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Witness: Charles R. Hyneman
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

CHARLES R. HYNEMAN

FILED

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Missouri Public
Service Commission

MISSOURI GAS ENERGY

CASE NO. GU-2005-0095

Jefferson City, Missouri
February 2005

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Date 3-8-05 Rptr tu

OF THE STATE OF MISSOURI

AFFIDAVIT OF CHARLES R. HYNEMAN

STATE OF MISSOURI)
)
COUNTY OF COLE) SS.

Charles R. Hyneman
Charles R. Hyneman

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
County of Cole
My Commission Exp. 07/01/2008

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CHARLES R. HYNEMAN
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1 **SURREBUTTAL TESTIMONY**

2 **OF**

3 **CHARLES R. HYNEMAN**

4 **MISSOURI GAS ENERGY**

5 **CASE NO. GU-2005-0095**

6 Q. Please state your name and business address.

7 A. Charles R. Hyneman, Fletcher Daniels State Office Building, Room G8,
8 615 East 13th Street, Kansas City, Missouri 64106.

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

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

12 Q. Are you the same Charles R. Hyneman who filed direct testimony in this
13 case?

14 A. Yes, I am.

15 Q. What is the purpose of this testimony?

16 A. The purpose of this testimony is to respond to certain comments in the rebuttal
17 testimonies of Missouri Gas Energy (MGE) witness Michael R. Noack and the Office of the
18 Public Counsel (OPC) witness Kimberly K. Bolin.

19 My concerns with Mr. Noack's rebuttal testimony relate to the start date of the
20 amortization of MGE's deferred property taxes (deferrals) if the Commission grants MGE an
21 Accounting Authority Order (AAO) in this case. My concerns with Ms. Bolin's testimony
22 relate to the determination of whether or not the first-time levying of property taxes by the

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1 State of Kansas on MGE meets the Commission's criteria to be classified as an extraordinary
2 event.

3 In addition to addressing the rebuttal testimonies of MGE witness Noack and OPC
4 witness Bolin, this testimony will also provide the Commission's Staff's (Staff)
5 recommendation that the Commission allow MGE to defer up to a maximum of two years of
6 property tax deferrals. The specific expenses to be deferred would be for the actual property
7 taxes paid for the years 2004 and 2005.

8 Q. Please explain why the Staff is recommending that MGE be allowed to defer
9 up to two years of property tax deferrals.

10 A. The extraordinary event, the first time imposition of property taxes by the
11 state of Kansas, took place in 2004. In 2004 this event could be classified as extraordinary as
12 it was unusual and nonrecurring and it lead to significant costs imposed on MGE. These
13 costs were not typical of MGE's ongoing and customary business expenses.

14 However, after a period of time, a new cost loses its extraordinary nature and
15 becomes a normal recurring cost. The Staff feels that two years is a sufficient period of time
16 for these costs to be classified as extraordinary. It is also a sufficient period of time for
17 MGE's management to adjust to the new expense and either absorb the new expense with
18 existing revenues or to file for a rate increase. MGE can file for a rate increase if existing
19 revenues are not sufficient to recover these ongoing expenses (assuming that the Kansas law
20 giving rise to these taxes is upheld) and earn a reasonable rate of return on invested capital.

21 **REBUTTAL OF MGE WITNESS NOACK**

22 Q. Please describe the difference between the Staff's position and MGE's
23 position as it relates to the start date of the amortization period.

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1 A. The Staff recommends that the Commission order MGE to begin to amortize
2 the deferred property tax expenses (deferrals) in the month following a final judicial
3 resolution of the legality of the Kansas tax. This event, according to MGE, could reasonably
4 be expected to occur some time in the summer of 2006.

5 Ideally, for several reasons that will be described later in this testimony, the Staff
6 believes that immediate amortization (starting the amortization the month following the
7 deferral or upon the issuance of an AAO) of a contingent asset deferred under an AAO is
8 preferable to any delay in the start of the amortization. The Staff's position is based not only
9 on the Commission's current policy on AAOs, but is also consistent with regulatory
10 accounting principles that are designed to achieve fairness and equity to both MGE's
11 shareholders and customers.

12 However, because MGE is contesting the legality of these costs and it is not known
13 for certain that MGE will actually incur these costs, the Staff believes it is more appropriate
14 to delay the start date of the amortization until the final legal determination is made.

15 MGE's position, however, is an admitted attempt to directly recover in rates, at a
16 minimum, every dollar of property tax deferred under this AAO. This position would not
17 only result in inappropriate regulatory treatment of these deferrals, but because it is a position
18 that is concerned only with the ratemaking treatment of these costs, it is borderline as to
19 whether this position should even be considered by the Commission in an AAO proceeding.

20 This position as described at page 2 of Noack's rebuttal testimony, is that the property
21 tax deferrals remain untouched on MGE's balance sheet and not amortized to expense until
22 they are fully and directly included in rates in MGE's next rate case. MGE also proposes that
23 if it does not file a rate case by May 2008, it will cease deferring the property tax expenses

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1 and begin the amortization at that time. In essence, MGE proposes that it be allowed to
2 "stockpile" the deferrals on its balance sheet for four years and five months before
3 commencing the amortization to expense to make sure that it will recover at least 100 percent
4 of its deferrals by direct rate recovery.

5 Q. As a point of clarification of the Staff's proposal, under accepted regulatory
6 accounting theory, would MGE be considered to be recovering the property tax deferral once
7 it begins to amortize the deferral to expense, even outside of a rate case?

8 A. Yes. There are two forms of rate recovery, indirect rate recovery and direct
9 rate recovery. When rates are set in a rate case, it is assumed that the new level of revenues
10 will be sufficient to cover a utility's total cost of service. This assumption may hold true
11 even if certain costs increase above the level currently reflected in rates, as such increases
12 can be offset either by increased revenues from customer growth or favorable weather
13 conditions, or decreases in other expenses from events such as technological changes or
14 employee efficiency.

15 When MGE begins to amortize this AAO deferral to expense outside of a rate case, it
16 will be assumed that it is recovering this expense in the revenues generated from its
17 customers. This ratemaking concept is referred to as indirect rate recovery. If for some
18 reason MGE's rates do not allow it to recover its entire cost of service, including the AAO
19 amortization, and its return on equity is below what it considers reasonable, it can choose to
20 file a rate case to directly recover the property tax deferrals in rates. This would be an
21 example of direct rate recovery.

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1 Q. Please provide an example where an extraordinary cost deferred under an
2 AAO granted by this Commission was considered to be fully recovered by the utility through
3 indirect rate recovery.

4 A. An example of indirect rate recovery is the AAO granted to Kansas City
5 Power & Light Company (KCPL) for extraordinary ice-storm damage in Case
6 No. EU-2002-1048. In that Case, KCPL sought the authority to defer its extraordinary cost
7 and begin to amortize this deferral over five years on the day it received the Commission
8 AAO. KCPL has never filed a rate case seeking direct rate recovery of these deferred
9 expenses. KCPL is assumed to be recovering these deferred expenses through existing rates.

10 Q. Other than what is described in Mr. Noack's rebuttal testimony, did MGE
11 provide to the Staff a description of the basis for its position on the start of the amortization
12 period?

13 A. Yes. The following is MGE's response to Staff Data Request No. (DR No.) 3
14 in this case:

15 Question 1. Please describe the amortization period and the
16 amortization start date that MGE is seeking in this case.

17 Response 1. MGE is seeking an order which would start the
18 amortization period at the time rates from the next rate case go into
19 effect.

20 Questions 2. If MGE is seeking to delay the amortization of this
21 deferral until the next rate case, please provide all rationale and
22 justification for this treatment. Include in this rationale how MGE
23 proposes to treat the revenues associated with this amortization (if
24 included in a rate case) if the amortization period ends outside of a rate
25 case.

26 Response 2. MGE feels that this is an extraordinary expense that if
27 realized, should be charged to rate payers. The only way to accurately
28 accomplish this is to defer until the next rate case and then include the
29 amortization in rates. Using a 60 month amortization period would

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1 adequately insulate ratepayers from overpaying for the amortization
2 expense based on MGE's past history of rate case frequency.

3 Q. Please comment on MGE's response to this data request.

4 A. This response either fails to recognize the existence of the concept of indirect
5 rate recovery or asserts that indirect rate recovery is not acceptable to MGE. MGE's
6 proposal requires a delay in the amortization of the deferral to ensure that the first month
7 amortization is included in rates; however, it relies on its past history of filing rate cases as
8 ratepayer protection that the deferral will not be over-recovered in rates.

9 Under MGE's proposal it maintains total control over the ratemaking phenomenon
10 knows as regulatory lag as it applies to this one expense. It is seeking control over the start
11 of the amortization period so that it coincides with its next rate case and it is seeking control
12 over the end of the amortization period, so that it can ensure that it recovers, at a minimum,
13 100 percent of the deferrals through direct rate recovery. As will be discussed later,
14 regulatory lag is a ratemaking phenomenon that is only fair if it is not manipulated in favor of
15 one party over another.

16 Q. What has been MGE's history of filing rate cases?

17 A. For its last three cases, MGE has filed for a rate increase every three years.

18 Q. Excluding for one moment the propriety of tying the start of the amortization
19 period to a rate case, has the Staff performed an analysis of MGE's assertion in response to
20 Staff DR No. 3 that ratepayers will be "protected" under MGE's proposal?

21 A. Yes it has.

22 Q. What is the result of the Staff's analysis?

23 A. There will be no ratepayer protection, only the potential for ratepayer
24 detriment.

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1 Q. Please explain.

2 A. Assuming that MGE files for a rate case every three years, and assuming
3 MGE is allowed to defer 2004 Kansas property tax expense in the amount of \$1,700,000
4 amortized over 60 months, if direct rate recovery is allowed at the start of the amortization
5 period, MGE could recover a total of \$2,039,991, for an over-recovery of \$339,991.

6 Q. How could this happen?

7 A. MGE would file its next rate case, Rate Case 1 in November 2006 and the
8 amortization of the deferrals will be included in rates that become effective in September
9 2007. MGE will file Rate Case 2 in November of 2009 and continue to include the
10 amortization in rates. MGE will file Rate Case 3 in November 2012 and since the deferrals
11 would have been fully amortized, the rates from Rate Case 3 that will go into effect in
12 September 2013 will not include the deferral. The deferrals will be included in rates from
13 September 2007 through August 2013, for a total of 72 months or six years. This example is
14 shown as Schedule 1, attached to this surrebuttal testimony. As shown in this Schedule,
15 under its proposal, it is very possible for MGE to directly recover in rates an amount
16 significantly in excess of the original deferral.

17 Q. Under the Staff's recommendation on the start of the amortization period, is it
18 also possible for MGE to recover directly in rates more than the original deferral?

19 A. Yes. The amount directly recovered in rates would depend on MGE's timing
20 of future rate cases, which should be a function of MGE's future earnings. Under the Staff's
21 proposal, recovery of an amount in excess of the original deferral is not necessarily a bad
22 thing. It would not be a bad thing if it occurred solely as a function of the timing of rate
23 cases and not through a manipulation of regulatory lag in an AAO proceeding.

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1 Q. Explain the foundation and basis of the Staff's opposition to MGE's proposal
2 on the start date of the deferral amortization period.

3 A. The basis of the Staff's opposition to MGE's proposal can be found primarily
4 in the Commission's two seminal Orders on AAOs. These two Orders outline and discuss
5 the standards the Commission has used and continues to use in its determination of whether
6 or not to grant an AAO. These Orders are: 1) the Report and Order in Case Nos. EO-91-358
7 and EO-91-360 (consolidated), Missouri Public Service (MPS) (Sibley Order); and 2) the
8 Report and Order on Remand in Case No. WO-2002-273, Missouri American Water
9 Company (Missouri American Order).

10 The Sibley Order set out the standards of deferrals for AAOs that the Commission has
11 followed for several years. The Missouri-American Order reaffirmed the standards of
12 deferral of the Sibley Order.

13 Q. Please compare the Staff's and MGE's proposal on the start date of the
14 amortization period in terms of compliance with accounting and ratemaking principles and
15 fairness to both MGE's customers and stockholders.

16 A. The Staff's position is superior in terms compliance with accounting and
17 ratemaking principles and fairness to both MGE's customers and stockholders for the
18 following reasons:

- 19 1. MGE's proposal ignores the matching principle and intergenerational equity.
20 The Staff's position, to the extent possible, is consistent with both principles.
- 21 2. MGE's proposal would result in an unbalanced and unfair manipulation of
22 regulatory lag. The Staff does not attempt to manipulate regulatory lag.
- 23 3. MGE's proposal to stockpile costs for several years creates the potential for a
24 significant write-off and charge to earnings that would be detrimental to
25 MGE's shareholders. The Staff's position greatly reduces the chance of a
26 significant asset write-off.

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1 4. MGE's proposal to defer costs far into the future does not consider events that
2 are likely to have caused significant expense decreases in the current period.
3 These expense decreases have the potential to offset most if not all of MGE's
4 annual deferral amortization expense.

5 5. After a couple of years, the Kansas property tax will become a normal
6 recurring expense and lose its extraordinary nature. MGE's proposal would
7 allow for a continuation of the deferral of this specific expense for up to 4.5
8 years, long after it becomes a normal and recurring operating expense.

9 Q. Please explain the accounting principle known as the "matching principle"
10 and a ratemaking application of this principle known as "intergenerational equity."

11 A. In the Missouri American Order, the Commission described intergenerational
12 equity and its application to the matching principle as follows:

13 The AAO is one of the Commission's chief regulatory tools for
14 implementing another aspect of the Matching Principle. As discussed
15 above, one aspect of the Matching Principle is to match revenues and
16 expenses with the period in which they were incurred. However,
17 under another aspect of the Matching Principle, "ratepayers are
18 charged with the costs of producing the service they receive." The
19 purpose is to match costs with benefits so that the ratepayers that enjoy
20 the benefits of utility property also bear the costs thereof.

21 An example is the replacement of water mains by a water company.
22 The mains will last for 80-100 years, while the costs of the
23 replacement - in the absence of an AAO - will be booked in the period
24 during which they are incurred. In other words, present customers
25 would bear all of the costs of the replacements, while the benefits
26 would be enjoyed by future generations of customers over the full life
27 of the mains. In that case, an AAO could be used to permit the costs
28 of the main replacements to be spread over the estimated life of the
29 new mains, so that every customer that uses them would pay some
30 portion of their cost. This application of the Matching Principle is
31 referred to as "inter-generational equity."

32 Q. How is the Staff's proposal more consistent with the matching principle and
33 intergenerational equity?

34 A. MGE's payment of 2004 and 2005 property taxes to the State of Kansas
35 allows it to acquire the natural gas to provide distribution service to its Missouri customers

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1 today-not five years into the future. This property tax expense that is incurred in the
2 provision of utility service should be charged against revenues provided by the ratepayers
3 who are currently receiving utility service. The Staff's recommended start date for the
4 deferral amortization allows for the recognition of an expense as close as possible to the
5 period the expense was incurred in the provision of utility service.

6 Q. How is MGE's proposal inconsistent with the matching principle and
7 intergenerational equity?

8 A. MGE clearly admits that its proposal is concerned only with rate recovery.
9 MGE does not express any consideration of the matching principle and intergenerational
10 equity. MGE's proposal would delay charging to expense any portion of a cost that was
11 incurred in the provision of 2004 and 2005 utility service until as late as the year 2008. This
12 will cause MGE's customers in 2008 and beyond to pay for costs that would have ordinarily
13 been borne by customers in 2004. The Staff's position would match the expense incurred in
14 2004 and 2005 with revenues collected from customers as soon as possible. As explained
15 earlier, ideally under the matching principle and intergenerational equity, this matching
16 (amortization) would take place immediately.

17 The Staff recognizes that the matching principle cannot be strictly applied in an AAO
18 case. Also, the regulatory accounting procedures allowed under an AAO will not result in
19 100 percent intergenerational equity. The goal is to come as close as possible consistent with
20 other legitimate concerns. The Staff believes its position best accomplishes this goal.

21 Q. How did the Commission handle the issue of intergenerational equity in the
22 Missouri American Order?

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1 A. The Commission's concern about intergenerational equity was the basis of the
2 Commission's decision to accept the Staff's proposed amortization period in that case. In the
3 Missouri American Order, both Missouri American and the Staff proposed immediate
4 amortization of the deferrals. The Commission agreed with Missouri-American that, if
5 amortization is to begin immediately, then the Commission must specify an amortization
6 period. The Commission adopted the Staff's suggestion of a ten-year amortization period,
7 because the costs would be amortized over a period more nearly contemporaneous with the
8 time the ratepayers receive the benefit of the expenditures being amortized.

9 Q. Please explain how MGE's proposal would result in an unfair manipulation of
10 regulatory lag.

11 A. Regulatory lag can be defined as the amount of time between 1) the date an
12 event occurs and 2) the date the expenses (or revenues) caused by the event is directly
13 included in rates. One of the benefits of regulatory lag is that, unless it is manipulated, it is
14 not partial to shareholders or ratepayers. In this case, MGE is attempting to manipulate
15 regulatory lag by delaying the amortization of the deferrals until its next rate case as opposed
16 to starting the amortization in the period that the costs were incurred to provide utility
17 service. MGE is manipulating regulatory lag in an attempt to secure direct rate recovery of at
18 least 100 percent of its AAO deferral by avoiding any recognition of indirect rate recovery.

19 Q. Does MGE inherently have more control over regulatory lag than MGE's
20 customers?

21 A. Yes. MGE can exercise significant control over the benefits of regulatory lag
22 through the timing of its rate cases. Assuming an immediate amortization of the AAO
23 deferral, if the annual charge to expense of this AAO deferral is truly a burden to MGE,

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1 giving consideration to the potential offsetting factors of decreases in expenses and increases
2 in revenues, then it could time the filing of rate cases to ensure that it recovers all, or
3 significantly all of the deferral through direct rate recovery.

4 Q. In previous cases where the Commission did not order an immediate
5 amortization of the costs deferred under an AAO, did it employ another mechanism to
6 balance the effects of regulatory lag?

7 A. Yes. The cases in which the Commission did not order an immediate
8 amortization were mostly cases that involved capital expenditures, such as MGE's service
9 line replacement program (SLRP), and MPS' cost to rebuild its Sibley Generation Station. In
10 the Sibley Order which was decided on December 20, 1991, the Commission allowed for the
11 deferral of costs to begin on January 1, 1992, but in order for MPS to have an opportunity to
12 seek recovery of these costs, it had to file a rate case no later than December 31, 1992. The
13 Commission stated that:

14 If there is no rate case pending at that time the Commission will
15 assume MPS is earning a reasonable return on its investment and will
16 not allow recovery in any rate case filed after December 31, 1992.

17 Q. Please explain the Staff's third reason for opposing MGE's amortization
18 proposal, that MGE's stockpiling of costs for 4.5 years creates the potential for a significant
19 write-off and charge to earnings.

20 A. MGE's proposal to stockpile the yearly property tax deferrals from 2004
21 through May 2008 could result in a total deferral of approximately \$7.7 million dollars
22 (annual charge of \$1.7 million times 4.5 years). If the Commission allowed MGE to
23 continue to defer these expenses up to its next rate case and in the next rate case the
24 Commission decided for whatever reason not to allow rate recovery of the deferrals, MGE

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1 would have to write-off the entire \$7.7 million, which is a significant charge to earnings for a
2 company the size of MGE.

3 The size of this write-off alone will add undue pressure on the Commission to take
4 some action to avoid, or at the least soften the blow of such a significant write-off. This
5 pressure would be undue because the proper way of handling this issue would be to begin the
6 amortization at the earliest possible date. This action would avoid the stockpiling of
7 deferrals that create the potential for a significant write-off.

8 Q. Has the Commission discussed this exact issue you are addressing in one of its
9 policy orders?

10 A. Yes. The Commission addressed this issue in the Sibley Order.

11 The Commission finds that a time limitation on deferrals is reasonable
12 since deferrals cannot be allowed to continue indefinitely. The
13 Commission finds that a rate case must be filed within a reasonable
14 time after the deferral period for recovery of the deferral to be
15 considered. For purposes of this case, the Commission finds that
16 twelve months is a reasonable period.

17 This limitation accomplishes two goals. First, it prevents the
18 continued accumulation of deferred costs so that total disallowance
19 would not affect the financial integrity of the company or the
20 Commission's ability to make the disallowance, and secondly, it
21 ensures the Commission a review of those costs within a reasonable
22 time.

23 If the costs are truly extraordinary, recovery in rates should not be
24 delayed indefinitely. A utility should not be allowed to save deferrals
25 to offset against excess earnings in some future period.

26 Q. Please explain the Staff's fourth reason for opposing MGE's amortization
27 proposal, that MGE's proposal fails to consider offsetting revenue increases or expense
28 decreases that are likely to occur.

29 A. As a result of Southern Union's recent pipeline acquisition, it is very likely
30 that MGE is currently experiencing a significantly lower level of corporate allocated

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1 overhead expenses than was included in rates in its most recent rate case, Case
2 No. GR-2004-0209.

3 In Case No. GR-2001-292, MGE sought rate recovery of approximately \$6.9 million
4 in corporate allocated overhead costs from its parent company, Southern Union Company
5 (Southern Union) (Stipulation and Agreement in Case No. GM-2003-0238). Between Case
6 No. GR-2001-292 and MGE's subsequent rate case, Case No. GR-2004-0209, Southern
7 Union purchased Panhandle Eastern Pipeline Company (Panhandle). The incorporation of
8 Panhandle into Southern Union's cost structure resulted in a major shift in corporate
9 overhead costs away from MGE and Southern Union's other utility divisions to Panhandle.

10 In Case No. GR-2004-0209, MGE sought rate recovery of approximately \$2.5 million
11 of corporate allocated overhead costs (Noack Corrected True-up testimony, Schedule 8)
12 compared to \$6.9 million just three years earlier. While some of this cost reduction was
13 offset by increases in MGE's direct costs due to MGE providing services that were
14 previously performed by Southern Union's corporate office, it was clear that the acquisition
15 of Panhandle resulted in a significant reduction in corporate overhead costs allocable to
16 MGE.

17 Q. Why was there such a significant decrease in costs charged from Southern
18 Union to MGE as a result of the Panhandle acquisition?

19 A. Southern Union's corporate officer salaries are allocated to its divisions based
20 on relative levels of investment, revenue and expenses of the operating divisions. Because
21 Panhandle was three times the size of MGE in terms of investment, revenue and expenses, it
22 picked up a big share of costs that were previously charged to MGE.

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1 Q. Why you expect a further significant reduction in the level of overhead costs
2 allocated from Southern Union to MGE?

3 A. Subsequent to MGE's last rate case, Case No. GR-2004-0209, Southern
4 Union and a partner acquired another large pipeline company, CrossCountry Energy, LLC
5 (CrossCountry). This acquisition was completed on November 17, 2004, for \$2.45 billion. It
6 is likely that incorporating CrossCountry into Southern Union's corporate cost allocation
7 system will result in another significant reduction in corporate overhead costs to MGE.

8 Q. What impact does Southern Union's acquisition of CrossCountry have on
9 MGE's regulatory lag with respect to corporate overhead costs?

10 A. Because of regulatory lag this potentially significant cost decrease will accrue
11 100 percent to MGE's shareholders until MGE's actual level of corporate overhead costs are
12 included in rates in MGE's next rate case. This is a normal application of regulatory lag,
13 which just happens to benefit MGE's shareholders. There is no manipulation involved and
14 as such, it is fair to both shareholders and ratepayers.

15 Q. Is it possible that this one potentially significant cost decrease to MGE could
16 offset all or a significant part of an amortization to expense of its annual Kansas property
17 tax?

18 A. Yes. It is not only possible it is very likely.

19 Q. Please explain the Staff's final reason for opposing MGE's proposed
20 amortization method, that after a couple of years, the Kansas property tax will become a
21 normal recurring expense and lose its extraordinary nature.

22 A. This reason is pretty self-explanatory. After a couple of years, a cost that
23 recurs annually, by definition, cannot be an extraordinary cost. Assuming this tax is not

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1 overturned in the courts in the first place, the cost of the property taxes will no longer be
2 unusual and nonrecurring. Therefore, stockpiling this cost, year after year, as proposed by
3 MGE would not constitute deferral of an extraordinary expense, but rather would be an
4 inappropriate deferral of a normal recurring cost that should no longer be eligible for deferral
5 under an AAO.

6 Q. Has the Commission in the past ordered and/or supported an immediate
7 amortization of a deferred extraordinary cost?

8 A. Yes. The Commission has ordered the amortization of costs deferred under
9 an AAO to begin prior to the next utility rate case in several AAOs. Some of these include
10 Case Nos. WO-2002-273 (Missouri-American Water Company), EU 2002-1048 (KCPL),
11 EO-94-149 (Empire), EO-95-193 (SJLP) and EU-2002-1053 (Aquila).

12 **REBUTTAL OF OPC WITNESS BOLIN**

13 Q. At page 3 of her rebuttal testimony, OPC witness Bolin states that MGE's
14 application is premature in that MGE has not yet paid the property taxes. Does the Staff
15 agree that MGE's application is premature?

16 A. No. The primary benefit of an AAO to a utility is the avoidance of a material
17 charge to earnings in the year the extraordinary event occurs. MGE should be afforded this
18 benefit by deferring the extraordinary expenses that it otherwise would have had to charge to
19 earnings in 2004. The Staff would be more concerned if the final determination of the
20 legality of these taxes had not been made prior to MGE seeking direct rate recovery of the
21 deferrals. At that point the issue of whether the taxes would actually have to be paid would
22 become more relevant. As it stands now, the Commission granting an AAO, prior to the
23 final legal determination, can do no harm to either MGE's customers or its shareholders.

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1 Q. At page 6 of her rebuttal testimony, OPC witness Bolin disagrees with the
2 Staff's position that the first time imposition of a property tax by the state of Kansas on MGE
3 is an extraordinary event. Please comment.

4 A. The problem with Ms. Bolin's testimony is her description of the event. She
5 describes the event at line 21 of her rebuttal testimony, as just an increase in a cost (property
6 taxes) of providing service. This is not the case. In the past, MGE has only paid property
7 taxes to the state of Missouri. It has never paid property taxes to the state of Kansas. This
8 imposition of a brand new tax, significant and material in amount, by a foreign state is a
9 unique, unusual and nonrecurring event that meets the Commission's criteria to be classified
10 as an extraordinary event.

11 Q. At page 11 of her rebuttal testimony, OPC witness Bolin describes the
12 matching principle and states that an AAO allows for the violation of the matching principle.
13 Do you agree?

14 A. Strictly speaking, yes. However, what is important in a regulatory proceeding
15 such as this is not necessarily the strict application of the matching principle, but the
16 application of the matching principle to the greatest extent possible consistent with other
17 equally important regulatory concerns. In my opinion, the granting of relief to a utility when
18 it incurs an extraordinary event that leads to significant and material costs is more important
19 than a strict application of the matching principle. However, as I described above, the
20 matching principle and its closely related principle of intergenerational equity in setting rates
21 is very important and also should be applied to the greatest extent possible.

22 Q. Does this conclude your surrebuttal testimony?

23 A. Yes, it does.

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Month	Year	Per Books Unamortized Deferral	Per Books Monthly Amortization	Rate Case Status	Direct Rate Recovery
3	2005	\$1,700,000	\$0	Commission grant AAO	
4	2005	\$1,700,000	\$0		
5	2005	\$1,700,000	\$0		
6	2005	\$1,700,000	\$0		
7	2005	\$1,700,000	\$0		
8	2005	\$1,700,000	\$0		
9	2005	\$1,700,000	\$0		
10	2005	\$1,700,000	\$0		
11	2005	\$1,700,000	\$0		
12	2005	\$1,700,000	\$0		
1	2006	\$1,700,000	\$0		
2	2006	\$1,700,000	\$0		
3	2006	\$1,700,000	\$0	MGE Files Rate Case 1	
4	2006	\$1,700,000	\$0		
5	2006	\$1,700,000	\$0		
6	2006	\$1,700,000	\$0		
7	2006	\$1,700,000	\$0		
8	2006	\$1,700,000	\$0		
9	2006	\$1,700,000	\$0		
10	2006	\$1,700,000	\$0		
11	2006	\$1,700,000	\$0		
12	2006	\$1,700,000	\$0		
1	2007	\$1,700,000	\$0	Rates--Case 1 in effect	
2	2007	\$1,700,000	\$0		
3	2007	\$1,700,000	\$0		
4	2007	\$1,700,000	\$0		
5	2007	\$1,700,000	\$0		
6	2007	\$1,700,000	\$0		
7	2007	\$1,700,000	\$0		
8	2007	\$1,700,000	\$0		
9	2007	\$1,700,000	\$28,333		\$28,333
10	2007	\$1,671,667	\$28,333		\$28,333
11	2007	\$1,643,333	\$28,333		\$28,333
12	2007	\$1,615,000	\$28,333		\$28,333
1	2008	\$1,586,667	\$28,333		\$28,333
2	2008	\$1,558,333	\$28,333		\$28,333
3	2008	\$1,530,000	\$28,333		\$28,333
4	2008	\$1,501,667	\$28,333		\$28,333
5	2008	\$1,473,333	\$28,333		\$28,333
6	2008	\$1,445,000	\$28,333		\$28,333
7	2008	\$1,416,667	\$28,333		\$28,333
8	2008	\$1,388,333	\$28,333		\$28,333
9	2008	\$1,360,000	\$28,333		\$28,333
10	2008	\$1,331,667	\$28,333		\$28,333
11	2008	\$1,303,333	\$28,333		\$28,333
12	2008	\$1,275,000	\$28,333		\$28,333
1	2009	\$1,246,667	\$28,333		\$28,333
2	2009	\$1,218,333	\$28,333		\$28,333
3	2009	\$1,190,000	\$28,333		\$28,333
4	2009	\$1,161,667	\$28,333		\$28,333
5	2009	\$1,133,333	\$28,333		\$28,333

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6	2009	\$1,105,000	\$28,333		\$28,333
7	2009	\$1,076,667	\$28,333		\$28,333
8	2009	\$1,048,333	\$28,333		\$28,333
9	2009	\$1,020,000	\$28,333		\$28,333
10	2009	\$991,667	\$28,333		\$28,333
11	2009	\$963,333	\$28,333	MGE Files Rate Case 2	\$28,333
12	2009	\$935,000	\$28,333		\$28,333
1	2010	\$906,667	\$28,333		\$28,333
2	2010	\$878,333	\$28,333		\$28,333
3	2010	\$850,000	\$28,333		\$28,333
4	2010	\$821,667	\$28,333		\$28,333
5	2010	\$793,333	\$28,333		\$28,333
6	2010	\$765,000	\$28,333		\$28,333
7	2010	\$736,667	\$28,333		\$28,333
8	2010	\$708,333	\$28,333		\$28,333
9	2010	\$680,000	\$28,333	Rates--Case 2 in effect	\$28,333
10	2010	\$651,667	\$28,333		\$28,333
11	2010	\$623,333	\$28,333		\$28,333
12	2010	\$595,000	\$28,333		\$28,333
1	2011	\$566,667	\$28,333		\$28,333
2	2011	\$538,333	\$28,333		\$28,333
3	2011	\$510,000	\$28,333		\$28,333
4	2011	\$481,667	\$28,333		\$28,333
5	2011	\$453,333	\$28,333		\$28,333
6	2011	\$425,000	\$28,333		\$28,333
7	2011	\$396,667	\$28,333		\$28,333
8	2011	\$368,333	\$28,333		\$28,333
9	2011	\$340,000	\$28,333		\$28,333
10	2011	\$311,667	\$28,333		\$28,333
11	2011	\$283,333	\$28,333		\$28,333
12	2011	\$255,000	\$28,333		\$28,333
1	2012	\$226,667	\$28,333		\$28,333
2	2012	\$198,333	\$28,333		\$28,333
3	2012	\$170,000	\$28,333		\$28,333
4	2012	\$141,667	\$28,333		\$28,333
5	2012	\$113,333	\$28,333		\$28,333
6	2012	\$85,000	\$28,333		\$28,333
7	2012	\$56,667	\$28,333		\$28,333
8	2012	\$28,333	\$28,333		\$28,333
9	2012	\$0			\$28,333
10	2012				\$28,333
11	2012			MGE Files Rate Case 3	\$28,333
12	2012				\$28,333
1	2013				\$28,333
2	2013				\$28,333
3	2013				\$28,333
4	2013				\$28,333
5	2013				\$28,333
6	2013				\$28,333
7	2013				\$28,333
8	2013				\$28,333
9	2013			Rates--Case 3 in effect	\$0
Total Amortized Per Books			\$1,700,000	Total Recovered in Rates	\$2,039,991