size of its customer base by pursuing and consummating future business combination transactions."

Also, in an article entitled "Investments Reveal Strategy" in Southern Union's corporate newsletter, Vision, dated February 2001, Southern Union describes its current focus on growth in reaching its strategic goals:

> The Company's focus on enhancing core business and services was a key in planning for the recent acquisitions of gas distribution companies in Pennsylvania and New England. In addition to a goal of serving 3 million customers, Southern Union is also pursuing geographic diversity to help assure company stability while meeting goals of growth.....Growth and diversification also enhance Southern Union's competitive position in an industry moving to deregulation, competition and consolidation.
>
> Today Southern Union's investment strategy looks like a running list of tick marks indicating the scope of ongoing activities: build network of companies throughout the United States; expand geographic base; ally with high-technology partners, create larger platforms to launch innovative customer service initiatives; forge ahead on new energy production frontiers; encourage employee foresight and reward performance and initiative; provide world class service; and set the stage for enhancing shareholder value.

Corporate Allocation Model

Q. Please describe how Southern Union allocates its costs to its divisions and subsidiaries.

A. To appropriately allocate its corporate overhead costs to its various divisions and subsidiaries, Southern Union has created a fairly extensive and detailed corporate allocation model. The model is separated into two major components, payroll costs and non-payroll related costs. While the corporate allocation model includes some costs that are directly assigned to divisions and subsidiaries, in my testimony I refer to all costs in the allocation model as allocated costs, unless stated otherwise.

After removing certain nonregulated costs and other costs that would not be appropriate to allocate to regulated entities (i.e., country club dues, acquisition-related litigation expenses), Southern Union allocates the pool of allocable costs to each of its divisions and subsidiaries based on causal allocation factors. The goal of the allocation methodology is to determine what causes a certain cost to exist, and then allocate the cost to the activity that causes the cost to exist. Costs that cannot be reasonably related to a specific set of activities are allocated using a general allocator based on factors such as a weighting of revenues, expenses and investment. The bulk of corporate expenses are allocated using allocation factors based on customers, employees, Information Technology (IT) processing, payroll, engineering activity, average payroll, insurance activity and corporate functions.

Q. How has Southern Union explained its ratemaking approach to corporate allocations in its direct filing?

A. The Company's direct testimony did not include an explanation of the rationale and methodology behind its corporate allocations. However, Mr. Ron Endres, Southern Union's Executive Vice President and Chief Financial Officer described the methodology employed in the Company's joint and common cost model in his testimony before the Massachusetts Department of Public Utilities seeking approval of its New England acquisition:

> Q. Please briefly describe the methodology employed in the Company's joint and common cost model.
>
> A. The first step in building the model is to identify all resources throughout the Company that provide services or support to more than one business unit, either divisions or unregulated subsidiaries. These resources are considered joint and common; the costs of which are included in the allocation model. Next, certain costs are retained (i.e., not allocated to any business unit) based on a determination that they are not properly assignable to any business unit, largely based on regulatory requirements. For example, lobbying expenses, contributions to charitable organizations, and expenses associated with social organization memberships are retained and not allocated to gas utility divisions for potential recovery through rates.

> Whenever possible, remaining costs are directly assigned to business units. Costs not directly assigned are causally allocated or generally allocated. Causally allocated costs can be traced, in terms of benefit received or cost caused, to a limited number of business units or work activities, while residual costs benefit the entire organization. For example, certain gas supply activity costs, such as the cost of resources dedicated to gas supply contract administration for Missouri gas supplies, are directly assigned. The costs of other gas supply activities involved in arranging gas supplies for both the Southern Union Gas and Missouri Gas Energy divisions are causally allocated using annual gas volumes in each division. By contrast, finance functions related to developing data and information for rating agencies or working with financial institutions on credit arrangements benefit the entire Company. Since the cost of these types of activities cannot be reasonably allocated to specific business units, they are allocated using a general allocator. The general allocator equally weights non-gas revenues, non-gas expenses, and investment.
>
> While the Company will not always agree with various parties in rate proceedings regarding some of the components of and adjustments pertaining to joint and common costs, the basic methods should not be controversial. These methods provide the framework for regulators to readily assess the reasonableness of cost allocations to a jurisdiction under Southern Union's divisional corporate structure.

Q. What percentage of corporate expenses is Southern Union proposing to allocate to MGE?

A. After removing directly assigned nonpayroll costs, the allocation of corporate overhead expenses is as follows:

MGE	$10,902,188	34.6%
Southern Union Gas Company	$10,502,464	33.3%
Other Divisions/Subs	$10,120,509	32.1%

Q. How is Southern Union's proposed level of allocated costs to MGE reflected in the Staff's Accounting Schedules?

A. Southern Union's proposed amount of corporate overhead costs allocated to MGE in this rate proceeding are included in Accounting Schedule 9, Income Statement through adjustments S-62.1 and S-62.2. Although insurance costs are allocated from corporate, MGE includes the corporate-allocated insurance costs in its Account 925, Injuries and Damages. Staff Accounting witness Sheldon Wood is sponsoring an adjustment to this account, S-49.1, as it relates to workers compensation and automobile and general liability claims. I am responsible for the allocated insurance premiums included in this account.

Payroll-Related Allocations

Q. Given all of its merger and acquisition activity over the last few years, does Southern Union allocate any of its internal payroll costs to merger and acquisition activities in its corporate allocation model?

A. No.

Q. How is Southern Union required to account for its merger and acquisition costs?

A. In accordance with generally accepted accounting principles (GAAP), Southern Union defers to an asset (or deferred debit) account all incremental merger-related expenses, such as travel, financial consultants, legal and regulatory fees. GAAP does not allow a company to defer internal labor costs (such as the amount of employee salary and benefits) to an acquisition account, but requires these expenses to be charged to income in the period incurred.

Q. Does GAAP control how Southern Union accounts for its corporate overhead costs in a ratemaking proceeding?

A. No. Southern Union allocates its corporate costs based on a mathematical allocation model that it designed. It can retain costs (i.e. exclude them from allocation) or allocate costs in any manner it chooses. For example, the Company could recognize that merger and acquisition activity in an ongoing activity at Southern Union, and it is even a necessary activity if the Company is to achieve its growth goals. Not allocating internal payroll costs to merger and acquisition activity may be proper for financial accounting, but it is not proper for ratemaking purposes in Missouri.

Q. Does the Staff have a concern the Southern Union is not allocating any of its corporate executives salaries and benefits to merger and acquisition activities?

A. Yes. Through interviews with 17 mostly senior-level corporate employees in Austin, Texas, and responses to Staff data requests, the Staff has obtained an understanding of the level of involvement in merger activity of these employees. It is the Staff's understanding that Southern Union's senior executives perform most of the merger due diligence work and do not rely to a great extent on outside consultants, such as investment banking firms, for this type of work.

Q. Does the fact that Southern Union does not allocate any of its corporate salaries and benefits to merger and acquisition activity result in an inappropriate allocation of overhead costs to its regulated operating divisions, such as MGE?

A. Yes. It has been the Commission's policy that merger and acquisition costs should not be directly charged to Missouri ratepayers. By not allocating corporate salaries to merger and acquisitions, activities in which Southern Union historically has been very active, MGE's customers are at risk of being charged these costs through higher corporate overhead costs than would be the case if Southern Union appropriately allocated its merger and acquisition internal payroll costs. Staff believes Southern Union should allocate costs to merger and acquisition activities in the corporate allocation model.

Q. Is the Staff proposing adjustments to Southern Union's corporate allocated employee related costs to impute an allocation to merger and acquisition activity?

A. Yes. Staff adjustment S-62.7 is an attempt to allocate a reasonable amount of corporate costs to Southern Union's merger and acquisition activities.

Q. Describe Staff adjustment S-62.7.

A. This adjustment removes 75 percent of the payroll cost and benefits of Southern Union's President and Chief Operating Officer, Mr. Pete Kelley from the level of payroll costs allocated to MGE in Southern Union's corporate allocation model. Mr. Kelley is also a member of Southern Union's Board of Directors. In addition, this adjustment removes 50 percent of the salary and benefits of Mr. Ronald Endres, Southern Union's Executive Vice President (VP) and Chief Financial Officer (CFO).

Q. Is it the Staff's position that Mr. Kelley spends exactly 75 percent of his time and Mr. Endres exactly 50 percent of his time on merger and acquisition activity?

A. No. To the extent that excluding 75 percent of Mr. Kelley's salary and benefits, and 50 percent of Mr. Endres' salary and benefits overstates the amount of time these particular individuals spend on mergers and acquisitions and other non-regulated investment activity, this overstatement should be more than compensated by the merger and acquisition activity performed by other Southern Union executive officers, whose salaries are being allocated to MGE with no adjustments in this Case.

Q. Which Southern Union executives are involved in merger and acquisition activities?

A. The Staff believes that most of Southern Union's merger and acquisition work is performed by the following individuals:

Mr. George Lindemann	Chairman and CEO
Mr. John Brennan	Vice Chairman, board member
Mr. Pete Kelly	President and COO, board member
Mr. Ronald Endres	Executive VP and CFO
Mr. Thomas Karam	Executive VP, board member

Other Southern Union executives get involved in merger and acquisition activity to a lesser extent. They include:

Mr. David Kvapil	Senior VP and Corporate Controller
Mr. Dennis Morgan	Senior VP – Legal
Nancy Capezzuti	Senior VP Human Resources
Mr. F. Jay Cummings	VP Pricing and Economic Analysis.

Other Southern Union employees have been involved with some merger and acquisition activity, although not to a great extent. They include:

Mr. James Wells	VP – Risk, Safety and Loss Control
Mr. Stuart Harbour	VP – Controller Gas Operations
Mr. Jon Graf	Director of Financial Reporting and Budgets
Mr. George Yankowski	Treasurer and Director – Investor Relations
Ms. Cheryl Yager	Assistant Treasurer

Q. Is Mr. Kelley significantly involved with managing Southern Union's nonregulated investments in other "high-tech" companies such as Pointserve, Servana, Advent Networks and Capstone in addition to other activities which are unrelated to running Southern Union's regulated natural gas operations?

A. Yes. During his interview with the Staff, Mr. Kelley indicated that he was the sole Southern Union executive who manages Company equity investments in other companies. Also, Mr. Kelley provided testimony before the Massachusetts' Department of Public Utilities seeking approval of the New England acquisition which describes his involvement with these investments and other activities:

> Q. Please summarize your professional experience.
>
> A. I have been President and Chief Operating Officer of the Company since February 1990. I have been a member of the Executive Committee of Southern Union's Board of Directors since March 1990. I serve on the Boards of Directors of Chase Bank Texas, Capstone Microturbines, and PointServe. I am also a board member of Texas Nature Conservancy, KLRU Public Television, the Progressive Policy Institute, a Washington, D.C. think tank, and past Chairman of the Board of the American Lung Association of Texas. I have been named to the National Petroleum Council, serve on the Seton Hospital Developmental Committee and the Governor's Economic Council, and am very active in the community Partners-in-Education program. Before joining Southern Union, I was employed in the competitive telecommunications business as Vice President of Operations of Metro Mobile in New York and Vice President of Technical Operations for Cellular Phone Stores in Maryland, Pennsylvania, and Virginia.

Q. Has either Mr. Kelley or Mr. Endres filed testimony in Missouri in MGE's three previous rate cases?

A. No. While both individuals get actively involved in mergers and acquisitions, they do not participate in even significant rate increase cases in their regulated gas distribution jurisdictions. The Staff believes these individuals are focused more on Southern Union's long-range growth objectives and the strategy of partnering with other nonregulated companies, than on running the day to day operations of Southern Union Company.

Q. Instead of significantly adjusting the salaries of Messrs. Kelley and Endres, why doesn't the Staff adjust a portion of each Southern Union employee who the Staff believes is involved in merger and acquisition activity?

A. The Staff believes while this would be better ratemaking theory, without adequate and verifiable documentation on how each executive spends his time, it would be an arbitrary exercise to assign a specific merger and acquisition allocation to each of the affected Southern Union employees. Until Southern Union includes a reasonable amount of corporate overhead costs to merger and acquisition activity, and nonregulated investment activity, the Staff will have to continues to determine a reasonable amount by imputing an adjustment as it is doing in this case.

Q. What are the other proposed Staff adjustments to Southern Union's level of corporate allocated payroll costs?

A. The Staff is proposing to adjust the level of salaries and benefits paid to Mr. George Lindemann, and Mr. John Brennan to a level that reflects their actual level of involvement in running Southern Union's day-to-day operations. Messrs. Lindemann and Brennan are paid salaries instead of board of director fees because they are technically Southern Union employees. The Staff believes, however, as it has in MGE's previous two rate cases, that these individuals act more as board members and not executive officers of the Company. The most significant basis for this belief is because Messrs. Lindemann and Brennan work out of an office in New York City and very rarely visit Southern Union headquarters in Austin, Texas. Adjustment S-62.6 removes the salaries and payroll benefits for Messrs. Lindemann and Brennan, and Mr. Lindemann's administrative assistant, and adds back $30,000 per year director fees for Messrs. Lindemann and Brennan.

Adjustment S-62.8 removes the salary and benefits paid to Southern Union's Vice President Legal, Dan Morgan. Mr. Morgan has spent and expects to spend in the future, a significant amount of time overseeing the Southwest Gas Company litigation. The size and scope of this project is indicated by the fact that Southern Union spent over $10 million on this litigation in its fiscal year ended June 30, 2000. There are several lawsuits pending that relate to activities surrounding Southern Union's efforts to acquire Southwest Gas. In addition to appeals from previous judicial rulings, there are or have been lawsuits concerning Southwest Gas and Southern Union in California, Nevada, Oklahoma and Arizona. Clearly, managing this project requires a substantial amount of Mr. Morgan's time, and to a lesser extent, the time of other Southern Union employees. Because of his significant involvement in this activity, the Staff does not believe it is appropriate to allocate Mr. Morgan's payroll costs to MGE's customers in this Case.

Adjustment S-62.5 removes certain corporate M&E expenses. Similar to its findings with MGE employees, the Staff believes that certain Southern Union corporate employees incurred excessive M&E charges in the test year. The Staff concludes, after a review of corporate expense accounts and a review of an expense account internal audit, that there were significant violations of Company policy in this area. This adjustment removes 50 percent of M&E expense for the corporate departments that charge these expenses to MGE, except for two departments in which the Staff noted significant compliance problems and one department that incurred a significant level of M&E expense with no apparent reason. The two departments that incurred the highest level of M&E expense (over 50 percent of total corporate M&E expense), Chairman and President/CFO were not included in this adjustment as these costs were included in other corporate payroll related adjustments.

Staff accounting witness Janis E. Fischer is sponsoring adjustments S-62.2, S-62.3, and S-62.4 to Southern Union's proposed level of payroll related overhead costs allocated to MGE.

<u>Non-Payroll Related Corporate Allocation Adjustments</u>

Q. Please explain adjustment S-63.2.

A. This adjustment removes allocated corporate dues paid to Southern Gas Association (SGA) from MGE's cost of service. MGE's corporate allocated charges include dues paid to the American Gas Association (AGA). While the AGA is a national organization, the SGA, based in Dallas, Texas is a regional association. Any benefits from membership in the SGA would primarily accrue to Southern Union's Texas gas distribution company, Southern Union Gas.

Q. Please explain Staff adjustment S-63.3.

A. This adjustment removes the portion of allocated corporate dues paid to AGA that relate to lobbying or governmental affairs. In response to Staff Data Request No. 52, MGE supplied a copy of AGA's fiscal year 2000 budget. Reflected in the budget was 23.04 percent of operating expenses allocated for government affairs. This amount is the basis for the Staff's adjustment.

Q. Please explain Staff adjustment S-63.4.

A. This adjustment removes environmental and related costs associated with former manufactured gas plant sites located in MGE's service territory. From discussions with Company personnel, the Staff understands that the first $3 million in costs incurred related to former manufactured gas plant sites were charged to Southern Union's acquisition adjustment account it recorded when it purchased the Missouri gas properties. According to the Stipulation And Agreement approved by the Commission in Case No. GM-94-40, Southern Union will not seek recovery of its acquisition adjustment in MGE's utility rates. To date, Southern Union has incurred less that $1 million in former manufactured gas plant site costs in Missouri. As such, all costs incurred to date have been charged to Southern Union's acquisition adjustment account for the Missouri properties and should not be included in rates. In addition, Southern Union has advised the Staff that it will pursue recovery of these costs from the appropriate insurance companies.

Q. Please explain Staff adjustment S-63.5.

A. This adjustment removes miscellaneous expenses such as corporate advertising costs, excessive dues and other expenses that should not be allocated to MGE.

Q. Please explain adjustment S-63.6, the removal of Southern Union's New York Office lease expense and related charges from MGE's allocated corporate overhead costs.

A. This adjustment eliminates MGE's allocated portion of the lease costs for the office space in New York City. The Staff's position in this Case, as it has been in MGE's previous two rates cases in Missouri, is that the use of this office space is unnecessary to the provision of utility service in Missouri. Also, the Staff believes that this office is an arrangement which is exclusively for the benefit and convenience of Messrs. Lindemann and Brennan.

Q. Please explain Staff adjustment S-63.7

A. This adjustment adjusts the level of legal expense allocated to MGE. These adjustments account for improper allocations, lack of documentation (redacted invoices), and no description of legal services charged to Southern Union by a member of the board of directors.

Q. Please explain Staff adjustments S-63.8 and S-63.9.

A. These adjustments capitalize to corporate allocated plant certain payments made by Southern Union for computer-related equipment.

Q. Does this conclude your testimony on corporate allocations?

A. Yes.

True-Up

Q. Has MGE requested a true-up audit in this proceeding?

A. Yes. MGE proposed a true-up audit through June 30, 2001, primarily driven by new plant additions related to its SLRP.

Q. Does the Staff recommend that a true-up audit be performed in this case?

A. Yes. The Staff is proposing a true-up audit in this proceeding through June 30, 2001. MGE estimates an increase in plant from December 31, 2000 through June 30, 2001 of approximately $19 million. The Staff believes that this projected increase is significant enough to justify a true-up audit in this Case.

Q. What specific revenue requirement items is the Staff recommending be included in MGE's true-up revenue requirement recommendation?

A. The Staff is recommending the following items included in the true-up audit through June 30, 2001:

RATE BASE:

1. Plant in service.
2. Depreciation reserve.
3. Deferred taxes.
4. Related cash working capital effects.

Charles R. Hyneman

Schedule of Testimony Filings

Case No.	Company
TR-93-181	United Telephone Company of Missouri
ER-94-163	St. Joseph Light & Power Company
HR-94-177	St. Joseph Light & Power Company
GR-95-160	United Cities Gas Company
EM-96-149	Union Electric Merger with CIPSCO, Inc.
GR-96-285	Missouri Gas Energy
GR-97-272	Associated Natural Gas Company
ER-97-394	UtiliCorp United, Inc.
GR-98-140	Missouri Gas Energy
EM-97-515	Western Resources, Inc. Acquisition of Kansas City Power & Light Co.
GM-2000-312	Atmos Energy Corporation Acquisition of Associated Natural Gas Company
EM-2000-292	UtiliCorp United Inc. Acquisition of St. Joseph Light & Power Company
GO-99-258	Missouri Gas Energy
EM-2000-369	UtiliCorp United Inc. Acquisition of Empire District Electric Company