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Witness: Michael R. Noack
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MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NO. GU-2007-0480

SURREBUTTAL TESTIMONY

OF

MICHAEL R. NOACK

Jefferson City, Missouri

July 2008

**SURREBUTTAL TESTIMONY OF MICHAEL R. NOACK
ON BEHALF OF
MISSOURI GAS ENERGY
GU-2007-0480**

INDEX TO TESTIMONY

	<u>Page Number</u>
Response to Paul Harrison's Rebuttal Testimony	2
Response to Ted Robertson's Rebuttal Testimony	8

**SURREBUTTAL TESTIMONY OF MICHAEL R. NOACK
ON BEHALF OF
MISSOURI GAS ENERGY
GU-2007-0480**

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Michael R. Noack, 3420 Broadway, Kansas City, Missouri.

**Q. ARE YOU THE SAME MICHAEL R. NOACK WHO PREVIOUSLY SUBMITTED
DIRECT TESTIMONY IN THIS PROCEEDING?**

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. I will respond to portions of the rebuttal testimony of Staff Witness Paul Harrison and Office of the Public Counsel (OPC) witness Ted Robertson related to their recommendation that the Commission deny MGE's request for an environmental Accounting Authority Order (AAO).

1 **1. Response to Rebuttal Testimony of Staff Witness Harrison**

2 **Q. ON PAGES 4 THROUGH 6, MR. HARRISON TESTIFIES THAT HE AGREES**
3 **WITH YOUR TESTIMONY THAT AN EXPENSE MUST BE EXTRAORDINARY,**
4 **UNUSUAL OR UNIQUE IN ORDER TO BE DEFERRED. DOES HE ALSO AGREE**
5 **WITH YOUR ASSESSMENT THAT MGE’S FORMER MANUFACTURED GAS**
6 **PLANT (FMGP) COSTS MEET THESE CRITERIA?**

7 **A.** No, he does not. On page 6 (lines 20 through 24) of his rebuttal testimony, Mr.
8 Harrison opines that because many gas distribution and electric utilities throughout
9 the United States are incurring MGP-related costs, that these costs should not be
10 considered unusual or unique. Mr. Harrison further opines on page 7 (lines 2
11 through 20) that because Southern Union or MGE has incurred MGP-related costs
12 since 1994 that these costs do not meet the Commission’s non-recurring or
13 “infrequency of occurrence” criteria. Mr. Harrison goes on to testify on page 7 (lines
14 20 through 22) that given the nature of the industry in which MGE operates, Staff
15 does not consider environmental costs unusual in nature.

16
17 **Q. DO YOU AGREE WITH MR. HARRISON’S TESTIMONY?**

18 **A.** Not at all. While it should be pointed out again that Mr. Harrison and I agree that
19 costs, in order to be deferred, should be extraordinary, unusual or unique, Mr.
20 Harrison attempts to characterize MGE’s net FMGP costs overbroadly – as simply
21 environmental costs – in order to support his conclusion that they do not meet the
22 Commission’s criteria for deferral.

1 **Q. ARE MGE’S NET FMGP COSTS EXTRAORDINARY, UNUSUAL, UNIQUE, NOT**
2 **RECURRING AND MATERIAL?**

3 A. Yes. As explained in the testimony of MGE witness Callaway, FMGP costs are
4 highly unpredictable in terms of nature, amount and timing. So while it is true that
5 MGE has incurred some form of FMGP cost on an annual basis since the
6 acquisition by Southern Union in February of 1994, analysis of the nature of those
7 costs demonstrates that they vary significantly in both nature and amount over time.
8 For example, in 2003 MGE spent more than \$6.4 million in FMGP-related costs –
9 which included \$3.4 million in payments to settle litigation, \$.3 million in legal fees
10 and \$2.7 million in technical services fees and other costs – while in 2004, the very
11 next year, MGE spent only \$615,000 in FMGP-related costs. This variability is one
12 factor driving the unusual nature of MGE’s FMGP costs. Because MGE’s FMGP
13 costs vary so substantially from year to year, it is difficult if not impossible to
14 determine a “normal” level of FMGP-related costs to include in MGE’s cost of
15 service.

16
17 Another reason that MGE’s FMGP costs are unusual and unique is that, until
18 recently, those costs have been completely offset by recoveries that have been
19 obtained over the years. Thus, even if MGE’s historical FMGP costs from 1994
20 through 2007 had been incurred in a manner that could have been “normalized” for
21 ratemaking purposes, this process would have been significantly complicated by the
22 fact that recoveries were (or could have been) obtained during that time period. As

1 explained in the surrebuttal testimony of MGE witness Morgan, the process of
2 obtaining recoveries – whether from insurance carriers, potentially responsible
3 parties or Westar – is inherently uncertain. Whether any further recoveries will
4 occur, how much and when is just not known until those recoveries actually occur,
5 and this factor also makes MGE's net FMGP costs unusual and unique.

6
7 MGE's FMGP costs are also unique and non-recurring because, as explained in the
8 surrebuttal testimony of MGE witness Callaway, the underlying activities are site-
9 specific, will differ depending on the characteristics of each site and, once a
10 particular activity has been undertaken at a particular site, that activity will generally
11 not be repeated again at that site. MGE Witness Callaway describes in her
12 surrebuttal testimony one example of the different underlying activities between
13 MGE's FMGP sites. In particular, she describes how the approaches for work at
14 MGE's Station A and Station B FMGP sites were very different due to the different
15 characteristics of the sites.

16
17 In summary, MGE's FMGP costs are not normal, run of the mill operating expenses
18 for which MGE receives recovery through the rates currently charged customers.

1 Q. YOU HAVE EXPLAINED WHY YOU CONSIDER THE COSTS UNUSUAL AND
2 UNIQUE. WHY DO YOU ALSO CONSIDER THESE COSTS EXTRAORDINARY?

3 A. First I will cite the same definition from the Uniform System of Accounts (USOA) that
4 Mr. Harrison does on page 5 of his rebuttal testimony, namely that "Those items
5 related to the effects of events and transactions which have occurred during the
6 current period and which are of unusual nature and infrequent occurrence shall be
7 considered extraordinary items. Accordingly, they will be events and transactions of
8 significant effect which are abnormal and significantly different from the ordinary
9 and typical activities of the company, and which would not reasonably be expected
10 to recur in the foreseeable future. " It is clear from the definition which Mr. Harrison
11 cites that these remediation costs cannot be defined as anything other than
12 extraordinary. Once MGE cleans up a MGP site, this action will not reasonably be
13 expected to ever recur in the foreseeable future for that site.

14
15 Q. ON PAGE 10 (LINES 12-15), MR. HARRISON TESTIFIES THAT MGE'S COSTS
16 DO NOT MEET THE 5% NET INCOME LEVEL FOUND IN THE UNIFORM
17 SYSTEM OF ACCOUNTS AND ON LINES 16-18, HE TESTIFIES THAT
18 DEFERRAL AUTHORITY SHOULD NOT BE GRANTED UNLESS THE COSTS
19 EXCEED A 5% THRESHOLD. DO YOU AGREE WITH MR. HARRISON?

20 A. No, I do not. First, the 5% of net income materiality rule is not a requirement in
21 order to receive approval from the Commission for an AAO, especially when there is
22 no question that the costs will continue to escalate. When Mr. Harrison's rebuttal

1 testimony was written, MGE's costs for FMGP remediation were less than the
2 combined total of reimbursements from insurance carriers and the \$3,000,000
3 accrued liability booked upon the January 31, 1994 closing in recognition of the
4 Environmental Liability Agreement (ELA) between Southern Union and Western.
5 However, MGE's FMGP costs have continued to escalate and as of June 30, 2008,
6 MGE has incurred costs that exceed reimbursements by \$845,233. The estimated
7 remediation costs to be incurred between June 30, 2008 and December 31, 2008,
8 as discussed in MGE witness Callaway's surrebuttal testimony, are approximately
9 \$3,000,000 making the total of unrecovered remediation costs for 2008
10 approximately \$3,845,233. That number significantly exceeds the 5% threshold
11 mentioned by Mr. Harrison.

12
13 **Q. DO YOU AGREE WITH MR. HARRISON'S TESTIMONY ON PAGE 11 (LINES 18**
14 **AND 19) OF HIS REBUTTAL TESTIMONY THAT "GIVEN THE UNCERTAIN AND**
15 **SPECULATIVE NATURE OF MGE'S FUTURE ENVIRONMENTAL COST LEVELS**
16 **AT THIS TIME, MGE'S INSTANT APPLICATION IS CLEARLY PREMATURE?"**

17 **A.** No. I do not understand his concern in this regard. As shown above, MGE has
18 been incurring FMGP costs at a steady and rapid pace in 2008 and expects to be
19 well above the 5% "threshold" before the end of the year, but even if this was not
20 the case, MGE could not (and would not) defer costs that it does not experience.

1 Q. DO YOU AGREE WITH MR. HARRISON'S TESTIMONY ON PAGE 11 (LINES 25-
2 26) WHERE HE RECOMMENDS THAT THE COMMISSION SHOULD REFUSE TO
3 DEFER OR ALLOW RATE RECOVERY OF ANY ENVIRONMENTAL COSTS
4 THAT OTHERWISE WOULD BE RECOVERABLE FROM WRI BY MGE?

5 A. No. As discussed by MGE witness Morgan, neither MGE nor Southern Union
6 presently knows whether, when or how much might be recovered from Westar
7 under the ELA. MGE has made a demand for payment to Westar and as costs are
8 expended, more demands for payment under the ELA will be made. If or when
9 MGE receives payment from Westar, those recovered funds will be applied to the
10 deferral account and offset against any deferred costs.
11

12 Q. DO YOU AGREE WITH MR. HARRISON'S RECOMMENDATION ON PAGE 14 OF
13 HIS REBUTTAL TESTIMONY WHICH REQUIRES MGE TO ONLY DEFER 50%
14 OF UNREIMBURSED FMGP EXPENDITURES THAT MAY OR MAY NOT BE
15 ELIGIBLE FOR POTENTIAL SHARING WITH WRI UNDER THE ELA?

16 A. No. As discussed in the surrebuttal testimony of MGE witness Morgan, neither
17 MGE nor Southern Union knows whether, when or how much will be recovered from
18 Westar under the ELA. Any recoveries obtained from Westar will be credited to the
19 deferral account as an offset to deferred FMGP costs.
20
21

1 Q. DO HAVE CONCERNS WITH ANY OF MR. HARRISON'S OTHER
2 RECOMMENDATIONS ON PAGE 14 (LINES 10-22)?

3 A. MGE would definitely agree, and in fact has proposed in its application which
4 initiated this proceeding, to credit any recoveries related to FMGP costs against the
5 deferral. However, the requirement that the deferral only last to the earlier of 24
6 months from the effective date of this order or the end of a Commission-ordered
7 test year as updated, or true-up period in MGE's next rate case is too uncertain.
8 MGE would suggest, however, that a more reasonable condition under the
9 circumstances would be that, in order for costs deferred pursuant to authority
10 granted by the Commission in this case to be eligible for rate recovery, MGE must
11 file a rate case within 24 months from the effective date of this order and that the
12 deferral would run through the end of the Commission-ordered test year as
13 updated, or true-up period in MGE's next rate case.

14
15 **2. Response to Rebuttal Testimony of OPC Witness Robertson**

16 Q. DO YOU AGREE WITH THE CONCLUSIONS MR. ROBERTSON REACHES ON
17 PAGES 6 AND 7 OF HIS REBUTTAL TESTIMONY CONCERNING THE ORDER
18 IN CASE NO. GU-2005-0095?

19 A. No. Whether costs are known and measurable is a ratemaking standard, not a
20 standard for the granting of deferral authority. As discussed on page 6 of this
21 testimony, the FMGP costs incurred by MGE are real and, through the second
22 quarter of 2008 have exceeded insurance recoveries by more than \$800,000; these

1 costs are certainly known and measurable. Moreover, as explained in the
2 surrebuttal testimony of MGE witness Callaway, MGE expects to incur some \$3
3 million in FMGP costs at its St. Joseph, Missouri site during the last six months of
4 2008; once incurred, these costs too will become known and measurable. To
5 suggest, as OPC witness Robertson does that such costs do not exist, is simply
6 ludicrous.

7
8 **Q. MR. ROBERTSON, ON PAGE 8 OF HIS REBUTTAL TESTIMONY (LINES 1-6),**
9 **STATES THAT OPC GENERALLY SUPPORTS THE COMMISSION STAFF**
10 **RECOMMENDATION AND MEMORANDUM FILED IN THE CASE AND DOES**
11 **NOT BELIEVE THE AAO IS APPROPRIATE BECAUSE THE STANDARDS FOR**
12 **DEFERRAL AUTHORIZATION HAVE NOT BEEN MET. DO YOU AGREE WITH**
13 **THAT TESTIMONY?**

14 **A.** No. Please see pages 2-5 of this testimony which discusses how the standards for
15 deferral authorization have been met.

16
17 In addition, referring to the same definition from the Uniform System of Accounts
18 (USOA) that Mr. Robertson refers to on pages 34 and 35 of his rebuttal testimony,
19 namely that "Those items related to the effects of events and transactions which
20 have occurred during the current period and which are of unusual nature and
21 infrequent occurrence shall be considered extraordinary items. Accordingly, they
22 will be events and transactions of significant effect which are abnormal and

1 significantly different from the ordinary and typical activities of the company, and
2 which would not reasonably be expected to recur in the foreseeable future”, it is
3 clear that MGE’s FMGP costs cannot be defined as anything other than
4 extraordinary. Once MGE cleans up a FMGP site, this action will not reasonably be
5 expected to ever recur in the foreseeable future at that site.

6
7 **Q. ON PAGE 10 OF MR. ROBERTSON’S REBUTTAL TESTIMONY, HE TESTIFIES**
8 **THAT SOUTHERN UNION HAS NOT YET PRESENTED CLAIMS TO WESTERN**
9 **RESOURCES INC. FOR REMEDIATION COSTS. IS THAT CORRECT?**

10 **A.** At the time Mr. Robertson wrote his rebuttal testimony, MGE had not yet made a
11 claim for remediation costs. As of the time of this testimony, because the costs
12 have exceeded the reimbursements, a request for sharing in the remediation costs
13 has been sent to Western Resources. Please refer to the surrebuttal testimony of
14 MGE witness Morgan.

1 Q. ON PAGE 11 OF MR. ROBERTSON'S TESTIMONY, HE QUESTIONS WHETHER
2 THE REMEDIATION COSTS ARE COMPLETELY OUTSIDE THE CONTROL OF
3 SOUTHERN UNION AND ANSWERS THAT BECAUSE OF THE EXPERIENCE
4 WITH MGP REMEDIATION IN MISSOURI THEY ARE NOT COMPLETELY
5 OUTSIDE OF SOUTHERN UNION'S CONTROL. IS THAT NECESSARILY A BAD
6 THING?

7 A. I am uncertain why OPC witness Robertson raises this topic at all. Whether MGE's
8 FMGP costs (or any other costs for that matter) are completely outside the control of
9 MGE is not any element of the criteria the Commission has ever used to determine
10 whether deferral authority should be granted. I certainly see no relationship
11 between that question and the central issue to this proceeding, which is whether
12 MGE's FMGP costs are unusual, unique, extraordinary, non-recurring and material.
13 Irrespective of this, however, I believe that it is a benefit for both MGE's customers
14 and Southern Union's shareholders that Southern Union has had some experience
15 with FMGP remediation activities. With that experience costs may end up lower
16 than they might otherwise be absent this experience.

1 **Q. IS MR. ROBERTSON'S TESTIMONY CORRECT ON PAGE 14 (LINES 20 AND 21)**
2 **AND PAGE 15 (LINES 1 AND 2) WHERE HE STATES THAT MGE HAS**
3 **CONSISTENTLY ATTEMPTED TO GARNER COMMISSION AUTHORIZATION**
4 **FOR RECOVERY OF THE MGP COSTS IN NEARLY EVERY RATE CASE SINCE**
5 **THE PURCHASE?**

6 **A.** Not really. Although MGE has been concerned about FMGP costs for some time, I
7 am only aware of two rate cases (out of a total of five filed by MGE since 1996)
8 where the topic has been addressed directly: Cases Nos. GR-2004-0209 and GR-
9 2006-0422. In those cases, MGE requested that an "Environmental Response
10 Fund" be set up with rate payer funds so as to mitigate the future rate effect of
11 remediation costs when costs exceeded recoveries. These funding mechanisms
12 were proposed in such a way that they would have been in an interest bearing
13 account set up specifically for these environmental funds collected from rate payers.

15 **Q. ON PAGE 20 MR. ROBERTSON ASKS WHETHER RATEPAYERS SHOULD BE**
16 **HELD RESPONSIBLE FOR FMGP REMEDIATION COSTS RECOVERABLE**
17 **FROM WESTERN RESOURCES INC. OR OTHERS. IS HIS CONCERN VALID?**

18 **A.** No. As discussed earlier and as explained more fully in the surrebuttal testimony of
19 MGE witness Morgan, whether, how much or when any recoveries under the ELA
20 will be obtained from Westar is presently unknown. Nevertheless, any such
21 recoveries – be they from Westar, insurance carriers or potentially responsible
22 parties – would be credited to the deferral account as an offset to deferred costs.

1
2 **Q. MR. ROBERTSON, ON PAGES 28 AND 29 OF HIS REBUTTAL TESTIMONY,**
3 **STATES THAT THE EASIEST WAY TO GET FMGP REMEDIATION COSTS OFF**
4 **OF MGE'S BOOKS IS TO TRANSFER THE LIABILITIES/RECOVERIES BACK TO**
5 **THE CORPORATE BOOKS. IS THIS A REASONABLE PROPOSAL?**

6 A. No. My laymen's understanding is that as an operating division of Southern Union,
7 MGE is not legally discrete from, and is essentially part and parcel of Southern
8 Union. Consequently, whether these costs are on MGE's books or Southern
9 Union's books does not affect the situation one way or the other. The simple fact is
10 that these FMGP costs are identifiable to the MGE business and, as such, should
11 be eligible for ratemaking treatment in Missouri. The transfer of the
12 liabilities/recoveries from the corporate books to the division books was for ease of
13 accounting. Previously corporate accounting had to track all of the costs and
14 recoveries associated with the FMGP cleanup and then either assign directly or
15 allocate those costs back to the divisions or subsidiaries. Those costs associated
16 with MGE plant sites are just as easily accounted for as a MGE direct cost and paid
17 directly by MGE's accounts payable.

1 Q. ON PAGE 32 OF HIS TESTIMONY, MR. ROBERTSON ATTEMPTS TO USE
2 MGE'S RESPONSE TO OPC DR 1007 AS AN EXCUSE FOR THE COMMISSION
3 TO DENY THE REQUEST FOR AN AAO. WHEN YOU REFERRED TO
4 REMEDIATION COSTS AS A "NORMAL COST OF DOING BUSINESS FOR AN
5 LDC THESE DAYS" WHAT WERE YOU REFERRING TO?

6 A. First it needs to be pointed out that Mr. Robertson took his two sentence quote
7 completely out of context. The entire question and answer was as follows:

8 OPC REQUEST:

9 "Regarding Company's response to MPSC Staff DR No. 1, please provide the
10 following:

11 1. If ratepayers are forced to reimburse MGE, or its parent, for MGP
12 remediation costs that were included in the consideration of the purchase
13 price paid for MGE, then wouldn't it be accurate to state that ratepayers
14 would actually be the party that is penalized?

15
16 2. If shareholders of MGE's parent are responsible for the payment of
17 the MGE MGP remediation costs because that was part of the consideration
18 included in the purchase price paid for MGE, then wouldn't it be accurate to
19 state that they would not be penalized for the MGP costs because they paid
20 a lower purchase price for MGE than would have otherwise occurred?

21
22 3. If the purchase price paid to the seller of MGE was lower than it
23 otherwise would have been absent the MGP remediation costs, then isn't it
24 accurate to state that shareholders actually, 1) benefited from the lower
25 purchase price paid for MGE, and 2) would also benefit if ratepayers are held
26 responsible for payment of the MGP remediation costs?"

27
28 MGE Answer:

29 "Before the questions posed can be answered, it is important to set the facts
30 straight as it relates to the purchase of the Western Resources' Missouri
31 properties and the environmental considerations incorporated into the
32 purchase price.
33

1 First- regardless of what was paid for the Western Resources properties,
2 MGE ratepayers only pay a return on the net book value of the gas
3 distribution assets. There is no acquisition premium allowed in rates in
4 Missouri.

5 Second- The first \$3,000,000 of MGP remediation costs have already been
6 paid for by Southern Union as part of the agreement and will not be paid by
7 ratepayers.

8 Third- the actual cost of the future MGP remediation could not be known at
9 the time of the sale and purchase so the parties put a sharing clause in the
10 agreement which splits costs equally between Western and Southern Union
11 up to a total of \$15,000,000 after all other avenues of recovery are
12 exhausted.

13
14 The answer to subpart 1 would be no. The ratepayers are not being
15 penalized. The rate payers do not pay a return on any more than book
16 value for the assets purchased. By deferring the remediation costs for future
17 inclusion in rates, ratepayers will only be paying for the cost of doing
18 business.

19
20 The answer to subpart 2 would also be no. Shareholders would indeed be
21 penalized if they were forced to foot the bill for the remediation. They have
22 already paid for the first \$3,000,000 and are not getting any additional return
23 on their investment. By ignoring the acquisition premium, shareholders have
24 already been penalized.

25
26 The answer to subpart 3 is the same as subpart 2. The shareholders are
27 only being allowed a return on the net book value of the asset purchased.
28 Subpart 3 also assumes the price was lower because of possible MGP
29 remediation. I don't believe that it is necessarily true. If rate payers foot the
30 bill for the remaining remediation costs, shareholders will not be penalized
31 for these. They are not being rewarded by having rate payers pick up the bill
32 for a normal cost of doing business for an LDC these days."

33
34 The term "normal" as used in the response to the DR is referring to the fact that
35 many LDC's across the nation are facing the same kind of FMGP-related
36 environmental concerns as MGE. A review of the various state Utility Commissions
37 on Lexis indicated that over the last 15 years, about 29 state utility commissions,
38 plus the District of Columbia have issued some type of order either allowing deferral

1 of FMGP environmental remediation costs or the recovery of such costs through
2 rates.

3
4 **Q. IS THE CHARACTERIZATION MR. ROBERTSON MAKES ON PAGE 33 OF HIS**
5 **REBUTTAL TESTIMONY WHEN HE REFERS TO SOUTHERN UNION'S**
6 **"ACCOUNTING SHUFFLE" ACCURATE?**

7 A. No, it is not. As explained earlier in my testimony, the cost center for MGE's FMGP
8 remediation costs was moved from Corporate to MGE to simplify the accounting.
9 Before that change was made, as Mr. Robertson should be well aware, the costs
10 were recorded on the corporate books in a liability account. There has been no
11 attempt to shift FMGP remediation liabilities to MGE by this change in the recording
12 of the costs nor do I see any way in which the change "taints" Missouri ratepayers.

13
14
15 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

16 A. Yes, at this time.
17

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of)
Missouri Gas Energy, a Division of)
Southern Union Company, for an)
Accounting Authority Order Concerning)
Environmental Compliance Activities)

Case No. GU-2007-0480

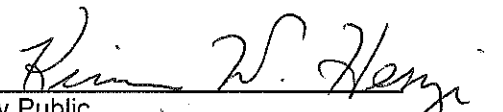
AFFIDAVIT OF MICHAEL R. NOACK

STATE OF MISSOURI)
)
COUNTY OF JACKSON) ss.

Michael R. Noack, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, to be presented in the above case; that the answers in the foregoing Surrebuttal 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.


MICHAEL R. NOACK

Subscribed and sworn to before me this 8th day of JULY 2008.


Notary Public Kim W. Henzi

My Commission Expires: 2-3-11

