REVISED ACTION REQUEST

Date: May 17, 2012

FROM: Public Service Commission Due: June 25, 2012__

SUBJECT: RMP Rate Case 11-035-200
(Company Name, Case Number, etc.)

This is a request for the Division to conduct:

_________ Review Tariff Compliance

_________ Analysis of Complaint

____X____ Investigation

_________ Other

EXPLANATION AND STATEMENT OF ISSUES TO BE ADDRESSED:

RE: Docket No. 11-035-200, Cost of Service Issues

In preparing the reformatted integrated model, "RR & COS direct RMP" the Commission observes three inconsistencies between the Company's jurisdictional and class cost of service studies: 1) relations among cash working capital, interest expense, and income taxes; 2) the determination of state income taxes; and 3) use of the income to revenue multiplier . These issues are further described below. The Commission requests the Division investigate these inconsistencies.

Relations of Cash Working Capital, Interest Expense, and Income Taxes

The jurisdictional study employs a specific treatment of the relations among cash working capital, interest expense and income taxes commonly used in allocation studies, for both electric and gas utilities. The functional and class studies do not employ these same relations.

For example, the functional study includes a revenue imputation process, discussed further below, which introduces inconsistent treatment of cash working capital, interest expense and income taxes.

Please investigate the need for these differences and the advantages and disadvantages of maintaining or eliminating these differences with respect to fairly stating cost of service by rate schedule.

Would a direct calculation of cash working capital, interest expense and income taxes by rate schedule, without assumptions or imputation, be simpler and result in a fair statement of cost of service by rate schedule?

Determination of State Income Taxes

In Docket No. 09-035-23, the Commission ordered the Company to calculate rate schedule income taxes based on taxable income, rather than by relative rate base.[1] In the Company's current filing, it proposes to implement this decision by first imputing revenues, cash working capital, interest expense and income taxes of the jurisdiction to functions based on an iterative calculation driven by the assumption all functions earn the jurisdictional rate of return. Then in the class cost-of-service study, each function's state income taxes are allocated to rate schedules based on relative taxable income, known as the Income-Before-Tax (IBT) factor. The state income taxes for a rate schedule are the sum of its allocated functional amounts.

In Docket No. 02-035-04, the Commission approved calculating jurisdictional state income taxes by applying a blended state income tax rate directly to jurisdictional taxable income rather than using the IBT factor. The Company stated in Docket No. 02-035-04 "this change is necessary because of the volatility of calculating results for a single jurisdiction."[2] The Company also made adjustments to the IBT factor in Docket Nos. 10-035-13[3] and 10-035-89,[4] the Major Plant Additions cases, noting the IBT factor produced irregularities. We observe the Company has eliminated use of the IBT factor for allocating state income taxes to jurisdictions in its current filing but maintains it for allocating state income taxes to rate schedules.

What are the advantages and disadvantages of maintaining use of the IBT Factor in the class cost of service study?

Could consistent application of the blended state income tax rate between models result in a simpler process and a fair statement of cost of service by rate schedule?

Income to Revenue Multiplier

The jurisdictional study applies the income to revenue multiplier to the excess or insufficient income in a given jurisdiction to determine the revenue change necessary to bring that jurisdiction from its earned rate of return to the Company's *requested* rate of return. The class study applies the income to revenue multiplier <u>only</u> to the excess or insufficient income in each rate schedule necessary to bring the rate schedule *from* the jurisdictional, rather than its own, earned rate of return to the Company's *requested* rate of return.

Does the Company's approach in the class cost of service study fairly account for the income tax and uncollectible effects of revenue changes for each rate schedule?

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[1] See Docket No. 09-035-23, Report and Order dated February 18, 2010, at 131-132.
[2] Steven R. McDougal, direct testimony, at 13, lines 291-292.
[3] Steven R. McDougal, direct testimony, at 7, lines 151-163.
[4] Brian S. Dickman, direct testimony, at 9 and 10, lines 214-232.