**Witness OCS – 1D**

**BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH**

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| IN THE MATTER OF THE APPLICATION OF QUESTAR GAS COMPANY TO INCREASE DISTRIBUTION RATES AND CHARGES AND MAKE TARIFF MODIFICATIONS | )<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>) | **Docket No. 13-057-05**<br><br>**Direct Testimony**<br>**Danny A.C. Martinez**<br>**On behalf of the**<br>**Office of Consumer Services** |

**October 30, 2013**

**Q. WHAT IS YOUR NAME, YOUR OCCUPATION AND YOUR BUSINESS ADDRESS?**

A. My name is Danny A.C. Martinez. I am a utility analyst for the Office of Consumer Services (Office). My business address is 160 E. 300 S., Salt Lake City, Utah 84111.

**Q. PLEASE DISCUSS YOUR EDUCATION AND QUALIFICATIONS.**

A. I have B.S. and M.S. degrees in economics from the University of Utah. I also have an MPA degree from the University of Utah. My private and public sector work experience spans over 20 years including ten years in financial services and ten years teaching economics. In 2010, I was hired by the Office of Consumer Services. At the Office, I have worked primarily in the areas of cost of service (COS) and demand side management (DSM). I also have attended various training opportunities, including a week long intensive training specializing on cost of service and rate design. Lastly, I have participated in technical conferences and ancillary meetings associated with the Cost of Service Work Group ( COS Work Group) ordered by the Commission in Questar Gas Company's (QGC or Company) last general rate case (GRC), Docket 09-057-16.

**Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

A. My testimony does the following:

- Introduces the Office's witnesses in this proceeding;
- Summarizes the Office's overall revenue requirement recommendation;
- Presents the Office's cost-of-service analysis and recommendations;
- Presents the Office's GS rate design analysis and GS BSF proposals;
- Presents the Office's policy recommendations on the following issues:

1. The continuation of the Infrastructure Tracker;
2. The appropriate size and scope of the Infrastructure Tracker; and
3. The proposed changes to contribution in aid of construction (CIAC) and line extension policy.

**Q. PLEASE IDENTIFY THE EXPERT WITNESSES HIRED BY THE OFFICE FOR THIS PROCEEDING AND THEIR GENERAL AREA OF TESTIMONY.**

A. The Office retained two expert witnesses for this general rate case. The first witness is Daniel J. Lawton who presents the Office's recommended cost of capital and return on equity for Questar Gas Company. The Office's second witness is Mr. Michael Arndt, a certified public accountant. Mr. Arndt proposes a number of adjustments in the areas of revenue, operating expense and rate base and presents the Office's overall revenue requirement recommendation for this case.

**Q. PLEASE DESCRIBE THE OFFICE'S GENERAL VIEWS ON THIS CASE.**

A. Generally, the Office views this case as having two major components. First, the Company has greatly overstated its revenue requirement needs, as will be demonstrated in Mr. Arndt's testimony. Second, the Company has provided a rate spread proposal designed to increase rates for all classes to full cost of service levels. Although the Office is recommending a revenue requirement decrease in this proceeding, the Office believes that it is imperative for the Commission to rebalance the overall rate structure so that customers in all classes are paying rates that appropriately reflect cost of service and are equitable, rather than just spreading the rate decrease.

**Q. PLEASE SUMMARIZE THE OFFICE'S REVENUE REQUIREMENT RECOMMENDATION FOR THIS CASE.**

A. The Office recommends an overall revenue requirement decrease of $5.7 million from current rate levels, which is based on the Office's proposed return on equity of 9.3% and return on rate base of 7.35%.

**Q. PLEASE SUMMARIZE THE OFFICE'S RECOMMENDATIONS RELATING TO COST OF SERVICE FOR THIS CASE.**

A. The Office recommends that the Commission approve the following:

1. The interruption test for the Interruptible Service (IS) class with its "Failure to Interrupt" charge methodology should be implemented;
2. The FT-1 criteria and rate increase proposed by the Company should be implemented.

Q. **PLEASE SUMMARIZE THE OFFICE'S RECOMMENDATIONS RELATING TO THE RATE SPREAD FOR THIS CASE.**

A. The Office supports the Company's rate spread proposal. The Company's proposed rate spread is designed to remove interclass subsidies and move all classes to full cost of service. The Office supports the principle that all customer classes should pay rates that reflect their full cost of service.

**Q. PLEASE SUMMARIZE THE OFFICE'S RATE DESIGN PROPOSAL FOR THIS CASE.**

A. The Office recommends that for the General Service (GS) class the Commission approve a basic service fee (BSF) of $7, $16.50, $57, $370 for BSF categories 1 through 4, respectively. The Office further recommends that the distribution non-gas (DNG) rate blocks be adjusted to maintain approximately the same proportions to each other and calculated to collect the remaining revenue assigned to the GS class.

The Office does not have a position on Questar Gas' rate design proposals for other customer classes.

**Q. PLEASE SUMMARIZE THE OFFICE'S POLICY RECOMMENDATIONS ON OTHER ISSUES.**

A. The Office recommends the following:

1. The infrastructure tracker mechanism should be allowed to continue, but should not be made permanent.
2. The Company should be required to file a general rate case within three years. In that rate case, the infrastructure tracker should again be reviewed to determine whether or not it should be continued.
3. Intermediate high pressure mains should not be included in the Tracker.
4. The infrastructure tracker budget should remain at $55 million and thereafter annually adjusted for simple inflation and not indexed.
5. The Company's CIAC cost sharing and line extension proposals should be approved. The Office will take a position on any related DSM proposals at the time they are presented in the appropriate DSM proceeding.

**Q. PLEASE DESCRIBE HOW YOUR TESTIMONY IS ORGANIZED.**

A. My testimony will be divided into the following sections:

- Cost of Service;
- Rate Spread;
- GS Rate Design; and
- Policy Issues.

## <u>COST OF SERVICE</u>

***Interruption Testing for Interruptible Service Customers***

**Q. PLEASE SUMMARIZE THE COMPANY'S INTERRUPTION TEST FOR THE (IS) CLASS.**

A. In this case, the Company has proposed an interruption test for IS customers. The test will be performed once annually with a 24-hour notification prior to the test. If a customer is unable to curtail its interruptible volumes, then a "Failure to Interrupt" charge is levied. The charge represents an annual demand charge similar to firm service annual demand charge. This charge is based on the functionalized demand costs of a comparable firm rate class and dividing the costs by the demand decatherms for each respective rate class.

**Q. DOES THE OFFICE AGREE WITH THE COMPANY'S PROPOSAL REGARDING AN ANNUAL INTERRUPTION TEST FOR INTERRUPTIBLE SERVICE CUSTOMERS?**

A. The Office supports the concept of an interruption test. The test provides verification that a given IS customer's service is interruptible when notified. Thus, the interruption test ensures that IS customers are able to provide the benefit to the system for which they are given lower rates.

**Q. DOES THE OFFICE AGREE WITH THE COMPANY'S PROPOSAL REGARDING THE FAILURE TO INTERRUPT CHARGE?**

A. In part. The "Failure to Interrupt" charge appears designed to provide compensation to Questar's other customers when an IS customer is unable to comply with the interruptible test. However, unless the failure to interrupt charges are accounted for in such a way that they will be passed through to customers through the 191 account, then any Failure to Interrupt charges collected will be a windfall to the Company. There is no justification for such a windfall. The Office recommends that changes must be made to the IS tariff to ensure that Failure to Interrupt charges are credited back to customers, otherwise it cannot be considered to be just and reasonable.

***FT-1 Qualifying Criteria***

**Q. WHAT IS THE PURPOSE FOR THE FT-1 RATE?**

A. The FT-1 rate was designed to provide incentives to large industrial customers with bypass options to remain on the Questar Gas system. In Docket 94-057-02, the FT-1 rate was originally established as the FT rate "in response to the challenges of competition and bypass." (Commission Order Dated December 28, 1994, Docket 94-057-02, p. 2.)

**Q. IN PAST GENERAL RATE CASES, HAS THE OFFICE SUPPORTED THE CONCEPT OF THE FT-1 RATE IN PREVENTING LARGE CUSTOMERS FROM BYPASSING QUESTAR GAS' SYSTEM?**

A. Yes. In the 2002 GRC, Office witness Michael J. McFadden testified about the importance of the FT-1 rate stating, "If it could be demonstrated that the benefits of retaining a large customer outweigh the costs, all customers on the system potentially benefit by avoiding a bypass situation." In other words, if the revenue from an FT-1 customer covers variable costs and makes a reasonable contribution towards covering fixed costs, then it makes economic sense to avoid a potential bypass situation. Thus, the Office has supported the concept of the FT-1 class, so long as these two key components are periodically reviewed. The FT-1 qualification should be reviewed to ensure FT-1 customers are truly bypass risks. Also, the FT-1 rate must be reviewed to ensure that it covers variable costs and makes a reasonable contribution to fixed costs.

**Q. DID THE COMPANY EVALUATE THE QUALIFYING CRITERIA FOR THE FT-1 CLASS ELIGIBILITY?**

**A.** Yes. Company witness Austin Summers outlines the Company's evaluation and proposed modification to the FT-1 criteria in his direct testimony at lines 433-478 and QGC Exhibit 4.10.

**Q. HOW MANY FT-1 CUSTOMERS WOULD REMAIN IN THE FT-1 CLASS UNDER THE NEW QUALIFYING CRITERIA?**

A. Three of the current nine customers would remain in the FT-1 class under the new qualifying criteria. Thus, six customers would no longer qualify for the FT-1 rate.

. **Q. DOES THE COMPANY'S PROPOSED FT-1 RATE COVER VARIABLE COSTS AND MAKE A CONTRIBUTION TO FIXED COSTS?**

A. The Company's spread proposal includes a rate increase for the FT-1 class that sets rates high enough such that those customers will cover their incremental costs as well as make a contribution to fixed costs. If the FT-1 rates are not raised by enough to ensure a reasonable contribution to fixed costs, then other customers would be better off not having the FT-1 customers on the system.

**Q. PLEASE PROVIDE THE OFFICE'S RECOMMENDATION ON THIS ISSUE.**

A. The Office supports the new qualifying criteria and rate increase proposed by the Company for the FT-1 class. The Office recommends that the Commission approve the Company's proposed FT-1 criteria and rate increase.

## RATE SPREAD

**Q. WHAT IS THE COMPANY'S PROPOSED RATE SPREAD IN THIS CASE?**

A. The Company's rate spread is based on moving all rate schedules to full cost of service. Table 1 below shows the Company's proposed rate spread:

**Table 1 - Proposed Rate Increase by Class**

| Customer Class | Proposed Rate Increase (%)[1] |
|---|---|
| GS | 2.80% |
| FS | 3.24% |
| IS | 38.87% |
| TS | 47.10% |
| FT-1 | 30.72% |
| NGV | 14.10% |

**Q. WHAT IS THE OFFICE'S RATE SPREAD RECOMMENDATION FOR THIS PROCEEDING?**

A. The Office conceptually supports the Company's proposed rate spread designed to result in rates that appropriately reflect cost of service. The specific proposed percentage increases will depend on the final revenue requirement ordered by the Commission.

**Q. WHAT IS THE BASIS FOR THE OFFICE'S RECOMMENDATION?**

A. Over the past three cases, the GS and FS classes have consistently performed well. However, the TS, IS, and NGV classes for years have significantly under-earned and this chronic poor performance has resulted in ongoing interclass subsidies. Thus, the Commission should rebalance the class rate structure by ensuring that the ordered rates for each class reflect cost causation and are equitable.

[1] This rate includes base DNG rates, inclusion of the Infrastructure Tracker, and the Lake Side 1 revenue credit.

**Q. PLEASE EXPLAIN THE ANALYSIS UNDERTAKEN TO SUPPORT THE OFFICE'S POSITION.**

A. The Office used a rate of return index analysis to measure the performance of each customer class. First, the Office examined the rate of return performance index for each class as presented by the Company in this GRC. The index value is calculated by taking the ratio of the actual return on rate base over the allowed rate of return. Second, the Office reviewed the rate of return indices for individual rate schedules over the last three rate cases to determine which classes consistently produced sufficient revenue to cover calculated costs. Typically in this type of analysis, a return of 1.00 means a class is producing sufficient revenue to cover its estimated cost of service.

**Q. HAS RATE OF RETURN ANALYSIS BEEN USED IN PREVIOUS GENERAL RATE CASES?**

A. Yes. In the 2007 rate case, some parties performed rate of return analysis, which was used by the Commission in determining the rate increases for each class.

**Q. WHAT DID THE COMMISSION CONCLUDE FROM THE 2007 RATE OF RETURN ANALYSIS?**

A. In referencing the class return analysis presented by various parties, the Commission stated, "From this data we conclude there is above satisfactory earnings performance by the GSC schedule, approximately satisfactory performance by the GSR schedule, mixed results from the FS and FT-1 schedules, and unsatisfactory performance by the IS and TS schedules." (Commission Order Dated December 22, 2008, Docket 07-057-13 p. 33)

**Q. DID THE OFFICE USE A SIMILAR RATE OF RETURN ANALYSIS TO EVALUATE CLASS RETURNS IN THE CURRENT GRC?**

A. Yes. The Office evaluated the Company's filed class return analysis from the last three GRCs. The results from these cases are shown in Table 2:

**Table 2 - Rate of Return Analysis by General Rate Case**

| Rate on Rate Base Index | UT Jurisdiction | GS | FS | IS | TS | FT-1 | NGV |
|---|---|---|---|---|---|---|---|
| 07-057-03 GRC | 0.88 | 1.03 | 0.67 | -0.01 | 0.04 | NA | NA |
| 09-057-16 GRC | 0.87 | 0.94 | 1.22 | 0.23 | 0.27 | 0.04 | 0.20 |
| 13-057-05 GRC | 0.85 | 0.91 | 0.95 | 0.39 | 0.27 | -0.42 | 0.79 |

**Q. PLEASE EXPLAIN HOW TO EVALUATE THE RETURN NUMBERS IN THE RATE OF RETURN ANALYSIS.**

A. A return of 1.00 is normally considered full cost of service in a revenue-neutral analysis. This means that a class is providing exactly the amount of revenue necessary to cover estimated costs. However, the return analysis presented by the Company is only based on its requested revenue requirement in this proceeding. Therefore, a better benchmark to use in evaluating class returns is the average Utah jurisdictional return in comparison to each individual class return.

In this analysis, the Utah jurisdictional return on rate base index for the 13-057-05 case is 0.85. This average return is an approximation of the difference between currently allowed rates and the Company's request for an increased revenue requirement. Thus, it represents a reasonable benchmark by which to evaluate how well different classes are performing. Generally, classes with a return over 0.85 are over-performing and classes with a return under 0.85 are under-performing. Similarly, the Utah jurisdictional return of 0.88 in the 07-057-13 case and 0.87 in the 09-057-165 can be used as performance benchmarks in those cases.

**Q. WHY DID THE OFFICE ONLY USE THE PAST TWO RATE CASES IN ITS ANALYSIS?**

A. Previous to the 2007 case, class cost of service information was not explicitly reported for all customer classes as currently defined. Since 2007 that information has been included in the Company's COS studies.

**Q. PLEASE DISCUSS YOUR RETURN ON RATE BASE INDEX ANALYSIS AND WHAT IT SHOWS?**

A. The analysis indicates certain classes are performing significantly better in this GRC compared to other classes. For example, in the current rate case the GS class and the FS class have a high return on rate base index of 0.91 and 0.95 respectively. The NGV class has a lower return on rate base index value of 0.79; the IS class has a very low return on rate base index value of 0.39; and the TS class has an even lower return on rate base index value of 0.27. The FT-1 class has a return on rate base index value of -0.42, but since it is designed to avoid bypass, this rate must be evaluated differently. In short, the returns for the GS and FS classes exceed the 0.85 average return benchmark discussed above; the return for the NGV class is a little below this benchmark; and the returns for the IS, and TS classes are significantly below the benchmark.

**Q. HAVE RETURNS CHANGED MUCH FROM PREVIOUS CASES?**

A. The results vary depending on the class. Table 2 above shows the return on rate base index for the past two GRCs and the current GRC for each customer class.

Table 2 generally shows that the same classes that were either strong or weak performers in past rate cases are the same classes that continue to be strong and weak performers in the current case. For example, Table 2 shows that the GS class has been a strong performer in each of the past three rate cases with a return exceeding the jurisdictional average.

Conversely, the TS class has been a chronic poor performer in each of the past three rate cases with a return far below the jurisdictional average. The NGV is the one class that made significant improvement since the last case, but is not yet covering its full costs.

**Q. HAS THE EXISTENCE OF SUBSIDIZED CLASSES LED TO CUSTOMERS SWITCHING CLASSES?**

A. Yes. One hundred and ninety-one customers switched from the GS or FS classes, the two classes that have been solid performers, to the TS class during 2012 and 2013. The Company indicated that the revenue impact from these customers switching classes was a revenue decrease of $993,058.

**Q. HOW DOES THIS REVENUE DECREASE IMPACT COST OF SERVICE AND POTENTIALLY AGGRAVATE EXISTING INTERCLASS SUBSIDIES?**

A. The classes losing customers (in this case GS and FS) also lose revenues to cover their cost of service. At the same time, the customers that switched classes are now paying rates that are set too low to cover costs. As the differential increases between the classes paying full cost of service and those being subsidized, additional customers become economically motivated to change classes. Over time, this creates a vicious cycle of increasing subsidies for the classes whose revenues fail to cover costs.

**Q. BASED ON THE OFFICE'S ANALYSIS, WHAT SHOULD BE DONE WITH THE UNSATISFACTORY PERFORMING CLASSES?**

A. Simply stated, the TS, IS and NGV classes need to be moved to full cost of service in this case. Furthermore, the FT-1 rate should be increased so that it provides a reasonable contribution to covering fixed costs. Enough time has passed during which these classes have enjoyed substantial discounts. Customers will continue to switch classes so long as there is an incentive to do so, further contributing to current interclass subsidies.

**Q. PLEASE SUMMARIZE THE OFFICE'S RATE SPREAD PROPOSAL.**

A. The Office recommends that the Company's spread proposal be utilized and updated to reflect the revenue requirement ordered by the Commission. For the reasons described in this section, it is important that the Commission rebalance the assignment of costs to the different classes and set new rates that better reflect cost causation. Absent such a rebalancing of the rate structure, the TS and IS classes will continue to be subsidized by the GS and FS classes thereby perpetuating a cycle that has been in place for years. Finally, this rate rebalancing should occur irrespective of the magnitude of the revenue requirement increase or decrease ordered by the Commission. .

**Q. DOES THE OFFICE HAVE ANY ADDITIONAL RECOMMENDATIONS REGARDING RATE SPREAD?**

A. Yes. In future general rate cases, the Company should file its class return results for a revenue neutral case as well as at the level of requested revenue increase. This will more easily facilitate an evaluation of the current performance of the various customer classes.

## RATE DESIGN

### *GS Basic Service Fee*

**Q. PLEASE DESCRIBE THE OFFICE'S BASIC SERVICE FEE PROPOSAL.**

A. The Basic Service Fee (BSF) for Category 1 should be calculated to reflect current costs for the categories allowed under the Commission's method. As explained later in my direct testimony, the BSF method should be expanded to include customer records. Consequently, the Office's proposal increases the BSF Category 1 charge from $5 to $7.

Regarding BSF Categories 2-4, the BSF calculation should include the same elements as identified for BSF Category 1. Thus, the existing BSF for categories 2 - 4 need to be modified to remove inclusion of any cost of mains. The result of this modification produces BSF's of $7, $16.50, $57, $370 for BSF categories 1 through 4, respectively.

**Q. HOW DOES THE OFFICE'S PROPOSAL COMPARE TO THE COMPANY'S PROPOSED BSF'S?**

A. Table 3 summarizes the BSF comparison:

**Table 3 - Basic Service Fee Comparison**

| BSFs | 1 | 2 | 3 | 4 |
|---|---|---|---|---|
| Current | $5.00 | $21.00 | $55.00 | $244.00 |
| Proposed by OCS | $7.00 | $16.50 | $57.00 | $370.00 |
| Proposed by QGC | $8.00 | $19.50 | $67.00 | $434.00 |

**Q. WHAT INFORMATION DID THE OFFICE RELY ON IN DEVELOPING THE OFFICE'S BSF PROPOSAL?**

A. The Office reviewed past Commission Orders addressing the residential customer charge, the Company's customer charge proposal in this GRC, and the responses to discovery requests submitted to the Company on the topic. In particular, the Commission provided specific guidance on what should be included in the BSF in docket 82-057-15. Although considerable time has elapsed since that docket, the Commission has not provided different guidance since that time. Further, the Commission's guidance generally reflects what the Office considers to be the sound fundamental principle that costs included in customer charges should be the types of costs that do not vary based on level of usage and are, therefore, appropriate to be included in a uniform charge applicable to each customer. Thus, I used the Commission's method as a starting point for developing the Office's BSF proposal.

**Q. PLEASE DESCRIBE THE COMMISSION'S METHODOLOGY.**

A. In Docket 82-057-15, the Commission approved a customer charge method. The language stated:

> "The Commission finds that the appropriate methodology to be utilized in developing a customer charge is to include only those plant costs that are on the customer's premises. These include the service line, the meter, the regulator, and related costs such as taxes and return. The Commission also finds that the expenses that should be included in a customer charge calculation are those expenses which are caused by every customer each month. Costs that generally increase with the number of customers, but are not caused by each customer should be excluded from the customer charge and instead included within the commodity portion of Mountain Fuel's rates." (Commission Order Dated, December 21, 1983, Docket 82-057-15, p. 27)

**Q. PLEASE DESCRIBE RECENT CHANGES TO THE BSF.**

A. In the 2002 rate case (Docket 02-057-02), the meter-based customer charge was renamed "Basic Service Fee." Furthermore, BSF's were benchmarked in that case as follows:

> "The current [BSF] Category I meter-based customer charge of $5.00 shall be maintained. Category II, III, and IV customer charges will be adjusted to reflect the authorized overall rate of return in this case."

(Commission Order – Dated December 30, 2002, Docket 02-057-02, p 70.)

Prior to that case, the GS-1 class and the FS class did not include mains in the BSF calculation as prescribed by the Commission. However, the Company proposed the inclusion of mains in that case. The Commission order to maintain a $5.00 BSF for Category 1 clearly does not cover the costs of mains as proposed by the Company. Although the Commission approved the higher costs for the BSF for categories 2 - 4, it did not explicitly endorse the inclusion of mains within any BSF category.

**Q. PLEASE COMPARE THE OFFICE'S PROPOSED BSF WITH THE COMPANY'S PROPOSAL.**

A. Table 4 below compares the Office's and the Company's BSF 1 proposals.

**Table 4 - BSF Cost Element Comparison for BSF Category 1**

| | Basic Service Fee Costs | OCS BSF | QGC BSF |
|---|---|---|---|
| 1 | Return on Net Investment | $20.63 | $23.55 |
| 2 | Grossed Up Income Tax | $8.34 | $9.94 |
| 3 | O&M: Based on Gross Plant | $5.93 | $14.82 |
| 4 | Weighted Avg. Billing Cost/Meter | $26.33 | $26.33 |
| 5 | Property Tax on Net Investment | $2.75 | $2.95 |
| 6 | Annual Depreciation | $18.78 | $19.92 |
| 7 | Annual Total Costs | $82.76 | $97.50 |
| | **Monthly Charge** | **$6.90** | **$8.13** |

With the key exception of mains, the Company and the Office generally agree on the cost elements that should be included in calculating the BSFs. Below I discuss the differences between the two proposals and provide the rationale for the Office's positions and calculations. In particular, I explain why the Office opposes including the cost of mains in the BSF.

**Q. WHY IS THE COMPANY'S "RETURN ON NET INVESTMENT" (LINE 1 OF TABLE 4) HIGHER THAN THE OFFICE'S "RETURN ON NET INVESTMENT"?**

A. There are two components that differ within the return on net investment cost element. The primary difference is that the Company includes 10% of the cost of mains in net investment. Also, the rates of return differ. The Company is proposing a 10.35% return on equity while the Office is proposing a 9.3% return on equity. The Company's higher requested return increases this cost component.

Q. **WHY IS THE COMPANY'S "GROSSED UP INCOME TAX" (LINE 2 OF TABLE 4) HIGHER THAN THE OFFICE'S "GROSSED UP INCOME TAX"?**

A. The Company's inclusion of mains and higher rate of return generates greater taxable income and thus a higher income tax liability compared to the Office's grossed up income tax.

**Q. WHY IS THE COMPANY'S "O&M: BASED ON GROSS PLANT" (LINE 3 OF TABLE 4) HIGHER THAN THE OFFICE'S "O&M: BASED ON GROSS PLANT"?**

A. The Company includes the O&M expenses associated with mains resulting in a higher amount for this cost component. Since the Office recommends excluding mains from the BSF calculation, O&M expenses decrease by $1,467,594.

**Q. HOW DID THE OFFICE CALCULATE REMOVING MAIN-RELATED COSTS FROM O&M EXPENSE?**

A. Part of the Company's O&M expense in line 3 includes FERC Account 874, which reflects the cost of labor, materials used, and expenses incurred in operating mains and service lines. The Company does not currently separate mains expenses from service line expenses in FERC

Account 874. In order to remove costs related to mains from FERC Account 874, I divided total service line plant by the sum of mains and service line plant in the Company's Distribution Plant Study. I then took the calculated ratio and multiplied it by the amount of FERC account 874 to derive the service line proportion to include in the Office's BSF proposal.

**Q. WHY IS THE COMPANY'S "WEIGHTED AVG. BILLING COST/METER" (LINE 4 OF TABLE 4) THE SAME AS OFFICE'S "WEIGHTED AVG. BILLING COST/METER"?**

A. Since the customer related charges are the same and don't depend on either rate of return or inclusion of mains, the amounts are the same in the BSF calculation.

**Q. WHY DOES THE OFFICE SUPPORT INCLUDING CUSTOMER RECORDS EXPENSE WITHIN THE WEIGHTED AVERAGE BILLING COST PER METER?**

A. FERC Account 903 includes "the cost of labor, materials used and expenses incurred in work on customer applications, contracts, orders, credit investigations, billing and accounting, collections and complaints." Although customer records are not included in the Commission method, such expenses appear to be associated with customer billing. Thus the Office believes it is reasonable to include this category of expenses in the customer charge.

**Q. WHY IS THE COMPANY'S "PROPERTY TAX ON NET INVESTMENT" (LINE 5 OF TABLE 4) HIGHER THAN THE OFFICE'S "PROPERTY TAX ON NET INVESTMENT"?**

A. Inclusion of mains increases the taxable rate base included in the BSF. The Office excludes mains and thus has a lower property tax on net investment.

**Q. WHY IS THE COMPANY'S "ANNUAL DEPRECIATION" (LINE 6 OF TABLE 4) HIGHER THAN THE OFFICE'S "ANNUAL DEPRECIATION"?**

A. The inclusion of mains increases the rate base to be included in the BSF. Again, the Office's position of excluding mains from the BSF lowers this cost element compared to the Company's proposal.

**Q. BASED ON THIS COMPARISON, WHAT IS THE PRIMARY DIFFERENCE BETWEEN THE OFFICE'S BSF PROPOSAL AND THE COMPANY'S PROPOSAL?**

A. The Company proposes to include the cost of mains in the BSF calculation while the Office recommends excluding the cost of mains.

**Q. PLEASE EXPLAIN WHY THE OFFICE DOES NOT INCLUDE MAINS IN ITS NET INVESTMENT ALLOCATION.**

A. First, mains are not included within the Commission-approved method. Second, mains are a type of cost that can vary by customer size, i.e. differences in customer requirements can influence the size and deployment of mains. Thus, the cost of mains should not be included in the BSF.

**Q. WHAT WAS THE COMPANY'S RATIONALE FOR INCLUDING MAINS IN THE BASIC SERVICE FEE CALCULATION?**

A. According to Company witness Austin Summers:

> "Traditionally the Company and the utility industry have given recognition to the fact that mains are sized to serve more than just individual customers. I have included a very small portion of the cost of IHP main (10%) to reflect this convention." (Austin Summers Direct Testimony p14, lines 374 – 376.)

**Q. DOES THE OFFICE AGREE WITH THE COMPANY'S RATIONALE FOR INCLUDING MAINS IN THE BSF CALCULATION?**

A. No. In fact, the Company's argument is additional justification for why the cost of mains should *not* be included in the BSF. If mains are sized to serve multiple customers, then costs associated with mains would only be appropriate for the BSF if customers were all the same size. However, the fact is that some customers are larger than others. Smaller customers should not have to pay the same cost for mains as larger customers pay, even for just the 10% of the costs that the Company proposes including in the BSF. The only fair allocation of the costs of mains, which are driven by the size of customers, is to include the full amount in the volumetric portion of rates.

**Q. DOES EXCLUSION OF MAINS IN THE BSF CALCULATION PREVENT THE COMPANY FROM RECOVERING COSTS RELATED TO MAINS?**

A. No. Costs related to mains will still be recovered through volumetric rates charged to customers.

**Q. DOES THE OFFICE INCLUDE THE COST OF MAINS IN ANY OF THE FOUR GS BSF CATEGORIES?**

A. No. While the Office acknowledges that the Company has previously included the cost of mains in the BSF for categories 2 – 4 in the GS class, we also note that the Commission never explicitly approved inclusion of mains in any BSF category. Based on our evaluation and analysis, the Office concludes that cost-causation differences do not exist that would justify the inclusion of mains in some BSF categories and not others. The Office's analysis shows that mains should be removed from the BSF 2 – 4 and not added to BSF 1. Table 5 below summarizes the Office's proposal for BSFs.

**Table 5 - OCS BSF Summary**

| Basic Service Fee Costs | I | II | III | IV |
|---|---|---|---|---|
| Return on Net Investment | $20.63 | $62.53 | $244.00 | $1,648.96 |
| Grossed Up Income Tax | $8.34 | $25.28 | $98.67 | $666.78 |
| O&M: Based on Gross Plant | $5.93 | $17.53 | $66.91 | $447.14 |
| Weighted Avg Billing Cost/Meter | $26.33 | $26.35 | $26.33 | $26.97 |
| Property Tax on Net Investment | $2.75 | $8.33 | $32.50 | $219.67 |
| Annual Depreciation | $18.78 | $55.81 | $213.97 | $1,433.20 |
| Annual Total Costs | $82.76 | $195.83 | $682.38 | $4,442.71 |
| Monthly Charge | $6.90 | $16.32 | $56.87 | $370.23 |

**Q. PLEASE SUMMARIZE THE OFFICE'S BSF PROPOSAL.**

A. In this GRC, the Office proposes that BSF's should be $7, $16.50, $57, $370 for BSF categories 1 through 4 respectively. OCS Exhibit 1.3 shows how each BSF was calculated using the same method I described above. The Office's BSF calculation is consistent with Commission orders related to BSF cost components and intent.

**Q. WHAT IS THE OFFICE'S PROPOSAL FOR CHANGES TO THE VOLUMETRIC RATES?**

A. The Office proposes to keep volumetric rates (blocks one and two for summer and winter) in approximately the same proportion to each other as the Company proposes. The precise rates would be calculated based on the final revenue requirement by subtracting the revenue associated with the BSF from the total costs assigned to the GS class.

## POLICY ISSUES

### *Infrastructure Tracker*

**Q. WHAT ARE THE ISSUES SURROUNDING THE INFRASTRUCTURE TRACKER (TRACKER)?**

A. The Office evaluated four issues related to the Company's current proposal for the Tracker. They are:

1. Should the Tracker become permanent?
2. Should intermediate high pressure mains be included in the Tracker?
3. What is the appropriate Tracker budget to be allowed?
4. Should the Tracker inflation adjustment reflect an indexed adjustment or a simple inflation rate adjustment?

I will address each of these questions below.

**Q. SHOULD THE TRACKER BECOME PERMANENT?**

A. No. When the Company initially requested approval of the Tracker in 2007, it specifically indicated that the purpose of the program was to replace, reinforce, and extend the high pressure feeder lines on its distribution system. In the 2007 GRC, Company Witness Alan Allred testified that "Feeder line replacement will run about $45 million annually for the next five years." Making the high pressure feeder line replacement program a permanent ratemaking mechanism would be inappropriate. The program was only designed to run five years and the scope was limited to the high pressure feeder lines. Further, continuing this program at an increasing level of funding for an indefinite time period provides a significant benefit to the Company without commensurate protections to ratepayers. In short, the Company's proposal to make the Tracker permanent removes important regulatory oversight.

The Commission should always exercise caution when considering approval of a tracker, especially one that was defined with a specific purpose and duration. By definition a tracker allows one set of costs to be recovered outside a complete review of other revenue and cost factors that could impact total revenue requirement. As this case demonstrates, the complete review afforded by a general rate case often yields offsetting revenue and cost adjustments to cost elements that may be increasing.

For these reasons, the Office recommends that the Tracker be allowed to continue with specific criteria, but not be made permanent. The Commission should re-impose the condition that the Company files a complete general rate case within three years. At the time of the next general rate case filing, the Company should be required to provide evidence justifying why the Tracker continues to be needed if it makes such a request.

**Q. SHOULD INTERMEDIATE HIGH PRESSURE MAINS BE INCLUDED IN THE INFRASTRUCTURE TRACKER?**

A. No. As indicated above, a Tracker should only be established under limited circumstances. When the Company requested approval of the Tracker, the scope was limited to the high pressure feeder lines. The Company asserted that the age of the pipeline, the fact that some of this pipeline was reconditioned after WWII and reused in pipeline service and growing demands on the system warranted special rate treatment to facilitate replacement over a reasonably short period of time. In this GRC, the Company has not provided evidence why the Tracker program should be expanded to include the intermediate high pressure mains.

**Q. HAS THE COMPANY ALREADY INCLUDED INTERMEDIATE HIGH PRESSURE MAINS IN THE TRACKER?**

A. Yes. According to QGC Exhibit 1.11, Column C, intermediate high pressure mains were included for 2013 totaling $3,175,000. These amounts should not have been included in the Tracker and should be removed. If the Company wants to recover costs related to investment in intermediate high pressure mains, it should seek recovery through base rates and provide supporting evidence in its rebuttal case.

**Q. WHAT SHOULD BETHE BUDGET LIMIT FOR THE TRACKER?**

A. The Company requested a total of $65 million adjusted for inflation to include intermediate high pressure mains. In QGC Exhibit 1.11, the Company requested $55 million for high pressure feeder lines during the test year. The Company has not justified a need for a higher budget. Consequently, the Office recommends maintaining $55 million for just the high pressure feeder lines, as adjusted for inflation.

**Q. DO YOU HAVE ANY ADDITIONAL RECOMMENDATIONS REGARDING THE TRACKER?**

A. Yes. The annual inflation adjustment to the tracker limit should be based on a simple inflation adjustment rather than an index adjustment.

**Q. WHY DOES THE OFFICE PROPOSE A CHANGE TO THE INFLATION INDEX?**

A. Under the current practice, indexing to inflation gives a compounding inflation effect. Using a simple inflation rate calculation maintains budgetary integrity by adjusting for price level changes relative to the previous year, not over past years.

**Q. PLEASE SHOW THE EFFECTS OF INFLATION INDEXING IN THE INFRASTRUCTURE TRACKER.**

A. The Utah Division of Public Utilities (Division) produced a table in its Infrastructure Tracker Pilot Program Report dated June 17, 2013 comparing the Company’s actual expenditures to the budget indexed to the Global Insight Distribution Steel Main Inflation Index. The results of the comparison are reproduced in Table 6 below:

**Table 6 - DPU Inflation Adjusted Allowance Table**

| Year | $55,000,000 | | Global Insight Index | Multiple | Allowed Amount | Difference |
|---|---|---|---|---|---|---|
| | | | 655.8 | | | |
| 2011 | $58,767,529 | Actual | 734.8 | 112.0% | $61,625,496 | $2,857,967 |
| 2012 | $58,773,693 | Actual | 805.6 | 109.6% | $67,563,281 | $8,789,588 |
| 2013 | $59,000,000 | Budget | 795.3 | 98.7% | $66,699,451 | $7,699,451 |

Source: DPU Report Infrastructure Tracker Plan, Docket 09-057-16, June 17, 2013, p. 8

The inflation indexing effect is shown in the “Allowed Amount” column. The $55 million cap for the tracker increases 21.27% to $66,699,451 due to indexing alone.

**Q. PLEASE SHOW THE IMPACTS OVER THE SAME PERIOD USING A SIMPLE INFLATION CALCULATION.**

A. In Table 7 below, I show the inflation adjustment using a simple inflation rate.

**Table 7 - OCS Simple Inflation Rate Comparison**

| Year | $55,000,000 | | QGC Index | Global Insight Index | Multiple | Inflation Factor | Allowed Amount (Simple) | Difference |
|---|---|---|---|---|---|---|---|---|
| | | | 100.00 | 655.8 | 100.00 | | | |
| 2011 | $58,767,529 | Actual | 106.85 | 734.8 | 112.05 | 1.1205 | 61,625,496 | 2,857,967 |
| 2012 | $58,773,693 | Actual | 106.86 | 805.6 | 122.84 | 1.0964 | 60,299,401 | 1,525,708 |
| 2013 | $59,000,000 | Budget | 107.27 | 795.3 | 121.27 | 0.9872 | 54,296,797 | -4,703,203 |

As shown in the “Allowed Amount (Simple)” column, the compounding effect is alleviated as the inflation is based on the $55 million cap adjusted for inflation relative to the previous year and not to 2010. Each year is adjusted for the inflation rate or the price change from the previous year. In other words, 2011 is based on the price change level from 2010. 2012's budget is adjusted for price level changes from 2011. Comparing Table 7 to Table 6 shows that using a simple inflation rate results in an allowed budget that is over $7,000,000 less in 2012 and over $11,000,000 less in 2013. Thus, the compounding effect of the current method for calculating inflation is not trivial.

**Q. WOULD A SIMPLE INFLATION RATE CALCULATION MATERIALLY IMPACT THE COMPANY'S ACTUAL BUDGETS?**

A. No. The Company has generally been under its budgeted allowance even with a simple inflation calculation. Only in 2013 did the Company exceed what its budget would have been using a simple inflation calculation. Furthermore, using a simple inflation rate coincides with budget practice as the budget is reset each year to the Commission authorized $55 million adjusted with the appropriate inflation rate and not to the compounded inflation amount.

**Q. PLEASE SUMMARIZE THE OFFICE'S POSITION ON THE TRACKER.**

A. The Tracker should not be made permanent, but should be allowed to continue. The Company should again be required to file a GRC within three years and as part of that proceeding justify the continuing need for the Tracker. Intermediate high pressure mains should not be included in the Tracker. The annual budget for the Tracker should continue at $55 million adjusted for inflation. Lastly, the inflation adjustment mechanism should be based on a simple inflation rate adjustment per year and not indexed to prevent compounding.

***CIAC and DSM Rebates***

**Q. PLEASE SUMMARIZE THE OFFICE'S POSITION RELATED TO THE COMPANY'S CIAC PROPOSAL.**

A. The Office does not oppose the Company's CIAC proposal related to cost sharing between the Company and new customers. However, the Office will take a position on the potential use of DSM programs related to this process at such time as a specific program is proposed.

**Q. IN THIS CASE, DID THE COMPANY PROPOSE A CHANGE TO ITS CIAC POLICY?**

A. Yes. The Company proposes to change the CIAC from a cost sharing policy to a cost splitting policy. "The Company proposes to do away with the varying allowance amounts and refunds over a five-year period and instead simply require[s] a CIAC from a new customer equal to external costs. The Company would continue to capitalize the internal costs and include them in the cost of the project." (Austin Summers' testimony at lines 523-529)

**Q. WHAT ARE THE EXTERNAL COSTS TO BE PICKED UP BY A NEW CUSTOMER UNDER THE COMPANY'S PROPOSAL?**

A. External costs are third-party costs, such as costs for contractors. These costs can include trenching and laying pipe, the pipe materials, backfill and compaction and possibly permitting and pavement restoration.

**Q. HOW ARE INTERNAL COSTS DEFINED UNDER THE COMPANY'S PROPOSAL?**

A. Internal costs are costs incurred by the Company in adding new mains and services for a new customer. These costs include costs for pre-construction, right-of-way, surveying, engineering and design, operations, inspection and mapping.

**Q. DOES THE PROPOSED CIAC POLICY REPRESENT A REASONABLE ALLOCATION OF COSTS BETWEEN NEW CUSTOMERS OR EXISTING CUSTOMERS?**

A. Yes. Under the current CIAC program, new customers are responsible for 50% of the costs. The new proposal allocates the costs differently, but maintains an approximate 50%- 50% split of the costs.

**Q. DOES THE OFFICE HAVE ANY CONCERNS WITH THE CIAC COST SPLITTING CONCEPT PROPOSED BY THE COMPANY?**

A. The Office does not oppose the Company's proposed changes to the CIAC program. However, the Office has potential concerns about the use of DSM programs to fund customer meter costs.

**Q. WHAT IS THE COMPANY PROPOSAL RELATING TO CIAC'S AND DSM REBATES?**

A. In Mr. Summer's testimony at lines 553 – 556, he indicates that in the next Energy Efficiency docket the Company plans to propose allowing new customers who participate in specific Thermwise® programs to apply their rebates to the cost of their meter.

**Q. WHAT IS THE OFFICE'S POSITION ON THIS ISSUE?**

A. Since a specific DSM program as described has not yet been proposed, the Office does not have a specific position at this time. In general, the Office does not support diverting DSM funds to cover the costs of meters. However, the Office is open to reviewing the program once it is proposed and will take a position in the appropriate future DSM proceeding.

**Q. PLEASE SUMMARIZE THE OFFICE'S POSITION RELATED TO THE COMPANY'S CIAC PROPOSAL.**

A. The Office does not oppose the Company's CIAC proposal related to cost sharing between the Company and new customers. However, the Office is not certain about the use of DSM rebate programs as a means to finance installing new customer meters and will take a specific position on that issue in the appropriate DSM proceeding.

***Line Extension Policy***

**Q. PLEASE DESCRIBE THE CHANGES AFFECTING RESIDENTIAL CUSTOMERS IN THE LINE EXTENSION POLICY.**

A. The Line Extension policy changes outlined in Tariff sections 9.03 and 9.04 are the same cited above in my testimony on CIAC's. The main change to section 9.03 removed the word "Residential" from the title of the section. This change makes the policy outlined in the tariff more general in application for all customer classes and not solely residential customers. The Office does not oppose the changes to the Line Extension policy as proposed in this case.

**Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

A. Yes.