

Exhibit No.:
Issues: Manufactured Gas Plant
Witness: Stuart Harbour
Sponsoring Party: Missouri Gas Energy
Case No.: GR-2001-292

MISSOURI PUBLIC SERVICE COMMISSION

MISSOURI GAS ENERGY

CASE NO. GR-2001-292

REBUTTAL TESTIMONY OF

STUART HARBOUR

Jefferson City, Missouri

May 22, 2001

Exhibit No. 209
Date 6-25-01 Case No. GR-2001-292
Reporter Stewart

REBUTTAL TESTIMONY OF STUART K. HARBOUR

CASE NO. GR-2001-292

MAY 22, 2001

1 **Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS**
2 **ADDRESS?**

3 A. Yes. My name is Stuart K. Harbour, and my business address is Southern Union
4 Company, 504 Lavaca, Suite 800, Austin, Texas, 78701.

5
6 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

7 A. I am employed by Southern Union Company as Vice President and Controller of
8 Gas Distribution Operations. This means that I serve as Controller for Southern
9 Union's gas distribution divisions which are Missouri Gas Energy ("MGE" or
10 "Company"), the New England Division, Pennsylvania Gas Energy, South Florida
11 Natural Gas and Southern Union Gas.

12
13 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**
14 **PROFESSIONAL EXPERIENCE.**

15 A. I received a Bachelor of Business Administration degree with a major in
16 Accountancy and Information Systems from The University of Texas of the
17 Permian Basin in 1986. From 1980 through 1986, I served as owner/manager of a
18 retail business located in Midland, Texas. From September 1986 through August
19 1989, I was a staff auditor for KPMG Peat Marwick in Austin, Texas, specializing

1 in audits of public utilities, oil and gas pipeline and production companies and
2 financial institutions. In September 1989, I joined Southern Union Company as
3 manager of general accounting and was promoted to Corporate Controller for the
4 Company one year later. I was appointed Director of Information Resources
5 Development in August of 1992 and given the task of implementing new
6 information systems and setting the strategic direction for our systems
7 development. In February 1994, I was appointed to the position of Controller for
8 our Missouri Gas Energy division and effective January 1, 1997 was named
9 Controller of Gas Operations for Southern Union Company. I was promoted to my
10 current position on December 12, 1997. I am a Certified Public Accountant
11 holding certificates in good standing in the states of Missouri and Texas.
12

13 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

14 A. The purpose of this testimony is to respond to the direct testimony of Office of the
15 Public Counsel ("OPC") witness Ted Robertson regarding the appropriate
16 ratemaking treatment of costs arising from the investigation and remediation of
17 environmental issues at former sites of manufactured gas plants (MGP). Through
18 this testimony, OPC has opposed any recovery of MGP costs.
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COSTS ASSOCIATED WITH MANUFACTURED GAS PLANTS

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**Q. PLEASE DESCRIBE THE TYPES OF EXPENDITURES INCLUDED
UNDER THE TERM "COSTS ASSOCIATED WITH MGPs"?**

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A. Costs associated with MGPs include all assessment and remediation costs, communications costs, legal and consulting services, land acquisition costs, carrying costs, costs associated with insurance recovery and other expenses related to MGP sites or sites to which material may have migrated. MGE witness Alan Fish addresses this in greater detail in his rebuttal testimony.

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**Q. WHAT AMOUNT IS INCLUDED IN THE CURRENT CASE PERTAINING
TO COSTS ASSOCIATED WITH MGPs?**

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A. The Company included \$280,448 as an adjustment to account 923 (Outside Services Employed) to reflect the amount of expenditures that occurred within the updated test year. However, this amount is primarily for early assessment and legal services and is not indicative that on-going and future costs associated with MGPs will be so modest. As more specifically stated in the rebuttal testimony of MGE witness Alan Fish, environmental remediation and other costs related to MGPs, including costs associated with pursuing insurance recoveries as well as recoveries from other potentially responsible parties, are significant expenditures and will escalate rapidly as physical remediation efforts are initiated at these sites.

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1 Q. WHAT IS THE COMPANY'S POSITION REGARDING THE
2 APPROPRIATENESS OF MGP COSTS FOR RECOVERY THROUGH
3 RATES?

4 A. Expenditures for the assessment and remediation of MGP sites are a reasonable
5 and necessary cost of doing business and are appropriately included in cost of
6 service rates. The Company strongly disagrees with OPC's objections to recovery
7 of MGP costs.

8
9 OPC refers to insurance recovery, other potentially responsible parties
10 ("PRPs") and an agreement with Western Resources ("Western") related to
11 potential sharing of a portion of the cost to remediate environmental issues. OPC
12 witness Robertson seems to suggest that awareness of potential environmental
13 liabilities at the time of the acquisition of the Missouri operations somehow severs
14 the recoverability of prudent and necessary costs from the ratemaking process.
15 This position is not credible.

16
17 Environmental issues related to MGPs have been acknowledged throughout
18 the country for many years. My understanding is that such costs have been
19 included in rates by virtually every Commission which has addressed the issue for
20 over a decade. Potential recovery of some of the MGP costs, pursuant to past
21 insurance or from other parties, does not change the fact that MGP costs will be
22 significant and should be recovered through rates. The transfer of assets in an
23 acquisition does not affect the character of these MGP costs as reasonable and

1 necessary for the Company to continue doing business. Missouri Gas Energy will
2 certainly pursue all potential sources of funds to mitigate and minimize costs to be
3 borne by Missouri customers. While MGP-associated costs for many of these sites
4 cannot be determined today with precision, the recoverability of these costs should
5 be addressed now, and funding should begin now. to minimize the potential for
6 future rate shock.

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8 **Q. WHAT OTHER ARGUMENTS DOES OPC ADVANCE RELATED TO**
9 **THE RECOVERABILITY OF MGP-RELATED COSTS?**

10 A. OPC argues that since gas is no longer manufactured in these plants, they are not
11 used and useful in providing service to current customers. This position blatantly
12 ignores the fact that payment of these costs is unquestionably required to continue
13 providing service to our utility customers. The MGP facilities were a component of
14 the entire system built to provide energy to Missouri customers. Some of that
15 system remains in place today, serving current customers, at a cost considerably
16 less than the cost that would have been incurred had the system been built at a later
17 date. Current customers pay lower rates because these MGP facilities were once in
18 service. The utilities acted prudently in both operating and in the closing of these
19 MGPs and the cost associated with the remediation of these sites could not
20 reasonably have been foreseen at the time the MGPs were in operation. The
21 Comprehensive Environmental Response Compensation and Liability Act, which
22 forms the basis for liabilities for MGP associated costs, was not even enacted until
23 1980, long after the Missouri MGP sites ceased operations.

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2 **Q. CAN YOU THINK OF ANY UTILITY-RELATED ANALOGY TO THE**
3 **SITUATION YOU JUST DESCRIBED?**

4 A. Yes. Nuclear generating facilities are currently in operation throughout the
5 country. The cost of de-commissioning these facilities will be significant and will
6 more than likely include significant environmental-related expenditures. It is my
7 understanding that in Missouri, and possibly elsewhere, these anticipated
8 significant nuclear de-commissioning costs are currently being funded by
9 customers through the use of an external trust-type mechanism. This funding is
10 occurring and it is not presently known with precision when the nuclear facilities
11 will be de-commissioned nor how much the de-commissioning will cost.

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1 Q. OPC WITNESS ROBERTSON IN HIS DIRECT TESTIMONY (PAGE 10,
2 LINES 2-7) STATES THAT "IF CURRENT CUSTOMERS ARE
3 REQUIRED TO PAY FOR THE COST OF SERVICE NOT RECOVERED
4 FROM PAST CUSTOMERS . . . THE RESULT IS
5 INTERGENERATIONAL INEQUITY, AND POSSIBLY RETROACTIVE
6 RATEMAKING. . . . ALSO, RECOVERY OF THESE COSTS FROM
7 RATEPAYERS WOULD GUARANTEE THE INVESTMENTS OF
8 STOCKHOLDERS RATHER THAN PRESENT THE COMPANY WITH
9 THE OPPORTUNITY TO EARN A RETURN APPROVED BY THE
10 COMMISSION." DO YOU AGREE?

11 A. No. As discussed above, current customers are benefiting from the system built to
12 distribute manufactured gas. Ratemaking is not a perfect science whereby all costs
13 are matched perfectly in time with the recovery in rates. Intergenerational equity
14 will be best served by starting recovery of these large costs (which apparently were
15 not foreseen when the MGPs were operational) today rather than pushing the issue
16 forward as a problem for future customers only. Furthermore, Mr. Robertson's
17 comment that "recovery of these costs from ratepayers would *guarantee* the
18 investments of stockholders rather than present the Company with the opportunity
19 to earn a return approved by the Commission[.]" (Emphasis added) is terribly
20 flawed. OPC witness Robertson would have the Commission believe that by
21 granting cost recovery, the Commission is somehow guaranteeing an investment
22 return. This is not true of recovery of MGP-related costs, or any other costs
23 addressed in this proceeding. Since 1994 it is my belief that the Company has

1 never earned the return approved in its recent rate cases (in any event, neither the
2 Commission Staff nor the Office of the Public Counsel has ever alleged over-
3 earnings on the part of the Company). Adopting Public Counsel's disallowance
4 of these costs would essentially remove any future opportunity for the Company to
5 earn the return approved by the Commission.

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7 **Q. OPC WITNESS ROBERTSON ASSERTS (ON PAGE 10, LINES 8-9 OF HIS**
8 **DIRECT TESTIMONY) THAT THE INVESTIGATION COSTS**
9 **EXPENSED BY THE COMPANY ARE NON-RECURRING AND SHOULD**
10 **BE EXCLUDED FROM RECOVERY. DO YOU AGREE?**

11 **A.** No. Costs associated with investigating MGPs are certainly recurring in that
12 Missouri Gas Energy has incurred them in this test year and will continue to incur
13 them (at an escalating level) each year for the foreseeable future. Mr. Robertson's
14 direct testimony (page 8, lines 7-30) establishes that MGE is involved in numerous
15 MGP sites, thereby increasing the likelihood and magnitude of MGP investigation
16 costs. However, whether they are viewed by the Commission as recurring or non-
17 recurring, Missouri Gas Energy is entitled to recover the costs as reasonable,
18 necessary and appropriate costs associated with its operations.

1 **Q. OPC WITNESS ROBERTSON STATES AT PAGE 10 OF HIS DIRECT**
2 **TESTIMONY (LINES 9-11) THAT SHAREHOLDERS ARE**
3 **COMPENSATED FOR THIS PARTICULAR BUSINESS RISK THROUGH**
4 **THE RISK PREMIUM APPLIED TO THE COMPANY'S WEIGHTED**
5 **AVERAGE RATE OF RETURN. DO YOU AGREE?**

6 **A. No. In fact, the rate of return on equity recommended by Public Counsel in this**
7 **case (and the mid-point of the return on equity range recommended in the direct**
8 **testimony of Staff witness Murray) is virtually identical to the return provided by**
9 **investments in the preferred stock of Southern Union. This completely contradicts**
10 **all sound theories of finance and will be addressed in the cost of capital testimony**
11 **of MGE witness John Dunn. The risk of disallowance of these costs is not**
12 **reflected in Missouri Gas Energy's current return, since this risk has not been**
13 **explicitly discussed or recognized in any return on equity calculation adopted by**
14 **the Missouri Public Service Commission with respect to MGE to date. Moreover,**
15 **virtually all jurisdictions have allowed recovery of these costs. To the contrary of**
16 **this OPC argument, a denial of recovery of MGP related costs would be more**
17 **likely to cause investors to demand a significantly higher return on equity than the**
18 **"comparable" companies used in Public Counsel's rate of return analysis to**
19 **compensate for the higher risk assumed by investors of the Company.**

1 Q. OPC WITNESS ROBERTSON STATES, AT PAGE 10 OF HIS DIRECT
2 TESTIMONY, LINES 11-15 THAT "SHAREHOLDERS NOT
3 RATEPAYERS RECEIVE THE BENEFITS OF GAINS OR LOSSES
4 (BELOW THE LINE TREATMENT) ON ANY SALE OR REMOVAL
5 FROM SERVICE OF COMPANY-OWNED LAND OR INVESTMENT.
6 SINCE IT IS THE SHAREHOLDER WHO RECEIVES EITHER THE
7 GAIN OR LOSS ON AN INVESTMENT'S DISPOSAL, IT IS THE
8 SHAREHOLDER WHO SHOULD SHOULD THE RESPONSIBILITY
9 FOR ANY LEGAL LIABILITY THAT ARISES AT A LATER DATE
10 RELATED TO THE INVESTMENT." DO YOU AGREE?

11 A. No. MGP-associated costs arise from activities that were engaged in to serve the
12 customers, and therefore are appropriately included in cost of service. The
13 Company is currently aware of six owned sites that could have associated MGP
14 costs and has identified thirteen unowned locations that may or may not involve
15 potential expenditures. Properties such as this are seldom sold at gains even before
16 there was knowledge of potential environmental liabilities. This is not an issue of
17 allocation of gains or losses. This is an issue of including prudently incurred and
18 necessary expenses in rates.

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4 **Q. OPC WITNESS ROBERTSON STATES IN HIS DIRECT TESTIMONY**
5 **(PAGE 10, LINES 15-19) THAT” THE LIABILITY FOR REMEDIATION**
6 **COSTS IS NOT INCURRED BECAUSE OF THE SERVICES MISSOURI**
7 **GAS ENERGY CURRENTLY PROVIDES TO ITS CUSTOMERS.**
8 **MISSOURI GAS ENERGY IS A POTENTIALLY RESPONSIBLE PARTY**
9 **BECAUSE IT EITHER OWNS THE PROPERTY NOW OR ITS**
10 **PREDECESSOR OWNED THE PROPERTY AT SOMETIME IN THE**
11 **PAST” DO YOU AGREE?.**

12 **A.** This argument appears to be a repetition of a previous objection raised by Public
13 Counsel that has already been addressed above. Current customers are benefiting
14 from the lower cost associated with the distribution system developed during the
15 MGP timeframe. These costs are necessary and reasonable and should be
16 recoverable in rates.

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1 **Q. OPC WITNESS ROBERTSON ALSO STATES (ON PAGE 10 OF HIS**
2 **DIRECT TESTIMONY, LINES 19-21) THAT “AUTOMATIC RECOVERY**
3 **OF THE REMEDIATION COSTS FROM MISSOURI GAS ENERGY’S**
4 **CUSTOMERS REDUCES THE INCENTIVE FOR THE COMPANY TO**
5 **SEEK PARTIAL OR COMPLETE RECOVERY OF THE COSTS FROM**
6 **OTHER PAST OWNERS OF THE PLANT SITES OR COMPANY’S**
7 **INSURERS” DO YOU AGREE?.**

8 **A. No. Missouri Gas Energy has demonstrated and will continue to be diligent and**
9 baggessive in its efforts to recover MGP related costs from potential responsible
10 parties and insurers. The existence of potential offsets to mitigate and minimize
11 the ultimate costs associated with MGPs in no way justifies denial of the recovery
12 of these costs (which should be netted against these offsets, of course).

13
14 **Q. WHAT MECHANISMS ARE AVAILABLE TO USE FOR RECOVERY**
15 **AND TRACKING OF COSTS ASSOCIATED WITH MGP SITES?**

16 **A. Various mechanisms could be utilized to recover and track the costs associated**
17 with MGPs. Rate riders are a viable alternative since they permit recovery of no
18 more than the actual costs as they are paid and allows for a reconciliation process
19 to match actual costs with actual collections. In addition, this method facilitates
20 Commission review of the prudence and reasonableness of expenditures. An
21 additional advantage of a rider is that the utility will not over-recover given the
22 wide variations in and the inherent difficulty in predicting MGP costs and their
23 timing.

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Another method that has been utilized related to MGP expenditures is the granting of accounting authority orders ("AAO") which call for the deferral of costs until such time as a rate case occurs. A strong disadvantage of this approach is that significant costs can build up due to regulatory lag and the uncertain timing of MGP costs and when a rate case finally occurs there is a much greater chance for rate shock. MGP costs have begun and all evidence suggests that they will grow rapidly for the foreseeable future. It would not be prudent to push the issue farther forward for future customers only. Initiation of recovery now will increase both the number of customers that contribute and the time frame designated for recovery thereby reducing the recovered costs on a per unit basis.

The weaknesses of the AAO mechanism are solved in the approach that the Company proposes which would recover cost under a trust fund concept. The amount established in rates for MGP associated costs would be contributed into a trusted account that accumulates interest on the fund balances. Insurance recoveries applicable to Missouri sites and recoveries from other parties would be deposited into the fund to offset MGP expenditures. Expenditures would be made either directly by the fund, or by the Company which would then be reimbursed from fund amounts. This methodology allows for accurate tracking of expenditures and recoveries, allows for Commission review of expenditures for prudence and, most important, allows for the initiation of the recovery of funds even though the exact amount of MPG costs is not known at present. At the

1 conclusion of all the Missouri MGP projects, any excess funds would be credited
2 to customers in some fashion. If expenditures exceeded the fund balance at any
3 one time, the Company would defer the costs in anticipation of reimbursement
4 from the fund, including reasonable carrying costs.
5

6 **Q. WHICH OF THESE MECHANISMS DOES MGE RECOMMEND?**

7 A. In my opinion, the trust approach seems to best meet the interests of customers
8 and shareholders. MGE has drafted, on a preliminary basis, conditions which may
9 be appropriate for such an approach and they are attached hereto as Schedule 1.
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11 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

12 A. Yes, it does.
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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.

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Case No. GR-2001-292

AFFIDAVIT OF STUART K. HARBOUR

STATE OF TEXAS

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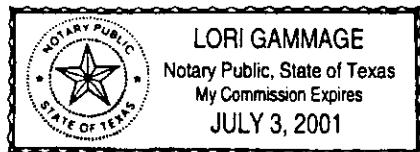
COUNTY OF TRAVIS

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Stuart K. Harbour, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, to be presented in the above case; that the answers in the foregoing 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.

Stuart K. Harbour
STUART K. HARBOUR

Subscribed and sworn to before me this 18th day of May 2001.



Lori Gammage
Notary Public

My Commission Expires: July 3, 2001

Environmental Response Fund:

An Environmental Response Fund shall be established to create a mechanism to fund the recovery of "Environmental Response Costs" as defined below.

- (a) Definition of "Environmental Response Costs". "Environmental Response Costs" are all the reasonable and prudently incurred costs associated with evaluation, remedial and clean-up obligations of Missouri Gas Energy arising out of the Company's utility-related ownership and/or operation of manufactured gas plants and sites associated with the operation and disposal activities from such gas plants. In addition to the actual remedial and clean-up costs, "Environmental Response Costs" also include costs of acquiring property associated with the clean up of such sites as well as litigation costs, claims, judgments, expenditures made in efforts to obtain insurance reimbursements, and settlements associated with such sites. The Company will use best efforts to satisfy its obligation to minimize the Environmental Response Costs charged to the fund consistent with applicable regulatory requirements and sound environmental policies and to minimize litigation costs that may arise. Any applicable insurance proceeds net of costs associated with obtaining such proceeds shall be credited to the fund.
- (b) Funding. The fund shall be maintained in an interest bearing trust account and shall be credited at the annual amount of _____ (the current amount reflected in rates for such costs) or _____ per month. Any cash expenditures shall be charged to the fund as long as the costs that are incurred or previously deferred are Environmental Response Costs, as defined above.
- (c) Annual Reports. Missouri Gas Energy shall file an annual report with the Commission (and serve the Parties with copies) providing a summary and accounting of all costs incurred during such year which have been applied to the fund. A separate account shall be maintained on the Company's books for accruals and expenditures for environmental response costs. Each of the Parties retain their right to review and challenge any costs that they believe do not fall within the definition of "Environmental Response Costs", as defined in subparagraph (a) above.

(d) Reservation of Rights. In the Company's next general rate case to establish rates after the approval of this Agreement, all parties reserve their rights to take any position they deem appropriate regarding (i) the level of funding to be permitted in rates on a prospective basis to recover costs charged to the fund as of the date of such case, and/or (ii) whether the fund should continue as designed for the recovery of prospective costs.

DRAFT