

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

DIRECT TESTIMONY

OF

CHARLES R. HYNEMAN

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

CASE NO. GR-2001-292

Exhibit No. 6
Date 6-25-01 Case No. GR-2001-292
Reporter Steven Oest

*Jefferson City, Missouri
April 2001*

1 **DIRECT TESTIMONY**
2 **OF**
3 **CHARLES R. HYNEMAN**
4 **MISSOURI GAS ENERGY,**
5 **A DIVISION OF SOUTHERN UNION COMPANY**
6 **CASE NO. GR-2001-292**

7
8 Q. Please state your name and business address.

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

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

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

14 Q. Have you previously filed testimony before the Commission?

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

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

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

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

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

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

12 A. See below:

13	Schedule 1	Revenue Requirement	Charles R. Hyneman
14	Schedule 2	Rate Base	Leslie L. Lucas
15	Schedule 3	Total Plant in Service	Leslie L. Lucas
16	Schedule 4	Adjustments to Total Plant	Leslie L. Lucas
17	Schedule 5	Depreciation Expense	Leslie L. Lucas
18	Schedule 6	Depreciation Reserve	Leslie L. Lucas
19	Schedule 7	Adjustments to Depreciation Reserve	Leslie L. Lucas
20	Schedule 8	Cash Working Capital	Graham Vesely
21	Schedule 9	Income Statement	Charles R. Hyneman
22	Schedule 10	Adjustments to Income Statement	Charles R. Hyneman
23	Schedule 11	Income Tax	Charles R. Hyneman
24			

25 Q. Please describe Accounting Schedule 1, Revenue Requirement.

26 A. Line 14 of Accounting Schedule 1, Revenue Requirement reflects the
27 Staff's recommended revenue increase for MGE as a result of its audit of MGE's
28 financial records for the test year ended December 31, 2000. MGE's Net Operating
29 Income requirement is calculated by multiplying its net investment in plant and other

1 assets (rate base) by the rate of return recommended by Staff witness David Murray of
2 the Financial Analysis Department. MGE's adjusted jurisdictional net operating income
3 from Accounting Schedule 9, Income Statement, is subtracted from this amount to arrive
4 at the additional income needed to earn the recommended rate of return (line 5). Finally,
5 the additional current income tax expense required as a result of the additional income
6 (line 9) is added to the additional income needed which results in the total recommended
7 revenue increase.

8 Q. What Rate Base components are you sponsoring?

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

11 Prepayments
12 Customer Advances for Construction
13 Customer Deposits
14 Deferred Taxes on Direct Plant
15 Deferred Taxes on Allocated Plant
16 Alternative Minimum Tax Credit
17 Rate Base Offset per GM-94-40

18 Q. Please describe the rate base component for Prepayments.

19 A. Prepayments represent shareholder-invested funds that are required to be
20 paid prior to the period when the related expense is recognized in the income statement.
21 The amount of prepayments included in Accounting Schedule 2, Rate Base, represents a
22 13-month average of prepaid corporate insurance expenses and postage expense allocated
23 or directly assigned to MGE. All insurance policies are recorded on the books of
24 Southern Union and are allocated or directly assigned to the individual divisions and
25 subsidiaries.

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

1 A. Customer advances are recorded as liabilities because they represent an
2 obligation to repay the advanced funds once the customers, on whose behalf the
3 construction was made, meet certain contractual requirements. The amount of customer
4 advances for construction included on Accounting Schedule 2, Rate Base, represents a
5 13-month average of end of month account balances.

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

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

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

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

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

3 A. Yes. The workpapers supporting MGE's calculation of deferred income
4 taxes used an incorrect effective tax rate. In response to Staff Data Request No. 136,
5 MGE provided a workpaper showing the calculation of individual book-tax timing
6 differences deferred at an effective tax rate (combined federal and state) of 37.15 percent.
7 The Staff's calculation of MGE's deferred tax balances for direct plant, allocated plant
8 and accounting authority order (AAO) amortizations reflects an effective tax rate of
9 38.61 percent. MGE provided the calculation of its 38.61 percent effective tax rate in
10 response to Staff Data Request No. 11. The effective tax rate includes the federal, state,
11 and Kansas City income tax rates. The Staff agrees with MGE's calculation of its 38.61
12 percent effective tax rate as reflected in its response to Staff Data Request No. 11.

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

15 A. MGE's deferred tax reserve represents, in effect, a prepayment of income
16 taxes by MGE's customers. As an example, because MGE is allowed to deduct
17 depreciation expense on an accelerated basis for income tax purposes, depreciation
18 expense used for income taxes is considerably higher than depreciation expense used for
19 ratemaking cost of service purposes. This results in what is referred to as a book-tax
20 timing difference and creates a deferral of income taxes to the future. The net credit
21 balance in the deferred tax reserve represents a source of cost-free funds to MGE.
22 Therefore, the rate base is reduced by the deferred tax reserve balance to avoid having
23 customers pay a return on funds that are cost-free to the Company. While the most

1 significant book-tax timing difference is caused by the differences between accelerated
2 tax depreciation and book depreciation, generally, deferred income taxes associated with
3 all book-tax timing differences which are created through the ratemaking process should
4 be reflected in rate base.

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

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

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

20 A. In Case No. GM-94-40, the Commission approved Southern Union's
21 purchase of the Missouri gas properties of Western Resources, Inc. (Western Resources).
22 In the Stipulation And Agreement to that case, there were several agreements reached
23 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. The amount shall reduce by \$3.0 million per year on each anniversary date of the closing of the subject transaction. [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:

<u>Adjustment No.</u>	<u>Description</u>
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

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

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

26 Q. Please describe Accounting Schedule 9, Income Statement.

27 A. Accounting Schedule 9, Income Statement, contains the Staff's adjusted
28 gas revenues, expenses and net income for MGE for the test year ended December 31,
29 2000.

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

32 A. Accounting Schedule 10 contains a listing of the specific adjustments that
33 the Staff has made to the unadjusted test year income statement to derive the Staff's

1 adjusted net income. A brief explanation for each adjustment and the name of the Staff
2 witness sponsoring the adjustment is listed in Accounting Schedule 10.

3 **Non Corporate Income Statement Adjustments**

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

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

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

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

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

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

4 Q. Please describe adjustment S-41.6.

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

8 Q. Please describe adjustment S-45.2.

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

13 Q. Please describe adjustment S-45.7.

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

17 Q. Please describe adjustment S-45.8.

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

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

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

4 Q. Please describe adjustment S-47.6.

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

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

21 Q. Please describe adjustment S-47.8.

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

4 Q. Please describe adjustment S-52.2.

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

7 Q. Please describe adjustment S-53.1.

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

10 Q. Please describe adjustment S-55.1.

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

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

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

21 Q. Please describe adjustment S-56.2.

22 A. This adjustment includes a five-year average of net salvage costs for gas
23 plant retired from service, consistent with the Staff's method used to calculate

1 depreciation rates in this Case. This issue is discussed in the testimony of Staff witness
2 Paul W. Adam of the Engineering and Management Services Department.

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

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

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

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

14 Q. Please describe Accounting Schedule 11, Income Tax.

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

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

20 A. The Current Income Tax component (Line 28) is calculated by taking the
21 Net Operating Income Before Taxes (NOIBT) amount from Accounting Schedule 9 and
22 adjusting for additions to and deductions from NOIBT that appear on Accounting
23 Schedule 11, lines 2 through 7. This amount (Net Taxable Income) is multiplied by the

1 appropriate federal and state income tax rates, giving consideration to the fact that federal
2 income taxes are deductible for state income tax purposes, and state income taxes are
3 deductible for federal income tax purposes.

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

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

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

1 weighted cost of debt). Interest synchronization has been consistently used by the Staff
2 and adopted by the Commission in numerous past orders.

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

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

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

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

22 In Case No. GM-94-40, the Commission approved the purchase subject to the
23 terms of a Stipulation And Agreement (Stipulation). Among other things, that Stipulation

1 provided that Southern Union agrees to reduce regulatory income tax expense by
2 \$296,363 in any Southern Union general non-gas rate increase case completed within ten
3 years of the closing date of the transaction. The purpose of this amortization is to
4 compensate Missouri ratepayers for the ITC that was eliminated as a result of the
5 acquisition.

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

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

10 **Corporate Allocations**

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

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

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

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

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

	<u>Payroll</u>	<u>NonPayroll</u>	<u>Total</u>
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?

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

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

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

16 Q. Please provide a brief history of Southern Union.

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

1 1.6 million customers makes the Company one of the top ten natural gas utilities in the
2 United States as measured by number of customers. The Company's goal of serving
3 3 million customers will make it one of the largest natural gas utilities in the nation, if
4 achieved.

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

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

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

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

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

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

14 On July 9, 1993, Southern Union entered into an Agreement for the Purchase of
15 Assets with Western Resources for the Missouri gas properties now operated as MGE.
16 Southern Union acquired 472,000 customers in the Kansas City, Joplin and St. Joseph,
17 Missouri service areas. The purchase was consummated on January 31, 1994 and
18 Southern Union paid Western Resources approximately \$400 million. As a result of this
19 acquisition, Southern Union became one of the top 15 gas utilities in the United States as
20 measured by number of customers. Also in July 1993, Southern Union acquired the
21 natural gas distribution facilities serving the city of Eagle Pass, Texas, for approximately
22 \$2 million. On September 30, 1993, Southern Union acquired Rio Grande Valley Gas

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

3 On May 1, 1996, Southern Union consummated the sale of various operations for
4 \$15,900,000. The operations included certain gas distribution operations in the Texas
5 and Oklahoma Panhandles, and Western Gas Interstate Company, a wholly owned
6 subsidiary. On August 30, 1996, Southern Union purchased certain propane distribution
7 operations in El Paso, Texas and on June 30, 1997, acquired propane operations located
8 in and around Alpine Texas. These acquisitions added 3,600 customers to the
9 Company's customer base.

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

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

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

1 12 months ended June 30, 2000, Southern Union spent \$10,363,000 on its attempt to
2 acquire Southwest and the related litigation.

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

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

12 ProvEnergy serves about 181,000 customers in Providence, Newport, and other
13 Rhode Island cities, as well as North Attleboro and Plainville, Mass. ProvEnergy offers
14 retail marketing of natural gas and other energy products, market retail fuel-oil, and
15 provides heating, ventilating and air conditioning and electricity services. Fall River Gas,
16 located in southeastern Massachusetts, serves approximately 48,000 residential,
17 commercial, and industrial natural gas customers. Valley Resources supplies natural gas
18 and propane to approximately 66,000 residential, commercial and industrial customers in
19 northeastern and eastern Rhode Island. Valley Resources' operations include the sale of
20 propane and appliances, as well as the sale, installation and design of natural gas
21 conversion systems and facilities. According to Southern Union's 2000 Annual Report to
22 Shareholders (Annual Report), the "assimilation of these New England companies will

1 create one large contiguous operation that will enhance service to our customers and
2 streamline operations.”

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

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

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

14 Southern Union had an approximate \$400,000,000 (market value) investment in
15 Capstone Turbine Corporation (Capstone) on August 31, 2000 with a cost basis of only
16 \$10,625,000. Capstone has developed a microturbine fueled by natural gas or propane
17 that produces electricity and creates less pollution than conventional systems.

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

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

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

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

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

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

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

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

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

4 The Company's focus on enhancing core business and services
5 was a key in planning for the recent acquisitions of gas distribution
6 companies in Pennsylvania and New England. In addition to a
7 goal of serving 3 million customers, Southern Union is also
8 pursuing geographic diversity to help assure company stability
9 while meeting goals of growth.....Growth and diversification also
10 enhance Southern Union's competitive position in an industry
11 moving to deregulation, competition and consolidation.

12 Today Southern Union's investment strategy looks like a running
13 list of tick marks indicating the scope of ongoing activities: build
14 network of companies throughout the United States; expand
15 geographic base; ally with high-technology partners, create larger
16 platforms to launch innovative customer service initiatives; forge
17 ahead on new energy production frontiers; encourage employee
18 foresight and reward performance and initiative; provide world
19 class service; and set the stage for enhancing shareholder value.

20 **Corporate Allocation Model**

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

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

29 After removing certain nonregulated costs and other costs that would not be
30 appropriate to allocate to regulated entities (i.e., country club dues, acquisition-related
31 litigation expenses), Southern Union allocates the pool of allocable costs to each of its

1 divisions and subsidiaries based on causal allocation factors. The goal of the allocation
2 methodology is to determine what causes a certain cost to exist, and then allocate the cost
3 to the activity that causes the cost to exist. Costs that cannot be reasonably related to a
4 specific set of activities are allocated using a general allocator based on factors such as a
5 weighting of revenues, expenses and investment. The bulk of corporate expenses are
6 allocated using allocation factors based on customers, employees, Information
7 Technology (IT) processing, payroll, engineering activity, average payroll, insurance
8 activity and corporate functions.

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

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

17 Q. Please briefly describe the methodology employed in the
18 Company's joint and common cost model.

19 A. The first step in building the model is to identify all resources
20 throughout the Company that provide services or support to more
21 than one business unit, either divisions or unregulated subsidiaries.
22 These resources are considered joint and common; the costs of
23 which are included in the allocation model. Next, certain costs are
24 retained (i.e., not allocated to any business unit) based on a
25 determination that they are not properly assignable to any business
26 unit, largely based on regulatory requirements. For example,
27 lobbying expenses, contributions to charitable organizations, and
28 expenses associated with social organization memberships are
29 retained and not allocated to gas utility divisions for potential
30 recovery through rates.

1 Whenever possible, remaining costs are directly assigned to
2 business units. Costs not directly assigned are causally allocated or
3 generally allocated. Causally allocated costs can be traced, in terms
4 of benefit received or cost caused, to a limited number of business
5 units or work activities, while residual costs benefit the entire
6 organization. For example, certain gas supply activity costs, such
7 as the cost of resources dedicated to gas supply contract
8 administration for Missouri gas supplies, are directly assigned. The
9 costs of other gas supply activities involved in arranging gas
10 supplies for both the Southern Union Gas and Missouri Gas
11 Energy divisions are causally allocated using annual gas volumes
12 in each division. By contrast, finance functions related to
13 developing data and information for rating agencies or working
14 with financial institutions on credit arrangements benefit the entire
15 Company. Since the cost of these types of activities cannot be
16 reasonably allocated to specific business units, they are allocated
17 using a general allocator. The general allocator equally weights
18 non-gas revenues, non-gas expenses, and investment.

19 While the Company will not always agree with various parties in
20 rate proceedings regarding some of the components of and
21 adjustments pertaining to joint and common costs, the basic
22 methods should not be controversial. These methods provide the
23 framework for regulators to readily assess the reasonableness of
24 cost allocations to a jurisdiction under Southern Union's divisional
25 corporate structure.

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

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

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

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

35 A. Southern Union's proposed amount of corporate overhead costs allocated
36 to MGE in this rate proceeding are included in Accounting Schedule 9, Income Statement

1 through adjustments S-62.1 and S-62.2. Although insurance costs are allocated from
2 corporate, MGE includes the corporate-allocated insurance costs in its Account 925,
3 Injuries and Damages. Staff Accounting witness Sheldon Wood is sponsoring an
4 adjustment to this account, S-49.1, as it relates to workers compensation and automobile
5 and general liability claims. I am responsible for the allocated insurance premiums
6 included in this account.

7 **Payroll-Related Allocations**

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

11 A. No.

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

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

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

22 A. No. Southern Union allocates its corporate costs based on a mathematical
23 allocation model that it designed. It can retain costs (i.e. exclude them from allocation)

1 or allocate costs in any manner it chooses. For example, the Company could recognize
2 that merger and acquisition activity in an ongoing activity at Southern Union, and it is
3 even a necessary activity if the Company is to achieve its growth goals. Not allocating
4 internal payroll costs to merger and acquisition activity may be proper for financial
5 accounting, but it is not proper for ratemaking purposes in Missouri.

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

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

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

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

1 should allocate costs to merger and acquisition activities in the corporate allocation
2 model.

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

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

7 Q. Describe Staff adjustment S-62.7.

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

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

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

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

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

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

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

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

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

16	Mr. James Wells	VP – Risk, Safety and Loss Control
17	Mr. Stuart Harbour	VP – Controller Gas Operations
18	Mr. Jon Graf	Director of Financial Reporting and 19 Budgets
20	Mr. George Yankowski	Treasurer and Director – Investor 21 Relations
22	Ms. Cheryl Yager	Assistant Treasurer

23
24 Q. Is Mr. Kelley significantly involved with managing Southern Union's
25 nonregulated investments in other "high-tech" companies such as Pointserve, Servana,
26 Advent Networks and Capstone in addition to other activities which are unrelated to
27 running Southern Union's regulated natural gas operations?

28 A. Yes. During his interview with the Staff, Mr. Kelley indicated that he was
29 the sole Southern Union executive who manages Company equity investments in other
30 companies. Also, Mr. Kelley provided testimony before the Massachusetts' Department

1 of Public Utilities seeking approval of the New England acquisition which describes his
2 involvement with these investments and other activities:

3 Q. Please summarize your professional experience.

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

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

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

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

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

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

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

22 Adjustment S-62.8 removes the salary and benefits paid to Southern Union's Vice
23 President Legal, Dan Morgan. Mr. Morgan has spent and expects to spend in the future,

1 a significant amount of time overseeing the Southwest Gas Company litigation. The size
2 and scope of this project is indicated by the fact that Southern Union spent over \$10
3 million on this litigation in its fiscal year ended June 30, 2000. There are several lawsuits
4 pending that relate to activities surrounding Southern Union's efforts to acquire
5 Southwest Gas. In addition to appeals from previous judicial rulings, there are or have
6 been lawsuits concerning Southwest Gas and Southern Union in California, Nevada,
7 Oklahoma and Arizona. Clearly, managing this project requires a substantial amount of
8 Mr. Morgan's time, and to a lesser extent, the time of other Southern Union employees.
9 Because of his significant involvement in this activity, the Staff does not believe it is
10 appropriate to allocate Mr. Morgan's payroll costs to MGE's customers in this Case.

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

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

4 **Non-Payroll Related Corporate Allocation Adjustments**

5 Q. Please explain adjustment S-63.2.

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

12 Q. Please explain Staff adjustment S-63.3.

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

18 Q. Please explain Staff adjustment S-63.4.

19 A. This adjustment removes environmental and related costs associated with
20 former manufactured gas plant sites located in MGE's service territory. From
21 discussions with Company personnel, the Staff understands that the first \$3 million in
22 costs incurred related to former manufactured gas plant sites were charged to Southern
23 Union's acquisition adjustment account it recorded when it purchased the Missouri gas

1 properties. According to the Stipulation And Agreement approved by the Commission in
2 Case No. GM-94-40, Southern Union will not seek recovery of its acquisition adjustment
3 in MGE's utility rates. To date, Southern Union has incurred less than \$1 million in
4 former manufactured gas plant site costs in Missouri. As such, all costs incurred to date
5 have been charged to Southern Union's acquisition adjustment account for the Missouri
6 properties and should not be included in rates. In addition, Southern Union has advised
7 the Staff that it will pursue recovery of these costs from the appropriate insurance
8 companies.

9 Q. Please explain Staff adjustment S-63.5.

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

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

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

21 Q. Please explain Staff adjustment S-63.7

22 A. This adjustment adjusts the level of legal expense allocated to MGE.
23 These adjustments account for improper allocations, lack of documentation (redacted

1 invoices), and no description of legal services charged to Southern Union by a member of
2 the board of directors.

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

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

6 Q. Does this conclude your testimony on corporate allocations?

7 A. Yes.

8 **True-Up**

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

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

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

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

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

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

21 **RATE BASE:**

- 22 1. Plant in service.
23 2. Depreciation reserve.
24 3. Deferred taxes.
25 4. Related cash working capital effects.

INCOME STATEMENT:

1. Revenue for customer growth.
2. Payroll - Employee levels, current wages and benefits.
3. Rate case expense.
4. Depreciation and amortization expense.
5. FAS 87 Pension and FAS 106 OPEB expense
6. Related income tax effects
7. PSC Assessment

CAPITAL STRUCTURE:

1. Embedded cost of debt.
2. Capital structure.

Q. Has the Staff included estimates for known and measurable changes in MGE's operations through June 30, 2001?

A. Yes. The Staff has included estimates for plant, reserve, pension expense, OPEB expense, payroll and 401K expense in its accounting schedules filed with its direct testimony.

Q. Please explain adjustment S-74.1.

A. This adjustment reflects the Staff's current estimate of the revenue requirement impact of true-up items not reflected in this filing, potential errors or omissions and future modifications. If these potential events do not occur, and the Staff finds that MGE is in an overearnings position, it will initiate a complaint filing with the Commission.

Q. Does this conclude your testimony?

A. Yes.

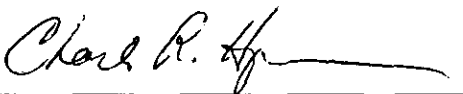
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

AFFIDAVIT OF CHARLES R. HYNEMAN

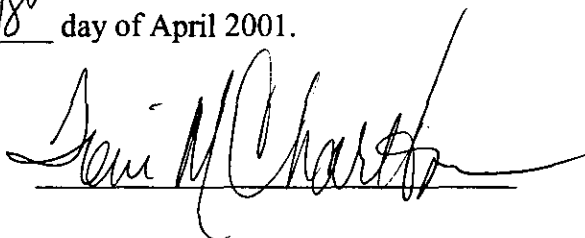
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Charles R. Hyneman, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 38 pages to be presented in the above case; that the answers in the foregoing Direct 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.



Charles R. Hyneman

Subscribed and sworn to before me this 18th day of April 2001.



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

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