BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of Application of Kansas Gas	**)**	
Service, a Division of ONE Gas, Inc. for Approval	**)**	
Of an Accounting Order to Track Expenses	**)**	
Associated with the Investigating, Testing,	**)**	**Docket No. 17-KGSG-455-ACT**
Monitoring, Remediating and Other Work	**)**	
Performed at the Manufactured Gas Plant Sites	**)**	
Managed by Kansas Gas Service	**)**	

DIRECT TESTIMONY

PREPARED BY

JUSTIN T. GRADY

UTILITIES DIVISION

KANSAS CORPORATION COMMISSION

September 8, 2017

Table of Contents

I. Introduction and Qualifications of Witness 2
II. Purpose of Testimony, Overview of Application, Other Staff Witnesses 3
A. Purpose of Testimony 3
B. Overview of Application 4
C. Introduction of Other Staff Witnesses 5
III. Executive Summary 6
IV. KGS's Requested AAO 8
A. Purpose of Accounting Authority Orders (Deferred Accounting) 9
B. KGS Support for AAO Request 10
C. Three Separate Elements of KGS's AAO Request 13
D. Background and Origin of $12.6 Million Environmental Liability 14
E. Staff's Position on Request to Recover $1.4 Million from Original Liability 14
F. Staff's Position on Request to Recover $4.5 million of 2016 Expense 17
G. Staff's Position on Request to Recover all Future Unquantifiable MGP Costs 18
H. Future MGP Costs, While Uncertain, May be Significant 19
I. Case-by-Case Filings of MGP AAOs Allows More Formal Structured Review 22
J. Additional Considerations Supporting Case-by-Case Review of MGP AAOs 22
K. Importance of Evaluating History of Insurance Proceeds/Settlements 24
L. Staff's Efforts to Evaluate in this Docket the Insurance Settlement Issue 25
V. Staff's Recommended Ratemaking Framework for Future MGP AAOs 29
A. 40% Nominal Cost Disallowance Consistent with Docket 185-507-U 30
B. Support for 40% Disallowance Percentage in 1993 KPS Docket 31
C. Staff Support for 40% "Sharing" Concept Ordered in 1993 KPS Docket 32
D. Explanation of the 40% "Sharing" Ordered in the 1993 KPS Docket 34
E. Introduction of Exhibit JTG-2 35
F. Recreation of "Sharing" Percentage with Recent WACC Assumption 36
G. Support for Application of Carrying Charges to Unamortized Balance 37
VI. KGS's Requested Ratemaking Treatment for Insurance Proceeds 38
A. KGS Support for Ratemaking Treatment for Insurance Proceeds 39
VII. Staff's Position on Ratemaking Treatment of Insurance Proceeds 40
A. Support for Staff's Position of 100% credit of All Insurance Proceeds 40

B. Staff's Position that Shareholders Are Not Entitled to Recoup $9.49 Million 42
C. Staff's Intergenerational Inequity Concerns with KGS's Proposal 42
D. Support for Synchronized Treatment of Insurance Proceeds and MGP Costs 44
E. Possible Shareholder Windfall if 40% of Insurance Proceeds are Retained..... 46
F. Staff's Position Retains KGS Incentive to Achieve Insurance Recoveries. 48

I. Introduction and Qualifications of Witness

Q. Please state your name and business address.

A. My name is Justin T. Grady and my business address is 1500 Southwest Arrowhead Road, Topeka, Kansas, 66604.

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

A. I am employed by the Kansas Corporation Commission (KCC or Commission) as the Chief of Accounting and Financial Analysis.

Q. Please summarize your educational and employment background.

A. I earned a Master of Business Administration degree, with a concentration in General Finance which includes emphases in Corporate Finance and Investment Management, from the University of Kansas in December of 2009. I also hold a Bachelor of Business Administration degree with majors in Finance and Economics from Washburn University. I have been employed by the KCC in various positions of increasing responsibility within the Utilities Division since 2002. I have been employed in my current capacity since May 2012.

While employed with the Commission, I've participated in and directed the review of various tariff/surcharge filings and rate case proceedings involving electric, natural gas distribution, water distribution, and telecommunications utilities. In my current position, I have managerial responsibility for the activities of the Commission's

Audit section within the Utilities Division. In that capacity, I plan, manage, and perform audits relating to utility rate cases, tariff/surcharge filings, fuel cost recovery mechanisms, transmission delivery charges, alternative-ratemaking mechanisms, and other utility filings which may have an impact on utility rates in Kansas including mergers, acquisitions, and restructuring filings.

Q. Have you previously submitted testimony before this Commission?

A. Yes. I have submitted written and oral testimony before this Commission on multiple occasions regarding various regulatory accounting and ratemaking issues. This work includes testimony filings in 48 dockets, including this one. A list of the other dockets that encompass this experience is available upon request.

II. Purpose of Testimony, Overview of Application, Other Staff Witnesses

A. Purpose of Testimony

Q. What is the purpose of your testimony in the Kansas Gas Service (KGS), a division of ONE Gas, Inc., (ONE Gas) Application for an Accounting Authority Order (AAO) in Docket No. 17-KGSG-455-ACT?

A. The purpose of my testimony is to provide Staff's recommendation to the Commission regarding KGS's requested AAO and related request for ratemaking treatment of insurance proceeds associated with environmental remediation activities at 12 former Manufactured Gas Plant (MGP) locations. I will provide support for Staff's primary recommendation, which is to deny KGS's AAO Application at this time and require KGS to file separate site-specific AAO requests for any future environmental remediation expense that exceeds $1,000,000 (per site). Additionally, Staff recommends that the Commission establish a framework that: 1) defines the information KGS should be

prepared to provide in support of its future AAO Applications; and 2) defines the ratemaking treatment that will apply to MGP cost recovery and insurance proceeds in the event that future AAO Applications are approved. Last, for any environmental remediation expenses that are not over $1,000,000 per site and/or do not meet the guidelines Staff recommends for deferred accounting treatment (discussed in more detail below), Staff recommends the Commission define the ratemaking treatment that will apply to these costs in future KGS rate cases.

B. Overview of Application

Q. Please provide an overview of KGS's Application.

A. KGS requests Commission approval to record, to a regulatory asset, at least $5.9 million in internal and external cash expenditures and an unknown quantity of future expenses associated with MGP environmental work performed after January 1, 2017. This work involves investigating, testing, monitoring, remediating, and other work related to identifying and remediating soil and groundwater contamination that exists at 12 former MGP sites owned by KGS or its predecessor companies. KGS requests permission to defer these costs to a regulatory asset that would then be amortized over 10 years during its next rate case without carrying charges on the balance of the asset.

KGS also requests permission to retain for shareholders any insurance proceeds associated with environmental losses until it has recouped past environmental expenditures of $9.49 million expended during the period of 1997 through 2016. Once this past deficit is recouped, KGS requests approval to retain 40% of all subsequent insurance proceeds for shareholders and to share 60% with ratepayers (applied as an offset to the gross MGP costs being amortized).

KGS contends that both the AAO request and requested ratemaking treatment of insurance proceeds is consistent with the 1993 Commission decision in Docket No. 185-507-U.

C. Introduction of Other Staff Witnesses

Q. Are there other Staff witnesses that are filing testimony in this matter?

A. Yes. In addition to my testimony, Staff witnesses Leo Haynos and William Baldry are filing testimony for Staff. The primary issues they address are as follows:

Leo Haynos: Staff witness Leo Haynos provides background information about the MGP environmental projects. He also discusses the nature of the MGP remediation projects and the inherent difficulty of predicting with certainty the costs of the projects. Last, he recommends Staff and the Commission have an active role in monitoring and overseeing KGS's management of the environmental projects to help ensure that the projects are completed in an efficient and cost effective fashion.

William Baldry: Staff witness William Baldry addresses KGS's request to record cash expenditures to a regulatory asset associated with the $4.5 million of expense that was recorded to KGS's and ONE Gas' financial books in the third and fourth quarters of 2016. Mr. Baldry discusses the accounting standards that are implicated by the MGP environmental remediation and KGS's request for a regulatory asset to record those costs. He also addresses his review of the standards used by the Commission to review AAO Applications over approximately the last 20 years in Kansas. Last, Mr. Baldry provides an evaluation of the stock performance of ONE Gas during the year the expenses in question were recorded and he addresses the possibility that KGS's requested AAO is impermissible retroactive ratemaking. At the conclusion of all of this analysis, Mr.

Baldry determines that KGS should not be allowed to retroactively record to a regulatory asset expenses that were reflected in the financial statements of KGS and ONE Gas in the third and fourth quarters of 2016. He also provides the Commission with guidance as to the accounting standards that should be used to evaluate KGS's future AAO Applications.

III. Executive Summary

Q. Please provide an executive summary of your testimony.

A. KGS requests to defer future cash expenditures to a regulatory asset and recover those expenditures over 10 years in its next rate case, without carrying charges accumulating on the unrecovered balance. KGS also requests to retain all insurance reimbursements received by the Company up to $9.49 million, sharing the proceeds above this amount with ratepayers at 60% of the actual amounts received. Staff recommends that both KGS's AAO and its requested ratemaking treatment for insurance proceeds be denied at this time.

KGS's requested AAO would authorize KGS to defer to a regulatory asset an estimated $5.9 million in cash expenditures that have either: 1) already been reflected as expenses in the third and fourth quarters of 2016; or 2) were part of the original liability recorded when ONEOK, Inc. (ONEOK)[1] acquired KGS in 1997. Neither of these categories of cash expenditures should be allowed to be recovered from KGS's current ratepayers for the reasons discussed in detail below.

[1] ONEOK was, in part, the predecessor to ONE Gas, Inc. KGS is a division of ONE Gas, Inc. For more information related to the ONE Gas, Inc. spinoff of ONEOK, refer to Commission Docket No. 14-KGSG-100-MIS.

KGS's request also includes all unquantifiable future expenses and cash expenditures associated with managing and remediating the MGP sites. This open-ended and unquantifiable request to shift risk from KGS's shareholders to its ratepayers is unnecessary, unreasonable, and would not be in the public interest. Instead, Staff recommends that the Commission require KGS to file site-specific AAO requests in the future should additional MGP remediation costs be likely to exceed $1,000,000 at any site. These filings should be filed as soon as a remediation project is identified to take place and in advance of any expenses being incurred. Further this will allow the Commission to evaluate the reasonableness and necessity of the requested AAO on a case-by-case basis which will enable the Commission to perform a much more thorough and substantive review than would be available in a general rate case, especially given the multitude of factors that should be considered.

Staff recommends the Commission endorse a framework in which all future ratepayer recovery of MGP costs will be accomplished by reducing the net MGP cost (net of insurance recoveries) amount by 40%, then amortizing the remaining balance over 10 years with carrying cost afforded to the unamortized balance at KGS's Commission-approved Weighted Average Cost of Capital (WACC). This treatment accomplishes the same ratemaking/policy goal that the Commission intended in the 1993 Kansas Public Service Company case, Docket No. 185-507-U, without the disallowance percentage varying over time as capital costs go up and down.

Last, Staff recommends that the Commission require KGS to credit 100% of all insurance proceeds received against any future MGP remediation expense where KGS seeks rate recovery. In the event that insurance recovery is applied after the regulatory

asset has already been approved, the insurance recovery should be credited to the regulatory asset balance in the same percentage as the nominal costs were recorded to the regulatory asset. In other words, 60% of insurance proceeds should be applied as a reduction to the regulatory asset balance because the regulatory asset balance only includes 60% of the nominal costs of MGP remediation. If the Commission accepts KGS's ratemaking request instead of Staff's, 100% of all insurance proceeds should be credited to the regulatory asset because 100% of MGP costs would be recovered through the regulatory asset. This approach treats both insurance proceeds and MGP remediation costs equally, which is logical and which would correct the skewed application of financial theory implicated when insurance proceeds are treated differently than MGP remediation costs.

IV. KGS's Requested AAO

Q. Please explain in detail the portion of KGS's Application that requests permission to defer cash expenditures related to MGP environmental work to a regulatory asset.

A. KGS requests an AAO which would grant it the permission to establish a regulatory asset on its books to record cash expenditures associated with MGP environmental remediation activities and other associated costs. The purpose of this regulatory asset account would be to allow KGS to accumulate these costs in a special regulatory account that could then be evaluated for recovery in a future rate case. If recovery is allowed, the balance of the regulatory account would be spread or "amortized" over a period of years that is typically defined at the time the AAO is granted by the Commission. KGS requests a pre-defined amortization period of 10 years.

A. **Purpose of Accounting Authority Orders (Deferred Accounting)**

Q. What purpose does deferred accounting treatment serve in the role of utility regulation?

A. The purpose of regulatory assets or liabilities is to allow costs or revenues to be "deferred" to a future period for evaluation and potential recovery/refund in a future rate case, instead of being recorded to the income statement in the period that they were incurred. This is referred to as deferred accounting treatment. This treatment preserves the expense or revenue for evaluation in a future rate case and, therefore, allows the utility to avoid claims of retroactive ratemaking when it attempts to recover past losses through a current adjustment of rates.[2] If a regulatory asset or liability is requested outside of a traditional rate case, the procedure to allow that treatment is called an Accounting Authority Order (AAO). The granting of an AAO does not automatically imply that rate recovery will eventually be authorized by the Commission, although in practice, recovery is seldom, if ever, denied once an AAO has been granted.

By their nature, regulatory assets and liabilities are a form of alternative ratemaking, and they are typically only used to accommodate an unusual or special circumstance that is difficult to address in the traditional ratemaking context. By that I mean AAOs are usually granted to defer the impact of an expense or revenue that is extraordinary, unusual, material, non-recurring, outside of the control of the utility, or some combination of these factors. Staff witness William Baldry discusses this

[2] Conversely, regulatory liabilities can be used to capture excess revenues or gains and credit those amounts to rates in a future rate case, without the utility claiming inappropriate retroactive ratemaking.

Commission's experience with AAO requests over approximately the last 20 years and the standards that have been applied in those decisions.

B. KGS Support for AAO Request

Q. What support does KGS provide for its AAO request?

A. KGS witness David Dittemore provides the majority of the testimony in support of KGS's requested AAO. Mr. Dittemore's support for the AAO can be summarized as follows:

- The total remaining MGP costs are not known at this time with any degree of certainty. (Dittermore Direct, page 4, lines 8-10);
- Absent the accounting treatment sought in the Application, any future costs that are identified (over the $4.5 million recorded in 2016) and become measurable will increase the operating expenses of KGS and likely pose uncertainty on the appropriate level of MGP Costs included in subsequent KGS rate case filings, to the detriment of both the Company and its customers. (Dittemore Direct, page 6, lines 9-13);
- If the KCC does not approve the request, KGS would request recovery of these expenses in a future ratemaking proceeding. However, these costs may vary significantly from year-to-year and, therefore, there will be uncertainty as to whether test period costs were appropriately representative of ongoing operations. (Dittemore Direct, page 8, lines 3-7);
- The recently identified probable and reasonably measured MGP Costs are significant to KGS and, therefore, warrant special regulatory treatment. (Dittemore Direct, page 8, lines 7-9);

- The proposal KGS is sponsoring to spread the costs to customers through adoption of a ten-year amortization period has benefits for KGS customers. (Dittemore Direct, page 8, lines 12-14);
- KGS's requested accounting treatment of MGP costs and related insurance proceeds is consistent with the 1993 Commission Order in Kansas Public Service Company's request in Docket No. 185-507-U, a copy of which is attached to Mr. Dittemore's testimony as Exhibit DND-1. (Dittemore Direct, page 8 line 16 to page 10 line 23);
- KGS's requested accounting treatment of MGP costs is consistent with other public utility commissions' treatment of such costs as allowing for such recovery as being in the public interest. (Dittemore Direct, page 12, lines 8-10 and page 13, lines 7-10);
- The recovery mechanism requested by KGS encourages the utility to continue to conduct thorough investigations and cleanups of environmental conditions at MGP sites. (Dittemore Direct, page 12, lines 10-12);
- The historical operations and waste disposal practices at MGP sites in Kansas were performed in accordance with common gas industry practices at the time these plants were being operated. (Dittemore Direct, page 12, lines 16-20);
- The Kansas Department of Health and Environment (KDHE), through its 1994 Consent Order, has found that the historical stewardship of these sites was prudent, therefore cost recovery should be allowed. (Dittemore Direct, page 12, lines 19-21);

- MGP costs are being incurred by the Company in response to the KDHE Consent Order and this Commission's Order in Docket No. 97-WSRG-486-MER (97-486 Docket). These costs are necessary for the utility to remain in business and thus to provide current service. Because these costs were prudently incurred, they are recoverable in rates. (Dittemore Direct, page 13, lines 1-7);
- KGS's proposal would result in an amortized cost to customers that is known, measurable, and consistent. In the absence of the accounting and regulatory treatment proposed in the Application, there may be a question of whether test period costs are representative of a normalized level of ongoing MGP costs to be included in KGS's revenue requirement. Because these costs will vary from year to year, it would be a challenge to determine an appropriate level to include in base rates. The KGS proposal would amortize incurred costs over a ten-year period, thus establishing a straight-forward consistent approach to annual cost recovery. (Dittemore Direct, page 14, lines 11-18);
- Under KGS's proposal, customers would not bear all of the economic cost associated with MGP remediation activities. This is due to the fact that the Company is foregoing a request for carrying charges and rate base recognition of the unamortized MGP Costs. Therefore, the Company's shareholders, who have already absorbed all of the MGP costs incurred between November 1, 1997, and December 31, 2016, would continue to absorb a significant portion of MGP costs going forward. The result is an incentive for KGS to be efficient in managing future MGP costs. (Dittemore Direct, page 14, line 19 to page 15, line 2); and

- Finally, Mr. Dittemore argues that the proposal set forth in the Application would provide for annual KCC monitoring of this issue by virtue of the reporting requirements that KGS proposes.[3] (Dittemore Direct, page 15, lines 6-9).

C. Three Separate Elements of KGS's AAO Request

Q. What expenses or revenues does KGS ask to include in its AAO request?

A. KGS's AAO request covers three different tranches of MGP remediation cost:

1. Cash expenditures associated with $1.4 million of environmental liability remaining associated with ONEOK's 1997 acquisition of KGS in the 97-486 Docket;
2. Cash expenditures associated with $4.5 million of environmental liability that was established when ONE Gas incurred increased operating expense and environmental liability associated with its Abilene, Kansas, MGP site in the third and fourth quarters of 2016; and
3. All future unquantifiable cash expenditures associated with potential environmental liability for KGS's MGP sites in Kansas. Currently, there are 12 of these sites known to KGS.

The Commission should deny KGS's request to defer cash expenditures for all three of these categories of MGP expenditures for the reasons discussed in detail below.

[3] The contents of the annual report KGS proposes to file with the Commission can be found on page 14, lines 1-5 of Mr. Dittemore's testimony. They are as follows: (1) all reports provided to KDHE during the reporting year; (2) a summary of MGP Costs incurred in the preceding year; (3) a description of the scheduled MGP Work to be conducted in the subsequent year, as well as a cost estimate for such work; and (4) the amount of insurance proceeds received, if any, associated with MGP remediation efforts in the past year.

D. Background and Origin of $12.6 Million Environmental Liability

Q. Please discuss the background and origin of the environmental liability that was recorded when ONEOK acquired KGS in 1997?

A. As discussed in KGS witness David Dittemore's testimony on page 5, and as clarified in response to Staff Data Requests Nos. 5 and 12[4], ONEOK recorded an environmental liability of $12.6 million in its financial records upon completion of the November 1997 acquisition of KGS in the 97-486 Docket. As MGP costs were expended over the years, this original reserve was decreased, ending up at $1.4 million in 2016, just prior to the addition of $4.5 million of new liabilities associated with the low end of KGS's estimated environmental remediation costs at the Abilene, Kansas, MGP site.

E. Staff's Position on Request to Recover $1.4 Million from Original Liability

Q. What is Staff's position on KGS's request to recover cash expenditures associated with the remaining portions of the environmental liability that was recorded when ONEOK acquired KGS in 1997?

A. Staff contends that the Commission should not allow KGS to recover cash expenditures associated with this original environmental reserve that was established at the time ONEOK acquired KGS from Western Resources (the predecessor company to Westar Energy, Inc.) in 1997. In the same manner, Staff recommends that the Commission not allow KGS to retain for its shareholders any insurance proceeds on the basis that shareholders have covered the $9.49 million of cash expenditures associated with MGP environmental liability from 1997-2016.

[4] Attached to this testimony.

Q. Why should the Commission deny KGS request to recover cash expenditures associated with the remaining portions of the liability that was recorded when ONEOK acquired KGS in 1997?

A. The original environmental reserve that ONEOK recorded when it acquired KGS was part of the overall economics of the deal and it ultimately played a part in the determination of the amount of the goodwill[5] (acquisition premium) that was recorded as a result of the transaction. As evidenced by the Executed Environmental Indemnity Agreement between Western Resources and ONEOK, all 12 MGP sites were a known liability to ONEOK when it acquired KGS in 1997.[6] Given that ONEOK knew about this liability, it should have discounted the price it was willing to pay for KGS by an amount equal to the liability it expected to be responsible for as the new owner of KGS. A rational business manager would account for all expected cash flows, both positive and negative, that could be expected from an acquisition when determining how much to pay for an acquisition target. In this case, when ONEOK performed those valuation calculations, it still agreed to pay substantially more than KGS's regulated book value for the right to acquire KGS. All other things being equal, if the environmental liability did not exist when ONEOK purchased KGS, ONEOK likely would have agreed to pay even more than KGS's book value for the right to receive the regulated cash flows of KGS.

[5] *See* response to Staff Data Request No. 22.
[6] *See* response to Staff Data Request No. 1 and attached Executed Environmental Indemnity Agreement.

Q. How do you respond to the assertion that ONEOK and ONE Gas shareholders deserve to be repaid for the cash outflow of $9.49 million before they credit any insurance proceeds to ratepayers?

A. There are several reasons why I disagree with KGS's proposed ratemaking treatment of insurance proceeds that relate to MGP costs, which I will discuss in more detail in section VII of this testimony. As it relates to this section of my testimony, I will state now that I fundamentally disagree with the assertion that KGS's actual cash expenditures, associated with the original environmental liability recorded in 1997, represent a pool of funds that KGS deserves to be compensated for now through the ratemaking process. To claim that these cash expenditures (associated with relieving a reserve account established at the time of the acquisition) create a deficit which needs to be repaid, at best is akin to reopening an evaluation of the reasonableness of the purchase price paid for KGS during the acquisition. It may also be considered impermissible retroactive ratemaking.[7] It's certainly intergenerationally inequitable.

The fact that ONEOK expended cash flow to relieve this liability is no more support for a deficit that needs to be repaid than the existence of the acquisition premium over book value that was paid to acquire KGS. Both were interrelated components that

[7] Whether or not it would be considered impermissible retroactive ratemaking to use current day insurance proceeds (that would otherwise inure to the benefit of today's ratepayers) to repay of $9.49 million of KGS shareholder cash payments over the last 20 years should be the subject of briefing or oral arguments before the Commission. Based on my non-legal opinion, it would appear to meet the definition of retroactive ratemaking as defined in Unified Sch. Dist. No. 259 v. State Corp. Comm'n, 176 P.3d 250 (Kan. Ct. App. 2008):

> The rule against retroactive ratemaking prohibits the Commission from " 'adjusting current rates to make up for a utility's over- or under-collection in prior periods." ' *Consolidated Edison Co. of New York, v. F.E.R.C., 347 F.3d 964, 969 (D.C.Cir.2003).* Retroactive ratemaking also can occur when a utility is required to refund revenues collected based on lawfully established rates. *Kansas Pipeline Partnership v. Kansas Corporation Comm'n, 24 Kan.App.2d 42, 57, 941 P.2d 390, rev. denied 262 Kan. 961 (1997).* Likewise, refusing to order a utility to make full refunds of amounts charged over Commission-approved tariffs also constitutes retroactive ratemaking. *Sunflower Pipeline Co. v. Kansas Corporation Commission, 5 Kan.App.2d 715, 722, 624 P.2d 466, rev. denied 229 Kan. 671 (1981).*

influenced, and were based on, the underlying economics of the deal, and thus the reasonableness of the purchase price. No one can go back today and reevaluate the reasonableness of the purchase price ONEOK paid for KGS. We must assume that ONEOK acted in a rational manner and discounted the price it paid for KGS based on the existence of the environmental liability it knew it was acquiring. If it didn't, its shareholders took on too much risk and they should be responsible for the consequences of that decision. The fact that ONEOK paid more than book value for KGS (while only acquiring the opportunity to earn a regulated return on the lower book value of rate base), is an indication that the regulated cash flows being produced by KGS were more than enough to compensate ONEOK shareholders for the risks associated with taking on the MGP environmental liability recorded at the time of the acquisition.

F. Staff's Position on Request to Recover $4.5 million of 2016 Expense

Q. What is Staff's position on KGS's request to recover cash expenditures associated with the $4.5 million of expense incurred by KGS during the 3rd and 4th quarters of 2016?

A. Staff contends the Commission should not allow KGS to recover cash expenditures associated with the $4.5 million of expense incurred in 2016. Staff witness William Baldry explains that Generally Accepted Accounting Principles dictate the economic impact of this event has already been reflected in ONE Gas' 2016 audited financial statements and, therefore, financial markets have already baked the impact of this event into ONE Gas' stock price, which outperformed the SNL Gas Utility Index substantially during the year 2016. Mr. Baldry also expresses concern that the untimely nature of

KGS's AAO request (after it had already incurred the expense) exposes the possibility of KGS's request amounting to impermissible retroactive ratemaking.

G. Staff's Position on Request to Recover all Future Unquantifiable MGP Costs

Q. What is Staff's position regarding KGS's request to recover all unquantified (and apparently unquantifiable) future cash expenditures associated with KGS's MGP environmental liabilities?

A. Staff does not recommend that the Commission grant KGS's requested AAO for all future unquantifiable MGP costs. If this request were to be approved, the Commission would have absolutely no insight into what level of future costs KGS would be deferring to a regulatory asset and asking ratepayers to pay for. This is reiterated several times in the testimony filed in support of KGS's request. Mr. Dittemore states on page 4 of his Direct Testimony, "As noted by both Mr. Haught and Mr. Smith, the total remaining MGP Costs are not known at this time with any degree of certainty, which is one of the reasons that the Company is seeking an accounting order in this matter." Mr. Haught expresses similar thoughts on page 11 of his testimony:

> **Q. Can the remaining total MGP costs be determined with any amount of certainty?**
>
> A. No, they cannot. It is extremely difficult to estimate with an acceptable amount of certainty what the remaining MGP costs will be at the 12 sites. This is because it is still unknown how much Environmental Work needs to be performed and how regulations governing these sites will change in the future. While a total cost cannot be reasonably estimated, Kansas Gas Service has estimated the costs associated with the Environmental Work at the 12 MGP sites that are known and measurable.

The "known and measurable" costs that Mr. Haught refers to is the $5.9 million level of the current environmental reserve. However, even that amount is far from certain. In

2016, the liability was increased by $4 million associated with estimated environmental work required at KGS's Abilene, Kansas, MGP site. As discussed in KGS's response to Staff Data Request No. 4, the cost estimates leading to that increased liability ranged from $4 million to $7 million, so KGS recorded $4 million of expense and liability. In other words, while KGS has quantified $5.9 million worth of environmental liability, that number could potentially swell by another $3 million, just for that one site.

H. Future MGP Costs, While Uncertain, May be Significant

Q. Does Staff have reason to be concerned that the potential MGP environmental costs could be significant?

A. Yes. On page 8 of Mr. Dittemore's Direct, he states the following: "Specifically, the request is to defer such costs, along with future, yet to be identified MGP Costs **(which could be significant)**, to a future rate case proceeding, at which time they would be amortized into the KGS revenue requirement." (Emphasis Added). More specifically, as discussed above, the current environmental reserve was increased by $4.5 million in 2016 associated with the estimated cost of the remediation activities to be performed at the Abilene MGP site. The driver behind this increased expense was the results of a Supplemental Site Investigation conducted in early-mid 2016 which identified the presence of contaminants commonly associated with MGP operations in both onsite and offsite groundwater.[8] It's important to remember that the increased expense and environmental liability as a result of the identification of this groundwater contamination occurred a full eleven years after the source of the contamination and 514 tons of

[8] See response to Staff Data Request No. 33. Also, Staff Data Request No. 24 contains all the recent reports to KDHE about the Abilene site and KDHE's responses. These reports are voluminous but are readily available if the Commission desires these reports be a part of the record.

contaminated soils were removed from the site in 2005.[9] It is also important to remember that the $4 million estimate of the costs recorded during 2016 for this site is the low end of estimated liability for the site. The estimates to remediate this site range from $4 million to $7 million.

Q. Are there other MGP sites that could be the cause of extensive MGP liabilities and cost exposure to KGS?

A. At this point, it is unclear. While KGS is in possession of three different cost estimates (from 1998, 2009, and 2013) that apparently contain the potential range of expenses that KGS may face related to the MGP sites, KGS objected to providing those estimates to Staff on the basis of attorney-client privilege.[10]

In the absence of these cost estimates, and keeping in mind that I am not an environmental scientist, I can share what I have learned through the discovery phase of this proceeding. What is clear is that several of KGS's MGP sites have significant unresolved environmental remediation issues to address, and there is considerable uncertainty as to just how significant (and expensive) these issues will be.

In response to Staff Data Request No. 7, KGS provides a summarized explanation of the current status of KGS's MGP sites, the work that has been performed to date at the site, and the regulatory status of the sites recognized by KDHE. In addition, the response to Staff Data Request No. 68 provides a summarized view of the results of groundwater sampling for the 12 MGP sites. With just these two discovery requests, the Commission can see that there is still one site which hasn't had the source of the contamination removed yet (Atchison). Additionally, there is still one site which hasn't been tested for

[9] See October 20, 2016 Supplemental Site Investigation Report on the Abilene, KS MGP Site. This report is 679 pages long, provided in response to Staff Data Request No. 24, and is available upon request.
[10] See June 27, 2016, objection to Staff Data Request No. 46 attached to my testimony.

the presence of groundwater contamination (Junction City). Of the 11 sites that have been sampled for groundwater contamination, four have not been tested for offsite groundwater contamination. Of the 11 sites tested, five have tested positive for onsite groundwater contamination and three others have tested positive for both onsite and offsite groundwater contamination. A final solution and cost estimate for remediating this offsite groundwater pollution has yet to be identified by KGS or approved by KDHE.

Q. Why does Staff believe that the presence of onsite and offsite groundwater contamination at these MGP sites is an important consideration for the Commission?

A. I chose to highlight this issue for the Commission because the presence of groundwater contamination at the Abilene, Kansas, site and the resulting planned remediation activities associated with that contamination was the driver behind KGS incurring a $4 million expense in 2016. As discussed above, this is the low end of the estimated cost of this remediation of $4 million to $7 million. As KGS witnesses testify, there's no way to accurately predict the future cost exposure of these MGP sites. However, the fact that there are several MGP sites that have measured groundwater contamination both onsite and offsite, coupled with the fact that no final solution or cost estimate has been settled on to remediate these issues, should be a cause for concern for the Commission. These facts only bolster the possibility of significant MGP liabilities in the future.

I. Case-by-Case Filings of MGP AAOs Allows More Formal Structured Review

Q. Other than the fact that the level of MGP costs are unquantifiable, are there reasons that Staff supports a case-by-case approach to future MGP AAO requests?

A. Yes. Staff witness Leo Haynos discusses Staff's desire to actively review and monitor KGS's management of the environmental remediation work performed at the MGP sites going forward. An individually docketed case-by-case AAO request for each MGP site that KGS expects to incur additional material cash expenditures (over $1,000,000 per site) will allow a more structured and deliberate review of this work. Because the review will occur in a docketed proceeding, it will be more formal and will be guaranteed to receive the time and attention these important matters deserve.

The alternative approach, supported by KGS, would result in KGS filing certain information about its MGP activities in annual reports, which would then need to be reviewed informally outside of a general rate case or formally during the timeframe allowed for Staff's review during a general rate case. KGS's approach is much less formal and would have the practical effect of Staff having the burden of reviewing, developing, documenting and supporting any issue with the cost of management of a site during a rate case when there are several other issues competing for Staff's review time.

J. Additional Considerations Supporting Case-by-Case Review of MGP AAOs

Q. Besides a structured formal review of KGS management of the remediation activities, what other factors do you believe should be considered by the Commission during future MGP AAO filings?

A. There are a multitude of factors that may or may not be important to future Commissions that will be asked to rule on these filings. These factors are no doubt broader and more

expansive by virtue of the fact that the original driver behind these costs being incurred is MGP technology, which ceased providing service to utility customers sometime between 87 and 150 years ago.[11] For example, because the MGP costs that will be the subject of these AAO filings are linked to the provision of utility service many generations ago, it would be expected that KGS should be prepared to defend its position that these sites were at one point owned by a predecessor company of KGS. Additionally, the Commission may find it pertinent to know the last time any portion of the land that is the subject of the MGP remediation activities was used to provide public utility service (for instance, a service center, or maintenance shop). Some additional details that may influence the Commission's policy decision on the recoverability of MGP costs include:

- whether or not a gain or loss was realized by the company's shareholders when the property was last sold;
- the ratemaking treatment of that gain or loss on company property, in other words, if there was a gain recorded on the property sale, was any of it shared with ratepayers at the time?;
- the extent and prudency of the company's efforts to achieve insurance reimbursements related to the MGP costs;
- the extent and prudency of the company's efforts to identify any potentially responsible third-parties that may share in the liability for these MGP sites; and
- whether the company has received any previous insurance settlements or payouts associated with the MGP sites that resulted in the company releasing the insurance company of all future liability for MGP costs at that site.

[11] According to Exhibit JEH-1, attached to the Direct Testimony of KGS witness James Haught, the first MGP plant in KGS's inventory began providing service in 1868 (Leavenworth) the last in 1930 (Concordia).

In addition to the above enumerated factors, Staff recommends that the Commission also evaluate the actual costs of the MGP environmental work in future AAO requests to determine if the costs meet the typical standards we recommend should apply to an AAO request. These standards are discussed in the testimony of Staff witness William Baldry. At a high level, any costs which are found to be eligible for deferred accounting treatment should be: 1) material; 2) timely; 3) extraordinary (unusual and infrequent); and 4) limited in scope and time. Last, Staff witness Leo Haynos describes a process whereby Staff and the Commission would review the reasonableness and necessity of the MGP remediation project, potential alternatives, legal requirements, etc. in order to ensure that only efficient and cost effective MGP projects are approved to be recovered from ratepayers.

The Commission will be able to review all of these factors (and perhaps others that are not in this list) more thoroughly in a case-by-case evaluation in future AAO filings than would be the case if KGS's blanket request was granted and all of the above information had to be examined in a general rate proceeding.

K. Importance of Evaluating History of Insurance Proceeds/Settlements

Q. When evaluating future AAO filings related to MGP recovery costs, why should the Commission consider whether or not KGS had received any insurance proceeds related to the particular MGP site in question?

A. The Commission should evaluate whether or not any previous insurance settlements (related to the MGP site in question) have been received by the company because those insurance settlements may have contained an agreement by the company to release the

insurer of all future liability. On pages 11 of his Direct Testimony in this Docket, KGS witness Mark W. Smith discusses that:

> Finally, the insurance companies, who hold these policies, are generally unwilling to enter into partial settlements (but instead demand full release from any future liability under the policy). Thus, the Company has taken a more deliberative approach that includes analyzing our actual historical cost together with additional testing and monitoring to provide us with information to assess future costs.

That provision is followed up by the following question and answer:

> Q. Why have the insurance companies been hesitant to enter into partial settlement agreements on claims related to these policies?
>
> A. The Insurance Companies have been reluctant to enter into partial settlements based on their interpretation of the terms contained in the early policies. To settle, they effectively want to repurchase the policy to eliminate the risk of additional claims in the future

If KGS entered into a settlement(s) that released an insurance carrier(s) from all future liability for certain MGP sites, that decision would deserve serious scrutiny to ensure that the company acted rationally, judiciously, and prudently—especially if those insurance settlements were not captured in the ratemaking process or otherwise credited to ratepayers. For example, a question that would deserve serious attention is what estimate(s) of all future costs did the company rely on when it made the determination that it was a prudent decision to release an insurance carrier from all future liability?

L. Staff's Efforts to Evaluate in this Docket the Insurance Settlement Issue

Q. Did Staff attempt to evaluate in this Docket whether KGS had settled claims with insurance carriers in exchange for a release of all future liability?

A. Yes. I attempted to evaluate this issue by issuing discovery requests to KGS. However, the discovery responses were not helpful as they were either incomplete or inconsistent with other discovery responses by the Company. Additionally, as mentioned above, one

discovery request I issued (Staff Data Request No. 46) attempted to clarify how the Company was prepared to begin the insurance recovery process, which might require KGS to release insurance carriers of all future liability, if the extent of the MGP costs was unquantifiable as suggested in KGS's testimony in this Docket. The Company objected to that request on the basis of attorney-client privilege and instead provided a cost breakdown for only the Abilene, Kansas, MGP site.

Q. Please elaborate on your statement above that KGS discovery responses in this proceeding, pertaining to the issue of settlements with insurance carriers, were incomplete or inconsistent with other responses?

A. I issued a series of discovery requests to KGS in this Docket in an attempt to gain a better understanding about the insurance recovery process, whether any insurance settlements had actually been entered into and whether those settlements resulted in KGS agreeing to release the insurance carrier of all future liability. The responses to those discovery requests are confusing and incomplete. For example, Staff Data Request No. 40 requested the following:

> Q. For all Insurance recoveries listed in Exhibit MWS-3, please provide all supporting documentation the company relied on in supporting each entry to the reserve from 2004 to the present. Additionally, for the most recent five insurance recoveries, please provide copies of the journal entries utilized to book this activity to both One Gas and KGS's books.

KGS response:

> A. The attached schedule shows the General Ledger detail for the receipt of checks to the reserve account. Note that the 5 lines in the ledger reflect workers compensation refunds for a total of $1,509.37. The amount for the worker compensation refunds should not have been included in the total. The balance of the information known is in the column labeled as "Comments." The schedule is the actual entry in the Accounts Receivable system. The column labeled "Notes" is information I have added based on my knowledge of what was being deposited, the

> description in the comment field, and any other information we have in our files. For the amounts marked "settlement or partial claim," we do not have the settlement documents. We have requested the documents from ONEOK and we will provide them when they become available.

The problem with this response is that the referenced attachment to the data request response doesn't contain any amounts marked as "settlement or partial claim." There are several amounts listed as "settlement or bankruptcy payments." But that's all the information given without any distinction drawn between those two possibilities. There is absolutely nothing in either the response or the schedule attached to the response that would indicate which payments from insurance providers were the result of a settlement versus the result of a bankruptcy process. Additionally, KGS never updated the request to provide the referenced settlement documents.

In Staff Data Request No. 41, I requested the following:

> Q. Exhibit MWS-3 appears to support the fact that ONEOK didn't receive any Insurance proceeds associated with MGP remediation costs until August of 2004. Is this accurate? If so, please explain in detail the activities occurring between 1997 and 2004 related to the Insurance recovery process and explain why it took over 6 and one half years to receive any insurance proceeds through these processes.

In response, KGS provided the following:

> A. Yes, it is accurate. Based on ONE Gas's (formerly ONEOK's) accounting records, no insurance proceeds were received until August 2004. From the transaction date until sometime in 2000, ONE Gas and Westar (formerly WRI) were researching the various insurance policies and companies in preparation to make a reasonable claim. Once the claim was made in 2000, the insurance companies responded with extremely low offers and implied that their intent was not to make partial payments. **In fact, some of the insurance carriers offered to only make payments in exchange for the return of the policies and an agreement from the Company to not hold the carrier liable for any future obligations. At that time ONE Gas decided not to move forward. As a result, these claims remain open with the carriers and have not been settled to date for the most part.** Also, some insurance companies have gone into bankruptcy and in accordance with the bankruptcy rulings have paid ONE

> Gas a share of their run-off proceeds. **Additionally, settlements were reached with a handful of the companies.** See KGS Response to DR 40 for additional detail on the settlements. (Emphasis Added)

This response indicates that "for the most part" the insurance claims have not been settled and that there have been "settlements reached with a handful of the companies" outside the bankruptcy process. The response also refers the reader to DR 40 for details on the settlements. As discussed above, DR 40 doesn't contain any details on the settlements, as it doesn't even identify any settlements. The only designation DR No. 40 contains is a blanket designation of "settlement or bankruptcy payments" and the response makes it clear that ONE Gas doesn't have the settlement documents.

Last, in Data Request No. 45, I requested detailed information regarding any settlements that KGS had entered into that resulted in a full release of liability from the insurance carrier. The question and the response were as follows:

> Q. Mr. Smith's testimony generally discusses ONE Gas's past actions and strategy for pursuing insurance company settlements. On Page 11, beginning at line 5, Mr. Smith states that the insurance companies, who hold these policies, are generally unwilling to enter into partial settlements but instead demand full release from any future liability under the policy. For each of the insurance settlements/recoveries that ONE Gas has received to date, please provide the name of the insurance company, the amount of the settlement, the site or sites that were covered under the policy, the year of recovery, and whether the settlement/recovery included a release of all future liability for ONE Gas MGP costs with that insurance company.

KGS's response was as follows:

> A. As disclosed in the response to data request number 40, **most of the insurance recoveries received to date are believed to have come from those companies who have become insolvent and the Company receiving partial reimbursement through the associated bankruptcy proceedings. As also identified within this response (data request number 40) there has been one actual settlement**. Please see the response to data request number 40 for the information requested. (Emphasis Added).

As the Commission can see, these discovery responses did not provide clarity or add useful information to this proceeding. Despite the fact that these discovery responses were verified and responded to on the same day, one response claims that there have been "settlements with a handful of companies," the other response states that there has been "one actual settlement," and both responses refer the reader to the response to DR 40, which does not contain the information requested.

As discussed earlier, this is one issue that deserves significant time and attention by Staff and the Commission in any future AAO Application KGS files to defer future MGP costs.

V. Staff's Recommended Ratemaking Framework for Future MGP AAOs

Q. What ratemaking framework does Staff recommend the Commission apply to KGS's future AAO filings pertaining to MGP remediation costs?

A. I recommend the Commission establish a ratemaking framework which allows KGS to recover 60% of the nominal value of any MGP costs which are found to have been prudently incurred. In other words, 40% of the total MGP costs will be disallowed from ratepayer recovery, with the remaining balance of MGP costs amortized over 10 years and accruing carrying costs at KGS's last Commission-authorized Weighted Average Cost of Capital (WACC).[12] This ratemaking treatment should apply to all future MGP costs the Commission may allow KGS to defer to a regulatory asset as a result of future AAO filings. For any MGP costs that KGS requests as part of any general rate case filing

[12] If a future AAO is approved, carrying costs would begin to accumulate on 60% of actual cash expenditures and compound monthly thereafter. At a rate case, the balance of the regulatory asset should be included in rate base and carrying cost accumulation will cease.

because the MGP expense was not expected to exceed $1,000,000 at any one site, I recommend the same 60% recovery (40% disallowance) of any amount that the Commission determines is representative of ongoing, normalize operations.

A. 40% Nominal Cost Disallowance Consistent with Docket 185-507-U

Q. Why does Staff recommend that the Commission disallow 40% of the nominal value of MGP costs incurred, with the residual amount recovered over 10 years with carrying costs?

A. Staff's recommended ratemaking framework accomplishes the same sharing of MGP costs between ratepayers and shareholders as the Commission implemented in the June 14, 1993, Order in the Kansas Public Service Company MGP/AAO case, Docket No. 185-507-U (1993 KPS Docket). As discussed at paragraph 8 on page 4 of that Order, (attached as Exhibit DND-1 to Mr. Dittemore's testimony) the Commission found: "KPS must bear some of the responsibility and related costs of the environmental damages now in need of remediation. Staff believes this should be equitably accomplished through a sharing of the cleanup costs between KPS and its ratepayers." The Order then goes on in paragraph 9 stating that the "sharing" of MGP costs would not be an actual disallowance of the nominal value of costs, instead, the sharing would be accomplished by utilizing a 10 year amortization period and disallowing carrying costs and rate base inclusion of the regulatory asset. In paragraph 10, the Order states that Staff's methodology results in an approximate split of costs of 60% payment by ratepayers and 40% by shareholders. This means the present value KPS would receive by recovering MGP costs over 10 years, instead of upfront, was approximately 60% of the original or nominal cost incurred.

Staff contends that the percentage of shareholder recovery of MGP costs ordered by the Commission was appropriate, but today's low capital cost environment does not accomplish the same percentage of "sharing" that resulted from the Commission's Order in the 1993 KPS Docket. Instead of relying on the disallowance of carrying charges and rate base treatment to accomplish the "sharing" percentage, Staff recommends the Commission disallow a nominal dollar amount equal to 40% of the total MGP costs incurred by KGS. Then, the remaining amount should be recovered in full, with carrying costs and rate base treatment allowed on the balance. This approach will accomplish the same policy goal of sharing 40% of costs with shareholders, without the actual disallowance percentage varying based on the capital costs of the company at any given time.

B. Support for 40% Disallowance Percentage in 1993 KPS Docket

Q. Why did the Commission order a "sharing" of MGP remediation costs in the 1993 KPS Docket?

A. A review of the Order supports the contention that the Commission accepted Staff's arguments as presented in the April 16, 1993, Report and Recommendation to the Commission.[13] In paragraphs 6 and 7, beginning on page 3 of the Order, the Commission states the following:

> The issue of who should bear the costs for environmental cleanup resulting from a site where previously a manufactured gas plant was operated yet no longer exists and therefore no longer provides service to the utility's customers poses a unique situation. Generally, costs which are allowed deferral and recovery by ratepayers result from the provision of current services to the benefit of the utility's current and future customers. In the instant case, however, the costs of environmental remediation relate to a plant which ceased providing service to customers

[13] A search of the Commission's files does not produce this Report and Recommendation. It appears as if the document was not made a part of the Commission's permanent files at the time.

> over approximately 40-years ago. KPS' current ratepayers are not the sole benefactors of such environment remediation; all residents and visitors in the area will benefit. Yet the company is requesting that its ratepayers bear the total burden of the related clean up costs.
>
> KPS stated in its application that "(t)he economic problem faced by KPS results from governmental mandates requiring compliance and such compliance causes cash flow problems for KPS." KPS appears to use this as a basis for requesting total recovery of the clean up costs from ratepayers. Staff argued, however, that this "economic problem" is not just the result of external government mandates. It is the direct result of the decisions and actions of the utility in the treatment of waste products at the former manufactured gas plant site—even if such procedures may have been in conformity with common utility practice at the time.

These passages reveal that the Commission did not believe it was just and reasonable for KPS ratepayers to pay for all of the economic costs associated the former MGP operations. The Commission based its decision on the fact that ratepayers would not be the sole benefactors of the remediation activities and that the driver behind the costs was not related to the provision of current utility services, but utility services which were provided over 40 years ago.[14]

C. Staff Support for 40% "Sharing" Concept Ordered in 1993 KPS Docket

Q. Why does Staff recommend the Commission continue the 40% "sharing" or disallowance percentage chosen by the Commission in the 1993 KPS Docket?

A. The Order in the 1993 KPS Docket supports the fact that the issue of cost recovery of MGP environmental remediation expenditures is not a clear cut and straightforward issue that leads easily to a yes or no answer. These are costs which are tied to utility operations from 87 to 150 years ago. Several generations of KGS ratepayers and shareholders have come and gone since the time when these MGP plants were actually providing service to

[14] It should be noted that this provision of the Order is likely a typo, because the Application in the 1993 KPS Docket explains that the MGP plant in question ceased production in 1905, nearly 90 years prior to filing of the 1993 Application.

ratepayers. There are serious questions of intergenerational equity presented by the request to fully recover costs from current ratepayers associated with cleaning up these sites. There are also questions of whether it is appropriate for ratepayers to pay for the entirety of an expense that benefits shareholders of the Company as much or more than current ratepayers. One could argue that ONE Gas shareholders should be responsible for the entirety of these costs because they have been compensated for this kind of risk over the years that it (and its predecessors) have operated the system and been given an opportunity to earn an allowed return on equity.

While ten different utility analysts or regulatory Commissions might examine this policy question and come up with ten different recommendations as to the amount and timing of cost recovery for these costs, in my opinion, allowing KGS to recover 60% of the costs of the MGP remediation expenses is an equitable, reasonable, and balanced result. While KGS's Application lists regulatory Commissions that allow for full recovery of MGP expenses from ratepayers, there are also several states that have ordered a sharing of MGP costs between ratepayers and shareholders, and there is one state that has disallowed all MGP expenses from ratepayers.[15] While I believe the methodology the Commission chose to effectuate the "sharing" percentage in the 1993 KPS Docket should be replaced with Staff's recommended methodology in this case, I do not disagree with the Commission's determination that having ratepayers pay for 60% of the MGP costs is a reasonable solution to this problem.

[15] Recovery by Utilities of Expenditures on Manufactured Gas Plant Claims: Recent Developments Regarding Insurance Coverage and Rate Relief, Nicholas W. Fels, William P. Skinner, and Saul B. Goodman, Covington and Burling, Washington D.C. 1996 John Wiley and Sons, Inc. (Attached as Exhibit JTG-1).

D. Explanation of the 40% "Sharing" Ordered in the 1993 KPS Docket

Q. Why did the amortization of nominal dollars over 10 years, without carrying costs, amount to shareholders "sharing" 40% of MGP costs?

A. The Order in the 1993 KPS Docket explains this concept in paragraphs 9 and 10 on page 4:

> Staff indicated that this sharing between ratepayers and shareholders can be best accomplished by utilizing a ten-year amortization period and by disallowing carrying charges and rate base treatment on the deferred clean up costs. Disallowing carrying costs on the deferred expenses and excluding the unamortized balance of the deferral from rate base would represent a "cost" to the shareholders because KPS would not be allowed to earn a return on the deferral. However, this treatment would allow KPS to recover the total clean up costs in nominal dollars from ratepayers yet not allow the company to recognize a profit as a result of these costs.
>
> This Methodology results in a sharing of costs of approximately 60% by ratepayers and 40% by shareholders.

What the Order in the 1993 KPS Docket did not discuss was that the "sharing" percentage accomplished by the disallowance of carrying costs and rate base treatment of a regulatory asset will vary overtime as the Company's discount rate, or cost of capital, fluctuates with the general state of the economy and money market conditions.

Q. Did the Order in the 1993 KPS Docket contain work papers or numerical support for the statement that an amortization over 10 years without carrying charges amounts to a "sharing" of 40% of the costs with shareholders?

A. No. Presumably the work papers or numerical calculations supporting these figures were attached to the Staff Report and Recommendation, but as the footnote above describes, Staff has not been able to locate this file. It is possible, however, to back into what the calculation would have looked like, as discussed in the next section.

E. Introduction of Exhibit JTG-2

On Exhibit JTG-2, I present three different "sharing" scenarios that calculate the present value of receiving an annual amortization of $1,000,000 for 10 years, instead of $10,000,000 at the time it was expended. Each scenario calculates a separate present value dollar amount and percentage. These calculations correspond to the amount of recovery shareholders would receive in each scenario, given an assumed WACC for the company. When the present value shareholders receive is equal to 60% of the nominal sum amortized over time, this represents a "sharing" of 40% of the nominal costs.

On lines 1 through 6 of the exhibit, I calculate the present value of a series of 10 annual payments of $1,000,000, assuming a discount rate or WACC of 9.8628%. The result is a present value of $6,180,950, or 61.81% of the total balance of payments of $10,000,000. The 9.8628% assumed discount rate corresponds to the WACC that Staff recommended in the 1992 KPS rate case, Docket No. 179-484-U. While this WACC assumption doesn't produce a shareholder recovery percentage of exactly 60%, it is quite close. Since the Commission's Order in the 1993 KPS Docket was based on Staff's recommendations and calculations, this may very well have been the discount rate used in Staff's present value analysis that supported the 40% shareholder "sharing".

On lines 7 through 12 of the exhibit, I calculated the WACC assumption that would result in a shareholder recovery percentage of 60% (a ratepayer payment percentage of 60%). The fallout WACC that calculates an exactly 40% disallowance of real or "present" value is 10.558%.

These examples show that when costs of capital were relatively high, as they were in the early 1990s, the approach of amortizing a fixed amount over 10 years would create

a significant disallowance or "sharing", as long as carrying costs did not accumulate on the balance. It is also quite possible that the calculations that supported the Commission's statement that "this methodology results in a sharing of costs of approximately 60% by ratepayers and 40% by shareholders" were based on Staff's present value calculations using KPS's 1992 WACC as the discount rate.

F. Recreation of "Sharing" Percentage with Recent WACC Assumption

Q. Did you perform an analysis to see how the percentage of shareholder recovery, or "sharing" percentage, would differ with the same recovery parameters in today's lower cost of capital environment?

A. Yes. On the same exhibit, lines 15 through 21, I calculated the "sharing" percentages that would result from the amortization of a fixed amount over 10 years without carrying costs, assuming a WACC (discount rate) of 6.5923%. This discount rate corresponds to the WACC recommended by Staff in KGS's most recent rate case, Docket No. 16-KGSG-491-RTS. It's also consistent with the after-tax WACC that supports the calculation of the pre-tax WACC of 9.74% the parties agreed KGS would utilize for GSRS purposes after that rate case.

As the Commission can see, when a fixed dollar amount is amortized over 10 years in today's lower capital cost environment, the result is a much lower "sharing" percentage of 28.42%. In other words, the ratemaking approach that KGS requests in this case does not result in ONE Gas shareholders absorbing an economic cost of 40% of the total MGP costs incurred. Rather, it results in ONE Gas shareholders absorbing an economic cost of 28.42% of MGP costs incurred.

The above examples support Staff's recommendation in this case that the 40% disallowance percentage adopted by the Commission in the 1993 KPS Docket can, and should be, effectuated in a different fashion than by disallowing carrying charges on the balance of the regulatory asset. The only way to ensure that the disallowance percentage will not fluctuate over time is by disallowing the desired amount of nominal MGP costs from the recovery through the regulatory asset, then allowing the remaining amount to be amortized over some period of time with carrying charges allowed on the unamortized balance. This approach will accomplish the same "sharing" concept adopted by the Commission in the 1993 KPS Docket, without the accompanying uncertainty and volatility of actual sharing that takes place when capital costs go up and down with the economy and money market conditions.

G. Support for Application of Carrying Charges to Unamortized Balance

Q. Why does Staff advocate for the application of carrying charges to the unamortized balance after 40% of the nominal cost is disallowed?

A. Once the 40% portion of nominal costs is disallowed, the remaining balance has to accrue carrying charges and receive rate base treatment, or the actual percentage disallowed will be much more than 40%. In other words, the amount disallowed would far exceed 40% if KGS were to lose the time value of money associated with the recovery of a fixed amount over ten years without carrying charges. On Exhibit JTG-3 attached to my testimony, I have proven this concept with a simple example using the same nominal cost assumption of $10,000,000 and amortization period of 10 years used before. In the first set of calculations presented on lines 1 through 10, I calculate the net present value of a $6,000,000 regulatory asset amortized over 10 years with carrying charges applied at the

WACC of 6.5923%. This is also the assumed discount rate used in the analysis. As the Commission can see, the net present value of this series of cash flows is exactly $6,000,000. The result is that shareholders recover 60% of the original $10,000,000 cost.

On lines 11 through 20 of the exhibit, I present the same net present value analysis, this time, without carrying charges applied to the balance as it is being amortized. The result is a net present value of $4,294,729, or just under 43% recovery by shareholders.

VI. KGS's Requested Ratemaking Treatment for Insurance Proceeds

Q. Please describe KGS's requested ratemaking treatment for insurance proceeds that it may receive related to MGP remediation costs.

A. KGS requests to be allowed to retain the first $9.49 million of insurance proceeds it receives related to the costs it incurs to remediate MGP costs and other damages associated with the MGP liability. After the first $9.49 million of insurance proceeds, KGS requests the ability to retain 40% of all proceeds and to exclude that income in the ratemaking process. The other 60% of ratemaking proceeds would be used to offset the MGP costs being recovered from ratepayers through the regulatory asset, which essentially means the insurance proceeds are credited to ratepayers over 10 years without carrying charges.

A. KGS Support for Ratemaking Treatment for Insurance Proceeds

Q. What support does KGS provide for its requested ratemaking treatment of insurance proceeds associated with MGP costs?

A. KGS's support for this ratemaking treatment is primarily found in the testimony of David N. Dittemore. Mr. Dittemore's support for this requested ratemaking can be summarized as follows:

- The proposed ratemaking treatment for insurance proceeds is identical to that contained in the KCC's Order in Docket No. 185-507-U. (Dittemore Direct, page 10, lines 22-23);
- The Company has incurred $10.75 million of MGP costs between November 1, 1997, and December 31, 2016 (offset by insurance proceeds received of $1.26 million). This leaves a net cost of $9.49 million that shareholders have covered to date. It would not be appropriate for customers to benefit from the insurance proceeds in the form of a reduction in the revenue requirement when the MGP costs to date have been solely absorbed by the Company's shareholders. This proposed treatment properly aligns the formal regulatory treatment of the legacy MGP costs with the treatment of insurance reimbursements for such costs. Additionally, the Company is not asking for any carrying cost on the first $9.49 million. (Dittemore Direct, page 11, lines 1-14); and
- The proposal to share insurance recoveries in excess of $9.49 million provides an incentive for KGS to maximize its insurance recoveries to the benefit of both customers and shareholders. This point was made by the KCC in its Order in Docket No. 185-507-U. (Dittemore Direct, page 15, lines 3-5).

VII. Staff's Position on Ratemaking Treatment of Insurance Proceeds

Q. What is Staff's recommendation regarding the ratemaking treatment of insurance proceeds received by KGS relating to MGP remediation costs?

A. Staff recommends that KGS only be allowed to recover 60% of MGP costs *net* of any insurance recoveries received. Staff's recommendation is that 100% of all insurance proceeds received after January 1, 2017, should be used to offset any *gross* MGP costs that are incurred and sought for ratepayer recovery. Likewise, if the Commission accepts Staff's recommended framework and allows KGS to recover 60% of the nominal amount of MGP costs over 10 years through a regulatory asset, 60% of insurance proceeds should be used to offset the amounts included in the regulatory asset. In other words, whether 100% of the insurance proceeds are used to offset the gross MGP costs before the MGP costs are split 60% to the regulatory asset, 40% to shareholders or whether 60% of the insurance proceeds are applied afterwards as a reduction to the regulatory asset (that only contains 60% of gross MGP costs), the effect is the same.

This treatment should apply whether future MGP costs are allowed to be recovered from ratepayers through a regulatory asset or through the general rate case process. Insurance proceeds received should always be credited to the regulatory asset in the same percentage as the nominal or gross MGP costs were recovered from ratepayers.

A. Support for Staff's Position of 100% Credit of All Insurance Proceeds

Q. Why does Staff recommend crediting 100% of insurance proceeds against the gross amount of MGP costs sought for ratepayer recovery?

A. Staff's recommendation is based on three primary considerations:

1. As discussed above, Staff fundamentally disagrees with the assertion that KGS's shareholders deserve to be compensated for the $9.49 million of MGP costs it has incurred to date. This issue is exacerbated by the fact that the insurance recovery process may require KGS to release insurers of all future liability, which would have the effect of siphoning off all future ratepayer protection against these costs in order to pay shareholders for expenditures incurred over the last 20 years;

2. Staff's recommended treatment of insurance proceeds treats the proceeds in the same fashion as the underlying costs that the proceeds are intended to offset, which is logical and avoids the potential unintended consequence of KGS shareholders receiving an unnecessary and unjustified windfall on behalf of ratepayers, if KGS is able to retain 40% of insurance proceeds;

3. Staff's recommended treatment of insurance proceeds corrects the skewed application of financial theory that occurred when the Commission treated insurance proceeds differently than MGP costs in the 1993 KPS Docket; and

4. Staff's recommended treatment of insurance proceeds maintains the incentive for KGS to aggressively pursue insurance recoveries in order to minimize the amount of gross MGP costs that are disallowed from ratepayer recovery.

B. Staff's Position that Shareholders Are Not Entitled to Recoup $9.49 Million

Q. Why does Staff disagree that KGS shareholders should retain the first $9.49 million of insurance proceeds in order to recoup past expenditures associated with MGP liabilities?

A. As I discussed in Section IV.E above, the fact that KGS shareholders have expended $9.49 million (net of insurance proceeds) over the last 20 years does not entitle the Company to use current insurance proceeds to recoup these expenditures. I contend that the liability recorded at the time of the 1997 KGS acquisition was an integral component of the economics of the decision to purchase KGS for more than the regulated book value of assets that ONEOK would have the ability to earn a return on. If this liability wasn't accounted for in ONEOK's due diligence and valuation of KGS, it should have been, and KGS shareholders should be held accountable for that decision, not its ratepayers.

C. Staff's Intergenerational Inequity Concerns with KGS's Proposal

Q. Why does Staff believe that KGS's proposal to retain the first $9.49 million of insurance proceeds is intergenerationally inequitable?

A. On page five of his Direct Testimony, KGS witness David N. Dittemore discusses the fact that the $9.49 million of net MGP costs incurred by KGS shareholders have been withheld from the revenue requirement determination in several rate cases during the period of 1997 to 2017. Mr. Dittemore does not describe why KGS never sought to recover these costs from ratepayers, only that KGS shareholders deserve to be repaid for these expenditures they have made over the years. There are several problems with this approach from Staff's perspective.

First, KGS is requesting that current day ratepayers pay for both the internal and external Company costs necessary to receive these insurance payouts—but KGS wants to keep the proceeds that it argues should have been recouped over the last 20 years. Momentarily setting aside the argument that I do not believe KGS shareholders are entitled to recover these costs at all because I believe they were included in the determination of the purchase price ONEOK paid for KGS, if KGS believed it was entitled to these costs over the last 20 years, it should have asked for recovery of those costs then. To ask current day ratepayers to fund the expenses of reaping insurance proceeds that will then be used to recoup costs that should have been funded by ratepayers over the last 20 years is a classic example of intergenerational inequity that is unjust and unreasonable.

Second, and potentially more concerning, is the fact that the insurance payouts KGS will be seeking may require KGS to forgive those insurers from all future responsibility for MGP costs that arise in the future.[16] This has the potential to be intergenerationally inequitable even if the proceeds are all credited to today's ratepayers (as opposed to both today's ratepayers and all future ratepayers). This concern is exacerbated significantly if these proceeds are used to repay KGS shareholders for costs they either: 1) are not entitled to (Staff's position); or 2) should have asked for over the last 20 years.

[16] This issue is discussed in on page 11 of the Direct Testimony of KGS witness Mr. Mark W. Smith.

D. Support for Synchronized Treatment of Insurance Proceeds and MGP Costs

Q. Why does Staff believe that insurance proceeds and MGP costs should always be treated the same for ratemaking purposes?

A. It is logical to treat MGP costs and the insurance proceeds that reimburse for those costs in an equal fashion. There are elements of the Commission's Order in the 1993 KPS Docket that indicate the Commission was trying to achieve that end result, but unfortunately that is not what results from a careful interpretation of the different provisions of that Order.

For example, in paragraph 14 of the Order, the Commission states: "To that end, the Commission finds that Staff's proposed recovery mechanism, described above, achieves an equitable end result, that is, a sharing of costs and any reimbursements or gains of approximately 60% by ratepayers and 40% by shareholders." While this passage supports the concept that the Commission intended to treat MGP costs, insurance proceeds, and any gains associated with the properties equally, in practice that is not what was ordered because in paragraph 11, when the Commission clarified that: "in other words, 60% of the insurance reimbursements would flow to ratepayers and the company would be allowed to retain the remaining 40%."

When these two passages are read together, it becomes clear that the Commission intended to treat MGP costs, insurance recoveries and gains equally, however, the result was not an equal approach. The reason for that is 100% of MGP costs are allowed to be amortized over 10 years without carrying costs, but only 60% of insurance proceeds are required to be amortized over those same 10 years. This has the effect of treating

insurance proceeds dramatically different than MGP costs, and it could potentially result in an unjust and unreasonable windfall to shareholders if it were approved in this case.

The methodology that Staff recommended and the Commission endorsed, to "share" a portion of MGP costs with shareholders, was to amortize those costs over 10 years without carrying charges during that time. Staff and the Commission reasoned that the loss of time value of money during this time period represented an economic cost to KPS shareholders of approximately 40% of the nominal value of MGP costs. Because shareholders were incurring an economic loss of 40% of MGP costs, it follows then that shareholders should be allowed to retain 40% of insurance proceeds. Conversely, in order for shareholders to retain 40% of insurance proceeds, ratepayers can only receive 60% of them. Staff was mistaken in making this recommendation as it is a flawed application of financial theory. In order for that math to work out, one must assume that ratepayers do not value their money more in Year 1 than they do in Year 10.

If spreading MGP cost recovery over 10 years without carrying costs is an economic cost of 40% to shareholders, then spreading insurance proceeds over 10 years without carrying costs is an economic cost of 40% to ratepayers.[17] In other words, if the Commission wanted to treat MGP costs and insurance proceeds equally, all it had to do was order that the two amounts be treated completely equally, that is, amortized at 100% of the nominal values, over 10 years, without carrying costs. Because the Commission allowed KPS to retain 40% of the insurance proceeds and then spread the remaining 60% over 10 years without carrying costs, the resulting economic cost to ratepayers was much more than 40%, in fact, depending on the timing of the receipt of the insurance proceeds,

[17] As long as you accept the premise that a proxy for a ratepayer discount rate is equal to the Company's WACC, which is frequently used assumption in public utility regulation.

this treatment could have been much worse for ratepayers and much better for shareholders—even to the point of a windfall for shareholders at the detriment of ratepayers.

E. Possible Shareholder Windfall if 40% of Insurance Proceeds are Retained

Q. Have you prepared an example of how the ratemaking treatment of insurance proceeds approved in the 1993 KPS Docket could result in a windfall for shareholders at the detriment of ratepayers?

A. Yes. Assume in my simple example that KGS incurred $10 million of MGP remediation costs in Year 0. In Year 1, KGS begins to recover that $10 million at the rate of $1 million per year for 10 years. By the end of Year 1, KGS has recovered $1 million from ratepayers and the balance of the regulatory asset is $9 million. Assume now that in the beginning of Year 2 KGS is able to recover 90% of its original loss from insurance carriers, or $9 million. If KGS's requested ratemaking treatment were to apply to these insurance proceeds, KGS would only be required to apply $5.4 million of these proceeds as a reduction to the regulatory asset (leaving a balance in the regulatory asset of $3.6 million). Recall that the $3.6 million in insurance proceeds was retained by KGS and was used to cover the original MGP cost. To recap, KGS spent $10 million in year 0, received $1 million from ratepayers in Year 1, and $9 million from the insurance carriers in Year 2. KGS has now been completely reimbursed for it's out of pocket MGP costs, but it will still reap the windfall of $3.6 million being recovered from ratepayers through the amortization of the regulatory asset over the next ten years.

While this is just one example, others could be developed. What is clear is that the ratemaking treatment KGS has requested and that was ordered in the 1993 KPS

Docket could easily result in a significant windfall to KGS shareholders, if approved by this Commission. Even if the percentages of insurance recovery in the above example were reduced to smaller percentages, or the timing of the insurance recoveries was pushed out, the result would still be an imbalanced treatment between MGP costs and insurance proceeds to the benefit of shareholders and the detriment of ratepayers. At the very least, this ratemaking treatment for insurance proceeds would significantly cut into the "sharing" that the Commission wanted to accomplish with the ratemaking approach it afforded MGP costs.

Q. How would the windfall to KGS shareholders be prevented in your example if Staff's recommended ratemaking treatment for insurance proceeds was applied?

A. With the above example and Staff's recommended ratemaking treatment for insurance proceeds, when KGS received the $9 million in insurance proceeds in Year 2, it would have credited the same $5.4 million to the regulatory asset amount, but the regulatory asset amount would have only been $5.4 million at the end of Year 1. That is because the original balance of the asset would have been $6 million (60% of the original $10 million in MGP costs). At the end of Year 2, the regulatory asset would be zero, and both ratepayers and KGS will have shared in the costs of the MGP remediation. Ratepayers would have paid $600,000 of the total $1,000,000 of unreimbursed MGP costs and KGS would have paid $400,000. Out of a total $10 million in MGP costs, KGS received $9.6 million and only paid $400,000, or 40%, of the net MGP cost outlay.

F. Staff's Position Retains KGS Incentive to Achieve Insurance Recoveries.

Q. Do you believe that Staff's recommended ratemaking treatment for insurance proceeds results in KGS retaining an incentive to pursue insurance recoveries?

A. Yes. KGS remains very well incentivized under Staff's recommended ratemaking approach for insurance recoveries. For every dollar that KGS can recover from insurance companies, it will prevent the loss of $.40 for its shareholders. The above example illustrates this nicely. Originally, KGS shareholders were facing a $4 million economic loss due to the $10 million in MGP remediation cost under Staff's recommended ratemaking approach for MGP costs. However, once it was successful in achieving an insurance payout of $9 million, that economic loss was cut to just $400,000. It is easy to see how Staff's recommended ratemaking treatment of insurance costs maintains KGS's incentive to maximize insurance recoveries, while also eliminating the possibility for an unjust and unreasonable windfall for KGS shareholders that can occur if KGS's ratemaking approach for insurance payments is accepted.

Q. Does this conclude your testimony?

A. Yes it does. Thank you.

Staff Data Request Responses

Note: Kansas Gas Service, a Division of ONE Gas, Inc. (KGS) designated certain responses to Staff Data Requests as confidential. Subsequent correspondence between Staff and KGS's counsel resulted in KGS lifting the confidential designation from the following items:

1. The Response to Staff Data Request Number 40.[1] However, the attachment submitted with the response shall remain confidential. This attachment is being filed with the confidential version of Staff's Data Request Responses;
2. The June 26, 2017, letter objecting to Staff Data Request Number 46;[2] and
3. The Response and Attachment 1 to Staff Data Request Number 22.[3] However, Attachment 2 submitted with the Data Request Response shall remain confidential.

[1] Correspondence from KGS's Counsel (Sep. 1, 2017).
[2] Correspondence from KGS's Counsel (Sep. 6, 2017).
[3] Correspondence from KGS's Counsel (Sep. 8, 2017).

Kansas Corporation Commission
Docket Number 17-KGSG-455-ACT
Information Request

Data Request: 17-455 KCC-001
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 4/28/17
Date Information Needed: 5/10/17
Requested By: Bill Baldry

Please provide the following:

Page 1 of the 97-WSRG-486-MER Order states the Application requested approval of the transfer of all of Western Resources' natural gas assets and debt to ONEOK. Paragraph 35 of the same order states that ONEOK will maintain the level of environmental performance as practiced by Western Resources.
a. Is it ONE Gas' position that the Transaction referenced in part a above transferred the environmental liability of the manufactured gas plants to ONEOK?
b. Is it ONE Gas' position that the acceptance by ONEOK to maintain the level of environmental performance practiced by Western Resources constitutes the transfer of the environmental liability?
c. If there is other support for ONE Gas' position that Western Resources transferred the environmental liability to ONEOK, please cite the docket number, document and paragraph that transferred the liability to ONEOK.

a. Yes.

b. No. The referenced regulatory commitment did not cause the transfer of the regulatory liability. However, it is evidence that the parties to the transaction were well aware that such liabilities were being transferred to ONEOK.

c. Please see the following attachments.

   i. The Transaction Agreement dated December 12, 1996, attached as an exhibit to Volume 1 of the Application in the merger case (*See* definition of assumed liabilities and retained liabilities) and Article VIII (Environmental Indemnity Agreement-Exhibit E), along with the Executed Environmental Indemnity Agreement, dated November 26, 1997;

   ii. The Amended and Restated Transaction Agreement dated May 19, 1997;

   iii. The Schedules referred to in those Agreements relating to assumed liabilities and environmental claims and liabilities, relating to MGP sites including attachments identified as Confidential WRI Disclosure Letter and WRI Disclosure Schedule and

Please note that the file named "Confidential WRI Disclosure letter" is <u>not</u> deemed confidential. However, the naming convention is used to preserve the original name of the document as used in the Amended and Restated Agreement in Docket No. 97-WSRG-486-MER.

Prepared by: David Dittemore

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: David Dittemore

Date: May 10, 2017

ENVIRONMENTAL INDEMNITY AGREEMENT

THE ENVIRONMENTAL INDEMNITY AGREEMENT (the "Agreement"), dated as of November 26, 1997 between **Western Resources, Inc.**, a Kansas corporation ("WRI"), **ONEOK Inc.**, a Delaware corporation ("ONEOK"), **WAI, Inc.**, an Oklahoma corporation ("WAI").

WHEREAS, WRI, ONEOK and WAI are parties to that Amended and Restated Agreement (the "Transaction Agreement") dated May 19, 1997 among WRI, ONEOK and WAI.

WHEREAS, WRI, ONEOK and WAI desire to provide herein for the liability of the parties for certain Environmental Claims and for the sharing of Environmental Costs (as both are hereinafter defined) for manufactured gas plant sites previously used in the operations of the Gas Business (as defined in the Transaction Agreement and as used hereinafter) being transferred to WAI; and

WHEREAS, the parties agree that the Environmental Costs shall mean all costs and expenses (including reasonable attorneys' fees and expenses, but excluding consequential damages) actually incurred to respond to and remediate an Environmental Claim.

NOW, THEREFORE, in consideration thereof and of the respective covenants, representations and warranties herein contained, the parties agree as follows:

Section 1. ASSUMPTION OF LIABILITY.

a. WAI hereby (1) assumes and agrees to be responsible for all Environmental Claims now pending or that may hereafter arise with respect to the properties listed on Exhibit A, attached hereto and by reference made a part hereof (the "WAI Properties"); and (2) agrees to pay, perform and discharge, as and when due and payable, all Environmental Costs with respect to such Environmental Claims arising out of the WAI Properties. WAI hereby agrees to indemnify and hold

WRI harmless from and against all Environmental Claims and Environmental Costs which WAI has assumed or agreed to be responsible for pursuant to this Section 1. For the purposes of WAI's assumption of liability, agreement to pay, perform and discharge and to indemnify set forth in this Section 1, the term "Environmental Claim" shall include, in addition to those claims which are included within such term as defined in the Transaction Agreement, any and all such claims and other matters hereafter arising which are based in whole or in part upon (A) any amendment or modification which occurs after the Closing of any Environmental Law which is extant on the Closing; (B) any law, statute, ordinance, rule, regulation, order or determination of any governmental authority or agency enacted or adopted after the Closing which would, if such law, statute, ordinance, rule, regulation, order or determination were in effect on the Closing, be an Environmental Law; or (C) any change in interpretation of any Environmental Law after the Closing by any court or by any governmental agencies having authority to enforce such Environmental Law.

b. WRI has conducted, at its sole expense, an environmental insurance archaeology survey (the "Survey") for all of the assets and properties used or with respect to the WAI Properties and has provided WAI with the results of the Survey. For any Covered Matter discovered by WAI after the Closing, WAI shall as promptly as possible after the discovery of such Covered Matter (as hereinafter defined) provide notice of such discovery, together with all factual information and copies of all notices, environmental assessments, reports and other information, to WRI's Environmental Services Department so as to allow WRI to provide prompt and timely notice to the appropriate insurance carrier or carriers identified in the Survey. The parties thereafter agree to cooperate in the filing and prosecution of claims with the appropriate insurance carrier(s) in a manner that the parties mutually agree so as to expeditiously prosecute such claims. WAI shall have the right to review in

advance all global settlements with insurance companies. The parties shall be under a Duty to Consult (as hereinafter defined) with respect to the matters covered by this subsection. Amounts recovered from such insurance carrier(s) from the pursuing of such claims shall, after allowance for WRI's post Closing outside legal fees and other reasonable out of pocket expenses, be paid to WAI. WRI shall provide to WAI copies of all records, files, data, correspondence, notes, statistical data, and all other information in the custody or control of WRI relating to Insurance, insurance policies, liabilities, other PRP and all other facts or events relating to the Shared Properties.

Section 2. RETENTION OF LIABILITY. WRI hereby (a) retains and agrees to be responsible for all Environmental Claims now pending or that may hereafter arise with respect to the properties listed on Exhibit B, attached hereto and by reference made a part hereof (the "WRI Properties"); and (b) agrees to pay, perform and discharge, as and when due and payable, all Environmental Costs with respect to such Environmental Claims arising out of the WRI Properties. WRI hereby agrees to indemnify and hold WAI harmless from and against all Environmental Claims and Environmental Costs which WRI has retained and agreed to be responsible for pursuant to this Section 2. For the purposes of WRI's assumption of liability, agreement to pay, perform and discharge and to indemnify set forth in this Section 2, the term "Environmental Claim" shall include, in addition to those claims which are included within such term as defined in the Transaction Agreement, any and all such claims and other matters hereafter arising which are based in whole or in part upon (A) any amendment or modification which occurs after the Closing of any Environmental Law which is extant on the Closing; (B) any law, statute, ordinance, rule, regulation, order or determination of any governmental authority or agency enacted or adopted after the Closing which would, if such law, statute, ordinance, rule, regulation, order or determination were in effect on the

Closing, be an Environmental Law; or (C) any change in interpretation of any Environmental Law after the Closing by any court or by any governmental agencies having authority to enforce such Environmental Law.

Section 3. SHARED PROPERTIES.

(a) Definitions.

(i) Properties Covered. Except as provided in Sections 1 and 2 of this Agreement, all other manufactured gas plants which were at any time prior to the date hereof owned or controlled by WRI or any of its predecessors in interest ("Shared Properties") shall be subject to the cost sharing provisions contained herein including but not limited to those plants listed on Exhibit C, attached hereto. These Shared Properties were at one time used in the operations of the Gas Business being transferred to WAI pursuant to the Transaction Agreement, but are not part of the Transaction Agreement.

(ii) As used herein, the term "Covered Matters" shall mean and refer to all Environmental Claims and Environmental Costs related to the Shared Properties which arise out of or are based upon Environmental Laws.

(iii) For purposes of this Section 3, Environmental Claims shall have the same definition as provided in Sections 1 and 2 hereof.

(b) Newly Discovered Matters. All Covered Matters discovered by WAI relating to the Shared Properties more than fifteen (15) years following the date of this Agreement shall be the sole responsibility of WAI.

(c) Management of Claims and Remediation.

(i) WAI, not WRI, shall have primary responsibility for initiating, managing, directing and completing all remediation, if any, for the Shared Properties.

(ii) With reference to the recovery of Environmental Costs for all Covered Matters from both Insurance First Line of Recovery ("Insurance") and Potentially Responsible Party First Line of Recovery ("PRP") (both of which are described in subsection (d) below), the Parties recognize that WRI shall, consistent and in accordance with WRI's Duty to Consult (as hereinafter defined), use reasonable and due diligence to pursue both Insurance and PRP contribution.

(iii) Notwithstanding anything which may be contained in this Section 3 to the contrary, WAI shall have the right to employ separate legal counsel in any claim against a third party relating to Environmental Claims or Environmental Costs with respect to the Shared Properties and participate in the prosecution thereof, but the fees and expenses of such other counsel shall be at the expense of WAI and not subject to Indemnification under this Agreement unless (1) the employment of such other counsel has been authorized by WRI; or (2) WRI has failed to prosecute diligently such action as above provided. WRI shall provide to WAI copies of all records, files, data, correspondence, notes, statistical data, and all other information in the custody or control of WRI relating to Insurance, insurance policies, liabilities, other PRP and all other facts or events relating to the Shared Properties.

(d) Shared Liability.

(i) Insurance First Line of Recovery. WRI has conducted, at its sole expense, an environmental insurance archaeology survey (the "Survey") for all of the assets and properties used or with respect to the Shared Properties and has provided WAI with the results of the Survey. To the extent that WRI may lawfully do so without adversely affecting the insurance coverage disclosed by the Survey, WRI hereby agrees that the insurance coverage disclosed by that Survey shall constitute the first line of recovery for the Shared Properties. For any Covered Matter discovered by WAI after the Closing, WAI shall as promptly as possible after the discovery of such Covered Matter provide notice of such discovery, together with all factual information and copies of all notices, environmental assessments, reports and other information, to WRI's Environmental Services Department so as to allow WRI to provide prompt and timely notice to the appropriate insurance carrier or carriers identified in the Survey. The parties thereafter agree to cooperate in the filing and prosecution of claims with the appropriate insurance carrier(s) in a manner that the parties mutually agree so as to expeditiously prosecute such claims. WAI shall have the right to review in advance all global settlements with insurance companies. Amounts recovered from such insurance carrier(s) from the pursuing of such claims shall, after allowance for WRI's post Closing outside legal fees and other reasonable out of pocket expenses, be paid to WAI. In the event insurance recovery is protracted, the parties shall accelerate the shared cost provisions of subparagraphs (d)(ii) through (v), crediting subsequent insurance or PRP contributions to the parties as their interests appear in subparagraphs (d)(iv) and (v).

(ii) Potentially Responsible Party First Line of Recovery. In those instances where other potentially responsible parties ("PRPs") are identified for purposes of cost sharing in the remediation of any site, amounts recovered from such PRPs shall, after allowance for WAI and WRI's post Closing outside legal fees and other reasonable out of pocket expenses, be paid to WAI and credited against the cost incurred with respect to such required remediation. In the event PRP recovery is protracted, the parties shall accelerate the sharing of cost as provided for in subparagraphs (d)(iii) through (v) hereof, crediting subsequent insurance or PRP contributions to the parties as their interests appear in subparagraphs (d)(iv) and (v). In the event of such acceleration of the sharing of costs, WRI shall, prior to the application of any subsequent insurance proceeds or PRP contributions, be entitled to receive reimbursement of amounts advanced under subparagraph (d)(v) for post Closing costs incurred in connection with Covered Matters as provided herein pursuant to said subparagraph.

(iii) Recovery of Remediation Costs through Regulated Cost of Service. In addition to seeking the relief contemplated under subparagraphs (d)(i) or (ii), WAI shall request from the appropriate regulatory agency, if any, having jurisdiction in the state where any remediation site is located for authority to include the cost incurred by WAI in connection with the remediation of such site, above that recovered under subparagraphs (d)(i) or (ii), in its applicable rates or other charges for service. Notwithstanding anything to the contrary contained in this Agreement, WAI shall retain complete discretion as to the timing of any filings with the appropriate regulatory agencies and may seek to recover such amount in rates either before or after the recovery of any amounts pursuant to any other provision of this

agreement. WAI shall be deemed to have recovered in its applicable rates or other charges for service an amount equal to the greater of (A) the amount actually authorized for inclusion in WAI's applicable rate or other charges for service reflected in tariffs, or (B) the amount which would be recovered if WAI would have been authorized to include in its applicable rate or other charges for service reflected in tariffs an amount which would have been authorized for such inclusion if WAI's request for inclusion had been accorded the treatment accorded similar expenditures under similar facts and circumstances by the applicable regulatory agency.

(iv) WAI's Initial Sole Liability Amount. Upon exhaustion of relief contemplated under subparagraphs (d)(i), (ii) and (iii), WAI shall thereafter be solely liable (as between WRI and WAI) for the payment of costs incurred by WAI or WRI in connection with Covered Matters in excess of the amounts received by WAI under subparagraphs (d)(i), (ii) and (iii) in the aggregate amount of Two Million, Five Hundred Thousand Dollars ($2,500,000), without regard to the number of claims concerning Covered Matters required to reach said amount.

(v) WAI/WRI Shared Liability Amount. Upon exhaustion of relief contemplated under subparagraphs (d)(i) through (iv), WAI and WRI shall share equally in payment of costs incurred by WAI in connection with Covered Matters in excess of the amounts received by WAI under subparagraphs (d)(i) through (iii) or paid by WAI under subparagraph (d)(iv) up to a maximum amount to be paid of Seven Million, Five Hundred Thousand Dollars ($7,500,000), without regard to the number of claims concerning Covered Matters required to reach said amount. Notwithstanding anything to the contrary herein, WRI's total liability

for the Shared Properties shall be limited to Three Million, Seven Hundred Fifty Thousand Dollars ($3,750,000), and WAI shall indemnify and hold WRI harmless with respect to all claims, costs, demands and liabilities in excess thereof.

(e) Costs Incurred by WAI and WRI. For the purposes of this Agreement, WRI and WAI agree that the costs incurred by WAI or WRI with respect to Covered Matters for which the other party is liable pursuant to subparagraph (d) above shall include only costs and expenses actually paid to unrelated third parties, and in no event shall WAI or WRI be responsible for nor shall either party receive credit for (i) pre-closing costs or expenses, or (ii) any costs or expenses paid with respect to any of either party's employees or any of either party's overhead. Each party hereby agrees to use its best reasonable efforts to control costs incurred for which the other party may be responsible and shall provide such other party with quarterly reports of costs incurred.

(f) Standstill Agreement. In the event either WAI or WRI is notified that they or either of them is asked to respond as a Potentially Responsible Party ("PRP") under any federal, state or local law or regulation with regard to a Covered Matter, the party receiving such notice shall notify the other party of the receipt of such notice, and shall deliver a copy of all notices and documents received, within ten (10) business days after receipt. With regard to Covered Matters, WAI and WRI each covenant and agree not to sue the other or attempt in any manner to avoid responsibility as a PRP by seeking or attempting to shift or allocate responsibility to the other. WAI and WRI agree to cooperate in the identification of all other PRPs for purposes of participation, remediation cost sharing and liability to regulatory agencies.

Section 4. DUTY TO CONSULT.

a. WAI and WRI shall at all times consult with and receive advice and consider recommendations from (which advice and recommendations shall not be rejected without just and reasonable grounds) and keep each other apprised of all activities and costs incurred in connection with the properties described in Exhibits A and C.

b. The parties recognize that WAI, not WRI, shall have the primary responsibility for initiating, managing, directing and completing all remediation, if any, for the Shared Properties. In order to protect WRI's interest, WAI is willing to consult (as described herein and herein referred to as the "Duty to Consult") with WRI concerning the aforementioned matters. This Duty to Consult is undertaken by WAI so as to keep WRI apprised on a current basis of all matters and events concerning the foregoing. In this regard, WAI agrees to use its best, good faith efforts to keep WRI informed on a current basis as to the foregoing matters. WAI shall willingly receive all advice, suggestions and recommendations from WRI concerning all of the foregoing matters, which advice, suggestions and recommendations shall not be rejected, disregarded or remain unheeded by WAI without just and reasonable grounds. WAI agrees to use methods and procedures to accomplish the foregoing that are consistent with industry practice, are in good faith and are consistent with the methods and procedures used in like circumstances.

c. The parties recognize that with respect to claims submitted in connection with, negotiations relating to settlement of litigation involving, and litigation regarding Environmental Claims and Environmental Costs for any or all of the properties described in Sections 1 and 3 hereof and the related exhibits, WAI has a direct interest in view of the obligations set forth herein. In order to protect WAI's interest, WRI is willing to consult (as described herein and herein referred to as the "Duty to Consult") with WAI concerning the aforementioned matters. In this regard, WRI agrees

to use its best, good faith efforts to keep WAI informed on a current basis as to the foregoing matters. WRI shall willingly receive all advice, suggestions and recommendations from WAI concerning all of the foregoing matters, which advice, suggestions and recommendations shall not be rejected, disregarded or remain unheeded by WRI without just and reasonable grounds. WRI agrees to use methods and procedures to accomplish the foregoing that are consistent with industry practice, are in good faith and are consistent with the methods and procedures used in like circumstances.

Section 5. ALTERNATE DISPUTE RESOLUTION.

(a) Dispute Resolution. No party to this Agreement shall be entitled to take legal action with respect to any dispute relating hereto until it has complied in good faith with the following alternative dispute resolution procedures, provided however, this Section shall not apply to the extent it is deemed necessary to take legal action immediately to preserve a party's adequate remedy.

(b) Negotiation. The parties shall attempt promptly and in good faith to resolve any dispute arising out of or relating to this Agreement, through negotiations between representatives who have authority to settle the controversy. Any party may give the other party written notice of any such dispute not resolved in the normal course of such negotiations. Within twenty (20) days after delivery of the notice, representatives of both parties shall meet at a mutually acceptable time and place, and thereafter as often as they reasonably deem necessary, to exchange information and to attempt to resolve the dispute, until the parties conclude that the dispute cannot be resolved through unassisted negotiation. Negotiations extending sixty (60) days after notice shall be deemed at an impasse, unless otherwise agreed by the parties.

If a negotiator for a party hereto intends to be accompanied at a meeting by an attorney, the other negotiator(s) shall be given at least ten (10) business days' notice of such intention and may also be accompanied by an attorney. All negotiations pursuant to this Section are confidential and shall be treated as compromise and settlement negotiations for purposes of the Federal and state Rules of Evidence.

(c) ADR Procedure. If a dispute with more than $100,000.00 at issue has not been resolved within sixty (60) days of the disputing party's notice, a party wishing resolution of the dispute ("Claimant") shall initiate assisted Alternative Dispute Resolution ("ADR") proceedings as described in this Section. Once the Claimant has notified the other ("Respondent") of a desire to initiate ADR proceedings, the proceedings shall be governed as follows: By mutual agreement, the parties shall select the ADR method they wish to use. That ADR method may include arbitration, mediation, mini-trial, or any other method which best suits the circumstances of the dispute. The parties shall agree in writing to the chosen ADR method and the procedural rules to be followed within thirty (30) days after receipt of notice of intent to initiate ADR proceedings. To the extent the parties are unable to agree on procedural rules in whole or in part, the current Center for Public Resources (CPR) Model Procedure for Mediation of Business Disputes, CPR Model Mini-trial Procedure, or CPR Commercial Arbitration Rules (whichever applies to the chosen ADR method) shall control, to the extent such rules are consistent with the provisions of this Section. If the parties are unable to agree on an ADR method, the method shall be arbitration.

The parties shall select a single neutral third party (a "Neutral") to preside over the ADR proceedings, by the following procedure: Within fifteen (15) days after an ADR method is established, the Claimant shall submit a list of five (5) acceptable Neutrals to the Respondent. Each Neutral listed

shall be sufficiently qualified, including demonstrated neutrality, experience and competence regarding the subject matter of the dispute. A Neutral shall be deemed to have adequate experience if an attorney or former judge. None of the Neutrals may be present or former employees, attorneys, or agents of either party. The list shall supply information about each Neutral, including address, and relevant background and experience (including education, employment history and prior ADR assignments). Within fifteen (15) days after receiving the Claimant's list of Neutrals, the Respondent shall select one Neutral from the list, if at least one individual on the list is acceptable to the Respondent. if none on the list are acceptable to the Respondent, the Respondent shall submit a list of five (5) Neutrals, together with the above background information, to the Claimant. Each of the Neutrals shall meet the conditions stated above regarding the Claimant's Neutrals. Within fifteen (15) days after receiving the Respondent's list of Neutrals, the Claimant shall select one Neutral, if at least one individual on the list is acceptable to the Respondent. If none on the list are acceptable to the Claimant, then the parties shall request assistance from the Center for Public Resources, Inc. to select a Neutral.

The ADR proceeding shall take place within thirty (30) days after the Neutral has been selected. The Neutral shall issue a written decision within thirty (30) days after the ADR proceeding is complete. Each party shall be responsible for an equal share of the costs of the ADR proceeding. The parties agree that any applicable statute of limitations shall be tolled during the pendency of the ADR proceedings, and no legal action may be brought in connection with this agreement during the pendency of an ADR proceeding.

The Neutral's written decision shall become final and binding on the parties, unless a party objects in writing within thirty (30) days of receipt of the decision. The objecting party may then file

a lawsuit in any court allowed by this Contract. The Neutral's written decision and the record of the proceeding shall be admissible in the objecting party's lawsuit.

Section 6. DEFENSE OF CLAIMS.

(a) Third Party Claims. If any party entitled to indemnification under this Agreement (the "Indemnified Party") receives notice of the assertion of any claim or of the commencement of a Third Party Claim with respect to which indemnification is to be sought from a party required to provide indemnification under this Agreement (the "Indemnifying Party"), the Indemnified Party will give such Indemnifying Party reasonably prompt written notice thereof, but in any event not later than ten (10) calendar days after the Indemnified Party's receipt of notice of a Third Party Claims. Such notice will describe the Third Party Claim in reasonable detail and will indicate the estimated amount, if practicable, of the Indemnifiable Loss, as hereinafter defined, that has been or may be sustained by the Indemnified Party. The Indemnifying Party will have the right to participate in or, by giving written notice to the Indemnified Party, to elect to assume the defense of any Third Party Claim at such Indemnifying Party's own expense and by such Indemnifying Party's own counsel (reasonably satisfactory to the Indemnified Party), and the Indemnified Party will cooperate in good faith in such defense at such Indemnified Party's own expense. For the purpose of Section 4 of this Agreement, "Indemnified Loss" shall mean all claims, demands or suits, losses, liabilities, damages, obligations, payments, costs and expenses (including, without limitation, the costs and expenses of any and all actions, suits, proceedings, assessments, judgments, settlements and compromises relating thereto and reasonable attorneys' fees and disbursements in connection therewith) in any such event only to the extent the foregoing is not (i) covered by insurance or (ii) the result of any Indemnified Party's

intentional act or failure to act and "Third Party Claim" shall mean claims, actions or proceedings made or brought by any person not a party to this Agreement or such parties' affiliates.

(b) Defense of Claims. If within ten (10) calendar days after an Indemnified Party provides written notice to the Indemnifying Party of any Third Party Claim the Indemnified Party receives written notice from the Indemnifying Party that such Indemnifying Party has elected to assume the defense of such Third Party Claim as provided in the last sentence of Section 4(a), the Indemnifying Party will not be liable for any legal expenses subsequently incurred by the Indemnified Party in connection with the defense thereof; provided, however, that if the Indemnifying Party fails to take reasonable steps necessary to defend diligently such Third Party Claim within ten (10) calendar days after receiving notice from the Indemnified Party that the Indemnified Party believes the Indemnifying Party has failed to take such steps, the Indemnified Party may assume its own defense, and the Indemnifying Party will be liable for any reasonable expenses thereof. Without the prior written consent of the Indemnified Party, the Indemnifying Party will not enter into any settlement of any Third Party Claim which would lead to liability or create any financial or other obligation on the part of the Indemnified Party for which the Indemnified Party is not entitled to indemnification hereunder. If a firm offer is made to settle a Third Party Claim without leading to liability or the creation of a financial or other obligation on the part of the Indemnified Party for which the Indemnified Party is not entitled to indemnification hereunder and the Indemnifying Party desires to accept and agree to such offer, the Indemnifying Party will give written notice to the Indemnified Party to that effect. If the Indemnified Party fails to consent to such firm offer within ten (10) calendar days after its receipt of such notice, the Indemnified Party may continue to contest or defend such Third Party Claim and, in such event, the maximum liability of the Indemnifying Party as to such

Third Party Claim will be the amount of such settlement offer, plus reasonable costs and expenses paid or incurred by the Indemnified Party up to the date of such notice.

(c) Direct Claim. Any claim other than a Third Party Claim ("Direct Claim") will be asserted by giving the Indemnifying Party reasonably prompt written notice thereof, but in any event not later than ten (10) calendar days after the Indemnified Party becomes aware of such Direct Claim, and the Indemnifying Party will have a period of thirty (30) calendar days within which to respond to such Direct Claim. If the Indemnifying Party does not respond within such thirty (30) calendar day period, the Indemnifying Party will be deemed to have accepted such claim. If the Indemnifying Party rejects such claim, then the Indemnified Party will be free to pursue such remedies as may be available to the Indemnified Party under any applicable Laws, subject to the terms of this Agreement, including without limitation, the enforcement of the Indemnified Party's rights under this Agreement.

(d) Recovery, Settlements, etc. If the amount of any Indemnifiable Loss, at any time subsequent to the making of an indemnity payment in respect thereof, is reduced by recovery, settlement or otherwise under or pursuant to any insurance coverage, or pursuant to any claim, recovery, settlement or payment by or against any other entity, the amount of such reduction, less any costs, expenses or premiums incurred in connection therewith (together with interest thereon from the date of payment thereof), will promptly be repaid by the Indemnified Party to the Indemnifying Party. Upon making any indemnity payment, the Indemnifying Party will, to the extent of such indemnity payment, be subrogated to all rights of the Indemnified Party against any Third Party in respect of the Indemnifiable Loss to which the indemnity payment relates; provided, however, that (i) the Indemnifying Party will then be in compliance with its obligations under this Agreement in respect of such Indemnifiable Loss and (ii) until the Indemnified Party recovers full payment of its

Indemnifiable Loss, any and all claims of the Indemnifying Party against any such third party on account of said indemnity payment is hereby made expressly subordinated and subjected in right of payment to the Indemnified Party's rights against such third party. Without limiting the generality or effect of any other provision hereof, each such Indemnified Party and Indemnifying Party will duly execute upon request all instruments reasonably necessary to evidence and perfect the above-described subrogation and subordination rights.

(e) Failure to Give Timely Notice. A failure to give timely notice as provided in this Section 4 will not affect the rights or obligations of any party hereunder except if, and only to the extent that, as a result of such failure, the party which was entitled to receive such notice was deprived of its right to recover any payment under its applicable insurance coverage or was substantively disadvantaged as a result of such failure.

(f) Right to Employ Separate Counsel. Notwithstanding anything which may be contained in this Section 4 to the contrary, Any Indemnified Party shall have the right to employ separate legal counsel in any Third Party Claim and participate in the defense thereof, but the fees and expenses of such other counsel shall be at the expense of the Indemnified Party and not subject to indemnification under this Agreement unless (i) the employment of such other counsel has been authorized by the Indemnifying Party; (ii) the Indemnifying Party has failed to defend diligently such action, as above provided; or (iii) the parties to such action (including any impleaded parties) include the Indemnified Party and the Indemnifying Party, and the Indemnified Party has been advised by legal counsel that there may be legal defenses available to it which are different from, in addition to or inconsistent with, the legal defenses available to the Indemnifying Party, or that the Indemnified Party's interest may be adverse in whole or in part to the interest of the Indemnifying Party.

Section 7. MISCELLANEOUS.

(a) Savings Provision. This Agreement, and the terms, provisions, covenants and agreements contained herein, shall survive the Closing under the Transaction Agreement.

(b) Defined Terms. All terms used herein as defined terms and not defined herein shall have the meaning set forth in the Transaction Agreement.

Section 8. WARRANTIES AND REPRESENTATIONS CONTAINED IN THE TRANSACTION AGREEMENT. Notwithstanding any provision that may be contained in this Agreement or the Transaction Agreement to the contrary, the terms and the conditions of this Agreement shall not affect, or in any way limit WRI's warranties and representations contained in the Transaction Agreement.

Section 9. EFFECTIVE DATE. This Agreement shall take effect upon the closing of the merger pursuant to the Transaction Agreement. If the merger is not consummated as of the Closing Date then this Agreement shall be null and void ab initio.

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement as of the date first above written.

THIS AGREEMENT CONTAINS A BINDING ARBITRATION PROVISION WHICH MAY BE ENFORCED BY THE PARTIES.

ONEOK Inc.

By _____

Western Resources, Inc

By _____

WAI, Inc.

By _____

EXHIBIT A

Town/Site	Address	Geographical Location
Kansas City, KS	Site #1	Lots 1, 2, 3, 4, 5 and 6, Block 13, Wyandotte City, now in and a part of Kansas City, Wyandotte County, Kansas (in the Southeast Quarter of Section 3, Township 11, Range 25, in Wyandotte County, KS).
Kansas City, KS	Site #2	Lots 1, 2, 3, 4, 5 and 6, Block 21, Wyandotte City, now in and a part of Kansas City, Wyandotte County, Kansas (in the Southeast Quarter of Section 3, Township 11, Range 25, in Wyandotte County, KS).
Leavenworth, KS	Second and Main (Esplanade) Streets	Commencing at the Northeast corner of Block N, City of Leavenworth Proper; thence West to the East line of Main Street; thence South on said East line of Main Street 150 feet; thence East to the East line of said Block N; thence North on the East line of said block to the place of beginning (commencing point), being a tract measuring 150 feet by 110 feet.
Topeka, KS	200 East First Street	Even Lots 14 through 22 on North Quincy Street; Odd Lots 13 through 23 on North Monroe Street; Even Lots 122 through 144 on East First Street; All in Crane's Additional to the City of Topeka, Shawnee County, Kansas.
Emporia, KS	Site is located southeast of the intersection of East Third and North Mechanic Street	Even Lots 30 through 42, Mechanics Street; City of Emporia, Lyon County, Kansas.
Parsons, KS	Southeast of the intersection of South 21st and West Morton Streets	Lots 4, 5, 6, 7 and 8, Block 89, City of Parsons, Labette County, Kansas.
Hutchinson, KS	200 West Second Street	Lots 44, 46, 48, 50, 52, 54, 56 and 58, Second Avenue West, City of Hutchinson, according to the duly recorded plat thereof.

Town/Site	Address	Geographical Location
Abilene, KS	Second & Mulberry Streets	Lots Five (5), Six (6), Seven (7) and Eight (8), Block Ten (10), Original Town of Abilene, Dickinson County, Kansas.

Exhibit B

Town/site	Address	Geographical Location
Newton, KS	300 West First Street	Lots Twenty-three (23), Twenty-five (25) and Twenty-seven (27), Block Fifty-two (52), City of Newton, Harvey County, Kansas.
Arkansas City, KS	Northwest of intersection of West Quincy and South First Streets.	KGE Tract No. 107, described as; Beginning at a point 453.75 feet South and 30 feet West of the Northeast corner of the Northeast Quarter of Section 36, Township 34 South, Range 3 East; thence South 156.75 feet; thence West 233.8 feet to an iron pin; thence North 20 Degrees 38 minutes West, a distance of 167.4 feet; thence East to place of beginning, City of Arkansas City, Kansas. Beginning at a point 610.5 feet South and 30 feet West of the Northeast corner of the Northeast Quarter of Section 36, Township 34 South, Range 3 East of the 6th P.M.; thence South 297 feet; thence West 116 feet to the East line of Canal Right of Way; thence Northwesterly along said Canal Right of Way 330.5 feet; thence East 256 feet to beginning, except the South 142 feet thereof conveyed to Marshall A. Morris, etal, by Deed recorded in Book 190 at Page 620, and except tracts Deeded to the new Era Milling Company by Deeds recorded in Book 134 at Pages 332 and 555, Cowley County, Kansas. Description of Exceptions: Commencing 765.5 feet South and 30 feet West of the Northeast corner of the Northeast Quarter of Section 36, Township South of Range 3 East of the 6th P.M.; thence south 142 feet; thence West 116 feet to the East line of Canal Company's Right of Way; thence Northwesterly along East line of said Right of Way to a point due West of point of

Town/Site	Address	Geographical Location
		beginning; thence East to point of beginning. and Beginning at a stone at the Northeast corner of the Northeast Quarter of Section 36, Township 34 South, Range 3 East of the 6th P.M.; run South, along the East line of said Section 36, 705.5 feet; thence run West, parallel with the North line of said Section 36, angle Right 90 Degrees, 42 Minutes, 228.1 feet to the Northeast corner of the tract; thence Left 117 Degrees, 1 Minute, 346.69 feet to the Southeast corner of the tract; thence Right 117 Degrees, 1 Minute, 18.7 feet to the Southwest corner of the tract; thence Right 62 Degrees, 59 Minutes, 346.69 feet to the Northwest corner of the tract; thence Right 117 Degrees, 1 Minute, 18.7 feet to the aforesaid Northeast corner of the tract, tract contains 0.0867 acres more or less. (per Book 134, Page 332). and Beginning at a stone at the Northeast corner of the Northeast Quarter of Section 36, Township 34 South, Range 3 East; run south along the East line of said Section 36, 610.5 feet; thence run West, parallel with the North line of said Section 36, angle Right, 90 Degrees, 42 Minutes, 275.5 feet to the Northeast corner of the tract; thence Left 117 Degrees, 1 Minute, 106.63 feet to the Southeast corner of the tract; thence Right 117 Degrees, 1 Minute, 18.7 feet to the Southwest corner of the tract; thence Right, 62 Degrees, 59 Minutes, 106.63 feet to the Northwest corner of the tract; thence Right 117 Degrees, 1 Minute, 18.7 feet Degrees, to the aforesaid Northeast corner of the tract, tract contains 0.0400 acres, more or less. (per Book 134, Page 555).

Town/Site	Address	Geographical Location
Pittsburg, KS	Southwest of the intersection of North Locust and East Second Streets	Lots Number Two-Hundred Eleven (211), Two-Hundred Twelve (212), Two-Hundred Thirteen (213) and Two-Hundred Fourteen (214) in Block Number Thirty Nine (30), in the "Town of Pittsburg" (Now the City of Pittsburg, Kansas), according to the recorded plat thereof.

EXHIBIT C

Town/Site	Address	Geographical Location
Atchison, KS	Operation was conducted at two locations separated by Main Street. The gas holders were located north of Main Street, northwest of the intersection of Main and South Seventh Streets. The main production facility was located on the South side of main Street.	Lots One (1) through Five (5), Block Five (5), L.C. Challis Addition, all that part of that alley lying between Block Forty-seven (47) Old Atchison and Block Five (5) L.C. Challiss North of the railroad tract in said Blocks, which alley was vacated by Ordinance #3402, duly passed on August 4, 1991. AND Lots One (1) through Forty-Seven (47), Old Atchison and the South line of Main Street and the North line of the Missouri Pacific Railroad property except the following: Part of Block Five (5) in L.C. Challiss Addition and Block Forty-seven (47) in Old Atchison described as follows: Beginning at the Northwest corner of Lot Five (5), Block Five (5) L.C. Challiss, running thence South along the West line of said Lot Five (5), 115 feet; thence East 292.27 feet; thence West 292.27 feet along the south line of Main Street to the point of beginning, all in the City of Atchison, Kansas.
Manhattan, KS	Northeast of the intersection of South 11th and El Paso Streets; lots 437; 438; 439; and 440, Ward 5.	The North 20 feet of Lots 439 and 440, in Ward 5, in the City of Manhattan, Riley County, Kansas.
Junction City, KS	325 Southeast Fourth Street	A parcel of land in Lots numbered Two (2), and Three (3), Section 12, Township 12, Range 5 East of the 6th P.M., Geary County, Kansas described as follows: Beginning at the Southeast corner of Block Forty-one (41) in Junction City, running thence East to the West line of the right of way of the Union Pacific Railway Company, thence in a Southerly direction along the west line of the right of way to a point in the East line of Block number Fifty-seven (57) in Junction City, Kansas where the West line of said right of way intersects said Block Fifty-seven (57); thence North along the East corporate limits of a Juntion City to place of beginning.

Town/Site	Address	Geographical Location
Salina, KS	403 North Third Street	Lots 14, 16 & 18, Block 50, Original Plat, City of Salina, Saline County, Kansas. (a/k/a Lots 14, 16 and 18 on 3rd Street, Original Town of Salina.)
Concordia, KS	410 Mill Street	A tract beginning 150.0 feet North of the Northwest corner of Block 176 and on the East side of Republic Street, and South side of Mill street; thence East on the South side of Mill Street and 150.0 feet North of the North line of Block 176, 230.9 feet to approximate East right of way line of the abandoned Union Pacific Railroad spur; thence Southerly 150.6 feet on the approximately East right of way line to the North line of Block 175 and 15.5 feet East of the Northwest corner of Lot 7, Block 176; thence West on the North line of Block 176, 243.5 feet to the Northwest corner of Block 176 and the East line of Republic Street 150.0 feet to the point of beginning.

Kansas Corporation Commission
Docket Number 17-KGSG-455-ACT
Information Request

Data Request: 17-455 KCC-004 Amended: Additional Liability
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 7/21/2017
Date Information Needed: 7/21/2017
Requested By: Bill Baldry

Please provide the following:

On page 5 of Mr. Dittemore's testimony, he discusses increasing the environmental liability by $4,500,000.

a. Please provide a copy of the work papers that support the additional liability of $4,500,000.

AMENDED

Based upon discussions with Staff, KGS has agreed to remove the confidential designation to the written response to this data request subject to KGS retaining its confidential designation on all of the information contained in the documents that were attached in support of the written response to data request number 4.

The associated attachments contain financial and business information the Company has deemed and treats as "CONFIDENTIAL" and as such, the information contained herein is subject to the Confidential treatment and protections proscribed in K.S.A. 66-1220a., K.A.R. 82-1-221a and the Protection Order issue in this docket. The improper release of the confidential information may result in irreparable economic harm to the Company and its customers.

Response:
The $4.5 million increase in the environmental liability was the result of two entries recorded in 2016. The first entry was the result of an internal review of our environmental reserve. Please see Attachment A as support for a $500,000 accrual recorded in September, 2016.

The second entry was the result of new information in 2016 at one of our former manufactured gas sites. Recent results from periodic monitoring and a 2016 interim site investigation at our Abilene site indicated elevated levels of potentially harmful materials at the site. In response to the results of the interim site investigation, during the fourth quarter of 2016, potential investigation and remediation alternatives were developed. We have estimated the potential costs associated with additional investigation and remediation to be in the range of $4.0 million to $7.0 million. A single reliable estimate of the remediation costs is not feasible due to the amount of uncertainty in the ultimate remediation approach that will be utilized. Accordingly, in the fourth quarter of 2016, we recorded a reserve of $4.0 million for this site. Please see the overview of the Abilene remediation efforts prepared by Burns McDonnell, included as Attachment B, that supports the $4 million accrual recorded in December, 2016.

Prepared by: Jeff Husen

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: David Dittemore

Date: July 21, 2017

Kansas Corporation Commission
Docket Number 17-KGSG-455-ACT
Information Request

Data Request: 17-455 KCC-005: Additional Liability
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 4/28/17
Date Information Needed: 5/10/17
Requested By: Bill Baldry

Please provide the following:

On pages 5 and 6 of Mr. Dittemore's testimony, he mentions that KGS recorded an additional liability of $4,500,000 to bring the environmental liability account up to a balance of $5,900,000. Before the additional liability of $4,500,000 was recorded in 2016, it appears the environmental liability account had a balance of $1,400,000 ($5,900,000 less $4,500,000).

ONEOK established an environmental reserve of $12,600,000 in 1997. (Dittemore testimony, page 5) Between 1997 and 2016, ONEOK incurred manufacturing gas plant costs of $10,750,000. (Dittemore testimony, page 6)

Reserve	$12,600,000
Less: Money expended	($10,750,000)
Remaining Liability Balance	$1,850,000

a. Please reconcile the liability account balances of $1,850,000 and $1,400,000 prior to the $4,500,000 addition in 2016.

Response:
When the liability account was orignially established, it was all part of the the legal reserve booked to account 2530 and the following liabilities were set up:

	Amount	
Manufactured Gas Plants	$ 8,300,000 MGP	
RCRA Remediation & Post Closure Site	3,500,000(1)	=$12,603,000
Manufactured Gas Site Insurance Litigation	800,000 MGP	
Underground Storage Tanks	3,000(2)	
Legal Reserves	5,611,021	
Correction for Billing Errors due to incorrect CustomerTariff	300,000	
Workers Compensation Claims	446,807	
City of Kansas City, KS Franchise Fee audit	100,000	
Total	$19,060,828	

(1) Relates to Resource Conservation and Recovery Act (RCRA) for Minneola Compressor Station, Abilene Compressor Station, Calista Compressor Station, Minneola Gas Processing Plan, Yaggy Storage, Derby, KS Storage Shed, and Obee Road

(2) Related to underground storage tanks at the Wichita gas service center and the Mission service center

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: David Dittemore

Date: May 10, 2017

Data Request: 17-455 KCC-005: Additional Liability
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 4/28/17
Date Information Needed: 5/10/17
Requested By: Bill Baldry

Note: The **Resource Conservation and Recovery Act (RCRA)**, enacted in 1976, is the principal federal law in the United States governing the disposal of solid waste and hazardous waste. Congress enacted **RCRA** to address the increasing problems the nation faced from its growing volume of municipal and industrial waste. **RCRA** amended the Solid Waste Disposal Act of 1965.

This amount was booked with other legal liabilities which resulted in a total liability of $19,060,829 being established. Over time some of the items were resolved for less than the accrued amount and some incurred cost higher than the amount reserved. It is important to note that while no expense was incurred, the company did incur cash expenditures to satisfy these obligations.The actual amount of expense related to MGPs was $10.75 million based on a review of the actual expenses. Additionally, insurance recoveries of $1.26 million were booked to this account and the resulting balance at 12/31/2016 was a liability of $1.4 million prior to the $4.5 million being booked.

Prepared by: Mark W. Smith

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: David Wittum

Date: May 10, 2017

Kansas Corporation Commission
Docket Number 17-KGSG-455-ACT
Information Request

Data Request: 17-455 KCC-007: Remindiation Action
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 4/28/17
Date Information Needed: 5/10/17
Requested By: Bill Baldry

Please provide the following:

Please provide an explanation of the remediation actions that have already been performed at these 12 manufactured gas plant sites, and what remediation action still needs to be undertaken.

Please see 17-455 KCC-007 Attachment

Prepared by: James Haught

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: David Wittenberg

Date: May 10, 2017

Abilene:

The Abilene manufactured gas plant (MGP) site is an inactive site owned by Kansas Gas Service. There are no longer any buildings on the site. An Interim Remedial Measure investigation was conducted at the site followed by an Interim Removal Action in 2005 that removed approximately 650 tons of contaminated source material and soil for disposal. Three groundwater monitoring wells were installed in 2004. In response to KDHE review comments, an additional up-gradient well was installed and a poorly functioning well was replaced. Wells were sampled multiple times between 2004 and 2016.

A supplemental site investigation was completed in 2016 to assess levels of soil and groundwater contamination remaining on-site and to measure the extent of off-site soil and groundwater contamination downgradient from the site. As part of the 2016 investigation, twenty-five on-site soil borings, six off-site soil borings and five monitoring wells were installed to help define the level of impacts to the soil and groundwater. The data showed persistent BTEX (benzene, toluene, ethylbenzene, xylene) and PAH (polyaromatic hydrocarbons) impacts to both soil and groundwater. A Comprehensive Investigation/Corrective Action Study is currently underway (2017) to further assess the nature and extent of the contamination in order to develop remediation alternatives for the site.

Atchison:

The Atchison MGP site consists of two parcels separated by a city street. The parcels have different owners, with neither being KGS. The south parcel is privately owned gravel lot that is currently leased by KGS and used for material storage for the adjacent Atchison service center. The MGP tar well is located below ground on the south parcel. The north parcel is owned by the Atchison Housing Authority and is occupied by a multi-story apartment building and associated asphalt parking. There are two below ground gas holder structures located on the north parcel. A portion of the multi-story apartment building is constructed over a portion of the lager, northern-most gas holder. The southern gas holder lies underneath the parking lot adjacent to the street and sidewalk. Installation of six groundwater monitoring wells was completed in 2007.

KGS conducted soil vapor sampling around the perimeter of the building in the area of the larger gas holder in order to assess the potential for movement of contaminant vapors (vapor intrusion) from the soil into the building. Sampling conducted in varying seasons over multiple years was somewhat inconsistent but supported a conclusion that the potential for vapor intrusion was below regulatory screening guidance levels and that no mitigation was required. KDHE reviewed and approved the 2014 vapor intrusion report.

the site "Resolved with Restrictions" although provisions of the Environmental Use Control must still be observed and the site may require additional testing and possible remediation if and when buildings are removed.

Hutchinson:

The Hutchinson MGP site is not owned by KGS and is occupied by a vacant commercial/professions office building. In 1990 a contractor to the United State Environmental Protection Agency, Region VII conducted a Preliminary Assessment and concluded that additional work was needed at the site. A Preliminary Assessment conducted in 1993 and a Site Investigation in 1994 found contaminants in the soil and groundwater. A Remedial Investigation was completed in 1996 and a Supplemental Remedial Investigation was completed in 1997. Both investigations indicated contamination, including fuel oil, in the groundwater and soil. A final RI summary was submitted to KDHE in February 2001. Burlington Northern/Santa Fe (BNSF) railroad performed a tank removal adjacent to the MGP site in 2005. From historical records, it appears this tank contained fuel oil use to heat a railroad platform north and adjacent to the MGP site. Ownership of a second tank structure immediately adjoining the northern boundary of the MGP site is uncertain.

In 2004 KGS prepared a report evaluating the potential risk posed by the site and proposed future actions at the site. KDHE has not approved the document. Since this time numerous investigations either directly or indirectly related to the MGP site have been performed and include a soil sampling effort associated with BNSF's Former Freight Platform (June 2007), an Excavation Report at the Former Freight Station (April 2008), additional groundwater sampling at the Former Freight Station which included MGP wells in 2008 and submittal of groundwater monitoring reports for four groundwater sampling events in 2009 and 2010. Additional rounds of groundwater sampling, performed under the authority of other KDHE programs were completed in 2011 and 2013. Sample results from these sampling events continue to report data consistent with previous results and still create some uncertainty as to origin of some of the contamination on and adjacent to the MGP site. An Environmental Use Control was filed on the property in 2012.

KDHE and KGS met in May 2012 to develop a programmatic strategy for all MGP sites that included the Hutchinson site. KGS concluded that further evaluation was necessary before committing to a specific path forward for remedial alternative development at this site. KDHE is reviewing added investigation information and other site characterization and/or monitoring activities from other KDHE programs and evaluating the relevance and/or impact this information has on the MGP site and future site remedial decisions. Hutchinson in included in the periodic groundwater sampling and is planned again for 2017.

level trends following the 2002 removal action before additional remediation and/or control activities can be identified.

Leavenworth

The Leavenworth MGP site, owned by KGS, was the subject of a preliminary assessment conducted in late 1988 and early 1989. The results indicated coal tar and cyanide wastes may have been deposited on the site sometime during its operating life. In June 1990 and March 1991, the KDHE conducted a Scanning Site Investigation which confirmed that soils were contaminated with MGP-associated waste types. Soil contamination levels were low, except near the former tar disposal well. No threat to groundwater, surface water or air was found during the KDHE investigation.

A field investigation and soil removal action was conducted in April 1995. Soil was excavated from two trenches in and around the former tar disposal well at the site. Soil/debris removed from this area was visually observed and field screened. Though some tar globules and hydrocarbon odor was present, the removed soil was not highly contaminated. Results from laboratory analyses did not report hazardous waste characteristics.

In 1995 the site was leased to the City of Leavenworth for a term of 99 years. The City constructed a clay "cap" over the impacted area as part of their River Front Redevelopment to further minimize residual risk of exposure to the subsurface contamination. In 2015, the lease agreement was amended to allow the City to construct a concrete parking lot over the "capped" area thereby providing an additional layer of protection from exposure.

No significant contamination was detected with groundwater sampling conducted under a plan approved by KDHE. A Restrictive Covenant, approved by KDHE, which limits soil disturbing activities is recorded for the property. The KDHE conducts periodic inspections to ensure compliance with the Restrictive Covenant. No additional investigations or remediations of MGP contamination are currently anticipated.

Manhattan

The City of Manhattan owns the property and has a Public Works/Traffic Operations building on the site of the former MGP. Initial sampling activities were completed in September 2003 with findings reported to KDHE in a January 2004 Site Investigation (SI) Report. The SI Report documented subsurface impacts from the MGP operations. An Interim Removal Action work plan was submitted to KDHE in August 2004 and, after satisfying public participation requirements, the interim removal action was completed. Over 5,500 tons of source material

future investigations will indicate if additional remediation or controls are required at the site. There are no groundwater monitoring wells at the Parsons site.

Salina

The Salina MGP site is located in a commercial/light industrial area and is currently used for parking, storage and as an automotive repair facility. KGS does not own the site.

A preliminary assessment and subsequent site Investigation identified both contaminants typical of former manufactured gas plant sites and petroleum sources. In response, KGS performed an Interim Removal Action between November 2006 and March 2007. A supplemental site investigation will be required to develop a Corrective Action Study necessary to identify the next steps. Groundwater wells at the Salina site are part of the ongoing periodic monitoring program.

Topeka

A Preliminary Assessment was conducted at the site in 1993. It is reported in this Preliminary Assessment that the original MGP owner sold process by-products commonly associated with MGP sites (tar and coke) generating nearly 1/2 the cost of coal used as a feedstock. Based on this significant by-product resale value, significant on-site disposal of coal tar and coke was not expected. The Preliminary Assessment did not identify potential site contaminant exposure concerns. In January 2004, KGS performed a site investigation supporting evaluation of whether an Interim Removal Action is necessary.

Concentrations of contaminants commonly associated with MGP sites were identified in soil samples exceeding both the Risked-based Standards for Kansas, soil, and soil to ground water pathways. In general, the concentrations detected in surface soil samples were greater than those detected in subsurface soil samples. The most significant detections were in and around the former tar well and the east purifier house. KGS conducted interim removal actions including recording an Environmental Use Control and soil excavation/disposal. It was not feasible to address contamination under existing buildings during the interim removal actions. That work remains to be completed when the buildings are removed in the normal course of business or if ongoing groundwater monitoring indicates movement of contamination to the extent earlier actions are warranted.

KGS submitted a revised Draft Corrective Action Study which KDHE initially approved. However, subsequent groundwater sampling identified unanticipated high readings that did not appear on

Kansas Corporation Commission
Docket Number 17-KGSG-455-ACT
Information Request

Data Request: 17-455 KCC-012: Accrued Liability for MGP Environmental Costs
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 4/28/17
Date Information Needed: 5/10/17
Requested By: Bill Baldry

Please provide the following:

On pages 5 and 6 of Mr. Dittemore's testimony, he discusses KGS recording an accrued liability for environmental costs in 1997 and in 2016. He mentions that the recording of the increase in the liability account in 2016 also increased the company's operating expense in 2016.

a. By establishing the liability in 1997 and increasing the liability in 2016, does this mean that KGS recognized an increase in operating expenses related to the liability only in the years 1997 and 2016?

b. If KGS recorded adjustments to the environmental liability account in years other 1997 and 2016, please provide the year, dollar amount, and an explanation as to why an adjustment was made to the accrued liability account

Response:

a. The establishment of the liability in 1997/1998 did not result in an expense. However, it did result in a recognition that future cash would have to be spent. The original environmental liability was made up of 4 items as stated below:

o Manufactured Gas Plants	$ 8,300,000
o Resource Conservation and Recovery Act Remediation & Post Closure Site	3,500,000
o Manufactured Gas Site Insurance Litigation	800,000
o Underground Storage Tanks	3,000
▪ Total	$12,603,000

This amount was booked with other legal liabilities which resulted in a total liability of $19,060,829 being established. Over time, some of the items were resolved for less than the accrued amount and some incurred costs higher than the amount reserved. At the end of 2016, prior to the additional $4.5 million being booked, a balance of $1.4 million remained that was associated with the original reserve. It is important to note that while no expense was incurred, the company did incur cash expenditures to satisfy these obligations.

The company did recognize an expense when the $4.5 million was booked in 2016.

Note: The **Resource Conservation and Recovery Act (RCRA)**, enacted in 1976, is the principal federal law in the United States governing the disposal of solid waste and hazardous waste. Congress enacted **RCRA** to address the increasing problems the nation faced from its

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: David Wittemore

Date: May 9, 2017

growing volume of municipal and industrial waste. **RCRA** amended the Solid Waste Disposal Act of 1965.

b. No other adjustments to the environmental liability account were made. The only environmental items would be remediation costs and insurance proceeds.

Prepared by: Mark W. Smith

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: David Wittman

Date: May 9, 2015

Kansas Corporation Commission
Docket Number 17-KGSG-455-ACT
Information Request

Data Request: 17-455 KCC-022: DR No. 12 Establishment of the Liability
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 6/1/2017
Date Information Needed: 6/15/17
Requested By: Bill Baldry

Please provide the following:

Please provide the journal entry that established the accrued liability for environmental costs in 1997/1998.

This response contains financial and business information the Company has deemed and treats as "CONFIDENTIAL" and as such, the information contained herein is subject to the Confidential treatment and protections proscribed in K.S.A. 66-1220a., K.A.R. 82-1-221a and the Protection Order issue in this docket. The improper release of the confidential information may result in irreparable economic harm to the Company and its customers.

KGS Response:

Attached is a copy of Kansas Gas Service Journal Entry #3243 recorded in the August 1998 accounting period. The liability for environmental remediation costs was part of the $13,457,828, recorded in account 51-000-2530-0-10-004, on page 2 of 6 of the Journal Entry. The estimated liability was recorded based on management's analysis of liabilities acquired in the acquisition of Kansas Gas Service by ONEOK. [Confidential] Attachment 2 includes the analysis of all liabilities acquired by ONEOK in the acquisition of Kansas Gas Service as prepared by ONEOK's General Counsel in 1998. The analysis in [Confidential] Attachment 2, is an inventory of all liabilities and does not express a judgment as to which of these items were considered probable to incur a loss by ONEOK following the acquisition. Included in this analysis, on pages 8 and 9 of the attachment, are estimates related to environmental matters of $800,000 for Environmental Insurance litigation, $8.3 million for Manufactured Gas Plant costs and $3.5 million in other Resource Conservation and Recovery Act (RCRA) remediation and post closure costs. These amounts are included in both the amount accrued in Attachment 1 and in the legal analysis presented in [Confidential] Attachment 2. Because the environmental obligation was established with the consent order related to the manufactured gas plants, the estimated amounts associated with the environmental obligations were considered "estimates of probable losses" for purposes of recording an accrued liability at the time of the acquisition.

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: David Wittenberg

Date: June 15, 2017

Kansas Corporation Commission
Docket Number 17-KGSG-455-ACT
Information Request

Data Request: 17-455 KCC-022: DR No. 12 Establishment of the Liability
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 6/1/2017
Date Information Needed: 6/15/17
Requested By: Bill Baldry

The difference between the remaining amounts in the amount recorded in Attachment 1 and the $19 million identified in [Confidential] Attachment 2, represent management's judgment of the probable losses related to the remaining amounts identified in [Confidential] Attachment 2.

Please note: [Confidential] Attachment 2, has been redacted to protect the identity of individuals involved in litigation and/or Workman Comp related actions against the Company.

Prepared by: Jeff Husen

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: David Wittenberg

Date: June 15, 2017

Kansas Corporation Commission
Docket Number 17-KGSG-455-ACT
Information Request

Data Request: 17-455 KCC-033: Follow up to DR No. 4
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 6/20/17
Date Information Needed: 6/29/17
Requested By: Justin Grady

Please provide the following:

Please refer to the Attachment A provided in response to KCC DR No. 4. That memo provides the rationale and explanation for an additional $500,000 that was needed to increase the environmental reserve at September 30, 2016 to approximately $2.2 million. Please describe the "estimates of additional work not contemplated in the three-year work plan that is probable of occurring in 2017," that was the catalyst for the establishment of the $500,000 of additional liability. Is this work contained in the Exhibit JEH-7? If so, please identify specifically where in this document that work is included.

KGS Response:

In 2016, a Supplemental Site Investigation (SSI) was conducted at the Abilene site as anticipated in the "three-year workplan" (*See*, Exhibit JEH-7). The SSI produced findings that indicated the project was ready to move forward to the next step - conducting a Comprehensive Investigation/Corrective Action Study (CI/CAS). The CI/CAS was not included in the intial three-year work plan because, while the study was anticpated, it was not certain that the 2016 SSI would produce the information necessary to allow the project to move forward within the plan's time-frame. However, in the third quarter of 2016, the $500,000 liability (an estimate of costs to develop the CI/CAS workplan, to conduct field sampling and to develop a report for KDHE), was established when it became clear that the study was the reasonable next step.

Prepared by: James Haught

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: David Wittenberg

Date: June 27, 2017

Kansas Corporation Commission
Docket Number 17-KGSG-455-ACT
Information Request

Data Request: 17-455 KCC-040: Insurance Recoveries Documentation
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 6/20/17
Date Information Needed: 6/29/17
Requested By: Justin Grady

Please provide the following:

For the Insurance recoveries listed in Exhibit MWS-3, please provide all supporting documentation the company relied on in supporting each entry to the reserve from 2004 to the present. Additionally, for the most recent five insurance recoveries, please provide a copy of the journal entries utilized to book this activity to both One Gas and KGS' books.

KGS CONFIDENTIAL Response:

The response to this data request in its entirety is designated as "CONFIDENTIAL" under sections (4), (5) and (6) of paragraph 11 of the Protective/Discovery Order issued in this docket on April 20, 2017.

The attached schedule shows the General Ledger detail for the receipt of checks to the reserve account. Note that 5 lines in the ledger reflect worker compensation refunds for a total of $1,509.37. The amount for the worker compensation refunds should not have been included in the total. The balance of the information known is in the column labeled as "Comments." The schedule is the actual entry in the Accounts Receivable system. The column labeled "Notes" is information I have added based on my knowledge of what was being deposited, the description in the comment field, and any other information we have in our files. For the amounts marked "settlement or partial claim," we do not have the settlement documents. We have requested the documents from ONEOK and we will provide them when they become available.

Prepared by: Mark W. Smith

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: David Wittenau

Date: June 29, 2017

Kansas Corporation Commission
Docket Number 17-KGSG-455-ACT
Information Request

Data Request: 17-455 KCC-041: Insurance Proceeds Delay
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 6/20/17
Date Information Needed: 6/29/17
Requested By: Justin Grady

Please provide the following:

Exhibit MWS-3 appears to support the fact that Oneok didn't receive any Insurance proceeds associated with MGP remediation costs until August of 2004. Is this accurate? If so, please explain in detail the activities occurring between 1997 and 2004 related to the Insurance recovery process and explain why it took over 6 and one half years to receive any insurance proceeds through these processes.

KGS Response:

Yes, it is accuate. Based on ONE Gas's (formerly, ONEOK's) accounting records, no insurance proceeds were received until August 2004. From the transaction date until sometime in 2000, ONE Gas and Westar (formerly, WRI) were researching the various insurance policies and companies in preparation to make a reasonable claim. Once the claim was made in 2000, the insurance companies responded with extremely low offers and implied that their intent was not to make partial payments. In fact, some of the insurance carriers offered to only make payments in exchange for the return of the policies and an agreement from the Company to not hold the carrier liable for any future obligations. At that time ONE Gas decided not to move forward. As a result, these claims remain open with the carriers and have not been settled to date for the most part. Also, some insurance companies have gone into bankruptcy and in accordance with the bankruptcy rulings have paid ONE Gas a share of their run-off proceeds. Additionally, settlements were reached with a handful of the companies. (See, KGS Response to DR 40 for additional detail on the settlements).

Prepared by: Mark W. Smith

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: Mark W. Smith

Date: June 29, 2017

Kansas Corporation Commission
Docket Number 17-KGSG-455-ACT
Information Request

Data Request: 17-455 KCC-045: Detail Behind Insurance Recoveries
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 6/20/17
Date Information Needed: 6/29/17
Requested By: Justin Grady

Please provide the following:

Mr. Smith's testimony generally discusses One Gas' past actions and strategy for pursuing insurance settlements. On Page 11, beginning at line 5, Mr. Smith states that the insurance companies, who hold these policies, are generally unwilling to enter into partial settlements but instead demand full release from any future liability under the policy. For each of the insurance settlements/recoveries that One Gas has received to date, please provide the name of the insurance company, the amount of the settlement, the site or sites that were covered under the policy, the year of recovery, and whether the settlement/recovery included a release of all future liability for ONE Gas MGP costs with that insurance company.

KGS Response: As disclosed in the response to data request number 40, most of the insurance recoveries received to date are believed to have come from those companies who have become insolvent and the Company receiving partial reimbursement through the associated bankruptcy proceedings. As also identified within this response (data request number 40) there has been one actual settlement. Please see the response to data request number 40 for the information requested.

Prepared by: Mark W. Smith

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: Mark D Whitten

Date: June 29, 2017

Kansas Corporation Commission
Docket Number 17-KGSG-455-ACT
Information Request

Data Request: 17-455 KCC-046: Support for "Assess Future Costs" statement
Company Name: Kansas Gas Service, a Division of ONE Gas, Inc.
Request Date: 6/20/17
Date Information Needed: 6/29/17
Requested By: Justin Grady

Please provide the following:

Mr. Smith's testimony generally discusses One Gas' past actions and strategy for pursuing insurance settlements. On Page 11, beginning at line 7, Mr. Smith states that "the Company has taken a more deliberate approach that includes analyzing our actual historical costs together with additional testing and monitoring to provide us with information to assess future costs."
Has ONE Gas prepared this analysis of future costs at each of its MGP sites? If so please provide this analysis. If the company has not prepared this analysis of future costs at each of its MGP sites, please explain how the company is prepared at this time to begin the insurance claims process, which may require a release of all future liability of the insurance carriers (Page 11, Lines 6 and 7 of Smith Testimony).

KGS Response:

See objection submitted to KCC Staff dated June 26, 2017. As indicated in that objection, KGS has contacted KCC Staff to provide the information regarding estimated future costs at MGP sites without KGS risking the loss of its attorney-client and attorney-work product privileges as it relates to the analysis requested by the KCC Staff.

Prepared by: Mark W. Smith

Verification of Response

I have read the foregoing Information Request and answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to the Commission Staff any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Information Request.

Signed: Dari O Wittemore

Date: June 29, 2017

LAW OFFICES OF

ANDERSON & BYRD

A Limited Liability Partnership

JOHN L. RICHESON
JAMES G. FLAHERTY
R. SCOTT RYBURN
KEITH A. BROCK
THOMAS H. SACHSE
JEFFREY A. WILSON

216 S. HICKORY, P. O. BOX 17
OTTAWA, KANSAS 66067
(785) 242-1234, *Telephone*
(785) 242-1279, *Facsimile*
www.andersonbyrd.com

ROBERT A. ANDERSON
(1920-1994)

RICHARD C. BYRD
(1920-2008)

June 26, 2017

THIS LETTER CONTAINS CONFIDENTIAL INFORMATION

Mr. Andrew J. French
Litigation Counsel
Kansas Corporation Commission
1500 S. W. Arrowhead Road
Topeka, Kansas 66604

Re: Docket No. 17-KGSG-455-ACT
Kansas Gas Service's Confidential Objection to KCC Staff Data Request No. 46.

Dear Andrew:

Pursuant to paragraph 22 of the Protective/Discovery Order issued in this docket on April 20, 2017, Kansas Gas Service provides this confidential objection to that portion of the KCC Staff Data Request No. 46 which requests that Kansas Gas Service provide analysis of future costs that may be incurred at the MGP sites that it plans to use in its negotiations of claims against insurance carriers on the grounds that such analysis are privileged and protected based upon the attorney-client communications privilege as set forth in K.S.A. 60-426 and the attorney work product privilege as set forth in K.S.A. 60-226(b)(4).

Such a waiver of those privileges could jeopardize Kansas Gas Service's efforts in negotiating and/or litigating its claims against the insurance carriers, which would be detrimental to both the utility and its customers. The analysis requested are communications between Kansas Gas Service and its attorney prepared in the course of that attorney-client relationship. The analysis were prepared in anticipation of litigation or trial on behalf of Kansas Gas Service against insurance carriers and contain mental impressions, conclusions, opinions or legal theories of Kansas Gas Service's attorney or other representatives/consultants concerning potential litigation against the insurance companies. See, *City of Neodesha v. BP Amoco Corporation*, 50 Kan. App. 2d 731, 755-757, 334 P.3d 830, 849-850 (2014), review denied October 7, 2015.

Without waiving said privileges, Kansas Gas Service will work with the KCC Staff in an attempt to provide information regarding future costs relating to the MGP sites so long as such can be done without waiving said privileges. The following is a privilege log identifying those documents in which Kansas Gas Service is claiming its privilege:

PRIVILEGE LOG
DESCRIPTION OF DOCUMENT

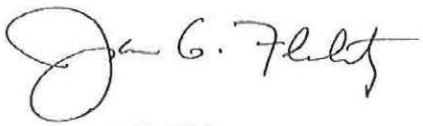
(1) 1998 Remediation Technologies Cost Estimates

(2) 2009 LECG Cost Estimates

(3) 2013 Burns & McDonnell Cost Estimates

I will give you a call to discuss how we might be able to provide the KCC Staff with information with respect to future costs without the risk to Kansas Gas Service of losing its privileges as it relates to the above-mentioned documents.

Sincerely,



James G. Flaherty
jflaherty@andersonbyrd.com

JGF:rr
cc: Thomas J. Connors
Todd E. Love
David W. Nickel
Jason K. Fisher

RECOVERY BY UTILITIES OF EXPENDITURES ON MANUFACTURED GAS PLANT CLAIMS: RECENT DEVELOPMENTS REGARDING INSURANCE COVERAGE AND RATE RELIEF*

Nicholas W. Fels
William P. Skinner
Saul B. Goodman

Covington & Burling
Washington, D.C.

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* The authors represent utilities and other policyholders in environmental insurance coverage litigation and rate proceedings. The views expressed in this article are the views of the authors and not necessarily those of the clients of Covington & Burling. The authors wish to thank Ronald G. Dove, Jr., Matthew S. Yeo and Jonathan B. Mirsky for their help with this article. Portions of this article originally appeared in Goodman, "Insurance Coverage for Environmental Claims: Cost Recovery by Utilities and Pipeline Companies for Expenditures on Environmental Claims," 5 *Nat. Gas Law. J.* 91 (1991).

I. INSURANCE COVERAGE FOR MGP COSTS 4
A. Policyholder Theory of Coverage 4
B. Insurer Defenses 5
1. No Damages 6
2. Trigger of Coverage 6
3. Scope of Coverage 7
4. Owned-Property Exclusion 7
5. Pollution Exclusion 8
6. Expected or Intended 9
C. Rulings Generally Favorable to Policyholders 10
1. *Washington Natural Gas Co. v. Aetna Casualty & Surety Co.* 10
a. Jury Verdict 10
b. Allocation 10
c. Attorney Fees and Costs 11
d. Owned/Alienated Property Exclusion 12
e. Coverage for Cleanup Costs Traceable to Acts of Others 12
f. "Expected or Intended" Standard 12
g. Stone & Webster Policies: "Event" and "Occurrence" 13
h. Property Damage in Policy Period 13
i. Pollution Exclusion 13
j. Known Loss/Loss in Progress 14
2. *Public Service Electric & Gas Co. v. Certain Underwriters at Lloyd's of London* 14
a. "Expected or Intended" Issue 15
b. Owned-Property Exclusion 16
c. Damages 17
d. Trigger of Coverage 17
e. Scope of Coverage 18
f. Late Notice 18
3. *Central Illinois Public Service Co. v. Allianz Underwriters Insurance Co.* 18
a. Jury Verdict and Appellate Reversal 19
b. Appellate Reversal of Ruling That CGL Insurers Were Bound By EIL Trial Verdict 20

c. Trigger and Scope of Coverage 20
d. "Property Damage" 20
e. Pollution Exclusion — "Sudden and "Accidental" 21
f. Notice and "Known Risk" Doctrine 21
g. "Premises Alienated" Exclusion 22
h. Notice 22
i. "Expected or Intended" Standard 23
j. "Damages" 23
4. *Northern States Power Co. v. Fidelity and Casualty Co.* 23
a. Primary Versus Excess Coverage 24
b. Trigger of Coverage 25
c. "Damages Because of Property Damage" 25
d. Owned-Property Exclusion 25
e. Allocation of Damages and Deductibles 26
5. *Stone & Webster Management Consultants v. Travelers Indemnity Co.* 27
a. Occurrence 27
b. Owned Property Exclusion 27
c. Expected or Intended 28
d. Notice 28
6. *Vermont Gas Systems, Inc. v. USF&G* 28
a. Pollution Versus Damage 28
b. Notice and Duty to Defend 29
7. *Puget Sound Power & Light Co. v. Aetna Casualty & Surety Co* 30
a. Duty to Defend and Allocation of Defense Costs 30
8. *Public Service Co. of Colorado v. Certain Underwriters at Lloyd's London* 31
a. Jury Verdict 31
9. *Chesapeake Utilities Corp. v. American Home Assurance Co.* 31
a. "As Damages" 32
b. "Operations" 32
10. *Pacific Gas & Electric Co. v. Lexington Insurance Co.* 32
a. Duty to Defend 32
b. Joinder of Excess Carriers 33

D. Rulings Generally Unfavorable to Policyholders 34
1. *Atlanta Gas Light Co. v. Aetna Casualty & Surety Co.* 34
2. *Union Gas Co. v. Aetna Casualty & Surety Co.* 35
a. Jury Verdict 35
3. *City of St. Petersburg, Florida v. USF&G* 35
a. Pollution Exclusion/Duty to Defend 36
E. Summary 36

II. RATE RECOVERY OF NET MGP COSTS 36
A. Arguments For and Against Allowing Full Recovery of Net MGP Costs From Ratepayer 37
B. Commission Decisions Granting Full Recovery of MGP Costs From Ratepayers 38
1. *ICC v. Illinois Power Company*, 1996 Ill. PUC LEXIS 53 (1996) 38
2. *Public Service Electric & Gas Company,* BRC Docket No. ER91111698J, 1993 WL 505443 (N.J. Bd. Reg. Comm'rs, Sept. 15, 1993), reh'g denied, (Jan. 21, 1994) 39
3. *Washington Gas & Light Company,* 146 PUR4th 429 (D.C. Pub. Serv. Comm'n, Oct. 8, 1993) 41
4. *Michigan Gas Utilities,* Case No. U-10503, 1994 Mich. PSC LEXIS 98 (Mich. Pub. Serv. Conm'n, Mar. 30, 1994) 43
5. Earlier Decisions Providing Full Recovery 43
C. Commission Decisions Requiring Sharing of Net MGP Costs Between Shareholders and Ratepayers 44
1. *Public Service Company of North Carolina,* 156 PUR4th 384 (N.C. 1994) 44
2. *Kansas Public Service,* 146 PUR4th 123 (Kan. S.C.C. 1993) 46
3. *Wisconsin Power & Light Company,* No. 6680-UR-108, 1993 Wisc. PUC LEXIS 64 (Wisc. Pub. Serv. Comm'n, Sept. 30, 1993) 46
4. Earlier Decisions Requiring Sharing of Net MGP Costs Between Shareholders and Ratepayers 47
D. The California MGP Rate Settlement 48
E. The Indiana Decision Denying Recovery of MGP Costs 50
F. Summary 51

July 1996

RECOVERY BY UTILITIES OF EXPENDITURES ON MANUFACTURED GAS PLANT CLAIMS: RECENT DEVELOPMENTS REGARDING INSURANCE COVERAGE AND RATE RELIEF[1]

Nicholas W. Fels
William P. Skinner
Saul B. Goodman

Covington & Burling
Washington, D.C.

Many utilities are facing substantial environmental liabilities under federal and state laws requiring the investigation and remediation of soil and groundwater contamination at sites where gas was manufactured from fossil fuels before the era of natural gas. The estimated cost of investigating and remediating a typical site of a former manufactured gas plant ("MGP") ranges between $1.4 million to $9 million,[2] and there are more than 1000 MGP sites throughout the United States.[3] In light of the substantial magnitude of these costs, an increasing number of utilities are pursuing various means for recovering the costs of defending and resolving environmental claims at former MGP sites ("MGP costs").

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[1] The authors represent utilities and other policyholders in environmental insurance coverage litigation and rate proceedings. The views expressed in this article are the views of the authors and not necessarily those of the clients of Covington & Burling. The authors wish to thank Ronald G. Dove, Jr., Matthew S. Yeo and Jonathan B. Mirsky for their help with this article. Portions of this article originally appeared in Goodman, "Insurance Coverage for Environmental Claims: Cost Recovery by Utilities and Pipeline Companies for Expenditures on Environmental Claims," 5 *Nat. Gas Law. J.* 91 (1991).

[2] Gas Research Institute, Remediation Alternatives and Costs for the Restoration of MGP Sites, iii-iv (1990).

[3] Radian Corp., Survey of Town Gas and By-Product Production and Locations in the U.S., 1880-1950 (1985).

One possible method of recovering MGP costs is through insurance coverage. Most utilities purchased for decades the broadest form of liability insurance sold in the marketplace, Comprehensive General Liability ("CGL") policies or excess policies that provide comparable coverage. The terms of the CGL policy and its drafting history provide compelling support for the argument that the policy generally covers environmental liabilities.[4] Accordingly, a number of utilities are now seeking — and some have already secured — insurance coverage for their MGP costs. A review of the judicial decisions in MGP coverage cases reveals that the courts have generally been ruling in favor of the utilities seeking coverage for MGP costs.

Another possible means for recovering MGP costs is through the utility's rates. A majority of the public utility commissions that have addressed this issue in contested cases have granted full recovery from ratepayers of costs prudently incurred in investigating and remediating MGP sites, net of any insurance or other third-party reimbursements (hereinafter "net MGP costs"). These commissions have done so by including projected net MGP costs in base rates, or, more commonly, by amortizing the net MGP costs over a specified period and allowing the recovery of those costs, with carrying charges, through a special "rider" or "tracker." A minority of commissions that have addressed this issue in contested cases have ruled that utility shareholders and ratepayers must share in net MGP costs through amortization without carrying costs, while several jurisdictions have approved settlements that embody some aspect of sharing of net MGP costs between shareholders and ratepayers. Only one commission has completely denied recovery of net MGP costs.

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[4] *See* Goodman, "Insurance Coverage for Environmental Claims: Cost Recovery by Utilities and Pipeline Companies for Expenditures on Environmental Claims," 5 *Nat. Gas Law.* (continued...)

These two means of recovering MGP costs — insurance coverage and utility rates — are interrelated, for public utility commissions in their rate decisions have expressly provided incentives to encourage utilities to pursue their insurers to recover MGP costs, such as by allowing utilities to recover through rates the costs of pursuing insurance coverage. Moreover, the aggressive pursuit of insurance coverage was cited by the New Jersey Board of Regulatory Commissioners as a factor supporting its favorable ruling in a contested rate proceeding involving the recovery of net MGP cleanup costs.[5]

This article first examines the issue of insurance coverage for MGP costs. It outlines the policyholder theory of coverage and summarizes the key coverage defenses typically asserted by insurers in MGP coverage cases. The article then summarizes the significant judicial decisions in cases in which utilities have sought insurance coverage for MGP costs.

The article next examines the issue of rate recovery of net MGP costs. It outlines the arguments typically made for and against the full recovery of net MGP costs from ratepayers, and then summarizes the current status of reported decisions from public utility commissions on the issue of rate relief for net MGP costs, with particular emphasis on recent commission decisions.

J., 91, 94-109 (1991).

5 *Public Serv. Elec. & Gas Co.*, BRC Docket No. ER91111698J, slip op. at 18 (N.J. Bd. Reg. Comm'rs, Sept. 15, 1993) (citing the fact that Public Service Electric & Gas Co. has "been aggressively pursuing insurance recoveries" as one reason for rejecting the argument of the New Jersey Public Advocate that MGP costs should be shared equally between stockholders and ratepayers), *reh'g denied*, (Jan. 21, 1994).

I. INSURANCE COVERAGE FOR MGP COSTS

One possible means of recovering MGP costs is through insurance coverage under Comprehensive General Liability ("CGL") policies and excess policies providing comparable coverage.[6] A review of the judicial decisions in MGP coverage cases reveals that the courts have generally been ruling in favor of the utilities seeking coverage for MGP costs.

A. Policyholder Theory of Coverage

The CGL policy is a standard-form contract that was drafted and periodically revised by insurance industry groups. The insurance industry, which began issuing CGL policies in the 1940s, marketed these policies as the broadest form of liability coverage generally available at the time.[7]

The CGL policy, consistent with its marketing, provides for broad liability coverage. It states that, subject to stated policy limits and deductibles, the insurer will:

> "pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of : . . property damage to which this insurance applies, caused by an occurrence . . . ."[8]

The term "property damage" refers broadly to any "physical injury to or destruction of tangible property which occurs during the policy period."[9] Similarly, the term

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6 In addition to CGL coverage, a utility may have coverage from MGP costs under its first-party property policies and environmental impairment liability policies. The focus here is principally on issues concerning CGL coverage.

7 The CGL policy was touted as "one of the most potent weapons for protection ever afforded a risk," Eglof, "The Outside," Best's Fire and Casualty News 19 (1941), and salesmen were urged to "[e]mphasize 'peace of mind' coverage, *i.e.*, [the] feeling of security and sense of protection that goes with Comprehensive Liability [coverage]." *Id.* at 56.

8 1 S. Miller & P. Lefebvre, *Miller's Standard Insurance Policies Annotated*, 411 (hereinafter cited as "*Miller & Lefebvre*"). The quoted language is drawn from the 1973 standard-form CGL policy.

9 *Id.* at 409.

"occurrence" is broadly defined to mean "an accident, including continuous or repeated exposure to conditions, which results in property damage neither expected or intended from the standpoint of the insured."[10]

The argument in support of coverage for MGP costs is straightforward: The CGL policy states that the insurer will pay "all sums" for damages because of "property damage" that occurs during the policy period. Policyholders assert that contamination at MGP sites is "property damage," and that such damage begins at the time contamination starts and continues until the contamination is remediated. Policyholders thus assert that coverage is triggered under each policy in effect during that period.

With regard to the scope of coverage, policyholders typically assert that, in light of the CGL language obligating the insurer to pay "all sums," each triggered policy is obligated to pay all of the costs associated with an MGP claim, subject only to applicable limits of liability and deductibles.[11]

B. Insurer Defenses

In response to these arguments, most insurers have, as one court put it in another context, "run for cover rather than coverage."[12] There is now a standard litany of defenses asserted by insurers in MGP coverage cases. The key defenses include:

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[10] *Id.*

[11] Policyholders also typically assert that, if several policies are triggered by the same claim, the policyholder is entitled to select which of the potentially applicable policies should provide coverage. They further assert that, although the insurer whose policy is selected may have a right to obtain contribution from other insurers whose policies are also triggered by the claim, under no circumstances can any portion of the loss be prorated back to the policyholder based on periods when no insurance was in effect or applicable insurance provides no coverage as a result of exclusions or exhaustion of limits.

1. No Damages

One of the stock defenses asserted by insurers is that government-mandated cleanup costs are not covered because such costs are akin to the costs of complying with an injunction and thus are not sums that the policyholder has become legally obligated to pay as "damages" within a strict legal definition of that term. In response, policyholders assert that the term "damages" should be read broadly to encompass not merely amounts awarded to other parties as legal damages, but also any funds expended to remedy damage that is otherwise covered by the policy, including funds expended for government-mandated cleanup actions.

2. Trigger of Coverage

Insurers also typically assert that even if environmental claims are found to be claims for "damages" within the meaning of their policies, they should not have to provide coverage because the property damage did not happen during the period of their policies. A recurring insurer argument is that all the contamination at MGP sites occurred before the inception of the policyholder's first policy.

By contrast, policyholders typically assert that property damage begins at the time contamination starts and continues until the contamination is remediated, and thus all policies in force during this period are triggered.

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12 *Sandoz, Inc. v. Employer's Liab. Assurance Corp.*, 554 F. Supp. 257, 258 (D.N.J. 1983).

3. Scope of Coverage

Another stock argument by insurers is that their policies should not have to pay all of the costs associated with a claim because their policies were only in effect during part of the time that the damage occurred.

They may argue, for example, that they should only have to pay a prorated share of the loss, based on the ratio of the length of time that their policies were in effect divided by the total length of time during which the damage has been occurring.

This is a very important issue in MGP coverage cases because many utilities are unable to locate policies acquired more than a few decades ago, whereas contamination at MGP sites may have occurred over a much longer time period, in some cases beginning well over a hundred years ago. If, for example, a loss were prorated over the period from 1885 to 1985, and the utility only has applicable insurance during one-third of that period, the utility would only be able to recover one-third of the loss from its insurers.

By contrast, policyholders typically assert that, because the CGL policy obligates the insurer to pay "all sums," a policyholder is entitled to recover the full amount of a claim under any triggered policy, subject only to the deductible and limits of the policy.

4. Owned-Property Exclusion

In environmental cases where a policyholder is seeking coverage for the costs of remedial work performed on its own property, the insurers typically assert that there is no CGL coverage because of the owned-property exclusion, pursuant to which coverage is excluded for "property damage to property damage to property owned or occupied by . . . the insured."[13]

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13 *Miller & Lefebvre* at 411 (1973 Standard CGL Policy).

In response, policyholders assert that remedial work performed on a policyholder's property is typically necessary to prevent third-property damage (such as the contamination of groundwater or adjacent property), and the owned-property exclusion does not purport to exclude coverage for third-party property damage, even if the remedy for such damage includes the remediation of the policyholder's property.

5. Pollution Exclusion

Another recurring insurer argument is that coverage for "gradual" pollution is excluded under policies containing the standard-form CGL pollution exclusion that was introduced in 1970.[14] This exclusion states that coverage is excluded for various types of environmental contamination, but contains an exception that "[t]his exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental."[15]

The insurers argue that the term "sudden" in the exception to the pollution exclusion is to be given a temporal meaning (*i.e.*, quick or abrupt) and thus the exception does not reinstate coverage for "gradual', pollution. By contrast, policyholders argue that the term "sudden" should be construed, in accordance with one of its accepted dictionary definitions, to

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[14] This argument has no applicability to policies that do not contain pollution exclusions, and many utilities were able to purchase such policies in various years during the 1970s and 1980s.

[15] The pollution exclusion provides in full:

> "[T]his insurance does not apply to bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any water course or body of water; but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental."

Miller & Lefebvre, at 411 (1973 Standard CGL policy).

mean "unexpected." Under this interpretation, the pollution exclusion would not exclude coverage for gradual pollution, unless it was "expected" or "intended."

6. Expected or Intended

The insurers, last line of defense in MGP coverage cases is typically the assertion that there is no covered "occurrence" because the utility "expected" or "intended" the property damage. The insurers attempt to prove this point by seeking to demonstrate that the gas industry had an early awareness that gas manufacturing could cause environmental problems. The insurers rely heavily on historical industry literature, particularly reports issued during the 1920s by the American Gas Associations' Subcommittee on Disposal of Waste from Gas Plants.[16]

The response of utilities is typically that their MGP operating and waste disposal practices were consistent with practices commonly followed by the gas industry (and other industries, for that matter) at the time in question and that those practices rarely resulted in nuisances for neighbors or any other types of environmental problems that were considered to be problems at the time that the plants were operating. The historical evidence about the gas industry demonstrates that the industry was aware that its operations could cause certain nuisances but it took steps to try to prevent nuisances and, for the most part, those steps were successful. There were, in fact, relatively few nuisance claims involving groundwater contamination for an industry that operated more than 1,000 gas plants at various times over a period of more than 100 years. Moreover, the reason why environmental regulators are now requiring that MGP sites be investigated and remediated could not have been reasonably

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[16] The centerpiece of the insurers, argument is the 1920 report of the AGA Subcommittee. See Willien, Disposal of Waste from Gas Plants, Report of the 1920 Committee, American Gas Association, Second Annual Convention 413 (1920).

foreseen — much less have been expected or intended — at the time that the plants were in operation.[17]

C. Rulings Generally Favorable to Policyholders

1. *Washington Natural Gas Co. v. Aetna Casualty & Surety Co.*

This case was filed by Washington Natural Gas Co. ("WNG") in state court in Washington. WNG sought coverage for cleanup and defense costs at a Tacoma, Washington site where it owned and operated a manufactured gas plant from 1928 until 1956.

a. Jury Verdict

After a two week trial and after deliberating for only 45 minutes, a jury returned a verdict in favor of WNG. The jury found that property damage had occurred during each of the years of WNG's insurance policies from 1950 through 1985, thus triggering coverage under the policies for each of those years. The jury also found that WNG did not expect or intend for such damage to occur during those years, thus rejecting one of the insurer's key coverage defenses.[18]

b. Allocation

Following the trial, the court rejected an attempt by the insurers to reduce their obligation to WNG by allocating a portion of the cleanup costs to years prior to WNG's policies. In granting WNG's motion for partial summary judgment on the issue of allocation, the court

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[17] In most jurisdictions, remediation requirements are premised on human health concerns that are of relatively recent origin. During the period of historical gas plant operations, leading health scientists would not have regarded contamination of soil or groundwater with gas plant materials as posing a human health risk (to the extent that wells became contaminated, people would not have drunk the water because it would have had a bad taste). The 1920 report of the AGA, which identified all of the problems that had ever allegedly been caused by the disposal of gas plant wastes in the United States or England on the basis of an industry survey, did not include injury to human health on its list of potential problems.

stated that WNG's "insurers must be held to their respective contract obligations to cover all sums, incurred by [the] insured as damages for WNG's [environmental] liabilities.[19] The court noted that "[t]here is a wide range of imaginable answers to the allocation problem, yet [all of them are] speculative."[20] Since defendants could not "meet their burden of proving either a uniform or an uneven allocation of remediation costs in fact, the terms of their contracts mandate[d] full joint and several coverage up to their policy limits (allowing, of course, for deductibles and the amount of underlying coverage where the policy [was] for excess coverage)."[21]

c. Attorney Fees and Costs

Following the trial, the court also ordered the insurers to reimburse WNG for $4.6 million in attorney fees and costs. The court ruled that the liability of the insurers for these fees and costs was joint and several, but limited the fees and costs that WNG could collect from certain insurers whose policies had relatively low face amounts until WNG had reasonably exhausted all other sources of payment from the remaining insurers."[22]

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18 Mealey's Litigation Reports — Insurance (Nov. 2, 1993), at 3. The insurers appealed the jury verdict, but the case was settled before any appellate decision on the merits of the case was issued.

19 Memorandum Opinion on Plaintiff's Motion for Partial Summary Judgment & on Defendants' Motion to Supplement Expert Testimony at 10-11, *Washington Natural Gas Co. v. Aetna Casualty & Surety Co.* (hereinafter "WNG"), No. 91-2-13506-1 (King County Super. Ct. Feb. 23, 1994).

20 *Id.* at 4.

21 *Id.* at 10 (emphasis in original).

22 *WNG*, No. 91-2-13506-1 (King County Super. Ct. Oct. 31, 1994), *reprinted in* Mealey's Litigation Reports — Insurance (Dec. 20, 1994), at D-4 to D-5.

d. Owned/Alienated Property Exclusion

The insurers were denied summary judgment on virtually every issue they raised prior to trial.[23] With regard to the owned/alienated property exclusion, the court held that "[w]henever the costs of removal of pollutants from [an insured's] owned or alienated property exceed the reasonable fair market value of the property, they are prima facie a covered form of damage to interests other than the owner's, and are not excluded by the owned/alienated property exclusion."[24] The court reasoned that "[o]nce the costs exceed that value, the interest being benefited by the cleanup costs is not the owner's ownership interest, but society's stated interest in the environment."[25]

e. Coverage for Cleanup Costs Traceable to Acts of Others

The same court rejected the insurers' argument that their insurance policies excluded all liability imposed by law that was traceable to the acts of parties other than WNG or its predecessors in interest.[26] The court held that "the fact that [another party] may have engaged in its own polluting activities, or may have aggravated or redistributed pollution initially attributable to the acts of WNG, will not provide a defense to or a limitation on coverage."[27]

f. "Expected or Intended" Standard

After holding that there was a genuine issue of material fact as to whether WNG expected or intended to cause property damage, the court stated that it would "instruct the jury

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23 The one exception was American Home's motion for partial summary judgment under its 1985-86 absolute pollution exclusion. order on Motions for Partial Summary Judgment at 1, *WNG*, No. 91-2-13506-1 (King County Super. Ct. Sept. 23, 1993).

24 *Id.* at 4-5.

25 *Id.* at 3-4.

26 *Id.* at 5-6.

27 *Id.* at 6.

that its findings [should] be based on what it determine[d] WNG subjectively expected or intended" at the time of the acts in question, not by the standards of the 1990s.[28] The jury ultimately found in favor of WNG on this issue.

g. Stone & Webster Policies: "Event" and "Occurrence"

The court held that the continuous process of soil and groundwater contamination at WNG's site — if proven —would trigger coverage under the Stone & Webster policies at issue in the case.[29] The court noted that the word "event" in the "occurrence,, definition of those policies was not limited "to a single unit of time."[30] The court specifically concluded that the Stone & Webster "occurrence" language at issue imposed no limitation on the coverage that would have existed if the policies had contained standard occurrence language.[31]

h. Property Damage in Policy Period

The court held that there was a genuine issue of material fact as to whether property damage occurred in each policy period and whether damages were the result of a continuous process.[32] The jury eventually found in favor of WNG on these issues.

i. Pollution Exclusion

The court held that there was a genuine factual dispute as to whether "the discharge, dispersal, release or escape of pollutants" at the WNG site was "sudden and accidental" and thus not subject to the pollution exclusion.[33] The court stated that it would

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28 *Id.* at 6-8.

29 *Id.* at 9-10.

30 *Id.* at 9.

31 *Id.*

32 *Id.* at 10-11.

33 *Id.* at 11.

"request the jury to make a determination as to when WNG developed a 'subjective expectation that contaminants would leak from its disposal ponds.'"[34] The court further stated that "WNG's expectation or intent [was] not to be judged by what is known or believed in the 1990's, but by what was known or believed at the time of the acts in question."[35]

j. Known Loss/Loss in Progress

The court rejected an insurer's argument that WNG should be denied coverage because it knew of the substantial probability of a loss prior to renewing its insurance coverage and failed to disclose that knowledge to the insurer.[36] The court stated that "[i]n the absence of affirmative misrepresentations of material fact, there is no general rule in Washington State courts permitting one party to avoid a contract based on an alleged omission or failure of the other party to disclose future undetermined events, however admirable such a doctrine might otherwise be."[37]

2. *Public Service Electric & Gas Co. v. Certain Underwriters at Lloyd's of London*

This case was filed by Public Service Electric and Gas Co. ("PSE&G") in the United States District Court for the District of New Jersey against AEGIS and certain London Market insurers. PSE&G sought coverage for MGP costs associated with 38 former manufactured gas plant sites and one third-party site at which MGP wastes had been disposed.

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34 *Id.*

35 *Id.*

36 *Id.* at 12-14.

37 *Id.* at 14.

In 1991, PSE&G dismissed its complaint against AEGIS pursuant to a settlement. PSE&G recently settled with the London Market insurers and dismissed the remainder of its complaint.

Prior to the recent settlement, the district court issued rulings on various cross-motions for summary judgment. These rulings were generally favorable to PSE&G.

a. "Expected or Intended" Issue

With regard to the "expected or intended" standard, the district court ruled that the insurers had the burden of proving that corporate officers of PSE&G expected or intended to cause environmental harm that is "qualitatively comparable" to the harm that triggered governmental cleanup demands.[38]

The court also ruled that the relevant time for making this determination was "the time that the acts causing the harm occurred and not the time that the policies were purchased." The district court denied the insurers' motion for summary judgment on the "expected or intended" issue. In denying the motion, the court noted:[39]

> Although there is evidence that contamination occurred during the relevant historical periods at each of the three sites, and that [PSE&G] was aware of the acts which contributed to, and in fact caused, that contamination, there is also evidence that those acts were consistent with accepted practices of the day, and therefore that [PSE&G] may have carried out those acts neither expecting nor intending to pollute the environment in such a way as ultimately led to demands for remediation by the NJDEP.[40]

The court also emphasized that one of the insurers' own experts had admitted during his deposition that none of the operators of the sites had acted unreasonably and that the operators

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38 *Public Serv. Elec. & Gas Co. v. Certain Underwriters at Lloyd's of London* (hereinafter "PSE&G"), No. 88-4811, slip op. at 21-24 (D.N.J. Sept. 30, 1994).

39 *Id.* at 25-26.

had acted in accordance with practices that were common at the time and did not expect or intend harm to the environment.[41]

The district court did not reach the question whether the conduct of prior operators of the sites could be imputed to PSE&G because of the court's conclusion that there was no evidence that the prior operators expected or intended harm.[42]

b. Owned-Property Exclusion

The district court ruled that owned-property restrictions did not apply to formerly owned-property or to groundwater that had migrated off-site.[43] The court ruled that "at this time" damage to groundwater that had not migrated off-site was subject to the owned-property exclusion under New Jersey law.[44] This holding was based on a decision by a New Jersey state trial court in another case that is now on appeal, *Reliance Insurance Co. v. Armstrong World Indus.*[45] Armstrong has been criticized by another New Jersey trial court, and a decision by the New Jersey intermediate appellate court supports a contrary result.[46]

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40 *Id.* at 53-54.

41 *Id.* at 66.

42 *Id.* at 31-32.

43 *Id.* at 62, 64-66.

44 *Id.* at 60-62.

45 625 A.2d 601 (Law Div. 1993), *appeal docketed* No. A-703-93T3 (App. Div. Oct. 12, 1993).

46 *UMC/Stamford, Inc. v. Allianz Underwriters Ins. Co.*, 647 A.2d 182, 186-87 (Law Div. 1994); *Morrone v. Harleysville Mut. Ins. Co.*, 662 A.2d 562, 566 (App. Div. 1995).

c. Damages

The district court held that environmental claims were claims for "property damage" within the meaning of the policies.[47]

d. Trigger of Coverage

The district court ruled that the trigger of coverage under most of the policies at issue was property damage during the policy period and that such damage included the continued leaching and migration of contaminants after an initial leak or spill.[48] The court ruled that in light of conflicting expert testimony, a trial was needed to resolve the question whether groundwater contamination occurred in each of the policy years, and whether the damage was "continuous" and "indivisible."[49]

Under certain policies that defined an occurrence to be a "happening or series of happenings arising out of or caused by one event taking place during the term of this contract," the court ruled that the trigger of coverage was the leak or spill that caused the damage rather than the continued leaching or migration of contaminants.[50] Because the operations that caused the contamination at the sites that were the subject of the motions ceased long before the inception of the policies that included this language, the court granted defendants' motion for summary judgment under these policies.

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47 *PSE&G*, slip op. at 9-10.

48 *Id.* at 13.

49 *Id.* at 15-17.

50 *Id.* at 11-13.

e. Scope of Coverage

The district court deferred a ruling on the scope of coverage issue. It held that this issue turns on whether the property damage had been continuous and indivisible and that issue was to be resolved at trial.[51]

f. Late Notice

The district court denied the insurers, motion for summary judgment on late notice with respect to one of the sites based on the court's conclusion that there had been no showing of prejudice.[52]

3. *Central Illinois Public Service Co. v. Allianz Underwriters Insurance Co.*

This case was filed by Central Illinois Public Service Co. ("CIPS") in state court in Illinois. CIPS sought coverage for cleanup and defense costs at 15 former MGP sites, including a site in Taylorville, Illinois where CIPS operated a gas plant from 1912 through 1932.

CIPS sought coverage under both CGL policies and Environmental Impairment Liability ("EIL") policies. Summary judgment rulings were issued relating to both types of policies.

A trial limited to EIL issues at the Taylorville site was held in October 1991. The trial court did not allow the CGL insurers to take part in that trial.

After the two week trial on EIL issues and after deliberating for only two hours, an Illinois jury found that CIPS did not expect or intend to discharge contaminants into the groundwater at its Taylorville site.[53] Several months later, the trial court ruled that CIPS' CGL

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51 *Id.* at 18-19.

52 *Id.* at 56-59.

53 Mealey's Litigation Reports — Insurance (Nov. 1, 1991), at 3.

insurers were precluded from relitigating the "expected or intended" issue and were bound to the jury verdict in the EIL trial.[54]

Both the jury verdict and the trial court's ruling that the jury verdict was binding on the CGL insurers were later effectively overturned on appeal.[55] Nonetheless, there are a number of other rulings in the *CIPS* case that are favorable to policyholders.

a. Jury Verdict and Appellate Reversal

The jury verdict in favor of CIPS in the EIL trial was effectively overturned in a decision by the Illinois Court of Appeals. It held that the trial court had erred in ruling that a claim had been made under a "claims made" EIL policy issued to CIPS in 1983 and extending to 1985.[56] The appeals court found that the term "claim" is not ambiguous and that the date of the actual claim asserted by the state regulatory agency — not the date when CIPS reasonably concluded that a claim was inevitable — was the relevant date for determining coverage.[57] Since it was undisputed that no claim was made by the state regulatory agency until after the expiration of the policy, the appeals court reversed the trial court and denied coverage as to the one EIL policy at issue.[58]

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54 *Central Illinois Public Service Co. v. Allianz Underwriters Ins. Co.* (hereinafter "CIPS"), No. 90-L-11094 (Cook County Cir. Ct. Jan. 16, 1992), *reprinted in* Mealey's Litigation Reports — Insurance (Jan. 28, 1992), at C-6.

55 The *CIPS* case has been settled with respect to all but one of the insurers. That remaining insurer was dismissed on late notice grounds. *See* note 71 *infra*.

56 *CIPS*, No. 1-92-3016 (Ill. App. Ct. Aug. 26, 1994), *reprinted in* Mealey's Litigation Reports — Insurance (Sept. 6, 1994), at E-1.

57 *Id.* at E-3 to E-5.

58 *Id.* at E-5.

b. Appellate Reversal of Ruling That CGL Insurers Were Bound By EIL Trial Verdict

The trial court's ruling that the CGL insurers were bound by the EIL trial verdict was reversed by the Illinois Supreme Court on due process grounds. Specifically, the Supreme Court found that:

> The due process clause requires, at a minimum, that a party have a full and fair opportunity to litigate an issue before he is bound by that issue's resolution. No such opportunity was provided to [the CGL insurers] in this case. To the contrary, [the CGL insurers] were barred from participation [at the trial.][59]

The judgments against the CGL insurers were vacated and the case was remanded to the trial court for further proceedings.

c. Trigger and Scope of Coverage

Before the appellate reversal, the trial court, in granting CIPS' post-trial motion for summary judgment on the trigger issue, found that the contamination at the site was "continuous" and "unrelenting"[60] and that "each policy in effect from 1955 through 1985 must provide coverage."[61] The court also found that, subject to policy limits and special provisions, each policy "must fully indemnify CIPS for the dollar amounts it has paid to satisfy governmental demands to clean up the environment." [62]

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59 *CIPS*, Nos. 73731, 73732 cons., 1994 Ill. LEXIS 27, at *11.

60 Ruling on Trigger of Coverage with Respect to Taylorville Site, *CIPS*, No. 90-L-11094 (Cook County Cir. Ct. Dec. 30, 1991), *reprinted in* Mealey's Litigation Reports — Insurance (Jan. 7, 1992), at F-3.

61 *Id.* at F-5.

62 *Id.*

d. "Property Damage"

In one of a series of summary judgment rulings in the fall of 1991, the circuit court held that "[d]ischarges of pollution into ground or water are damage or injury to tangible property" under the CGL policies at issue.[63]

e. Pollution Exclusion – "Sudden and "Accidental"

The court also held that "the term 'sudden and accidental' as contained in the pollution exclusion clauses of the general liability policies is ambiguous."[64] However, the court refused to grant summary judgment in favor of CIPS because of certain notes written by CIPS' Risk Manager that were arguably relevant to the issue of the parties, intent.[65] In the court's view, "the intent of the contracting parties when they agreed on the pollution exclusion clause [was] the essential issue."[66]

f. Notice and "Known Risk" Doctrine

The court held that AEGIS — a CIPS insurer —waived its right to assert late notice and "known risk" defenses by expressly agreeing to coverage prior to the filing of the insurance coverage lawsuit."[67]

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63 Ruling on Cross-Motions for Partial Summary Judgment Based on the Definition of "Property Damage", *CIPS*, No. 90-L-11094 (Cook County Cir. Ct. Nov. 18, 1991), *reprinted in* Mealey's Litigation Reports — Insurance (Dec. 3, 1991), at C-1.

64 Ruling on Cross-Motions for Summary Judgment on the Pollution Exclusion, *CIPS*, No. 90-L-11094 (Cook County Cir. Ct. Nov. 6, 1991), *reprinted in* Mealey's Litigation Reports — Insurance (Nov. 12, 1991), at C-4.

65 *Id.* at C-6.

66 *Id.*

67 Rulings on CIPS and AEGIS Motions and Cross-Motions for Summary Judgment on Late Notice and Known Risk Issues, *CIPS*, No. 90-L-11094 (Cook County Cir. Ct. Oct. 3, 1991), *reprinted in* Mealey's Litigation Reports — Insurance (Oct. 8, 1991), at B-9 to B-10.

g. "Premises Alienated" Exclusion

In granting CIPS' summary Judgment motion on the "premises alienated" exclusion, the court held that the ,"premises alienated, clauses [in the CGL policies] do not bar coverage for the cost of cleaning, remediating, mitigating, or preventing further actual or threatened harm to third-person property."[68] The court defined "'third-person property' [to] mean the property owned by adjoining owners and the waters, ground or otherwise, on and adjoining the Taylorville site."[69] The court concluded that "groundwater is part of the waters of the state."[70]

h. Notice

The court held that notice was timely as to all of CIPS, insurance carriers with coverage levels of greater than $500,000.[71] The court stated that under Illinois law, "[t]he question to be decided is whether the policyholder gave notice . . . within a reasonable time, considering all the facts and circumstances of the case."[72] "More leeway is given to the insured where an excess policy is concerned.[73]

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68 Ruling on Cross-Motions for Summary Judgment Based on the "Premises Alienated" Exclusion, *CIPS*, No. 90-L-11094 (Cook County Cir. Ct. Sept. 26, 1991), *reprinted in* Mealey's Litigation Reports — Insurance (Oct. 8, 1991), at B-7.

69 *Id.*

70 *Id.*

71 Rulings on Cross-Motions for Summary Judgment on the Basis of Late Notice, CIPS, No. 90-L-11094 (Cook County Cir. Ct. Sept. 26, 1991), reprinted in Mealey's Litigation Reports — Insurance (Oct. 8, 1991), at B-2 to B-3. The court later dismissed on late notice grounds one insurer with much lower coverage levels.

72 *Id.* at B-1.

73 *Id.*

The court further noted that under Illinois law "[t]he absence of prejudice does not dispense with the notice requirement."[74]

i. "Expected or Intended" Standard

In one of several rulings on various motions for summary judgment concerning the EIL policies, the court held that "[f]or coverage to exist, the emission, discharge, dispersal etc. must have been neither expected nor intended by CIPS." [75] The court found the EIL policy language "clear and unambiguous" on this point.[76]

j. "Damages"

The court held that the word "damages" in the CGL policies at issue "can include government-ordered cleanup costs . . . includ[ing] funds expended to mitigate, investigate, correct, or remedy existing or threatened environmental harm to air, ground, or water."[77]

4. *Northern States Power Co. v. Fidelity and Casualty Co.*

This case was filed by Northern States Power Co. ("NSP") in state court in Minnesota. NSP operated a manufactured gas plant in Faribault, Minnesota in the early 1900s. The trial court issued summary judgment rulings on a number of issues, and appeals were taken.

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74 *Id.*

75 Rulings on Various Motions and Cross-Motions for Summary Judgment Concerning the EIL Policies, CIPS, No. 90-L-11094 (Cook County Cir. Ct. June 12, 1991), *reprinted in* Mealey's Litigation Reports — Insurance (June 25, 1991), at D-5.

76 The court also ruled that timely notice was provided under CIPS' EIL policies and that the waste disposal site exclusion in the policies was ambiguous and did not apply to the incident at issue. *Id.* at D-2 to D-7.

77 Ruling on Plaintiff's Motion for Partial Summary Judgment that Clean-Up Costs Are Covered Damages, CIPS, No. 90-L-11094 (Cook County Cir. Ct. Feb. 1, 1991), *reprinted in* Mealey's Litigation Reports — Insurance (Feb. 5, 1991), at D-1.

NSP had settled with 13 of its 14 insurance carriers before decisions were issued in the case by the Minnesota Court of Appeals and the Minnesota Supreme Court.[78]

a. Primary Versus Excess Coverage

In holding that the remaining insurance policies provided primary coverage, the Minnesota Court of Appeals "examin[ed] the total policy insuring intent, as determined by the primary function of the policy and primary policy risks upon which the premiums were based."[79] The court found that the defendant insurer "intended to provide the first layer of coverage subject to NSP's self-insured retentions."[80]

The court also noted that "[c]omparing other insurance, clauses in policies providing coverage over different time periods may lead to inequitable results . . . . It is unfair for a later carrier to provide . . . coverage [for] damages it believed were covered by earlier policies [like the policies in question]."[81]

The Minnesota Supreme Court affirmed the Court of Appeals' result on this issue on other grounds, noting that there was no "other insurance" in effect during the time a policy issued by the defendant insurer was in effect.[82]

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78 *Northern States Power Co. v. Fidelity & Casualty Co.*, No. C3-92-2363 (Minn. Ct. App. Aug. 3, 1993), *reprinted in* Mealey's Litigation Reports — Insurance (Aug. 31, 1993), at E-2. The case was settled with the remaining insurer after the Minnesota Supreme Court issued its decision.

79 *Id.* at E-3.

80 *Id.* at E-4.

81 *Id.*

82 *Northern States Power Co. v. Fidelity & Casualty Co.*, 523 N.W.2d 657, 664 (Minn. 1994).

b. Trigger of Coverage

In concluding that coverage under the insurance policies at issue was triggered, the Minnesota Court of Appeals relied on the district court's finding on summary judgment "that there was one ongoing occurrence and that the actual injury was continually manifested during the [relevant] policy periods."[83]

c. "Damages Because of Property Damage"

The Court of Appeals concluded that "[m]andated expenditures necessary to clean up the groundwater and the contaminated soil causing the groundwater pollution and other expenses causally related to remedying the groundwater pollution are covered [as] damages because of property damage."[84] The court did note, however, that "not all expenditures mandated by the [state regulatory agency] are necessarily covered under a general liability policy."[85] While "[c]osts and expenses for cleanup of pollution that is already present are covered, . . . [e]xpenditures to prevent future pollution of a type which has yet to occur or from a source which has yet to cause pollution . . . are not covered."[86] The Court of Appeals then remanded the case for the trial court to make the necessary factual findings to determine whether the costs at issue were covered under this legal standard.

d. Owned-Property Exclusion

The Court of Appeals further concluded that costs incurred to remedy groundwater pollution are not subject to the owned-property exclusion because groundwater

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83 *Northern States Power Co. v. Fidelity & Casualty Co.*, No. C3-92-2363 (Minn. Ct. App. Aug. 3, 1993), *reprinted in* Mealey's Litigation Reports — Insurance (Aug. 31, 1993), at E-4.

84 *Id.* at E-5 to E-6.

85 *Id.* at E-5.

86 *Id.*

contamination is damage to public property, not "injury to or destruction of . . . property owned by the Insured."[87] Under this rationale, "cleanup expenses needed to correct already existing soil contamination which continues to damage the groundwater" are covered, while "[m]andated expenses remedying problems confined on NSP's property that do not rectify the groundwater and associated soil contamination [are not]."[88] The case was remanded for factual determinations on this point.

e. Allocation of Damages and Deductibles

NSP argued that its insurers were "concurrently liable and damages should be prorated according to the policy limits."[89] The defendant insurer responded that the policies should be stacked "according to the total policy insuring intent to allocate damages."[90]

After analyzing these arguments, the Minnesota Court of Appeals held that damages resulting from contamination were to be allocated "based on the percentage of property damage that occurred when [the defendant insurer] provided coverage" and remanded the case for factual determinations on this point.[91] The court concluded that "NSP is required to pay one deductible for each policy under which it is invoking coverage."[92]

The Minnesota Supreme Court modified this ruling by adopting a "pro rata by time on the risk" method of allocating damages.[93] Under this method, "the contamination of the

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87 *Id.* at E-6.

88 *Id.* at E-6 to E-7.

89 *Id.* at E-7.

90 *Id.*

91 *Id.* at E-7.

92 *Id.* at E-8.

93 *Northern States Power Co. v. Fidelity & Casualty Co.*, 523 N.W.2d 657, 663-64 (Minn. 1994). The Minnesota Supreme Court accepted the court of appeals' analysis regarding trigger of (continued...)

groundwater should be regarded as a continuous process in which the property damage is evenly distributed over the period of time from the first contamination to the end of the last triggered policy (or self-insured) period, and . . . the total amount of the property damage should be allocated to the various policies in proportion to the period of time each was on the risk."[94]

5. *Stone & Webster Management Consultants v. Travelers Indemnity Co.*

This case was filed by Stone & Webster in the United States District Court for the Southern District of New York. Stone & Webster sought a declaratory judgment that its insurers were obligated to defend lawsuits seeking cleanup costs at former MGP sites.

a. Occurrence

The court held that environmental contamination can be a continuous, progressive process beginning upon initial release of the contaminants and continuing until the contaminants are removed. The court observed that, as a factual matter, groundwater migrates and contaminants can form plumes that expand over time."[95]

b. Owned Property Exclusion

The court ruled that the owned-property exclusion would not bar coverage for off-site damage, such as damage from seeping pollution to the soil, sediment, and groundwater of an

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coverage, "damages because of property damage," and the "owned-property" exclusion. *Id.* at 660-62.

[94] *Id.* at 664. The Minnesota Supreme Court further explained: "If, for example, contamination occurred over a period of 10 years, 1/10oth of the damage would be allocable to the period of time that a policy in force for 1 year was on the risk and 3/10ths of the damage would be allocable to the period of time a 3-year policy was in force."

[95] *Stone & Webster Management Consultants v. Travelers Indem. Co.*, 94 Civ. 6619, 1996 U.S. Dist. LEXIS 4852, at *32 (S.D.N.Y. Apr. 16, 1996).

adjacent river.[96] The court did not rule on whether the owned-property exclusion would exclude coverage for on-site property damage.

c. Expected or Intended

The pollution exclusion in the policies in dispute provided that coverage would not apply to release or escape of pollutants where the release was "expected or intended" by the insured. The court held that since the complaints in the underlying litigations did not state or imply that the release of MGP wastes at the sites was expected or intended, the insurer would not be relieved of its duty to defend.[97]

d. Notice

Travelers contended that Stone & Webster had failed to provide timely notice to the insurer because Stone & Webster had prior knowledge of environmental cleanup problems at MGP sites. The court held that knowledge in general of potential liability at MGP facilities is not knowledge of an occurrence at a particular site."[98]

6. *Vermont Gas Systems, Inc. v. USF&G*

This case was filed by Vermont Gas Systems ("VGS") in the United States District Court for the District of Vermont. VGS operated a manufactured gas plant in Burlington, Vermont from 1964 through 1966.

a. Pollution Versus Damage

In an opinion on summary judgment, the district court rejected the argument of VGS's insurers that "if pollution is apparent before the inception of an insurance policy, there can

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96 *Id.* at *36-37.

97 *Id.* at *40-42.

98 *Id.* at *55.

be no coverage under that policy for claims related to that pollution."[99] The court noted that the case cited by the insurers in support of their argument actually "hinged on when *damage* occurred or was apparent, not when pollution was apparent."[100] In any event, the court ruled that the issue of when pollution was apparent was a fact-specific one that would have to be resolved at trial, rather than on summary judgment.[101]

b. Notice and Duty to Defend

In granting VGS's motion for partial summary judgment on the duty to defend, the court held that VGS's insurers had an initial duty to defend VGS even though those insurers contended that they had not received timely notice.[102] The court "agree [d] with the proposition that [under Vermont law) if VGS cannot prove timely notice its coverage will be forfeited without regard to prejudice."[103] However, the court noted that "there may be circumstances that will explain or excuse a delay.[104] The court stated that more facts were needed before it could decide whether VGS's delay in notifying its insurers was excusable.[105] In the meantime, the court ruled that the insurers had an obligation to defend VGS.

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99 *Vermont Gas Sys., Inc. v. United States Fidelity & Guar. Co.*, No. 90-121 (D. Vt. Sept. 14, 1993), *reprinted in* Mealey's Litigation Reports — Insurance (Oct. 19, 1993), at C-3.

100 *Id.* at C-4 (emphasis in original).

101 *Id.* at C-4 to C-5.

102 *Vermont Gas Sys., Inc. v. United States Fidelity & Guar. Co.*, 805 F. Supp. 227, 232-33 (D. Vt. 1992).

103 *Id.* at 232.

104 *Id.* at 232 n. 8 (citation omitted).

105 *Id.* at 232.

7. *Puget Sound Power & Light Co. v. Aetna Casualty & Surety Co.*

This case was filed by Puget Sound Power & Light Co. (11PSPL11) in the United States District Court for the Western District of Washington. PSPL had sent MGP wastes to the Tacoma Tar Pits site in Washington.

a. Duty to Defend and Allocation of Defense Costs

In a 1993 opinion, the district court held that two of PSPL's insurers had breached their duty to defend PSPL and were each jointly and severally liable for all of PSPL's defense costs.[106] The court observed that neither the underlying EPA complaint nor the complaint in the third-party action "Provide[d] any details about the timing or nature of [PSPL's] deliveries of hazardous materials to the Tar Pits."[107] Thus, there was "no rational basis for apportioning defense costs."[108] Under Washington law, "'when an insurer wrongfully refuses to defend and there is no reasonable means of prorating the costs of defense between those items that are covered and those that are not covered, the insurer is liable for the entire cost of the defense.'"[109]

This decision was affirmed by the U.S. Court of Appeals for the Ninth Circuit in an unpublished opinion.[110] The insurer, which had been on the risk for only three years, argued for a time-on-the-risk method of allocating the costs of defense."[111] The Ninth Circuit rejected

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106 *Puget Sound Power & Light Co. v. Aetna Casualty & Sur. Co.*, No. C92-0119C (W.D. Wash. Dec. 8, 1993), *reprinted in* Mealey's Litigation Report — Insurance (Jan. 4, 1994), at E-4 to E-5.

107 *Id.* at E-4.

108 *Id.*

109 *Id.* at E-3 (citation omitted).

110 *Puget Sound Power & Light Co. v. Great Am. Ins. Co.*, No. 94-35072 (9th Cir. Apr. 5, 1995), *reprinted in* Mealey's Litigation Reports — Insurance (Apr. 18, 1995), at G-1.

111 *Id.* at G-2.

this proration method because it was a not a reasonable means of approximating the extra cost of defending PSPL on matters outside the insured years.[112]

8. *Public Service Co. of Colorado v. Certain Underwriters at Lloyd's London*

This case was filed by Public Service Company of Colorado ("PSC") in state court in Colorado. Public Service sought coverage for the cleanup costs for a landfill, a scrapyard, and a former MGP.

a. Jury Verdict

PSC discovered on-site contamination at the former MGP site in June 1989, and thereafter began remedial activities, but did not notify its insurer of the claim until March 1992.

The jury found that an occurrence took place at the former MGP site, and that policies from 1955 to 1977 would be triggered. However, the jury found also that PSC did not provide timely notice and had no justifiable excuse for not doing so. Accordingly, coverage was denied for the MGP site.

With regard to the two non-MGP sites, the jury ruled that PSC's notice was timely, there had been an occurrence, the relevant policies were triggered, and that PSC had not expected or intended the property damage. The jury awarded a verdict to PSC of $4.2 million, and the case is now on appeal.

9. *Chesapeake Utilities Corp. v. American Home Assurance Co.*

This case was filed by Chesapeake Utilities Corp. ("Chesapeake") in the United States District Court for the District of Delaware. Chesapeake's predecessors operated two

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112 *Id.*

MGPs — one in Maryland and one in Delaware. These plants were dismantled between 1948 and 1950.

a. "As Damages"

In denying the insurers, motions for summary judgment, the district court held that under both Maryland and Delaware law, the term "damages" does not exclude cleanup costs.[113]

b. "Operations"

The court rejected the insurers, argument that the term "operations" as used in several of the insurance policies at issue "[could not], as a matter of law, include Chesapeake's disposal of coal tar."[114] The court held that the interpretation of the term "operations" was a factual question involving the intent of the contracting parties, and must therefore await resolution at trial.[115]

10. *Pacific Gas & Electric Co. v. Lexington Insurance Co.*

This case was filed by Pacific Gas and Electric Co. ("PG&E") in a California state court. Thirty-seven former manufactured gas plant sites in California are at issue.

a. Duty to Defend

In granting PG&E's motion for summary adjudication, the court held that the defendant insurers had a duty to defend PG&E for thirty-two sites in which a lawsuit had already

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113 *Chesapeake Utils. Corp. v. American Home Assurance Co.*, 704 F. Supp. 551, 561, 565 (D. Del. 1989). The court also rejected the insurers' argument that under Maryland law, environmental response costs are not "property damage". *Id.* at 565-66 & n.32.

114 *Id.* at 564. The policies at issue required the defendant insurers to pay "all sums which the insured shall become obligated to pay by reason of liability for damages because of injury to or destruction of property . . . *arising out of the operations of the insured as defined herein.*" *Id.* at 561. (emphasis in original).

115 *Id.*

been filed or a Federal or State agency order or request to investigate and remediate environmental damage had been entered.[116] The court concluded that agency orders and requests, while "not technically lawsuits', . . . fit into the concept of 'litigation, involving a 'claim' covered by policies in this case.[117]

The court denied PG&E's motion for summary adjudication regarding the duty to defend as to one site where tender had not been made and four sites where settlements had been reached (though the court held that PG&E was entitled to post-tender investigation and defense costs for the settled sites).[118] The court also denied PG&E's motion as to two policies that the court held did not include or imply a duty to defend.[119]

b. Joinder of Excess Carriers

The excess insurers sought to be dismissed as defendants in PG&E's comprehensive coverage action on the ground that PG&E's underlying policies of insurance had not been exhausted. The court held that PG&E, by alleging a reasonable possibility of exhaustion, had met the burden of alleging that its primary policies may be exhausted, and therefore the excess carriers should be joined in the suit.[120]

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116 Order Re: PG&E's Motion for Summary Adjudication after Reconsideration at 3-7, *Pacific Gas & Electric Co. v. Lexington Ins. Co.*, No. 948209 (Cal. Super. Ct. San Francisco Jan. 17, 1995).

117 *Id.* at 5.

118 *Id.* at 6.

119 *Id.* at 5-6.

120 Order Re: Certain Excess Insurers' Demurrer and Motion to Strike, *Pacific Gas & Electric Co. v. Lexington Ins. Co.*, No. 948209 (Cal. Super. Ct. San Francisco June 1, 1995), *reprinted in* Mealey's Litigation Reports — Insurance (July 11, 1995), at E-1.

D. Rulings Generally Unfavorable to Policyholders

1. *Atlanta Gas Light Co. v. Aetna Casualty & Surety Co.*

This case was filed by Atlanta Gas Light Company ("AGL") in the United States District Court for the Northern District of Georgia. AGL owned and operated MGPs in Florida and Georgia from 1848 until 1954.

The district court granted summary judgment for the insurers on the issue of timeliness of notice. On appeal, the U.S. Court of Appeals for the Eleventh Circuit vacated the grant of summary judgment on the ground that no justiciable controversy existed at the time AGL filed suit against its insurers.[121] AGL had filed its declaratory judgment action before the insurance companies received the notice of potential liability that AGL mailed to them the previous day.[122] The court ruled that because AGL's insurers had not been given the opportunity to respond to the notice of potential liability, AGL's declaratory judgment action presented conjectural issues that were not ripe for decision.[123]

The district court had previously dismissed all of AGL's insurance coverage claims, ruling that AGL failed to give its insurers timely notice of an occurrence under the policies issued to AGL.[124] The district court specifically found that "AGL knew [several years before giving notice to its insurers] that its potential liability was in the millions of dollars and

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121 *Atlanta Gas Light Co. v. Aetna Casualty & Sur. Co.*, 68 F.3d 409 (11th Cir. 1995).

122 68 F.3d at 414-15.

123 *Id.* at 415.

124 Order at 4, *Atlanta Gas Light Co. v. Aetna Casualty & Sur. Co.*, No. 1:91-CV-1803-RLV (N.D. Ga. Oct. 8, 1993); Order at 3, *Atlanta Gas Light Co.* (Aug. 13, 1993).

further knew that its potential liability exceeded the coverage provided by its self insurance retention fund and . . . direct insurance carrier.[125]

In addition, the district court concluded that under Georgia law, the insurers were "not required to show that they were prejudiced by such untimely notice.[126]

The Eleventh Circuit never reached the issue of timeliness of notice.

2. *Union Gas Co. v. Aetna Casualty & Surety Co.*

This case was filed by Union Gas Co. ("Union Gas") in the United States District Court for the Eastern District of Pennsylvania. Union Gas's predecessors manufactured gas at a site in Stroudsburg, Pennsylvania in the early 1900s.

a. Jury Verdict

A jury found that the contaminating incidents at issue were unintended, unexpected and accidental, but were not "sudden and accidental" under the pollution exclusion language of the policies.[127] This verdict released the defendant insurer from any coverage obligations.[128]

3. *City of St. Petersburg, Florida v. USF&G*

This case was filed by the City of St. Petersburg, Florida ("the City") in the United States District Court for the Middle District of Florida. The City operated a manufactured gas plant from 1914 through 1954.

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125 Order at 6 (Aug. 13, 1993).

126 Order at 4 (Oct. 8, 1993).

127 Mealey's Litigation Reports – Insurance (May 26, 1987), at 4360-62.

128 *Id.*

a. Pollution Exclusion/Duty to Defend

In granting the insurer's motion for summary judgment, the court held that the insurer had "no duty to defend the City under [the primary policy at issue] because the pollution damage was not sudden or accidental," within the meaning of the exception to the pollution exclusion in the policy.[129] The plaintiffs in the underlying action complained of illnesses and other related problems as the result of exposure to contamination "occurring on the [MGP] site over an extended period of time."[130] The court relied on the fact that under Florida law, "the term 'sudden' includes a temporal aspect with a sense of immediacy or abruptness," and thus did not apply to gradual pollution.[131]

The court also held that the insurer did not have a duty to defend the City under the excess policy at issue, which contained an absolute pollution exclusion.[132]

E. Summary

The case law on insurance coverage for MGP costs is still evolving. But most of the courts that have addressed the issue have ruled in favor of coverage.

II. RATE RECOVERY OF NET MGP COSTS

Another possible means for recovering MGP costs is through the utility's rates. This article next outlines the arguments typically made for and against the full recovery from ratepayers of net MGP costs, and then summarizes the reported decisions of public utility commissions on the recovery of such costs, with particular emphasis on recent decisions.

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129 *City of St. Petersburg, Florida v. USF&G*, No. 92-1224-CIV-T-23C (M.D. Fla. Aug. 15, 1994), *reprinted in* Mealey's Litigation Reports – Insurance (Sept. 20, 1994), at E-5 to E-6.

130 *Id.* at E-1, E-2, and E-5.

131 *Id.* at E-4 to E-5.

132 *Id.* at E-6.

The commission decisions on rate recovery of net MGP costs fall into three general categories: (1) those granting full recovery of net MGP costs from ratepayers through base rate treatment or trackers; (2) those granting only partial recovery of such costs; and (3) those denying all recovery of net MGP costs (of which there is only one). A majority of the commissions that have addressed the issue in contested cases have ruled in favor of full recovery.

A. Arguments For and Against Allowing Full Recovery of Net MGP Costs From Ratepayer

Proponents of the full recovery of net MGP costs from ratepayers typically make the following arguments. First, they assert that the costs of investigating and remediating MGP sites — which are incurred in response to claims made under recently enacted statutes that impose strict retroactive liability — are costs of resolving claims that are necessary to remaining in business and thus to providing current service to customers; like other costs of providing current service, they are properly recoverable in rates, unless found to be imprudently incurred. Second, they assert that full recovery of net MGP costs serves the best interest of the public — including the utility's ratepayers — by encouraging the utility to conduct prompt and thorough investigations and cleanups of environmental conditions at MGP sites. Third, they assert that the historical stewardship of MGP sites was prudent, because the historical operating and waste disposal practices at those sites were in accord with common gas industry practices at the time. Fourth, they assert that the prospect of regular prudence reviews creates a sufficient incentive for the utility to manage its cleanups efficiently and to aggressively pursue recoveries from insurers and other third parties.

Those opposing the full recovery of net MGP costs from ratepayers typically respond in the following manner. First, they assert that net MGP costs are not related to the cost of providing service to current customers but rather to past operations, and therefore the recovery

of such costs would be retroactive ratemaking. Second, they argue that current customers do not directly benefit from net MGP costs. Third, they assert that sharing is necessary to provide the utility with sufficient incentives to perform MGP cleanups efficiently and to maximize recoveries from insurers and other third parties. Fourth, they assert that net MGP costs should be disallowed because the utility acted unreasonably in its operating and waste disposal practices during the MGP era. Finally, they assert that, for those jurisdictions where any appreciation in the value of utility property goes to the shareholders when the property is sold, it is only fair to require the shareholders to share in the net MGP costs.

B. Commission Decisions Granting Full Recovery of MGP Costs From Ratepayers

The majority of state commissions that have addressed the issue of rate recovery of net MGP costs in contested cases have granted full recovery from ratepayers through base rate treatment or trackers. The reported commission decisions granting full recovery are summarized below, with an emphasis on the most recent decisions.

1. *ICC v. Illinois Power Company*, 1996 Ill. PUC LEXIS 53 (1996)

In January 1996, the Illinois Commerce Commission (ICC) permitted full recovery of all prudently-incurred MGP remediation costs, including carrying charges. This decision came on remand from the Illinois Supreme Court, which had affirmed in part and reversed in part a generic investigation into MGP cost recovery initiated by the ICC in 1992.[133] In the 1992 generic inquiry, the ICC had allocated MGP cleanup expenses between ratepayers and shareholders through a five-year recovery period, with no carrying charges on the

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[133] *Citizens Util. Bd. v. Illinois Commerce Comm'n*, 651 N.E.2d 1089 (Ill. 1995), *reh'g denied* (May 30, 1995).

unamortized balance.[134] The Illinois Supreme Court reversed the ICC with respect to the cost-sharing issue, finding that the ICC had failed to articulate a reasoned basis for its departure from its longstanding position that all mandatory operational expenses are recoverable.

In the 1992 generic inquiry, the ICC had determined that MGP cleanup expenses would be afforded a rebuttable presumption of prudence in future rate cases. In reaching this conclusion, the ICC rejected arguments that utilities had acted imprudently in their past operation of MGP facilities and that the recovery of MGP remediation expenses bore no relationship to the provision of current service. with regard to the latter conclusion, the Illinois Supreme Court affirmed that "the cost of delivering utility service reasonably encompasses current costs of doing business, including necessary costs of complying with legally mandated environmental remediation."[135] The Court also upheld the ICC's authority to permit MGP cost recovery through the use of a rider mechanism.

2. *Public Service Electric & Gas Company*, BRC Docket No. ER91111698J, 1993 WL 505443 (N.J. Bd. Reg. Comm'rs, Sept. 15, 1993), reh'g denied, (Jan. 21, 1994)

The New Jersey Board of Regulatory Commissioners issued this ruling in a contested rate proceeding involving the recovery by Public Service Electric & Gas Co. ("PSE&G") of the costs of investigating and remediating 38 sites at which gas was manufactured and one site at which gas plant wastes were disposed.

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134 This decision departed from the ICC's earlier position in two utility-specific proceedings, in which it had permitted full cost recovery. *See Central Illinois Light Co.*, 124 PUR4th 498 (Ill. Comm. Comm'n 1991); *North Shore Gas Co.*, 1991 Ill. PUC LEXIS 636 (Ill. Comm. Comm'n 1991).

135 651 N.E. 2d at 1096.

Rejecting the arguments of New Jersey's Public Advocate that, in accordance with precedent, the costs should be shared equally between ratepayers and shareholders,[136] the Board held that "PSE&G has made a convincing case that the reasonable and prudent costs associated with the remediation of its MGP sites should be recovered from ratepayers."[137] The Board approved the following recovery mechanism: PSE&G is authorized to amortize over a seven-year period the reasonable and prudent net costs incurred each year in connection with its MGP cleanup program, and to recover those amortized costs, including carrying charges at an interest rate equivalent to the Company's cost of intermediate-term (7-year) debt (less the benefit of deferred taxes), through remediation adjustment clauses.[138]

With respect to the company's historical stewardship of the MGP sites, the Board ruled:

> With respect to cleanup of the MGP sites, the Board believes that PSE&G has demonstrated the prudence and reasonableness of its conduct, both in operating and decommissioning the MGP sites in the past, as well as investigating and remediating the sites currently. The record indicates that the Company's historical operating practices were consistent with then-prevailing industry practices . . . . The Board believes that the Company's past actions as to the operation and decommissioning of these sites must be measured against practices acceptable at the time in question. To do otherwise would penalize the Company for

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136 The Board had previously approved settlements for South Jersey Gas Company and New Jersey Natural Gas Company that provided for an amortization of MGP costs over seven years, without carrying charges.

137 *Public Serv. Elec. & Gas Co.*, BRC Docket No. ER91111698J, slip op. at 14 (N.J. Bd. Reg. Comm'rs, Sept. 15, 1993), *reh'g denied*, (Jan. 21, 1994).

138 *Id.* at 14-21. The Board also required that PSE&G1s gas customers provide 60 percent of the net cleanup costs and that its electric customers provide 40 percent of the net cleanup costs. This issue of rate responsibility as between gas and electric customers of a combined utility has also been raised in other jurisdictions. *See, e.g., New York State Elec. & Gas Corp.*, 90 PUR4th 322 (N.Y. Pub. Serv. Comm'n 1988) (sharing MGP cleanup costs between gas and electric customers).

> lacking the prescience to conform to today's ever-exacting environmental standards.[139]

Thus, no costs were disallowed on grounds of imprudence.

In rejecting the Advocate's argument that carrying costs should not be allowed, the Board cited a number of reasons: (1) environmental cleanup costs are "viewed as being a necessary and ongoing cost of doing business;"[140] (2) the need for, and parameters of, the MGP site cleanups had been mandated by the State; (3) PSE&G had acted prudently both in MGP operations and remediation, and in "aggressively pursuing insurance recoveries;"[141] (4) the allowance of carrying costs at a debt rate yields no return to shareholders; and (5) periodic prudence reviews would provide a greater incentive for PSE&G to carry out its MGP cleanups efficiently than would arbitrary restrictions on cost recovery.[142]

3. ***Washington Gas & Light Company,*** 146 PUR4th 429 (D.C. Pub. Serv. Comm'n, Oct. 8, 1993)

In this case, the District of Columbia Public Service Commission granted full recovery of MGP cleanup costs for one site, but reserved the option of requiring shareholders to bear part of the cleanup costs under undefined conditions in future cases.

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139 *Id.* at 14.

140 *Id.* at 16. The Board emphasized that remediation costs arise out of recently-enacted environmental standards, not out of any failure to meet standards applicable during the MGP era:

> Additionally, the fact that remediation costs were not provided for in rates when they were incurred is less a basis for denying cost recovery than it is an indication of the fact that environmental awareness of the kind evident today was unknown at that time.

Id. at 17.

141 *Id.* at 18.

142 *Id.* at 15-18. To facilitate these periodic prudence reviews, the Board adopted detailed auditing and verification measures, *id.* at 20, and stressed that it "will be vigilant in its oversight of the Company's remediation programs." *Id.* at 15.

The Commission observed that there were clearly advantages to District of Columbia ratepayers from the cleanup and that the company had been prudent and reasonable in its operations. The Commission set forth a general rule for when it would allow recovery of MGP cleanup costs: "when: (1) the costs are necessary; (2) the costs are prudently incurred; (3) the Commission has the opportunity to review the Company's actions during a general rate case; and (4) . . . ratepayers have an opportunity to share in monetary benefits which may accrue from an environmental cleanup that enhances the value of the property.[143]

The Commission granted amortization of identified cleanup costs over a three-year period, requiring appropriate adjustments for any tax benefits and carrying costs applied to the unamortized rate base portion in conformance with the company's overall rate of return. The Commission also required that, if the subject property was ever sold or leased, the ratepayers should share in any profits. The Commission was not specific in how such sharing should occur, except to say the ratepayers should receive at least 50 percent of any net revenues from the remediated property. The parties and Staff were directed to submit proposals in the company's next rate case on how to implement this revenue sharing mechanism.

Future cleanup costs were to be recorded in a deferred account and addressed in the company's next rate case.

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143 146 PUR4th at 503.

4. *Michigan Gas Utilities*, Case No. U-10503, 1994 Mich. PSC LEXIS 98 (Mich. Pub. Serv. Conm'n, Mar. 30, 1994)

In this brief decision, the Commission followed its prior rulings and approved the company's proposal for deferred accounting of MGP cleanup costs, which would be amortized over a ten-year period, taking into account any reimbursement of costs from insurance companies or other third parties.[144] If the Commission finds the costs prudently incurred, the company will accrue carrying charges on the unamortized balance at the company's overall pre-tax rate of return by including the unamortized balance in its rate base.[145]

5. Earlier Decisions Providing Full Recovery

The following earlier decisions also granted full recovery from ratepayers: *Yankee Gas Services Co.*, Docket No. 92-02-19, 1992 WL 333210 (Conn. Dept. Pub. Util. Control, Aug. 26, 1992) (prudently incurred MGP cleanup costs allowed as proper operating expenses; recovery via five-year amortization, with unamortized amounts included in rate base; rate of return equal to short-term cost of debt); *Midwest Gas*, 133 PUR4th 380 (Iowa Util. Bd. 1992) (accepting cleanup costs as current and legitimate costs of doing business; recovery of costs by inclusion of representative amount in base rates); *National Fuel Gas Distribution Corp.*, Op. No. 91-16, 1991 N.Y. PUC LEXIS 11 (N.Y. Pub. Serv. Comm'n, July 19, 1991) (MGP cleanup costs to be collected by amortization over three-year period with unamortized amount in

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[144] The Commission recently adopted a virtually identical approach in Consumers Power Company, Case No. U-10755 (March 11, 1996). *See also Michigan Consol. Gas Co.*, 98 PUR4th 273 (Mich. Pub. Serv. Comm'n 1988).

[145] However, the Commission apparently would not allow the carrying charge to accrue until after the Commission had found the costs to be prudently incurred in a rate case. *See Michigan Consol. Gas Co.*, 1993 Mich. PSC LEXIS 230, 147 PUR4th 1 (Mich. Pub. Serv. Comm'n, Oct. 28, 1993) (amortized costs over ten years, with carrying charges at the pre-tax authorized rates, but amortization was to begin only after a prudence review in a rate case).

rate base, adjusted to reflect any insurance recoveries);[146] *Chesapeake Utilities Corp.*, Order No. 68462, 1989 Md. PSC LEXIS 81 (Md. Pub. Serv. Comm'n, June 9,'1989) (amortized cleanup costs over ten years, with unamortized amounts in rate base to cover carrying costs) (followed in *Washington Gas Light Co.*, 84 MD PSC 401, 1993 WL667150 (Nov. 12, 1993)); and Peoples Gas System Inc., Order No. 16313, 1986 Fla. PUC LEXIS 586 (Fla. Pub. Serv. Comm'n, July 8, 1986) (accepting cleanup costs as "normal ongoing, utility business expenses"; amortization over five years, with unamortized amounts in rate base).[147]

C. Commission Decisions Requiring Sharing of Net MGP Costs Between Shareholders and Ratepayers

A minority of commissions that have addressed this issue in contested cases have ruled that utility shareholders and ratepayers must share net MGP costs through amortization without carrying costs, while several jurisdictions have approved settlements that embody some aspect of sharing of net MGP costs.

1. *Public Service Company of North Carolina*, 156 PUR4th 384 (N.C. 1994)

In this general rate case, the North Carolina Utilities Commission rejected the company's request to use a tracker to recover all cleanup costs associated with six former MGP

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146 The New York Public Service Commission has continued to allow Full cost recovery. *See National Fuel Gas Distrib. Corp.*, 153 PUR4th 523 (N.Y. Pub. Serv. Comm'n, 1994). However, it has recognized that further consideration of cost sharing may be appropriate in light of possible difficulties in evaluating prudence and to ensure appropriate incentives for cost controls on clean-up efforts. *See id.*

147 There are also earlier decisions in California that granted full recovery. *See, e.g.*, *Southern California Edison Co.*, Decision No. 9112076, 1991 Cal. PUC LEXIS 911 (Cal. Pub. Util. Comm'n, Dec. 20, 1991) ("costs recovered entirely from ratepayers," using combination of base rate treatment and special accounting mechanism). In California, however, full recovery has been replaced with a sharing mechanism pursuant to a settlement agreement. *See* section II.D., *infra*.

sites. The Commission instead opted for deferral and amortization of actual costs, denying recovery of carrying costs on the deferred or unamortized balances. Actual costs incurred to date were amortized over three years. The length of amortization for future costs would depend on the circumstances, including the magnitude of the costs involved.

The Commission identified several reasons for this result. First, amortization was seen as providing more stable rates than the tracker. Second, treating the costs in a rate case would afford a better opportunity for prudence review of the MGP costs than would a tracker. Third, the Commission was concerned that the tracker's cost pass-through would remove the utility's motivation to minimize cleanup costs and to pursue contributions from insurers and potentially responsible third parties. Finally, the Commission believed that some degree of sharing of cleanup costs between ratepayers and shareholders was appropriate. On the one hand, the Commission recognized that it was "proper and in the public interest" for the utility to recover "prudently-incurred cleanup costs from current ratepayers as reasonable operating expenses, even though the MGP sites are not used and useful" for current services.[148] And on the other hand, the Commission found that "it is not appropriate for ratepayers to relieve shareholders of all cost responsibility associated with the ratemaking treatment of MGP cleanup."[149] The Commission found Further support for this result in decisions of other commissions where MGP cleanup costs had been shared and by viewing the situation to be analogous to its treatment of costs associated with abandoned nuclear power plants.

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148 156 PUR4th at 402.

149 *Id.*

2. *Kansas Public Service,* 146 PUR4th 123 (Kan. S.C.C. 1993)

In this decision, on motion to reconsider, the Commission reaffirmed its requirement that the utility shareholders bear 40 percent of the investigation and cleanup costs related to MGPs, with the ratepayers bearing 60 percent of the costs. The Commission dismissed the utility's arguments that the subject property was currently being used in company operations — as the sites of a warehouse, garage, storage, operations facilities, and parking lot. Rather, the Commission found that the costs related to the cleanup do not relate to current services, but are a result of the former MGPs which are no longer providing services to customers. it also found that the ratepayers will not receive a current or future benefit from the remediation costs.

Relying on its broad authority to establish rates and balance the interests of ratepayers and shareholders, the Commission ordered that the utility record actual remediation costs into a deferred account, subject to approval at the utility's next rate case. The approved costs will be amortized over ten years without carrying charges. The Commission granted the utility 40 percent of any insurance recoveries, as an intended incentive to pursue such recoveries aggressively. Finally, the Commission required that any gain from the sale of remediated property be shared between ratepayers and shareholders, based on a prior decision regarding capital gains, which would give shareholders less than 30 percent of any such gain.

3. *Wisconsin Power & Light Company,* No. 6680-UR-108, 1993 Wisc. PUC LEXIS 64 (Wisc. Pub. Serv. Comm'n, Sept. 30, 1993)

In this case, which involved estimated cleanup costs in excess of $80 million projected over 35 years, the Wisconsin Commission acknowledged that the MGP cleanup was required under current law, and, from that perspective, the cleanup costs are current and legitimate expenses reasonably incurred and therefore subject to recovery from ratepayers.

However, the Commission also found that the MGPs had been removed from service over 40 years ago, that current ratepayers received no benefit from manufactured gas and that the cleanup costs were not related to the provision of service to current customers. The Commission also noted that in Wisconsin the profit (or loss) on the sale of land goes exclusively to the shareholders. Thus, any increase in land value resulting from the remediation of the MGP sites, even if paid for by the ratepayers, would accrue solely to the shareholders' benefit.

Citing its obligation to balance the interests of ratepayers and shareholders, the Commission found that sharing of cleanup costs would be reasonable and just. sharing would be achieved by deferred accounting of the cleanup costs, which would then be recovered in rates over a five-year period, with no recovery of carrying costs on the unamortized balances. The cleanup costs were to be netted against insurance and third-party recoveries, which the Commission viewed as an incentive for the company to pursue such recoveries vigorously and thereby limit the cleanup costs for which it received no carrying costs.

4. Earlier Decisions Requiring Sharing of Net MGP Costs Between Shareholders and Ratepayers

The following earlier decisions in contested rate proceedings required shareholders to bear part of the net MGP costs: *Northern States Power Co.*, Nos. G-002/GR-86-160; G-002/M-86-165, 1987 Minn. PUC LEXIS (Minn. Pub. Util. Comm'n, Jan. 27, 1987) (cleanup costs amortized over five years, but unamortized amounts not included in rate base);[150]

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[150] More recently, in *Interstate Power Company*, Docket No. G-001/GR-95-406 (Feb. 29, 1996), the Minnesota Public Utilities Commission overruled an ALJ1s decision to impose a 50% sharing of costs and authorized full recovery. The Commission did not, however, authorize carrying charges on the unamortized balance, thus resulting in some *de facto* sharing of costs.

and *Chesapeake Utilities Corp.*, No. 2728, 1986 Del. PSC LEXIS 6 (Del. Pub. Serv. Comm'n, Mar. 25, 1986) (five-year amortization, unamortized amounts not included in rate base).

The following decisions have approved settlements in which companies agreed that their shareholders would bear part of the net MGP costs: *Energy North Natural Gas, Inc.*, DE 93-168, 1993 WL733960 (N.H.P.U.C. Nov. 22, 1993) (approving settlement with seven year amortization, but without carrying costs or rate base treatment, noting that "some sharing of the burden between ratepayers and shareholders may be appropriate"); *Atlanta Gas Light Co.*, No. 4167-U (Ga. Pub. Serv. Comm'n, Sept. 1, 1992) (five-year amortization, deferred tax benefits to ratepayers, carrying costs on unamortized amounts not allowed, but company allowed to retain one-half of insurance and third-party recoveries, up to amount of carrying costs); and *Generic Investigation Into Ratemaking Treatment for Remediation of Hazardous Waste From the Manufacture of Natural Gas*, No. 89-161, Mass. D.P.U. (May 25, 1990) (abstract at 115 PUR4th 275) (amortize costs over seven years, without carrying costs, but company allowed to retain one-half of net insurance or third-party recoveries, towards its share of the cleanup costs).[151]

D. The California MGP Rate Settlement

Early California decisions addressing MGP cleanup costs provided for full recovery of prudent and reasonable net MGP costs from ratepayers. In a rather complicated system, a utility could maintain deferred accounting of net remediation costs, which would later

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[151] As noted above, the New Jersey Board of Regulatory Commissioners has also approved two settlements that provide for amortization of net MGP costs without carrying costs. *South Jersey Gas Co.*, Order Adopting Stipulation, Docket No. GR91071243J (Aug. 10, 1992) (amortize net MGP cleanup costs over seven years, no carrying costs on unamortized costs, and tax benefits allocated to ratepayers); *New Jersey Natural Gas Co.*, Order Adopting Partial Initial Decision, Docket No. GR91081393J (June 24, 1992) (same). But as further noted above, the Board has since ruled in a contested proceeding in favor of full recovery of net MGP costs from ratepayers. *Public Serv. Elec. & Gas. Co.*, BRC Docket No. ER91111698J, slip op. at 14-21 (amortization over seven years with carrying charges).

be reviewed for reasonableness, and all reasonable costs could be recovered through the rates, with all carrying costs and appropriate rate of return included. However, in November 1992, the California Public Utilities Commission invited comments and suggestions for alternative mechanisms to recover MGP costs, including sharing between ratepayers and shareholders.[152] After extensive negotiations between the major utilities and the ratepayers' advocates, a settlement proposal was reached, although not signed by one ratepayer advocate group. The settlement, outlined below, was approved without change by the California Commission on May 4, 1994.[153]

The California settlement calls for ratepayers to bear 90 percent, and shareholders to bear 10 percent, of the MGP costs.[154] But the settlement also allows shareholders to recover their share of the MGP costs from insurance coverage or other third-party recoveries, and possibly to recover even more than their share. Insurance litigation costs are allocated 70 percent to ratepayers and 30 percent to shareholders, and insurance recoveries are allocated in the same manner until both groups are made whole for their insurance litigation costs. Any remaining insurance recoveries are then allocated 10 percent to ratepayers and 90 percent to shareholders, until the shareholders recover their share of the MGP costs. If, after that, there are still insurance recovery funds remaining, those funds are allocated 60 percent to ratepayers and 40 percent to

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152 *Southern California Gas Co.*, 1992 WL 401656, 46 CPUC2d 242 (Cal. Pub. Util. Comm'n, Nov. 23, 1992) (inviting comments on appropriateness of reasonableness review and on alternative methods for recovering MGP cleanup expenses, including sharing between ratepayers and shareholders).

153 *See 1991 Hazardous Substance Reasonableness Review Application of Southern California Gas Company et al.*, 54 CPUC2d 391, 1994 Cal. PUC LEXIS 379 (Cal. Pub. Util. Comm'n, May 4, 1994).

154 If the costs are below $5 million for an 84-month period, ratepayers will be responsible for 95 percent and shareholders for 5 percent of the remediation costs.

shareholders. As to third-party recoveries, all related litigation costs and recoveries are allocated 90 percent to ratepayers and 10 percent to shareholders.

The settlement precludes any reasonableness review for the cleanup costs, litigation costs and recoveries, or associated activities. The cleanup costs are recorded in interest-bearing accounts, created specifically to record these costs. The utility will then recover the properly recorded costs in a subsequent proceeding or proceedings as it deems appropriate.

In approving the settlement, the California Commission rejected comments from the one objecting ratepayer advocacy group, which urged a 50/50 sharing of costs between ratepayers and shareholders. The Commission recognized that the allocation percentages were a matter of judgment and concluded the 90/10 allocation would provide sufficient incentive to utility management to pursue efficient remediation and recovery of insurance coverage. The Commission made particular note that the utilities should aggressively pursue recovery from their insurers:

> We believe the primary responsibility for paying for hazardous substance expenses should fall on the insurers under the policies issued by them to the utilities over the years. The purpose of having utilities obtain insurance coverage is to ensure that neither the ratepayers nor the utilities have to bear the expense of liability or losses.[155]

E. The Indiana Decision Denying Recovery of MGP Costs

The Indiana Utility Regulatory Commission (IURC) is, to date, the only state commission that has completely denied recovery of MGP costs.[156] The IURC found that the MGP costs at issue "were not sufficiently related to the provision of public utility service as to merit recovery." In reaching that conclusion, the IURC relied upon a state statute that restricted

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155 1994 Cal. PUC LEXIS 379 at *13.

the scope of includable property to property used in the performance or furnishing of service. A prior decision of the Indiana Supreme Court had interpreted this provision to mean that includable property must be "producing" property or "used and useful" property.[157] On this basis, the IURC concluded that costs recovered in rates must have some relationship to the provision of current utility service, and found that the MGP costs requested by Indiana Gas bore no such relationship. Moreover, because it found that the MGP costs did not relate to the provision of current service, the IURC argued that MGP cost recovery would place Indiana Gas' ratepayers "in the position of insurers" with regard to a liability that any type of business could conceivably incur and for which the utility could have obtained insurance.

Indiana Gas has appealed the IURC decision to the Indiana Court of Appeals, where it is pending.[158]

F. Summary

The clear majority of public utility commissions that have addressed the issue of the rate recovery of MGP costs in contested cases have ruled in favor of full recovery. only one commission has completely denied recovery of net MGP costs. The California settlement presents a possible middle ground between the jurisdictions granting full recovery and those granting partial recovery of net MGP costs.

CONCLUSION

Although the caselaw is still evolving, utilities have generally been successful in their efforts to recover MGP costs through insurance and rates.

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156 *Indiana Gas Company, Inc.*, 162 PUR4th 283 (1995).

157 *Citizens Action v. Northern Indiana Public Service*, 485 N.E.2d 610 (Ind. 1985).

158 Petition of Indiana Gas Company, Cause No. 39353, Phase II (May 3, 1995), *appeal docketed*, Cause No. 93AO2-9505-EX-288 (Ind. Ct. App. May 25, 1995).

Analysis of Different "Sharing" Percentages with Different Discount Rates

Exhibit JTG-2

Line No.																
1	Balance	$ 10,000,000	# of Periods	1	2	3	4	5	6	7	8	9	10			
2	Periods	10	Year	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027			
3	Rate	9.8628%	Annual Amortization	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000			
4	Pymts	$ 1,000,000	Discount Factor	1.09863	1.20698	1.32603	1.45681	1.60049	1.75834	1.93177	2.12229	2.33161	2.56157			
5	PV	$6,180,950	Present Value	$ 910,226	$ 828,512	$ 754,133	$ 686,432	$ 624,808	$ 568,717	$ 517,661	$ 471,189	$ 428,888	$ 390,385			
6	Ratepayers %	61.81%										Sum of all PV	$ 6,180,950			
7	Shareholders %	38.19%														
8	Balance	$ 10,000,000	# of Periods	1	2	3	4	5	6	7	8	9	10			
9	Periods	10	Year	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027			
10	Rate	10.5580%	Annual Amortization	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000			
11	Pymts	$ 1,000,000	Discount Factor	1.10558	1.22231	1.35136	1.49403	1.65177	1.82617	2.01897	2.23214	2.46781	2.72836			
12	PV	$6,000,000	Present Value	$ 904,503	$ 818,125	$ 739,997	$ 669,329	$ 605,410	$ 547,595	$ 495,301	$ 448,001	$ 405,218	$ 366,521			
13	Ratepayers %	60.00%										Sum of all PV	$ 6,000,000			
14	Shareholders %	40.00%														
15	Balance	$ 10,000,000	# of Periods	1	2	3	4	5	6	7	8	9	10			
16	Periods	10	Year	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027			
17	Rate	6.5923%	Annual Amortization	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000			
18	Pymts	$ 1,000,000	Discount Factor	1.06592	1.13619	1.21109	1.29093	1.37603	1.46675	1.56344	1.66651	1.77637	1.89347			
19	PV	$7,157,881	Present Value	$ 938,154	$ 880,133	$ 825,700	$ 774,634	$ 726,726	$ 681,781	$ 639,616	$ 600,058	$ 562,947	$ 528,131			
20	Ratepayers %	71.58%														
21	Shareholders %	28.42%										Sum of all PV	$ 7,157,881			

Proof of NPV of 40% Disallowance Approach with/without Carrying Charges

Exhibit JTG-3

Line No.												
	# of Periods		1	2	3	4	5	6	7	8	9	10
1	Year		2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
2	Beginning Balance		$ 6,000,000	$ 5,755,984	$ 5,453,721	$ 5,086,591	$ 4,647,355	$ 4,128,102	$ 3,520,191	$ 2,814,190	$ 1,999,806	$ 1,065,820
3	Plus Carrying Charges		$ 395,538	$ 379,452	$ 359,526	$ 335,323	$ 306,368	$ 272,137	$ 232,062	$ 185,520	$ 131,833	$ 70,262
4	Less Amortization		$ 639,554	$ 681,715	$ 726,656	$ 774,559	$ 825,620	$ 880,048	$ 938,063	$ 999,903	$ 1,065,820	$ 1,136,082
5	Equals Ending Balance		$ 5,755,984	$ 5,453,721	$ 5,086,591	$ 4,647,355	$ 4,128,102	$ 3,520,191	$ 2,814,190	$ 1,999,806	$ 1,065,820	$ -
6	Discount Factor		1.06592	1.13619	1.21109	1.29093	1.37603	1.46675	1.56344	1.66651	1.77637	1.89347
7	Present Value		$ 600,000	$ 600,000	$ 600,000	$ 600,000	$ 600,000	$ 600,000	$ 600,000	$ 600,000	$ 600,000	$ 600,000
8	WACC	6.5923%										
9	Shareholder %	40.00%										
10	Ratepayer %	60.00%									Sum of all PV	$ 6,000,000

	# of Periods		1	2	3	4	5	6	7	8	9	10
11	Year		2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
12	Beginning Balance		$ 6,000,000	$ 5,400,000	$ 4,800,000	$ 4,200,000	$ 3,600,000	$ 3,000,000	$ 2,400,000	$ 1,800,000	$ 1,200,000	$ 600,000
13	Plus Carrying Charges											
14	Less Amortization		$ 600,000	$ 600,000	$ 600,000	$ 600,000	$ 600,000	$ 600,000	$ 600,000	$ 600,000	$ 600,000	$ 600,000
15	Equals Ending Balance		$ 5,400,000	$ 4,800,000	$ 4,200,000	$ 3,600,000	$ 3,000,000	$ 2,400,000	$ 1,800,000	$ 1,200,000	$ 600,000	$ -
16	Discount Factor		1.06592	1.13619	1.21109	1.29093	1.37603	1.46675	1.56344	1.66651	1.77637	1.89347
17	Present Value		$ 562,892	$ 528,080	$ 495,420	$ 464,781	$ 436,036	$ 409,069	$ 383,769	$ 360,035	$ 337,768	$ 316,879
11	WACC	6.5923%										
19	Shareholder %	57.05%										
20	Ratepayer %	42.95%									Sum of all PV	$ 4,294,729

STATE OF KANSAS)
) ss.
COUNTY OF SHAWNEE)

VERIFICATION

Justin Grady, being duly sworn upon his oath deposes and says that he is Chief Accounting and Finance for the Utilities Division of the State Corporation Commission of the State of Kansas, that he has read and is familiar with the foregoing *Direct Testimony*, and that the statements contained therein are true and correct to the best of his knowledge, information and belief.

Justin Grady
Chief Accounting and Finance, Utilities Division
State Corporation Commission of the
State of Kansas

Subscribed and sworn to before me this 8th day of September, 2071.

PAMELA J. GRIFFETH
Notary Public - State of Kansas
My Appt. Expires 08-17-2019

Notary Public

My Appointment Expires: August 17, 2019

CERTIFICATE OF SERVICE

17-KGSG-455-ACT

I, the undersigned, certify that a true and correct copy of the above and foregoing Direct Testimony was served by electronic service on this 8th day of September, 2017, to the following:

JAMES G. FLAHERTY, ATTORNEY
ANDERSON & BYRD, L.L.P.
216 S HICKORY
PO BOX 17
OTTAWA, KS 66067
Fax: 785-242-1279
jflaherty@andersonbyrd.com

THOMAS J. CONNORS, ATTORNEY AT LAW
CITIZENS' UTILITY RATEPAYER BOARD
1500 SW ARROWHEAD RD
TOPEKA, KS 66604
Fax: 785-271-3116
tj.connors@curb.kansas.gov

TODD E. LOVE, ATTORNEY
CITIZENS' UTILITY RATEPAYER BOARD
1500 SW ARROWHEAD RD
TOPEKA, KS 66604
Fax: 785-271-3116
t.love@curb.kansas.gov

DAVID W. NICKEL, CONSUMER COUNSEL
CITIZENS' UTILITY RATEPAYER BOARD
1500 SW ARROWHEAD RD
TOPEKA, KS 66604
Fax: 785-271-3116
d.nickel@curb.kansas.gov

DELLA SMITH
CITIZENS' UTILITY RATEPAYER BOARD
1500 SW ARROWHEAD RD
TOPEKA, KS 66604
Fax: 785-271-3116
d.smith@curb.kansas.gov

SHONDA SMITH
CITIZENS' UTILITY RATEPAYER BOARD
1500 SW ARROWHEAD RD
TOPEKA, KS 66604
Fax: 785-271-3116
sd.smith@curb.kansas.gov

BRIAN G. FEDOTIN, DEPUTY GENERAL COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD RD
TOPEKA, KS 66604-4027
Fax: 785-271-3314
b.fedotin@kcc.ks.gov

JAKE FISHER, LITIGATION COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD RD
TOPEKA, KS 66604-4027
Fax: 785-271-3354
j.fisher@kcc.ks.gov

ROBERT VINCENT, LITIGATION COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD RD
TOPEKA, KS 66604-4027
Fax: 785-271-3354
r.vincent@kcc.ks.gov

JANET BUCHANAN, MANAGER OF RATES & ANALYSIS
KANSAS GAS SERVICE, A DIVISION OF ONE GAS, INC.
7421 W 129TH ST
OVERLAND PARK, KS 66213-2713
Fax: 913-319-8622
janet.buchanan@onegas.com

CERTIFICATE OF SERVICE

17-KGSG-455-ACT

DAVID N. DITTEMORE, DIRECTOR OF RATES AND
REGULATORY AFFAIRS
KANSAS GAS SERVICE, A DIVISION OF ONE GAS, INC.
7421 W 129TH ST
OVERLAND PARK, KS 66213-2713
Fax: 913-319-8622
david.dittemore@onegas.com

JUDY JENKINS, MANAGING ATTORNEY
KANSAS GAS SERVICE, A DIVISION OF ONE GAS, INC.
7421 W 129TH ST
OVERLAND PARK, KS 66213-2713
Fax: 913-319-8622
judy.jenkins@onegas.com

/s/ Pamela Griffeth

Pamela Griffeth
Administrative Specialist