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Witness: Mark L. Oligschlaeger

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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

MISSOURI GAS ENERGY

A Division of Southern Union Company

CASE NO. GR-2009-0355

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REBUTTAL TESTIMONY OF
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1 Company witness Robert J. Hack that are supported by schedules attached to Mr. Noack's
2 direct testimony.

3 **KANSAS PROPERTY TAXES/AAO**

4 Q. Please summarize the history of this issue.

5 A. On July 13, 2009, MGE filed an Application before the Commission for an
6 Accounting Authority Order (AAO) for certain property tax expenses. This case is docketed as
7 Case No. GU-2010-0015. At page 3 of its Application, MGE described the reason why it sought
8 an AAO in that case:

9 6. In its 2009 session, the Kansas Legislature again enacted
10 legislation that permits Kansas counties to assess property taxes
11 against the value of natural gas held in storage in that county. The
12 legislation in question is known as House Substitute for
13 Senate Bill No. 98 (2009 Property Tax). This bill was signed into
14 law by the Kansas Governor on April 17, 2009... The legislation
15 was made retroactive to inventories held as of January 1, 2009...

16 8. Based upon the December 31, 2008 level of natural gas
17 held in storage by MGE in Meade County, Kansas and other
18 Kansas counties, MGE believes that it will pay property taxes
19 associated with this new Kansas tax in the amount of \$1,745,000,
20 in 2009.

21 On September 8, 2009, the Commission ordered that Case No. GU-2010-0015 be
22 consolidated with MGE's general rate proceeding, Case No. GR-2009-0355.

23 Q. What are the Staff's findings and recommendations concerning MGE's request
24 for an AAO in this case?

25 A. The Staff has determined that the initial imposition of a property tax by the
26 State of Kansas on MGE should be considered an extraordinary event as defined by this
27 Commission. This event has caused MGE to incur a cost that is significant and material to
28 its financial operations. The Staff also asserts that such circumstances warrant an AAO for the

1 amount of property taxes expensed on MGE's books related to Kansas property taxes on gas
2 in storage.

3 The Staff recommends that the Commission authorize MGE to defer the amount of
4 property tax expense associated with amounts assessed by Kansas taxing authorities on gas in
5 storage, and to begin to amortize to expense, over a 60-month period, any amount deferred
6 pursuant to this AAO beginning in the month following a final judicial resolution of the legality
7 of the Kansas tax. If a final resolution of the legality of the Kansas property taxes has not been
8 reached by the time MGE files its next general rate proceeding in Missouri, then the ratemaking
9 disposition of deferred property taxes can be considered in that case.

10 Q. Is the extraordinary nature of these costs related in any way to the fact that the
11 costs in question are in the nature of property taxes?

12 A. No. The first-time imposition of virtually any cost of any nature by an
13 outside regulatory body on a Missouri utility, if material, would likely qualify as an extraordinary
14 event under the Commission's current policy on AAOs.

15 Q. Is this the first time that the State of Kansas has attempted to assess property taxes
16 on MGE's gas in storage located in that jurisdiction?

17 A. No. At least twice before, the Kansas Legislature has passed laws allowing gas in
18 storage to be assessed for property tax purposes. However, in both instances, those laws were
19 ultimately overturned in the courts.

20 Q. What is the Commission's current position and policy on granting
21 AAOs in Missouri?

22 A. On November 10, 2004, the Commission issued its Report and Order on Remand
23 in Case No. WO-2002-273, Missouri-American Water Company. In this Order, the
24 Commission reaffirmed its longstanding policy on AAO standards of deferral.

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1 Q. How did the Commission describe AAOs in its Order on Remand in
2 Case No. WO-2002-273?

3 A. At pages 19 - 20 of this Order, the Commission described an AAO as:

4 ... an order of the Commission pursuant to Section 393.140(8)
5 authorizing an accounting treatment for a transaction or group of
6 transactions other than that prescribed by the USOA. It is an
7 accounting mechanism that has most often been used to permit
8 deferral of costs from one period to another. The immediate and
9 primary benefit of an AAO to the utility is that the deferred item is
10 booked as a regulatory asset rather than as an expense, thereby
11 improving the financial picture of the utility during the deferral
12 period. The regulatory asset is amortized over a prescribed interval
13 and a portion is recognized as an expense each month. A secondary
14 and more remote benefit of an AAO is that, during a subsequent
15 rate case, the Commission may permit recovery in rates of some
16 portion of the amount deferred. However, it is well-established that
17 the mere granting of an AAO does not guarantee recovery of any
18 amount of the deferral...

19 Q. Please describe the standards the Commission has applied in issuing
20 AAOs in the past.

21 A. The Commission first expressed its general position on standards for deferral of
22 costs incurred outside a rate case test year in its Report and Order in Case Nos. EO-91-358 and
23 EO-91-360, cases filed by Missouri Public Service (MPS), a division of UtiliCorp United, Inc.,
24 now KCP&L Greater Missouri Operations Company. This Order related to costs of rehabilitating
25 and upgrading MPS's Sibley Generation Station, and has subsequently been referred to by the
26 Commission as the "Sibley Order." In the Standards For Deferral section of the Sibley Order, the
27 Commission described certain requirements that must be met for it to allow the deferral as a
28 regulatory asset certain costs incurred outside of a rate case test year. These standards, for the
29 most part, hold that deferral treatment should only be granted to costs related to
30 "extraordinary items" or "extraordinary events." These requirements are founded, in part, on the
31 Federal Energy Regulatory Commission's (FERC) Uniform System of Accounts (USOA)

1 definition of and description of "extraordinary items" in General Instruction No.7 to the USOA for
2 natural gas companies.

3 The Commission's standards listed in the Sibley Order for determining whether a cost
4 should be allowed deferral treatment state that:

- 5 1. Extraordinary events are events that occur during a period
6 that are extraordinary, unusual and unique, and not
7 recurring;
- 8 2. Materiality of the cost is relevant to whether the event is
9 extraordinary, although not case dispositive;
- 10 3. The determination of whether or not a cost is extraordinary
11 will be made on a case-by-case basis.

12 Since issuing its Sibley Order, the Commission has consistently referred to the
13 deferral requirements of the Sibley Test as the basis for its decisions on granting or rejecting
14 deferral requests in AAO applications. In addition, in its most recent order setting forth general
15 policy on AAOs in Case No. WO-2002-273, the Commission reaffirmed the Sibley Test.
16 At pages 28 - 29 of the Order on Remand, the Commission stated:

17 In the Sibley decision, the Commission emphasized that it is the
18 extraordinary event that is the "primary focus" in any request for
19 an AAO, considered on a case-by-case basis: "The decision to
20 defer costs associated with an event turns on whether the event is
21 in fact extraordinary and nonrecurring." The Commission
22 emphasized that "[e]xtraordinary means unusual and nonrecurring."
23 Also relevant, but not dispositive, the Commission explained, is
24 "whether the event has a material or substantial effect on a utility's
25 earnings." Another relevant factor is the certainty of the event's
26 occurrence. "Utilities should not seek deferral of speculative events
27 since it is hard to determine whether an event is extraordinary or
28 material unless there is a high probability of its occurring within
29 the near future."

30 Q. How does FERC USOA define "extraordinary items?"

1 A. The FERC describes "extraordinary items" in General Instruction No.7 to the
2 USOA for natural gas companies as follows:

3 Those items related to the effects of events and transactions which
4 have occurred during the current period and which are not typical
5 or customary business activities of the company shall be
6 considered extraordinary items.

7 Accordingly, they will be events and transactions of significant
8 effect which would not be expected to recur frequently and which
9 would not be considered as recurring factors in any evaluation of
10 the ordinary operating processes of business ...

11 To be considered as extraordinary under the above guidelines, an
12 item should be more than approximately 5 percent of income,
13 computed before extraordinary items. Commission approval must
14 be obtained to treat an item of less than 5 percent, as extraordinary.

15 Q. Why should an item, event or cost have to be considered extraordinary before it
16 can be eligible for AAO treatment?

17 A. The ratemaking process is premised upon normality and regularity as the basis for
18 setting rates. Accounting and ratemaking rules and conventions generally reflect the ongoing and
19 normal changes to revenues, expenses and rate base that a utility will experience over time.
20 Only infrequently do extraordinary events occur which justify changes to normal
21 utility accounting and ratemaking practices and procedures.

22 Q. Please explain the reasons for the Staff's finding that the initial imposition of this
23 property tax by the State of Kansas meets the Commission's standards of deferral for AAOs.

24 A. MGE has been operating as a Missouri natural gas company since 1994 and has
25 never had to pay such a tax to the Kansas taxing authorities. The initial imposition of this tax by
26 the State of Kansas is an event that is unusual in nature and abnormal. In addition to meeting
27 the unusual in nature standard, the initial imposition of this tax on MGE by definition, meets the
28 infrequency of occurrence standard. If the courts decide for the State of Kansas, MGE will incur
29 these expenses on an annual basis and this cost will become a normal recurring cost that can be

1 handled in a normal manner in general rate proceedings. However, if the courts decide for MGE,
2 it is not likely that MGE will incur this cost on a recurring basis in the future. Given the history of
3 past efforts to impose this tax in the State of Kansas, it is at least reasonably likely that MGE will
4 not have to ultimately pay this tax, and the uncertainty of whether this tax will survive legal
5 challenge also makes this particular cost extraordinary, in the Staff's opinion.

6 Q. Will imposition of Kansas property taxes have a material impact on
7 MGE's earnings?

8 A. Yes. The latest estimate from MGE concerning its 2009 property tax assessment
9 from Kansas is that the Company will be billed approximately \$1.345 million, per Mr. Noack's
10 direct testimony filed in Case No. GU-2010-0015. This amount is approximately 6.0% of MGE's
11 adjusted 2008 net income, based upon the Staff's current revenue requirement calculation for
12 MGE in this case. The final amount of the Kansas property tax bill will not be known until later
13 this year. The Staff believes this cost will be material to MGE's annual income. The fact that this
14 cost is material to MGE, while not dispositive to the determination of whether it is associated with
15 an extraordinary event, does support such a determination.

16 Q. Has MGE received an AAO from the Commission for Kansas property taxes in
17 the past?

18 A. Yes, in Case No. GU-2005-0095. The facts and circumstances facing MGE in that
19 case regarding Kansas property taxes assessed on its gas in storage holdings were highly similar to
20 MGE's situation in this proceeding. In that case, the Commission agreed that the costs of the
21 property taxes assessed upon MGE at that time by Kansas were associated with an
22 extraordinary event, and allowed the Company to defer such costs. MGE's property tax deferral
23 was later written off without ever being included in rates for Missouri customers since the
24 governing law in Kansas was subsequently overturned in the courts.

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1 Q. Will granting MGE's request for an AAO in this proceeding benefit
2 Missouri ratepayers?

3 A. Yes, in the Staff's opinion. In the previous attempts by the State of Kansas
4 to assess property taxes on gas in storage, MGE actively participated in efforts to challenge the
5 new laws before state taxing authorities and in the court system. Currently, if the Commission
6 were to authorize an AAO for MGE to defer Kansas property taxes on gas in storage, the
7 Company would be held harmless from charges against earnings related to this tax during the
8 course of its challenges to the tax. With an AAO, MGE has a strong incentive to take
9 reasonable actions to challenge this new tax. If MGE and other involved parties are again
10 successful in overturning the new Kansas property taxes, Missouri customers will benefit through
11 lower rate levels.

12 Q. Does MGE intend to challenge the 2009 Kansas law in the courts?

13 A. Yes, in conjunction with other interested parties.

14 Q. Will MGE have to pay property taxes to the State of Kansas while the 2009 Law is
15 under court challenge?

16 A. The Staff's current understanding is no. However, MGE has been required to
17 accrue the new Kansas property taxes on its books in 2009, and thus has taken a charge against
18 earnings in 2009, and will continue to accrue expense for the new tax as long as the law is in
19 effect, whether the taxes are actually paid or not.

20 Q. Please summarize the Staff's recommendation regarding MGE's request for
21 AAO deferral treatment in this case.

22 A. The Staff believes that the new tax being imposed on MGE by the State of Kansas
23 is extraordinary and material and meets the standards of deferral established by the Commission.
24 Therefore, the Staff recommends that the Commission approve MGE's request for an AAO in this

1 case. The Staff further recommends that the Commission, in its order, direct MGE to begin to
2 defer only the amount of property tax expense associated with assessments from Kansas taxing
3 authorities and order MGE to begin to amortize this regulatory asset, over a 60-month period,
4 beginning the month following a final judicial resolution of the legality of the Kansas tax. If MGE
5 files its next general rate case prior to final judicial resolution of the legality of the Kansas tax,
6 then ratemaking treatment of the deferred costs will be considered in that proceeding.

7 Finally, the Staff recommends that the Commission include language in its Order stating
8 that granting this AAO does not in any way control how the Commission will treat this deferral
9 for ratemaking purposes in subsequent rate cases.

10 **BAD DEBTS/TRACKER**

11 Q. What issue are you addressing in this testimony concerning bad debt expense?

12 A. On pages 14-15 of his direct testimony in Case No. GR-2009-0355,
13 Company witness Noack suggests an alternative ratemaking treatment of MGE's bad debt
14 expense that would treat the portion of the Company's uncollectibles allegedly attributable to its
15 gas costs through a "tracking mechanism." This proposal is a companion piece to Mr. Noack's
16 suggestion that the gas cost portion of MGE's bad debt expense be handled through the
17 Company's Purchased Gas Adjustment (PGA) mechanism. Staff witness David M. Sommerer of
18 the Procurement Analysis Department will be addressing Mr. Noack's proposal for flowing
19 bad debts through the PGA Mechanism in his rebuttal testimony.

20 Q. What is a "tracking mechanism?"

21 A. A "tracking mechanism," or "tracker," is a ratemaking approach that allows a
22 utility to set its financial statement expense for a particular item equal to the ratemaking allowance
23 for that item established in its most recent rate proceeding. Any difference between the

1 utility's actual incurred expense level for that item compared to the amount of its rate recovery
2 allowance is booked to a regulatory asset account (if the incurred expense amount exceeds the
3 rate allowance amount) or a regulatory liability account (if the rate allowance is greater than the
4 incurred expense). The amount booked to the regulatory asset or regulatory liability is then
5 eligible to be charged to customers or flowed back to customers through an amortization,
6 depending upon the circumstances, in the utility's next general rate proceeding. In essence, use
7 of a tracking mechanism will "true-up" a utility's rate recovery of a particular cost to its
8 actual expense level over time.

9 Q. Is the Staff opposed to use of tracking mechanisms to set rates?

10 A. In most circumstances, yes. A utility's rates are set to provide it with a
11 reasonable opportunity to recover its total cost of service. Just because a utility may
12 under-recover in rates one element of its cost of service does not mean it is not over-recovering
13 another revenue requirement element, and hence the utility may still be earning an
14 adequate return. For this reason, selectively truing up certain cost of service element's rate
15 recovery to actual costs, but not others, is very likely to lead to inappropriate ratemaking results.
16 For this reason, the Staff believes tracker mechanisms should be ordered by the Commission
17 sparingly, if at all.

18 Q. Under what circumstances should use of tracking mechanisms be considered?

19 A. In this jurisdiction, tracking mechanisms have generally been limited to certain
20 costs whose rate recovery has special cash flow implications to the utility, or to costs that are
21 ordered or mandated by the regulator.

22 In the first category of costs are pensions and post-retirement benefits. (Post-retirement
23 benefits are also known as "Other Post Employment Benefits" or "OPEBs"). These are
24 costs that, once recovered in rates, under law should be placed by the utility in an external

1 trust fund mechanism. Once monies are placed in external trust funds, it is very difficult or
2 impossible for utilities to remove funds from the trusts prior to payment to the ultimate pension
3 and OPEB beneficiaries. Under current accounting requirements, pension and OPEB expenses
4 can be either positive or negative. (A negative expense generally means that the annual return on
5 funds already invested in the trust exceed the additional cost for pensions or OPEBs incurred by a
6 utility in a given year.) For that reason, when these expenses turn negative (as was the case during
7 much of the 1990s for pension expense), and the negative expense was reflected in the ratemaking
8 process, this phenomenon meant less cash recovery from ratepayers in rates, and in turn meant a
9 potential cash flow detriment to the company because it could not take funds out of the
10 trust mechanism to offset the reduced cash flow in rates. For this reason, within the last ten years
11 the Staff had advocated, and the Commission has accepted, use of tracking mechanisms to set
12 rates for pensions and OPEBs expenses for most large Missouri utilities, in order to ensure that
13 utilities do not experience serious cash flow detriments due to fluctuations in their rate recovery of
14 pension and OPEB costs.

15 The second category of costs frequently provided tracker treatment is costs imposed upon
16 utilities by rule or mandate by the Commission. It is my understanding that courts have generally
17 held that when the Commission imposes costs upon a utility, the Commission has an obligation to
18 allow timely recovery of those costs in rates. In several instances, the Commission has allowed
19 such costs recovery through use of tracker mechanisms.

20 Q. Do bad debts belong to either category of cost that has been typically afforded
21 tracker treatment in Missouri?

22 A. No. Bad debts do not create special cash flow difficulties for utilities, as pensions
23 and OPEBs rate recovery has the potential to do. They also (generally) do not result from specific
24 Commission mandates or rules. To cover even a portion of bad debts under a tracking mechanism

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1 would amount to a significant and in the Staff's opinion, unwarranted expansion of the use of
2 trackers in this jurisdiction.

3 Q. Why is it inappropriate to allow bad debts to be recovered in rates through a
4 tracker mechanism?

5 A. Bad debts are a normal and ongoing cost to all companies in all utility industries.
6 There is no reason to provide these costs different treatment than other normal incurred expenses.
7 Fluctuations in a company's bad debt levels can be offset by changes to other aspects of a utility's
8 revenue requirement, and it would therefore be inequitable to guarantee utilities recovery of even
9 a portion of their bad debt expenses through use of a tracker without analysis of all relevant
10 factors affecting the company's overall earnings.

11 Q. Can a utility's bad debt costs be reasonably associated with the gas cost portion of
12 a customer's bill?

13 A. The Staff believes not. This point is addressed in the rebuttal testimony of
14 Staff witness Sommerer.

15 **FAS 106/OPEBS**

16 Q. What aspect of the Company's request for recovery of OPEBs are you going to
17 address in this testimony?

18 A. At page 11 of Mr. Noack's direct testimony, he states that the Company is
19 including an amount in this case for OPEBs as calculated under Financial Accounting Standard
20 No. 106 (FAS 106), *Employers' Accounting for Postretirement Benefits Other Than Pensions*.
21 Post-retirement benefits/OPEBs usually consist of medical benefits offered to a
22 utility's employees after their retirement.

1 I will explain in this testimony that recovery of OPEBs on a FAS 106 expense is
2 inappropriate as long as MGE refuses to place all of its OPEBs rate recovery monies in an
3 external trust mechanism.

4 Q. Please explain FAS 106.

5 A. FAS 106 is the Financial Accounting Standards Board (FASB) approved accrual
6 accounting method used for financial statement recognition of annual OPEBs costs over the
7 estimated service life of employees.

8 Q. When was the accrual accounting method for OPEBs costs, FAS 106, adopted by
9 the Commission for ratemaking purposes?

10 A. House Bill 1405 (Section 386.315, RSMo), approved by the Missouri Legislature
11 in 1994, required the adoption of FAS 106 for setting rates for OPEB costs. In Commission cases
12 following the date that House Bill 1405 became law, the Commission used FAS 106 to determine
13 ratemaking recovery of OPEB costs.

14 Q. What method was used for setting rates for OPEB costs prior to the effective date
15 of Section 386.315?

16 A. Prior to the effective date of Section 386.315, rates were set on a "pay-as-you-go"
17 or cash basis for OPEB costs. The utility's actual paid claims for OPEBs for current retirees were
18 included in rate recovery.

19 Q. When was FAS 106 adopted for ratemaking purposes by MGE?

20 A. FAS 106 was adopted by MGE in Case No. GR-96-285.

21 Q. Does Section 386.315 include a funding requirement as a prerequisite for the
22 adoption of FAS 106 for ratemaking purposes?

23 A. Yes. A copy of Section 386.315 is attached as Schedule 1 to my rebuttal
24 testimony. The recognition of FAS 106 for ratemaking purposes is conditioned on a requirement

1 that annual FAS 106 costs collected in rates be placed in a separate external funding mechanism to
2 be used solely for the payment of OPEB benefit costs to retirees. Paragraph 2 of Section 386.315
3 addresses the funding requirement:

- 4 2. A public utility which uses Financial Accounting Standard 106
5 shall be required to use an independent external funding
6 mechanism that restricts disbursements only for qualified
7 retiree benefits. In no event shall any funds remaining in such
8 funding mechanisms revert to the utility after all qualified
9 benefits have been paid; rather, the funding mechanism shall
10 include terms which require all funds to be used for employee
11 or retiree benefits...

12 Q. Is MGE currently in compliance with funding requirement for OPEBs under
13 Section 386.315?

14 A. No, and according to the Staff's analysis MGE has not been in compliance since at
15 least mid-year 2003. This is discussed in further detail in Section VII.C.4 of the Staff's Cost of
16 Service Report at pages 93-95 filed in this proceeding on August 21, 2009.

17 Q. Why should utilities place recoveries in rates of FAS 106 expense in an
18 external trust fund mechanism?

19 A. FAS 106 provides for accrual accounting for companies' OPEB costs. That is,
20 FAS 106 requires that companies recognize as a current expense on their income statement its
21 obligation to provide post-retirement benefits to their employees at some point in the future,
22 perhaps 20 or 30 years. If a regulated utility has its rates set on a FAS 106 measurement of
23 OPEBs, then that company will receive the current benefit of upfront cash recovery of a cost it
24 may not have to pay out until many years in the future. In that circumstance, without an
25 external funding requirement, utilities will likely utilize their OPEB cash rate recoveries for more
26 immediate, near-term uses, and such funds may or may not be available for their intended purpose
27 when the utility's retirees actually are due payment of their OPEB benefits.

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1 Q. Is ratemaking for OPEBs in Missouri similar to that afforded for pensions?

2 A. Yes. Both expense items are collected in rates by utilities years in advance of
3 when they are due to be paid to their ultimate beneficiaries, the Company's retirees. Both items
4 are also required by federal or state law to be externally funded by utilities; to ensure that
5 collection of monies from ratepayers are used for their intended purpose and are available to
6 retirees when due.

7 Q. How does the Staff propose that MGE remedy its current long-term failure to
8 externally fund its FAS 106 OPEB rate collections?

9 A. As discussed in the Cost of Service Report, the Staff's position is that MGE should
10 make an immediate shareholder-funded contribution in the amount of approximately \$16.5 million
11 to its Voluntary Employment Benefit Association (VEBA) trust funds in order to fully fund its
12 prior FAS 106 OPEB rate collections from customers.

13 Q. What is the Staff's recommendation in the event MGE does not make the necessary
14 contributions to its OPEBs trust funds?

15 A. In that event, the Staff will consider filing a complaint based on MGE's failure to
16 comply with 386.315 and fully fund its OPEBs rate collections.

17 Q. What is the Staff's recommendation in this case for OPEBs rate recovery by MGE?

18 A. Consistent with its current policy for major utilities in this State, the
19 Staff recommends that MGE recover its current OPEB costs on a FAS 106 basis. However, that
20 recommendation is contingent upon MGE fully funding all prospective FAS 106 rate recoveries,
21 and making a "catch-up" shareholder contribution to its trust funds to account for all amounts that
22 should have been externally funded by MGE in the past. Without MGE's commitment to take
23 those actions, the Staff recommends that MGE be placed on a "pay-as-you-go" treatment for its
24 OPEB costs. However, placing MGE on a prospective "pay-as-you-go" ratemaking basis

1 does not remedy its past over-collections of OPEBs costs from customers on a FAS 106 basis.
2 To appropriately address these over-collections, either MGE should make a refund to customers
3 to return to them past FAS 106 rate recoveries that were not funded or, alternatively,
4 MGE's current OPEBs expense should be set at zero in this and future cases until its current
5 over-collected FAS 106 amount, plus interest, has been used in entirety for payment of
6 "pay-as-you-go" OPEB retiree payments.

7 **POLICY**

8 Q. Please summarize Mr. Hack's testimony on policy matters.

9 A. In his direct testimony, Mr. Hack makes a claim that MGE is currently providing
10 its customers with high quality service at very reasonable prices. However, he also criticizes the
11 general approach utilized by the Commission in the past to set rates for MGE, on the grounds that
12 this approach has impaired the Company's ability to earn its authorized rate of return.

13 Q. What does Mr. Hack present in his direct testimony to justify his claim that
14 MGE provides utility service on a very cost effective basis?

15 A. Mr. Hack provides analyses that purport to compare MGE's performance in the
16 areas of operation and maintenance (O&M) expense per customer for the years 1998-2007 to
17 other Missouri local distribution companies (LDCs), and MGE's current annual residential rate
18 level per customer to other Missouri LDCs. Both the comparative O&M and rate analyses
19 reflected in Mr. Hack's direct testimony are based upon work actually performed by
20 Company witness Noack, and reflected in Schedule G to Mr. Noack's direct and updated test year
21 direct testimony filed in this proceeding.

22 Q. What conclusion has the Staff reached concerning MGE's claims that its
23 residential customer rate levels are lower than other Missouri LDCs?

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1 A. The Staff does not dispute that MGE's current residential rate levels are currently
2 lower than the other Missouri LDCs considered in MGE's analysis. However, Mr. Hack does not
3 directly address what the impact of MGE's current rate increase request would be on these
4 comparative rate levels.

5 Q. What would be the impact of MGE's current rate request on its comparative
6 rate levels?

7 A. The Staff believes that if the Commission were to grant the full amount of
8 MGE's rate request in this case, then MGE would have slightly lower residential rates than
9 Laclede Gas Company (Laclede), the most comparable LDC depicted in Mr. Hack's testimony.
10 In addition, MGE would then have higher residential rates than Empire Gas' current rates (though
11 Empire Gas is also seeking a rate increase currently before the Commission). In other words,
12 MGE is effectively seeking to eliminate in this rate increase case most of the comparative rate
13 advantage it otherwise touts as evidence of its superior management efficiency.

14 Q. Do you agree with Mr. Hack's conclusion that MGE's O&M expenses are lower
15 than Laclede's, AmerenUE's and Empire Gas' (Empire) gas O&M expenses, when measured on
16 a per customer basis?

17 A. I do not disagree with the data shown at page 10 of Mr. Hack's direct testimony.
18 However, one must be cautious when making direct cost comparisons between different utilities.
19 Each utility faces unique circumstances that may cause different cost levels from other
20 regional utilities of its type. For example, both AmerenUE and Empire have been primarily
21 electric utilities in Missouri, with their natural gas operations being a relatively small percentage
22 of their total business in this state. This fact alone may make direct historic gas O&M
23 cost comparisons between AmerenUE and Empire on one hand, and MGE (a 100% gas utility) on
24 the other, not particularly meaningful.

1 Laclede is on the surface more like MGE than AmerenUE or Empire, in that both are
2 entirely gas utilities that serve, among other areas, Missouri's two largest cities. Even in this case,
3 however, there may be significant differences between Laclede's service territory and MGE's
4 that may cause differences in comparative cost levels. MGE has not performed the detailed
5 analysis of Laclede and MGE necessary to determine whether the two companies are
6 truly comparable enough to justify MGE's conclusions regarding its cost levels compared
7 to Laclede's.

8 Q. Mr. Hack states in his testimony at page 14, that MGE "has consistently failed to
9 earn its authorized rate of return." What is the basis for this statement?

10 A. This statement appears to be based upon an analysis performed by Mr. Noack.
11 Mr. Noack attached a copy of this analysis to his direct testimony as Schedule G-4.

12 Q. What is the nature of Mr. Noack's rate of return analysis?

13 A. Mr. Noack takes the per book revenue and expense numbers for MGE for its
14 fiscal years ending in June 1996 through December 2008, and compares the resulting net operating
15 income amounts to the last rate base amount reflected in its rates, updated for the change in
16 net plant in service (gross plant in service, less depreciation reserve) since the time of its last
17 rate proceeding. The resulting earned rate of returns demonstrate, according to Mr. Hack, that
18 MGE has consistently failed to earn its authorized rate of return over the time period examined.

19 Q. Do you have any concerns with how Mr. Noack conducted his analysis shown on
20 his Schedule G-4?

21 A. Yes, the Staff has several concerns with Mr. Noack's approach to this analysis.

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1 Q. What is your first concern with Mr. Noack's analysis?

2 A. One problem in how this analysis is presented is that Mr. Noack compares
3 net operating income (NOI) amounts derived from a 12-month period to an "end-of-period"
4 rate base amount. Such a methodology will always understate the earned rate of return because
5 the calculation in effect assumes that a company is underearning if the company has not earned
6 12 months of return on investment that has actually been in service less than 12 months.
7 Calculation of an accurate earnings number for a 12-month period should require a comparison of
8 12 months of net operating income to an average rate base for the 12-month period examined.
9 Conversely, if one desires to use an end-of-period rate base to compare to NOI, then one should
10 adjust the revenues and expenses to an end-of-period perspective.

11 As long as rate base is increasing over time (which is true of MGE), comparison of
12 12 months of NOI to an end-of-period rate base will only serve to mathematically understate the
13 true earned rate of return of the utility.

14 Q. Do you have any other concerns with MGE's earnings analysis?

15 A. Yes. As previously mentioned, Mr. Noack simulates the growth in
16 MGE's rate base over time by inputting in his analysis the increase in net plant since the time of
17 MGE's last rate proceeding in determining each fiscal year's earnings result for the Company.

18 Q. Is this an appropriate method to simulate MGE's growth in rate base over time?

19 A. No. The Staff acknowledges that the trend of increase or decrease in net plant
20 over time usually will be the primary driver of the increase or decrease over time in total rate base.
21 However, Mr. Noack's approach totally ignores an offset to rate base that almost always serves to
22 reduce rate base over time: deferred income taxes. While this item is smaller in value than
23 net plant in utility rate base, it is still a significant and material rate base item, and for almost
24 all utilities the balance of deferred income taxes grows larger over time. For a more

1 valid simulated rate base calculation, MGE should have offset the increase over time in deferred
2 income taxes against the increase in net plant shown on Noack Schedule G-4.

3 Q. How has MGE's deferred income tax balance changed since the mid-1990s?

4 A. In MGE's first Missouri rate case, Case No. GR-96-285, the deferred tax offset
5 balance in rate base was valued at approximately \$9 million. In the current rate proceeding,
6 MGE's deferred tax offset is valued by the Staff at approximately \$92.5 million. None of the
7 growth to this rate base offset over time has been reflected in Mr. Noack's earnings analysis.
8 To reiterate, growth in the Company's deferred income tax balance over time serves to reduce its
9 revenue requirement, all other things being equal.

10 Q. What is your final concern with Mr. Noack's earnings analysis?

11 A. On Schedule G-4, page 1 of 2 attached to his direct testimony, a footnote indicates
12 that Mr. Noack adjusted MGE's calendar year 2005 earnings by eliminating the impact of
13 certain sizeable property tax refunds MGE received in that year. At page 23 of his
14 direct testimony, Mr. Noack states that the refunds were eliminated from his calculation
15 because they were "non-recurring."

16 Q. Do you agree with Mr. Noack's elimination of any consideration of
17 MGE's property tax refunds from his historical earnings analysis?

18 A. No, because Mr. Noack did not appear to eliminate the impact of the higher
19 property tax payments in previous years that gave rise to the 2005 refunds in his analysis. By
20 including the excessive property tax expense amounts in previous years' financial results, but
21 excluding the later refund of those property taxes, Mr. Noack has overstated MGE's overall
22 earnings deficiency for those years.

1 Q. If the Staff's concerns on Mr. Noack's Schedule G-4 were to be corrected,
2 what would be the impact on MGE's earnings analysis?

3 A. All of these corrections (use of an "average period" rate base, offsetting of deferred
4 taxes against net plant, consistent treatment of property taxes and refunds) would have the effect
5 of increasing MGE's calculated historical earnings levels shown on Noack Schedule G-4.

6 Q. What is Mr. Hack's overall conclusion related to the information contained in
7 Noack Schedule G?

8 A. Mr. Hack appears to be characterizing the Missouri ratemaking process as being
9 flawed and unfair in not allowing MGE an adequate opportunity to earn a reasonable
10 rate of return. This, in turn, has required MGE to file rate cases more often than MGE prefers.

11 Q. What is Mr. Hack's remedy for this situation?

12 A. Mr. Hack's proposed solution to this alleged problem appears to be to allow the
13 Company more access to single-issue rate approaches outside the context of general
14 rate proceedings, so that the Company can potentially increase its rates to cover certain
15 increasing costs without submitting to an "all relevant factors" review of its revenue requirement.
16 In their direct testimony, both Mr. Hack and Mr. Noack point to items such as bad debt expense
17 and environmental remediation costs as being suitable for special single-issue treatment of
18 various sorts.

19 Q. Does the Staff believe MGE's complaints as to the current Missouri
20 ratemaking process have any validity?

21 A. No. In Missouri, the traditional ratemaking process gives a utility an opportunity
22 to recover its costs and earn a reasonable return on its investment. To the extent a utility's costs
23 increase above the level upon which rates were set, all other things being equal, the
24 utility's earnings will then decline. If the decline in earnings were significant enough, the

1 utility would be expected to file for rate relief to have the opportunity to restore its earnings to a
2 reasonable level. The Staff continues to believe that general rate proceedings are the best
3 mechanism to determine whether a utility's rate levels are excessive, adequate or insufficient; and
4 that single-issue ratemaking measures are inappropriate in most circumstances.

5 Q. Has MGE and other Missouri utilities had increased opportunities in recent years
6 to benefit from single-issue rate practices?

7 A. Yes. By statute, the Missouri Legislature approved use of an Infrastructure System
8 Replacement Surcharge (ISRS) mechanism under certain circumstances. The ISRS mechanism
9 has allowed MGE and other gas utilities to receive single-issue rate increases related to
10 certain categories of plant in service additions. Since 2004, MGE has also received the benefit of
11 use of a tracker mechanism for its pension expenses, which serves over time to synchronize a
12 utility's incurred level of costs for pension expense with its rate recovery of that item.
13 As explained in the Staff's Cost of Service Report, the Staff is willing to consider extending
14 tracker mechanism treatment to MGE's OPEB costs under the condition that the utility fully fund
15 its past and ongoing rate recoveries of this expense as calculated under FAS 106.

16 Q. Mr. Hack suggests at page 21 of his direct testimony that ideally a utility such as
17 MGE should not have to file for rate relief more often than twice a decade. Do you agree?

18 A. Again, a utility's ability to control its costs is key to its decisions regarding
19 rate case timing. However, it is interesting to note that MGE and other utilities that currently
20 take advantage of ISRS rate increases are required by law to file general rate cases every
21 three years (or forfeit their ISRS rate recovery amounts), so under current law MGE presumably
22 would not choose to file rate cases as infrequently as twice a decade as long as it seeks
23 ISRS rate increases, even if the Commission were to "reform" its rate policies in the direction that
24 MGE advocates. In fact, the Staff believes the current three-year rate case filing requirement tied

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1 to the ISRS rate increase provisions is justified, in that use of single-issue ratemaking practices
2 makes it more important, not less important, to periodically review a utility's rate levels for
3 reasonableness. Use of single-issue rate practices increase the chance that a company's overall
4 rate levels are set inappropriately when rates can be adjusted for fluctuations in individual
5 revenue requirement components without review of all relevant factors.

6 Q. Please summarize your testimony concerning MGE's policy statements contained
7 within Mr. Hack's testimony.

8 A. MGE appears to dislike having to file general rate proceedings in order to change
9 its rates when it experiences increases in its cost of service. The Staff believes that, as costly
10 and time-consuming as the general rate case process arguably may be, it is far superior to the
11 alternative of allowing utilities to increase rates on a selective basis without a review of all
12 relevant factors affecting its revenue requirement.

13 Q. Does this conclude your rebuttal testimony?

14 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy and Its)
Tariff Filing to Implement a General Rate)
Increase for Natural Gas Service)
)

Case No. GR-2009-0355

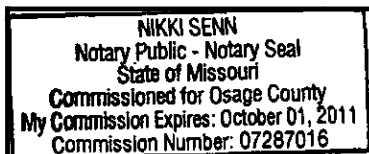
AFFIDAVIT OF MARK L. OLIGSCHLAEGER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Mark L. Oligschlaeger, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 23 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Mark L. Oligschlaeger
Mark L. Oligschlaeger

Subscribed and sworn to before me this 28th day of September, 2009.



Nikki Senn
Notary Public

Missouri Revised Statutes

Chapter 386 Public Service Commission Section 386.315

August 28, 2008

Commission shall not change terms of employment subject to collective bargaining or certain accounting standards--use of accounting standard by utility, requirements--tariff filing allowed, conditions--examination of tariffs, review period.

386.315. 1. In establishing public utility rates, the commission shall not reduce or otherwise change any wage rate, benefit, working condition, or other term or condition of employment that is the subject of a collective bargaining agreement between the public utility and a labor organization. Additionally, the commission shall not disallow or refuse to recognize the actual level of expenses the utility is required by Financial Accounting Standard 106 to record for postretirement employee benefits for all the utility's employees, including retirees, if the assumptions and estimates used by a public utility in determining the Financial Accounting Standard 106 expenses have been reviewed and approved by the commission, and such review and approval shall be based on sound actuarial principles.

2. A public utility which uses Financial Accounting Standard 106 shall be required to use an independent external funding mechanism that restricts disbursements only for qualified retiree benefits. In no event shall any funds remaining in such funding mechanism revert to the utility after all qualified benefits have been paid; rather, the funding mechanism shall include terms which require all funds to be used for employee or retiree benefits. This section shall not in any manner be construed to limit the authority of the commission to set rates for any service rendered or to be rendered that are just and reasonable pursuant to sections 392.240, 393.140 and 393.150, RSMo.

3. Any public utility which was the subject of a rate proceeding resulting in the issuance of a report and order subsequent to January 1, 1993, and prior to August 28, 1994, directing or permitting the establishment of new rates by such utility, may file one set of tariffs modifying its rates to reflect the revenue requirement associated with the utility's expenses for postretirement employee benefits other than pensions, as determined by Financial Accounting Standard 106, including the utility's transition benefit obligation, regardless of whether the deferral or immediate expense recognition method was used, if such utility is funding the full extent of its Financial Accounting Standard 106 obligation at the time such tariffs are filed. The tariffs shall reflect the annual level of expenses as determined in accordance with Financial Accounting Standard 106. The commission may suspend such tariffs for no longer than one hundred fifty days to examine the assumptions and estimates used and to review and approve the expenses required by Financial Accounting Standard 106, including an amortization of the transition benefit obligation over no greater amortization period than twenty years based upon sound actuarial principles, and to address any rate design issues associated with the utility's Financial Accounting Standard 106-based revenue requirement. The commission shall not examine any other revenue requirement issues.

(L. 1993 S.B. 289, A.L. 1994 H.B. 1405)