

*Exhibit No.:*  
*Issues:* *Environmental Expense*  
*FAS 106/OPEBs*  
*Witness:* *Mark L. Oligschlaeger*  
*Sponsoring Party:* *MoPSC Staff*  
*Type of Exhibit:* *Surrebuttal Testimony*  
*Case No.:* *GR-2009-0355*  
*Date Testimony Prepared:* *October 14, 2009*

**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

**SURREBUTTAL TESTIMONY**

**OF**

**MARK L. OLIGSCHLAEGER**

**MISSOURI GAS ENERGY,  
a Division of Southern Union Company**

**CASE NO. GR-2009-0355**

*Jefferson City, Missouri*  
*October 2009*

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

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**EXECUTIVE SUMMARY ..... 1**

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1           A.       Regarding the issue of environmental expenses, I explain why the Commission  
2 should adjust MGE's ratemaking allowance for environmental remediation costs for insurance  
3 reimbursement offsets and for amounts currently subject to a claim against Western Resources,  
4 Inc. for reimbursement. I also state the Staff's opposition to MGE's alternative request for a  
5 "tracker mechanism" to handle ratemaking treatment of environmental expenses. Finally, I  
6 address OPC's claim that MGE's failure to take into account the existence of "favorable" tax  
7 treatment applicable to its environmental expenditures has caused it to overstate the extent of its  
8 past costs in this area.

9           Regarding the issue of FAS 106/OPEBs costs, this testimony will explain that  
10 MGE's current policy of not funding its full ratemaking recovery of FAS 106 costs is at the very  
11 least imprudent, leaving aside the question of whether it is consistent with state law,  
12 Section 386.315 RSMo.

### 13 **ENVIRONMENTAL EXPENSES**

14           Q.       Has MGE's position changed regarding the amount of environmental remediation  
15 costs to include in its case?

16           A.       Yes. Based upon the rebuttal testimony of MGE witness Noack, the Company  
17 has apparently accepted the Staff's approach to normalizing MGE's costs in this area, using a  
18 three-year average, in the amount of \$2.546 million. However, MGE still opposes offsetting this  
19 expense amount with a normalized level of insurance reimbursements, or reducing the net  
20 remaining amount of expense by 50% on account of the provisions of the Environmental  
21 Liability Agreement (ELA) in place between MGE and Western Resources, Inc. (WRI).

1           Q.     Why does MGE oppose inclusion of insurance proceeds as an offset to its  
2 environmental expenses?

3           A.     According to both Mr. Noack and Mr. Morgan, the amount and timing of such  
4 insurance recoveries is uncertain, and there is no way of knowing whether MGE will receive  
5 such reimbursements in the period that new rates from this case will be in effect.

6           Q.     Do you find this argument persuasive?

7           A.     No. Likewise, the timing of MGE's future environmental clean-up activities and  
8 associated costs is uncertain, but MGE still believes some amount of this cost should be built  
9 into rates in this case. Such uncertainty regarding both future environmental outlay and  
10 insurance reimbursement amounts is typically and is best handled by review and analysis of past  
11 levels of costs and reimbursements to determine an appropriate level for inclusion in rates.

12          Q.     How often has MGE received insurance recoveries that it has offset against its  
13 environmental expenditures?

14          A.     MGE has received insurance reimbursements that it offset against its  
15 environmental costs in four out of the last eight years (2001 through 2008). This includes  
16 recoveries received by the Company in both the test year and the preceding year of 2007. This  
17 history shows that these events occur with sufficient frequency to reasonably include recoveries  
18 in prospective rates.

19          Q.     Over the ten years 1999 – 2008, what percentage of environmental expenditures  
20 has been offset by insurance reimbursements?

21          A.     Over half (57.3%) of MGE's total environmental costs booked during this period  
22 were offset by insurance recoveries.

1 Q. Over the three years 2006 – 2008, what percentage of environmental expenditures  
2 has been offset by insurance recoveries?

3 A. Approximately 26% of MGE’s environmental costs booked during this period  
4 were offset by insurance recoveries. Based on this fact, the Staff has recommended an amount  
5 of insurance recoveries be reflected in its normalization adjustment that would offset  
6 approximately 26% of its adjusted environmental outlays for purposes of setting prospective  
7 rates in this case. To permit MGE full recovery of environmental costs without consideration of  
8 insurance offsets is not reasonable when it has obtained insurance recoveries on a frequent basis  
9 in the past. Full recovery in rates of environmental outlays without consideration of  
10 reimbursements would provide a disincentive to MGE to make every effort to obtain insurance  
11 recovery.

12 Q. Does MGE still have pending discussions with insurance companies concerning  
13 reimbursement or settlement of environmental expenses?

14 A. Yes, per the Company’s response to Staff Data Request No. 139, which is  
15 attached to this rebuttal testimony as Schedule 1. In his rebuttal testimony, Mr. Morgan states  
16 that “there continues to be reasonable prospects of obtaining recoveries on a cost-effective  
17 basis.” (page 6, lines 20-21).

18 Q. Why should the Commission reduce MGE’s recovery of environmental  
19 remediation expenses by half because of the ELA with WRI?

20 A. As explained in the Staff’s Cost of Service Report, filed August 21, 2009,  
21 MGE has filed a claim against WRI for reimbursement of past environmental expenditures.

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Q. Please explain.

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A. Per the terms of the ELA, if MGE does not recover qualifying costs from

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insurance carriers, potentially responsible third parties, or from MGE's customers in rates, WRI

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is liable for half of MGE's qualifying environmental expenditures between February 1994 and

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January 2009 (after MGE has absorbed the first \$3 million of such costs). \*\*

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Q. Both Mr. Noack and Mr. Morgan note that any rate recovery granted to MGE in

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this case will be prospective in nature, and accordingly will not apply to the ELA timeframe,

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which expires in January 2009. Are they correct?

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A. I agree with Mr. Noack and Mr. Morgan about the prospective nature of

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ratemaking in this jurisdiction. However, in this jurisdiction prospective ratemaking allowances

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are normally based upon a review and adjustment of historical incurred costs. \*\*

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Q. Why should this matter to the Commission?

1           A.       MGE's customers may be harmed. Under the structure of the ELA, environmental  
2 costs incurred by MGE in recent years are potentially recoverable from WRI if the Commission  
3 refuses to include the costs in MGE's rates. MGE should be given a strong incentive to attempt  
4 to maximize its recovery of these costs from WRI before MGE turns to its ratepayers for  
5 reimbursement.

6           Q.       As an alternative approach to his suggested three-year normalization average of  
7 gross environmental costs, Mr. Noack suggests use of a "tracker mechanism" to set rates for  
8 MGE's environmental costs in this case. Please comment.

9           A.       As discussed in my rebuttal testimony concerning bad debt expense, the Staff is  
10 opposed to use of trackers in setting rates, except in limited circumstances. For the same reasons  
11 the Staff opposes use of trackers for bad debt expense, we also oppose their use in relation to  
12 environmental remediation costs. Please refer to my rebuttal testimony in this case for more  
13 details behind the Staff's opposition to tracker mechanisms.

14          Q.       Turning to OPC witness Robertson, what aspects of his rebuttal testimony on this  
15 issue would you like to address?

16          A.       At page 3 of his rebuttal testimony, Mr. Robertson claims that MGE's  
17 quantifications as to its total incurred remediation costs have been inflated because that total  
18 does not reflect certain "favorable" tax treatments for those expenses.

19          Q.       What is the basis for this contention?

20          A.       By "favorable" tax treatment, Mr. Robertson appears to be referring to the fact  
21 that MGE's environmental expenditures have been deductible for income tax purposes. Based  
22 upon current federal and state income tax rates, Mr. Robertson opines that this has reduced  
23 MGE's claimed environmental outlays by approximately 37-38%.



1           Q.     Do you agree with Mr. Robertson's perspective on this matter?

2           A.     No. Like virtually all utility expenses allowed in rates, MGE's environmental  
3 costs are considered tax deductible for rate purposes. This means that, if allowed rate recovery,  
4 these costs are included in rates on a dollar-for-dollar basis, without the need for a tax gross-up.

5           Q.     Please provide a simple example of how tax deductibility affects the rate recovery  
6 amount of an item.

7           A.     Assume a utility incurs a cost in the amount of \$10, and this amount is assumed to  
8 be tax-deductible for income tax purposes. In that situation, no additional income tax expense is  
9 associated with that expenditure and, if otherwise reasonable and prudent, ratepayers would be  
10 expected to provide the utility \$10 in rates to cover this item.

11           Alternatively, assume a utility incurs a \$10 cost that is not tax-deductible for rate  
12 purposes. Based upon an effective income tax rate of 38.39%, then the customers would have to  
13 reimburse the utility \$10 in rates for that particular expense, and then pay an additional \$6.23 in  
14 income tax expense to cover the additional amount payable to the federal and state governments  
15 in taxes related to that item. (The tax gross-up factor, assuming an effective tax rate of 38.39%  
16 is 1.623%, or one divided by the reciprocal of the effective tax rate. Application of the tax gross-  
17 up factor in this instance means the utility would have to receive approximately \$16.23 in rates  
18 from the customer in order to retain the \$10 rate allowance for environmental costs after  
19 payment of income taxes.) In short, a tax-deductible expense is less expensive from a ratepayer  
20 perspective than a non-tax deductible expense in the same amount, because there are no  
21 additional income taxes due to federal and state governments related to the expense in question.

22           Q.     Did the Staff assume that its environmental expense rate recommendation in this  
23 case is tax-deductible?

1           A.     Yes, in full.

2           Q.     What is the Staff's conclusion on this matter?

3           A.     As long as an expenditure is assumed to be tax-deductible for rate purposes, its  
4 financial impact should be measured on a dollar-for-dollar basis. MGE's quantifications of its  
5 past net expenditures have been properly valued on a dollar-for-dollar basis. It is not appropriate  
6 to "discount" that item's face value cost to the utility because of its tax-deductibility, as  
7 Mr. Robertson appears to be suggesting in regard to MGE's environmental costs.

8           **FAS 106/OPEBS**

9           Q.     What aspects of Mr. Davis' testimony on FAS 106/OPEBs will you be  
10 addressing?

11          A.     I will be addressing Mr. Davis' statement at page 2, line 24 of his rebuttal  
12 testimony that Missouri law does not require "any particular funding level" for FAS 106 costs  
13 provided in rates.

14          Q.     Do you disagree with this statement from a legal perspective?

15          A.     The Staff, through the Chief Staff General Counsel's Office, will address this  
16 issue in briefs filed in this proceeding. However, I will discuss the practical implications of the  
17 Company's failure to fully fund its FAS 106 rate recoveries for OPEB expense.

18          Q.     Is there any disagreement that Section 386.315, RSMo requires a utility using  
19 FAS 106 for rate recovery of OPEBs to "use" an "independent external funding mechanism" for  
20 OPEBs?

1           A.     I believe not. Please refer to Schedule 1 to my rebuttal testimony in this  
2 proceeding for a copy of Section 386.315, and the language therein regarding use of funding  
3 mechanisms.

4           Q.     What type of independent external funding mechanism does MGE use in regard  
5 to its FAS 106 costs?

6           A.     MGE currently utilizes three Voluntary Employees' Beneficiaries Association  
7 (VEBA) trusts in relation to its OPEB expenses. However, as previously discussed in the Staff's  
8 direct and rebuttal filings, MGE is not using these trusts to fund the entire amount of its rate  
9 recoveries of OPEB costs. Instead, the Staff's understanding is that MGE only transfers cash  
10 into the funds shortly before they are actually paid out to eligible retirees. This is the "pay-as-  
11 you-go" approach to payment of and "funding" of OPEBs obligations.

12          Q.     What are the advantages of a utility "using" a trust mechanism to fund its  
13 FAS 106 expenses?

14          A.     I am aware of at least two primary benefits:  
15                 1) the assets in the trust are protected until the time that payments of the benefits  
16                 to retirees is required; and  
17                 2) the funds in the trust earn investment income, thereby reducing the long-term  
18                 amount the utility must collect from its customers for FAS 106 expense.

19          Q.     Do MGE's customers or its future retirees derive either of these benefits from the  
20 way MGE currently uses its VEBA trusts?

21          A.     No. Amounts currently collected in rates in excess of MGE's pay-as-you-go cash  
22 outlays are not preserved in a trust; instead, they are utilized for MGE's other cash needs.  
23 Accordingly, those funds may or may not be available when the time comes to meet MGE's

1 responsibility for OPEB payment to retirees. Also, funds collected in rates for OPEBs that are  
2 used for other purposes do not earn investment income in a trust and do not lower the amount  
3 that future ratepayers will need to pay to cover the Company's FAS 106 expense.

4 Q. Is MGE seeking additional FAS 106 expense in this case because of its prior  
5 decision not to fully fund its FAS 106 expense?

6 A. Yes. The FAS 106 expense amount based on Schedule H5 attached to  
7 Mr. Noack's direct testimony of \$880,091 is the basis for MGE's requested rate recovery for  
8 FAS 106 expense in this case. This FAS 106 quantification reflects an investment income offset  
9 based upon MGE's actual contribution amounts to the trusts. The Staff's recommended level of  
10 FAS 106 expense recovery in this case, in contrast, includes an imputed amount of investment  
11 income based upon the amount of trust fund assets that would exist if MGE had used its  
12 FAS 106 rate collections to fund the trusts. Only use of this approach will hold MGE's  
13 ratepayers harmless from MGE's decisions regarding OPEBs funding.

14 Q. Other than the investment income imputation difference, does the Staff agree with  
15 the Company's FAS 106 calculation of OPEBs expense?

16 A. No. Please refer to the surrebuttal testimony of Staff witness Keith D. Foster for  
17 a further discussion of why the Company's recommendation in this case of \$880,091 for ongoing  
18 OPEBs expense is not appropriate for ratemaking purposes.

19 Q. Is MGE's current approach to funding OPEBS prudent?

20 A. The Staff views MGE's current approach as an inherently imprudent approach,  
21 because MGE's current practice of seeking rate recovery on an accrual (FAS 106) basis but  
22 funding this expense only on a pay-as-you-go basis potentially exposes ratepayers to higher rates  
23 for FAS 106 both currently and in the future. To the extent utilities such as MGE continue to

1 follow this approach, the Staff must adjust any FAS 106 rate recovery amounts to ensure that  
2 customers are not financially harmed by the utilities' approach. MGE should bear the risk of its  
3 funding decisions.

4 Q. At page 4 of his rebuttal testimony, MGE witness Davis advocates use of a  
5 "tracker mechanism" to set rates for FAS 106 expense. Please comment.

6 A. The Staff has agreed to the use of tracker mechanisms for rate treatment of  
7 FAS 106 expense for other Missouri utilities. However, in the Staff's opinion, use of such  
8 mechanisms is premised upon a full funding policy by the utility regarding their rate collections  
9 of FAS 106 expense. Unless MGE is willing to commit to a full funding approach to its  
10 FAS 106 rate recoveries, use of a tracker mechanism should not be considered for this Company.

11 Q. Please summarize your testimony concerning MGE's current policy on funding  
12 FAS 106 rate recoveries.

13 A. MGE's apparent position that while it is required by law to "use" an external trust  
14 fund mechanism for its FAS 106 rate recoveries, it is only required to pay into the trust its actual  
15 near-term cash payments to retirees will, in practice, impose extra costs upon its customers. By  
16 taking this approach, MGE denies its customers and its future retirees the real advantages of  
17 using external funding mechanisms.

18 Q. Please summarize the Staff's position on the amount of OPEBs expense to  
19 include in MGE's rates in this case.

20 A. If MGE commits to a prospective policy of fully funding its FAS 106 rate  
21 collections and making a catch-up shareholder contribution to make up for its past underfunding,  
22 the Staff recommends a continuation of the Company's OPEBs rate recovery on a FAS 106  
23 basis. Additionally, the Staff is willing to consider implementation of a tracker mechanism for

1 rate recovery of OPEB costs if the Company will make the commitment to fully fund. Absent  
2 this commitment from MGE, if the Commission wished to maintain its current FAS 106 policy  
3 for setting rates for OPEBs, it should make this approach contingent upon MGE fully funding its  
4 prospective collection of OPEBs costs from customers and making a catch-up contribution to  
5 make up for its prior underfunding policy.

6 As an alternative decision, if MGE wishes to continue on its current pay-as-you-go policy  
7 of OPEBs funding, and the Commission believes that this approach is appropriate for setting  
8 rates, then the Commission could order that rates be set for OPEBs in this case, and on an  
9 ongoing basis, according to a cash (pay-as-you-go) basis rather than an accrual (FAS 106) basis.  
10 However, this approach is problematical for two reasons: 1) it would leave unresolved  
11 the question of what should happen to MGE's prior over-collection of rates from its  
12 customers on a FAS 106 basis; and 2) the ability of the Commission to set rates on this basis,  
13 even with the Company's agreement, may be questioned under 386.315. The legality of using a  
14 "pay-as-you-go" approach for setting rates for utility OPEB expense will be addressed by the  
15 Chief Staff Counsel's briefs.

16 Q. Does this conclude your surrebuttal testimony?

17 A. Yes, it does.



**Missouri Public Service Commission****Respond Data Request**

<b>Data Request No.</b>	0139
<b>Company Name</b>	Missouri Gas Energy-Investor(Gas)
<b>Case/Tracking No.</b>	GR-2009-0355
<b>Date Requested</b>	6/12/2009
<b>Issue</b>	Expense - Operations - Environmental Expense
<b>Requested From</b>	Michael R Noack
<b>Requested By</b>	Mark Oligschlaeger
<b>Brief Description</b>	FMGP Insurance Claims
<b>Description</b>	Does MGE or (Southern Union) have any pending claims for reimbursement by insurance providers of prior FMGP clean-up work? If yes, please provide the amounts of each claim, and the expected time by which SU/MGE will learn whether such claims will be paid in full or in part by the providers.
<b>Response</b>	Settlement discussions with respect to historical insurance policies are ongoing. There is no timeframe in which SU/MGE expects to learn whether any insurance settlements will be achieved or if any payments will be made pursuant to those potential settlements.
<b>Objections</b>	NA

The attached information provided to **Missouri Public Service Commission** Staff in response to the above data information request is accurate and complete, and contains no material misrepresentations or omissions, based upon present facts of which the undersigned has knowledge, information or belief. The undersigned agrees to immediately inform the **Missouri Public Service Commission** if, during the pendency of Case No. **GR-2009-0355** before the Commission, any matters are discovered which would materially affect the accuracy or completeness of the attached information. If these data are voluminous, please (1) identify the relevant documents and their location (2) make arrangements with requestor to have documents available for inspection in the **Missouri Gas Energy-Investor(Gas)** office, or other location mutually agreeable. Where identification of a document is requested, briefly describe the document (e.g. book, letter, memorandum, report) and state the following information as applicable for the particular document: name, title number, author, date of publication and publisher, addresses, date written, and the name and address of the person(s) having possession of the document. As used in this data request the term "document(s)" includes publication of any format, workpapers, letters, memoranda, notes, reports, analyses, computer analyses, test results, studies or data, recordings, transcriptions and printed, typed or written materials of every kind in your possession, custody or control or within your knowledge. The pronoun "you" or "your" refers to **Missouri Gas Energy-Investor(Gas)** and its employees, contractors, agents or others employed by or acting in its behalf.

<b>Security :</b>	Public
<b>Rationale :</b>	NA

**SCHEDULE 1**