

Exhibit No.: 861
Issues: True-Up Audit, Rate Case Expense
Witness: Charles R. Hyneman
Sponsoring Party: MoPSC Staff
Type of Exhibit: True-Up Direct Testimony
Case No.: GR-2004-0209
Date Testimony Prepared: July 19, 2004

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

TRUE-UP DIRECT TESTIMONY

OF

CHARLES R. HYNEMAN

FILED

JUL 29 2004

MISSOURI GAS ENERGY

Missouri Public
Service Commission

CASE NO. GR-2004-0209

*Jefferson City, Missouri
July 2004*

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

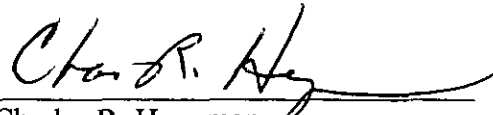
In the Matter of Missouri Gas Energy's)
Tariffs to Implement a General Rate)
Increase for Natural Gas Service)

Case No. GR-2004-0209

AFFIDAVIT OF CHARLES R. HYNEMAN

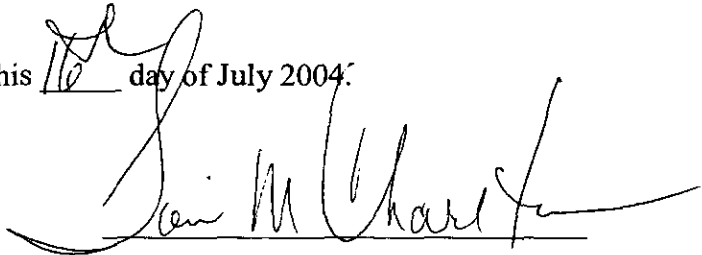
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

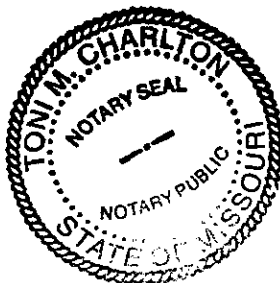
Charles R. Hyneman, being of lawful age, on his oath states: that he has participated in the preparation of the following true-up direct testimony in question and answer form, consisting of 10 pages to be presented in the above case; that the answers in the following true-up direct testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.



Charles R. Hyneman

Subscribed and sworn to before me this 10 day of July 2004.





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

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TRUE-UP DIRECT TESTIMONY
CHARLES R. HYNEMAN
MISSOURI GAS ENERGY
CASE NO. GR-2004-0209**

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1 **TRUE-UP DIRECT TESTIMONY**

2 **OF**

3 **CHARLES R. HYNEMAN**

4 **MISSOURI GAS ENERGY**

5 **CASE NO. GR-2004-0209**

6 Q. Please state your name and business address.

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

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

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

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

14 A. Yes, I am.

15 Q. What is the purpose of your true-up direct testimony?

16 A. The purpose of this testimony is to present to the Commission the results
17 of the Staff's true-up audit of Missouri Gas Energy's (MGE) revenue requirement. The
18 Staff updated its recommended level of MGE's revenue requirement based on a review of
19 certain components of MGE's books and records through the end of the Commission-
20 ordered true-up period of April 30, 2004.

21 **TRUE-UP AUDIT**

22 Q. What components were included in the Staff's true-up audit?

1 A. The revenue requirement components included in the Staff's audit
2 included all rate base components with the exception of gas inventory, alternative
3 minimum taxes, corporate allocated plant, corporate allocated deferred taxes and cash
4 working capital. Gas inventory and alternative minimum taxes were not included
5 because the parties to the case settled these components as to dollar amount. Also,
6 because corporate allocated costs were not included in the true-up, the rate base
7 components of corporate allocated plant and deferred taxes were not updated.

8 The major income statement expenses that were updated include postretirement
9 benefits expense (OPEBs), amortization of the prepaid pension asset, payroll and payroll
10 taxes, employee benefits, medical and dental expenses and rate case expense.

11 Finally, the Staff updated Southern Union's capital structure and cost of long-term
12 debt, which is discussed in the true-up testimony of Staff witness David Murray.

13 Q. What were the results of the Staff's true-up audit?

14 A. The true-up audit resulted in an increase in the Staff's proposed revenue
15 requirement for MGE from \$8,944,747 to \$12,742,038 at the midpoint rate of return, or
16 an increase of approximately \$3.8 million. This amount is reflected in the Staff's True-
17 up Accounting Schedules which are being separately filed today.

18 Q. What changes in the components of MGE's revenue requirement had a
19 significant impact on the increase in the Staff's proposed revenue requirement?

20 A. Staff witness Murray's recommended update of Southern Union's capital
21 structure resulted in approximately \$2.7 million of the increase. Payroll increases were
22 approximately \$1 million; medical expenses \$451,000; and OPEB expense increased by

1 approximately \$249,000. These revenue requirement increases were partially offset by
2 the increase in accumulated deferred income taxes of approximately \$630,000.

3 **RATE CASE EXPENSE**

4 Q. What level of rate case expense is MGE seeking to recover in rates in this
5 case?

6 A. MGE has advised Staff that it is seeking to recover approximately
7 \$1.3 million in costs associated with this rate case.

8 Q. Is this level of rate case expense reasonable in amount?

9 A. No. The Staff has reviewed the levels of rate case expense incurred by
10 utilities in Missouri in recent rate proceedings. From this review, the Staff has found that
11 the greatest level of rate case expense claimed for recovery by a utility in a rate increase
12 proceeding was \$750,000 in Case No. ER-2001-672, UtiliCorp United, Inc.

13 Q. What were the levels of rate case expense allowed for recovery in MGE's
14 previous litigated rate cases?

15 A. In MGE's first rate case in Missouri, Case No. GR-96-285, there were
16 59 litigated issues. The Commission approved \$537,186 in rate case expense for that
17 case. In MGE's second rate case in Missouri, Case No. GR-98-140, the Commission
18 approved \$579,566 in rate case expense. The very fact that MGE is seeking over two
19 times the amount of rate case expense the Commission allowed in its last litigated rate
20 case indicates that the level of expense MGE asks to recover is questionable.

21 Q. Has the Commission previously commented upon the amount of rate case
22 expenses for which MGE has sought rate recovery?

1 A. Yes. The Commission found in its Report and Order in Case
2 No. GR-98-140 that:

3 The costs claimed by the Company in this case in the amount of
4 \$928,210 is excessive and many of the costs the Company claims
5 such as the fees for Dennis Gilmore and the Coopers and
6 Lybrand's amicus brief are simply imprudent.

7 Q. Is all of MGE's proposed level of \$1.3 million in rate case expense
8 supported by appropriate documentation, such as invoices?

9 A. No. A substantial amount of the \$1.3 million being sought by MGE is
10 based on estimated costs with no supporting documentation. At this time, only
11 approximately \$750,000 of MGE's proposed \$1.3 million in rate case expense is
12 supported by invoices. Most of the remaining \$550,000 in claimed costs consist of
13 unsupported and undocumented cost estimates from the New York office of the law firm
14 Kasowitz, Benson, Torres & Friedman. Messrs. Eric Herschmann and Michael Fay are
15 partners of this law firm and performed legal services for MGE on the issues of capital
16 structure and rate of return in this case. The estimated costs for their legal services for
17 the months of April through June 2004 alone are \$505,000. Schedule 1 attached to this
18 testimony shows these cost estimates.

19 Q. Should the Commission allow recovery of rate case expenses that are
20 based on estimated costs?

21 A. No. This Commission generally follows the principle that only costs that
22 are known and measurable, in addition to being reasonable and prudent, should be
23 allowed rate recovery. Cost estimates of rate case expense without supporting
24 documentation do not meet the known and measurable standard.

True-up Direct Testimony of
Charles R. Hyneman

1 Q. Did MGE provide any reasons why the invoices supporting the legal
2 services provided by Messrs. Herschmann and Fay for April, May and June 2004 could
3 not be provided to the Staff during its true-up audit conducted during the week ending
4 July 16, 2004?

5 A. No.

6 Q. Does the Staff have some concerns about the documentation supporting
7 the \$750,000 in rate case expense that is supported by invoices?

8 A. Yes. For example, the Staff reviewed \$29,490 in invoices from the firm
9 Klett Rooney Lieber & Schorling. This firm employs Mr. John Quain, who filed
10 testimony for MGE on regulatory policy in this case. The invoices reviewed by the Staff
11 show that this firm receives a monthly retainer of \$20,000 from Southern Union
12 Company for regulatory and legislative activities. The invoices have no description of
13 the type of work performed, number of hours worked and cost per hour of the work
14 performed by Mr. Quain specifically for MGE. No documentation was provided to the
15 Staff to show that the work performed by Mr. Quain during this period was related to the
16 rate case, nor that this cost was a reasonable expenditure on the part of MGE.

17 Q. Is it common for outside vendors, such as legal firms, to provide adequate
18 documentation in support of the billing of services provided to MGE?

19 A. Yes. I have reviewed significantly all of MGE's legal invoices in this case
20 and its previous rate case, No. GR-2001-292. Substantially all of the invoices I reviewed
21 included at least an adequate description of the work provided, the number of hours spent
22 and the rate charged per hour.

True-up Direct Testimony of
Charles R. Hyneman

1 Q. Is there another example of MGE paying for invoices that were not
2 supported by adequate documentation?

3 A. Yes. Black & Veatch Corporation (Black & Veatch), an outside vendor
4 who performs substantially all of MGE's depreciation consulting work, submitted
5 invoices related to this case in the amount of \$59,000 for 275 hours of work. However,
6 the invoices submitted to MGE and approved by MGE do not include a description of the
7 type of work provided. The only information provided was the name of the consultant
8 who did the work and the number of hours charged during that billing period.

9 Also, one of MGE's rate of return and capital structure witnesses in this case,
10 John Dunn, submitted invoices in excess of \$50,000 with only a minor description of the
11 type of work performed.

12 Q. In response to the concerns conveyed to MGE, did MGE provide to the
13 Staff a description of the work provided by Black & Veatch?

14 A. Yes. A sheet describing these services was obtained by MGE from Black
15 & Veatch on July 16, 2004, and provided to the Staff.

16 Q. Did some vendors who performed services for MGE on this rate case
17 provide detailed supporting documentation in support of the amounts charged?

18 A. Yes. R.J. Covington Consulting, LLC, MGE's consultant on revenues,
19 and Brydon, Swearingen & England, MGE's outside legal counsel, provided adequate
20 documentation supporting the costs of the services performed. These invoices included a
21 description of the type of work performed each day, the rate per hour, and the total cost
22 charged.

1 Q. What is the Staff's primary concern with the lack of documentation
2 provided by some of the consultants who provided rate case services to MGE on this
3 case?

4 A. The Staff's concern is with MGE's internal controls over the amounts paid
5 for outside consulting work.

6 When work is performed by an outside consultant, there is an opportunity for
7 abuse. The process used by a utility to contract for services from an outside vendor
8 should attempt to ensure that costs paid for outside services are competitive in the
9 market, and that the charges for the work performed are commensurate with the quality
10 and amount of work performed. Reasonable internal controls that should be employed to
11 protect company resources are competitive bidding (to ensure prices paid are reasonable)
12 and requiring adequate detailed documentation supporting the charges for the services
13 performed.

14 Q. Has MGE employed either of these internal controls in relation to the
15 payment for rate case expenses in this case?

16 A. Apparently not. In response to Staff Data Request No. 322, MGE
17 indicated that it did not solicit competitive bids for any of the services provided in this
18 rate case. Given this fact, the Staff is not aware how MGE could have determined that
19 the costs of the services provided to it in this rate case are reasonable. Also, as described
20 above, MGE's internal controls over the required documentation supporting payment for
21 rate case expenses in this case is very weak.

22 Q. Is the Staff aware of any other internal control problems related to MGE's
23 handling of rate case expense in this case?

1 A. Yes. In response to Staff Data Request No. 322, MGE provided Southern
2 Union's policy on approving the hiring of outside consultants, which was issued by
3 Southern Union on February 2, 2004. The policy states that "consultants may only be
4 engaged with the prior written consent of the Company's President and Chief Operating
5 Officer when the estimated annual cost of such Consultant exceeds \$10,000 or when the
6 duration of such consultant's work and/or contract exceeds six months."

7 The Staff is aware that one of MGE's rate of return and capital structure witnesses
8 in this case, Roger Morin, was hired by MGE at a cost of \$30,000 and prior written
9 consent of Southern Union's President and Chief Operating Officer was not obtained
10 prior to the submission of his rebuttal testimony in this proceeding. This is just another
11 example which indicates that MGE's application of internal controls in relation to rate
12 case expense in this case is flawed.

13 Q. Does the Staff believe that MGE has paid excessive costs for the legal
14 services it received in this case?

15 A. Yes. For example, MGE's outside legal counsel Brydon, Swearingen and
16 England have over 30 years experience with all type of regulatory matters, especially the
17 processing of litigated rate cases in Missouri. MGE has employed this firm for
18 substantially all of its regulatory cases since 1996, and continues to employ this firm
19 today. The Staff have reviewed invoices submitted by Brydon, Swearingen and England
20 in this case, and this firm charges MGE approximately \$200 per hour for rate case work.
21 It is safe to say that MGE has found this rate per hour to be reasonable and the work by
22 Brydon, Swearingen and England to be satisfactory.

1 However, in this case, and for the first time since it began operations in Missouri,
2 MGE hired the firm of New York firm of Kasowitz, Benson, Torres & Friedman for rate
3 case work. Specifically, MGE employed the services of Eric Herschmann and
4 Michael Fay at a rate of \$670 to \$690 per hour.

5 Of particular concern is that MGE is seeking approximately \$600,000 in rate case
6 expense for the services performed by Messrs. Herschmann and Fay when, according to
7 MGE's response to Office of the Public Counsel (OPC) Data Request No. 1065,
8 "Mr. Herschmann and Mr. Fay have not litigated any regulated utility rate cases other
9 than the immediate proceeding." MGE pays \$200 per hour for a Missouri firm with more
10 than 30 years experience in Missouri rate cases, and almost \$700 an hour to a New York
11 firm for attorneys with no regulatory experience. The costs paid to Kasowitz, Benson,
12 Torres & Friedman are excessive and unreasonable and they should not be recovered
13 from Missouri ratepayers.

14 Q. In addition, does the Staff have any other concerns with the invoices
15 submitted by the firm Kasowitz, Benson, Torres & Friedman?

16 A. Yes, there are internal control questions on some of the invoices. The
17 invoice submitted on December 31, 2003, was for \$6,440 for 11.2 hours, equivalent to a
18 rate of \$575 per hour. All subsequent invoices (including other work done in December
19 2003), and cost estimates submitted by this firm reflect an hourly rate of \$670 and \$690
20 per hour with no explanation for the \$100 per hour increase.

21 Q. Has MGE engaged the legal services of another firm where the Staff
22 considers the costs charged to MGE to be excessive?

True-up Direct Testimony of
Charles R. Hyneman

1 A. Yes. MGE hired the firm Watson Bishop London Brophy, P.C. from
2 Austin, Texas. The Staff's review of the invoices from this firm indicate that the only
3 service provided by this firm was legal research and litigation preparation. This firm
4 charged MGE approximately \$50,000 at a rate of \$265 per hour. The Staff considers this
5 cost to be redundant and excessive. This cost should not be charged to MGE's
6 ratepayers.

7 Q. Considering what the Staff finds to be major problems with MGE's
8 control over rate case expenses and the excessive costs incurred by MGE in this case,
9 what level of rate case expense does the Staff recommend to the Commission to be
10 included in rates in this case?

11 A. The Staff believes that the Commission should allow \$650,000 in rate case
12 expense to be amortized over 3 years. This amount approximates what the Commission
13 found to be reasonable and prudent in MGE's last litigated rate case, Case
14 No. GR-98-140. It also exceeds the amount found reasonable by the Commission in Case
15 No. GR-96-285, a case where MGE litigated 59 issues before this Commission. If the
16 Commission does not adopt this recommendation, then the Staff as an alternative
17 recommends that MGE be allowed to recover no more than \$750,000 over three years,
18 which the Staff has found to be the highest level of rate case expense claimed by a utility
19 for a rate increase case in this jurisdiction.

20 Q. Does this conclude your true-up direct testimony?

21 A. Yes, it does.

Mike Noack

From: Lisa Jicha [LJicha@kasowitz.com]
Sent: Wednesday, July 14, 2004 4:46 PM
To: mnoack@mgemail.com
Cc: Eric D. Herschmann
Subject: KBT&F Estimates

April:

Herschmann - 115.20 - \$79,488

Fay - 69.00 - \$47,610

Olacio (para.) - 8.10 - \$1,134.00

May:

Herschmann - 112.00 - \$77,280

Fay - 92.00 - \$63,480

Hawry (para.) - 5.70 - \$1,111.50

Rafael (para.) - 7.50 - \$1,050

June:

Herschmann - 220.90 - \$152,421

Fay - 116.90 - \$80,661

Rafael (para.) - 17.00 - \$2,380

Shakir (para.) - 3.60 - \$432

Lisa Jicha
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