Exhibit No.:	
Issues:	*Revenues; Bad Debt; Manufactured Gas Plant Environmental Fund*
Witness:	*Paul R. Harrison*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Rebuttal Testimony*
Case No.:	*GR-2004-0209*
Date Testimony Prepared:	*May 24, 2004*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

PAUL R. HARRISON

MISSOURI GAS ENERGY

CASE NO. GR-2004-0209

Jefferson City, Missouri
May 2004

****Denotes Highly Confidential Information****

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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 PAUL R. HARRISON

STATE OF MISSOURI COUNTY OF COLE	)))	ss.

Paul R. Harrison, being of lawful age, on his oath states: that he has participated in the preparation of the following amended rebuttal testimony in question and answer form, consisting of 11 pages to be presented in the above case; that the answers in the following amended rebuttal testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Paul R. Harrison

Subscribed and sworn to before me this 21st day of May 2004.

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

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

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MISSOURI GAS ENERGY

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Q. Please state your name and business address.

A. Paul R. Harrison, P. O. Box 360, Jefferson City, Missouri 65102.

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

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

Q. Have you previously submitted testimony in this proceeding?

A. Yes, I have previously submitted direct testimony in this case.

Q. What is the purpose of your rebuttal testimony?

A The purpose of my testimony is to update the Staff's proposed annualized and normalized level of revenues based upon updated customer numbers received from Missouri Gas Energy (MGE or Company). In addition, I will respond to the direct testimony of MGE witness Michael R. Noack involving bad debt expense and MGE's proposed Manufactured Gas Plant Environmental Response Fund (ERF).

<u>REVENUES</u>

Q. Please explain why the Commission Staff's (Staff's) annualization of revenues has changed from the level included in its direct filing.

A. In my direct testimony, I identified on pages 11 and 12 that data obtained from MGE indicated it experienced customer losses during the period July through December 2003. The Staff believed that one possible reason for this apparent customer loss was faulty data computation from the Company's customer software system (CSS) downloads. As a result of this belief, the Staff used the actual customer numbers for the test year to annualize customer growth in its direct filing. During the prehearing conference that took place on May 3 through May 6, 2004, the Company acknowledged that three Kansas City town codes had been inadvertently dropped from the CSS download for all three of its customer classes since July 2003. After receiving the new and accurate customer numbers, the Staff has updated its customer growth annualization through December 31, 2003, the end of the test year update period.

Q. Please explain how the Staff annualized gas operating revenues for the residential, small general service (SGS) and large general service (LGS) class customers through December 31, 2003.

A. The annualization of residential, SGS and LGS customer revenues contains two components; the base charge and the commodity charge. The base charge is the minimum monthly charge that MGE assesses to a customer for supplying the gas service. The monthly base charge revenue is calculated by multiplying the base charge by the Staff's proposed monthly level of customers. The Staff's annualized base charge revenue is the sum of the twelve monthly base charge revenues. SGS and LGS customers have two commodity charges covering different periods (November through March and April through October) of the year. In addition, residential and LGS customers have only one commodity charge rate block, while SGS customers have two commodity charge rate blocks. For SGS customers, block one represents usage of 0 through 600 Ccf and block two represents usage over 600 Ccf by month.

For SGS customers, the Staff allocated the normal monthly usages to each of the Company's rate blocks and then multiplied the blocked usage by the appropriate block commodity charge. The sum of each rate block for each of the twelve months was the Staff's annualized commodity revenue. The total annualized revenue for the residential, SGS and LGS rate class was calculated by adding the annualized base charge revenues to the annualized commodity charges.

Q. Please explain how the annualized level of residential, SGS and LGS customers was determined.

A. The Staff used a three-step process to calculate customer growth for MGE's three different classes of customers. During the first step, the Staff divided each month of the year by the twelve-month total of customers for that same year to determine the percentage of customers within each month. Then, the Staff added the percentage of each month of the past six years (January 1998 thru January 2003, February 1998 thru February 2003, etc…) and divided that number by six to get the monthly average of each month for the six-year period.

The second step of the process involved dividing the December level of customers for each year by the twelve-month average of the following year. This process created a percentage that was summed for the most current five years, and then divided by five to determine a five-year average.

The third step of this process was to take this number and divide the December 31, 2003 customer count by the five-year average that was determined in the second step above. The number that was created in the third step is then multiplied by twelve to calculate an annualized number of customers. The annualized number of customers was then multiplied by the monthly percentage that was created in the first step to create average monthly customers for each month of the test year. The monthly final bill for customers that are discontinuing service with MGE, were subtracted from the monthly averaged customers to develop the monthly-annualized customers for the test year as updated.

<u>BAD DEBT EXPENSE</u>

Q. At page 25 of his direct testimony, Company witness Noack refers to his Schedule G-3 and states that when comparing MGE actual bad debt expense with the rate case allowance in past cases MGE has realized a shortfall of $12,717,264 over the last eight years, or $1,589,658 per year. Do you agree with that conclusion?

A. No. Mr. Noack is comparing to the rate allowance the amount that is accrued on the Company's books for bad debt expense in account 904, instead of actual bad debt write-offs. It has been a traditional Commission practice to use actual write-offs to base the amount of bad debts to include in rates, not expense accruals. When one compares the actual bad debt write-offs to the amount that was allowed in rates since the beginning of 1997, $1,477,405 of the $1,589,658 per year that was identified by Mr. Noack can be accounted for in just one year. The Company had $14,666,835 of actual bad debt write-offs during the calendar year of 2001. This amount is far above the amount of actual write-offs the Company has incurred before or since. Below is a table that properly compares MGE's bad debt write-offs to the rate allowance for this item for the calendar years 1997-2003.

Year	Bad Debt Write-Offs	Rate Allowance
1997	$5,249,015	$3,409,662
1998	$5,327,307	$3,409,662
1999	$2,507,947	$4,325,000
2000	$2,531,756	$4,325,000
2001	$14,666,835	$4,325,000
2002	$5,544,382	$4,323,292
2003	$5,426,928	$4,323,292

Q. Is it appropriate to normalize bad debt expense for rate purposes?

A. Yes, due to the volatility shown in the amount of annual write-offs for the period shown in the above table, it would be appropriate to normalize. The Staff recommends a five-year average of bad debt write-offs for rate purposes in this case of $6,135,570.

Q. After eliminating the impact of the "spike" in bad debt write-offs in calendar year 2001, was there any additional shortfall in rates for bad debts over the past five years?

A. No, after eliminating the impact of the "spike" in bad debt write-offs in calendar year 2001, the Company would have over-recovered in rates for bad debt expense approximately $1.3 million or $321,393 per year over the last five years.

MANUFACTURED GAS PLANT

Q. What are manufactured gas plant (MGP) remediation costs?

A. MGP remediation costs can be defined as all costs relating to investigation, testing, land acquisition if appropriate, remediation and/or litigation, and expenses or other liabilities, excluding personal injury claims, specifically relating to gas manufacturing facility sites, disposal sites, or sites to which material may have migrated, as a result of the operation or decommissioning of gas manufacturing facilities.

Q. Please explain the Environmental Response Fund (ERF) proposed by Company witness Noack.

A. This issue relates to the Company's proposal to establish an ERF to be included in rates of $750,000 for clean up of sites where previous owners of MGE’s properties formerly operated a MGP. This proposal is discussed in the direct testimony of Company witness Noack at pages 22 and 23 and Schedule H-28 of the Company workpapers.

The ERF is intended to work as a “tracking mechanism” by which MGP costs (of unknown future quantity) are collected from customers through a separate rate element, and later “trued up” by the Company by comparing the amount of the rate collections to the MGP expense actually incurred by MGE.

It is my understanding that any over-recovery or under-recovery of MGP costs, as reflected by the tracking mechanism will be refunded to/collected from customers at a later date. Also, as part of this proposal, the Company proposes that fifty percent (50%) of any applicable insurance proceeds and/or contributions obtained from Westar Energy and/or contributions obtained from potentially responsible parties (PRP), net of costs associated with obtaining such proceeds and/or contributions, shall be credited to this fund. Westar Energy is the current name of Western Resources, Inc (WRI); the owner of MGE’s Missouri gas properties prior to 1994.

Q. What happens to the other 50% of insurance proceeds and/or contributions obtained from Westar Energy and/or contributions obtained from PRP’s?

A. In response to Staff Data Request No. 9.3, the Company states that under the terms of the proposed ERF, contributions to and/or proceeds obtained from other parties, net of the cost of obtaining such contributions and/or proceeds, shall be shared evenly between the Company's shareholders (as a form of profit) and customers (as a credit to the ERF). The fund shall also be given credit for the accrued liability in the amount of $3,000,000 recorded on Southern Union Company's (Southern Union) books following the acquisition of the Missouri property (which was to become MGE) from WRI. Southern Union is the parent company of MGE.

Thus, under the Company's ERF proposal, shareholders would receive the benefit of 50% of any insurance proceeds and/or contributions received to reimburse MGE for MGP environmental costs. While customers are expected to pay 100% of the costs of MGPs, they would receive credit for only one-half of any reimbursements.

Q. How are MGP costs treated by MGE?

A. In response to Staff Data Request No. 9.1, the Company states that currently MGP clean-up costs are being booked at the Southern Union's corporate level. No costs are being booked at the MGE level at the present time. The $750,000 proposal for the ERF is an estimate of an appropriate level to use to establish a fund from which future costs can be paid. MGE also believes the ERF is appropriate in that it will prevent future rate shock at such time as the costs are incurred. It is intended that all monies paid into the fund will be held in a separately segregated interest bearing account.

Q. Why is the Company potentially liable to incur MGP cleanup expenditures in the first place?

A. To deal with the contamination and cleanup problems presented by abandoned and/or inactive hazardous waste sites, Congress in 1980 enacted the Comprehensive Environment Compensation and Liability Act (CERCLA or Superfund). CERCLA provided funding and enforcement authority to the Environmental Protection Agency (EPA) to enable it to respond to hazardous substance releases and to enable the EPA to undertake or regulate the cleanup of those hazardous sites where owners/operators were either without resources or unwilling to implement such cleanups.

In 1986, CERCLA was amended by the Superfund Amendments and Reauthorization Act (SARA), which intensified Superfund activities and set a goal of achieving "permanent" solutions at Superfund sites. CERCLA imposes strict, joint, and several liabilities on present or former owners or operators of facilities where substances have been or are threatened to be released into the environment. PRP's include owners of contaminated land from point of contamination to date, operators (which is interpreted as any party that had possession, control, or influence over the premises during the same period), transporters, and generators of the contaminants regardless of whether they directly released such substances into the environment.

Q. For how many Missouri MGP sites is Southern Union a PRP?

A. Southern Union has recognized that it currently has ownership interests in six sites in Missouri that could require potential responsibility for cleanup efforts. In addition to the currently owned sites, the Company has identified fourteen unowned facilities for which it may or may not be a PRP under the Superfund statute.

Q. Has MGE's liability for the above mentioned sites been determined?

A. No. The Company's response to Staff Data Request No. 9.2 states that no final determination has been made for MGE's liability of the above-mentioned sites. Such determinations are typically made through the litigation or settlement process in the event remediation is necessary at a given site. If MGE is held responsible for a given site, MGE will pursue recovery from available PRPs, insurance proceeds or WRI.

Q. What is the Staff's position on the ERF proposal?

A. The Staff believes that the $750,000 environmental fund should not be allowed as an MGE operating expense in this case.

Q. Please explain why the Staff opposes inclusion of MGE's proposed ERF for manufactured gas site remediation costs in MGE's cost of service.

A. The Staff's opposition to the inclusion of the manufactured gas plant site remediation costs in MGE's instant case cost of service is based on a number of reasons. First, MGE and WRI have already recognized and accepted that they, their insurers and potentially other PRP's are responsible for the costs of the MGP remediation.

Pursuant to the terms of the highly confidential *Environmental Liability Agreemen*t (ELA), dated January 31, 1994, (attached as Highly Confidential Schedule 1 to this testimony)** ____

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Q. What are the other reasons the Staff is opposed to rate recovery of MGE's proposed MGP fund?

A. MGE's MGP costs do not meet the longstanding Commission requirement that costs, to be included in cost of service must be known and measurable, During the Staff's field work in this case, MGE was unable to provide the Staff with an estimate or projection of the dollar amount associated with the mediation and clean up of MGP sites.

Also, to the extent the ERF is intended to be used as a true-up or tracking mechanism, and current customers are required to pay for the cost of service not recovered from past customers or be reimbursed for past over-payments in rates (e.g., past rates were set too low or too high), MGE's proposal could constitute single-issue and retroactive ratemaking.

Finally, it has been a longstanding policy of this Commission that shareholders, not ratepayers, receive the benefits of gains or losses (below-the-line treatment) of any sale or removal from service of Company-owned land or other investment. Since it is the shareholder who receives either the gain or the loss on an investment's disposal, it is the shareholder who should shoulder the responsibility for any legal liability that arises at a later date related to the investment.

Q. Does MGE's proposed ERF contain a flaw in design?

A. Yes, automatic recovery of the remediation costs from MGE's customers in rates reduces the incentive for the Company to seek partial or complete recovery of the costs from other past owners of the plant sites or Company's insurers.

Q. How does the Staff recommend that MGE treat any MGP costs it may incur in the future?

A. MGP costs specifically attributable to MGE may be charged to expense and MGE can seek recovery of these costs at an appropriate time. MGE should be prepared to demonstrate that it has maximized recovery from third parties of MGP costs before seeking recovery from customers. In addition, if MGE's MGP costs meet the Commission's requirements for accounting authority orders (AAOs), MGE is free to seek a Commission AAO for these costs.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

SCHEDULE 1

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN IT'S ENTIRETY.