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SLRP Deferrals
Witness: Mark L. Oligschlaeger
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

**MISSOURI GAS ENERGY,
A DIVISION OF SOUTHERN UNION COMPANY**

CASE NO. GR-2001-292

Jefferson City, Missouri
May 2001

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Reporter Stewart

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1 A. In 1989, the Commission implemented new rules which required
2 systematic upgrades to portions of Missouri utilities' natural gas distribution systems,
3 particularly relating to replacement of certain service lines and yard lines and
4 replacement and cathodic protection of mains. 4 CSR 240-40.030. Promulgation of
5 these rules generally had an impact of substantially increasing gas utilities' construction
6 expenditures, especially for MGE and prior to MGE, Western Resources, Inc. (WRI).

7 Q. Has the Commission allowed the use of any special regulatory
8 mechanisms to aid utilities in recovering costs associated with their safety construction
9 programs that would not normally be recovered under the traditional ratemaking process?

10 A. Yes. The Commission has set a policy of using accounting authority
11 orders (AAOs) to allow gas utilities to defer the costs associated with safety construction
12 programs for potential rate recovery. Use of AAOs lessens the impact of "regulatory lag"
13 on utilities' earnings related to safety construction.

14 Q. What is "regulatory lag"?

15 A. Regulatory lag is the lapse of time between a change in a utility's revenue
16 requirement and reflection of that change in the utility's rates.

17 Q. What are AAOs?

18 A. AAOs are devices that are used to "capture" the financial impact of certain
19 events that are normally reflected on the utility's income statement, and suspend the
20 related dollars on the utility's balance sheet for future periods, when it will be eligible for
21 inclusion in rates. A more detailed description of how AAOs work can be found in my
22 direct testimony in this proceeding.

1 Q. What is the relationship between the current use of AAOs by MGE for
2 treatment of gas safety costs and the proposed CSE/GSIP?

3 A. MGE is proposing the CSE/GSIP as a replacement for the current AAO
4 deferral process, as noted by Dr. Cummings on page 14 of his direct testimony.

5 Q. Please describe your understanding of how MGE intends the CSE/GSIP
6 mechanism to work.

7 A. As described by Mr. Cummings, the CSE/GSIP is intended to allow the
8 Company to attempt to automatically increase rates on an annual basis to reflect the
9 revenue requirement impact of safety plant additions made since the last general rate case
10 or CSE/GSIP filing. MGE's proposed tariff sheets for the CSE/GSIP show that the
11 annual increase will be based on gas safety projects completed by March 31 of each year.
12 MGE will make its tariff filing by May 15 of each year, with the new rate levels to go
13 into effect on July 1. Under the Company's proposal, the CSE/GSIP annual rate changes
14 will reflect only the revenue requirement impact of the gas safety program, and will not
15 incorporate the impact of any revenue requirement changes related to other facets of
16 MGE's operations.

17 Q. What is the Staff's position on the Company's CSE/GSIP proposal?

18 A. The Staff is opposed to the CSE/GSIP proposal on the grounds that it
19 constitutes single-issue ratemaking, which is an inappropriate ratemaking policy and is
20 prohibited in this jurisdiction. The Staff continues to recommend the use of AAOs for
21 rate treatment of safety construction expenditures.

22 Q. What is single-issue ratemaking?

1 A. Single-issue ratemaking is the setting of rates based upon one factor, with
2 all other relevant factors germane to the rate setting process excluded from consideration.
3 Counsel for the Staff has advised me that setting rates without consideration of all
4 relevant factors is unlawful in Missouri.

5 Q. Why is single-issue ratemaking inappropriate from a policy perspective?

6 A. Rates are set in Missouri based upon the relationship of rate base,
7 revenues and expense as measured at a consistent point in time. Changes in revenue
8 requirement that would have the impact of increasing rate levels when examined in
9 isolation (increases in rate base or in certain expenses) may be offset entirely by
10 concurrent changes in revenue requirement that have the impact of reducing rates, all
11 other things being equal (increasing revenues, decreases in certain expenses). Setting
12 rates based upon changes in one factor can potentially lead to rates being changed when
13 there is no true change in a utility's revenue requirement, or even when the overall
14 revenue requirement is trending in the opposite direction than the change indicated by the
15 single factor. For that reason, it is improper to set rates without a thorough examination
16 of all ratemaking factors at a point in time.

17 Q. Why does MGE's CSE/GSIP proposal constitute single-issue ratemaking?

18 A. The CSE/GSIP mechanism proposed by the Company is intended to allow
19 annual rate changes based on a calculation of a change in revenue requirement associated
20 with safety plant additions only. The CSE/GSIP mechanism will ignore revenue
21 requirement changes in other rate base items, including non-safety plant additions,
22 depreciation accruals, deferred income taxes, corporate allocations, cash working capital,
23 etc. The CSE/GSIP mechanism will also ignore changes in the levels of revenues and

1 non-safety expenses incurred by the Company. All of these other potential revenue
2 requirement impacts must be examined in order to determine whether any rate change
3 calculated based on safety construction components only represents a true and accurate
4 depiction of an overall change in MGE's revenue requirement since the time rates were
5 last set for the Company.

6 Q. Does the Company's CSE/GSIP mechanism allow for the possibility of an
7 examination of all relevant factors in conjunction with proposed single-issue rate changes
8 associated with safety construction?

9 A. No. The 45-day period between the proposed filing of the annual
10 CSE/GSIP rate change and the proposed effective date for the new rates does not leave
11 sufficient time for a reasonably comprehensive review of all relevant factors to take
12 place.

13 Q. Doesn't the current use of AAOs to account for safety related construction
14 costs also involve the use of single-issue ratemaking?

15 A. No. All ratemaking issues related to amounts deferred under AAOs
16 approved by the Commission are reserved to general rate proceedings, and not ruled on
17 by the Commission in the context of AAO applications. That means that rate disposition
18 or deferred amounts are considered by the parties and the Commission at the same time
19 all other relevant factors in the determination of just and reasonable rates are available for
20 consideration as well. In fact, parties are free to argue that previously deferred amounts
21 should not be given rate recovery, on the grounds that such amounts were imprudently
22 incurred or because it is alleged that the amounts were previously recovered in existing
23 rate levels, or other reasons.

1 Q. In his direct testimony, Dr. Cummings discusses making the rate increases
2 that would otherwise result from operation of the CSE/GSIP contingent upon the
3 Company attaining certain performance levels in customer service indices. Please briefly
4 describe this proposal.

5 A. In his direct testimony, Dr. Cummings proposes to limit the ability of the
6 Company to receive rate increases otherwise justified under the operation of the
7 CSE/GSIP if it does not attain certain levels of performance in the areas of Abandoned
8 Call Rate (ACR) and Average Speed of Answer (ASA), both call center indices. The
9 targets proposed for ACR and ASA are 7.5% and 65 seconds, respectively. If both
10 targets were exceeded, MGE would recover 98% of its revenue requirement associated
11 with its SLRP. (The proposal to forego 2% of its SLRP revenue requirement is intended
12 to take into account possible maintenance expense savings associated with SLRP.) If one
13 target is met, and the other exceeded, MGE proposes to recover 93% of its SLRP revenue
14 requirement. If both targets were met, the Company would recover 88% of its SLRP
15 revenue requirement. If either the ACR or ASA target is not met, then no revenue
16 requirement recovery of SLRP expenses would be allowed under the CSE/GSIP,
17 although 75% of that amount could be held over until the following year and recovered at
18 that time if the customer service targets are met in that annual period.

19 Q. What is the Staff's position concerning the customer service aspects of the
20 Company's CSE/GSIP proposal?

21 A. The Staff is opposed to the CSE/GSIP for the reasons already outlined in
22 my testimony. The Staff also questions why it is more appropriate to make operation of
23 an automatic rate adjustment plan contingent upon achievement of two customer service

1 targets, but not make it contingent upon the overall earnings level of the Company.

2 Nonetheless, if the Commission were inclined to approve the CSE/GSIP, the Staff has

3 additional concerns regarding the specific customer service aspects of MGE's proposal.

4 These concerns are:

5 1. As discussed in the rebuttal testimony in this case of Staff
6 witnesses Lisa Kremer and Gary Bangert, there are many different
7 determinants of the overall quality of a utility's customer service.
8 Attaining goals in the ACR and ASA areas does not demonstrate
9 or prove that a utility provides overall an adequate level of service
10 to customers.

11 2. The specific targets advocated by MGE for ACR and ASA are
12 derived from values agreed to by the Company, the Staff and other
13 parties in a series of Southern Union Company (Southern Union)
14 merger and acquisition applications before the Commission in
15 1999 and 2000. (Southern Union is the parent company of MGE.)
16 These standards were derived from MGE's actual past
17 performance in these areas, and failure by the Company to
18 maintain these standards (after taking into account a "zone of
19 reasonableness") after the mergers can possibly result in payment
20 of penalty credits to MGE customers. The targets were agreed to
21 in order to help ensure that Southern Union's merger activity did
22 not lead to any degradation in MGEs' performance in these areas
23 in Missouri. The Staff would consider such degradation, if it

1 occurs, as a merger detriment. Therefore, it is not appropriate to
2 consider that MGE merely continuing to meet these targets in
3 future years, in and of itself, would necessarily represent
4 acceptable customer service by MGE in these areas.

5 Q. In the event the Commission does not approve the CSE/GSIP, Dr.
6 Cummings asks that the Commission as an alternative to authorize a new SLRP AAO for
7 MGE. Is this alternative acceptable to the Staff?

8 A. At this time, no. MGE is presently involved in ongoing discussions with
9 the Commission's Safety Department (Operations Division) concerning possible
10 modifications of the SLRP at the Company. It is my understanding that these proposed
11 modifications may change the types of plant and the dollar amount of the plant being
12 replaced under the program.

13 The Staff recommends that the Commission not consider granting an AAO to
14 MGE for SLRP investment until such time as the Commission and the parties to this
15 proceeding have more definite knowledge as to whether proposals to modify the SLRP
16 will be formally made to the Commission or not, and whether the Commission will
17 approve the modifications that may be offered. This approach would allow the
18 Commission, the Staff and other parties the opportunity to consider whether the
19 construction amounts at issue in any new SLRP would continue to be material enough to
20 justify a new AAO, and would otherwise continue to meet this Commission's standard as
21 an extraordinary item justifying deferral treatment.

1 Q. If the Commission is inclined to grant MGE a new SLRP AAO in the
2 context of this rate case, does the Staff recommend that the Commission place any
3 conditions upon that action?

4 A. Yes. The Staff recommends that the Commission grant any new AAO
5 pursuant to its traditional conditions, most importantly that all ratemaking decisions
6 regarding the new SLRP AAO be reserved to future MGE rate proceedings. Also, the
7 Commission should require that MGE file a rate proceeding within two years of the
8 effective date of the Commission order in this case, or forfeit future rate recovery of the
9 deferred amounts.

10 **SLRP DEFERRALS**

11 Q. On pages 8-9 of his direct testimony, Mr. Noack explains the Company's
12 position that the unamortized portion of SLRP deferrals should be placed in rate base.
13 Does the Staff agree with MGE's position?

14 A. No. The Staff's proposal to allow recovery of deferral amortization
15 expense in rates, but to not allow rate base treatment for the unamortized balance of
16 SLRP deferrals, is appropriate in that it provides for a fair mitigation of the effects of
17 regulatory lag that MGE experiences as a result of its safety plant additions, but does not
18 absolve the Company entirely of the risk of regulatory lag on safety plant.

19 Q. Please explain.

20 A. If the intent of an AAO is to completely protect a utility against the impact
21 of regulatory lag associated with extraordinary events not anticipated in the normal
22 ratemaking process, then such complete protection would require allowing a utility
23 recovery in rates of deferred amounts (normally through a multi-year amortization), as

1 well as allowing a return in rate base of any unamortized amounts at the point rates are
2 set. In other words, a recovery both of and on the deferred amounts is required if a
3 regulatory commission desires to make a utility completely "whole" for the impact of
4 regulatory lag on extraordinary items. However, to the extent a commission wishes only
5 to mitigate the detrimental impact of regulatory lag associated with extraordinary items
6 on a utility, but not eliminate all negative impacts of the regulatory lag on shareholders,
7 then it might decide to allow only a recovery of deferred amounts, but not allow a rate
8 base return on any unamortized balance of deferred amounts.

9 Q. Has the Commission allowed utilities to recover deferrals in rates through
10 expense amortizations, but not authorized rate base treatment of the unamortized amounts
11 of the deferrals?

12 A. Yes, in many instances.

13 Q. What is the past history of rate base treatment for SLRP deferrals for
14 MGE?

15 A. Prior to MGE's last rate proceeding, the Commission had allowed MGE,
16 as well as its predecessor company Western Resources, Inc. (WRI), both a return of and
17 on SLRP deferrals in rates. In Case No. GR-98-140, however, the Commission
18 determined that rate base treatment of the unamortized balance of SLRP deferrals was not
19 appropriate. The Report and Order in that case read:

20 The Commission finds that the unamortized balance of SLRP
21 deferrals should not be included in rate base for MGE. ... All
22 of the parties agree that it is the purpose of the AAO to lessen
23 the effect of the regulatory lag, not to eliminate it nor to protect
24 the Company completely from risk. Without the inclusion of
25 the unamortized balance of the AAO account included in rate
26 base, MGE will still recover the amounts booked and deferred,
27 including the cost of carrying these SLRP deferral costs, property

1 taxes, and depreciation expenses through the true-up period...
2 (Pages 19-20).

3
4 Q. Does the Staff agree with the Commission's rationale for excluding SLRP
5 deferrals from rate base as expressed in its Report and Order in Case No. GR-98-140?

6 A. Yes. The Staff believes that the Commission has the discretion to
7 determine whether amounts deferred pursuant to AAOs that it has granted should be
8 given rate base treatment, as well as whether the amounts deferred should be granted rate
9 recovery at all. In regard to MGE's SLRP deferrals, the Staff believes allowing such
10 amounts recovery through an expense amortization, while not reflecting rate base
11 treatment of unamortized amounts, is an appropriate balancing of shareholder and
12 customer interests in regard to mitigating the impact of regulatory lag on the Company
13 associated with its safety program.

14 Q. In your direct testimony, you stated that the Staff is including deferred
15 taxes associated with SLRP deferrals as an offset to rate base. Is this treatment of
16 deferred taxes consistent with the Staff's recommendation that the unamortized balance
17 of SLRP deferrals not be given rate base treatment?

18 A. Yes. As explained in my direct testimony, deferred taxes associated with
19 SLRP deferrals are created as a result of the fact that the Company can take an immediate
20 tax deduction for deferred SLRP amounts when the deferrals are booked, but does not
21 charge these amounts to expense on its books until the amounts are amortized at a later
22 time. A tax-timing difference of SLRP deferrals arises from the different point in time
23 that SLRP deferred amounts can be deducted for tax purposes, compared to when these
24 costs are expensed for financial reporting purposes. This tax-timing difference exists

1 whether the Commission includes the unamortized balance of SLRP deferrals in rate base
2 or not. Inclusion of deferred taxes in rate base as an offset recognizes the cost-free
3 capital provided to MGE by customers through current recovery of these deferred taxes
4 in rates. Therefore, customers should get the benefit of a rate base offset for SLRP
5 deferred taxes whether the Commission allows rate base treatment of SLRP deferrals or
6 not.

7 Q. Does the issue of rate base treatment of SLRP deferrals affect other
8 decisions the Commission may make regarding rate recovery of these costs?

9 A. Yes, the Staff believes that the issue of rate base treatment of SLRP
10 deferrals should be tied to the amortization period allowed for SLRP deferral recovery.
11 In rate cases prior to Case No. GR-98-140, the Commission allowed MGE (and WRI) to
12 recover SLRP deferrals through a 20-year amortization. In Case No. GR-98-140, the
13 Commission allowed MGE a ten-year amortization of the SLRP deferrals. The
14 Commission explicitly tied its change in policy to a shorter amortization period to its
15 decision not to allow for rate base treatment of unamortized deferrals, stating “[g]iven
16 that the Company will recover the amortized amount of the SLRP deferral at the AFUDC
17 rate in ten years, instead of the previous 20 years’ amortization, it is proper for the
18 ratepayers and shareholders to share the effect of regulatory lag by allowing the
19 Company to earn a return of the SLRP deferred balance but not a return on the SLRP
20 deferred balance” (Page 20). For this reason, the Staff believes the Commission’s
21 decision on SLRP deferral amortization periods and on rate base treatment of SLRP
22 deferrals should be linked.

23 Q. Does the Company agree with this perspective?

1 A. No. MGE's case reflects both a proposed ten-year amortization period for
2 SLRP deferrals and rate base treatment of the deferrals. In effect, it is advocating the best
3 of all possible worlds for it in regard to rate treatment of SLRP deferrals.

4 Q. In the event the Commission decides in MGE's favor on the SLRP
5 deferral rate base issue, what does the Staff recommend in terms of an amortization
6 period for the deferrals?

7 A. If the Commission determines in this case that the unamortized balance of
8 SLRP deferrals should be given rate base treatment, the Staff recommends that the
9 Commission also order a 20-year amortization period for the deferrals in this case.

10 Q. Does this conclude your rebuttal testimony?

11 A. Yes, it does.

12

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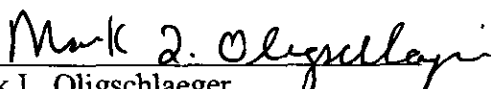
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In The Matter of Missouri Gas Energy's Tariff)
Filing For General Rate Increase) Case No. GR-2001-292

AFFIDAVIT OF MARK L. OLIGSCHLAEGER

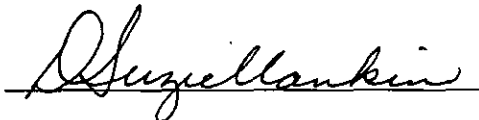
STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

Mark L. Oligschlaeger, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 13 pages to be presented in the above case; that the answers in the foregoing 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

Subscribed and sworn to before me this 21st day of May 2001.



D SUZIE MANKIN
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. JUNE 21, 2004