Exhibit No.:
Issue: Noranda Rate and Cost Of Service
Witness: Donald Johnstone
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Noranda
Case Number: GR-2006-0387
Date Testimony Prepared: October 31, 2006

Atmos Energy Corporation

Case No. GR-2006-0387

Prepared Rebuttal Testimony of

Donald Johnstone

On behalf of

Noranda Aluminum, Inc.

October 2006

Noranda Exhibit No. 59
Date 9-09-14 Reporter KF
File No GR-2014-0152

BEFORE THE

PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Atmos Energy Corporation's Tariff Revision Designed to Consolidate Rates and Implement a General Rate Increase for Natural Gas Service in the Missouri Service Area of The Company.	))))))	Case No. GR-2006-0387

Affidavit of Donald Johnstone

State of Missouri)
) ss
County of _____)

Donald Johnstone, of lawful age, on his oath states: that he has reviewed the attached written testimony in question and answer form, all to be presented in the above case, that the answers in the attached written testimony were given by him; that he has knowledge of the matters set forth in such answers; that such matters are true to the best of his knowledge, information and belief.

Donald Johnstone

Subscribed and sworn before me this 31st th day of October, 2006

Carolyn Neporadny
Notary Public

SEAL

CAROLYN NEPORADNY
Notary Public - Notary Seal
STATE OF MISSOURI
Commissioned for Camden County
My Commission Expires: August 30, 2009
Commission Number 05452654

My Commission expires:_____

Before the
Missouri Public Service Commission

Atmos Energy Corporation

Case No. GR-2006-0387

Prepared Rebuttal Testimony of Donald Johnstone

Q PLEASE STATE YOUR NAME AND ADDRESS.

A Donald Johnstone. My address is 384 Black Hawk Drive, Lake Ozark, Missouri, 65049.

Q BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A I am employed as President of Competitive Energy Dynamics, L. L. C.

Q WHAT ARE THE PURPOSES OF YOUR REBUTTAL TESTIMONY?

A My purposes are to respond to the class cost of service and rate design recommendations of Staff and OPC. As in my direct testimony I confirm the intent of Noranda to abide by the Gas Transportation Agreement between Atmos and Noranda (the "Agreement" or the "Noranda Agreement") and I will again refer to the Noranda facility as the "Smelter." The Noranda Agreement

has also been referred to as the Noranda Special Contract.

I will explain several of the ways in which the cost studies of Staff and OPC overstate the cost to serve Noranda, although I will focus primarily on a single issue that overwhelms most all others in terms of its financial impact - distribution mains. I will also show the impact of the correct approach and make conforming rate recommendations.

Also, the question of imputed revenues for the Smelter is before the Commission. I will explain why revenues should not be imputed from a cost of service perspective.

As an alternative to establishing the Agreement as a rate schedule, I recommend adjusting the present rate for Large Volume service to a level even with the class cost-of-service results and the rates in the Agreement. While this approach would leave the rate substantially above cost, it would render moot the issue of revenue imputation because the tariff rate would be essentially equal to the contract rate. Furthermore, inasmuch as the rates paid by Noranda pursuant to the Agreement will continue to include a substantial contribution in excess of cost, for the benefit of the all other customers and Atmos, it makes no sense to litigate again and again the question of imputed revenues when the present large volume rate that is the basis for the computation, if unchanged, is unjust and unreasonable. The large volume rate is unjust and unreasonable for application to the Smelter because it is so extraordinarily far above any reasonably determined cost of the service

provided.

Q HAVE THERE BEEN SETTLEMENT DISCUSSIONS IN REGARD TO THE CURRENT TOTAL COST OF SERVICE, EXCLUDING THE COST OF GAS?

A There have been discussions, but no settlement. At the time of my prefiled direct testimony Atmos had applied for an increase of $3.4 million in the overall nongas revenues. In contrast, Staff in its direct case proposed a rate decrease. However, it is my understanding that Staff has not submitted a complaint for the purpose of pursuing a rate reduction. If a zero overall revenue increase were to be the result it would appear that the status quo need not change for Noranda. While this is a possibility, the joint issues list filed by the Staff makes it clear that a wide range of issues will be brought to the Commission.

Q WOULD YOU OBJECT TO MAINTAINING THE NORANDA AGREEMENT?

A No. Noranda is in the fourth year of a ten year agreement and expects to continue to receive service under the Agreement. Of course, Noranda would also need to ensure the continuing availability of interruptible service beyond the agreement and also support all reasonable actions that will bolster the likelihood that the Agreement will be allowed to run its course. Any action to restrict the availability of interruptible service or to undermine the Agreement will be opposed.

Q HAVE YOU REVIEWED THE OPC CLASS COST-OF-SERVICE STUDY?

A Yes. Unfortunately it grossly overstates the cost to serve Noranda. There are many reasons, but perhaps the most fundamental problem from the Noranda perspective is the failure to remove Noranda from the cost allocations related to the distribution mains. The distribution facilities are unrelated to service for Noranda and no costs should be allocated.

In other respects the study uses allocation methods that taken together produce a result that is biased against a large customer such as Noranda. For example, Ms. Meisenheimer discusses the economic concept economies of scale, but moves from an undisputed principle to a cost allocation that unreasonably shifts costs -- it removes costs from smaller customers and places them on larger customers. The effect of the application is illogical and incorrect. Instead, it is far more reasonable to allocate costs based on the principle of cost causation. The principle determinant of capacity costs -- for example the investment in transmission and distribution mains -- is the demand for service during or very near to the peak periods. Hence, the capacity related costs of mains are reasonably allocated on measures of usage during peak periods. Also, there is a customer component of the cost of mains that is often quantified and that would reflect the efficiencies of delivering gas to larger than average customers. At the other extreme costs would be allocated on annual usage without regard for the cost reducing effects of above average load factors and larger than average customer sizes. Unfortunately, the OPC

method goes beyond this extreme and would allocate even less cost to smaller customers than the extreme method of annual usage.

Interruptibility is another consideration. Service to Noranda is interruptible as a contractual matter and as a practical matter service has been interrupted from time to time. In an important sense service which is fully interruptible does not create capacity costs on shared system facilities that are not designed with the capacity to provide the service. As a practical matter customers receiving the interruptible service should, nevertheless, make some contribution to the cost of the facilities used -- even if the use is only on an as available basis.

The service to Noranda has long been interruptible and has been interrupted from time to time. There were interruptions in 1996 and 2001. In 2006 there were two unusual near misses related to a tornado and a digging caused rupture. Consequently, Noranda has good reason to expect no more than interruptible service and continues to maintain a propane system as a backup.

Q EARLIER IN THIS TESTIMONY YOU CHARACTERIZED THE ALLOCATION OF THE COSTS OF DISTRIBUTION MAINS AS PERHAPS THE MOST IMPORTANT ISSUE FOR NORANDA. PLEASE EXPLAIN.

A Noranda uses a large quantity of natural gas and is served off of an 8" transmission main. Due to the quantities of gas used (transported), it is both

impractical and impossible to provide service over the smaller distribution mains. Hence, no costs have been incurred by Atmos to construct distribution mains for the service provided to Noranda. It follows that no costs should be allocated if none are incurred.

Another consideration is the lack of any integrated system with the capacity to move gas to Noranda. The system is radial and Noranda is at the end of the line. There is no system of mains, whether functionalized as transmission or distribution that can bring the gas to Noranda. Hence, the Atmos system offers no service, no benefits, and has incurred no costs beyond the transmission facilities used to serve Noranda.

Another consideration is the electric analogy. When a customer is served uniquely from the transmission system (a situation familiar to Noranda) the costs of the distribution transformers is avoided. Equally important is the fact that the miles of primary distribution lines are not needed or useful. Also equally important is the even more miles of secondary distribution lines that are not needed and not useful. And beyond all the implications of the physical facilities is the operation of the system. The electrical distribution system, even though highly integrated between transmission and distribution, cannot move large quantities of power to a large customer like Noranda. As a consequence, it is a longstanding practice to allocate the cost of secondary distribution only to secondary customers, to allocate primary distribution to both secondary and primary customers since the facilities are useful to both,

and to allocate transmission facilities to all customers. My recommendations are entirely consistent with practice in the electric industry.

However, OPC has allocated the costs associated with distribution mains to Noranda. This is incorrect and only exacerbated by OPC's particular approach to the allocation of capacity costs.

Q WHAT IS THE IMPACT ON THE OPC CLASS COST-OF-SERVICE STUDY IF YOU DO NOT ALLOCATE THE COSTS ASSOCIATED WITH DISTRIBUTION MAINS TO NORANDA?

A I made adjustments to the OPC class cost-of-service study for the Southeast Missouri Division in order to reflect the physical realities of the service to Noranda. There should be no allocation to Noranda of the costs of the distribution mains that are of no use in providing service to Noranda. I also adjusted the allocation method for transmission and distribution mains with two alternative approaches. I performed one study with the mains allocation factors based on the estimated peaks and another based on the extreme approach of annual usage. With these adjustments the OPC study shows that revenues under the Noranda Agreement exceed the cost by $96,000 to $213,000. Thus, even with the use of an allocation for transmission mains that is extreme and adverse for Noranda, the study shows that the revenues provided by Noranda under the Agreement far exceed any reasonably determined cost for the service.

Q **HAVE YOU PROVIDED A SUMMARY OF THE STUDIES IN SCHEDULES 1 AND 2?**

A Yes. Schedule 1 is a summary of the OPC study with modifications to allocate the cost of mains on peak usage and Schedule 2 is a similar summary with modifications to allocate the cost of mains on annual usage. Neither study allocates the cost of distribution mains to Noranda. In both cases my intent is only to illustrate the cost to serve Noranda and I have made no changes beyond those necessary for my limited purposes in this situation.

Q **WHAT IS THE PROPOSAL OF STAFF WITNESS ANNE ROSS ON THE MATTER OF INTERRUPTIBLE SERVICE?**

A She proposes to charge firm and interruptible customers the same nongas rate for service. The proposal may or may not be appropriate for smaller customers that presently receive interruptible service, but it is certainly not appropriate for Noranda. Instead, there should be an interruptible rate available for service to Noranda that reasonably reflects the cost of the interruptible service, the only service that is available for Noranda. In the last case, GR-97-322, Associated Natural Gas, then owner of the facilities in southeast Missouri, did studies that demonstrated that the Company could not provide firm service. No one has demonstrated any change to that status with respect to Noranda.

Q WHY IS NORANDA CONCERNED WITH THE LARGE VOLUME RATE SCHEDULE INASMUCH AS IT RECEIVES SERVICE UNDER THE NORANDA AGREEMENT?

A There are several reasons. But first, please note that I have recommended that the Agreement be made a rate schedule. Noranda has no objection to the Agreement being a published as rate schedule and I have confirmed that Atmos also has no objection to its publication for that purpose. That approach would establish the continuing availability of the service, although prices may need to be visited at the close of the 10 year term December 31, 2013. On the other hand, to date the Agreement has been treated as a Special Contract. That makes it vulnerable to questions of prudence and revenue imputation; and there is no assurance that the service would be available after the Agreement has run its term. Hence if it continues to be treated as a Special Contract the otherwise applicable Large Volume rate schedule has continuing importance to Noranda as that rate would be the vehicle for service absent the Agreement. Consequently, the benefits to Noranda of maintaining the rate are several.

First, the continuation of large volume interruptible gas transportation service will ensure that the service will remain available to Noranda when the Agreement terminates. Second establishing the existing large volume rate with a price level equal to the special contract would resolve questions about prudence and any imputation of revenues that might be pursued (even though such pursuit is in my opinion unnecessary or inappropriate, or both, in Noranda's circumstances). Third, these matters would be clarified at no cost to

any party because Noranda would in any event continue to provide the same revenues under the Agreement. Hence, there would be benefits to Noranda at no cost to any other party.

Q **IN THE CONTEXT OF AN ALTERNATIVE TO ESTABLISHING THE NORANDA AGREEMENT AS A RATE SCHEDULE, WHAT CHANGES DO YOU RECOMMEND TO THE LARGE VOLUME RATE?**

A I recommend several changes. First the availability should be limited to customers that received service without use of the distribution mains. Second, there should be a volume threshold to ensure it will only be applicable to customers that are similarly situated to Noranda. Third, I recommend a customer charge of $265 per month, consistent with the Company proposal for large volume transportation and in excess of the customer costs computed by the Staff class cost-of-service study. Fourth, I recommend a volumetric charge $.18 per MCF, the level of the volumetric charge for the last year in the Noranda Agreement.

Q **WOULD THIS HAVE THE SAME EFFECT AS MAKING THE NORANDA AGREEMENT A RATE SCHEDULE?**

A The effect would be very similar through the remainder of the term of the Agreement inasmuch as service would continue to be provided under the Agreement until it had run its course. Absent some new agreement I would

presume that Noranda would move back to service under the Large Volume rate schedule January 1, 2014. Of course, Noranda's decision would not and should not be made until the time arrives so that all then current circumstances can be given consideration.

Q **WOULD THE RATE BE CONSISTENT WITH THE CURRENT COST OF THE SERVICE PROVIDED TO NORANDA?**

A No, it would be above cost. In making this statement I have given due consideration to the cost study submitted with my direct testimony, and the cost studies prepared by Staff and OPC when adjusted only to reflect the fact that distribution mains are not used in providing service to Noranda to reflect a range of capacity allocation methods.

Q **PLEASE EXPLAIN HOW YOUR RECOMMENDATION FOR THE LARGE VOLUME RATE IS CONSISTENT WITH THE STAFF CLASS COST-OF-SERVICE STUDY?**

A Again, in order to reflect the physical realities of the service to Noranda there should be no allocation to Noranda of the costs of the distribution mains that are of no direct use in providing service to Noranda. Also, I used the extremely adverse annual usage method for the allocation of the costs of the transmission mains. This approach provides a check on the computations made in my modifications of the OPC class cost-of-service study. One caveat is that the cost to Noranda will be overstated because a customer component of the mains

is not incorporated and because of my use of annual volumes for the allocation of the cost of transmission mains.

The computation is complicated slightly in the Staff study because Staff did not maintain Noranda as a separate class in its study. The changes I made were in order to provide a very conservative approximation of the effect. In contrast to the adjusted test year Noranda revenue of $ .25 per MCF, the result was $ .13 per MCF. When these results are applied to Noranda test year usage, the study so adjusted indicates that the revenues from Noranda under the Agreement are $153,000 above the costs incurred by Atmos to provide service to Noranda.

Q **PLEASE SUMMARIZE YOUR ANALYSIS OF THE CLASS COST-OF-SERVICE APPLICABLE TO NORANDA.**

A The rates under the Noranda Agreement provide revenues substantially in excess of any reasonably determined cost to provide the services consumed by Noranda. As such, my initial proposal to establish the Noranda Agreement as a rate schedule would provide no undue benefit to Noranda. Also, my alternative proposal in this rebuttal would maintain the current Large Volume rate, which has been applicable only to Noranda, and would adjust the rates to be consistent with the contract level. That too would provide no undue benefit to Noranda. What is achieved in either case is a reasonable rate and a reasonable

expectation for Noranda of a continuation of that rate without any serious concerns of continuing prudence reviews or imputations of revenues.

Q **PLEASE SUMMARIZE THE IMPACT OF YOUR ANALYSIS ON ANY PROPOSAL TO IMPUTE REVENUES.**

A My analysis shows that the present Large Volume rate far exceeds costs under any reasonable class cost-of-service study. In my, opinion, the rate is so far out of alignment with costs that it fails to provide any reasonable basis for imputing revenues. In contrast, with the Large Volume rate adjusted to a level even with the contract and much closer to the cost as reasonably determined, any basis for imputing revenues is effectively eliminated.

Q **IS THIS A GOOD OPPORTUNITY TO ADJUST THE RATE SCHEDULES TO BETTER REFLECT THE COSTS INCURRED BY ATMOS TO PROVIDE SERVICE TO NORANDA?**

A Yes. Based on the information available to me there is little or no possibility in this case of a negative effect for Atmos or any other customer. On the other hand, the Noranda Agreement would, one way or the other, be brought into the mainstream and any continuing litigation over the prudence of the contract or imputed revenues would be virtually eliminated. Thus, this is an ideal time to make the changes I recommend.

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

2 A Yes it does

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OPC Modified to Allocate Mains on Peak Day CCF and to Remove Noranda from Distribution Mains

TOTAL COST OF SERVICE SUMMARY:		TOTAL	Residential	SGS	LGS	LV	Special Contract
O & M EXPENSES	3,734,351	3,893,051	2,907,783	789,953	36,616	132,095	26,605
DEPRECIATION EXPENSE	1,782,985	1,882,151	1,356,789	407,054	19,142	71,397	27,769
TAXES	1,579,928	1,674,433	1,195,160	367,589	17,178	72,700	21,805
TOTAL - Expenses and Taxes		7,449,635	5,459,731	1,564,596	72,936	276,193	76,178
		7,449,635					
CURRENT RATE REVENUE							
Purchased Gas		0	0	0	0	0	0
Non-gas margin		8,665,303	5,139,948	1,956,489	247,643	1,017,176	304,047
TOTAL RATE REVENUE(non-gas)		8,665,303	5,139,948	1,956,489	247,643	1,017,176	304,047
Other Revenue		63,877	37,890	14,422	1,826	7,498	2,241
TOTAL CURRENT REVENUES		8,729,180	5,177,838	1,970,911	249,469	1,024,674	306,288
		8,729,180					
OPERATING ~~REVENUES~~ INCOME		1,279,545	(281,894)	406,315	176,533	748,481	230,110
		1,279,545					
TOTAL RATE BASE		25,759,184	18,013,325	5,905,318	287,906	1,224,783	331,116
		25,762,448					
IMPLICIT RATE OF RETURN		4.97%	-1.56%	6.88%	61.32%	61.11%	69.50%
OPERATING INCOME WITH EQUALIZED RATES OF RETURN		1,279,545	894,783	293,337	14,301	60,839	16,448
		1,279,708					
REVENUE SHIFTS TO EQUALIZE CUSTOMER CLASS RATES OF RETURN (assuming unchanged Co. revenues)		0	1,176,676	(112,978)	(162,232)	(687,642)	**(213,662)**
		213,825					
PERCENTAGE REVENUE CHANGE TO EQUALIZE RATES OF RETURN		0%	23%	-6%	-66%	-68%	-70%
		(1)					
REQUIRED % MARGIN REVENUE CHANGE		0	0	(0)	(1)	(1)	(1)
CLASS COST OF SERVICE		8,729,342	6,354,514	1,857,933	87,237	337,032	92,626
		8,729,342					$ 0.075 per MCF

Schedule 1

OPC Modified to Allocate Mains on Annual CCF and to Remove Noranda from Distribution Mains

TOTAL COST OF SERVICE SUMMARY:		TOTAL	Residential	SGS	LGS	LV	Special Contract
O & M EXPENSES	3,493,125	3,893,051	2,681,938	735,452	75,735	349,520	50,406
DEPRECIATION EXPENSE	1,630,581	1,882,151	1,220,479	370,810	39,292	182,941	68,629
TAXES	1,428,717	1,674,433	1,057,408	332,342	38,967	193,535	52,181
TOTAL - Expenses and Taxes		7,449,635	4,959,824	1,438,605	153,995	725,996	171,215
		7,449,635					
CURRENT RATE REVENUE							
Purchased Gas		0	0	0	0	0	0
Non-gas margin		8,665,303	5,139,948	1,956,489	247,643	1,017,176	304,047
TOTAL RATE REVENUE(non-gas)		8,665,303	5,139,948	1,956,489	247,643	1,017,176	304,047
Other Revenue		63,877	37,890	14,422	1,826	7,498	2,241
TOTAL CURRENT REVENUES		8,729,180	5,177,838	1,970,911	249,469	1,024,674	306,288
		8,729,180					
OPERATING ~~REVENUES~~ INCOME		1,279,545	218,013	532,307	95,474	298,678	135,073
		1,279,545					
TOTAL RATE BASE		25,759,184	15,733,723	5,330,393	657,130	3,273,577	767,625
		25,762,448					
IMPLICIT RATE OF RETURN		4.97%	1.39%	9.99%	14.53%	9.12%	17.60%
OPERATING INCOME WITH EQUALIZED RATES OF RETURN		1,279,545	781,547	264,779	32,642	162,610	38,131
		1,279,708					
REVENUE SHIFTS TO EQUALIZE CUSTOMER CLASS RATES OF RETURN (assuming unchanged Co. revenues)		0	563,534	(267,528)	(62,832)	(136,069)	**(96,942)**
		97,105					
PERCENTAGE REVENUE CHANGE TO EQUALIZE RATES OF RETURN		0%	11%	-14%	-25%	-13%	**-32%**
		(0)					
REQUIRED % MARGIN REVENUE CHANGE		0	0	(0)	(0)	(0)	(0)
CLASS COST OF SERVICE		8,729,342	5,741,371	1,703,383	186,637	888,605	209,346
		8,729,342					$ 0.171 per MCF

Schedule 2