REBUTTAL TESTIMONY
OF
TED ROBERTSON

MISSOURI GAS ENERGY
CASE NO. GR-2006-0422

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Ted Robertson, P. O. Box 2230, Jefferson City, Missouri 65102.

Q. ARE YOU THE SAME TED ROBERTSON THAT HAS PREVIOUSLY FILED DIRECT TESTIMONY IN THIS CASE?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of this rebuttal testimony is to address the Public Counsel's positions regarding the determination of an appropriate level of costs associated with Missouri Gas Energy's ("MGE" or "Company") Safety Line Replacement Program ("SLRP") Accounting Authority Order ("AAO") Costs, Former Manufactured Gas Plant Remediation ("FMGP"), Infinium Software Amortization, Oklahoma Property Tax, Uncollectible Expense, and Uncollectible Expense/PGA Recovery.

II. SAFETY LINE REPLACEMENT PROGRAM AAO COSTS

Q. WHAT IS THE ISSUE?

A. The issue concerns the determination of the appropriate level of safety line replacement program deferred costs to include in Company's new rates.

Q. WHAT ARE THE COSTS THAT THE COMPANY IS PROPOSING?

A. Pursuant to Commission decisions in Accounting Authority Order ("AAO") Case Nos. GO-92-185 (2nd Order), Case No. GO-94-234 (3rd Order), Case No. GO-97-301 (4th Order), and the general rate increase cases GR-98-140 (5th Order) and GR-2001-292 (6th Order), Company was authorized to defer carrying costs, property tax expense, and depreciation expense on investments related to its safety line replacement program during the period from when the plant is initially placed in service until its cost is included in rates. In order to recover the deferred costs, Company has calculated a net SLRP deferral of $10,753,310 which it has included as an addition to rate base (source: Company Schedule B-1 attached to the updated direct testimony of Michael R. Noack). Company also proposes that the costs deferred be amortized to expense over a period of ten years (i.e., $3,204,805 annually) to USOA Accounts 404/405 (source: Schedule B-1 and Schedule H-13 of Mr. Noack's updated direct testimony).

Q. DOES THE PUBLIC COUNSEL OPPOSE THE COMPANY'S REQUEST?

A. Yes, in part. Public Counsel opposes the Company's request for rate base recovery treatment of the AAO unamortized deferred balances.

Q. DIDN'T THE COMMISSION RENDER A DECISION THAT ORDERED A TEN YEAR AMORTIZATION OF COSTS DEFERRED PURSUANT TO THE COMPANY'S SAFETY REPLACEMENT PROGRAM ACCOUNTING AUTHORITY ORDERS?

A. Yes, in Missouri Gas Energy, Case No. GR-98-140, the Commission approved a ten year amortization of the deferred balances associated with the Company's gas service line replacement program. The Commission also ordered that the deferred costs balances would not be included in the determination of the Company's rate base and that the deferred income taxes related to the SLRP would be included as a reduction to rate base.

Q. IS THE MGE CASE NO. GR-98-140 REPORT AND ORDER THE SUPPORT RELIED UPON BY PUBLIC COUNSEL TO OPPOSE THE COMPANY'S REQUEST FOR RATE BASE TREATMENT OF THE UNAMORTIZED DEFERRED BALANCES?

A. Yes. Public Counsel has calculated the recovery of the unamortized SLRP balances pursuant to the Commission's Order in MGE Case No. GR-98-140. In that Order, the Commission determined that guaranteeing the Company a "return of" and "return on" the unamortized SLRP deferral is not a fair allocation of regulatory lag resulting from the ongoing construction project. In complying with that Commission decision, Public

Counsel has not adjusted the Company's rate base so that it can earn a "return on" the current unamortized SLRP balances.

Q. DOES PUBLIC COUNSEL BELIEVE THAT THE COMMISSION'S ORDER IN MGE CASE NO. GR-98-140 WAS A REASONABLE RESOLUTION TO THE ISSUE?

A. Public Counsel believes that the Commission's Order in Case No. GR-98-140 regarding this issue was a fair and equitable allocation of the risk and costs associated with the SLRP projects. While we continue to believe that an amortization period of 20 years or longer is more appropriate, we are firmly committed to and in agreement with the Commission's decision to disallow any addition to rate base of the unamortized SLRP deferral. This view is based on the fact that OPC believes management is responsible for planning and operating the activities of the Company. If management is unable to or chooses not to implement processes and procedures which would limit the effect of regulatory lag on the its finances, the Company should not be protected by the Commission with an effective guarantee of earnings. Therefore, in order that ratepayers and shareholders both share in the effect of regulatory lag, the Public Counsel is recommending that Company be allowed to earn a "return of" the SLRP deferred balance, but not a "return on" the SLRP deferred balance.

Q. WHY WAS THE SLRP CONSTRUCTION IMPLEMENTED?

A. It's my understanding, in the late 1980's, a series of natural gas explosions occurred in Missouri. Some of them in western Missouri. People were killed, others were injured and

substantial property damage resulted. Because the Commission regulates the safety of natural gas providers in Missouri, it was heavily involved in the investigation of these matters. Largely as a result of these occurrences, the ensuing investigation and the companies obvious shortcomings regarding their responsibility for oversight and replacement of dangerous aging gas systems, the Commission in 1989 promulgated the extensive gas safety rules now found in Chapter 40 of the Commission's rules. A part of these gas safety rules requires the change out of service lines and mains within certain time frames according to various factors which include age and construction material.

Q. SHOULD MANAGEMENT AND SHAREHOLDERS OF THE COMPANY ALSO SHARE IN SOME OF THE FINANCIAL RISK ASSOCIATED WITH SLRP CONSTRUCTION?

A. Yes. The management and shareholders (as owners) are the primary persons responsible for the safe operation of the Company. It is their responsibility to survey the adequacy and safety of the entire system at all times. Management is responsible for the identification, selection, installation and operation of the gas transfer system because only the Company has the knowledge and resources to continually access and monitor the reliability and safety of the system. It is their responsibility to know whether or not the gas transfer system is operating as designed; however, defective and/or dangerous gas transfer situations have occurred on their watch (i.e., explosions) and such events tend to reinforce the Public Counsel's belief that management did not take those responsibilities seriously enough. Rather than update the gas transfer system over the years as needed, management chose

instead to ignore the problems until the Commission was forced to address the issue for the protection of consumers.

Q. WHAT IS THE ACTUAL PURPOSE FOR THE COMPANY'S SERVICE LINE REPLACEMENT PROGRAM ACCOUNTING AUTHORITY ORDERS?

A. The Commission's authorization of AAO treatment for the Company's SLRP insulates MGE shareholders from some of the risks associated with regulatory lag that occurs if the SLRP construction projects are completed, and placed in service, before the operational law date of a general rate increase case.

Q. HAS THE COMMISSION RULED THAT IT IS NOT REASONABLE TO PROVIDE REGULATORY LAG PROTECTION TO SHAREHOLDERS?

A. Yes. Public Counsel is aware of at least two cases where the Commission has stated that it will not violate the cost of service rules and procedures in order to protect a utility from the effects of regulatory lag. Beginning on page nineteen of the Commission's Report and Order in Missouri Gas Energy, Case No. GR-98-140, it states:

> The Commission finds that the unamortized balance of SLRP deferrals should not be included in the rate base for MGE. The AAOs issued by the Commission authorize the Company to book and defer the amount requested but do not approve any ratemaking treatment of amounts from the deferred and booked balances. AAOs are not intended to eliminate regulatory lag but are intended to mitigate the cost incurred by the Company because of regulatory lag. Given that the Company will recover the amortized amount of the SLRP deferral at the AFUDC rate in ten years, instead of the previous 20 years' amortization period, it is proper for the ratepayers and shareholders to share the effect of

> regulatory lag by allowing the Company to earn a return of the SLRP deferred balance but not a return on the SLRP deferred balance. The Commission has noted previously in the consolidated cases entitled In The Application of Missouri Public Service for the Issuance of an Accounting Order Relating to Its Electrical Operation, and In the Matter of the Application of Missouri Public Service for the Issuance of an Accounting Order Relating to its Purchase Power Commitments, 1 Mo. P. S.C. 3rd 200, that "the Court upheld the Commission's decision to place the initial risk of cancellation on the shareholders since to do otherwise would be to make the investment practically risk-free." State ex rel. Union Electric Company v. PSC (UE), 765 S.W.2d 618, 622 (Mo. App. 1988); State ex rel Hotel Continental v. Burton, 334 S.w.2d 75, 80 (Mo. 1960). Most recently, the Western District Court found that "AAOs are not a guarantee of an ultimate recovery of a certain amount by the utility." Missouri Gas Energy v. P.S.C., 1998 W.D. 54710 (Mo. App. Aug. 18, 1998). All of the parties agree that it is the purpose of the AAO to lessen the effect of the regulatory lag, not to eliminate it nor to protect the Company completely from risk. Without the inclusion of the unamortized balance of the AAO account included in the rate base, MGE will still recover the amounts booked and deferred, including the cost of carrying these SLRP deferral costs, property taxes and depreciation expenses through the true-up period ending May 31, 1998. The Commission finds that OPC's position on this issue is just and reasonable and is supported by competent and substantial evidence in the record.

Also, beginning on page twenty-three of the Commission's Report and Order in St. Louis County Water Company, Case No. WR-2000-844, it states:

> In Case No. GR-98-140, a Missouri Gas Energy (MGE) rate case, the Commission adopted a position advocated by Public Counsel that "guaranteeing the Company a 'return of' and 'return on' the . . . deferred balance [of an ongoing construction project] is not a fair allocation of regulatory lag. . . ." The Commission concluded that, for ratepayers and shareholders to share in the effect of regulatory lag, MGE should be allowed to earn a return of the deferred balance, but not a return on the deferred balance.

And continuing on page twenty-four, it states:

> Nothing binds the Commission to particular ratemaking treatment of deferrals made pursuant to an AAO:
>
> > In the Public Counsel case [State ex rel. Office of Public Counsel v. Public Service Com'n of Missouri, 858 S.W.2d 806, Mo. App. W.D. (1993)], the court made it clear that AAOs are not the same as ratemaking decisions, and that AAOs create no expectation that deferral terms within them would be incorporated or followed in rate application proceedings. Missouri Gas Energy v. Public Service Com'n, State of Mo., 978 S.W.2d 434, (Mo. App. W.D. 1998), at 438.

The Commission based its decision in the St. Louis County Water Company case on the same reasoning it used in Case No. GR-98-140; that is, it will allow the Company to recover the deferred balances over ten years, but will not authorize the earning of a return on the unamortized balance.

Q. DOES COMMISSION DISALLOWANCE OF THE RATE BASE TREATMENT FOR THE DEFERRED COSTS PENALIZE THE COMPANY?

A. No. The truth of the matter is that the AAO process forces ratepayers to "give" the Company and its shareholders a carrying cost return, depreciation expense and property tax expense recognition on constructed plant which under normal regulatory accounting they would never have received. That recognition translates directly into dollars authorized for collection from ratepayers. The carrying cost (along with depreciation expense and property tax expense) is a gift from the Commission to MGE shareholders

the purpose of which is to mitigate the effect of alleged regulatory lag associated with the SLRP construction without looking at all other relevant factors. In fact, it enhances the return on equity to the stockholders. Disallowance of rate base inclusion for the deferred costs does not penalize the Company, it merely does not allow the Company to be completely shielded from all the financial risk that occurs during the regulatory lag period. In essence, it forces ratepayers to share the responsibility for costs associated with SLRP construction during a period when, under normal regulatory ratemaking, the Company and shareholders would own 100% of the liability.

Q. DOES THE PUBLIC COUNSEL ALSO SUPPORT THE RATE BASE REDUCTIONS FOR ACCUMULATED DEFERRED INCOME TAXES ASSOCIATED WITH THE SLRP DEFERRALS?

A. Yes. Public Counsel recommends that the SLRP-related accumulated deferred income tax be included as a reduction in the determination of the Company's total rate base because it is a cost free source of capital made available to the Company by virtue of it having various tax deductions that lower the amount of income taxes actually paid to the IRS, the benefit of which is not flowed through directly to customers as a reduction in the income tax.

Q. HAS THE COMPANY REACHED AN AGREEMENT WITH THE MPSC STAFF AND PUBLIC COUNSEL THAT WILL RESOLVE THE RATEMAKING TREATMENT OF ALL THE SLRP COSTS?

A. Yes, I believe that we have. On November 14, 2006, I met with Mr. Noack, and several MPSC Staff members, to discuss this and other issues remaining in the case. During that meeting Mr. Noack stated that it is the Company's intention to accept the Staff and OPC positions on this issue. If the Company follows through on Mr. Noack's statements, the issue will have been resolved, and Public Counsel believes there will be no need to spend any additional efforts litigating the issue.

III. FORMER MANFACTURED GAS PLANT REMEDIATION

Q. WHAT IS THE ISSUE?

A. Company is seeking Commission authorization to obtain ratepayer funding for a reserve to be utilized to pay costs associated with former manufactured gas plant remediation. On page twenty-three, lines 4-7, of Mr. Noack's original direct testimony he states:

> Q. PLEASE EXPLAIN SCHEDULE H-25
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> A. Schedule H-28 (sic) requests annual funding of $500,000 to set aside to cover the clean up costs associated with former manufactured gas plant ("FMGP") sites and other environmental clean up costs.

Q. HOW DOES THE COMPANY DEFINE AND DESCRIBE THE PROPOSED ENVIRONMENTAL RESPONSE FUND?

A. On Schedule H-25, page 2 of 2, of Mr. Noack's original direct testimony, is the Company's definition and description of the how the fund would operate. My summarization of Schedule H-25 is as follows:

1. An Environmental Response Fund shall be established to create a mechanism to fund the recovery of environmental costs.

2. Environmental costs are defined those related to former manufactured gas plant remediation and litigation.

3. 50% of proceeds, net of costs of obtaining the proceeds, from insurance, Westar and/or other potentially responsible parties shall be credited to fund.

4. The fund shall be credited for the $3,000,000 accrued liability recorded on Southern Union Company's books following the acquisition MGE from Western Resources, Inc.

5. Expenditures shall be charged to the fund as long as the costs that are incurred or previously deferred are environmental response costs.

6. The fund shall be maintained in an interest bearing trust account and shall be credited at an annual amount of $500,000.

7. The annual credit shall be based on actual billed revenues produced by the discrete rate element included in the basic service charge or delivery charge of all customer classes.

8. MGE will file an annual report with the Commission providing a summary and accounting of all costs in the fund.

9. A separate account shall be maintained on Company's books for accruals and expenditures for the environmental costs.

10. Parties will retain the right to review and challenge costs charge to the fund.

11. Parties will retain the right in next general rate case to challenge the level of funding on a prospective basis and/or whether fund should continue as designed.

(Emphasis added by OPC)

Q. IS THE PUBLIC COUNSEL OPPOSED TO THE COMPANY'S REQUEST FOR THE ENVIRONMENTAL RESPONSE FUND?

A. Yes.

Q. PLEASE EXPLAIN WHY.

A. Public Counsel's opposition to the inclusion of the manufactured gas plant remediation costs in Missouri Gas Energy's cost of service is based on a plethora of reasons. First and foremost, is that MGE and Western Resources Inc. ("WRI") have already recognized and accepted that they, their insurers and other potentially responsible parties ("PRP") are responsible for the costs of the FMGP remediation (WRI is the former owner of the Missouri gas utility assets). Pursuant to the terms of the *Environmental Liability Agreement* attached to the *Agreement for Purchase of Assets* between Southern Union Company and Western Resources Inc., the companies agreed to share the liability for payment of any costs associated with any FMGP remediation that might occur subsequent to Southern Union Company buying the Missouri gas utility assets. The *Environmental Liability Agreemen*t is attached to this rebuttal testimony as Schedule TJR-1 (source: Robertson Rebuttal Testimony, Schedule TJR-1, MGE Case No. GR-2001-292).

Q. ACCORDING TO THE ENVIRONMENTAL LIABILITY AGREEMENT WHAT IS WRI'S FINANCIAL RESPONSIBILITY?

A. Article 2(c) of the Environmental Liability Agreement states:

> (v). Buyer/Seller Shared Liability Amount. Upon exhaustion of relief contemplated under subparagraphs (c)(i) through (iv), Buyer and Seller shall share equally in payment of costs incurred by Buyer in connection with Covered Matters in excess of the amounts received by Buyer under subparagraphs (c)(i) through (iii) (or paid by buyer under subparagraph (c)(iv)) to a maximum aggregate amount of Fifteen Million Dollars ($15,000,000.00), without regard to the number of claims concerning Covered Matters required to reach said amount. Notwithstanding anything to the contrary herein, Seller's total liability for Covered Matters shall be limited to the amount of Seven Million Five Hundred Thousand Dollars ($7,500,000.00), and Buyer shall indemnify and hold Seller harmless with respect to all claims, costs, demands and liabilities with respect to all other Covered Matters.

Furthermore, in Article 2(d) it states:

> Limitation on Seller's Liability. Seller's liability under Subparagraph (c) above shall terminate upon that date (the "Termination Date") which is fifteen (15) years after the Closing Date. From and after the Termination Date, Seller shall have no further obligation or responsibilities with respect to all other Covered Matters.

Q. DID SUC WILLINGLY ASSUME RESPONSIBILITY FOR THE POTENTIAL LIABILITY ASSOCIATED WITH THE MGP REMEDIATION?

A. Yes, it did. On page one of the Environmental Liability Agreement it states:

> Article 1. ASSUMPTION OF LIABILITY. Except as hereinafter provided, Buyer hereby (a) assumes and agrees to be responsible for all Environmental Claims now pending or that may hereafter arise with respect to the Assets and the Business and (b) agrees to pay, perform and discharge, as and when due and payable, all Environmental Costs with respect to such Environmental Claims. Buyer hereby agrees, except as herein provided, to indemnify and hold Seller harmless from and against all Environmental Claims and Environmental Costs which Buyer has assumed or agreed to be responsible for pursuant to this Article 1.

Q. WHAT EXACTLY WAS THE LIABILITY THAT SUC ASSUMED?

A. Covered matters are defined on page 2 of the Environmental Liability Agreement as:

> Article 2. DEFINITION OF COVERED MATTERS. (a) Definition. As used herein, the term "Covered Matters" shall mean and refer to all Environmental Claims and Environmental Costs related to the Assets or the Business which (i) arise out of or are based upon Environmental Laws, and (ii) are not included in Assumed Liabilities.
>
> (b) Newly Discovered Matters. Covered Matters that are discovered by Buyer prior to the date which is two (2) years following the date of this Agreement shall be subject to the cost sharing provisions contained herein. All Covered Matters discovered by Buyer more than two (2) years following the date of this Agreement shall be the sole responsibility of Buyer.

Q. IS IT THE PUBLIC COUNSEL'S ASSERTION THAT SUC WILLINGLY AND WITH FULL KNOWLEDGE OF ITS ACTIONS AGREED TO ACCEPT, AS PART OF THE PURCHASE OF THE MISSOURI ASSETS, THE RESPONSIBILITY FOR THE POTENTIAL LIABILITY ASSOCIATED WITH THE FMGP REMEDIATION?

A. Yes, it did.

Q. DID THE COMPANY INITIALLY RECOGNIZE ITS LIABILITY?

A. Yes, it did. Southern Union Company in recognition of the potential FMGP remediation liability it had taken on with its purchase of the Missouri gas utility assets, in conjunction with the advice of its outside auditors, established an "Acquisition Adjustment" of $3,000,000 on its financial books of record. The $3,000,000 represents, according to the terms of the Environmental Liability Agreement, the buyer's initial sole liability amount that must be incurred prior to WRI sharing in any costs to remediate the MGP sites. Furthermore, the $3,000,000 is described as occurring only after exhaustion of relief from insurance, other potentially responsible parties and recovery of remediation costs through regulated cost of service.

According to the Company's response to MPSC Staff Data Request No. 275 (MGE Case No. GR-2001-292), effective September 1, 1994, Company booked a $3,000,000 adjusting entry to its financial records to recognize the initial liability it had assumed pursuant to the terms of the Environmental Liability Agreement. The adjusting entry debited USOA Account No. 114, Gas Plant Acquisition Adjustments for $3,000,000 and credited USOA Account No. 253, Other Deferred Credits for $3,000,000. The Company's description for the accrual was that the adjusting entry was for "possible environmental liabilities."

Further corroboration of this position is provided in the Company's response to OPC Data Request No. 1150 (MGE Case No. GR-2001-292). It states:

> 1. Missouri Gas Energy was required by our third party auditors (PriceWaterhouseCoopers) to record a reserve of $3,000,000 at June of 1994 for certain environmental costs that may arise at MGE. The acquisition of MGE occurred on January 31, 1994. This amount was not an attempt to quantify all potential environmental obligations, only a specific portion of initial costs that would be excluded from any potential sharing arrangement with Western Resources.

In essence, the Company, and apparently its outside accountants, recognized that pursuant to the terms of the Environmental Liability Agreement recoveries of FMGP remediation costs from insurers, other potentially responsible parties and ratepayers was unknown, or at least not forthcoming, so it booked the adjusting entry to recognize its "initial sole liability amount." It also recognized that the initial sole liability amount was part of the excess purchase price over book value that SUC paid WRI for the assets.

Q. PLEASE EXPLAIN WHAT IS MEANT BY THE ACCOUNTING TERM "ACQUISITION ADJUSTMENT?"

A. In traditional accounting, fixed assets, such as plant, are usually recorded at "original cost." Original cost, as applied to utility plant, means the cost of property to the utility first devoting it to public service. An acquisition adjustment results when utility property is purchased or acquired for an amount either in excess of or below book value. Book value relates to the value placed on utility property and recorded on the Company's

financial books and records at the time the utility property is first placed in public service.

If the utility property is purchased by another utility, the purchaser must record the acquisition in the appropriate "plant and property" accounts at the selling utility's original cost; similarly, the purchaser records the seller's accumulated depreciation, amortization, and contributions in aid of construction ("CIAC") in the appropriate account(s). Any difference between the original cost and the actual price paid by a subsequent purchaser is recorded as the acquisition adjustment. An acquisition adjustment does not represent a contribution of capital (i.e., neither cash or new investment) to the public service. It merely represents a purchase of the legal interests in the properties that were possessed by the seller.

Q. IS THIS ACQUISITION ADJUSTMENT AMOUNT THE $3,000,000 MR. NOACK REFERENCES IN ITEM #4 OF YOUR ENVIRONMENTAL RESPONSE FUND SUMMARY?

A. Yes, I believe that it is.

Q. DOES THE $3,000,000 IDENTIFIED BY MR. NOACK APPEAR TO BE AN INACCURATE AMOUNT FOR THE CURRENT BALANCE FOR THE ACQUISITION ADJUSTMENT?

A. Yes. It is my understanding that current Generally Accepted Accounting Procedures require acquisition adjustments to be amortized over a certain period of time if a direct write-off method is not utilized. Since SUC has owned MGE for almost eighteen years, I would expect the original adjustment to have been reduced significantly and/or completely amortized off the books of SUC. It appears that the Company would credit the fund for the entire $3,000,000 balance of the original booked acquisition adjustment even though it is unlikely that that should be the actual current balance of the original liability. I suspect that Company's generosity would be more than offset by its request in item #5 of my summary wherein it would also charge the proposed fund for all expenditures previously deferred thereby obliterating recognition of the credit.

Q. HAS WRI PAID ANY OF THE COSTS INCURRED BY MGE RELATED TO THE FMGP REMEDIATION?

A. No. Company's response to OPC Data Request No. 1006 states:

> Seller (Western Resources) has paid nothing under the Environmental Liability to date. As such, Seller's total potential liability under the Environmental Agreement remains as $7.5 million.

Furthermore, Company's response to OPC Data Request No. 1007 states:

> As provided in the Environmental Liability Agreement (Article 2(c)), insurance is the first line of cost recovery (Article 2(c)(i)) and Buyer (Southern Union Company) is solely liable for the initial $3 million dollars worth of "Covered Matters" not recovered from insurance,

potentially responsible parties or regulated rates (Article 2(c)(iv)). Because the sum of $3 million and insurance recoveries received to date is roughly equal to expenditures on "Covered Matters" under the Environmental Liability Agreement, Southern Union has not yet requested payment from Seller. It is expected that such a request will be made by Southern Union in the near future, especially in light of the remediation activity (and associated expenditures) expected to occur at MGE's Kansas City Central Plant Service Center beginning in the latter part of 2007.

Q. DOES THE COMPANY ACTULLY KNOW WHAT THE EXPECTED FUTURE REMEDIATION COSTS WILL BE?

A. No. OPC Data Request No. 1010 asked for a reconciliation of expected future MGP remediation costs, by specific site; however, the Company's response stated:

> **Information of this type is not presently available**.
>
> (Emphasis added by OPC)

Q. DOES THE ENVIRONMENTAL LIABILITY AGREEMENT IDENTIFY A TERMINATION DATE FOR WESTERN RESOURCES LIABILITY?

A. Yes. Company's response to OPC Data Request No. 1005 states:

> As provided in the Environmental Liability Agreement (Article 2(d)), "Seller's liability under Subparagraph (c) above shall terminate upon that date (the "Termination Date") which is fifteen (15) years after the Closing Date." The Termination Date is, therefore, January 31, 2009.

Q. IS THE WESTERN RESOURCES LIABILITY TERMINATION DATE DESCRIBED ABOVE SUBSEQUENT TO THE OPERATION OF LAW DATE FOR THE INSTANT RATE CASE?

A. Yes. The operation of law date for the instant case (i.e., March 30, 2007) occurs almost two years before the contracted termination date of WRI's liability to Southern Union Company. Therefore, WRI and SUC are still contractually obligated to pay for future FMPG remediation costs which MGE is attempting to seek recovery of from Missouri ratepayers.

Q. ARE THERE OTHER REASONS WHY THE COMPANY'S REQUEST SHOULD BE DENIED?

A. Yes, there are. Other reasons include:

1. It is likely that prior ratepayers have already provided the Company with a "return on" and a "return of" its investment in the MGP operations. This return of (i.e., depreciation) included costs to dismantle and decommission the plant, current and future ratepayers bear no responsibility for the contamination which exists at the sites.

2. Future costs espoused by the Company are not sufficiently fixed, or "known and measurable," and should not be relied on for ratemaking purposes.

3. The costs to analyze, study, remediate and litigate MGP contamination are not a current or future cost of providing safe, adequate and reliable gas service to ratepayers.

4. Guaranteeing full recovery of the costs from ratepayers removes the incentive for the Company to control costs and may lessen other PRPs willingness to contribute to cleanup efforts.

5. The Company has not completed its pursuit of recovery of the costs incurred from insurers and other PRPs; consequently, full recovery of these costs from ratepayers would likely lessen the incentive to aggressively pursue and maximize recovery from insurers and PRPs.

6. Implicit in Company's rate of return is a risk factor for unknown and unanticipated expenditures such as environmental compliance costs. The "return on" component of prior rates included recognition of this risk factor. Company stockholders have therefore already been compensated for the costs.

7. The FMGP remediation costs are associated with plant that is no longer in service and therefore no longer used and useful. The Company does not currently own or operate any manufactured gas plants. It does own some of the plant sites where manufactured gas plant was formerly operated, but no coal gas is manufactured there now. Therefore, current and future ratepayers did not and will not receive service from any FMGP.

Q. IF THE COMMISSION DISALLOWS THE COMPANY'S REQUEST FOR THE ENVIRONMENTAL RESPONSE FUND WOULD THAT DECISION MATERIALLY IMPACT THE COMPANY'S CURRENT FINANCIAL POSITION?

A. No, in fact, it will have no impact at all. As I stated on page fourteen of my direct testimony, lines 5-10, the actual remediation costs incurred during the test year were a relatively immaterial amount (source: Company response to OPC Data Request No. 1004). Furthermore, the costs that were incurred are not included in MGE's rate increase request as they are recorded on the financial books of MGE's parent company; thus, the actual test year costs have absolutely no impact on the rate increase request. However, if the Commission were to authorize the Company's Environmental Response Fund proposal, rates would be increased $500,000 on an annual basis to compensate Company for future, and previously deferred, FMGP remediation costs. That is, costs which have not been incurred and/or are inappropriate for recovery from Missouri ratepayers;

therefore, it is the Public Counsel's recommendation that the Commission deny MGE authorization of the Environmental Response Fund proposal.

IV. INFINIUM SOFTWARE AMORTIZATION

Q. WHAT IS THE ISSUE?

A. Beginning on page seventeen of Mr. Noack's original direct testimony he discusses his calculation of an annualized level of amortization expense. He states that the third part of his adjustment amortizes the unamortized cost of recently replaced Infinium Software over a three year period. His proposal is to expense the unamortized balance of $1,225,756 results in an adjustment to increase amortization expense by $408,585 (see Schedule H-13, Noack updated direct testimony). Whereas, Public Counsel recommends that the entire unamortized balance be disallowed and written off as a non-recoverable loss.

Q. IS THE INFINIUM SOFTWARE USED AND USEFUL IN PROVIDING SERVICE TO CURRENT CUSTOMERS?

A. No. It's my understanding that the Company has obtained and implemented new software to replace the functions previously performed by the Infinium Software. Therefore, current and future ratepayers will not receive any services which includes the utilization of the Infinium Software.

Q. PLEASE EXPLAIN THE CONCEPT "USED AND USEFUL".

A. The Public Counsel's main objection to the Company's proposed treatment of this issue is that we believe it violates the regulatory "used and useful" standard. The general rule is that, "the rate base on which a return may be earned is the amount of property used and useful, at the time of the rate inquiry, in rendering a designated utility service." (A.J.G. Priest, Principles of Public Utility Regulation (1969), p. 139, vol. 1). This principle is certainly grounded in common sense. In dividing the responsibility for a utility's operations between ratepayers and stockholders, regulators have traditionally required that stockholders rather than ratepayers be required to bear the costs of any utility investment which is not used and useful to provide service to the ratepayers.

In a discussion of the policy in Missouri, State ex rel. Union Electric v. Public Service of the State of Missouri, 765 S.W. 2d 618 (Mo. App. 1988), the Court of Appeals for the Western District endorsed the used and useful policy. That case involved Union Electric's appeal of the Commission's denial of the costs of cancellation of its Callaway II nuclear unit. The Commission ruled that the risk of cancellation should be borne by the shareholder, since if it was not, the shareholder's investment would be practically risk free. The Court, in upholding the Commission's decision, stated:

> The utility property upon which a rate of return can be earned must be utilized to provide service to its customers. That is, it must be used and useful. This used and useful concept provides a well-defined standard for determining what properties of a utility can be included in its rate base.

Q. SHOULD RATEPAYERS BE HELD RESPONSIBLE FOR COSTS ASSOCIATED WITH PLANT ASSETS THAT ARE NO LONGER IN SERVICE?

A. No. Current ratepayers should not be held responsible for additional costs, for assets, that do not provide current service capabilities or benefits. The Company is asking the Commission to have ratepayers pay for software programs that do not provide current utility service. I don't believe this is a normal practice of this Commission and it is unreasonable to force a consumer to pay for something they are not using. MGE is entitled to the opportunity to earn a fair rate of return only upon monies prudently invested in property used and useful in rendering utility service. It is not entitled to a guaranteed recovery of costs which it has voluntarily removed from active service.

Q. DOES THE REGULATORY RATEMAKING PROCESS GUARANTEE A CERTAIN LEVEL OF EARNINGS FOR A UTILITY?

A. No. The purpose of the regulatory ratemaking process is to identify a reasonable monetary return that the monopoly enterprise has the opportunity to earn. Regulation does not guarantee that level of earnings, nor does it force a company to return any overearnings retroactively, in the event overearnings occur. In simplistic terms, the ratepayers part of the regulatory bargain is to provide the company with a level of revenues that allow it to earn the Commission approved rate of return on current used and useful investment along with the costs of operating and maintaining that investment, and no more. Ratepayers do not assume, willing or implied, any risk assumed by the stockholders.

Q. DO SHAREHOLDERS RECEIVE AN INCREASED RETURN FOR THE BUSINESS RISKS ASSOCIATED WITH OPERATING A UTILITY?

A. Yes. The Company is attempting to pass the natural risks associated with a business that is a continuing enterprise, a "going concern," entirely from stockholders to ratepayers. Stockholders, not ratepayers, are the actual risk-takers and for assumption of risk they receive a market determined return on their investment. It is my understanding that MGE's parent company decided to switch its accounting software systems and that is an economic event which I believe should have resulted in a thorough analysis of the negative or positive manner in which stockholders would have been affected. Since SUC management apparently decided that the replacement of the software was a positive move, shareholders, not ratepayers, should weather the effects of the write-off of the unamortized costs associated with the software that was abandoned.

V. OKLAHOMA PROPERTY TAX

Q. WHAT IS THE ISSUE?

A. Schedule H-17 of Mr. Noack's direct testimony identifies that he included in MGE's case $218,521 of property tax expense associated with the state of Oklahoma jurisdiction. Public Counsel recommends that the expense be disallowed for the reasons I discussed in my instant case direct testimony.

Q. IS THIS STILL AN ISSUE BETWEEN COMPANY AND PUBLIC COUNSEL?

A. On November 14, 2006 I met with Mr. Noack, and several MPSC Staff members, to discuss this and other issues remaining in the case. During that meeting Mr. Noack stated that it is the Company's intention to remove these costs from its case recovery request. If the Company follows through on Mr. Noack's statements, the issue will have been resolved, and Public Counsel believes there will be no need to spend any additional efforts litigating the issue.

VI. UNCOLLECTIBLE EXPENSE

Q. WHAT IS THE ISSUE?

A. Beginning on page thirteen of Mr. Noack's original direct testimony he discusses his calculation of an annualized level of bad debt write-offs. He states that his adjustment is based on the averaging of costs for 2004 and 2005 which he then compares to the bad debt expense recorded in 2005. His analysis resulted in an adjustment to increase uncollectible expense by $3,079,961 (see Schedule H-9, page 1, Noack updated direct testimony). Whereas, Public Counsel, and the MPSC Staff, utilized a five year average of bad debt costs in order to levelize the volatility exhibited by these costs.

Q. IS THIS STILL AN ISSUE BETWEEN COMPANY AND PUBLIC COUNSEL?

A. On November 14, 2006 I met with Mr. Noack, and several MPSC Staff members, to discuss this and other issues remaining in the case. During that meeting Mr. Noack stated that it is the Company's intention to accept the uncollectible expense adjustment amount calculated by the MPSC Staff. If the Company follows through on Mr. Noack's statements, the issue

will have been resolved, and Public Counsel believes that there will be no need to spend any additional efforts litigating the issue.

VII. UNCOLLECTIBLE EXPENSE/PGA RECOVERY

Q. WHAT IS THE ISSUE?

A. Beginning on page fourteen of Mr. Noack's direct testimony he discusses alternatives to consider when dealing with the unpredictable nature of uncollectible "bad debt" expense. His alternatives include, 1) separating the bad debt write-offs into a gas cost piece and a distribution piece and then authorizing recovery of the gas cost piece through the purchased gas adjustment process ("PGA"), or 2) utilize a tracking mechanism for the over/under recovery of the bad debt costs. On page sixteen of his direct testimony he states that the Company has included proposed tariff language to apply to the inclusion of the gas portion of bad debts in the PGA (see tariff language Noack original direct testimony, Schedule H-9, pages 2 and 3). Public Counsel is opposed to both of the alternatives which Mr. Noack has identified.

Q. IS THIS STILL AN ISSUE BETWEEN COMPANY AND PUBLIC COUNSEL?

A. On November 14, 2006 I met with Mr. Noack, and several MPSC Staff members, to discuss this and other issues remaining in the case. During that meeting Mr. Noack stated that it is the Company's intention to withdraw its request for alternative treatment of the bad debt costs. If the Company follows through on Mr. Noack's statements, the issue will have been

resolved, and Public Counsel believes there will be no need to spend any additional efforts litigating the issue.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.