Exhibit No.:	
Issue:	*Accounting Schedules, Ratebase, Plant in Service, Adjustments to Plant in Service, Depreciation Reserve, Cash Working Capital, Interest on Customer Deposits, Depreciation Expense, Advertising, Promotional Giveaways, Dues & Donations, Postage, Property Taxes, Injuries & Damages, Insurance, Regulatory Expenses, Miscellaneous Expenses*
Witness:	*Paula Mapeka*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Direct Testimony*
Case No.:	*GR-2006-0422*
Date Testimony Prepared:	*October 13, 2006*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

PAULA MAPEKA

MISSOURI GAS ENERGY

CASE NO. GR-2006-0422

Jefferson City, Missouri

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri Gas Energy's Tariff Sheets Designed to Increase Rates for Gas Service in the Company's Missouri Service Area.	)))	Case No. GR-2006-0422

AFFIDAVIT OF PAULA MAPEKA

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Paula Mapeka of lawful age, on her oath states: that she has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 29 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.

MMapeka
Paula Mapeka

Subscribed and sworn to before me this 23th day of October 2006

Ashley M. Harrison

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

ASHLEY M. HARRISON
My Commission Expires
August 31, 2010
Cole County
Commission #06898978

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MISSOURI GAS ENERGY

CASE NO. GR-2006-0422

Q. Please state your name and business address.

A. My name is Paula Mapeka. My business address is Governor Office Building, Suite 440, 200 Madison Street, Jefferson City, MO 65102.

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

A. I am a Utility Regulatory Auditor I with the Missouri Public Service Commission (Commission or PSC).

Q. Please describe your educational background.

A. I graduated with a Masters degree in Business Administration from Lincoln University, Jefferson City, Missouri in August 2005. I attained a Bachelor of Science degree in Accounting from Lincoln University in May 2004.

Q. Please describe your employment history.

A. Prior to employment with the Commission, I was employed by the Department of Health and Senior Services. I assumed my current position as a Utility Regulatory Auditor with the Commission in March 2006.

Q. What are your responsibilities with the Commission?

A. I am responsible for assisting in the audits and examinations of the books and records of regulated utility companies operating within the state of Missouri.

Q. What knowledge, skill, experience, training or education do you have in these matters?

A. In addition to my MBA and degree in accounting, I have acquired knowledge of the audit topics assigned to me through the review of the Staff's testimony and workpapers from previous rate cases involving Missouri Gas Energy (MGE or Company), as well as materials from rate cases filed by other Missouri jurisdictional utilities. I have reviewed in-house training materials on the topics assigned to me in this proceeding. I have also reviewed prior Commission decisions regarding these areas. I have reviewed the Company's testimony, workpapers and responses to the Staff's data requests addressing these topics. My immediate supervisor and other senior auditors have provided guidance and training in these areas and oversight of my work.

Q. Did you make an examination and analysis of the books and records of MGE in regard to issues raised in this case?

A. Yes, in conjunction with other members of the Commission Staff (Staff), I specifically examined and analyzed the following documentation: the Company's filed testimony, the Company's responses to Staff data requests, general ledger information related to my assigned issues and Company workpapers.

Q. Have you previously filed testimony before this Commission?

A. Yes, I filed testimony in Case No. ER-2006-0315, The Empire District Electric Company.

<u>EXECUTIVE SUMMARY</u>

Q. Please give a brief summary of your direct testimony in this case.

A. The purpose of this direct testimony is to address the Staff's proposed treatment of various rate base items in this case, including plant in service, depreciation reserve and cash working capital.

The Staff's income statement adjustments supported within this testimony include advertising, promotional giveaways, dues and donations, property taxes, postage and billing expenses, injuries and damages, PSC assessment and rate case expenses.

Each of these items will be discussed in turn in my testimony.

Q. What Staff accounting schedules and adjustments are you sponsoring?

A. I am sponsoring the following accounting schedules:

Accounting Schedule	Description
Schedule 2	Rate Base
Schedule 3	Plant in Service
Schedule 5	Adjustments to Plant in Service
Schedule 6	Depreciation Reserve
Schedule 7	Adjustments to Depreciation Reserve
Schedule 8	Cash Working Capital

Q. What adjustments are you sponsoring?

A. I am sponsoring the following adjustments:

Interest on customer deposits:	S-57.1
Depreciation Expenses:	S-66.1 and S-66.2
Advertising:	S-54.1
Promotional Giveaways:	S-54.2

Dues and Donations:	S-21.4, S-35.5, S-37.3, S-47.4, S-49.6, S-51.5, S-54.3
Postage:	S-35.3
Amortization Expenses:	S-59.1
Property Taxes:	S-60.3
Injuries and Damages:	S-51.3, S-51.4
Insurance:	S-50.1
Regulatory Expenses:	S-53.1, S-53.2, S-53.3, S-53.4, S-53.5, S-53.6, S-53.7
Miscellaneous Expenses:	S-21.3, S-35.4, S-37.2, S-47.3

RATE BASE

Q. Please describe Accounting Schedule 2, Rate Base.

A. This Accounting Schedule represents the investment upon which the Company is allowed to earn a rate of return. This Accounting Schedule includes the Company's adjusted jurisdictional plant in service balance from Accounting Schedule 3, Total Plant in Service, and deducts the Company's adjusted jurisdictional depreciation reserve from Accounting Schedule 6, Depreciation Reserve, to compute the net plant in service amount. Added to net plant in service are amounts for cash working capital, materials and supplies, prepayments, gas inventory and prepaid pension asset. Rate base deductions include the federal income tax offset, state income tax offset, interest expense offset, customer advances for construction, customer deposits and deferred income taxes. The mathematical total of these items is the Rate Base amount incorporated in the Gross Revenue Requirement recommendation shown on Accounting Schedule 1, Revenue Requirement.

Q. Please describe the items that are added to net plant in service in determining the rate base.

A. The Staff's calculation of materials and supplies, prepayments, customer deposits, customer advances, deferred income tax rate base offset, federal and state income tax offsets and interest expense offset. will be discussed later in this direct testimony. Staff witness Anne M. Allee of the Procurement Analysis Department will discuss the gas inventory, and gas stored underground line items in her direct testimony. Staff witness Paul R. Harrison of the Auditing Department will be sponsoring the items of prepaid pension asset, pension regulatory asset – additional contribution, and pension regulatory asset in his direct testimony.

MATERIALS AND SUPPLIES

Q. What are materials and supplies?

A. These are small dollar assets intended for use in the utility business for construction, operation and maintenance activities. Materials and supplies are stored in inventory by the utility and are dispensed as needed.

Q. Please describe the Staff's treatment of materials and supplies.

A. The Staff used a 13-month average method ending June 30, 2006, to normalize or smooth out variations for purposes of determining the value of materials and supplies to include in rate base. June 30, 2006, is the endpoint of the Staff's test year update period in this proceeding.

PREPAYMENTS

Q. What are prepayments?

A. These are goods or services a company pays for in advance of their intended use in order obtain the goods or services for the utility to carry out its normal operations. Such items include, but are not limited to, insurance, taxes, rents, interest and other miscellaneous items.

Q. Please describe the Staff's treatment of prepayments.

A. As there were variations or fluctuations in the balances of MGE's prepayment accounts throughout the audit period, Staff used a 13-month average method ending June 30, 2006, to normalize or smooth out these variations for purposes of determining the value of prepayments to include in rate base.

CUSTOMER DEPOSITS

Q. What are customer deposits and how are they treated?

A. These are amounts deposited with the utility by customers as security for the payment of bills. Customer deposits are treated as a liability repayable to customers by the utility company and, therefore, are deducted from the rate base.

The Staff used a 13-month average method ending June 30, 2006, to normalize or smooth out monthly variations in MGE's customer deposit balances for purposes of determining the value of customer deposits to include as a reduction to rate base.

Q. Are you addressing any proposed changes to MGE's customer deposit tariff?

A. No, Staff Witness Michael J. Ensrud of the Energy Department, Tariff/Rate Design Section, will address proposed changes to MGE's tariff regarding customer deposits in his testimony.

INTEREST EXPENSE ON CUSTOMER DEPOSITS

Q. Please explain Income Statement adjustment S-57.1.

A. The Staff adjustment S-57.1 annualizes interest expense related to customer deposits. Customer deposits are interest bearing, so the interest expense paid by MGE to its customers that have provided customer deposits is included as an expense in the cost of service. The Staff used an 8.25% interest rate (prime rate + 1%), reported on December 31, 2005, in the Wall Street Journal to determine the interest rate to apply to MGE's customer deposits balance as of June 30 2006. This calculation of interest expense on customer deposits is consistent with the methodology set forth within the Company's tariffs.

CUSTOMER ADVANCES

Q. Please describe the customer advances amount that is deducted from rate base.

A. Customer advances are funds provided by customers of the Company to cover certain specific costs incurred by the Company on behalf of these customers. These funds represent interest free money to the Company; therefore, it is appropriate to include the funds as an offset to rate base. The Staff used a 13-month average method ending June 30, 2006, to normalize or smooth out monthly variations in MGE's customer advances balances for purposes of determining the value of customer advances to include as a reduction to rate base.

PLANT IN SERVICE & DEPRECIATION RESERVE

Q. Please describe the plant in service and depreciation reserve balances included in Accounting Schedule 3 and 6.

A. Accounting Schedule 3, Plant in Service and Accounting Schedule 6, Depreciation Reserve, respectively, reflect MGE's balances for these items as of June 30, 2006, the end of the test year update period in this proceeding.

Q. Please describe Accounting Schedule 4.

A. Accounting Schedule 4, Adjustments to total plant, details the Staff's individual adjustments to the total plant in service, which are normally listed in Column C of Accounting Schedule 3. Staff Witness David G. Winter of the Auditing Department will be sponsoring the Staff's proposed adjustments to total plant in service in this proceeding.

Q. Please explain Accounting Schedule 7, Adjustments to Depreciation Reserve.

A. Accounting Schedule 7, Adjustments to Depreciation Reserve, details the Staff's individual adjustments making up the total company and Missouri jurisdictional adjustments listed in "Column C" of Accounting Schedule 6. Staff Witness Winter will be sponsoring the Staff's proposed adjustments to depreciation reserve in this proceeding.

DEPRECIATION EXPENSE

Q. Please Describe Accounting Schedule 5.

A. Accounting Schedule 5, Depreciation Expense, lists in column B the Missouri adjusted jurisdictional plant in service balances from Accounting Schedule 3, Column F. Column C contains the depreciation rates sponsored in this proceeding by Staff Witness Gregory E. Macias of the Engineering and Management Services Department. These depreciation rates will be discussed in his direct testimony. The rates in Column C are then applied to the plant balances in Column B to determine the annualized level of depreciation expense that appear in Column D.

Q. Please explain Income Statement Adjustments S-66.1 and S-66.2.

A. Adjustment S-66.1 and S-66.2 remove the annualized depreciation expense charged to clearing accounts 392 and 396 which are supposed to carry a zero balance at the end of the year.

<u>CASH WORKING CAPITAL</u>

Q. What is cash working capital (CWC)?

A. CWC is the amount of cash necessary for the Company to pay the day-to-day expenses incurred to provide gas service to MGE's customers.

Q. Where are the results of the Staff's CWC analysis?

A. The results of The Staff's CWC analysis can be found on Accounting Schedule 8, Cash Working Capital.

Q. Is the method you used to calculate MGE's CWC requirement the same method the Staff has used in previous rate cases?

A. Yes, the method has been used by the Staff and adopted by the Commission in numerous rate proceedings dating back to the 1970's including the Company's most recent rate cases (Case Nos. GR-96-285, GR-98-140, GR-2001-292 and GR-2004-0209).

Q. How did the Staff determine the CWC requirement?

A. The Staff calculated the CWC requirement by performing a lead/lag study.

Q. What is the purpose of a lead/lag study?

A. The lead/lag study determines the amount of cash that is necessary on a day-to-day basis in order for MGE to provide service to its ratepayers. The lead/lag study analyzes the cash flows related to the payments received from the Company's customers for the provision of service and the disbursements made by the Company to its suppliers and vendors for goods and services necessary to provide gas service. The lead/lag study takes into account the number of days it takes MGE to make payments after receiving goods or services from a vendor, compared with the number of days it takes the Company to receive payments for the gas service provided to its customers. A lead/lag study also determines who provides CWC.

Q. What are the sources of CWC?

A. The shareholders and the ratepayers are the sources of CWC.

Q. How do the shareholders supply CWC?

A. When MGE spends cash to pay for an expense before the ratepayer provides the cash, the shareholders are the source of the funds. This cash represents a portion of the shareholders' total investment in the Company. The shareholders are compensated for the CWC funds by the inclusion of these funds in the rate base, thereby providing a return on their investment.

Q. How do the ratepayers provide CWC?

A. Ratepayers supply CWC when they pay for the gas service received before MGE pays for expenses incurred in providing that service. The ratepayers are compensated for the funds supplied through a reduction to rate base by the amount of CWC the ratepayers provide.

Q. How does the Staff interpret lead/lag studies?

A. A positive CWC requirement indicates that in the aggregate, the shareholders provide the CWC for the test year. This also means that, on the average, the Company paid the expenses incurred to provide the gas service to the ratepayers before the ratepayers in turn paid for that service.

A negative CWC requirement indicates that, in the aggregate, the ratepayers provide the cash working capital during the test year. This means that, on average, the ratepayers paid for their gas service before the Company paid the expense incurred to provide that service.

Q. Please explain the components of the Staff's calculation of CWC, which appear on Accounting Schedule 8, Cash Working Capital.

A. The components of the Staff's calculation are as follows:

1) Column A (Account Description): lists the types of cash expenses, which the Company pays on a day-to-day basis.

2) Column B (Test Year Expenses): provides the amount of annualized expense included in the cost of service. It shows the dollars associated with the items listed in Column A on an adjusted Missouri jurisdictional basis.

3) Column C (Revenue Lag): indicates the number of days between the midpoint of the provision of service by the Company and the payment for the service by the ratepayer. The revenue lag addressed in this case is explained later in this direct testimony.

4) Column D (Expense Lag): indicates the number of days between the receipt of and the payment for, the goods and services (i.e., cash

expenditures) used to provide service to the ratepayer. The expense lags addressed in this case are discussed later in this direct testimony.

5) Column E (Net Lag): results from the subtraction of the Expense Lag (Column D) from the Revenue Lag (Column C).

6) Column F (Factor): expresses the CWC lag in days as a fraction of the total days in the test year. This is accomplished by dividing the Net Lags in Column E by 365.

7) Column G (CWC Requirement): represents the average amount of cash necessary to provide service to the ratepayer. This is computed by multiplying the annualized amount in the Test Year Expenses (column B) by the CWC Factor (Column F).

Q. Please describe the revenue lag.

A. The revenue lag is the amount of time from when the Company provides the service to when it receives payment from the ratepayers for that service. The overall revenue lag in this case is the sum of three subcomponent lags. They are the following:

1) Usage Lag: The midpoint of the average time elapsed from the beginning of the first day of a service period through the last day of that service period.

2) Billing Lag: The period of time between the end of the last day of a service period and the day the bill is placed in the mail by a utility.

3) Collection Lag: The period of time between the day the bill is placed in the mail by a utility and the day the utility receives payment from the ratepayer for services performed.

The Staff's subcomponent calculations and overall revenue results are as follows:

	Staff
Usage Lag	15.21 days
Billing Lag	4.26 days
Collection Lag	20.87 days
Total	**40.34 days**

Q. Please explain how the usage lag was determined.

A. The usage lag was determined by dividing the number of days in a typical year (365) by the number of months in a year (12) to yield the average number of days in a month (30.42). This 30.42 was then divided by two to yield an average usage lag of 15.21. Two was used as the divisor since the Company bills monthly; the Staff assumed service is delivered to the customer evenly throughout the month.

Q. Please explain how the Staff determines the billing lag.

A. The billing lag is determined as the time it takes between when MGE reads the meter and when the bills are subsequently mailed to the customer. The Staff determined a billing lag of 4.26 days was appropriate.

Q. Please explain the Staff's approach to determining the collection lag.

A. The collection lag is the average number of days that elapse between the day that the bill was mailed and the day when MGE receives payment for the bill. To measure this lag, the Staff sampled MGE customer billings in the following numbers: 978 residential accounts; 119 average billing calculation plan (ABC); residential customers accounts, 877 small general service, large general service and large volume service customers; and 100% of transportation customers. The ABC plan is designed so that, to the extent possible, each of the subscribing customers' bills over a twelve-month period, from August to July will be the same amount.

Based on the Staff statistical sample, the average collection lag for MGE was determined to be 20.87 days.

Q. What expense lags did the Staff calculate in this case?

A. The Staff calculated the following expense lags in this audit: other operating and maintenance expenses, payroll and employee withholdings, vacation expenses, pensions and benefits, purchased gas expense, property taxes, corporation franchise taxes, employer FICA taxes, federal and state unemployment taxes, use taxes, sales taxes and gross receipt taxes,

Q. Please explain the cash voucher expense lag/other operations and maintenance expenses.

A. The cash vouchers line item is designed to include all Operation and Maintenance (O&M) expenses within the study that are not specifically analyzed in a separate line item. The expense lag represents the amount of time elapsed between the receipt of and payment for goods and services necessary to provide service to ratepayers. The Staff used a sample of O&M expense vouchers to calculate this expense lag.

Q. Please explain the base payroll expense lag calculation on Line 2 of Accounting Schedule 8.

A. The base payroll expense lag is the time elapsed between the midpoint of the period in which employees earn wages (i.e., weekly, bi-weekly - the payroll period) and the date the wages are paid by MGE. The base payroll expense lag utilized in this case is 12.38 days.

Q. What is the basis for the expense lag days assigned to tax withholdings?

A. The expense lag days for tax withholdings are based upon the same payroll periods used for base payroll. The respective expense lag day computations consider the time elapsed between the average date the respective payroll is earned by the employee and the tax due dates.

Q. Please explain the Staff's calculation of the vacation expense lag.

A. The vacation expense lag attempts to reflect the time period from when employees "earn" vacations and when MGE actually pays out the cash to these employees for vacations. Employees are given vacation accrual each December 31 based upon past service to the Company. The accrual varies based upon the employee's number of years of service. Employees can begin taking vacation as soon as it is accrued, but most of the vacation earned by MGE employees is taken in the twelve months following the date it is accrued. However, employees can carry over up to one week of vacation to the following calendar year. MGE employees do not take vacation evenly throughout the year. For these reasons, the Staff utilized an expense lag of 365 days as a conservative estimate of the time elapsed between when vacation was "earned" and actually "paid" to its employees by MGE.

Q. Please explain the Staff's calculation of MGE's pensions and benefits expense lag line 4 and 5.

A. The pensions and benefits line item within the CWC Accounting Schedule represents the health and dental claims, group health and dental administration, pensions, and life insurance (which includes accidental death and dismemberment, and long term disability coverage). The Company changed its group health and dental providers at the beginning of 2006, per its response to Staff Data Request No. 54.25. The expense lag for pensions and benefits is the time elapsed between the midpoint of the period of service and the date on which payments were made. Staff used the period from January – June 2006 to calculate this expense lag.

Q. Please explain the expense lag calculation for 401(k) employee portion.

A. The expense lag for the employee portion of 401(k) is based on the same payroll periods as base payroll; the time elapsed between the midpoint of the period in which employees earn wages and the date the wages are paid by MGE.

Q. Please explain the expense lags for purchased gas.

A. The expense lag for fuel is the time elapsed between the midpoint of the period when MGE receives the fuel from suppliers and the date on which payments for such fuels are due.

Q. Please explain the expense lag for property taxes as shown on Accounting Schedule 8 at Line 9.

A. The property tax lag days were calculated by using the midpoint of the service period (a calendar year) and the required due date for property taxes paid by MGE.

Q. Please explain the expense lag for corporate franchise tax.

A. Corporation franchise taxes are paid annually. The expense lag considers the time elapsed between the midpoint of the taxable period (a calendar year) and the statutory due date (April 15 of the current fiscal year). The Staff determined the expense lag for corporation franchise taxes is (78) days.

Q. Please explain the expense lag for the employer's portion of FICA tax on Accounting Schedule 8 at Line12.

A. The employer's portion of FICA (social security) taxes is the amount of taxes paid by the employer on payroll paid to the employees. The expense lag for employer's portion of FICA is computed as the period of time between the midpoint of the pay period for which the taxes are withheld, and the date the tax withholdings must be paid to the taxing authorities.

Q. Please explain the expense lag for federal and state unemployment taxes on Accounting Schedule 8 at Lines 12.

A. The expense lags for federal and state unemployment taxes represent the length of time between the average day services are rendered by the employee and the date MGE pays the tax associated with that service.

Q. Please explain the use and sales taxes expense lag on Accounting Schedule 8 at Line 13 and 14.

A. The expense lag for use and sales taxes take into consideration the time elapsed between the midpoint of the taxable month and the date sales tax was paid to the state of Missouri (Response to Staff Data Request No. 54.7).

Q. Please explain the expense lag for gross receipts tax on Accounting Schedule 8 at Line 15.

A. Gross receipts taxes are paid based upon the individual requirements of the taxing entities. The Staff used an expense lag of 53.24.

Q. Why does the revenue lag depicted on Accounting Schedule 8 for use and sales tax, and gross receipts taxes, differ from the revenue lag calculation of 40.34 days you discussed above?

A. MGE acts as an agent of the taxing authority in collecting sales and use taxes and gross receipts taxes from the ratepayer and in paying the proper institution on a timely basis. MGE does not provide any service to the ratepayers associated with these taxes. Since the expense lags for gross receipts taxes is measured from the date of billing, the revenue lag equals only the period of time required to collect revenues. The revenue lag associated with sales and use taxes, and gross receipt taxes, was calculated to be 20.87 days.

Q. Please identify any other components of CWC that do not directly appear in the Staff's Accounting Schedule 8.

A. The federal income tax offset, state income tax offset and interest expense offset line items do not directly appear in the Accounting Schedule 8, Cash Working Capital. These items appear as separate line items in the Staff's Accounting Schedule 2, Rate Base. These cash payments are known and certain obligations of MGE with payment periods and payment dates established by statute or bond indentures. The Staff believes amounts collected from ratepayers, which the Company intends to use for the payment of taxes and interest, represent a source of cash for MGE which has use of such funds until they are passed on to the appropriate taxing authority or bondholder. The Staff believes it is appropriate to include taxes and interest as offsets in a lead/lag analysis.

Q. Why are the federal income tax offset, state income tax offset and interest expense offsets included in the Staff's Accounting Schedule 2, Rate Base, rather than Accounting Schedule 8, Cash Working Capital?

A. The expense component used for these offsets is tied directly to the mechanical computation of the revenue requirement. The Staff's computer-generated revenue requirement is based on a computer program with the capability of extracting appropriate amounts for federal income tax, state income tax and interest expense based on amounts obtained from Accounting Schedule 11, Income Tax. The computer program applies the

CWC factor for each respective component and places the CWC revenue requirement directly in Accounting Schedule 2.

Q. Please explain the federal and state income tax offsets.

A. The federal and state income tax offsets represent the period of time between the midpoint of the taxable period (a calendar year) and the required dates taxes are due to the federal and state taxing authorities. Currently, 100% of the estimated federal tax must be paid during the year in four quarterly installments, which are due by the 15th day of April, July, October and January. The same due dates apply to state income taxes.

Q. Please explain the interest expense offset.

A. The interest expense lag is computed by determining the time elapsed between the midpoint of the interest period and the required due date for the payment of interest on long-term debt. A similar calculation is performed for short-term debt and trust preferred stock. Staff then calculated a dollar-weighted average to derive an overall interest expense lag of 87.55 days. This expense lag was subtracted from the revenue lag and then divided by 365 days to determine the CWC factor used for calculating the interest offset appearing on Accounting Schedule 2, Rate Base.

Q. What was the result of the Staff's lead/lag calculation?

A. The aggregate of the individual calculations, including the offsets for interest and income taxes, result in total net ratepayers-supplied funds and illustrate the excess of CWC supplied by the ratepayers over the amount supplied by the shareholders.

ADVERTISING EXPENSES

Q. Please explain adjustment S-54.1.

A. Adjustment S-54.1 disallows certain advertising costs incurred by the Company.

Q. Please describe the history of such adjustments before the Commission.

A. As part of RE: *Kansas City Power and Light Company*, 28 Mo. P.S.C. (N.S.) 228 (1986) (hereinafter *KCPL*), the Commission adopted an approach that classifies advertisements into five categories and provides separate rate treatment for each category. The five categories of advertisements adopted by the Commission for purposes of this approach are:

1. General - informational advertising that is useful in the provision of adequate service;
2. Safety - advertising which conveys the ways to use the Company's service safely and to avoid accidents;
3. Promotional - advertising used to encourage or to promote the use of the particular commodity the utility is selling;
4. Institutional - advertising used to improve the Company's public image; and
5. Political - advertising which is associated with political issues.

The Commission adopted these categories of advertisements because it believed that a utility's revenue requirement should include the reasonable and necessary cost of general and safety advertisements, should disallow the cost of institutional or political advertisements, and should include the cost of promotional advertisements only to the extent that the utility can provide cost justification for the advertisement (*Ibid*., pp. 269-271).

Q. What standard did the Staff use to evaluate the Company's advertising expense in this case and to develop the adjustments?

A. The Staff utilized the standards as initially established in the *KCPL* case and in subsequent cases, to determine the test year level of allowable advertising expense for the general, safety, institutional, promotional and political advertising categories. The Staff proposes to disallow advertisements that are institutional, promotional, unrelated to the natural gas industry or that ask for charitable donations. The Staff proposes to allow all general and safety-related advertisements to the extent that they are related to the natural gas industry and beneficial to Missouri ratepayers.

Q. How did you apply the standard established in the *KCPL* case to your examination of advertising expense in this case?

A. Staff categorized all of the Company's advertisements on an ad-by-ad basis using the *KCPL* standard to determine the amount to be allowed or disallowed. Staff reviewed each advertisement to determine which of the following primary messages the advertisement was designed to communicate:

1. the promotion of a service or product (Promotional);
2. the dissemination of information necessary to obtain safe and adequate electric service (General and Safety);
3. the promotion of the Company image (Institutional); or
4. the endorsement of a political candidate or any political message (Political).

Once The Staff determined the primary message, The Staff classified the advertisements accordingly. Schedule 1, attached to this testimony, is that itemized analysis of the Company's advertising costs and a copy of all the Company's advertisements for the test year, as provided in response to Staff Data Request Nos. 38 and 38.3.

Q. How did the Staff develop its advertising adjustments?

A. The Staff requested that the Company supply the cost of all advertisements on a per-ad basis. Based on its categorization, the Staff disallowed the expense associated with advertisements that it classified as institutional or promotional, as well as general advertisements unrelated to the natural gas industry or Missouri ratepayers. Certain institutional or promotional advertisements were billed to the Company on the same invoice with allowable advertisements. In this instance, when the associated invoice did not break out the costs for the individual advertisements, Staff removed a representative portion of the costs associated with the disallowed advertisements.

Q. Describe the institutional advertisements that the Staff disallowed.

A. The Staff disallowed the following advertisements as institutional in nature: Holiday Greetings, Katrina, Income tax filing, Community Recognition and Logo Advertising, as well as advertising requesting Missourians to contribute to help those individuals struggling to pay their bills. A portion of the Energy Prices advertisements and the entirety of the cost of the Dr. Martin Luther King Jr's Shared Dreams and Katrina advertisements were disallowed because these ads were designed to build the Company's image and provided no information on natural gas safety. Community Recognition and Logo advertisements, which sponsored and provided support for local causes and events, were disallowed because none of these advertising programs were necessary for the provision of safe and adequate service.

PROMOTIONAL GIVEAWAYS

Q. Please describe the Staff's proposed treatment promotional giveaways costs.

A. Adjustment S-54.2 decrease expenses for Company promotional giveaway items distributed during the test year.

Q. Please describe the items that the Company offers as promotional giveaways.

A. The Company distributed many types of items (e.g., pens, golf balls, monitor calendars) during the test year. The Staff believes that the cost of promotional giveaways provides no direct benefit to the ratepayer and, therefore, should be absorbed by the shareholders. Additionally, the Commission has previously disallowed giveaway items that were similar in nature. See *Missouri Cities Water Company, et al.*, Case No. WR-92-207.

DUES AND DONATIONS

Q. Please explain the income statement adjustments S-21.4, S-35.5, S-37.3, S-47.4, S-49.6, S-51.5 and S-54.3.

A. The adjustments decrease test year expenses relating to various dues and donations the Company has included in its cost of service. Examples of dues excluded from the case are dues paid to the Rotary Club, The Optimist Club of St. Joseph, MEDC (Missouri Economic Development Council), etc.

Consistent with the Commission's decision in Case No. GR-77-33, Laclede Gas Company, Staff excluded these dues from the cost of service because they: 1) are not necessary for the provision of safe and adequate service, 2) do not provide any direct benefit to ratepayers, and 3) including such expenditures in rates places the ratepayer in the position of being an involuntary donor to the organization in question.

POSTAGE EXPENSES

Q. Please describe the Staff's postage expense adjustment, Income Statement adjustment S-35.3.

A. Adjustment S-35.3 reflects the increase on postal rates which became effective January 2006.

To calculate its adjustment, Staff reviewed postage expenses from the Company workpapers for 2005 and 2006. The Company provided Staff with the number of mailings that was posted in 2005 and multiplied the 2005 postage expense rate by 5.4% to derive the incremental adjustment to postage expense for the January 2006 postage increase.

AMORTIZATION EXPENSE

Q. Please explain adjustment S-59.1

A. Adjustment S-59.1 annualizes the Company's amortization expenses.

PROPERTY TAXES

Q. Please explain Adjustment S-60.3.

A. This adjustment brings the test year December 2005 balance to the annualized property tax expense level for MGE

Q. How did the Staff compute property tax expense in this case?

A. The Staff examined the actual amounts of property tax payments made by MGE for 2001 through 2005. The Staff analyzed the relationship of actual property tax payments to the level of property at January 1 of each of these years. Staff applied the 2005 actual property tax rate to the plant in service balance at the end of test year period, December 31, 2005, to calculate an annualized property tax amount in this case.

Q. How are property taxes paid?

A. The state and local taxing authorities determine the annual property tax payment through an assessment of utilities' real property. This assessment is made based upon the utilities' property balances on January 1 of each year. The taxing authorities also determine a property tax rate that is applied to the assessed values to compute the property tax amount billed to utilities.

Q. When are property taxes paid by the utility?

A. The property taxes related to a utility's plant in service level at January 1 of each year are paid to the state and local taxing authorities at the end of each year, generally by December 31st.

Q. Are a portion of MGE's property taxes currently subject to legal dispute?

A. Yes. In recent years, both the states of Oklahoma and Kansas have attempted to collect property taxes from gas local distribution companies (LDCs) for gas held in storage at sites physically located in those jurisdictions. MGE and other LDCs have pursued appeals of these state actions in the court system to overturn the property tax assessments on stored gas.

Q. What is the status of MGE's appeals on this matter?

A. MGE and the other LDCs have received favorable initial rulings in Oklahoma concerning their property tax liability for gas held in storage. Based on the Company's response to Staff Data Request No. 54.28, however, the Oklahoma property tax is subject to further appeals.

In Kansas, MGE and other LDCs have received an initial favorable ruling from the Kansas Board of Tax Appeals. However, as in Oklahoma, a final decision from the Kansas courts system on this matter does not appear to be imminent.

Q. Has the Staff included any of the disputed Oklahoma and Kansas property taxes in its case?

A. No. The Staff believes such amounts should not be collected from Missouri ratepayers until there is a final and non-appealable decision on this issue from the Oklahoma and Kansas court systems.

Q. What is Staff's position on the Accounting Authority Order authorized in Case No. GU-2005-0095?

A. In Case No. GU-2005-0095, the Commission granted MGE authority to defer property taxes billed to it by Kansas taxing authorities for gas held in storage until a final decision on the legality of such taxation was issued in Kansas. The deferral authority granted by the Commission to MGE applied to property taxes billed in Kansas for tax years 2004, 2005 and 2006. The Staff recommends that the Commission grant MGE the authority to continue deferring these costs through the end of an additional tax year (2007), or until a final decision is issued by the Kansas courts, whatever occurs first, when it issues Its Report and Order for this rate proceeding. At such time when MGE ceases deferring these property taxes, it will either begin to amortize the deferred costs to expense, or writing-off the deferred amount, as appropriate.

Q. Did MGE receive a refund of past Missouri property taxes in the test year?

A. Yes, Staff Witness Winter will be addressing this issue in his direct testimony.

INJURIES AND DAMAGES

Q. How did the Company treat injuries and damages in this case?

A. The Company normalized its injuries and damages by taking a three-year average of workmen's compensation claims paid and auto and general liability claims paid and adding that average to the insurance premiums paid during the test year.

Q. How did the Staff treat injuries and damages?

A. The Staff used the same method, but used a five-year average on actual auto and general liability payments.

Q. Why has the Staff used a five-year average?

A. A historical analysis of injuries and damages payouts from 2001 to 2005 by MGE shows that these payments fluctuate. Staff used the five year average to normalize payments as representative of injuries and damages costs for MGE.

INSURANCE EXPENSE

Q. Please explain adjustment S-50.1.

A. This adjustment annualizes the insurance to reflect the premiums in effect at June 2006 to reflect the ongoing and normal expense for this item to MGE.

RATE CASE EXPENSE

Q. Please describe Income Statement adjustment S-53.1.

A. Adjustment S-53.1 removes all test year expenses from FERC account 928, Regulatory Commission Expense. The Staff has proposed separate adjustments to add back normalized and annualized rate case costs to Account 928 (Adjustment Nos S-53.2, S-53.3, S-53.4, S-53.5, S-53.6 and S-53.7). The Company books costs such as the PSC assessment and rate case expenses to this account.

Q. Please explain Adjustment S-53.4.

A. This adjustment normalizes rate case expenses over a three-year period. The total amount of rate case expenses incurred by MGE in rate case GR-2006-0422 through September 2006 is being allowed at this time. This date falls beyond the test year update period, which ends June 30, 2006, because Staff considers all reasonably incurred expenses by utilities seeking rate changes throughout the rate case process. This approach allows costs such as consulting fees, employee travel expenditures and legal representation, which are directly associated with the length of the case, to be properly included in this case. This adjustment however, does not include those rate case expenses booked within the test year that are associated with Case No. GR-2004-0209, or MGE's prior rate proceeding or any other proceeding. This exclusion is appropriate because the Staff's policy is to recommend recovery in rates of normalized rate case expense only on a prospective basis. Staff believes it is inappropriate to allow specific recovery in rates of amounts related to past rate proceedings.

The Staff will work with the Company through the duration of this case to establish a reasonable and ongoing normalized level of rate case expense for inclusion in rates.

Q. Please explain Adjustments S-53.6 and S-53.7

A. Adjustment S-53.6 and S-53.7 annualize the Infrastructure System Replacement Surcharge (ISRS) Application and the Actual Cost Adjustment (ACA) expenses respectively.

PSC ASSESSMENT

Q. Please discuss Income Statement adjustment S-53.2 to annualize the PSC Assessment.

A. This adjustment represents the difference between the Staff's annualized PSC Assessment and the test year recorded assessment expense. The most recent PSC Assessment, in effect for the fiscal year July 1, 2006 to June 30, 2007, was used in the Staff's annualization.

Q. Please explain adjustment No S-53.5

A. This adjustment normalizes a Commission ordered depreciation study over five years.

Q. Please explain Adjustment S-53.3

A. Adjustment S-53.3 annualizes the National Association of Regulatory Utility Commission assessment.

MISCELLANEOUS EXPENSES

Q. Please explain adjustments S-21.3, S-35.4, S-37.2 and S-47.3.

A. These adjustments remove from the cost of service expenses associated with costs such as retirement meals, retirement cakes, luncheons, entertainment tickets etc. These costs provide no benefit to the ratepayers and are excluded because they are not necessary to the provision of service.

Q. Does this conclude your direct testimony?

A. Yes, it does.

K R M O - A M

ANA.RAB
RADIO 'TEAR SHEET' PROCEDURE
FORM AT BOTTOM OF SHEET INDICATES WHICH COPY RAN.

(417) 235-6041

1569 N. CENTRAL   MONETT MO 65708

CLIENT: MISSOURI GAS ENERGY   ACCOUNT NUMBER: 271

SCRIPT: A   START: 11/21/2005   STOP: 11/24/2005   LENGTH: 15
PRODUCT NAME:

MISSOURI GAS ENERGY
:10

THE EMPLOYEES OF MISSOURI GAS ENERGY WISH YOU A HAPPY HOLIDAY SEASON AND URGE YOU TO CONTINUE TO FOLLOW ENERGY CONSERVATION MEASURES IN YOUR HOMES. WE KNOW ABOUT HIGH ENERGY COSTS, WE'RE CUSTOMERS TOO.

(THIS AD RAN 6XS EACH ON KRMO, KKBL, KSWM AND RAN 16XS ON KQMO FOR THANKSGIVING GREETINGS)

(THIS AD RAN 6XS EACH ON KRMO, KKBL, KSWM AND RAN 15XS ON KQMO FOR CHRISTMAS GREETINGS)

STATION DOCUMENTATION STATEMENT APPROVED BY THE CO-OPERATIVE ADVERTISING COMMITTEE OF THE ASSOCIATION OF NATIONAL ADVERTISERS

This announcement was broadcast 6 time[s], as entered in the station's program log. The times this announcement was broadcast were billed to this station's client on our invoice, as follows:

6 SPOTS AT A RATE OF $ 2.50   TOTAL: $ 15.00
GRAND TOTAL: $ 15.00

Sue Ann Merritt
(Notarize above)

SUE ANN MERRITT
Notary Public - Notary Seal
STATE OF MISSOURI
Lawrence County
My Commission Expires June 19, 2008

DEWAYNE GANDY-Station Official

Schedule PM 1-1

K R M O - A M

ANA.RAB
RADIO 'TEAR SHEET' PROCEDURE
FORM AT BOTTOM OF SHEET INDICATES WHICH COPY RAN.

(417) 235-6041

1569 N. CENTRAL MONETT MO 65708

CLIENT: MISSOURI GAS ENERGY ACCOUNT NUMBER: 271

SCRIPT: B START: 12/20/2004 STOP:12/24/2004 LENGTH: 30
PRODUCT NAME:

MISSOURI GAS ENERGY
:30

CHURCH BELLS RING! CAROLERS SING! THERE'S CHRISTMAS IN THE AIR! THE EMPLOYEES OF MISSOURI GAS ENERGY SEND SEASON'S GREETINGS TO ALL THEIR CUSTOMERS AND FRIENDS THROUGHOUT THE AREA, ESPECIALLY THE CHILDREN: SHARE A CHILD'S HOLIDAY LAUGHTER, AND CAPTURE THAT SPECIAL CHRISTMAS JOY NOW AND THROUGHOUT THE YEAR. HAPPY HOLIDAYS FROM MISSOURI GAS ENERGY!

STATION DOCUMENTATION STATEMENT APPROVED BY THE CO-OPERATIVE ADVERTISING COMMITTEE OF THE ASSOCIATION OF NATIONAL ADVERTISERS

This announcement was broadcast 15 time[s], as entered in the station's program log. The times this announcement was broadcast were billed to this station's client on our invoice, as follows:

15 SPOTS AT A RATE OF $ 10.00 TOTAL: $ 150.00

GRAND TOTAL: $ 150.00

Sue Ann Merritt
(Notarize above)

SUE ANN MERRITT
Notary Public - Notary Seal
STATE OF MISSOURI
Lawrence County
My Commission Expires June 19, 2008

DEWAYNE GANDY-Station Official

Schedule PM 1-2

K R M O - A M

ANA.RAB
RADIO 'TEAR SHEET' PROCEDURE
FORM AT BOTTOM OF SHEET INDICATES WHICH COPY RAN.

(417) 235-6041

1569 N. CENTRAL MONETT MO 65708

CLIENT: MISSOURI GAS ENERGY ACCOUNT NUMBER: 271

SCRIPT: C START: 01/01/2005 STOP:01/04/2005 LENGTH: 30
PRODUCT NAME:

MISSOURI GAS ENERGY
:30

NEW YEAR'S GREETINGS:

THE EMPLOYEES OF MISSOURI GAS ENERGY HOPE YOUR HOLIDAY SEASON HAS BEEN THE BEST EVER, AND THAT YOUR SPECIAL HOLIDAY FEELINGS WILL LINGER THE WHOLE YEAR THROUGH. EACH NEW YEAR BRINGS NEW OPPORTUNITIES FOR ALL, AND WE HOPE THE BRIGHT NEW YEAR STRETCHING OUT IN FRONT OF YOU IS FILLED WITH HAPPINESS AND GOOD HEALTH FOR YOU AND YOUR FAMILY. HAPPY NEW YEAR FROM MISSOURI GAS ENERGY!

STATION DOCUMENTATION STATEMENT APPROVED BY THE CO-OPERATIVE ADVERTISING COMMITTEE OF THE ASSOCIATION OF NATIONAL ADVERTISERS

This announcement was broadcast 12 time[s], as entered in the station's program log. The times this announcement was broadcast were billed to this station's client on our invoice, as follows:

12 SPOTS AT A RATE OF $ 10.00 TOTAL: $ 120.00
GRAND TOTAL: $ 120.00

Sue Ann Merritt
(Notarize above)

SUE ANN MERRITT
Notary Public - Notary Seal
STATE OF MISSOURI
Lawrence County
My Commission Expires June 19, 2008

DEWAYNE GANDY-Station Official

Schedule PM 1-3

OCT 2 6 2005

KSWM / KRMO

This is Pam with Missouri Gas Energy.

Energy prices continue to be high all over the country including natural gas and that's bad for MGE and our customers. Please know that the prices we pay for gas is exactly what you pay. MGE does not benefit from the price of gas - only from the delivery of the gas to our customers. We want what our customers want: an abundant supply of natural gas at affordable prices. In the meantime, we're doing our part by continually looking for ways to purchase natural gas at the lowest available cost. And you can do yours, weatherize, sign up for our level bill payment plan called ABC, and look for energy efficiency ratings when buying new gas appliances. These tips and other good information are available by visiting our website at missourigasenergy.com.

Brought to you by Missouri Gas Energy. The most efficient energy choice for decades is safe, clean, reliable natural gas...feel the difference.

Sept. 05

Morning News copy

This is Pam with Missouri Gas Energy.

Energy prices continue to be high all over the country including natural gas and that's bad for MGE and our customers. Please know that the prices we pay for gas is exactly what you pay. There is no markup. MGE does not benefit from the price of gas - only from the delivery of the gas to our customers. We want what our customers want: an abundant supply of natural gas at affordable prices. In the meantime, we're doing our part by continually looking for ways to purchase natural gas at the lowest available cost. And you can do yours, weatherize, sign up for our level bill payment plan called ABC, and look for energy efficiency ratings when buying new gas appliances. These tips and other good information are available by visiting our website at missourigasenergy.com.

Brought to you by Missouri Gas Energy. The most efficient energy choice for decades is safe, clean, reliable natural gas...feel the difference.

Sept. 05

This is Pam with Missouri Gas Energy.

We've all pitched in to help the victims of Hurricane Katrina and are wondering when they will be able to return to their lives and their homes. From the day they arrived, they became our neighbors and in the Midwest we take care of our neighbors. That means all of our neighbors past, present, future, permanent or temporary. So give when you can - the Red Cross, Salvation Army, United Way and others continue to need your support. And think about the area fuel funds too - like Missouri Gas Energy's "Neighbors Helping Neighbors" - every dime makes a difference.

Brought to you by Missouri Gas Energy. The most efficient energy choice for decades is safe, clean, reliable natural gas...feel the difference.

March 2005

This is Pam with Missouri Gas Energy. Spring weather is here, however, many families struggle to pay their winter heating bills and their summer cooling bills. You can help by contributing to one of the fuel funds available in your community, or to Missouri Gas Energy's Neighbors Helping Neighbors Program on your next natural gas bill. Giving a dollar or two each month can make a big difference to those in need. Visit missourigasenergy.com to sign up or for more information.

Brought to you by Missouri Gas Energy - The most affordable energy choice for decades is safe, clean, reliable natural gas...compare the difference.

DEC 2 8 2005

The Employees Of Missouri Gas Energy Are Proud To Join Kansas City

SHARED

MGE MISSOURI GAS ENERGY

Dr. Martin Luther King, Jr. -- Whether seen as a pragmatist, a radical, a prophet or a politician, his lasting legacy is that he helped open doors than can never again be closed.

DREAMS

In Celebrating The Life And Legacy Of Dr. Martin Luther King, Jr.

Advertisement in the 2006 Commemorative Book.

9.05

MGE MISSOURI GAS ENERGY

Salutes One Of

Our Country's Greatest Resources:

The American Business Woman

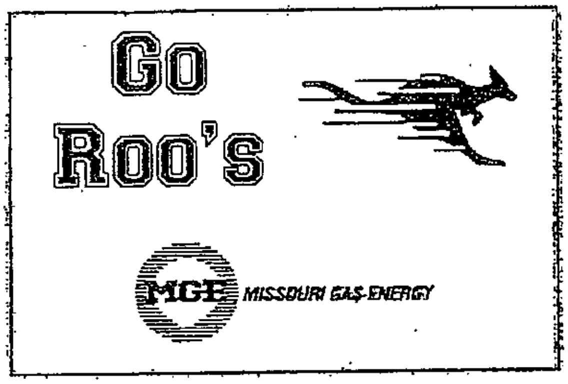
Advertisement in the American Business Women's Day Souvenir Booklet.

MGE MISSOURI GAS ENERGY (MGE) is proud to serve it's customers each and every day - - natural gas is clean, safe, reliable and efficient.
Congratulations to the graduating class of 2005 from MGE's employee's and customers.

Independence School District - Support Project Graduation by sponsoring an advertisement in the Independence Examiner newspaper.

MAR 14 2005

JUL 21 2005



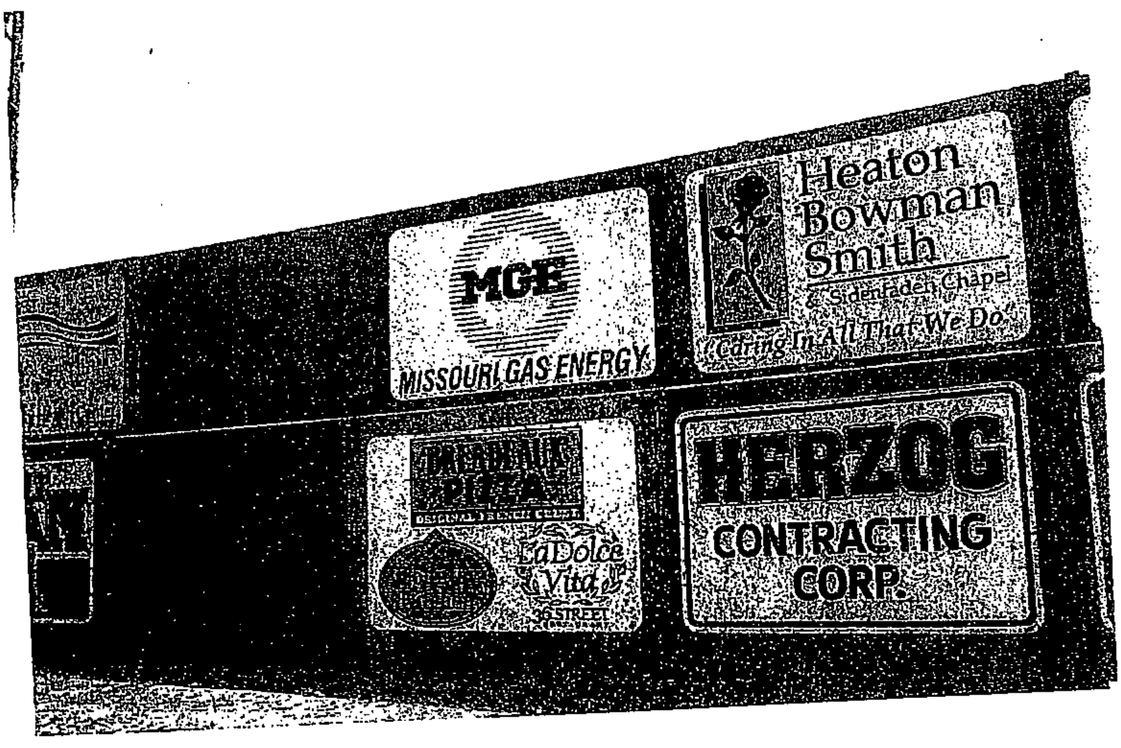
8·04

2004 Univ of KC
Basketball Yearbook

Same in 7·05

University Sports Publication
Advertisement placed in the
2005 University of Missouri
at Kansas City basketball yearbook.

St. Jos[illegible]



St. Joseph

JUN 27 2005