

Direct Testimony and Schedules
Joylyn C. Hoffman Malueg

Before the Minnesota Public Utilities Commission
State of Minnesota

In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to
Increase Rates for Natural Gas Service in Minnesota

Docket No. G007,011/GR-10-977

Exhibit _____

Class Cost of Service Study

November 30, 2010

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1 **I. INTRODUCTION AND QUALIFICATIONS**

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is Joylyn C. Hoffman Malueg. My business address is Integrys Energy Group,
4 Inc. (“Integrys”), 700 North Adams Street, P.O. Box 19001, Green Bay, WI 54307-9001.

5
6 Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

7 A. I am a Rate Case Consultant in the Regulatory Affairs Department of Integrys Business
8 Support, LLC (“IBS”). Both Minnesota Energy Resources Corporation (“MERC” or the
9 “Company”) and IBS are wholly-owned subsidiaries of Integrys.

10
11 Q. PLEASE SUMMARIZE YOUR QUALIFICATIONS AND EXPERIENCE.

12 A. I am a 1999 graduate of the University of Wisconsin – Green Bay where I received a
13 Bachelor of Science Degree in Mathematics with a Statistical emphasis. I received my
14 Master of Business Administration degree from Cardinal Stritch University, Milwaukee,
15 Wisconsin, in February of 2006. I am also a Certified Management Accountant
16 (“CMA”), having received such certification in November of 2009 from the Institute of
17 Certified Management Accountants. From 1999 to 2001, I worked for two separate
18 companies performing retirement benefits analysis and valuation. In March of 2001, I
19 was hired by Wisconsin Public Service Corporation (“WPSC”) as a Revenue
20 Requirements Forecaster in the Rates and Economic Evaluation Department. While
21 working as a Revenue Requirements Forecaster, I was primarily responsible for revenue
22 requirements and cost of service analyses pertaining to WPSC’s wholesale jurisdiction.
23 In October of 2003, my job title changed to Rate Analyst within the Regulatory Affairs

1 Department. My primary job responsibilities during that time related to revenue
2 requirements analyses for WPSC's Michigan retail jurisdiction, as well as performing
3 revenue requirement analyses and cost of service studies for WPSC's sister company,
4 Upper Peninsula Power Company ("UPPCO"). In December of 2006, I became a Rate
5 Case Consultant within the Regulatory Affairs Department. Currently, my primary job
6 duties as a Rate Case Consultant for Integrys consist of performing cost of service study
7 analyses for all regulated Integrys subsidiaries. I am also responsible for conducting the
8 revenue requirement analyses for WPSC's Michigan retail electric and gas jurisdictions.

9
10 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY REGULATORY AGENCY?

11 A. Yes, I have. I have provided sworn testimony before the Minnesota Public Utilities
12 Commission ("Commission") in Docket No. G007,011/GR-08-835, and before the
13 Illinois Commerce Commission ("ICC") in Docket Nos. 09-0166 and 09-0167. I have
14 also filed testimony before the Michigan Public Service Commission ("MPSC") in Case
15 Nos. U-14410, U-14745, U-15352, U-15549, U-15988, U-15590, and U-16166, as well
16 as before the Public Service Commission of Wisconsin ("PSCW") in Docket Nos. 6690-
17 UR-119 and 6690-UR-120. In addition, I have participated in the preparation of various
18 accounting and filing exhibits for WPSC, UPPCO and Michigan Gas Utilities for
19 presentation to the MPSC, the PSCW, and the Federal Energy Regulatory Commission.

20
21 Q. FOR WHOM ARE YOU PROVIDING TESTIMONY?

22 A. I am providing testimony for MERC, which is a wholly-owned subsidiary of Integrys.

23

1 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

2 A. My Direct Testimony and schedules describe and present MERC's cost of service studies
3 for the 2011 proposed test year.
4

5 Q. ARE YOU SPONSORING ANY INFORMATIONAL REQUIREMENTS OR
6 SCHEDULES WITH THIS TESTIMONY?

7 A. Yes, I am. As required by Minn. R. 7825.4300(C), I am sponsoring Informational
8 Requirement Document 12, Schedules 1 through 35, which contains six cost of service
9 studies for the 2011 proposed test year along with supporting data. These cost of service
10 studies include:

- 11 1) A cost of service study of the MERC-NMU service territory, portraying Income
12 Tax allocated to the rate schedules based upon the Net Income allocation
13 methodology. *See* Volume 3, Informational Requirement Document 12, Schedule
14 12.
15
- 16 2) A cost of service study of the MERC-PNG service territory, portraying Income
17 Tax allocated to the rate schedules based upon the Net Income allocation
18 methodology. *See* Volume 3, Informational Requirement Document 12, Schedule
19 1.
20
- 21 3) A cost of service study of the MERC-NMU service territory, portraying Income
22 Tax allocated to the rate schedules based upon the Rate Base allocation
23 methodology. *See* Volume 3, Informational Requirement Document 12, Schedule
24 18.
25
- 26 4) A cost of service study of the MERC-PNG service territory, portraying Income
27 Tax allocated to the rate schedules based upon the Rate Base allocation
28 methodology. *See* Volume 3, Informational Requirement Document 12, Schedule
29 9.
30
- 31 5) A cost of service study of the MERC-Consolidated service territory, as defined by
32 the Direct Testimony and schedules of MERC witnesses Mr. Greg Walters and
33 Mr. Seth DeMerritt. This cost of service study portrays Income Tax allocated to
34 the rate schedules based upon the Net Income allocation methodology. *See*
35 Volume 3, Informational Requirement Document 12, Schedule 21.

1
2 6) A cost of service study of the MERC-Consolidated service territory, as defined by
3 the Direct Testimony and schedules of MERC witnesses Mr. Greg Walters and
4 Mr. Seth DeMerritt. This cost of service study portrays Income Tax allocated to
5 the rate schedules based upon the Rate Base allocation methodology. *See* Volume
6 3, Informational Requirements, Document 12, Schedule 27.
7

8 The following testimony explains these schedules.

9
10 Q. DOES YOUR TESTIMONY ADDRESS ANY OTHER FILING REQUIREMENTS?

11 A. Yes, it does. The Minnesota Public Utilities Commission's ("Commission") June 29,
12 2009 Findings of Fact, Conclusions of Law, and Order ("Final Order") in Docket No. G-
13 007,011/GR-08-835, required that in future class cost of service studies filed in general
14 rate cases that the Company allocate income taxes on the basis of the taxable income
15 attributable to each customer class, rather than on the basis of rate base. Included in
16 Volume 3, Informational Requirement Document 12, Schedules 1, 12, and 21,
17 respectively, are class cost of service studies for MERC-PNG, MERC-NMU, and MERC-
18 Consolidated that allocate income taxes on the basis of taxable income. As discussed
19 further in my testimony, I have also provided class cost of service studies that allocate
20 income taxes on the basis of rate base and propose that the Commission adopt this
21 allocation methodology as it better allocates costs to customers based on cost causation.
22 *See* Volume 3, Informational Requirement Document 12, Schedules 18 (MERC-NMU), 9
23 (MERC-PNG), and 27 (MERC-Consolidated).

24
25 In the Final Order, the Commission also required that in future class cost of service
26 studies filed in general rate cases, that MERC include an explanatory filing identifying

1 and describing each allocation method used in the study and detailing the reasons for
2 concluding that each allocation method is appropriate and superior to other allocation
3 methods considered. Volume 3, Informational Requirement Document 12, Schedules 31-
4 33, includes these explanatory filings for MERC-PNG, MERC-NMU, and MERC-
5 Consolidated, respectively.

6
7 Q. PLEASE EXPLAIN WHY YOU HAVE PREPARED SEPARATE COST OF SERVICE
8 STUDIES FOR MERC-NMU, MERC-PNG, AND MERC-CONSOLIDATED.

9 A. MERC provides gas service to its customers in Minnesota through its two operating
10 divisions MERC-NMU and MERC-PNG, and MERC currently submits separate cost of
11 service studies for each division. *See* Stipulation and Agreement, Docket No.
12 G007,011/GR-00-951 (Mar. 31, 2003) at 36. Additionally, in this rate proceeding MERC
13 is proposing to consolidate the rate areas of its MERC-NMU and MERC-PNG operating
14 divisions. I therefore provide class cost of service studies for a consolidated MERC
15 system in addition to those prepared for MERC-NMU and MERC-PNG.

16

1 **II. GENERAL INFORMATION**

2 Q. WHAT IS THE PURPOSE OF A CLASS COST OF SERVICE STUDY?

3 A. The purpose of a Class Cost of Service Study (“CCOSS”) is to identify the revenues,
4 costs and profitability for each class of service, as required by Minn. R. 7825.4300(C).
5 The CCOSS analysis should result in an appropriate allocation of the utility’s total
6 revenue requirement among the various customer classes.

7
8 Q. HOW IS A CCOSS PREPARED?

9 A. The CCOSSs for MERC-PNG, MERC-NMU, and MERC-Consolidated are fully
10 allocated, embedded cost of service studies. In general, preparing a CCOSS involves
11 three major steps: (1) cost functionalization; (2) cost classification, and (3) cost
12 allocation of all the costs of the utility’s system to the customer classes.

13
14 The first step, cost functionalization, identifies and separates plant and expenses into
15 specific categories based on the various characteristics of utility operation. MERC’s
16 functional cost categories associated with gas service include: Production, Transmission,
17 Distribution, and Customer.

18
19 Step two, cost classification, further separates the functionalized plant and expenses into
20 the cost defining characteristics of: (1) Commodity related, which for MERC can be
21 further broken down into categories of Purchased Gas Cost and Gas Supply Acquisition,
22 (2) Demand, which can be further broken down into the categories of capacity related and

1 Daily Firm Capacity related; and (3) Customer related, which for MERC can be further
2 broken down into the categories of Fixed Costs and Enhanced Services.

3
4 The final step of preparing a CCOSS is allocation of each functionalized and classified
5 cost element to the customer classes.

6
7 Q. ARE THERE ANY DIFFERENCES IN THE CCOSSs PRESENTED IN THIS
8 PROCEEDING AND THE CCOSSs THE COMMISSION USED AS THE BASIS FOR
9 SETTING RATES IN THE COMPANY'S LAST GENERAL RATE CASE IN
10 DOCKET NO. G007,011/GR-08-835?

11 A. Yes, there are. In the Final Order, the Commission required that in future class cost of
12 service studies filed in general rate cases, that MERC include an explanatory filing
13 identifying and describing each allocation method used in the study and detailing the
14 reasons for concluding that each allocation method is appropriate and superior to other
15 allocation methods considered. In doing this, MERC made changes to four allocation
16 methodologies:

17 1) The use of the Average-Customer allocation method was eliminated from the
18 CCOSSs and replaced with the use of the Customer allocation method. The Average-
19 Customer allocation method was comprised of total yearly bill counts divided by 12,
20 which in effect, produces the same allocation percentage amounts as the Customer
21 allocation method, which is comprised of total yearly bill counts. Therefore the
22 Average-Customer allocation method was eliminated to remove redundancy within
23 the CCOSSs.

- 1 2) Account 487: Late Payments was previously allocated to Residential customers only,
2 and is now allocated using the Customer allocation method. In reviewing the
3 allocation methods used in the CCOSSs, MERC determined that the Customer
4 allocation method is the most appropriate method to allocate these costs because all
5 customer classes cause the Company to incur costs for late payments. *See* Volume 3,
6 Informational Requirement Document 12, Schedules 31-33 at 8.
- 7 3) Account 378: Measuring & Regulation Equipment - General was previously allocated
8 using the Account 378 Demand allocation method that included Main Line
9 customers. It is now allocated using an updated Account 378 Demand allocation that
10 does not include the Main Line customers. In reviewing the allocation methods used
11 in the CCOSSs, MERC concluded that it is appropriate to allocate these costs only to
12 General Service and Small Volume rate schedules because these are the only
13 customer classes that utilize these assets, which consist mainly of regulating stations
14 at the distribution system level. . *See* Volume 3, Informational Requirement
15 Document 12, Schedules 31-33 at 5.
- 16 4) Account 379: Measuring & Regulation Equipment - Gate Station was previously
17 allocated to only General Service customers through the use of the GS Peak Demand
18 allocation method. It is now allocated using the TP Peak Demand allocation, which
19 allocates costs to all Town Plant customers. In reviewing the allocation methods used
20 in the CCOSSs, MERC determined that use of the TP Peak Demand allocation
21 method is the most appropriate method to allocate these costs because all Town Plant
22 customers cause the Company to incur these costs. *See* Volume 3, Informational
23 Requirement Document 12, Schedules 31-33 at 3-4.

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Q. ARE ANY OF THESE CHANGES SUBSTANTIVE?

A. No. While the changes to these four allocation methodologies provide more accurate, cost-based CCOSSs, MERC does not feel that these changes are material.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. In sections III to VII, I explain the factors I used to allocate distribution, transmission, production, customer, and administrative and general costs to the rate schedules. In section VIII, I describe four unique allocators used to distribute remaining costs in the CCOSS. Section IX provides a roadmap to the schedules that present the CCOSSs for MERC-PNG, MERC-NMU and MERC-Consolidated.

Q. WOULD YOU PLEASE EXPLAIN THE PROCEDURES USED TO DEVELOP THE COST OF SERVICE STUDIES SHOWN IN INFORMATIONAL REQUIREMENT DOCUMENT 12?

A. There are six CCOSSs submitted for the 2011 proposed test year in the instant general rate case proceeding: two for the MERC-NMU service territory, two for the MERC-PNG service territory, and two for the MERC-Consolidated service territory. All values in the CCOSSs are allocated to each rate schedule as described in the far right-hand column of each page titled "Source or Allocation Factor". Direct assignment of values to the appropriate rate schedules was conducted whenever possible, as recommended by both the American Gas Association ("AGA") in their Fourth Edition of Gas Rate Fundamentals (1987), page 140 as well as the National Association of Regulatory

1 Commissioners (“NARUC”) in their Gas Distribution Rate Design Manual (1989), page
2 31.

3
4 Q. PLEASE DESCRIBE HOW YOU DEFINED THE CUSTOMER CLASSES IN YOUR
5 COST OF SERVICE STUDIES.

6 A. In the two CCOSSs provided for MERC-NMU and the two CCOSSs provided for
7 MERC-PNG, the customer classes that were utilized generally follow the rate schedules
8 under which MERC currently provides service in the MERC-NMU and MERC-PNG
9 service territories. In the remaining two CCOSSs for the MERC-Consolidated service
10 territory, the customer classes that were utilized are those presented in the Direct
11 Testimony and schedules of MERC witness Mr. Greg Walters.

12
13 The classes shown in the MERC-NMU CCOSSs consist of the following:

- 14 1. General Service - Residential,
- 15 2. General Service – Small Commercial and Industrial (“C&I”),
- 16 3. General Service – Large C&I,
- 17 4. Small Volume Interruptible Service (“SVI”),
- 18 5. Large Volume Interruptible Service (“LVI”) Town Plant (“TP”),
- 19 6. Transportation – Small Volume Interruptible Service,
- 20 7. Transportation – Small Volume Joint Firm/Interruptible Service (“SVJ”),¹
- 21 8. Transportation – Large Volume Interruptible Service Town Plant,
- 22
- 23
- 24
- 25
- 26
- 27
- 28

¹ Although the Commission approved the consolidation of MERC’s joint and interruptible rate schedules in the Company’s last rate case, to correctly allocate costs to customers taking joint service, I separately calculate the cost of service for interruptible customers and joint firm/interruptible customers.

- 1
- 2 9. Transportation – Large Volume Interruptible Service Mainline (“ML”),
- 3
- 4 10. Transportation – Large Volume Joint Firm/Interruptible Service (“LVJ”)
- 5 Town Plant, and
- 6
- 7 11. Transportation – Super Large Volume Interruptible Service (“SLVI”).
- 8

9 There are no customers currently being served firm sales under MERC-NMU’s Large
10 Volume Interruptible Service Mainline, Small Volume Joint Firm/Interruptible Service,
11 or Large Volume Joint Firm/Interruptible (“LVJ”) Service rate schedules.

12

13 The classes shown in the MERC-PNG CCOSs consist of the following:

- 14 1. General Service – 1, which includes the rate schedules GS-1 Residential, GS-
15 1 Small C&I, and GS-1 Large C&I served by Northern Natural Gas,
- 16
- 17 2. General Service - 4, which includes the rate schedules GS-4 Residential, GS-4
18 Small C&I, and GS-4 Large C&I served by Viking Gas Transmission,
- 19
- 20 3. General Service - 5, which includes the rate schedules GS-5 Residential, GS-5
21 Small C&I, and GS-5 Large C&I served by Great Lakes Gas Transmission,
- 22
- 23 4. Small Volume Interruptible Service, which includes the rate schedules SVI-1
24 served by Northern Natural Gas, SVI-4 served by Viking Gas Transmission,
25 and SVI-5 served by Great Lakes Gas Transmission,
- 26
- 27 5. Large Volume Interruptible Service, which includes the rate schedules LVI-1
28 TP and LVI-1 ML served by Northern Natural Gas, LVI-4 served by Viking
29 Gas Transmission, and LVI-5 served by Great Lakes Gas Transmission,
- 30
- 31 6. Small Volume Joint Firm/Interruptible Service, which includes the rate
32 schedules SVJ-1 served by Northern Natural Gas, SVJ-4 served by Viking
33 Gas Transmission, and SVJ-5 served by Great Lakes Gas Transmission,
- 34
- 35 7. Transportation – Small Volume Interruptible Service, which includes the rate
36 schedules Transport - SVI-1 served by Northern Natural Gas, Transport - SVI-
37 4 served by Viking Gas Transmission, and Transport - SVI-5 served by Great
38 Lakes Gas Transmission,
- 39

- 1 8. Transportation – Small Volume Joint Firm/Interruptible Service, which
2 includes the rate schedules Transport – SVJ-1 served by Northern Natural Gas
3 and Transport – SVJ-4 served by Viking Gas Transmission,
4
- 5 9. Transportation – Large Volume Interruptible Service, which includes the rate
6 schedules Transport - LVI-1 TP and Transport – LVI – 1 ML served by
7 Northern Natural Gas, and Transport - LVI-5 TP served by Great Lakes Gas
8 Transmission,
9
- 10 10. Transportation – Large Volume Joint Firm/Interruptible Service Town Plant,
11 which includes the rate schedules Transport - LVJ-1 TP served by Northern
12 Natural Gas, Transport – LVJ-4 served by Viking Gas Transmission, and
13 Transport - LVJ-5 TP served by Great Lakes Gas Transmission,
14
- 15 11. Transportation – Super Large Volume Joint Firm/Interruptible (“SLVJ”)
16 Service,
17
- 18 12. Transportation – Super Large Volume Interruptible Service,
19
- 20 13. Transportation – Large Volume Interruptible FLEX Service Town Plant,
21
- 22 14. Transportation – Large Volume Joint Firm/Interruptible Service Town Plant,
23
- 24 15. Transportation – Large Volume Joint Firm/Interruptible Service Mainline, and
25
- 26 16. Transportation for Resale.
27
28
29

30 There are no customers currently being served firm service under MERC-PNG’s Large
31 Volume Joint Firm/Interruptible Service.

32 The classes shown in the MERC-Consolidated CCOSs consist of the following:

- 33 1. General Service – NNG, which includes the rate schedules GS Residential -
34 NNG, GS Small C&I - NNG, and GS Large C&I - NNG served by Northern
35 Natural Gas,
36
- 37 2. General Service - Consolidated, which includes the rate schedules GS
38 Residential - Consolidated, GS Small C&I - Consolidated, and GS Large C&I
39 - Consolidated served by the proposed consolidated pipelines of Centra, Great
40 Lakes Gas Transmission and Viking Gas Transmission,
41

- 1 3. Small Volume Interruptible Service, which includes the rate schedules SVI –
2 NNG, served by Northern Natural Gas, and SVI - Consolidated served by the
3 proposed consolidated pipelines of Centra, Great Lakes Gas Transmission and
4 Viking Gas Transmission,
5
- 6 4. Large Volume Interruptible Service, which includes the rate schedules LVI-
7 TP - NNG and LVI-ML - NNG served by Northern Natural Gas, and LVI –
8 Consolidated served by the proposed consolidated pipelines of Centra, Great
9 Lakes Gas Transmission and Viking Gas Transmission,
10
- 11 5. Small Volume Joint Firm/Interruptible Service, which includes the rate
12 schedules SVJ - NNG served by Northern Natural Gas and SVJ –
13 Consolidated served by the proposed consolidated pipelines of Centra, Great
14 Lakes Gas Transmission and Viking Gas Transmission,
15
- 16 6. Transportation – Small Volume Interruptible Service, which includes the rate
17 schedules Transport – SVI - NNG served by Northern Natural Gas and
18 Transport – SVI - Consolidated served by the proposed consolidated pipelines
19 of Centra, Great Lakes Gas Transmission and Viking Gas Transmission,
20
- 21 7. Transportation – Small Volume Joint Firm/Interruptible Service, which
22 includes the rate schedules Transport – SVJ - NNG served by Northern
23 Natural Gas and Transport – SVJ - Consolidated served by the proposed
24 consolidated pipelines of Centra, Great Lakes Gas Transmission and Viking
25 Gas Transmission,
26
- 27 8. Transportation Large Volume Interruptible Service, which includes the rate
28 schedules Transport - LVI-TP - NNG and Transport - LVI-ML - NNG served
29 by Northern Natural Gas, and Transport - LVI – Consolidated served by the
30 proposed consolidated pipelines of Centra, Great Lakes Gas Transmission and
31 Viking Gas Transmission,
32
- 33 9. Transportation – Large Volume Joint Firm/Interruptible Service Town Plant,
34 which includes the rate schedules Transport – LVJ-TP - NNG served by
35 Northern Natural Gas, and Transport – LVJ-TP – Consolidated served by the
36 proposed consolidated pipelines of Centra, Great Lakes Gas Transmission and
37 Viking Gas Transmission,
38
- 39 10. Transportation – Super Large Volume Joint Firm/Interruptible Service, served
40 by Northern Natural Gas,
41
- 42 11. Transportation – Super Large Volume Interruptible Service, which includes
43 the rate schedules Transport – SLVI - NNG served by Northern Natural Gas,
44 and Transport – SLVI – Consolidated served by the proposed consolidated

1 pipelines of Centra, Great Lakes Gas Transmission and Viking Gas
2 Transmission,

3
4 12. Transportation – Large Volume Interruptible FLEX Service Town Plant
5 served by Northern Natural Gas,

6
7 13. Transportation – Large Volume Joint Firm/Interruptible FLEX Service Town
8 Plant served by Northern Natural Gas,

9
10 14. Transportation – Large Volume Joint Firm/Interruptible FLEX Service
11 Mainline served by Northern Natural Gas, and

12
13 15. Transportation for Resale.
14

15 Q. PLEASE DESCRIBE MERC'S APPROACH IN THE DEVELOPMENT OF ITS COST
16 OF SERVICE STUDIES.

17 A. MERC's CCOSs attempt to associate costs with customers based on cost causation. In
18 following the direction of the AGA in their Fourth Edition of Gas Rate Fundamentals
19 (1987), pages 136 and 137, there are some cases where there can be a direct association
20 of costs to customers based on causation. For example, some plant costs such as
21 investment in meters and services can be directly associated with customers. In other
22 cases, causation can be based on a direct relationship between costs and some parameter
23 that can be related to customers. An example of this is gas supply acquisition costs,
24 which has a direct relationship to customers' sales. Therefore, gas supply acquisition
25 costs are allocated to customers based on sales. Other costs may have relationships to
26 customer parameters that are not direct, but are significantly influenced by those
27 parameters. As stated by the NARUC in their Cost Allocation Manual (1973), page 54,
28 distribution system costs fall into this category.
29

1 Q. PLEASE SUMMARIZE THE RESULTS OF THE CCROSSs.
 2 A. The results with respect to revenue deficiency by customer class based on the requested
 3 revenue requirement are summarized below for the MERC-NMU, MERC-PNG, and
 4 MERC-Consolidated service territories.
 5

MERC - NMU	Income Taxes Allocated on Net Income		Income Taxes Allocated on Rate Base	
	Revenue Deficiency/(Surplus)		Revenue Deficiency/(Surplus)	
	\$	%	\$	%
GS-NMU Residential	3,145,864	10.43%	5,885,249	19.51%
GS-NMU SC&I	209,511	8.88%	328,966	13.94%
GS-NMU LC&I	123,900	0.71%	(1,559,187)	(8.88%)
SVI-NMU Sales	(56,444)	(0.96%)	(578,199)	(9.84%)
LVI-NMU Town Plant Sales	7,310	0.23%	(73,302)	(2.31%)
SVI-NMU Transport	(18,667)	(13.07%)	(107,829)	(75.50%)
SVJ-NMU Transport	(11,605)	(5.61%)	(119,481)	(57.72%)
LVI-NMU Town Plant Transport	(42,086)	(11.55%)	(258,825)	(71.01%)
LVI-NMU Mainline Transport	-	-	-	-
LVJ-NMU Town Plant Transport	(6,747)	(5.41%)	(69,778)	(55.98%)
SLVI-NMU Town Plant Transport	30,846	7.54%	(65,734)	(16.06%)

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7

MERC - PNG	Income Taxes Allocated on Net Income		Income Taxes Allocated on Rate Base	
	Revenue Deficiency/(Surplus)		Revenue Deficiency/(Surplus)	
	\$	%	\$	%
GS-1 Residential Sales	10,194,507	7.64%	18,985,854	14.23%
GS-1 SC&I Sales	440,009	7.16%	690,931	11.25%
GS-1 LC&I Sales	235,745	0.40%	(4,998,346)	(8.51%)
GS-4 Residential Sales	282,120	9.75%	579,366	20.03%
GS-4 SC&I Sales	21,771	9.14%	38,510	16.16%
GS-4 LC&I Sales	17,101	0.86%	(166,174)	(8.33%)
GS-5 Residential Sales	367,699	9.38%	724,930	18.49%
GS-5 SC&I Sales	30,182	7.03%	41,710	9.72%
GS-5 LC&I Sales	15,106	0.48%	(304,308)	(9.69%)
SVI-1 Sales	(91,996)	(0.92%)	(1,310,384)	(13.17%)
SVI-4 Sales	(6,169)	(1.06%)	(79,745)	(13.76%)
SVI-5 Sales	(1,004)	(0.78%)	(17,185)	(13.34%)
LVI-1 Town Plant Sales	9,939	0.26%	(142,085)	(3.66%)
LVI-1 Mainline Sales	(95)	(0.07%)	(5,495)	(3.79%)
LVI-4 Sales	1,857	0.28%	(18,058)	(2.77%)
SVJ-1 Sales	(788)	(0.68%)	(15,280)	(13.16%)
SVJ-4 Sales	(391)	(0.48%)	(11,059)	(13.56%)
SVJ-5 Sales	758	0.39%	(22,245)	(11.57%)
SVI-1 Transport	(32,025)	(13.25%)	(212,220)	(87.78%)
SVI-4 Transport	(3,777)	(9.40%)	(29,393)	(73.19%)
SVI-5 Transport	(6,272)	(11.01%)	(45,066)	(79.09%)
SVJ-1 Transport	(10,149)	(9.22%)	(83,438)	(75.80%)
SVJ-4 Transport	(2,025)	(7.50%)	(18,942)	(70.17%)
LVI-1 Town Plant Transport	(145,266)	(10.08%)	(1,126,529)	(78.13%)
LVI-1 Mainline Transport	(1,084)	(3.02%)	(9,860)	(27.50%)
LVI-5 Town Plant Transport	(1,751)	(9.46%)	(13,932)	(75.26%)
LVJ-1 Town Plant Transport	(134,640)	(6.66%)	(1,417,252)	(70.16%)
LVJ-4 Transport	2,227	3.55%	(26,579)	(42.42%)
LVJ-5 Town Plant Transport	(3,904)	(9.87%)	(30,792)	(77.84%)
SLVJ-1 Transport	382,610	87.92%	743,476	170.84%
SLVI-1 Transport	161,053	28.18%	166,103	29.06%
LVI-1 Town Plant Flex Transport	13,186	3.10%	(178,753)	(42.06%)
LVJ-1 Town Plant Flex Transport	16,926	11.42%	(30,145)	(20.35%)
LVJ-1 Mainline Flex Transport	33,693	88.83%	143,140	377.40%
Transport for Resale	(1,724)	(7.15%)	(17,328)	(71.86%)

MERC - Consolidated	Income Taxes Allocated on Net Income		Income Taxes Allocated on Rate Base	
	Revenue Deficiency/(Surplus)		Revenue Deficiency/(Surplus)	
	\$	%	\$	%
GS Residential NNG Sales	11,873,470	8.00%	22,235,595	14.99%
GS SC&I NNG Sales	516,942	7.33%	813,236	11.54%
GS LC&I NNG Sales	309,596	0.47%	(5,407,631)	(8.24%)
GS Residential Consolidated Sales	2,059,934	9.27%	3,817,585	17.18%
GS SC&I Consolidated Sales	163,906	7.74%	234,239	11.06%
GS LC&I Consolidated Sales	24,444	0.16%	(1,773,100)	(11.35%)
SVI NNG Sales	(123,256)	(0.97%)	(1,574,251)	(12.34%)
SVI Consolidated Sales	(35,722)	(0.93%)	(447,201)	(11.60%)
LVI Town Plant NNG Sales	10,279	0.23%	(159,460)	(3.52%)
LVI Mainline NNG Sales	(149)	(0.11%)	(5,432)	(3.89%)
LVI Consolidated Sales	9,664	0.31%	(77,853)	(2.53%)
SVJ NNG Sales	(584)	(0.50%)	(14,258)	(12.08%)
SVJ Consolidated Sales	1,228	0.45%	(29,929)	(10.96%)
SVI NNG Transport	(40,376)	(13.43%)	(257,119)	(85.53%)
SVI Consolidated Transport	(20,800)	(11.48%)	(142,080)	(78.45%)
SVJ NNG Transport	(9,543)	(7.43%)	(87,717)	(68.27%)
SVJ Consolidated Transport	(8,244)	(3.82%)	(131,489)	(60.99%)
LVI Town Plant NNG Transport	(154,921)	(10.67%)	(1,119,628)	(77.10%)
LVI Mainline NNG Transport	(1,147)	(3.20%)	(9,667)	(26.96%)
LVI Town Plant Consolidated Transport	(37,054)	(9.94%)	(280,455)	(75.26%)
LVJ Town Plant NNG Transport	(123,688)	(6.11%)	(1,346,234)	(66.46%)
LVJ Town Plant Consolidated Transport	(2,037)	(0.92%)	(115,811)	(52.35%)
SLVJ NNG Transport	492,849	113.25%	1,014,971	233.23%
SLVI NNG Transport	167,644	29.33%	205,405	35.94%
SLVI Consolidated Transport	23,495	5.74%	(126,487)	(30.91%)
LVI Town Plant Flex NNG Transport	24,241	6.65%	(105,248)	(28.88%)
LVJ Town Plant Flex NNG Transport	9,400	4.50%	(77,995)	(37.37%)
LVJ Mainline Flex NNG Transport	37,423	98.67%	150,096	395.74%
Transport for Resale	(1,687)	(7.00%)	(16,773)	(69.56%)

1
2 Q. HOW SHOULD THE COMMISSION REFLECT THE RESULTS OF YOUR CCOSs
3 IN RATE DESIGN?

4 A. Mr. Greg J. Walters presents MERC's requested rate design, based in part upon the
5 results of my CCOSs, and on other principles of rate design discussed in his testimony.

6

1 **III. ALLOCATION OF DISTRIBUTION COSTS**

2 Q. HOW DOES MERC ALLOCATE DISTRIBUTION COSTS TO CUSTOMERS IN THE
3 MERC-NMU, MERC-PNG, AND MERC-CONSOLIDATED COST OF SERVICE
4 STUDIES?

5 A. In the case of distribution costs, MERC has identified two significant cost causation
6 relationships. Some distribution costs are incurred in order for customers to simply be
7 connected to the distribution system. Other distribution costs are incurred due to the
8 level of the demand of the customers.

9
10 Some gas distribution demand related costs are influenced by the sizing of facilities based
11 on the coincident consumption of gas on the distribution facilities. These costs are
12 allocated based upon a form of the weighted group peak demand. An example of these
13 costs would be Accounts 378 and 379, measuring and regulating station equipment.

14
15 Other demand related costs of gas distribution facilities, such as the demand related
16 portion of Account 376, gas mains, are influenced by both the customer maximum
17 demand and the coincident group demand. In the CCOSSs, these costs were allocated to
18 rate schedules based upon a form of the weighted group peak demand, a daily firm
19 capacity allocation, as well as a customer count basis.

20
21 MERC has performed minimum-intercept distribution system studies that identify a
22 hypothetical no-load situation with respect to the transmission and distribution gas mains
23 used to connect customers to the system regardless of their gas usage or demand. The

1 costs needed to support the minimum-intercept distribution system have a relationship to
2 the number of customers, and are allocated on that basis. The costs in excess of the
3 minimum-intercept system are related to the demand of customers, and are therefore
4 allocated based on the customers' demands in the form of a weighted peak demand
5 allocator and a daily firm capacity allocator.

6
7 Specifically, distribution costs are allocated within the CCOSs based upon the following
8 methods:

- 9 1. Accounts 301, 302 & 303 Intangible Plant, 374 Land and Land Rights, and 375
10 Structures and Improvements were allocated to all rate schedules based on the
11 weighted peak demand allocator.
12
- 13 2. Account 376 Gas Distribution Mains utilized a zero-intercept method based on a
14 regression of cost per foot versus pipe diameter squared within the MERC-NMU
15 service territory and the MERC-PNG service territory individually, as well as for
16 a MERC-Consolidated service territory. These analyses are shown in
17 Informational Requirement Document 12, Schedules 5, 16, and 25 respectively
18 for MERC-PNG, MERC-NMU and MERC-Consolidated.
19

20 The regression analyses provided a split of system distribution gas mains costs
21 that are attributable to fixed costs and demand related costs. The regression
22 analysis for MERC-PNG shows 76.1% of the costs are attributable to the
23 hypothetical no-load system; the remaining 23.9% are attributable to customer
24 demand. The regression analysis for MERC-NMU shows 64.7% of the costs are
25 attributable to the hypothetical no-load system; the remaining 35.3% are
26 attributable to customer demand. The regression analysis for MERC-Consolidated
27 shows 73.2% of the costs are attributable to the hypothetical no-load system; the
28 remaining 26.8% are attributable to customer demand.
29

30 The hypothetical no-load minimum system piece was allocated to each of the rate
31 schedules based upon customer counts for non-Mainline customers connected to
32 the system. The customer demand piece was broken down one step further into
33 the two sub-components of customer demand and daily firm capacity ("DFC").
34 The customer demand piece of the analyses was allocated to rate schedules based
35 upon firm peak demand, and the daily firm capacity piece of the customer demand
36 was allocated to rate schedules based upon a DFC allocator.

1 A minimum-size analysis was also performed on MERC's transmission and
2 distribution mains, and provides comparable results to the zero intercept method.
3 A minimum-size analysis is similar to a minimum-intercept analysis, but rather
4 than assuming a hypothetical no-load situation, the minimum-size analysis is built
5 upon the assumption that a minimum-size system can be built to serve the
6 minimum load requirements of customers. Both the minimum-intercept and
7 minimum-size methods are described as acceptable means of determining demand
8 and customer cost splits by NARUC in both their Cost Allocation Manual (1992)
9 and Gas Distribution Rate Design Manual (1989). The minimum size analyses
10 performed on MERC's transmission and distribution assets are shown in
11 Informational Requirement Document 12, Schedules 6, 17, and 26 respectively
12 for MERC-PNG, MERC-NMU and MERC-Consolidated.
13

- 14 3. Account 377 Compressor Station Equipment was allocated based on therm
15 throughput.
16
- 17 4. Account 378 Measuring & Regulation Equipment – General was allocated based
18 on the Account 378 demand allocator, which is a variation of the weighted peak
19 demand allocator, and allocates costs to only the General Service and Small
20 Volume rate schedules.
21
- 22 5. Account 379 Measuring & Regulation Equipment – Gate Station was allocated
23 based on the Town Plant (TP) demand allocator, which is a variation of the
24 weighted peak demand allocator, and allocates costs to only Town Plant rate
25 schedules.
26
- 27 6. Account 380 Services was allocated on a customer basis, using a weighting factor
28 of Cost Per Customer for Services which was derived from an average of the three
29 years of actual plant investment as of December 31, 2007, December 31, 2008,
30 and December 31, 2009 categorized by associated meter size.
31
- 32 7. Account 381 Meters and Account 382 Meter Connections & Installations were
33 allocated on a meter count basis, using a weighting factor of Cost Per Meter
34 which was based on actual plant investment as of December 31, 2009 by rate
35 schedule.
36
- 37 8. Account 383 House Regulators was allocated on a customer basis to only the
38 General Service and Small Volume rate schedules.
39
- 40 9. Account 385 Industrial Metering & Regulating Station Equipment was allocated
41 based on the weighted peak demand of industrial sized customers only, excluding
42 Mainline industrial sized customers.
43

44

1 **IV. ALLOCATION OF TRANSMISSION COSTS**

2 Q. HOW DOES MERC ALLOCATE TRANSMISSION COSTS TO EACH RATE
3 SCHEDULE IN THE MERC-NMU, MERC-PNG AND MERC-CONSOLIDATED
4 COST OF SERVICE STUDIES?

5 A. For the MERC-NMU, MERC-PNG, and MERC-Consolidated service territories,
6 transmission costs are allocated based upon the same methodology conducted for
7 Account 376 Gas Distribution Mains. MERC utilized a zero-intercept regression analysis
8 of cost per foot versus pipe diameter squared for both the MERC-NMU and MERC-PNG
9 service territories combined. Unlike distribution mains, there was a minimal amount of
10 data with respect to transmission mains, requiring the MERC-NMU and MERC-PNG
11 service territories' data to be combined in order to be able to conduct a meaningful
12 regression analysis. The regression analysis, which can be found in Informational
13 Requirement Document 12, Schedule 7, provided a percentage of the system transmission
14 mains that are attributable to fixed costs, which is 57.3%, and the remaining percentage,
15 42.7%, is assumed to be attributable to customer demand. The fixed costs were then
16 allocated to the rate schedules based on customer counts for non-Mainline customers.
17 The customer demand piece is broken down one step further into the two sub-
18 components of customer demand and daily firm capacity. The customer demand piece
19 was allocated to rate schedules based upon firm peak demand, and the daily firm capacity
20 piece of the customer demand was allocated to rate schedules based upon a DFC
21 allocator.

22

1 A minimum-size analysis was also performed on transmission mains and provides
2 comparable results to the zero-intercept method. The minimum-size analyses are shown
3 in Informational Requirement Document 12, Schedule 8 for the MERC-NMU and
4 MERC-PNG service territories' data combined.

5
6 Q. IN THE COMPANY'S LAST RATE CASE IN DOCKET NO. G007,011/GR-08-835,
7 OFFICE OF ENERGY SECURITY WITNESS MR. ADAM HEINEN NOTED
8 CONCERNS REGARDING THE RELIABILITY OF THE REGRESSION ANALYSES
9 FOR DISTRIBUTION AND TRANSMISSION MAINS. HAVE YOU ADDRESSED
10 MR. HEINEN'S CONCERNS IN THIS PROCEEDING?

11 A. Yes. Mr. Heinen's concerns regarding the regression analyses for distribution and
12 transmission mains should be alleviated by MERC providing a minimum-size analysis,
13 which provides results that are comparable to the zero-interception method, and its
14 associated regression analyses. *See* Volume 3, Informational Requirement Document 12,
15 Schedules 6, 17, and 26 for the minimum-size analyses for MERC-PNG, MERC-NMU
16 and MERC-Consolidated, respectively.

1 **V. ALLOCATION OF PRODUCTION COSTS**

2 Q. HOW DOES MERC ALLOCATE PRODUCTION COSTS TO CUSTOMERS WITHIN
3 THE MERC-NMU, MERC-PNG AND MERC-CONSOLIDATED COST OF SERVICE
4 STUDIES?

5 A. MERC first classifies production costs within the appropriate categories of Purchased
6 Gas, Gas Supply Acquisition, Daily Firm Capacity, and Demand. Once assigned to these
7 four classifications, costs are then allocated to the rate schedules based on the
8 Commodity Cost allocator for Purchased Gas, the Sales allocator for Gas Supply
9 Acquisition costs, the DFC allocator for Daily Firm Capacity costs, or the Firm Peak
10 Demand allocator for Demand costs.

11

1 **VI. ALLOCATION OF CUSTOMER COSTS**

2 Q. HOW DOES MERC ALLOCATE CUSTOMER COSTS TO EACH RATE SCHEDULE
3 WITHIN THE MERC-NMU, MERC-PNG, AND MERC-CONSOLIDATED COST OF
4 SERVICE STUDIES?

5 A. In general, customer costs are allocated based on total annual customer counts by rate
6 schedule.

7
8 Costs that could be directly related to customers that utilize transmission service (i.e.
9 Non-Mainline customers) were identified and allocated directly to those customers based
10 upon a specific Customer – Transmission allocator. Costs that could be directly related
11 to General Service and Small Volume customers were identified and allocated directly to
12 those customers based upon a specific Customer – GS & Small Volume allocator. Costs
13 that could be directly related to Residential customers were identified and allocated
14 directly to those customers based upon a specific Customer – Residential allocator. Costs
15 that could be directly related to transportation customers were identified and allocated
16 directly to those customers based upon a specific Transport Customer allocator. All of
17 these specific allocators are shown on Informational Requirement Document 12,
18 Schedule 3, 14, and 23 for MERC-PNG, MERC-NMU and MERC-Consolidated,
19 respectively.
20

1 **VII. ALLOCATION OF ADMINISTRATIVE AND GENERAL COSTS**

2 Q. HOW DOES MERC ALLOCATE ADMINISTRATIVE AND GENERAL COSTS TO
3 EACH RATE SCHEDULE IN THE MERC-NMU, MERC-PNG, AND MERC-
4 CONSOLIDATED COST OF SERVICE STUDIES?

5 A. First, a piece of Administrative and General (“A&G”) costs are directly allocated to
6 transportation customers based upon a proportional split of direct assigned O&M
7 Customer Accounts Expense (Accounts 901-905) to Total O&M Expense (excluding any
8 direct assigned costs or purchased gas costs). Once the transportation direct assigned
9 piece of A&G is calculated, the remaining A&G is classified to Gas Supply Acquisition,
10 Daily Firm Capacity, Demand and Fixed Cost classifications according to the proportion
11 of Total O&M Expense (excluding any direct assigned costs or purchased gas costs),
12 which can be found on Line 35 of Informational Requirement Document 12, Schedules 1
13 and 9 for MERC-PNG, Schedules 12 and 18 for MERC-NMU, and Schedules 21 and 27
14 for MERC-Consolidated. Once classified, the Gas Supply Acquisition costs are then
15 allocated to rate schedules based upon the Sales allocator, the Daily Firm Capacity costs
16 are allocated based upon the DFC allocator, the Demand costs are allocated based upon
17 the Weighted Peak Demand allocator, and the Fixed costs are allocated based upon the
18 Customer allocator. The direct assigned transportation A&G costs are allocated to only
19 the transportation rate schedules based upon the Transport Customer allocator.

20

1 **VIII. UNIQUE ALLOCATIONS**

2 Q. PLEASE DESCRIBE THE REMAINING COMPONENTS OF THE MERC-NMU,
3 MERC-PNG, AND MERC-CONSOLIDATED CLASS COST OF SERVICE STUDIES
4 THAT HAVE UNIQUE ALLOCATORS.

5 A. The remaining components of the MERC-NMU, MERC-PNG and MERC-Consolidated
6 CCOSs which have unique allocators are as follows:

- 7 1. Taxes other than Income Taxes (“TOTIT”) associated with Real Estate &
8 Property and Unauthorized Insurance Tax, and Miscellaneous Revenues in
9 Account 493 were allocated to the rate schedules based upon a Rate Base
10 allocator, which was created on pages 1 - 4 of Informational Requirement
11 Document 12, Schedule 1 for MERC-PNG, page 1 of Informational Requirement
12 No. 12, Schedule 12, for MERC-NMU, and pages 1 - 4 of Informational
13 Requirement Document 12, Schedule 21 for MERC-Consolidated. In Schedules
14 9, 18, and 27, of Informational Requirement Document 12, Income Taxes are also
15 allocated to the rate schedules based upon a Rate Base allocator for MERC-PNG,
16 MERC-NMU, and MERC-Consolidated, respectively.
17
- 18 2. In Schedule 1, 12, and 21, Income Taxes were allocated to the rate schedules
19 based upon a Net Income allocator, which was created on pages 1 - 4 of
20 Informational Requirement Document 12, Schedule 1 for MERC-PNG, page 1 of
21 Informational Requirement Document 12, Schedule 12, for MERC-NMU, and
22 pages 1 - 4 of Informational Requirement Document 12, Schedule 21 for MERC-
23 Consolidated.
24
- 25 3. TOTIT relating to Unemployment Compensation, Tax Credit, IBS Payroll Tax,
26 and Retirement Benefits are allocated to the rate schedules based upon a Salaries
27 and Wages allocator, which can be found in Informational Requirement
28 Document 12, Schedule 3, 14, and 23 for MERC-PNG, MERC-NMU, and
29 MERC-Consolidated, respectively.
30
- 31 4. Transmission related Working Capital and Transmission related Regulatory
32 Assets & Liabilities are allocated to the rate schedules based upon a Town Plant
33 Peak Demand allocator, which is a variation of the weighted peak demand
34 allocator, and allocates costs to only the Town Plant rate schedules. The Town
35 Plant Peak Demand allocator can be found in Informational Requirement
36 Document 12, Schedule 3, 14, and 23 for MERC-PNG, MERC-NMU, and
37 MERC-Consolidated, respectively.
38
39

1 **IX. NATURAL GAS COST OF SERVICE STUDIES**

2 Q. PLEASE DESCRIBE SCHEDULE 1 OF INFORMATIONAL REQUIREMENT
3 DOCUMENT 12.

4 A. Schedule 1 shows the summarized results of MERC's natural gas embedded CCOSS for
5 the MERC-PNG service territory for the 2011 proposed test year expenses. Schedule 1
6 consists of 50 pages, and meets the requirements of Order Point 7 of the Commission's
7 Final Order in Docket No. G-007,011/GR-08-835, requiring that future CCOSSs must
8 allocate income taxes on the basis of the taxable income attributable to each customer
9 class.

10
11 Pages 1 through 4 summarize the various components of the operating income, operating
12 expenses, and rate base to the MERC-PNG rate schedules. Line 42 of pages 1 through 4
13 shows the Rate of Return resulting from operations. Line 54 of pages 1 through 4 shows
14 the amount revenue deficiency by rate class based on the required rate of return on
15 common equity of 11.25%, which is MERC's requested return on common equity in this
16 general rate case proceeding and is supported by the testimony of MERC witness Mr.
17 Paul Moul. Line 58 of pages 1 through 4 shows the percentage of revenue deficiency by
18 rate class with cost of gas excluded. Pages 1 through 4 also include the creation of the
19 allocation methodology for Rate Base, which is used throughout other pages of the
20 CCOSS, and the creation of the allocation methodology for Net Income which is used to
21 allocate Income Taxes.

22

1 Pages 5 through 8 contain the Operating Revenues for the MERC-PNG service territory
2 by rate schedule based on the rates authorized in MERC's last general rate case
3 proceeding in Docket No. G007,011/GR-08-835.
4

5 Pages 9 through 12 contain the Allocation of Operation and Maintenance ("O&M")
6 Expenses for the MERC-PNG service territory. Page 50 contains a detailed breakdown
7 of the classification of O&M Expenses that were utilized on Pages 9 through 12. Page 50
8 also includes the creation of the classificational methodology titled Total O&M
9 (excluding direct assigned and purchased gas cost related items), which is used to classify
10 costs in other areas of the CCOSS. Direct allocations were made whenever possible.
11

12 Pages 13 through 16 contain the Allocation of Depreciation Expenses, with General
13 expense apportioned, for the MERC-PNG service territory. Page 49 contains a detailed
14 breakdown of the classification of Depreciation Expenses that was utilized on Pages 13
15 through 16.
16

17 Pages 17 through 20 contain the Allocation of Taxes Other Than Income Taxes for the
18 MERC-PNG service territory.
19

20 Pages 21 through 24 contain the Allocation of Other Income and Adjustments, for both
21 Before Income Taxes as well as After Income Taxes, for the MERC-PNG service
22 territory. In the 2011 proposed test year, there were no Other Income and Adjustments.
23

1 Pages 25 through 28 contain the Allocation of Plant in Service, with General expense
2 apportioned, for the MERC-PNG service territory. Page 45 contains a detailed
3 breakdown of the classification of Plant in Service that was utilized on Pages 25 through
4 28. Page 45 also includes the creation of the classificational methodology for Gross
5 Plant, which is used throughout other pages of the CCOSS.
6

7 Pages 29 through 32 contain the Allocation of Depreciation Reserve – Straight Line, with
8 General expense apportioned, for the MERC-PNG service territory. Page 46 contains a
9 detailed breakdown of the classification of Depreciation Reserve – Straight Line that was
10 utilized on Pages 29 through 32.
11

12 Pages 33 through 36 contain the Allocation of Depreciation Reserve – Deferred Taxes,
13 with General expense apportioned, for the MERC-PNG service territory. Page 47
14 contains a detailed breakdown of the classification of Depreciation Reserve – Deferred
15 Taxes that was utilized on Pages 33 through 36.
16

17 Pages 37 through 40 contain the Allocation of Construction Work in Progress, with
18 General expense apportioned, for the MERC-PNG service territory. Page 48 contains a
19 detailed breakdown of the classification of Construction Work in Progress that was
20 utilized on Pages 37 through 40. In the 2011 proposed test year, there is no Construction
21 Work in Progress.
22

1 Pages 41 through 44 contain the Allocation of Other Rate Base Components for the
2 MERC-PNG service territory. The Working Capital methodology utilized on Pages 41
3 and 44 follows the Lead Lag Study approach, which is the suggested methodology of the
4 Commission.

5
6 Q. CAN YOU PLEASE DESCRIBE SCHEDULE 2 OF INFORMATIONAL
7 REQUIREMENT DOCUMENT 12?

8 A. Schedule 2 contains a functionalized and classified revenue requirement and rate base
9 allocation for each of the rate schedules in the MERC-PNG service territory. There is
10 one page of information for each rate schedule. Schedule 2 consists of 30 pages

11
12 Q. CAN YOU PLEASE DESCRIBE SCHEDULE 3 OF INFORMATIONAL
13 REQUIREMENT DOCUMENT 12?

14 A. Schedule 3 contains a summary of the external allocation methodologies used within the
15 CCROSS shown in Informational Requirement Document 12, Schedule 1 for the MERC-
16 PNG service territory. Schedule 3 consists of 8 pages.

17
18 Pages 1 through 4 show the development of the following allocation factors:

- 19 1. The Group Demand allocation, which consists of the monthly peak of each
20 rate schedule (group, or class), including transportation, to simulate
21 distribution system peaking (based on the highest one month of demand
22 for each group),
23
24 2. The Weighted Peak Demand allocation, which consists of the group
25 demand for each rate schedule, including transportation, and weighting
26 those demands based on annual therm throughput,
27

- 1 3. The TP Peak Demand allocation, which consists of the weighted peak
2 demand for only Town Plant rate schedules,
3
- 4 4. The Firm Peak Demand allocation, which consists of the weighted peak
5 demand for rate schedules that take 100% firm service,
6
- 7 5. The DFC allocation, which consists of the annual summation, utilizing an
8 average of 30 days per month for 12 months, of the daily firm capacity
9 nominations of the rate schedules that are Joint Firm/Interruptible,
10
- 11 6. The Account 378 Demand allocation, which consists of the weighted peak
12 demand for rate schedules that are General Service and Small Volume rate
13 schedules,
14
- 15 7. The Account 378 Mainline allocation, which consists of the weighted peak
16 demand for rate schedules that are Mainline,
17
- 18 8. The Account 385 Demand allocation, which consists of the weighted peak
19 demand for rate schedules that are industrial sized but excluding Mainline,
20 which consist of the Large Volume and Super Large Volume rate
21 schedules,
22
- 23 9. Sales allocation, which is the sales of all customers, not including
24 transportation sales, and
25
- 26 10. The Therm Throughput allocation, which is the sales of all customers,
27 including transportation sales.
28

29 Pages 5 through 8 show the development of the following allocation factors:

- 30 1. The Customer allocation factor, which is based on total yearly bill counts
31 for all rate schedules,
32
- 33 2. The Customer – Transmission allocation, which is based on total yearly
34 bill counts of all rate schedules excluding Mainline,
35
- 36 3. The Customer – GS & Small Volume allocation, which is based on total
37 yearly bill counts of the General Service and Small Volume rate
38 schedules,
39
- 40 4. The Services allocation, which is based on total annual bill counts and
41 utilizes a Cost Per Customer for Services weighting factor,
42

- 1 5. The Direct - Residential allocation, which is based on total annual bill
2 counts for Residential rate schedules only,
3
- 4 6. The Meters allocation, which is based on total annual meter counts and
5 utilizes a Cost Per Customer for Meters weighting factor,
6
- 7 7. The Transport Customer allocation factor, which is based on the total
8 yearly meter counts for transportation rate schedules,
9
- 10 8. The Commodity Cost allocation, which is based on the purchased cost of
11 gas for each rate schedule,
12
- 13 9. The Salaries and Wages functional allocation factor, and
14
- 15 10. The Salaries and Wages rate schedule allocation factor.
16

17 Q. CAN YOU PLEASE EXPLAIN THE SIGNIFICANCE OF THE FAR RIGHT
18 COLUMN LABELED “SOURCE OR ALLOCATION FACTOR” ON EACH PAGE OF
19 SCHEDULE 3 OF INFORMATIONAL REQUIREMENT DOCUMENT 12?

20 A. The far right column labeled “Source or Allocation Factor” represents the name that was
21 given to each of the specific allocators created within Schedule 3. Each of these names
22 shown in the “Source or Allocation Factor” column is what is used throughout the
23 CCOSSs for the MERC-PNG service territory in Informational Requirement Document
24 12, Schedules 1 and 9 when referencing the allocation methodology that was used to
25 allocate costs to the rate schedules.
26

27 Q. PLEASE DESCRIBE INFORMATIONAL REQUIREMENT DOCUMENT 12,
28 SCHEDULE 4.

1 A. Schedule 4 shows the cost of service for the MERC-PNG service territory rate schedules
2 by billing unit based upon the CCOSS presented in Schedule 1. Schedule 4 consists of
3 three pages.

4
5 Page 1 of Schedule 4 is a summary of all the billing unit costs by rate schedule, broken
6 down into the billing units of Local Transmission/Distribution Fixed Charge, Enhanced
7 Administrative Charge, Local Transmission/Distribution Volumetric Rate, Gas Supply
8 Acquisition Rate, and Daily Firm Capacity Rate. The column titled Total Per Meter
9 Fixed Charge is the summation Columns [B] and [C] for each rate schedule. The column
10 titled Total Therm Rate is the summation of Columns [E] and [F] for each rate schedule.

11
12 Page 2 of Schedule 4 shows the creation of the Local Transmission/Distribution
13 Volumetric Rate, the Daily Firm Capacity Rate, and Gas Supply Acquisition Rate for
14 each of the rate schedules. Therm Throughput and Daily Firm Capacity values were
15 taken from Informational Requirement Document 12, Schedule 3, pages 1 through 4.
16 Basic Transmission/Distribution Demand Costs, Daily Firm Capacity Costs, and Gas
17 Supply Acquisition Costs were taken from the respective columns of Informational
18 Requirement Document 12, Schedule 2 on each of the respective pages for the rate
19 schedules.

20
21 Page 3 of Schedule 4 shows the creation of the Local Transmission/Distribution Fixed
22 Charge and Enhanced Administrative Charge for each of the rate schedules. Meter
23 Counts were taken from Informational Requirement Document 12, Schedule 3, pages 5

1 through 8. Local Transmission/Distribution Fixed Costs and Enhanced Administrative
2 Costs were taken from the respective columns of Informational Requirement Document
3 12, Schedule 2 on each of the respective pages for the rate schedules.

4
5 Q. PLEASE DESCRIBE SCHEDULES 5 AND 6 OF INFORMATIONAL
6 REQUIREMENT DOCUMENT 12.

7 A. Schedule 5 contains the detail of the Distribution Mains Zero-Intercept study for the
8 MERC-PNG service territory and consists of 12 pages. When conducting the Zero-
9 Intercept study for the MERC-PNG service territory Distribution Mains, an outlier was
10 found and a second study was performed removing the outlier from the data set. The
11 Zero-Intercept study was performed utilizing historical data for the year ending
12 December 31, 2009.

13
14 Schedule 6 contains the Distribution Mains Minimum-Size study for the MERC-PNG
15 service territory, and consists of one page. In theory, the results of a Zero-Intercept study
16 and Minimum-Size study should be approximately similar. Schedule 6 was provided to
17 prove that this theory holds true. The Minimum-Size study was also performed utilizing
18 the same historical data for the year ending December 31, 2009 as the Zero-Intercept
19 study.

20
21 Q. PLEASE DESCRIBE SCHEDULES 7 AND 8 OF INFORMATIONAL
22 REQUIREMENT DOCUMENT 12.

1 A. Schedule 7 contains the detail of the Transmission Mains Zero-Intercept study for both
2 the MERC-PNG and MERC-NMU service territories combined, and consists of 5 pages.
3 Due to the small amount of investment in Transmission Mains, the investment for
4 MERC-PNG and MERC-NMU service territories needed to be combined into one
5 Transmission Mains Zero-Intercept study in order to receive meaningful results from the
6 analysis. There were no outliers found in the Transmission Mains Zero-Intercept study.
7 The Zero-Intercept study was performed utilizing historical data for the year ending
8 December 31, 2009.

9
10 Schedule 8 contains the Transmission Mains Minimum-Size study for both the MERC-
11 PNG and MERC-NMU service territories, and consists of one page. In theory, the results
12 of a Zero-Intercept study and Minimum-Size study should be approximately similar.
13 Schedule 8 was provided to prove that this theory holds true. The Minimum-Size study
14 was also performed utilizing the same historical data for the year ending December 31,
15 2009 as the Zero-Intercept study.

16
17 Q. PLEASE DESCRIBE SCHEDULE 9 OF INFORMATIONAL REQUIREMENT
18 DOCUMENT 12.

19 A. Schedule 9 shows the summarized results of MERC's natural gas embedded CCOSS for
20 the MERC-PNG service territory for the 2011 proposed test year expenses, but utilizing a
21 Rate Base allocation method to allocate Income Taxes. Schedule 9 consists of 50 pages.

22

1 Q. DO THE 50 PAGES OF THE 2011 PROPOSED TEST YEAR CCROSS SHOWN IN
2 SCHEDULE 9 OF INFORMATIONAL REQUIREMENT DOCUMENT 12 FOLLOW
3 THE SAME LAYOUT AS PRESENTED IN SCHEDULE 1 OF INFORMATIONAL
4 REQUIREMENT DOCUMENT 12?

5 A. Yes, they do. The only differences would be on pages 1 – 4 of Schedule 9, lines 12, 19,
6 and 50, which show Income Taxes and related items being allocated to the rate schedules
7 based upon the Rate Base allocation methodology. In Schedule 1, pages 1-4 show
8 Income Taxes and related items being allocated based upon Net Income. This difference
9 in allocation methodology affects the values shown in Schedule 9, page 1, on Line 40, the
10 Percent Rate of Return, and Lines 44-56, which calculate the revenue deficiency by rate
11 class, as compared to these items shown in Schedule 1.

12
13 Q. ARE THERE ANY OTHER DIFFERENCES TO THE 50 PAGES OF THE 2011
14 PROPOSED TEST YEAR CCROSS SHOWN IN SCHEDULE 9 OF INFORMATIONAL
15 REQUIREMENT DOCUMENT 12 AS COMPARED TO THE CCROSS PRESENTED
16 IN SCHEDULE 1 OF INFORMATIONAL REQUIREMENT DOCUMENT 12?

17 A. No, there are not. All remaining pages and allocation methods presented in Schedule 9 of
18 Informational Requirement Document 12, with the exception of the difference explained
19 above, are identical to those presented in Schedule 1 of Informational Requirement
20 Document 12.

21
22 Q. PLEASE DESCRIBE SCHEDULE 10 OF INFORMATIONAL REQUIREMENT
23 DOCUMENT 12.

1 A. Schedule 10 contains a functionalized and classified revenue requirement and rate base
2 allocation for each of the rate schedules in the MERC-PNG service territory based upon
3 the CCOSS presented in Schedule 9. There is one page of information for each rate
4 schedule. Schedule 10 consists of 30 pages.

5
6 Q. DO THE 30 PAGES OF SCHEDULE 10 OF INFORMATIONAL REQUIREMENT
7 DOCUMENT 12 FOLLOW THE SAME LAYOUT AS PRESENTED IN SCHEDULE 2
8 OF INFORMATIONAL REQUIREMENT DOCUMENT 12?

9 A. Yes, they do.

10

11 Q. PLEASE DESCRIBE SCHEDULE 11 OF INFORMATIONAL REQUIREMENT
12 DOCUMENT 12.

13 A. Schedule 11 shows the cost of service for the MERC-PNG service territory rate schedules
14 by billing unit based upon the CCOSS presented in Schedule 9. Schedule 11 consists of
15 three pages.

16

17 Q. DO THE 3 PAGES OF SCHEDULE 11 OF INFORMATIONAL REQUIREMENT
18 DOCUMENT 12 FOLLOW THE SAME LAYOUT AS PRESENTED IN SCHEDULE 4
19 OF INFORMATIONAL REQUIREMENT DOCUMENT 12?

20 A. Yes, they do.

21

1 Q. IS THERE ANYTHING OF NOTE WHEN COMPARING SCHEDULE 11 TO
2 SCHEDULE 4 OF INFORMATIONAL REQUIREMENT DOCUMENT 12 THAT YOU
3 WOULD LIKE TO BRING ATTENTION TO?

4 A. Yes, there are two items I would like to bring attention to when comparing Schedule 11
5 to Schedule 4 for MERC-PNG.

6
7 The first item of note is that use of the Net Income allocation method to allocate Income
8 Taxes, which is incorporated into Schedule 4, consequentially produces larger cost-based
9 fixed charges than the use of the Rate Base allocation method to allocate Income Taxes,
10 which is incorporated into Schedule 11. The fixed charges are significantly higher in
11 Schedule 4 particularly for rate classes Large Volume General Service, Small Volume,
12 Large Volume, and Transport for Resale, as compared to Schedule 11, as shown in
13 Column [B] on page 1 of each Schedule. This is attributable to the fact that allocated
14 Basic Transmission/Distribution Fixed Costs are higher for these rate classes when using
15 the Net Income allocation method to allocate income taxes, as compared to using the
16 Rate Base allocation method, as shown in Schedules 4 and 11, page 3, Column [C]. A
17 summary is presented below.

18

1

Determination of Basic Transmission/Distribution Fixed Costs – MERC-PNG

Income Taxes allocated via:

	Net Income allocation method	Rate Base allocation method	\$ Difference: Net Income to Rate Base	% Difference: Net Income to Rate Base
Residential	\$45,371,678	\$53,186,194	(\$7,814,515)	-14.69%
Small General Service	\$2,267,336	\$2,496,010	(\$228,675)	-9.16%
Large General Service	\$7,342,428	\$4,466,714	\$2,875,714	64.38%
Small Volume Service	\$1,194,127	\$456,725	\$737,403	161.45%
Large Volume Service	\$465,868	\$180,319	\$285,549	158.36%
Super Large Volume Service	\$49,514	\$49,577	(\$63)	-0.13%
Large Volume Flex Service	\$32,038	\$26,723	\$5,314	19.89%
Transport for Resale	\$4,027	\$1,368	\$2,659	194.43%

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This consequence of higher fixed costs is directly attributable to the allocation of income taxes, as can be seen when comparing Schedule 2 and Schedule 10 of Informational Requirement Document 12 for MERC-PNG. To provide an example, examining the functional and classified revenue requirements and rate base allocated to Large General Service, GS-1 Large C&I in particular, which is shown on page 3 of both Schedule 2 and Schedule 10. Column [F] of page 3 of these Schedules shows the Basic Transmission/Distribution Fixed Costs that are being allocated to GS-1 Large C&I; Schedule 2 portrays the revenue requirements and rate base using a CCOSS where Income Taxes are allocated using a Net Income allocation method, and Schedule 10 portrays the revenue requirements and rate base using a CCOSS where Income Taxes are allocated using a Rate Base allocation method. By examining each of the line items in Column [F] of page 3 of these two Schedules, the only line items that change are line 30, Income Taxes, and line 50, Additional Income Taxes on Deficiency (note: lines 46 and 48 of page 3 of each Schedule also change, but when netting the values of these two

1 lines, then comparing the two Schedules, the comparison is negligible). A summary is
2 presented in the table below.

GS-1 Large C&I			
	Schedule 2; page 3, Column [F]	Schedule 10; page 3, Column [F]	
	Net Income allocation method	Rate Base allocation method	\$ Difference: Net Income to Rate Base
Line 30 - Income Taxes	\$543,062	\$62,109	\$480,953
Line 50 - Additional Income Taxes on Deficiency	\$2,408,806	\$275,490	\$2,133,316

3
4 The consequence of using the Net Income allocation method to allocate Income Taxes
5 has the affect of allocating effectively an Income Tax “Credit”, rather than “expense”, to
6 the rate classes that are showing a Pre-Tax Net Loss in the CCOSS, which in turn reduces
7 their overall Revenue Deficiency. At the same time, the rate classes that are showing a
8 Pre-Tax Net Gain/Income in the CCOSS (i.e. Large General Service, Small Volume,
9 Large Volume, Large Volume Flex Service, and Transport for Resale) are receiving an
10 allocation of Income Tax Expense – a disproportionately larger share of Income Tax
11 Expense such that it covers the subsidization of an Income Tax “credit” that is being
12 allocated to the rate classes that are showing a Net Loss (i.e. Residential, Small General
13 Service, and Super Large Volume).

14
15 The second item of note relates to the calculated fixed charges for MERC-PNG portrayed
16 on Schedule 4, which utilizes the Net Income allocation method to allocate Income
17 Taxes, as compared to Schedule 11, which utilizes the Rate Base allocation method to
18 allocate Income Taxes. In theory, based upon cost causation, fixed charges should

1 progressively become larger as the customer classes contain larger customers. While this
2 occurrence appears in Schedule 11 when using Rate Base to allocate Income Taxes, it
3 does not occur in Schedule 4, where Net Income to allocate Income Taxes. As shown in
4 Schedule 4, page 1, Column [B], the calculated fixed charge for Super Large Volume
5 customers is \$229.23, while the calculated fixed charge for Large Volume customers,
6 which are smaller than Super Large, is \$254.99.

7
8 Q. PLEASE DESCRIBE SCHEDULE 12 OF INFORMATIONAL REQUIREMENT
9 DOCUMENT 12.

10 A. Schedule 12 shows the summarized results of MERC's natural gas embedded CCOS for
11 the MERC-NMU service territory for the 2011 proposed test year expenses. Schedule 12
12 consists of 17 pages, and meets the requirements of Order Point 7 of the Commission's
13 Final Order in Docket No. G-007,011/GR-08-835, requiring that future CCOSs must
14 allocate income taxes on the basis of the taxable income attributable to each customer
15 class.

16
17 Page 1 summarizes the various components of the operating income, operating expenses,
18 and rate base to the MERC-NMU rate schedules. Line 41 of page 1 shows the Rate of
19 Return resulting from operations. Line 53 of page 1 shows the amount of revenue
20 deficiency by rate class based on the required rate of return on common equity of
21 11.25%, which is MERC's requested return on common equity in this general rate case
22 proceeding and is supported by the testimony of MERC witness Mr. Paul Moul. Line 57
23 of page 1 shows the percentage of revenue deficiency by rate class with cost of gas

1 excluded. Page 1 also includes the creation of the allocation methodology for Rate Base,
2 which is used throughout other pages of the CCOSS, and the creation of the allocation
3 methodology for Net Income which is used to allocate Income Taxes.

4
5 Page 2 contains the Operating Revenues for the MERC-NMU service territory by rate
6 schedule based on the rates authorized in MERC's last general rate case proceeding in
7 Docket No. G007,011/GR-08-835.

8
9 Page 3 contains the Allocation of O&M Expenses for the MERC-NMU service territory.
10 Page 17 contains a detailed breakdown of the classification of O&M Expenses that were
11 utilized on Page 3. Page 17 also includes the creation of the classificational methodology
12 titled Total O&M (excluding direct assigned and purchased gas cost related items), which
13 is used to classify costs in other areas of the CCOSS. Direct allocations were made
14 whenever possible.

15
16 Page 4 contains the Allocation of Depreciation Expenses, with General expense
17 apportioned, for the MERC-NMU service territory. Page 16 contains a detailed
18 breakdown of the classification of Depreciation Expenses that was utilized on Page 4.

19
20 Page 5 contains the Allocation of Taxes Other Than Income Taxes for the MERC-NMU
21 service territory.

1 Page 6 contains the Allocation of Other Income and Adjustments, for both Before Income
2 Taxes as well as After Income Taxes, for the MERC-NMU service territory. In the 2011
3 proposed test year, there were no Other Income and Adjustments.

4
5 Page 7 contains the Allocation of Plant in Service, with General expense apportioned, for
6 the MERC-NMU service territory. Page 12 contains a detailed breakdown of the
7 classification of Plant in Service that was utilized on Page 7. Page 12 also includes the
8 creation of the classificational methodology for Gross Plant, which is used throughout
9 other pages of the CCOSS.

10
11 Page 8 contains the Allocation of Depreciation Reserve – Straight Line, with General
12 expense apportioned, for the MERC-NMU service territory. Page 13 contains a detailed
13 breakdown of the classification of Depreciation Reserve – Straight Line that was utilized
14 on Page 8.

15
16 Page 9 contains the Allocation of Depreciation Reserve – Deferred Taxes, with General
17 expense apportioned, for the MERC-NMU service territory. Page 14 contains a detailed
18 breakdown of the classification of Depreciation Reserve – Deferred Taxes that was
19 utilized on Page 9.

20
21 Page 10 contains the Allocation of Construction Work in Progress, with General expense
22 apportioned, for the MERC-NMU service territory. Page 15 contains a detailed

1 breakdown of the classification of Construction Work in Progress that was utilized on
2 Page 10. In the 2011 proposed test year, there is no Construction Work in Progress.

3
4 Page 11 contains the Allocation of Other Rate Base Components for the MERC-NMU
5 service territory. The Working Capital methodology utilized on Page 11 follows the
6 Lead Lag Study approach, which is the suggested methodology of the Commission.

7
8 Q. CAN YOU PLEASE DESCRIBE SCHEDULE 13 OF INFORMATIONAL
9 REQUIREMENT DOCUMENT 12?

10 A. Schedule 13 contains a functionalized and classified revenue requirement and rate base
11 allocation for each of the rate schedules in the MERC-NMU service territory. There is
12 one page of information for each rate schedule. Schedule 13 consists of 11 pages.

13
14 Q. CAN YOU PLEASE DESCRIBE SCHEDULE 14 OF INFORMATIONAL
15 REQUIREMENT DOCUMENT 12?

16 A. Schedule 14 contains a summary of the external allocation methodologies used within the
17 CCOSs shown in Informational Requirement Document 12, Schedule 12 and Schedule
18 18 for the MERC-NMU service territory. Schedule 14 consists of 2 pages.

19
20 Page 1 shows the development of the following allocation factors:

- 21 1. The Group Demand allocation, which consists of the monthly peak of each
22 rate schedule (group, or class), including transportation, to simulate
23 distribution system peaking (based on the highest one month of demand
24 for each group),
25

- 1 2. The Weighted Peak Demand allocation, which consists of the group
2 demand for each rate schedule, including transportation, and weighting
3 those demands based on annual therm throughput,
4
- 5 3. The TP Peak Demand allocation, which consists of the weighted peak
6 demand for only Town Plant rate schedules,
7
- 8 4. The Firm Peak Demand allocation, which consists of the weighted peak
9 demand for rate schedules that take 100% firm service,
10
- 11 5. The DFC allocation, which consists of the annual summation, utilizing an
12 average of 30 days per month for 12 months, of the daily firm capacity
13 nominations of the rate schedules that are Joint Firm/Interruptible,
14
- 15 6. Sales allocation, which is the sales of all customers, not including
16 transportation sales,
17
- 18 7. The Therm Throughput allocation, which is the sales of all customers,
19 including transportation sales, and
20
- 21 8. The Account 385 Demand allocation, which consists of the weighted peak
22 demand for rate schedules that are industrial sized but excluding Mainline,
23 which consist of the Large Volume and Super Large Volume rate
24 schedules.
25

26 Page 2 shows the development of the following allocation factors:

- 27 1. The Commodity Cost allocation, which is based on the purchased cost of
28 gas for each rate schedule,
29
- 30 2. The Customer allocation factor, which is based on total yearly bill counts
31 for all rate schedules,
32
- 33 3. The Customer – Transmission allocation, which is based on total yearly
34 bill counts of all rate schedules excluding Mainline,
35
- 36 4. The Customer – GS & Small Volume allocation, which is based on total
37 yearly bill counts of the General Service and Small Volume rate
38 schedules,
39
- 40 5. The Services allocation, which is based on total annual bill counts and
41 utilizes a Cost Per Customer for Services weighting factor,
42

- 1 6. The Meters allocation, which is based on total annual meter counts and
2 utilizes a Cost Per Customer for Meters weighting factor,
3
4 7. Transport Customer allocation factor, which is based on the total yearly
5 meter counts for transportation rate schedules,
6
7 8. The Salaries and Wages functional allocation factor, and
8
9 9. The Salaries and Wages rate schedule allocation factor.
10

11 Q. CAN YOU PLEASE EXPLAIN THE SIGNIFICANCE OF THE FAR RIGHT
12 COLUMN LABELED “SOURCE OR ALLOCATION FACTOR” ON EACH PAGE OF
13 SCHEDULE 14 OF INFORMATIONAL REQUIREMENT DOCUMENT 12?

14 A. The far right column labeled “Source or Allocation Factor” represents the name that was
15 given to each of the specific allocators created within Schedule 14. Each of these names
16 shown in the “Source or Allocation Factor” column is what is used throughout the
17 CCOSSs for the MERC-NMU service territory in Informational Requirement Document
18 12, Schedules 12 and 18 when referencing the allocation methodology that was used to
19 allocate costs to the rate schedules.
20

21 Q. PLEASE DESCRIBE INFORMATIONAL REQUIREMENT DOCUMENT 12,
22 SCHEDULE 15.

23 A. Schedule 15 shows the cost of service for the MERC-NMU service territory rate
24 schedules by billing unit based upon the CCOSS presented in Schedule 12. Schedule 15
25 consists of three pages.
26

1 Page 1 of Schedule 15 is a summary of all the billing unit costs by rate schedule, broken
2 down into the billing units of Local Transmission/Distribution Fixed Charge, Enhanced
3 Administrative Charge, Local Transmission/Distribution Volumetric Rate, Gas Supply
4 Acquisition Rate, and Daily Firm Capacity Rate. The column titled Total Per Meter
5 Fixed Charge is the summation of Columns [B] and [C] for each rate schedule. The
6 column titled Total Therm Rate is the summation of Columns [E] and [F] for each rate
7 schedule.

8
9 Page 2 of Schedule 15 shows the creation of the Local Transmission/Distribution
10 Volumetric Rate, the Daily Firm Capacity Rate, and Gas Supply Acquisition Rate for
11 each of the rate schedules. Therm Throughput and Daily Firm Capacity values were
12 taken from Informational Requirement Document 12, Schedule 14, page 1. Basic
13 Transmission/Distribution Demand Costs, Daily Firm Capacity Costs, and Gas Supply
14 Acquisition Costs were taken from the respective columns of Informational Requirement
15 Document 12, Schedule 13 on each of the respective pages for the rate schedules.

16
17 Page 3 of Schedule 15 shows the creation of the Local Transmission/Distribution Fixed
18 Charge and Enhanced Administrative Charge for each of the rate schedules. Meter
19 Counts were taken from Informational Requirement Document 12, Schedule 14, page 2.
20 Local Transmission/Distribution Fixed Costs and Enhanced Administrative Costs were
21 taken from the respective columns of Informational Requirement Document 12, Schedule
22 13 on each of the respective pages for the rate schedules.

23

1 Q. PLEASE DESCRIBE SCHEDULES 16 AND 17 OF INFORMATIONAL
2 REQUIREMENT DOCUMENT 12.

3 A. Schedule 16 contains the detail of the Distribution Mains Zero-Intercept study for the
4 MERC-NMU service territory and consists of 12 pages. When conducting the Zero-
5 Intercept study for the MERC-NMU service territory Distribution Mains, an outlier was
6 found and a second study was performed removing that outlier from the data set. The
7 Zero-Intercept study was performed utilizing historical data for the year ending
8 December 31, 2009.

9
10 Schedule 17 contains the Distribution Mains Minimum-Size study for the MERC-NMU
11 service territory, and consists of one page. In theory, the results of a Zero-Intercept study
12 and Minimum-Size study should be approximately similar. Schedule 17 was provided to
13 prove that this theory holds true. The Minimum-Size study was also performed utilizing
14 the same historical data for the year ending December 31, 2009 as the Zero-Intercept
15 study.

16
17 Q. PLEASE DESCRIBE SCHEDULE 18 OF INFORMATIONAL REQUIREMENT
18 DOCUMENT 12.

19 A. Schedule 18 shows the summarized results of MERC's natural gas embedded CCOSS for
20 the MERC-NMU service territory for the 2011 proposed test year expenses, but utilizing
21 a Rate Base allocation method to allocate Income Taxes. Schedule 18 consists of 17
22 pages.

23

1 Q. DO THE 17 PAGES OF THE 2011 PROPOSED TEST YEAR CCROSS SHOWN IN
2 SCHEDULE 18 OF INFORMATIONAL REQUIREMENT DOCUMENT 12 FOLLOW
3 THE SAME LAYOUT AS PRESENTED IN SCHEDULE 12 OF INFORMATIONAL
4 REQUIREMENT DOCUMENT 12?

5 A. Yes, they do. The only differences would be on page 1, lines 12, 19, and 49, which show
6 Income Taxes and related items as being allocated to the rate schedules based upon the
7 Rate Base allocation methodology. In Schedule 12, page 1 shows Income Taxes and
8 related items being allocated based upon Net Income. This difference in allocation
9 methodology affects the values shown in Schedule 18, page 1, on Line 39, the Percent
10 Rate of Return, and Lines 43-55, which calculate the revenue deficiency by rate class, as
11 compared to these items shown in Schedule 12.

12
13 Q. ARE THERE ANY OTHER DIFFERENCES TO THE 17 PAGES OF THE 2011
14 PROPOSED TEST YEAR CCROSS SHOWN IN SCHEDULE 18 OF
15 INFORMATIONAL REQUIREMENT DOCUMENT 12 AS COMPARED TO THE
16 CCROSS PRESENTED IN SCHEDULE 12 OF INFORMATIONAL REQUIREMENT
17 DOCUMENT 12?

18 A. No, there are not. All remaining pages and allocation methods presented in Schedule 18
19 of Informational Requirement Document 12, with the exception of the difference
20 explained above, are identical to those presented in Schedule 12 of Informational
21 Requirement Document 12.

22

1 Q. PLEASE DESCRIBE SCHEDULE 19 OF INFORMATIONAL REQUIREMENT
2 DOCUMENT 12.

3 A. Schedule 19 contains a functionalized and classified revenue requirement and rate base
4 allocation for each of the rate schedules in the MERC-NMU service territory based upon
5 the CCROSS presented in Schedule 18. There is one page of information for each rate
6 schedule. Schedule 19 consists of 11 pages.

7

8 Q. DO THE 11 PAGES OF SCHEDULE 19 OF INFORMATIONAL REQUIREMENT
9 DOCUMENT 12 FOLLOW THE SAME LAYOUT AS PRESENTED IN SCHEDULE
10 13 OF INFORMATIONAL REQUIREMENT DOCUMENT 12?

11 A. Yes, they do.

12

13 Q. PLEASE DESCRIBE SCHEDULE 20 OF INFORMATIONAL REQUIREMENT
14 DOCUMENT 12.

15 A. Schedule 20 shows the cost of service for the MERC-NMU service territory rate
16 schedules by billing unit based upon the CCROSS presented in Schedule 18. Schedule 20
17 consists of three pages.

18

19 Q. DO THE 3 PAGES OF SCHEDULE 20 OF INFORMATIONAL REQUIREMENT
20 DOCUMENT 12 FOLLOW THE SAME LAYOUT AS PRESENTED IN SCHEDULE
21 15 OF INFORMATIONAL REQUIREMENT DOCUMENT 12?

22 A. Yes, they do.

23

1 Q. PLEASE DESCRIBE SCHEDULE 21 OF INFORMATIONAL REQUIREMENT
2 DOCUMENT 12.

3 A. Schedule 21 shows the summarized results of MERC's natural gas embedded CCOSS for
4 the MERC-Consolidated service territory for the 2011 proposed test year expenses.
5 Schedule 21 consists of 50 pages, and meets the requirements of Order Point 7 of the
6 Commission's Final Order in Docket No. G-007,011/GR-08-835, requiring that future
7 CCOSSs must allocate income taxes on the basis of the taxable income attributable to
8 each customer class.

9
10 Pages 1-4 summarize the various components of the operating income, operating
11 expenses, and rate base to the MERC-Consolidated rate schedules. Line 42 of pages 1-4
12 shows the Rate of Return resulting from operations. Line 54 of pages 1-4 shows the
13 amount of revenue deficiency by rate class based on the required rate of return on
14 common equity of 11.25%, which is MERC's requested return on common equity in this
15 general rate case proceeding and is supported by the testimony of MERC Witness Mr.
16 Paul Moul. Line 58 of pages 1-4 shows the percentage of revenue deficiency by rate
17 class with cost of gas excluded. Pages 1-4 also includes the creation of the allocation
18 methodology for Rate Base, which is used throughout other pages of the CCOSS, and the
19 creation of the allocation methodology for Net Income which is used to allocate Income
20 Taxes.

21

1 Pages 5-8 contain the Operating Revenues for the MERC-Consolidated service territory
2 by rate schedule based on the rates authorized in MERC's last general rate case
3 proceeding in Docket No. G007,011/GR-08-835.

4
5 Pages 9-12 contain the Allocation of O&M Expenses for the MERC-Consolidated service
6 territory. Page 50 contains a detailed breakdown of the classification of O&M Expenses
7 that were utilized on Pages 9-12. Page 50 also includes the creation of the classificational
8 methodology titled Total O&M (excluding direct assigned and purchased gas cost related
9 items), which is used to classify costs in other areas of the CCOSS. Direct allocations
10 were made whenever possible.

11
12 Pages 13-16 contain the Allocation of Depreciation Expenses, with General expense
13 apportioned, for the MERC-Consolidated service territory. Page 49 contains a detailed
14 breakdown of the classification of Depreciation Expenses that was utilized on Pages 13-
15 16.

16
17 Pages 17-20 contain the Allocation of Taxes Other Than Income Taxes for the MERC-
18 Consolidated service territory.

19
20 Pages 21-24 contain the Allocation of Other Income and Adjustments, for both Before
21 Income Taxes as well as After Income Taxes, for the MERC-Consolidated service
22 territory. In the 2011 proposed test year, there were no Other Income and Adjustments.

23

1 Pages 25-28 contain the Allocation of Plant in Service, with General expense
2 apportioned, for the MERC-Consolidated service territory. Page 45 contains a detailed
3 breakdown of the classification of Plant in Service that was utilized on Pages 25-28.
4 Page 45 also includes the creation of the classificational methodology for Gross Plant,
5 which is used throughout other pages of the CCOSS.

6
7 Pages 29-32 contain the Allocation of Depreciation Reserve – Straight Line, with General
8 expense apportioned, for the MERC-Consolidated service territory. Page 46 contains a
9 detailed breakdown of the classification of Depreciation Reserve – Straight Line that was
10 utilized on Pages 29-32.

11
12 Pages 33-36 contain the Allocation of Depreciation Reserve – Deferred Taxes, with
13 General expense apportioned, for the MERC-Consolidated service territory. Page 47
14 contains a detailed breakdown of the classification of Depreciation Reserve – Deferred
15 Taxes that was utilized on Pages 33-36.

16
17 Pages 37-40 contains the Allocation of Construction Work in Progress, with General
18 expense apportioned, for the MERC-Consolidated service territory. Page 48 contains a
19 detailed breakdown of the classification of Construction Work in Progress that was
20 utilized on Pages 37-40. In the 2011 proposed test year, there is no Construction Work in
21 Progress.

1 Pages 41-44 contain the Allocation of Other Rate Base Components for the MERC-
2 Consolidated service territory. The Working Capital methodology utilized on Pages 41-
3 44 follows the Lead Lag Study approach, which is the suggested methodology of the
4 Commission.

5
6 Q. CAN YOU PLEASE DESCRIBE SCHEDULE 22 OF INFORMATIONAL
7 REQUIREMENT DOCUMENT 12?

8 A. Schedule 22 contains a functionalized and classified revenue requirement and rate base
9 allocation for each of the rate schedules in the MERC-Consolidated service territory.
10 There is one page of information for each rate schedule. Schedule 22 consists of 29
11 pages.

12
13 Q. CAN YOU PLEASE DESCRIBE SCHEDULE 23 OF INFORMATIONAL
14 REQUIREMENT DOCUMENT 12?

15 A. Schedule 23 contains a summary of the external allocation methodologies used within the
16 CCOSS shown in Informational Requirement Document 12, Schedule 21 for the MERC-
17 Consolidated service territory. Schedule 23 consists of 8 pages.

18
19 Pages 1-4 show the development of the following allocation factors:

- 20 1. The Group Demand allocation, which consists of the monthly peak of each
21 rate schedule (group, or class), including transportation, to simulate
22 distribution system peaking (based on the highest one month coincident
23 demand for each group),
24

- 1 2. The Weighted Peak Demand allocation, which consists of the group
2 demand for each rate schedule, including transportation, and weighting
3 those demands based on annual therm throughput,
4
- 5 3. The TP Peak Demand allocation, which consists of the weighted peak
6 demand for only Town Plant rate schedules,
7
- 8 4. The Firm Peak Demand allocation, which consists of the weighted peak
9 demand for rate schedules that take 100% firm service,
10
- 11 5. The DFC allocation, which consists of the annual summation, utilizing an
12 average of 30 days per month for 12 months, of the daily firm capacity
13 nominations of the rate schedules that are Joint Firm/Interruptible,
14
- 15 6. The Account 378 Mainline allocation, which consists of the weighted peak
16 demand for rate schedules that are Mainline,
17
- 18 7. The Account 385 Demand allocation, which consists of the weighted peak
19 demand for rate schedules that are industrial sized but excluding Mainline,
20 which consist of the Large Volume and Super Large Volume rate
21 schedules,
22
- 23 8. Sales allocation, which is the sales of all customers, not including
24 transportation sales, and
25
- 26 9. The Therm Throughput allocation, which is the sales of all customers,
27 including transportation sales.
28

29 Pages 5-8 show the development of the following allocation factors:

- 30 1. The Customer allocation factor, which is based on total yearly bill counts
31 for all rate schedules,
32
- 33 2. The Customer – Transmission allocation, which is based on total yearly
34 bill counts of all rate schedules excluding Mainline,
35
- 36 3. The Customer – GS & Small Volume allocation, which is based on total
37 yearly bill counts of the General Service and Small Volume rate
38 schedules,
39
- 40 4. The Services allocation, which is based on total annual bill counts and
41 utilizes a Cost Per Customer for Services weighting factor,
42

- 1 5. The Direct Residential allocation, which is based on annual bill counts for
2 Residential rate schedules only,
- 3
- 4 6. The Meters allocation, which is based on total annual meter counts and
5 utilizes a Cost Per Customer for Meters weighting factor,
- 6
- 7 7. Transport Customer allocation factor, which is based on the total yearly
8 meter counts for transportation rate schedules,
- 9
- 10 8. The Commodity Cost allocation, which is based on the purchased cost of
11 gas for each rate schedule,
- 12
- 13 9. The Salaries and Wages functional allocation factor, and
- 14
- 15 10. The Salaries and Wages rate schedule allocation factor.
- 16

17 Q. CAN YOU PLEASE EXPLAIN THE SIGNIFICANCE OF THE FAR RIGHT
18 COLUMN LABELED “SOURCE OR ALLOCATION FACTOR” ON EACH PAGE OF
19 SCHEDULE 23 OF INFORMATIONAL REQUIREMENT DOCUMENT 12?

20 A. The far right column labeled “Source or Allocation Factor” represents the name that was
21 given to each of the specific allocators created within Schedule 23. Each of these names
22 shown in the “Source or Allocation Factor” column is what is used throughout the
23 CCOSS for the MERC-Consolidated service territory in Informational Requirement
24 Document 12, Schedules 21 and 27 when referencing the allocation methodology that
25 was used to allocate costs to the rate schedules.

26

27 Q. PLEASE DESCRIBE INFORMATIONAL REQUIREMENT DOCUMENT 12,
28 SCHEDULE 24.

1 A. Schedule 24 shows the cost of service for the MERC-Consolidated service territory rate
2 schedules by billing unit based upon the CCOSS presented in Schedule 21. Schedule 24
3 consists of three pages.

4

5 Page 1 of Schedule 24 is a summary of all the billing unit costs by rate schedule, broken
6 down into the billing units of Local Transmission/Distribution Fixed Charge, Enhanced
7 Administrative Charge, Local Transmission/Distribution Volumetric Rate, Gas Supply
8 Acquisition Rate, and Daily Firm Capacity Rate. The column titled Total Per Meter
9 Fixed Charge is the summation of Columns [B] and [C] for each rate schedule. The
10 column titled Total Therm Rate is the summation of Columns [E] and [F] for each rate
11 schedule.

12

13 Page 2 of Schedule 24 shows the creation of the Local Transmission/Distribution
14 Volumetric Rate, the Daily Firm Capacity Rate, and Gas Supply Acquisition Rate for
15 each of the rate schedules. Therm Throughput and Daily Firm Capacity values were
16 taken from Informational Requirement Document 12, Schedule 23, pages 1-4. Basic
17 Transmission/Distribution Demand Costs, Daily Firm Capacity Costs, and Gas Supply
18 Acquisition Costs were taken from the respective columns of Informational Requirement
19 Document 12, Schedule 22 on each of the respective pages for the rate schedules.

20

21 Page 3 of Schedule 24 shows the creation of the Local Transmission/Distribution Fixed
22 Charge and Enhanced Administrative Charge for each of the rate schedules. Meter
23 Counts were taken from Informational Requirement Document 12, Schedule 23, pages 5-

1 8. Local Transmission/Distribution Fixed Costs and Enhanced Administrative Costs
2 were taken from the respective columns of Informational Requirement Document 12,
3 Schedule 22 on each of the respective pages for the rate schedules.

4
5 Q. PLEASE DESCRIBE SCHEDULES 25 AND 26 OF INFORMATIONAL
6 REQUIREMENT DOCUMENT 12.

7 A. Schedule 25 contains the detail of the Distribution Mains Zero-Intercept study for the
8 MERC-Consolidated service territory and consists of 12 pages. When conducting the
9 Zero-Intercept study for the MERC-Consolidated service territory Distribution Mains, an
10 outlier was found and a second study was performed removing that outlier from the data
11 set. The Zero-Intercept study was performed utilizing historical data for the year ending
12 December 31, 2009.

13
14 Schedule 26 contains the Distribution Mains Minimum-Size study for the MERC-
15 Consolidated service territory, and consists of one page. In theory, the results of a Zero-
16 Intercept study and Minimum-Size study should be approximately similar. Schedule 26
17 was provided to prove that this theory holds true. The Minimum-Size study was also
18 performed utilizing the same historical data for the year ending December 31, 2009 as the
19 Zero-Intercept study.

20
21 Q. PLEASE DESCRIBE SCHEDULE 27 OF INFORMATIONAL REQUIREMENT
22 DOCUMENT 12.

1 A. Schedule 27 shows the summarized results of MERC's natural gas embedded CCOSS for
2 the MERC-Consolidated service territory for the 2011 proposed test year expenses, but
3 utilizing a Rate Base allocation method to allocate Income Taxes. Schedule 27 consists
4 of 50 pages

5
6 Q. DO THE 50 PAGES OF THE 2011 PROPOSED TEST YEAR CCOSS SHOWN IN
7 SCHEDULE 27 OF INFORMATIONAL REQUIREMENT DOCUMENT 12 FOLLOW
8 THE SAME LAYOUT AS PRESENTED IN SCHEDULE 21 OF INFORMATIONAL
9 REQUIREMENT DOCUMENT 12?

10 A. Yes, they do. The only differences would be on pages 1-4 of Schedule 27, lines 12, 19,
11 and 50, which show Income Taxes and related items being allocated to the rate schedules
12 based upon the Rate Base allocation methodology. In Schedule 21, pages 1-4 show
13 Income Taxes and related items being allocated based upon Net Income. This difference
14 in allocation methodology affects the values shown in Schedule 27, pages 1-4, on Line
15 40, the Percent Rate of Return, and Lines 44-56, which calculate the revenue deficiency
16 by rate class, as compared to these items shown in Schedule 21.

17
18 Q. ARE THERE ANY OTHER DIFFERENCES TO THE 50 PAGES OF THE 2011
19 PROPOSED TEST YEAR CCOSS SHOWN IN SCHEDULE 27 OF
20 INFORMATIONAL REQUIREMENT DOCUMENT 12 AS COMPARED TO THE
21 CCOSS PRESENTED IN SCHEDULE 21 OF INFORMATIONAL REQUIREMENT
22 DOCUMENT 12?

1 A. No, there are not. All remaining pages and allocation methods presented in Schedule 27
2 of Informational Requirement Document 12, with the exception of the difference
3 explained above, are identical to those presented in Schedule 21 of Informational
4 Requirement Document 12.

5
6 Q. PLEASE DESCRIBE SCHEDULE 28 OF INFORMATIONAL REQUIREMENT
7 DOCUMENT 12.

8 A. Schedule 28 contains a functionalized and classified revenue requirement and rate base
9 allocation for each of the rate schedules in the MERC-Consolidated service territory
10 based upon the CCOSS presented in Schedule 27. There is one page of information for
11 each rate schedule. Schedule 28 consists of 29 pages.

12
13 Q. DO THE 29 PAGES OF SCHEDULE 28 OF INFORMATIONAL REQUIREMENT
14 DOCUMENT 12 FOLLOW THE SAME LAYOUT AS PRESENTED IN SCHEDULE
15 22 OF INFORMATIONAL REQUIREMENT DOCUMENT 12?

16 A. Yes, they do.

17
18 Q. PLEASE DESCRIBE SCHEDULE 29 OF INFORMATIONAL REQUIREMENT
19 DOCUMENT 12.

20 A. Schedule 29 shows the cost of service for the MERC-Consolidated service territory rate
21 schedules by billing unit based upon the CCOSS presented in Schedule 27. Schedule 29
22 consists of three pages.

23

1 Q. DO THE 3 PAGES OF SCHEDULE 29 OF INFORMATIONAL REQUIREMENT
2 DOCUMENT 12 FOLLOW THE SAME LAYOUT AS PRESENTED IN SCHEDULE
3 24 OF INFORMATIONAL REQUIREMENT DOCUMENT 12?

4 A. Yes, they do.

5
6 Q. IS THERE ANYTHING OF NOTE WHEN COMPARING SCHEDULE 29 TO
7 SCHEDULE 24 OF INFORMATIONAL REQUIREMENT DOCUMENT 12 THAT
8 YOU WOULD LIKE TO BRING ATTENTION TO?

9 A. Yes, I would like to note that the same issues that I addressed when comparing Schedule
10 11 to Schedule 4 of Informational Requirement Document 12 for MERC-PNG, are
11 occurring when comparing Schedule 29 to Schedule 24 for MERC-Consolidated.

12
13 The use of the Net Income allocation method to allocate Income Taxes, which is
14 incorporated into Schedule 24, consequentially produces larger cost-based fixed charges
15 than the use of the Rate Base allocation method to allocate Income Taxes, which is
16 incorporated into Schedule 29. This is attributable to the fact that allocated Basic
17 Transmission/Distribution Fixed Costs are higher for certain rate classes when using the
18 Net Income allocation method to allocate income taxes, as compared to using the Rate
19 Base allocation method, as shown in Schedules 24 and 29, page 3, Column [C]. A
20 summary is presented below.

21

22

1

Determination of Basic Transmission/Distribution Fixed Costs – MERC-Consolidated

Income Taxes allocated via:

	Net Income allocation method	Rate Base allocation method	\$ Difference: Net Income to Rate Base	% Difference: Net Income to Rate Base
Residential	\$56,624,192	\$66,534,523	(\$9,910,332)	-14.90%
Small General Service	\$3,086,301	\$3,380,051	(\$293,749)	-8.69%
Large General Service	\$9,610,772	\$5,984,872	\$3,625,900	60.58%
Small Volume Service	\$1,506,486	\$604,272	\$902,213	149.31%
Large Volume Service	\$534,180	\$219,449	\$314,732	143.42%
Super Large Volume Service	\$63,514	\$63,190	\$325	0.51%
Large Volume Flex Service	\$31,846	\$26,593	\$5,253	19.75%
Transport for Resale	\$3,705	\$1,369	\$2,337	170.69%

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As stated earlier, this consequence of higher fixed costs is directly attributable to the allocation of income taxes. The consequence of using the Net Income allocation method to allocate Income Taxes has the affect of allocating effectively an Income Tax “Credit”, rather than “expense”, to the rate classes that are showing a Pre-Tax Net Loss in the CCOSS, which in turn reduces their overall Revenue Deficiency. At the same time, the rate classes that are showing a Pre-Tax Net Gain/Income in the CCOSS (i.e. Large General Service, Small Volume, Large Volume, Large Volume Flex Service, and Transport for Resale) are receiving an allocation of Income Tax Expense – a disproportionately larger share of Income Tax Expense such that it covers the subsidization of an Income Tax “credit” that is being allocated to the rate classes that are showing a Pre-Tax Net Loss (i.e. Residential, Small General Service, and Super Large Volume).

1 Additionally, the second item of note relates to the calculated fixed charges portrayed on
2 Schedule 24, which utilizes the Net Income allocation method to allocate Income Taxes,
3 as compared to Schedule 29, which utilizes the Rate Base allocation method to allocate
4 Income Taxes. In theory, based upon cost causation, fixed charges should progressively
5 become larger as the customer classes contain larger customers. While this occurrence
6 appears in Schedule 29 when using Rate Base to allocate Income Taxes, it does not occur
7 in Schedule 24, where Net Income to allocate Income Taxes. As shown in Schedule 24,
8 page 1, Column [B], the calculated fixed charge for Super Large Volume customers is
9 \$186.81, while the calculated fixed charge for Large Volume customers, which are
10 smaller than Super Large, is \$236.05.

11
12 Q. WHAT DO YOU PROPOSE TO ADDRESS THE ISSUES THAT ARISE DUE TO
13 ALLOCATING INCOME TAX ON THE BASIS OF NET INCOME?

14 A. To address the issues noted above, I recommend that income tax be allocated on the basis
15 of rate base rather than net income. The computation of the amount of revenue required
16 for MERC is significantly related to the amount of MERC's rate base and is calculated by
17 multiplying the rate of return by the amount of rate base. Since MERC's income taxes
18 are a function of its earnings, using rate base is an appropriate method to allocate income
19 tax and more accurately allocates costs based on causation than use of the Net Income
20 allocator because Net Income does not necessarily portray the actual cost to serve
21 customers, especially in the current instance with MERC, where customers are currently
22 being undercharged, the Company is showing a revenue deficiency, and therefore certain
23 rate schedules have artificially low present revenues. As shown above, in using Net

1 Income as the allocation method for income taxes, the rate schedules that show an
2 artificially low net income are allocated an artificially low amount of income taxes.
3 Therefore use of the Net Income allocation method to allocate income taxes can
4 inappropriately skew cost responsibility among rate schedules.
5

6 Q. PLEASE DESCRIBE SCHEDULE 30 OF INFORMATIONAL REQUIREMENT
7 DOCUMENT 12.

8 A. Schedule 30 shows an incremental cost analysis for MERC's Super Large Volume
9 customers. The result of the analysis is utilized by MERC witness Mr. Greg Walters to
10 demonstrate that the Super Large Volume customer classes are covering the incremental
11 cost of serving them.
12

13 Q. PLEASE DESCRIBE SCHEDULE 31 TO 33 OF INFORMATIONAL REQUIREMENT
14 DOCUMENT 12.

15 A. As required by Order Point 8 of the Commission's Final Order in Docket No. G-
16 007,011/GR-08-835, Schedules 31, 32, and 33 identify and describe each allocation
17 method used in the CCOSs for MERC-PNG, MERC-NMU, and MERC-Consolidated,
18 respectively. Schedules 31, 32, and 33 also detail the reasons for concluding that each
19 allocation method is appropriate and superior to other allocation methods considered.
20

21 Q. PLEASE DESCRIBE SCHEDULE 34 OF INFORMATIONAL REQUIREMENT
22 DOCUMENT 12.

23 A. Schedule 34 provides the determination of the appropriate Enhanced Administration

1 Monthly Fixed Charge, also known as the Transportation Administration Fee, for both
2 the MERC-PNG and MERC-NMU service territories. The Transportation
3 Administration Fee is charged only to Transportation customers to cover the added
4 administrative costs of providing transportation service. The Transportation
5 Administration Fee does not differ between service territories because when MERC
6 provides transportation service, it does not distinguish between the service provided to
7 MERC-PNG transport customers versus MERC-NMU transport customers; the service is
8 provided to MERC transport customers as a whole. The added administrative costs of
9 providing transportation service are caused on a per customer basis; i.e. the costs do not
10 vary with each customers' usage. Therefore the charge was calculated based upon meter
11 counts.

12
13 Q. HAS THE TRANSPORTATION ADMINISTRATION FEE CALCULATED FROM
14 THE CCOSS CHANGED SINCE MERC'S LAST RATE CASE FILING?

15 A. Yes, it has decreased from a calculated value of \$162.18 in MERC's last rate case Docket
16 No. G-007,011/GR-08-835, to a calculated value of \$70.20, as shown in Informational
17 Requirement Document 12, Schedule 34.

18
19 Q. WHAT ARE THE REASONS FOR THE DECREASE IN THE TRANSPORTATION
20 ADMINISTRATION FEE, AS CALCULATED FROM THE CCOSS?

21 A. The decrease is attributable to improved administration and reduced employee labor
22 costs. In Docket No. G-007,011/GR-08-835, a portion of the costs associated with the
23 \$162.18 transportation administration fee were attributable to the initial time period after

1 the MERC acquisitions by Integrys dedicated to establishing processes, controls, and
2 procedures associated with administering the transportation program, along with bill
3 verifications and pipeline reconciliations. These initial costs were reasonable and
4 necessary because Integrys was required to contract with a new entity (VERTEX,
5 formerly Alliance Data Systems, or “ADS”) for customer billing and call center services
6 after Aquila’s departure. The necessary processes, controls, and procedures are now in
7 place, resulting in reduced costs.

8

1 **X. CONCLUSION**

2 Q. IN YOUR OPINION, DO THE COST OF SERVICE STUDIES PROVIDE A
3 REASONABLE BASIS FOR ESTABLISHING RATES IN THIS CASE?

4 A. Yes, they do. The CCOSSs for the MERC-NMU, MERC-PNG, and MERC-
5 Consolidated service territories are reasonable estimates of revenue requirements by
6 customer class and support the rates requested in this case.

7
8 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY ON THE COST OF
9 SERVICE STUDIES FOR THE MERC-NMU, MERC-PNG, and MERC-
10 CONSOLIDATED SERVICE TERRITORIES AT THIS TIME?

11 A. Yes, it does.