

<u>Component</u>	<u>Component Ratio (%)</u>	<u>Cost (%)</u>	<u>Weighted Cost (%)</u>
Long-Term Debt	44.64	5.5606	2.4822%
Short-Term Debt	5.05	2.3487	0.1186%
Common Equity	<u>50.31</u>	<u>9.35</u>	<u>4.7040%</u>
Total	100.00%		7.3048%

CLASS COST OF SERVICE STUDY ISSUES

XV. Class Cost of Service Study in General

As required by rule, the Company's rate-case filing included a class cost of service study.⁵⁷

The purpose of a class cost of service study is to determine, as accurately as possible, the costs of serving each customer class. While these costs cannot be determined with precision, it is critical that the cost study make both its underlying assumptions and the cost figures they yield as accurate and transparent as possible, because the Commission puts substantial weight on cost causation in determining what portion of the total revenue requirement each customer class should pay.

The OAG challenged three aspects of the Company's cost study: (1) its compliance with the Commission's order that it allocate income taxes on the basis of the taxable income attributable to each class, not rate base; (2) its interclass allocation of distribution-mains costs; and (3) its interclass allocation customer-service costs.⁵⁸

Each challenge is addressed below, followed by the Commission's determination that the class cost of service study is acceptable for use as a ratemaking tool in this case.

XVI. Allocating Income Taxes

A. Introduction

In MERC's 2008 rate case, the Commission ordered the Company to change how it allocated income-tax expense among its customer classes. Previously, MERC had allocated income-tax responsibility according to each class's share of rate base. The Commission ordered MERC instead to "allocate income taxes on the basis of the taxable income attributable to each customer class."⁵⁹

In its next rate case, MERC provided class cost of service studies that allocated income taxes both on the basis of the taxable income attributable to each customer class and on the basis of rate base.⁶⁰ The Company recommended that the Commission adopt the rate-base allocation methodology, claiming that it better allocated costs to customers based on cost causation.

⁵⁷ Minn. R. 7825.4300(C).

⁵⁸ The OAG also disagrees with MERC's allocation of its meter-reading expenses. However, the OAG stated in its exceptions to the ALJ's Report that it is no longer pursuing this issue. It merely requested that Commission update Finding 649 to correctly reflect its position. The Commission will so order.

⁵⁹ Docket No. G-007, 011/GR-08-835, Findings of Fact, Conclusions of Law, and Order (June 29, 2009).

⁶⁰ Docket No. G-007, 011/GR-10-977.