

Exhibit No.:

Issue(s):

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Case No.:

Cost of Service/
Rate Design

Meisenheimer/Direct

Public Counsel

GR-2010-0363

DIRECT TESTIMONY

OF

BARBARA A. MEISENHEIMER

Submitted on Behalf of the Office of the Public Counsel

**UNION ELECTRIC COMPANY,
D/B/A AMERENUE**

RATE DESIGN

CASE NO. GR-2010-0363

November 19, 2010

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of Union Electric Company)
d/b/a AmerenUE for Authority to File)
Tariffs Increasing Rates for Natural)
Gas Service Provided to Customers in the)
Company's Missouri Service Area)

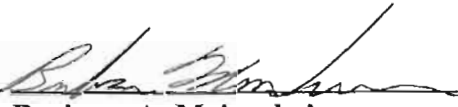
GR-2010-0363

AFFIDAVIT OF BARBARA A. MEISENHEIMER

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Barbara A. Meisenheimer, of lawful age and being first duly sworn, deposes and states:

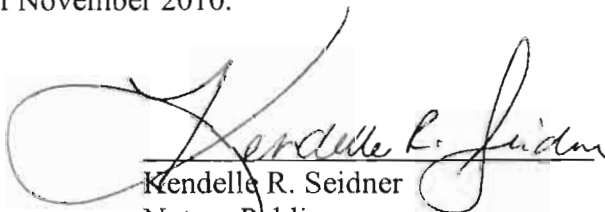
1. My name is Barbara A. Meisenheimer. I am Chief Utility Economist for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my direct testimony.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.


Barbara A. Meisenheimer

Subscribed and sworn to me this 19th day of November 2010.



KENDELLE R. SEIDNER
My Commission Expires
February 4, 2011
Cole County
Commission #07004782


Kendelle R. Seidner
Notary Public

My Commission expires February 4, 2011.

**DIRECT TESTIMONY
OF
BARBARA A. MEISENHEIMER**

**UNION ELECTRIC COMPANY, D/B/A AMERENUE
(GAS CLASS COST OF SERVICE & RATE DESIGN)**

CASE NO. GR-2010-0363

Introduction

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. Barbara A. Meisenheimer, Chief Utility Economist, Office of the Public Counsel (OPC or Public Counsel), P. O. Box 2230, Jefferson City, Missouri 65102. I am also employed as an adjunct Economics and Statistics Instructor for William Woods University.

Q. HAVE YOU TESTIFIED PREVIOUSLY IN THIS CASE?

A. Yes. I filed direct testimony on revenue requirement issues on November 8, 2010.

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. My testimony addresses Public Counsel's class cost of service study and resulting rate design recommendations for the Union Electric Company's (AmerenUE's) service area.

Q. HAVE YOU TESTIFIED ON CLASS COST OF SERVICE AND RATE DESIGN ISSUES IN PAST AMERENUE CASES?

A. Yes, I testified on class cost of service and rate design issues in AmerenUE's last rate case; Case No. GR-2007-0003.

A. Small General Service customers pay a fixed customer charge of \$24.00 per month and volumetric rates that vary by usage block; 27.77¢ per Ccf for volumes less than 7,000 Ccf per month and 18.16¢ per Ccf for all Ccf in excess of 7,000.

	Customer Charge	Percentage Change From Previous	Volumetric Rate	Percentage Change From Previous
Proposed	\$ 28.00	17%	\$ 0.3248 0.3248	17% 79%
4/1/2007	\$ 24.00	0%	\$ 0.2777 \$ 0.1816	11% 11%
2/15/2004	\$ 24.00	15%	\$ 0.2496 \$ 0.1632	39% 38%
11/1/2000	\$ 20.80	36%	\$ 0.1796 \$ 0.1180	3% 3%
1/1/1998	\$ 15.25		\$ 0.1746 \$ 0.1145	

A. If the Commission allows a rate increase, Public Counsel recommends that for the Residential and Small General Service classes the customer charges should not increase as a result of this case. If against Public Counsel's recommendation, the Commission decides to increase the Residential and Small General customer charges, then Public Counsel requests that the customer charges be increased by

1 no more than the class increase. For example, if the Commission determines that
2 Residential rates should increase by 5% and requires that a portion of the increase
3 be collected through the customer charge then Public Counsel requests that the
4 customer charge should increase by no more than 5%.

5 **Q. WHY DOES PUBLIC COUNSEL RECOMMEND NO INCREASE IN THE CUSTOMER**
6 **CHARGE?**

7 A. Customers have little if any control over the customer charge. Unlike volumetric
8 charges, the customer charge can't be reduced through conservation. High
9 customer charges also disproportionately impact low-use and low-income
10 households. In AmerenUE's case, the customer charge is also virtually
11 inescapable because a customer disconnecting for up to 12 months repays missed
12 customer charges as a condition of reconnecting service. Based on my cost study
13 results, I believe the current customer charge adequately recovers direct customer
14 related costs. Allowing greater recovery through the customer charge
15 unnecessarily reduces the Company's risk at the expense of captive ratepayers.

16 **Q. DO YOU BELIEVE RECOVERING COSTS THROUGH A TRADITIONAL RATE**
17 **STRUCTURE IS REASONABLE?**

18 A. Yes. Under traditional rate design, consumers have better ability to control the non-gas
19 portion of their bill by reducing use and the Company and customers shared the risk
20 associated with weather. Later in this testimony I discuss the benefits and
21 appropriateness of traditional rate design in greater detail.
22

Q. DOES PUBIC COUNSEL HAVE ADDITIONAL RECOMMENDATIONS RELATED TO THE RECONNECTION CHARGE?

A. Yes. The Commission should eliminate the portion of the reconnection charge that recovers "lost" customer charges associated with customers who stopped service but restarted service within 12 months. This charge makes customers even more captive to a monopoly provider. Coupling this reconnection charge with a high customer charge substantially limited a customer's ability to reduce non-gas charges paid to the utility even by disconnecting service.

Class Cost of Service Study Results

Q. HAVE YOU PREPARED A CLASS COST OF SERVICE STUDY AND A CLASS REVENUE REQUIREMENT RECOMMENDATION?

A. Yes. The class cost of service study results and class revenue requirement recommendations are summarized below. Later in this testimony I describe the class cost of service methodology. The class cost of service study is attached as Schedule BAM DIRECT RD-3.

Q. WHAT ARE THE RESULTS OF PUBLIC COUNSEL’S CLASS COST OF SERVICE STUDY?

A. The results of my class cost of service studies are shown below:

Table 3

Revenue Neutral Percentage Change To Equalize Class Rates Of Return					
Residential	Small General Service	Large General Service	Interruptible Service	Standard Transport	Large Volume Transport
6.01%	-6.35%	-3.06%	-12.70%	-18.08%	-27.70%

Based on my study, the Residential class would need to increase by about 6% to equalize the rate of return among classes. The rates of return for the

1 Transport and Interruptible classes, and to a lesser extent, the General Service
2 classes would need to be reduced in order to equalize the rate of return among
3 classes.

4 Schedule BAM DIRECT RD-1 provides additional detail on the derivation
5 of these revenue neutral adjustments. The current rate of return for each class is
6 shown on Line 16, of Schedule BAM DIRECT RD-1. The revenue neutral shift
7 required to equalize the class rates of return is shown on Line 24, of Schedule
8 BAM DIRECT RD-1.

9 **Q. WHAT LEVEL OF RESIDENTIAL CUSTOMER CHARGE IS SUPPORTED BY YOUR**
10 **CLASS COST OF SERVICE STUDY?**

11 A. My cost of service study results indicates that the direct customer costs related to
12 serving the customer premises are \$13.87 for the Residential customer class and
13 \$20.80 for the Small General Service class. These amounts include a return on
14 the Company's investment in meters, regulators, service lines and other customer
15 premises, operating and maintenance expenses associated with those investments,
16 meter reading expenses and billing expenses. The customer cost calculations are
17 shown in the class cost of service study included in this testimony as Schedule
18 BAM DIRECT RD-3.

19 **Class Revenue Requirement Recommendations**

20 **Q. WHAT CLASS REVENUE REQUIREMENTS DO YOU PROPOSE BASED ON YOUR CLASS**
21 **COST OF SERVICE STUDY RESULTS?**

22 Generally, Public Counsel recommends that, where the existing revenue structure
23 departs greatly from the class cost of service, the Commission should impose, at a
24 maximum, class revenue shifts equal to one half of the "revenue neutral shifts"
25 indicated by Public Counsel's class cost of service study. Revenue neutral shifts
26 are shifts that hold overall company revenue at the existing level but allow for the

1 share attributed to each class to be adjusted to reflect the cost responsibility of the
2 class. In addition to moving half way to the revenue neutral shifts, if the
3 Commission determines that an overall increase in revenue requirement is
4 necessary, then no customer class should receive a net decrease as the combined
5 result of: (1) the revenue neutral shift that is applied to that class, and (2) the share
6 of the total revenue increase that is applied to that class. Likewise, if the
7 Commission determines that an overall decrease in revenue requirement is
8 necessary, then no customer class should receive a net increase as the combined
9 result of: (1) the revenue neutral shift that is applied to that class, and (2) the share
10 of the total revenue decrease that is applied to that class.

11 **Q. HAVE YOU PREPARED A SCHEDULE ILLUSTRATING THIS METHOD OF**
12 **DETERMINING CLASS REVENUE REQUIREMENTS?**

13 A. Yes. Line 1 of Schedule BAM DIRECT RD-2 shows the revenue neutral shift
14 required to equalize class rates of return. Line 5 illustrates one half of the revenue
15 neutral shift. Line 7 illustrates the spread of a net increase of \$4M. Lines 10-13
16 illustrate the adjustments to ensure that no class receives a reduction if another
17 class would receive an increase as the result of the combined impact of $\frac{1}{2}$ the
18 revenue neutral shift and the net increase. Lines 15-16 illustrate the resulting
19 revenues and revenue percentages.

20 **Q. CAN THIS METHOD OF DETERMINING CLASS REVENUE REQUIREMENTS BE USED**
21 **FOR ANY NET INCREASE OR NET DECREASE APPROVED BY THE COMMISSION?**

22 A. Yes.

23 **Class Cost of Service Study Method**

24 **Q. WHAT IS THE REGULATORY PURPOSE OF A CLASS COST OF SERVICE STUDY?**

25 A. A class cost of service study is a tool used by regulators to aid in determining an
26 appropriate rate structure. It can be used as a guide in identifying, on a cost

1 causative basis, the cost of serving a particular group of customers. A class cost
2 of service study can also be used to evaluate the relative cost of service among
3 classes. This comparison of relative cost is the focus of Public Counsel's study
4 and is reflected in the study assumption that the Company's revenue requirement
5 is equal to the level of current revenue.

6 **Q. WHAT IS THE RELATIVE IMPORTANCE OF CLASS COST OF SERVICE STUDY**
7 **RESULTS IN RATE DESIGN?**

8 A. A class cost of service study provides the Commission with a general guide for a
9 service based on costs to determine just and reasonable rates. The Commission
10 must, on a case by case basis, balance the results of a cost of service study with
11 other relevant factors that go into the rate making decision process. Other
12 relevant factors include the value of a service, the affordability of service, rate
13 impacts, and rate continuity, to highlight a few.

14 **Q. WHAT COSTS ARE REFLECTED IN YOUR CLASS COST OF SERVICE STUDY?**

15 A. Public Counsel's class cost of service study includes non-gas or margin costs
16 associated with storing, transporting and delivering gas to customers. Gas costs
17 recovered through the purchased gas adjustment rate are generally determined in a
18 separate proceeding.

19 **Q. WHAT ARE THE REPRESENTATIVE CLASSES INCLUDED IN PUBLIC COUNSEL'S**
20 **CLASS COST OF SERVICE STUDY?**

21 A. For class cost of service study purposes, customers are grouped into "classes"
22 based on type of customer and utilization patterns. My class cost of service
23 studies include the same customer classes as the AmerenUE study: Residential,
24 Small General Service, Large General Service, Standard Transport, Large Volume
25 Transport and Interruptible.

1 **Q. ON WHAT DATA ARE YOUR CLASS COST OF SERVICE STUDIES BASED?**

2 A. The Accounting Schedules filed with the Staff's direct revenue requirement
3 testimony were the source of most of the investment and expense data that I used
4 in my studies. The Accounting Schedule data is associated with a test year ending
5 December, 31, 2009, updated through September 2010. I used data based on
6 Company workpapers and Company responses to Staff data requests. The data
7 including information on customer counts, revenues and usage patterns was used
8 to develop allocation factors for assigning revenues and costs to customer classes.
9 Except where specified, my use of Staff and Company information should not be
10 viewed as an endorsement of either Staff's or the Company's methods for
11 calculating accounting costs, billing determinants, peak demands or allocation
12 factors.

13 **Q. IS THERE A POSSIBILITY THAT SOME INFORMATION USED IN YOUR STUDY WILL**
14 **BE UPDATED AND REVISED AS THE CASE PROGRESSES?**

15 A. Yes. It is common for the Staff and Company to update or reconcile information
16 as cases progress. I will update my studies accordingly.

17 **Q. PLEASE DESCRIBE THE ASSIGNMENT OF COST TO THE CUSTOMER CLASSES.**

18 A. The assignment of costs to customer classes involves a three-step process in
19 which costs are first functionalized, then classified, and finally allocated to
20 customer classes based on factors that reflect cost causation.

21 **Q. PLEASE DESCRIBE THE FUNCTIONALIZATION OF COSTS.**

22 A. Functionalization involves categorizing cost accounts by associated function.
23 Functional categories include; Production, Storage, Transmission, Distribution,
24 Customer Accounts and Administrative and General (A&G).

1 **Q. PLEASE DESCRIBE THE CLASSIFICATION OF COSTS.**

2 A. Classification is achieved by further categorizing costs into customer related,
3 commodity related, demand related or “other related” costs. Some costs are
4 categorized as having multiple cost components.

5 **Q. PLEASE DESCRIBE CUSTOMER RELATED COSTS.**

6 A. Customer related costs vary directly (in fixed proportion) with the number of
7 customers served. Examples of customer related costs include: expenses
8 associated with meter reading, billing, and the return on investments associated
9 with metering equipment and service connections.

10 **Q. PLEASE DESCRIBE COMMODITY RELATED COSTS.**

11 A. Commodity related costs vary with the quantity of gas purchased. While
12 Missouri's local distribution companies recover purchased gas cost through the
13 PGA, other plant accounts may still be categorized as commodity related.

14 **Q. PLEASE DESCRIBE DEMAND RELATED COSTS.**

15 A. Demand related costs vary with the capacity requirement of plant or equipment.
16 They are related to the maximum system requirements that reflect the capacity
17 necessary to serve demand during peak periods. Demand related costs include
18 most production, transmission and storage costs and expenses associated with
19 these types of plant. In addition, some distribution plant and related expenses are
20 demand related costs.

21 **Q. PLEASE DESCRIBE THE ALLOCATION PROCESS.**

22 A. Following functionalization and classification, allocation factors are applied to
23 distribute a reasonable share of jurisdictional costs to each customer class. Some
24 costs are uniquely attributable to, and therefore directly assignable to, a particular
25 customer class. For costs that are jointly attributable, in measurable proportions,
26 to a group of customer classes, the costs are assigned to each customer class based

1 on factors that reflect each class's share of joint use. Finally, cost accounts
2 associated with common facilities or common overheads that cannot be directly or
3 jointly assigned are allocated to classes based on general factors. Typical
4 allocation factors include measures of usage, sales, or weighted measures of
5 customer counts.

6 **Q. WHAT TYPES OF PLANT INVESTMENTS ARE ALLOCATED IN A CLASS COST OF**
7 **SERVICE STUDY?**

8 A. Common types of plant allocated in a class cost of service study include
9 intangible plant, production plant, storage plant, transmission plant, distribution
10 plant and general plant.

11 **Q. HOW ARE INTANGIBLE PLANT ACCOUNTS ALLOCATED?**

12 A. Intangible plant accounts include expenses related to organizing the enterprise,
13 obtaining franchise and consent and other miscellaneous items. (Accounts 301,
14 302, and 303) These costs are not directly or jointly attributable to particular
15 customer classes, instead they are common costs allocated on the basis of the
16 portion of overall net non-general plant assigned to each customer class.

17 **Q. HOW ARE PRODUCTION PLANT ACCOUNTS ALLOCATED?**

18 A. I allocated these investments and associated revenue based on the annual sales
19 volumes attributable to each customer class.

20 **Q. HOW ARE GAS STORAGE PLANT ACCOUNTS ALLOCATED?**

21 A. I allocated storage related investments based on the winter sales volumes
22 associated each customer class.

23 **Q. HOW ARE TRANSMISSION PLANT ACCOUNTS ALLOCATED?**

24 A. Transmission plant accounts are allocated based on a transmission allocator that
25 reflects non-coincident peak sales.

1 **Q. HOW ARE DISTRIBUTION PLANT ACCOUNTS ALLOCATED?**

2 A. Mains transport gas throughout the Company's service area and represent a
3 significant portion of distribution plant. I used an Average and Excess allocation
4 method to assign Mains (Account 376) to customer classes.

5 The commodity related component of my mains allocator is related to the
6 use of mains to deliver gas throughout the year. I allocated 27% of Mains
7 (Account 376) based on each customer class's share of average annual system
8 throughput volumes measured in Ccf.

9 The demand related component of my mains allocator (the remaining 73%
10 of Mains (Account 376) is related to the use of mains to deliver gas during
11 periods of peak use. I allocated this portion of Mains (Account 376) based on
12 each customer class's share of excess capacity measured as non-coincident peak
13 use minus average use.

14 Land and Land Rights, Structures and Improvements (Accounts 374 and
15 375) are closely related to the system of distribution mains. I allocated these costs
16 on the same basis as Mains (Account 376).

17 Measuring and Regulating Station Equipment (Accounts 378 and 379) are
18 related to the year round flow of gas and are therefore classified as commodity
19 related. I allocated these costs based on each customer class's share of annual
20 throughput.

21 Accounts 380 through 385 include cost directly related to serving
22 customer premises. For example, services connect the customer premise to
23 distribution mains. Similarly, meters and regulators at the customer premise
24 measure and regulate gas flow at the premise. While these types of cost may
25 differ by customer class, for example the cost of a typical meter associated with
26 residential use is less expensive than the typical meter used to serve a large

1 industrial customer, within each class, the costs tend to vary directly with the
2 number of customers served. Based on this direct relationship between the
3 number of customers served and costs, I classified these costs as customer related
4 and developed allocation factors based on customer numbers weighted to reflect
5 cost differences between customer classes. The type of allocation for each
6 account is shown below:

7 **Table 4**

<u>Account</u>	<u>Description</u>	<u>Allocation based on</u>
380	Service Lines	Weighted services
381	Meters	Weighted meters
383	House Regulators	Weighted regulators
385	Meas. and Reg. Station Equip. - Industrial	Large Customer Bills

8 **Q. HOW ARE GENERAL PLANT ACCOUNTS ALLOCATED?**

9 A. General plant accounts excluding Communications Equipment Account 397 are
10 allocated to customer classes based on each class's allocation of net non-general
11 plant. Communications Equipment Account 397 allocated to residential and
12 commercial customers based on the number of bills.

13 **Q. HOW ARE OTHER RATE BASE ITEMS ALLOCATED?**

14 A. Other rate base items include additions and deductions to net plant in service. For
15 each, I selected an allocator that seemed most clearly related to the cost causation.
16 The types of cost and allocation factor used in my studies are listed below:
17

Table 5

<u>Rate Base Additions</u>	<u>Allocation Factor</u>
Cash Working Capital	Cost of Service
Materials and Supplies	Total Net Plant
Prepayments	Cost of Service
Prepaid Pension Asset	Labor
Natural Gas Stored Underground	Winter Sales
Unamortized Balances	Rate Base
Insulation Financing Loans	Residential Bills
Energywise	Residential and Commercial Bills
<u>Rate Base Deductions</u>	<u>Allocation Factor</u>
Interest Offset	Cost of Service
Federal Income Tax Offset	Rate Base
State and Local Income Tax Offset	Rate Base
Pension and OPEB Trackers	Rate Base
Accumulated Amortization	Total Net Plant
Customer Advances	Weighted Meters
Customer Deposits	Bills
Deferred Income Taxes	Rate Base

Q. PLEASE DESCRIBE HOW OPERATION AND MAINTENANCE EXPENSES ARE ALLOCATED IN YOUR CLASS COST OF SERVICE STUDIES.

A. For allocating most of the accounts in this category, I used the “expenses follow plant principle”. For example, the operations and maintenance expenses related to mains and services are allocated to customer classes on the same basis as the

mains and services plant accounts. Similarly, operations and maintenance expenses related to storage are allocated on the basis of winter sales. For cost accounts not directly associated with a corresponding plant account, I selected an allocator that seemed most clearly related to the cost causation. The types of operation or maintenance expense and allocation factor used in my study are listed below:

Table 6

Operations

<u>Account</u>	<u>Description</u>	<u>Allocation based on</u>
870	Supervision & Engineering	Mains
871	Load Dispatch	Mains
874	Mains and services	Net Mains/Services Plant
875	Measuring & Regulating Stations	Annual Throughput
876	Measuring & Reg. Commercial	Large Ind. Bills
877	Measuring & Regulating City Gate	Annual Throughput
878	Meter & House Regulating	Weighted Meters and Regulators
879	Customer Installations	Weighted Meters and Regulators
880	Other Expenses	Mains
881	Rents	Net Distribution Plant

Maintenance

<u>Account</u>	<u>Description</u>	<u>Allocation based on</u>
885	Supervision & Engineering	Mains

902	Meter Reading	Bills
903	Customer Records and Collection	Customer Accounts Expense
904	Uncollectible Accounts	Cost of Service
905	Miscellaneous	Customer Acct. Expense

Customer Service and Information

<u>Account</u>	<u>Description</u>	<u>Allocation based on</u>
908	Customer Assistance	Bills
909	Inform & Instruct Advertising	Bills

Sales

<u>Account</u>	<u>Description</u>	<u>Allocation based on</u>
911	Supervision	Bills
912	Demonstrating and Selling	Bills
912	Advertising	Bills
912	Misc. Expense	Bills

Q. HOW ARE ADMINISTRATIVE AND GENERAL (A & G) EXPENSES ALLOCATED?

A. Property insurance (Account 924) is allocated on the basis of net non-general plant. Expenses related to salaries, supplies, administration, outside services, injuries and damages, and employee pensions and benefits (Accounts 920, 921, 922, 923, 925 and 926) are allocated on the basis of payroll. The remainder of A & G expenses are allocated on the basis of the overall class cost of service.

1 **Q. HOW ARE TAXES ALLOCATED?**

2 A. Property taxes are allocated on the basis of the total net plant previously allocated
3 to each class. Franchise taxes are allocated on the basis of rate base. Payroll
4 taxes are allocated as a function of payroll expense. Income taxes are allocated
5 according to the rate base attributable to each class.

6 **Benefits of Traditional Rate Design**

7 **Q. DO YOU BELIEVE THAT A TRADITIONAL RATE DESIGN THAT RECOVERS A**
8 **PORTION OF COSTS IN A CUSTOMER CHARGE AND A PORTION IN A VOLUMETRIC**
9 **RATE PER UNIT PROVIDES AN INCENTIVE FOR CUSTOMERS TO CONSERVE?**

10 A. Yes. The traditional rate design provides an incentive for customers to conserve
11 because, change in consumption has an impact on the non-gas charges a customer
12 must pay.

13 **Q. HOW IS COST CAUSATION INCORPORATED INTO SETTING THE PORTION OF COSTS**
14 **TO BE RECOVERED THROUGH THE CUSTOMER CHARGE AND THE PORTION TO BE**
15 **RECOVERED THROUGH VOLUMETRIC RATES?**

16 A. It is common in regulated industries for companies to recover costs that are
17 incurred independent of usage in a fixed fee and to recover costs that vary with
18 usage through a usage based fee. Recovering a usage based cost through a usage
19 based fee insures that those who did not cause the cost are not required to pay for
20 it. This objective can be met through establishing a fixed component and a
21 variable component of rates. The cost of meters that tend to be similarly sized for
22 the majority of residential customers can be described as being independent of use
23 and therefore reasonably recovered through a uniform fixed fee. However, the

1 cost of other facilities and equipment are driven by consumption or peak demand
2 and should be recovered on a volumetric basis. For example, storage facilities are
3 associated with consumption during winter months and are reasonably recovered
4 based on consumption. The cost of distribution mains is driven in large part by
5 peak demand requirements and is another example of costs most reasonably
6 recovered through volumetric rates.

7 In the context of class cost of service studies, we assign the portion of
8 investments and expenses that are incurred based on demand and commodity
9 related considerations to classes based on demand and commodity related factors.
10 It is reasonable to collect these costs from each class through usage based charges.

11 **Q. HOW CAN TRADITIONAL RATE DESIGN ENCOURAGE HIGHER SUBSCRIPTION TO**
12 **THE SYSTEM?**

13 A. Traditional rate design composed of a customer charge component and a
14 volumetric component can benefit both low and high use customers. Low use
15 customers benefit by retaining access to utility service. High use customers and
16 other customer classes benefit by not having to make up the revenue lost when
17 low use customers disconnect service.

18 **Q. IS THE TRADITIONAL RATE DESIGN THAT CORRELATES HIGHER USE WITH**
19 **HIGHER CHARGES CONSISTENT WITH THE PURPOSE OF REGULATION?**

20 A. Yes. Utility regulation is intended to mimic the outcomes and market
21 environment that is faced by competitive firms. The use of utility regulation to
22 simulate a competitive environment and encourage the benefits that would accrue
23 if the industry were suitable for a competitive structure has been referred to as the
24 competitive market paradigm. This paradigm was described by Dr. James

1 Bonbright on page 93 of *Principles of Public Utility Rates* in the following
2 manner:

3 Regulation, it is said, is a substitute for competition. Hence
4 its objective should be to compel a regulated enterprise, despite its
5 possession of complete or partial monopoly, to charge rates
6 approximating those which it would charge if free from regulation
7 but subject to market forces of competition. In short, regulation

8 should be not only a substitute for competition, but a closely
9 imitative substitute.

**Q. IS THE TRADITIONAL RATE DESIGN THAT CORRELATES HIGHER USE WITH
HIGHER CHARGES CONSISTENT WITH PRICING IN COMPETITIVE SERVICE
MARKETS?**

10 A. Absolutely. In highly competitive markets, it is common for firms to recover all
11 cost through only usage based fees. Even in more concentrated markets, rate
12 structures that recover some portion of costs through volumetric charges are the
13 norm. For example, telephone rates typically include a fixed minimum fee
14 charged for basic access to the telephone network and additional usage based
15 incremental fees that recover a portion of the investment and associated expenses.
16 If customers demand either more services “over the pipe” or “a larger pipe” the
17 customer pays more.

18 It is also the norm in competitive markets for customers to have some
19 control over the charges they pay to the service provider. Rate designs that
20 consist of a customer charge and volumetric charge are supportable based on
21 recognizing that the value of service is both in having access to gas as well as in
22 using gas so cost would not be uniformly allocated to customers. In my opinion,
23 recovery through a customer charge and volumetric rate is reasonable and fair
24 from both an economic and policy perspective. Historically, this Commission has

1 determined that it is appropriate for those who use more to pay more. Public
2 Counsel encourages the Commission to adhere to this policy.

3 **Q. IS THE TRADITIONAL RATE DESIGN CONSISTENT WITH MIMICKING THE RATE OF**
4 **RETURN OPPORTUNITIES AND RISK THAT EXISTS IN COMPETITIVE MARKETS?**

5 A. Yes. The Commission's ordered non-gas revenue requirement is not a fixed or
6 guaranteed level of revenue that a Company is entitled to recovery each year.
7 Instead, the level of revenue requirement approved by the Commission is a target
8 level of costs including expenses, taxes and return on investment that an
9 efficiently run company, barring unforeseen events has the opportunity to recover
10 under long term average weather conditions. The Commission approved revenue
11 requirement accounts for and is intricately related to potential weather variations
12 that may affect costs and revenues from year to year. The process of normalizing
13 demand determinates to account for weather and establishing a rate of return
14 sufficient to attract investment despite the risk of weather variations are probably
15 the two most obvious elements linking weather variations to revenue requirement.
16 After the revenue requirement is determined, rates are set at a level anticipated to
17 recover the target level of costs. However, the ratemaking process only reflects
18 the anticipated cost and revenues at a snap shot in time. It does not guarantee or
19 limit levels of either future costs or revenues and is not designed or intended to
20 provide uniform recovery each year. Once rates are set, by improved efficiency or
21 circumstances, a Company has an opportunity to earn a return above that
22 incorporated in the revenue requirement. Likewise, by inefficiency, a Company
23 faces the potential to earn a return below that incorporated in the revenue
24 requirement. This process mimics a competitive business environment by creating
25 incentives for the Company to minimize costs.

1 Utility regulation does not create an “entitlement” for the utility to earn a
2 Commission determined return that fully compensates the utility for its cost of
3 service. If that were the case, there would be no reason to determine an
4 appropriate level of a risk adjusted return that should be included in a utility’s
5 rates. Instead, utility regulation is intended to mimic the outcomes and market
6 environment that is faced by competitive firms. While viewed by investors as
7 undesirable, earnings uncertainty serves an important role in the efficient
8 operation of competitive markets by providing inherent protections for
9 consumers. Earnings uncertainty motivates competitive business entities to
10 minimize costs and to strive for customer satisfaction. Eliminating earnings
11 uncertainty in a regulated environment would have a similar detrimental effect on
12 consumers as would eliminating earnings uncertainty in an unregulated market.
13 However, in a competitive environment, consumers retain the ability to reduce or
14 forgo purchases in response to excessive prices or poor service.

15 In recognition and in consideration of the service it provides as a natural
16 monopoly, a local gas distribution company is granted an additional concession
17 not ordinarily available in a competitive business environment. It is allowed to
18 request a rate review to, when justified, realign revenues to costs. This
19 concession together with other concessions made by the Commission and other
20 governmental entities more than adequately addresses issues of potential under
21 earnings. For example, direct pass-through of costs such as those flowed through
22 the PGA have substantially shifted weather related risks to consumers. It is
23 undesirable and unnecessary to shift greater earnings risk to consumers.

1 **Q. CAN YOU CITE ANY ANALYSIS BY A RECOGNIZED UTILITY INDUSTRY EXPERT**
2 **THAT SUPPORTS YOUR BELIEF THAT UTILITY COMMISSIONS GENERALLY SET**
3 **RATES AT A LEVEL WHICH ALLOWS UTILITIES THE OPPORTUNITY (AS OPPOSED**
4 **TO A GUARANTEE) TO ATTAIN THEIR AUTHORIZED RETURN?**

5 A. Yes, the following quote from page 202 of A. J. G. Priest's *Principles of Public*
6 *Utility Regulation* supports this widely recognized regulatory principle:
7 ...the utility's return allowance might be compared with fishing
8 or hunting license with a limit on the catch. Such a license does
9 not guarantee that the holder will catch anything at all; it simply
10 makes the catch legal (up to a specified limit) provided the holder
11 is successful in his own efforts.

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

13 A. Yes.