

Appeal of Texas Gas Service Company from the Ratesetting Actions of the Cities of Port Neches, Nederland and Groves

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PROPOSAL FOR DECISION

PROCEDURAL HISTORY

PETITION FOR REVIEW:

November 12, 2003

HEARING DATES:

April 13, 14, 15, 2003

May 4, 2003

HEARD BY:

John Chakales, Hearings Examiner

Gene Montes, Hearings Examiner

Rose Ruiz, Technical Examiner

RECORD CLOSED:
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STATUTORY DEADLINE:

May 4, 2004
June 15, 2004
July 23, 2004

STATEMENT OF THE CASE

Texas Gas Service Company sought an increase to the rates charged to the cities in its South Jefferson County Service Area (“SJCSA”). The SJCSA is composed of four cities. Those cities are Groves, Nederland, Port Neches, and Port Arthur. Three cities – Groves, Nederland, and Port Neches (collectively referred to as “Cities”) – denied the requested revenue increase. This case is an appeal from the decision of the Cities to deny the rate request of Texas Gas Services Company. On November 12, 2003, TGS filed its Petition for Review.¹ On appeal TGS argues that it is entitled to an overall revenue requirement of \$6,743,246. TGS alleges that this represents an increase over current rates of \$1,225,856. The Cities allege that TGS has not perfected this appeal and that the Commission is without jurisdiction to consider the proposed rate request. The Cities allege other jurisdictional arguments limiting the amount of an increase that the Railroad Commission may consider in this case. In any case, even if no jurisdictional limits were to apply the Cities allege that TGS has not established that it is entitled to a revenue requirement in excess of \$6,140,847, which is a decrease of \$253,057.

The Examiners recommend that the revenue requirement for TGS be set at \$6,472,582. Based on test year adjusted revenue, the Examiners’ recommendation results in an increase of \$708,852.

Comparison of Proposed Revenue Requirement by the parties, and Recommendation of the Examiners

	TGS 11/15/02 Municipal Level Statement of Intent	TGS 11/12/03 Commission Petition for Review	Cities Proposed	Examiners’ Recommended
Revenue Requirement	\$6,466,468	\$6,743,246	\$6,140,847	\$6,472,581
Test year adjusted revenues	\$5,612,707	\$5,517,836	\$6,393,057	\$5,763,730
Recommended Increase	\$853,761	\$1,225,856	(\$253,057)	\$708,851

SUMMARY OF MAJOR ISSUES

There are seven major areas of consideration for the Railroad Commission in this case.

1. **Multiple filings:**

The Cities have raised several issues regarding the fact that multiple filings were made in

this case with differing analyses. Although, no one disputes the proposed treatment of revenue-related taxes as a surcharge, the presentation of by the utility of this issue caused considerable confusion. The confusion is compounded by the fact that in making the requested updated filing on June 27, 2003 and filing its *Petition for Review* TGS changed certain aspects of its presentation and calculations. The Examiners provide an analysis of the confusion caused by the filings and attempt to clarify the bottom line in this case: (1) Revenue Requirement; (2) the Test Year Adjusted Revenues; and (3) the Increase.

Impact of Examiners' Recommendation on the Revenue Requirement:
None.

2. Jurisdictional Issues

Second, and related to the first issue, are the several jurisdictional issues that the Cities allege are raised by the multiple filings. The potential consequences of the jurisdictional challenges range from divesting the Commission of jurisdiction to consider any rate increase, to limiting the increase that the Commission may allow. The Examiners conclude that the Commission does have jurisdiction to consider the proposed increase. Nevertheless, the Examiners recognize that there is a potential limit. Specifically, the Railroad Commission lacks the jurisdiction to provide an increase greater than \$853,761. No adjustment is necessary, however, because the recommended increase is less than the jurisdictional limitation.

Impact of Examiners' Recommendation on the Revenue Requirement:
Limit increase to \$853,761

3. Rate of Return

Third, the Applicant proposed a rate of return of 9.33%. The Cities proposed a rate of return of 7.99%. Ultimately, the Examiners recommended rate of return is 8.42%.

Impact of Examiners' Recommendation on the Revenue Requirement:
\$147,512 Reduction

4. Fourth is the adjustments to revenues.

The Applicant proposed a series of adjustments to the revenues that affect the test year revenue calculation and billing determinants: (1) gross receipts and franchise taxes; (2) normalized weather adjustment; (3) normalized customer growth adjustment; and (4) load attrition adjustment. The Cities proposed a different normalized weather adjustment and normalized customer growth. In addition, the cities propose a rate annualization adjustment to take into account the revenues from the settlement between TGS and the City of Port Arthur. The Examiners make the following recommendations:

- Gross receipts and franchise taxes—Recommend adoption as proposed by TGS

- Normalized Weather—Recommend adoption as proposed by the Cities
- Normalized Customer Growth—Recommend adoption as proposed by the Cities
- Load Attrition Adjustment—Recommend rejection
- Rate annualization—Recommend Rejection

Impact of Examiners' Recommendation on test year revenues:
Increase proposed test year revenues by \$261,079

5. Rate Base and Expenses

A sixth issue are the adjustments proposed to rate base and expenses. The Cities propose to change the allocation of indirect costs from the various corporate division of ONEOK to the SJCSA. The Examiners recommend that TGS' recommended allocation methodology be adopted and that the proposed allocation of the Cities be rejected. This recommendation impacts the adjustments to rate base and expenses proposed by the cities. Only one adjustment to Rate Base is unrelated to the allocation factor, and that relates to the bad debt expense. The Examiners recommend that the bad debt expense recommendation of the Cities be adopted.

Impact of Examiners' Recommendation on proposed rate base: None

Impact of Examiners' Recommendation on Expenses: \$53,266

6. Rate Design

TGS proposed a rate design based on a cost-of-service study and on the proposed revenue requirement. The Cities propose to allocate the rate increase/decrease on the equal percentage basis based upon the existing rates. The Examiners agree that rates should be designed as proposed by the Applicant and the rates include a weather normalization adjustment clause.

Impact of the Examiners' Recommendation on the revenue requirement: None

7. Rate Case Expense

A seventh issue concerns the rate case expenses incurred by both the Cities and TGS. The Examiners recommend that the Cities recover their actual rate case expenses of \$193,084.99 and estimated future rate case expenses of \$92,800, subject to verification. The Examiners recommend TGS be allowed to recover \$530,690.75 in actual rate case expenses and \$134,320 in estimated future rate case expenses, subject to verification.

Impact of the Examiners' Recommendation on Rate Case Expenses: Reduce amount awarded to TGS by \$147,314.

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1. Procedural History and Notice

Southern Union Gas Company (“SUG”) filed a *Statement of Intent* to change rates in the municipalities served by the company’s South Jefferson County Service Area (“SJCSA”) on November 15, 2002.¹ SUG published notice of the proposed increase in a newspaper of general circulation during the weeks of November 30, December 7, 15, and 21, 2002.² ONEOK, a diversified energy company, entered into a purchase agreement for the sale of Texas properties of Southern Union Gas in 2002.³ The sale was closed in January of 2003.⁴ Texas Gas Services, an operating division of ONEOK took over the Texas operations of SUG.⁵

On February 27, 2003, the Cities held a public hearing in Port Neches, Texas to consider the proposed rate increase.⁶ TGS settled with Port Arthur in March of 2003. On June 27, 2003, pursuant to an agreement with the Cities, TGS filed an updated rate case.⁷ The Cities denied the proposed rate increase in October of 2003. On November 12, 2003, TGS filed its *Petition for Review* with the Railroad Commission of Texas. Notice of Hearing in this matter was provided on March 26, 2004.

Hearings were held on April 13, 14, 15, and May 4, 2004. At the hearing the following witnesses testified on behalf of TGS: Stacey L. McTaggart, Director of Financial and Regulatory Analysis;⁸ Denise E. Dembowsky, Pricing Analyst, Rates and Regulatory Affairs Department;⁹ June M. Dively, Senior Partner and Chief Executive Officer, Dively & Associates;¹⁰ Nicole A. Simmons, TGS Pricing Analyst,¹¹ Thomas A. Sullivan, Black & Veatch, Corporation;¹² Donald A. Murry, C.H. Guernsey & Co. and Professor Emeritus of Economics at the University of Oklahoma;¹³ Judson W. Larson, TGS Pricing Analyst;¹⁴ Dr. F. Jay Cummings, Senior Management Consultant with R.J. Covington Consulting.¹⁵ The following witnesses testified on behalf of the Cities: Daniel J. Lawton and Sara E. Coleman, both with Diversified Utility Consultants.¹⁶

1. Jurisdiction

The Commission has jurisdiction over the matters at issue in this proceeding under TUC §§ 102.001(a), 121.051, and 121.151.¹⁷ The statutes and rules involved include, but are not limited to TEX. UTIL. CODE ANN. §§ 103.022, 103.054, & 103.055, (Vernon 1998) and 16 TEX. ADMIN. CODE § 7.57 (West 2004). The Notice of Hearing was issued in this Docket on March 26, 2004, and satisfied the requirements of 16 TEX. ADMIN. CODE § 1.45 and TEX. GOV’T CODE ANN. § 2001.052 (Vernon 2000 & Supp. 2004.)

1. Overview of TGS and the service area

TGS is a division of ONEOK, a public corporation with its headquarters in Tulsa, Oklahoma.¹⁸ TGS provides natural gas distribution service to approximately 535,000 customers in eighty-four cities in Texas.¹⁹ The TGS operating areas in Texas are divided into several regions. The Eastern Region of TGS includes the following areas: North Texas, the *Gulf Coast Area*, and Central Texas.²⁰ The *Gulf Coast Area* includes the Galveston Area and the South Jefferson County Service Area (“SJCSA”). The South Jefferson County Service Area includes

the cities of Groves, Nederland, Port Neches and Port Arthur as well as the environs of those cities.²¹ TGS seeks a revenue increase of \$1,225,856 for the South Jefferson County Service Area.²²

1. **Analysis of the three filings: Statement of Intent, Update, and Petition for Review.**

B. **Introduction**

Several issues have been raised by the Cities which potentially affect the jurisdiction of the Commission. While some of the jurisdictional issues raised may preclude a review of the proposed rate by the Commission, others may limit the overall increase that the Commission may approve. Throughout the closing brief and the testimony presented at the hearing, the Cities have repeatedly raised several issues regarding the jurisdiction of the Commission. Although, the allegations with regards to the jurisdiction have not been succinctly stated by the Cities, the may be summarized as follows¹:

1. Is the jurisdiction of the Commission on this appeal limited by the original Statement of Intent and accompanying notice?
2. May an acquiring utility rely on the Statement of Intent and Notice filed by its predecessor in interest?
3. Sufficiency of the Petition for Review: Did TGS perfect its appeal?

In order to evaluate these issues it is important to consider the various filings and key elements of those filings. The three principal filings are as follows: (1) The initial *Statement of Intent* filed at the municipal level on November 15, 2002; (2) the updated filing made at the municipal level on June 27, 2003 (“*June 27, 2003, Update*”); and (3) the *Petition for Review* filed with the Railroad Commission on November 12, 2003. Between the initial filing at the municipal level and the *Petition for Review*, there are four events which also impact this analysis. First, in January of 2003, Southern Union Gas (“SUG”) consummated its sale to ONEOK. Thus, SUG transferred its assets to TGS less than two months after it filed the *Statement of Intent* with the municipalities. Second, a public hearing was held in Port Neches. Third, TGS settled with the city of Port Arthur in May of 2003. Fourth, the parties engaged in mediation on April 11, 2003, which resulted in a mediation agreement. The relevant events and corresponding dates are summarized in Table 4.1 below:

Table 4.1: Time line of Proceedings at the Municipal Level

November 15, 2002	Statement of Intent filed by SUG with the following municipalities: Port Arthur, Port Neches, Nederland, and Groves
January 1, 2003	Sale between ONEOK and SUG
February 17, 2003	Public hearing held in Port Neches
March, 2003	TGS settled with Port Arthur
April 11, 2003	Mediation with Port Neches, Nederland, and Groves
June 27, 2003	Updated filing with the following municipalities: Port Neches, Nederland, and Groves
November 12, 2003	Petition for Review filed with the Railroad Commission

B. Summary of the Three Rate Filings

Initial Rate Request (November 15, 2002)

Southern Union Gas approached the four cities in the SJCSA service area prior to filing a Statement of Intent and discussed its alleged need for rate relief.¹ The initial rate request was filed with the municipalities on November 15, 2002.² The test year in the initial filing was the twelve months ended March 2002.³ The total base rate revenue requirement requested was \$6,466,468. Based upon revenues calculated for the test year of \$5,947,518, the *Statement of Intent* indicated that the total base rate revenue deficiency was \$518,950. TGS asserted that this amounted to a 5.78 percent increase in overall rates.⁴ The Cities allege that it is about an 8.7 percent increase.⁵ Table 4.2 summarizes that filing:

Table 4.2: Revenue Requirement and Revenue Deficiency Calculation in Original Statement of Intent, November 15, 2002

1	Total Base Rate Revenue Requirement	\$6,466,468
2	Test Year Adjusted Revenue	\$5,947,518
3	Total Base Rate Revenue Deficiency	\$518,950

SUG proposed to keep its existing rate design and the proposed revenue increase was distributed among customer classes by the same percentage of total test year as adjusted revenue under existing rates. Under the proposed rate design customers would pay less during the winter when usage and customer bills were generally higher.⁶ As noted in that filing, revenue-related taxes were removed because the utility intended to collect those amounts separately.⁷ As set forth in the proposed tariffs, the actual tax rates paid by SUG would be added to the cost of service rates for purposes of calculating customer bills.⁸ As indicated in the testimony filed in this case, the total amount of revenue-related taxes was \$334,881.⁹

It is important to note that the Total Base Rate Revenue Deficiency of \$518,950 is not the total revenue deficiency of the utility. In order to identify the total revenue deficiency an adjustment needs to be made because of how SUG chose to present the revenue deficiency. In its *Statement of Intent*, the utility excluded revenue-related taxes when it calculated Total Base Rate Revenue Requirement (Table 4.2, Line 1). On the other hand, the utility included revenues from revenue-related taxes when it calculated Test Year Adjusted Revenue (Table 4.2, Line 2).¹⁰ Thus, Test Year Adjusted Revenues of \$5,947,518 overstates the amount of revenues collected by the amount of revenue-related taxes. Revenue-related taxes were \$334,811.¹¹ If an adjustment is made to Test Year Adjusted Revenue and revenues from revenue-related taxes are removed, then the Total Revenue Deficiency is \$853,740.¹² Revising Table 4.2 above reveals the actual revenue deficiency, as shown in Table 4.3.

**Table 4.3: Revenue Requirement and Revenue Deficiency Calculation in Original Statement of Intent, November 15, 2002
 Adjusted for Revenue-related taxes**

1	Total Base Rate Revenue Requirement	\$6,466,468
2	Test Year Adjusted Revenue	\$5,612,707
3	Total Base Rate Revenue Deficiency	\$853,761

SUG published notice to support its application beginning on November 30, 2002, and continuing for four consecutive weeks:¹³

The Company's proposed base rate increase would result in an overall base rate increase of \$518,950, which represents a 5.78 percent increase in the Company's total adjusted base revenues in its South Jefferson County Service

Area. The Company is also proposing to recover revenue-related taxes as a separate line item on the bill . . . The annual base revenue increase in the Cities of Port Arthur, Groves, Nederland, and Port Neches would be approximately \$295,250, \$75,041, \$72,339 and \$61,632 respectively . . .

In January SUG completed its transfer of assets to TGS. On or about February 12, 2003, the consultants for the Cities, Diversified Utility Consultants, Inc. (“DUCI”) issued their report, *Summary of Findings and Conclusions Regarding the Reasonableness of Southern Union Gas Company’s Statement of Intent to Change Rates within the Cities of Port Neches, Nederland, and Groves, Texas*. The consultants made two basic recommendations. First, TGS’ rate request should be dismissed as a deficient filing given that the test year and historical operating data for which the increase was based did not comply with TEX. UTIL. CODE ANN. § 101.003(16). Second, if the rate filing was not dismissed, the rate request should be rejected as not being justified, reasonable or supported by operating costs adjusted for known and measurable changes. A public hearing was held in Port Neches on February 17, 2003.¹

In March 2003, Port Arthur reached an agreement with TGS.² The city of Port Arthur agreed to a most favored nation’s status.³ On April 11, 2003, the remaining cities and TGS engaged in mediation presided by Judge James Meyers and reached a mediation agreement (“Agreement in Principle”).⁴ As pointed out by the Cities in closing argument, the agreement was not a dismissal of the original case resulting in a new rate filing.⁵

Agreement in Principle (April 11, 2003)

The mediation agreement directed TGS to file on or before June 27, 2003, a supplemental rate package, based on a test year ending December 31, 2002, adjusted for known and measurable changes, and supporting the rate proposed by TGS in its original filing with the Cities of November 15, 2002, or such modifications to those rates as TGS shall then deem appropriate. Pursuant to that agreement TGS would be permitted to put changed rates into effect under bond. Except as adjusted to reflect agreed rate design modifications, the bonded rates would be based upon its filing of November 15, 2002.⁶

Updated Rate Request (June 27, 2003)

On June 27, 2003, TGS delivered its updated filing to the Cities.⁷ The test year in the *June 27, 2003, Update* was the twelve months ended December 2002.⁸ The total base rate revenue requirement requested was \$6,595,875.⁹ Based upon revenues calculated for the test year of \$5,903,147,¹⁰ the updated filing indicated that the total base rate revenue deficiency was \$685,402.¹¹ Table 4.4 summarizes that filing:

Table 4.4: Revenue Requirement and Revenue Deficiency Calculation in Updated Update, June 27, 2003

1	Total Revenue Requirement ¹²	\$6,595,875
2	Test Year Adjusted Revenue	\$5,903,143
3	Total Revenue Deficiency ¹³	\$692,728

As with the original filing, TGS included revenues from revenue-related taxes when it calculated Test Year Adjusted Revenues (Table 4.4, Line 2). Accordingly, a similar adjustment, as was done in the calculations accompanying the *Statement of Intent*, must be made in order to determine the total revenue deficiency. Revenue-related taxes in the updated filing were calculated as \$320,275.¹⁴ That amount must be removed from Test Year Adjusted Revenue. Table 4.5 below reveals the actual total revenue deficiency once that adjustment is made.

Table 4.5: Revenue Requirement and Revenue Deficiency Calculation in Updated Update, June 27, 2003 Adjusted for Revenue-related taxes

1	Total Revenue Requirement	\$6,595,875
2	Test Year Adjusted Revenue	\$5,582,868
3	Total Revenue Deficiency	\$1,013,007

The updated filing indicated that the revenue deficiency was higher than the revenue deficiency noted in the initial Statement of Intent. Table 4.6 compares the two filings, adjusted for revenue-related taxes:

Table 4.6: Comparison of proposed rate increase as presented in the Statement of Intent filed November 15, 2002, and in the update filed on June 27, 2003.

	Statement of Intent	Update	Change
Total Revenue Requirement	\$6,466,468	\$6,595,875	\$129,407
Test Year Adjusted Revenue	\$5,612,707	\$5,582,868	(\$29,839)
Total Revenue Deficiency	\$853,761	\$1,013,007	\$159,246

Although the updated filing indicated a greater revenue deficiency and a greater total revenue requirement, TGS indicated that it would not seek the increased amount:

Although the supplemental rate filing reflects a deficiency that is \$173,778¹ greater than the original, the Company does not, at this time, seek recovery of the additional deficiency. The proposed tariffs included in this package reflect rates which would result in a \$518,950 increase we originally requested, or no change over revenue at interim rates. The Company respectfully requests that the Cities adopt a final rate setting ordinance approving the attached proposed tariffs and authorizing a surcharge to recover the Cities' and Company's associated rate case expenses.²

In October of 2003, the cities of Groves, Nederland, and Port Neches, denied the proposed rate increase. Nevertheless, the cities allowed TGS to continue to maintain the new rates into effect under bond.¹

Appeal (November 12, 2003)

On November 12, 2003, TGS filed its *Petition for Review*.² The *Petition for Review* was based on the twelve months ended December 31, 2002, allegedly adjusted for known and measurable changes through September 30, 2003. As indicated in that filing the Total Revenue Requirement was \$6,743,246; Test Year Adjusted Revenues were \$5,517,390; and the alleged Total Revenue Deficiency was \$1,225,856. Table 4.7 provides a summary:

**Table 4.7: Revenue Requirement and Revenue Deficiency Calculation in
June 27, 2003, Update Adjusted for Revenue-Related Taxes**

1	Total Revenue Requirement ³	\$6,743,246
2	Test Year Adjusted Revenue	\$5,517,390
3	Total Revenue Deficiency ⁴	\$1,225,856

Unlike the earlier filings, no adjustment is necessary in this filing to identify the Total Revenue Deficiency. TGS changed its presentation of the revenue deficiency on appeal. Specifically, TGS removed revenue-related taxes from its calculation of Test Year Adjusted Revenue (Table 7, Line 2). Therefore, no adjustment is required. The Total Revenue Deficiency (Table 7, Line 3) of \$1,225,856 is the amount of revenues TGS will recover if the proposed rates are approved by the Commission. This is consistent with the testimony of Gregg A. Phillips: “Schedule A (line 12) shows that the Company is currently earning \$5,517,390 in South Jefferson County resulting in . . . a revenue deficiency of \$1,225,856.”⁵ Furthermore, it is confirmed by the testimony of F. Jay Cummings stating that the proposed rates are designed to collect the \$1,225,856 increase.⁶

A comparison of all three filings reveals that TGS’ calculation of the Total Revenue Deficiency has increased from \$853,761, to \$1,225,856. In other words, the calculated revenue deficiency increased by \$372,095, or 30%. The overall increase in the total revenue requirement is \$276,778, or 4.28%. Table 4.8 provides a comparison of the three filings and calculates the overall change from the initial *Statement of Intent* filed on November 15, 2002, to the *Petition for Review*, filed on November 12, 2003.

Table 4.8: Comparison of proposed rate increase: All Three Filings

	Statement of Intent	Update	Petition for Review	Change
Total Revenue Requirement	\$6,466,468	\$6,595,875	\$6,743,246	\$276,778
Test Year Adjusted Revenue	\$5,612,707	\$5,582,868	\$5,517,390	(\$95,317)
Total Revenue Deficiency	\$853,761	\$1,013,007	\$1,225,856	\$372,095

Finally, it should be noted that the rates being proposed for Cities in this *Petition for Review* are higher than the rates approved for Port Arthur as part of the settlement agreement reached between TGS and Port Arthur.⁷

C. Confusion in the filings.

The Cities have alleged that there is considerable confusion regarding the overall revenue request and the amount of the total revenue deficiency. TGS alleges that this case presents issues that are unusual, “such as the fact that there were three filings — two before the Cities and on appeal — and that the Company’s presentation of the revenue request changed in the course of these three filings, providing the opportunity for misunderstanding.”¹ Depending on the ultimate revenue requirement and deficiency determined in this case, the level of confusion may result in a direct recommendation regarding the jurisdiction of the commission to consider the proposed rates. The level of confusion may also impact the analysis of rate case expenses.

Applicant’s Position

TGS argues that its appeal is a rather straightforward request premised on the need to recognize increased investments in utility plant and a steady decline in sales and load since the last rate case in 1992.² TGS argues that it is the Cities who mischaracterize the relevant facts relating to the precise content of the notice and the *Statement of Intent*.³ TGS’ witness, Ms. McTaggart, testified that at the municipal level there appeared to be some confusion regarding its filing: “During negotiations with the Cities, it appeared to the Company that some people did not understand that the recovery of revenue-related taxes would result in a revenue increase in addition to the requested rate increase.”⁴

Cities Position

The Cities allege that the three filings garner a considerable amount of confusion. Cities’ Exhibit 5, for example is entitled *What is the Revenue Increase?*⁵ Daniel J. Lawton, who testified on behalf of the Cities noted that the rate increase being requested by TGS cannot be determined by the filing.⁶ He also testified that this is “an illustrative exercise in how not to set rates.”⁷

Examiners Recommendation

The Examiners agree that there is considerable confusion regarding the revenue deficiency. There are two significant components in seeking a rate increase. First, from the utility's perspective there is the overall revenue requirement. On appeal that amount was calculated as \$6,743,246. That amount has not increased much from the amount included in the *Statement of Intent* filed at the municipal level on November 15, 2002, \$6,466,468. The increase is \$276,778, or about 4.2 percent. Ms. McTaggart states that "so long as rates are designed based on revenue requirement . . . the question of how to present revenue deficiency will be immaterial."⁸

Ms. McTaggart is incorrect. A second significant component in the presentation of a rate is the revenue deficiency. Without an accurate presentation of the revenue deficiency, the regulatory authority and the rate payer cannot comprehend the significance of the proposed increase. The Texas Utilities Code requires that the utility identify the proposed increase, determine whether or not that increase is a "major change," and provide notice of the proposed increase to the public.⁹

As noted above, TGS changed the presentation of revenue deficiency at the municipal level and at the Commission. The presentation made determining the revenue deficiency difficult. Comparing the two filings required an adjustment that was not immediately apparent from the filings. Even the nomenclature associated with Schedule A used to describe the different elements of the revenue calculation changed. The presentation at the hearing served to underscore the confusion at the municipal level. TGS spent considerable time adjusting the numbers to compare "apples to apples." The cumbersome analysis presented at the hearing was necessary in order to compare the revenue deficiency from filing to filing.

The explanation provided at the hearing and in Ms. McTaggart's rebuttal testimony further confuses the issue. TGS suggested that the overall revenue increase is \$905,581.¹⁰ Even if taxes are collected as a surcharge, the overall revenue deficiency will be \$1,225,856. Gregg A. Phillips, Vice President — Eastern Region for TGS testified that the proposed rates are intended to recover \$1,225,856.¹¹ Further, Mr. Cummings testified that "Attachment FJC-7 provides proof of revenue that demonstrates that the proposed rates are designed to collect \$1,225,856."¹²

1. Analysis Jurisdictional Issues

The Texas Utility Code provides that a party to a rate proceeding before a municipality's governing body may appeal the governing body's decision to the Railroad Commission.¹ An appeal is initiated by filing a petition for review with the Commission and serving a copy of the petition on each party to the original rate proceeding.² An appeal is "*de novo* and based on the test year presented to the municipality adjusted for known changes and conditions that are measurable with reasonable accuracy."³ The Commission shall enter a final order establishing the rates the Commission "determines the municipality should have set in the ordinance to which the appeal applies."⁴

A. Is the jurisdiction of the Commission in this appeal limited by the original Statement of Intent and Accompanying Notice?

The Cities maintain that pursuant to the Texas Utilities Code TGS is limited to the revenue request stated in the original *Statement of Intent* and Notice that was published at the municipal level.

Applicant's Position

TGS argues that it is not limited by the *Statement of Intent* and the *Notice* that was filed. TGS maintains that it may update the original *Statement of Intent* for known and measurable changes and changes in methodology that are revenue neutral. TGS also argues that any changes made between the November 12, 2002, filing and the June 27, 2003, filing can be considered by the Commission since the Cities specifically agreed to allow the utility to make an updated filing incorporating any changes that TGS deems appropriate.

TGS argues that the *June 27, 2003, Update* may contain revised methodologies because the Cities explicitly agreed to those modifications. The terms of the *Agreement in Principle* explicitly provide that TGS may adjust its *Statement of Intent* for known and measurable changes. The entire relevant paragraph from the *Agreement in Principle* provides as follows:

TGS shall file on or before June 27, 2003, a supplemental rate package, based on a test year ending December 31, 2002, adjusted for known and measurable changes, and support the rates proposed by TGS in its original filing with the cities of November 15, 2002, or such modifications to those rates as TGS shall then deem appropriate.¹

That agreement, in particular the language allowing “such modification to those rates as TGS shall then deem appropriate,” allowed TGS to make, not only changes in methodology, but to update the filing for known and measurable changes. Ms. McTaggart testified that all of the revisions made by TGS in the *June 27, 2003, Update* are either known or measurable changes or modifications to the originally filed rates “deemed appropriate” by TGS. Ms. McTaggart alleges that the Cities take issue with changes the Cities expressly agreed TGS could make.¹

In addition, TGS argues that any attempts to limit its proposed increase to \$518,950 are disingenuous. The Cities have mischaracterized the original *Statement of Intent* and accompanying *Notice* that was filed with the Cities by asserting at the hearing and in its closing brief, that the original noticed rate request was \$518,950.² TGS argues that it was clear from the filing that the total increase was \$518,950 plus revenue-related taxes, totaling \$853,761. TGS used average bill impacts, expressed in both dollars and percentages, to inform customers about the expected impact of the rates. These dollar and percentage increase amounts represented the total increase that the customer would experience — base rate, revenue-related taxes, and cost of gas all included.³

Cities Position

The Cities argue that TGS' overall revenue request is limited by the notice that was issued to support its original *Statement of Intent*. The Cities pointed out that this issue has never been squarely addressed at the Commission.⁴ On the other hand, this issue has been squarely addressed at the Public Utility Commission (“PUC”). The Cities argue that the PUC requirement

in PURA and the Commission requirements in GURA are the same and should be given the same reading here.

In *Application of Central Power and Light Company for Authority to Change Rates: Petition of Central Power and Light Company to Continue Deferred Accounting for Unit 1 of the South Texas Project Beyond February 15, 1990*; PUC Docket Nos. 8646 and 9141, 16 P.U.C. Bull. 1388, 1626 - 1627 (October 19, 1990), the PUC addressed this issue.⁵

There the Examiners were faced with establishing a revenue requirement for a nuclear plant in service under a rate moderation plan. The utility noticed increase was less than the increase required by the utility. The Examiners concluded that the PUC could not approve an increase greater than the amount noticed by the utility — even if the utility had established that it needed a greater increase:

The Commission has held in numerous cases that the maximum rate increase that may be granted to a utility is the amount stated in the public notice, even when it is undisputed that the requested increase described in the public notice will not fully cover the utility's cost of service."¹ The Cities have pointed to other PUC decisions which support this proposition.²

The Cities also point to the discussion in the proposal for decision in *Appeal of TXU Gas Distribution from the Action of the City of Dallas, City of University Park, and the Town of Highland Park, Texas and the Statement of Intent filed by TXU Gas Distribution to Increase Rates Charged in the Environs of the City of Dallas*, Docket No. 9145 - 9148 (Gas Utils. Docket, November 20, 2000) (Final Order). In the Proposal for Decision issued in that case the Examiners stated that “. . . Section 103.055 allows the Commission to consider an appeal de novo based on the test year presented for known ‘changes and condition.’ To the extent that the rates proposed at the Commission level result in a higher revenue requirement than requested at the City of Dallas, the Commission is without jurisdiction to grant the higher request, unless it is linked to a known and measurable change. Changes in methodology that result in a higher request cannot form the basis of the commissions decision.”¹

Examiners' Recommendation

The Examiners agree with TGS that the general rule is that on appeal, the Commission may consider the rate case presented at the municipality, “adjusted for known changes and conditions that are measurable with reasonable accuracy.”² Further, the Examiners agree that changes in methodology may be considered that do not result in a higher rate request. The two-stage process at the municipal level in this case, however, poses a unique problem.

The Commission's authority is limited to entering a final order establishing the rates the Commission “determines the municipality should have set in the ordinance.”³ When TGS filed its updated request, TGS indicated that it could seek a rate increase of \$692,728.⁴ TGS offered to forgo the difference from the original *Statement of Intent* to the *June 27, 2003, Update*. Even if TGS decided to seek that increase, the Cities could not award that increase without a new notice being issued. This fact limits the jurisdiction of the Commission on appeal and that is the

significance of the PUC cases cited by the Cities.

The Regulatory Authority is limited to the amount stated in the *Notice*. On June 27, 2003, the amount of the increase that the Cities could have awarded was limited by the Notice that was in effect at that time. TGS's decision to appeal the denial does not eliminate that limitation. The appeal must be based on the amount of the revenue increase that the Cities could grant. On June 27, 2003, the Notice stated that the amount of the increase was \$518,950, plus revenue-related taxes.

Table 5.1 provides a summary of the rate case presented by the utility in its *Statement of Intent*, and compares that to the rate case presented by the utility in its *June 27, 2003, Update*:

Table 5.1 Summary Comparison of the Statement of Intent and the *June 27, 2003, Update*

		Statement of Intent 11/15/03 Column A	Update 06/27/03	Change
1	Rate Base	\$14,501,855	\$15,797,552	
2	Rate of Return	9.74%	9.33%	
3	Required Return	\$1,412,916	\$1,473,912	\$60,996
4	Depreciation & Amortization	789,576	722,226	(67,350)
5	Taxes other than Income Taxes	431,955	426,455	21,500
6	Interest on Customer Deposits	28,304	29,234	930
7	Distribution Expense	1,234,230	1,296,439	62,209
8	Customer Accounts Expense	857,966	808,714	(49,252)
9	Administrative and General Ex.	1,269,583	1,299,709	30,126
10	FIT	<u>435,450</u>	<u>504,860</u>	<u>69,410</u>
11	Revenue Requirement	\$6,459,980	\$6,588,549	\$128,569
12	Test Year Adjusted Revenues	<u>(5,947,518)</u>	<u>(5,903,147)</u>	
13	Base Rate Revenue Deficiency	\$512,462	\$685,402	
14	Uncollectable Expenses	6,406	7,248	
15	Total Base Rate Revenue Deficiency	<u>\$518,868</u>	<u>\$692,650</u>	
16	Total Base Rate Revenue Req. ln 11 + ln 14	<u>\$6,466,386</u>	<u>\$6,595,797</u>	

Because the utility did not issue a revised notice, the Cities could not have granted a rate increase greater than the increase requested on November 15, 2002 (Table 5.5, Col. A, ln. 15). The Notice that was issued during the pendency of this appeal does not cure this jurisdictional limitation. Consequently, on appeal the Commission cannot enter an order greater than the amount of the increase set out in the original Notice. The Examiners agree that the starting point is not \$518,868, instead it is that amount adjusted for known and measurable changes. Thus, the starting point for the appeal is summarized in Table 5.2.

Table 5.2 – Maximum Rate Increase Municipalities Could Approve on June 27, 2004

		Statement of Intent	Adjusted for Revenue-related taxes
1	Total Revenue Requirement	\$6,466,386	\$6,466,468
2	Test Year Adjusted Revenue	\$5,947,518	\$5,612,707
3	Total Revenue Deficiency	\$518,868	\$853,761

Nevertheless, known and measurable changes between the date of the *June 27, 2003, Update*, and the *Petition for Review* may be awarded.

B. May TGS step into the shoes of SUG, its predecessor in interest, for purposes of the Statement of Intent?

In Cities’ Reply to TGS Post-Hearing brief, the Cities apparently, for the first time raise the question of whether or not TGS, a division of ONEOK, may lawfully “step into the shoes” of the Statement of Intent filed by Southern Union Gas Company, a different corporation and different utility.¹ The Cities point out that in *Entex v. Railroad Commission of Texas*, 18 S.W.2d 858 (Tex. App. — Austin 2000, pet. denied), the Austin Court of Appeals held that section 104.005(a) of the Texas Utilities Code prohibits Entex from charging rates filed by another utility.² The Examiners disagree that *Entex v. Railroad Commission* precludes a utility from adopting the *Statement of Intent* filed by its predecessor in interest. That case did not address this situation and suggests that filing the *Statement of Intent* shortly after, or contemporaneously with, a corporate transfer is appropriate.

C. Sufficiency of the Petition for Review: Did TGS perfect its appeal.

On January 2, 2004, the Cities filed a *Motion to Dismiss* arguing that the *Petition for Review* filed by the utility lacked sufficient specificity to meet the requirements of the Commission’s rules. The Examiners denied the motion to dismiss on February 20, 2004, and the interim appeal was denied by operation of law.¹ The Cities urge the motion again in their closing argument.

Section 103.054 of the Texas Utilities Code provides that a utility may appeal the decision of a municipality to deny a proposed rate increase by filing “a petition for review with the Railroad Commission and serving a copy of the petition on each party to the original proceeding.” TEX. UTIL. CODE ANN. § 103.054. The statute does not provide specific guidance regarding the substance of the petition. As discussed in the Examiners’ determination of this issue during the proceedings, Commission rules offer some guidance regarding the general contents of pleadings.² The general rules of the Commission appear to encompass the “fair notice” pleading standard which is common to Texas civil procedure.³ In the context of gas utilities, however, the Commission has issued rules that require greater specificity. The issue presented by the Cities is not whether or not the Commission and the Interevenors were provided

“fair notice,” rather the issue is whether or not TGS complied with the specific requirements of Section 7.205 of the Gas Services Division rules.

The Commission, through Rule 7.205 has offered additional, though limited, guidance regarding the contents of the petition for review. The rule requires that all parties comply with the requirements of Section 1.25 of the Commission’s rules relating to the form and content of pleadings. Section 7.250 imposes the following additional requirements: (1) The proposed revisions of rates and schedules must be submitted; (2) a statement specifying in detail each proposed change; (3) the effect the proposed change is expected to have on the revenues of the applicant, and; (4) the classes and numbers of utility customers affected.

Cities Position

In the *Motion to Dismiss*, the Cities raised issues regarding the Applicant’s explanation, required by Section 7.205(a)(3), that the effect the proposed change is expected to have on the revenues of the applicant. The Cities also specifically noted certain alleged deficiencies. The Cities argued that the *Petition for Review* nowhere notes that the customer charge for residential, commercial, and public authority customers would change from \$6.50 to \$11.00, \$7.25 to \$14.50, and \$6.50 to \$13.00, respectively. Although the attachments indicate that the rates will be \$11.00, \$14.50, and \$13.00, they do not state the existing rates: \$6.50, \$11.00, and \$7.25, respectively. Finally, the Cities complained that information was not provided on a city-by-city basis.

Applicant’s Position

TGS argued that this issue has already been decided in its favor, the Cities’ motion was denied by the Examiners and the Cities lost their subsequent interim appeal to the Commission.⁴

In its pleadings, and at prehearing conferences, TGS argued that it provided all of the information required by Rule 7.205. Although some information was provided on a city-by-city basis, TGS did not agree that the rule requires a breakdown by city of the rate increase. Instead, TGS argued that it satisfied the requirements regarding the sufficiency of its revenue statements because it provided that information on a system-wide basis i.e. South Jefferson County Service Area.

TGS argues that the city-by-city allocation is not required by Rule 7.205. Nevertheless, TGS pointed out that it did provide the proposed revenue increase for each city involved in the appeal.⁵ In addition, TGS also noted the total number of customers affected within each city.⁶ Finally, TGS argued that a city-by-city allocation can be derived from the prefiled testimony and would be further delineated through discovery, and at the hearing.

As to the specific changes to rates, TGS argued that this could be ascertained through an examination of the tariffs attached to the Petition and comparing them to the tariffs already on file with the municipalities and Commission on file with both those entities. In filing its appeal here TGS filed its proposed tariffs. TGS did not file the original tariffs and the proposed tariffs so that the Commission or the public could compare them. TGS argued that the Commission and the Cities could easily compare the tariffs on file with the proposed tariffs and ascertain the

specific changes.

Examiners' Recommendation

As explained in **Examiners' Letter No. 6**, the issues raised by the Cities depend upon an evaluation of Section 7.205 and the filing that was made. The filing itself can be divided into three parts: The pleading, entitled *Petition for Review (Petition)*, the attachments to the *Petition (Exhibits)*, and the prefiled direct testimony of TGS. The *Exhibits* include the following: (1) Ordinances of the Cities denying the rate request; (2) rate schedules summarizing the cost of service study, and; (3) copies of the proposed tariffs.

The Examiners agree with TGS that it has complied with the requirements of Section 7.205. Current and proposed revenues for the entire SJCSA were provided.¹ Customer classes were identified by attaching proposed tariffs for each class to the *Petition for Review*.² Additional information regarding customer classes was provided in the prefiled testimony.³ The total number of customers affected by the proposed changes were identified.⁴ By filing its *Petition* based upon the revenue requirement of the SJCSA, and including certain city-by-city analysis TGS complied with the requirements of Section 7.205.

6. Allocation of Common Costs: Rate Base, Expenses, and Revenues.

As noted above TGS is a division of ONEOK, and the TGS operating areas in Texas are divided into several regions. The Eastern Region of TGS includes the following areas: North Texas, the *Gulf Coast Area*, and Central Texas. The *Gulf Coast Area* includes the Galveston Area and the South Jefferson County Service Area (“SJCSA”). In addition to direct components of rate base, direct expenses, and revenues of TGS in the SJCSA, there are portions ONEOK, Eastern Region, and Gulf Coast Area rate base, expenses, and revenues that must be allocated to SJCSA.

Applicant’s Position

Ms. Dively testified regarding the allocation of joint and common costs of ONEOK to SJCSA. She testified that joint and common costs are those costs incurred at a corporate and divisional level that must be allocated to specific jurisdictions for the purpose of establishing a jurisdiction’s revenue requirement.⁵ ONEOK uses a “three step” allocation methodology. First, costs specifically attributed to a business unit are directly charged to that business unit. Second, indirect costs that are significant in amount but cannot be directly charged are allocated to business units using allocation factors that distribute the costs in a manner consistent with the functions that caused those costs. Third, any remaining costs that cannot be associated with a specific, identifiable causal relationship are pooled as corporate overhead and allocated among the business entities using a three-factor formula comprised of gross plant and investment, operating income, and labor expenses.⁶

Ms. McTaggart testified regarding the allocations of costs from the Gulf Coast Area to SJCSA. The Gulf Coast Area Director and his staff provide management and accounting services to the SJCSA. Those expenses are allocated based on the ratio of customers in South Jefferson County to total customers in the Gulf Coast Area, or 66.11 percent.⁷ Ms. McTaggart also testified regarding the allocation of costs from the Eastern Region to the Gulf Coast Area. The Eastern Region Vice President and his staff provide management, accounting, human resources, and engineering services to the SJCSA. Those expenses are allocated to South Jefferson County based on the ratio of customers in South Jefferson County to total customers in the Eastern Region, or 11.94 percent.⁸ Finally, Ms. McTaggart testified that expenses are incurred at the TGS Division level for essential functions such as management, engineering, customer call center, accounting, regulatory affairs and gas supply that benefit customer in South Jefferson County. Those expenses are allocated to South Jefferson County based on the ratio of customers in South Jefferson county to total TGS customers, or 5.98 percent.⁹

Cities’ Position

Mr. Lawton, testifying on behalf of the Cities, argues that this method of allocation results in a disjointed and arbitrary allocation process.¹⁰ He points out that the allocation of corporate costs from ONEOK to the various Texas regions of ONEOK are based upon a composite allocator derived from an equal weighting of plant investment, operating income, and labor expense.¹¹ On the other hand, when data is allocated among Texas operations, TGS abandons the composite allocator and allocates based upon a customer allocator. Mr. Lawton

developed a composite allocator employing the plant, labor, and operating income of Texas operations, which he alleges is consistent with the methodology employed by ONEOK. The resulting Texas level Distrigas allocator is 4.536%.¹² Mr. Lawton maintains that this is a more rational basis for allocating costs because costs are incurred for a host of reasons other than the fact that customers are on a system. An allocator based on investment levels, contributions to income and labor costs covers a much wider range of cost responsibility and is more equitable.¹³

Examiners' Analysis and Recommendation

The Examiners find that the customer-based allocator is the most reasonable measure of the relative need for and use of by each of TGS' service areas. For the purpose of allocating joint and common costs, the size of each of TGS' service areas is best reflected by the number of customers in that services area. On rebuttal, Ms. Dively testified that the methodology proposed by the utility is the appropriate methodology because the number of customers is the most reasonable measure of the relative need for and use of support services by each of TGS's services areas.¹⁴ Furthermore, the Commission's Natural Gas Rate Review Handbook states that "in the case of diversified energy corporations which include utility divisions . . . a multi-factor formula is generally used."¹⁵ Finally, TGS's proposed allocation is consistent with the Commission's order in *Appeals of Southern Union Gas Company from the Actions of the City of El Paso, Texas*, Dockets Nos. 8878 and 8887 (Gas. Utils. Docket November 17, 1998) (Final Order).¹⁶ The Examiners agree with Ms. McTaggart's testimony that the method of allocation of area, region, division, and TGS's share of corporate expenses to South Jefferson County, based upon number of customers, is the method of allocation approved by the Commission in GUD No. 8878, *Appeals of Southern Union Gas Company from Action of the City of El Paso, Texas* and is a reasonable approach to the quantification and allocation of these costs to the SJSCA.¹⁷

7. Rate Base

Nicole A. Simmons, Stacey L. McTaggart and June M. Dively testified in support of TGS' rate base request.¹ TGS seeks a total rate base amount of \$16,210,135.² The Cities contest the direct costs associated with SJCSA. The Cities contest the allocation of joint and common costs and suggest an adjustment to rate base of \$63,838, reducing the total rate base to \$16,146,299.

Table 7.1 Summary of Rate Base calculations and Examiners' Recommendation

TGS Statement of Intent	TGS June 27, 2003 Update	TGS Petition for Review	Cities	Examiners' Recommende d
\$14,501,855	\$15,797,552	\$16,210,135	\$16,146,299	\$16,210,137

A. Gross Plant in Service

Applicant's Position

Ms. Dively presented testimony in support of TGS Gross Plant in Service component of \$27,934,360.¹ That Plant in Service is the per book SJCSA Plant in Service as of December 31, 2002 of \$25,785,494 adjusted for various items: (1) elimination of fully depreciated items; (2) known and measurable changes that occurred from December 31, 2002, through September 30, 2003; and, (3) addition of Joint and Common Plant in Service.² TGS presented evidence that since the time of the last rate case in 1992, TGS has invested approximately \$8.5 million in new plant in the SJCA.³ From December 31, 2002, through September 30, 2003, known and measurable changes to plant in service were \$1,069,921.

Cities' Position

The TGS Division Joint and Common Plant costs are calculated to be \$6,117,882.⁴ TGS has allocated \$365,591 of those costs to SJCSA.⁵ The Cities propose to adjust this amount by changing the amount of Joint and Common Costs allocated to the SJCSA from \$365,591 to \$277,547.⁶

Examiners' Recommendation

For the reasons noted above, the Examiners recommend that the Cities' adjustment be rejected and that the Commission approve \$27,934,360 in Gross Plant in Service.

B. Completed Construction not Classified

Applicant's Position

TGS presented testimony in support of Completed Construction Not Classified in the amount of \$716,966. Ms. Simmons testified that CCNC represents utility plant that is functionally in service but that has not yet been transferred from Account 106 (CCNC to Account 101 (Plant in Service), on TGS' books. After a construction project is completed, there is typically a delay in the accounting transfer. Ms. Simmons testified that this is administrative in nature. In other words, the delay occurs because accounting must wait until all charges have been processed to close and transfer projects to Account 1010.

Cities' Position

The TGS Division Joint and Common Plant costs are calculated to be \$354,362.¹ TGS has allocated \$21,176 of those costs to SJCSA.² The Cities propose to adjust this amount by changing the amount of Joint and Common Costs allocated to the SJCSA from \$21,176 to \$16,076.

Examiners' Recommendation

For the reasons noted above, the Examiners recommend that the Cities' adjustment be rejected and that the Commission approve \$716,966 in Gross Plant in Service.

C. Accumulated reserves for depreciation

Applicant's Position

Ms Simmons presented testimony in support of TGS' calculation for accumulated reserves and depreciation in the amount of \$10,646,960.¹ This amount was increased by \$551,725 to reflect known and measurable changes in the Reserve Balance that occurred between December 31, 2002, and September 30, 2003.² In addition, the amount was adjusted to reflect Joint and Common Reserves in the amount of \$106,948.³

Cities' Position

The TGS Division Joint and Common Reserve balances are calculated to be \$10,646,690.⁴ TGS has allocated \$106,948 of those costs to SJCSA.⁵ The Cities propose to adjust this amount by changing the amount allocated to Joint and Common reserves to the SJCSA from \$106,948 to \$81,192.⁶

Examiners' Recommendation

For the reasons noted above, the Examiners recommend that the Cities' adjustment be rejected and that the Commission approve \$10,646,690 to Net Depreciation and Amortization Reserves..

D. Prepayments

Applicant's Position

Ms. Simmons testified in support of \$40,972 for prepayments.¹ She testified that TGS Division Prepayments of \$685,624 consist of the monthly balances associated with prepaid costs of the direct TGS Division Office amount of \$441,281 plus \$244,342 of allocated Corporate Prepayments based upon the month average for the thirteen month period that ended September 30, 2003. This entire amount is an allocated joint and common cost.

Cities' Position

The Cities propose to adjust the amount of prepayments, which are an allocated costs by reducing the prepayments from \$40,972 to \$31,105.²

Examiners' Recommendation

For the reasons noted above, the Examiners recommend that the Cities' adjustment be rejected and that the Commission approve Prepayments in the amount of \$40,972..

E. Accumulated Deferred Taxes - Test Year Allocated Joint & Common

Applicant's Position

Ms. Dively testified that Joint and Common deferred federal income taxes allocated to TGS are \$933,811.¹ Based on the allocation factor developed by TGS of that amount \$55,803 is

allocated to SJCSA.²

Cities' Position

The Cities propose to adjust the amount of entirely allocated costs by reducing the deferred federal income taxes from \$55,803 to \$42,364.³

Examiners' Recommendation

For the reasons noted above, the Examiners recommend that the Cities' adjustment be rejected and that the Commission approve Accumulated Deferred Taxes in the amount of \$55,803.

F. Other uncontested Rate Base Items

Applicant's Position

Ms. Simmons also testified regarding several other components to rate base: Customer Deposits, Customer Advances, Contributions in Aid of Construction, Materials and Supplies Inventory, and Prepayments. Ms. Simmons testified that Customer Deposits amounted to \$472,127, Customer Advances equaled \$62,029, and Contributions in Aid of Construction were \$62,029.¹ Ms. Simmons testified that September 30, 2003, balances were used to be consistent with other adjustments to rate base for known and measurable changes.² In addition, Ms. Simmons testified that Materials and Supplies amounted to \$96,388. She calculated that amount using a thirteen month average of the months from September 2002, through September 2003).³ Finally, Ms. Simmons testified in support of \$40,972 for prepayments.⁴

Ms. McTaggart testified regarding the cash working capital requirement of TGS.⁵ Cash working capital is the cash flow required to finance the day-to-day operations of a business. Because business operations both generate and utilize cash, cash working capital can be a net inflow or a net outflow of cash to a company. Ms. McTaggart presented evidence in support of a negative cash flow of \$277,492.⁶

Examiners' Recommendation

TGS has established through testimony that these amounts are just and reasonable and have not been contested by the Cities. Accordingly, the Examiner recommends that they be approved.

8. Rate of Return

The Commission must establish a reasonable rate of return for TGS. In establishing a gas utility's rates, the regulatory authority shall establish the utility's overall revenues at an amount that will permit the utility a reasonable opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public in excess of its reasonable and necessary operating expenses.¹ The regulatory authority may not establish a rate that yields

more than a fair return on the adjusted value of the invested capital used and useful in providing service to the public.²

A utility's return on its investment is a product of the rate base multiplied by a fair rate of return.³ After determining the utility's rate base, the Commission must set a suitable rate of return.⁴ The rate of return is the amount of money that a utility is allowed an opportunity to earn, over and above operating expenses, depreciation and taxes. The first step in determining an appropriate rate of return for TGS is calculating its capital structure. Each of the elements of the capital structure of the utility is given a weighting based upon its contribution to the company's capital structure to arrive at a composite rate of return.⁵

After the *Statement of Intent* was filed TGS reduced its requested Rate of Return from 9.74% to 9.33%. The Cities proposed a Rate of Return of 7.99%. The Examiners recommend a Rate of Return of 8.24%. Table 8.1 summarizes the various proposals and the Examiners' recommendation.

Table 8.1 Summary of Return calculations and Examiners' Recommendation

	TGS Statement of Intent	TGS June 27, 2003 Update	TGS Petition for Review	Cities	Examiners' Recommend ed
Rate Base	\$14,501,855	\$15,797,552	\$16,210,135	\$16,146,299	\$16,210,137
Rate of Return	9.74%	9.33%	9.33%	7.99%	8.24%
Return	\$1,412,916	\$1,473,912	\$1,512,406	\$1,290,263	\$1,364,137

Applicant's Position

Donald A. Murry, PhD. of C.H. Guernsey & Company, provided testimony on behalf of TGS in regards to the utility's proposed rate of return.⁶ TGS has requested an overall rate of return of 9.33 percent. This rate of return proposal is based on a capital structure of 46.5 percent long-term debt and 53.5 percent common equity. TGS has proposed a cost of long-term debt of 6.25 percent. TGS has proposed a return on common equity of 12.00 percent. The following tables summarize TGS' and Intervenors' proposals for this docket.

Table 8.2 Capital Structure

Capital Structure	TGS & Intervenors - Proposed
Long-term debt	46.5 %
Common equity	53.5 %

Table 8.3 Cost of Capital

Capital Cost	TGS - Proposed	Intervenors - Proposed
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Long-term debt	6.25 %	6.25 %
Common equity	12.00%	9.50 %

Table 8.4 Rate of Return

	TGS - Proposed	Intervenors - Proposed
Rate of Return	9.33 %	7.99 %

Dr. Murry based his recommended rate of return for TGS on a weighted average cost of capital calculated by using the average common equity ratios of eight publicly traded local natural gas distribution companies (LDCs) and an assumed long-term debt ratio, a cost of equity based on an analysis of the proxy group of LDCs, and the embedded cost of long-term debt for ONEOK, the parent company of TGS.⁷ Dr. Murry testified that his proposal for TGS’s capital structure is based on an analysis of the common stock equity ratios of eight publicly traded LDCs over the previous five years.⁸ Dr. Murry testified that the proxy group of LDCs possess similar basic operating and financial characteristics and represent companies that are primarily engaged in the gas distribution business.⁹ From this analysis Dr. Murry determined an average common equity ratio of 53.5% for the proxy group and which he therefore uses in calculating TGS’ weighted average cost of capital. Dr. Murry testified that the ratio of long-term debt for purposes of determining TGS’ weighted average cost of capital should therefore be 46.5%.¹⁰ Dr. Murry used the embedded cost of long-term debt of ONEOK, the parent company of TGS, as the cost of debt for the capital structure of TGS. ONEOK’s embedded cost of long-term debt is 6.25%.¹¹

Dr. Murry used the cost of equity of the proxy group of LDC’s because TGS is a subsidiary of ONEOK, Inc., and he was not able to estimate the cost of TGS stock directly.¹² Dr. Murry used two methodologies to calculate a cost of equity: the Discounted Cash Flow (DCF) method and the Capital Asset Pricing Model (CAPM) method. Dr. Murry calculated a cost of equity range for the proxy group of 9.39% to 11.2% using current share prices, and 9.23% to 12.43% using 52-week share prices.¹³ Dr. Murry used the CAPM method to calculate the average cost of common stock for the proxy group at 11.67% and 11.21% (size adjusted).¹⁴ Dr. Murry testified that the CAPM method “is a rather imprecise method, but it is a good tool for assessing the general cost of a security, and in this instance it serves as a useful check on the results of the DCF calculation.”¹⁵ Based on his DCF and CAPM analysis of the proxy group, Dr. Murry testified that he believed a cost of equity range for TGS of 11.50% to 12.00% is appropriate for rate-making purposes.¹⁶ He testified that the upper range of 12.00% is the more appropriate value for setting TGS’ rate of return.¹⁷

Cities’ Position

Daniel J. Lawton of Diversified Utility Consultants, Inc. testified on behalf of the Cities with regards to the utility’s proposed rate of return.¹⁸ Essentially, the only issue contested by the

Cities with respect to TGS' rate of return is the appropriate cost of equity. The objection to the utility's cost of equity forms the basis of the Cities' proposed rate of return of 7.99%. Mr. Lawton testified that the Cities do not contest the utility's proposed capital structure with common equity and long-term debt ratios of 53.5% and 46.5%, respectively, and he uses this proposed capital structure to recommend a rate of return for the utility.¹⁹ The Cities do not contest the use of ONEOK's embedded cost of debt (at 6.25%) to determine the utility's weighted average cost of capital / rate of return in this proceeding and Mr. Lawton uses this in his recommended rate of return.²⁰ The Cities contest the cost of equity recommended by Dr. Murry and his ultimate recommended rate of return. Mr. Lawton testified that the utility's requested rate of return and a 12.0% cost of equity are excessive.²¹

Mr. Lawton testified that there are two primary reasons that TGS' 12.0% cost of equity is excessive: One, the utility's expert witness did not support a 12.0% cost of equity with a reasoned analysis and did not use current market data; and two, TEX. UTIL. CODE ANN. § 104.301 (Vernon Supp. 2004) allows the utility to recover capital and current return on new investment more rapidly, increases the utility's cash flow between rate proceedings, and thus makes an investment in TGS less risky.²² As to GURA § 104.301, Mr. Lawton testified that this statute affects the risk of TGS such that the cost of equity approved by the Commission should be at the midpoint to low end of a cost of equity range rather than the high end as recommended by Dr. Murry.²³

In his direct testimony, Mr. Lawton contested the DCF analysis performed by TGS's expert witness.²⁴ Mr. Lawton testified that Dr. Murry's proxy group of eight LDCs were appropriately selected, are a reasonable proxy for TGS, and should be used to establish an appropriate cost of equity for the utility.²⁵ Mr. Lawton testified that the "main problem with Dr. Murry's conclusion noted above is that his 9.39% to 11.20% DCF range, a range he claims to have relied on in this case, does not square with his 12% return on equity recommendation in this proceeding."²⁶

Mr. Lawton performed his own cost of equity analysis using Dr. Murry's proxy group of LDCs and recommends a cost of equity of 9.50% and an overall rate of return of 7.99%.²⁷ Mr. Lawton performed three cost of equity studies: a constant growth DCF analysis, a two stage DCF analysis, and a Risk Premium analysis.²⁸ His recommended 9.50% cost of equity is the midpoint of the range of cost of equity estimates from his analyses.²⁹

Examiners' Recommendation

The Commission must approve a rate of return on TGS's rate base that is just and reasonable and which fairly compensates the utility for investments made in providing gas service. The parties contest the appropriate rate of return. TGS argues for a 9.33% rate of return and the Cities argue for a 7.99% rate of return. The one hundred thirty four (134) basis point differential is due to the parties' differences over an appropriate cost of equity to be used in a weighted average cost of capital calculation. The Cities did not contest a capital structure comprised of 53.5% common equity and 46.5% long-term debt. The Cities did not contest using ONEOK's embedded cost of long-term debt of 6.25%.

The Examiners agree with the parties that a capital structure comprised of 53.5% common equity and 46.5% long-term debt is reasonable for determining an appropriate rate of return for the utility. The Examiners also agree with the parties that using ONEOK's 6.25% embedded cost of debt is reasonable for determining an appropriate rate of return for the utility.

The primary rate of return issue the Commission must decide is the appropriate cost of equity. Dr. Murry proffered rebuttal testimony regarding problems with Mr. Lawton's cost of equity calculations.³⁰ Dr. Murry testified that Mr. Lawton's study contained calculation errors and that the theoretical bases for Mr. Lawton's constant growth and two-stage growth DCF studies are flawed.³¹ The Examiners do not agree with Dr. Murry that Mr. Lawton's cost of equity studies are somehow defective and useless. Mr. Lawton corrected his studies with an errata filing. However, the effect of his changes were *de minimis*, non-material and non-substantive. Mr. Lawton's studies, which use current market data, yield a 9.50% cost of equity which falls within the cost of equity range (9.39% - 11.2%) of Dr. Murry's study using current market data. Mr. Lawton's methodology is reasonable for rate making purposes and does not yield results out of line with the methodology used by Dr. Murry.

Dr. Murry ultimately recommends a 12% cost of equity for TGS. This is above the DCF cost of equity range he calculated using current market data. Dr. Murry justifies his higher cost of equity by his analysis, interpretation and application of current market conditions to the results of his studies. Thus, the reasonableness and soundness of his analysis of current market conditions is at issue in this proceeding.

Dr. Murry testified that he considered current market conditions in his analysis and interpretation of utilizing the DCF and CAPM methodologies in estimating the cost of equity for the proxy group of LDCs. "For example, among the most important market influences on the current cost of capital are the risks to investors posed by recent market movements, investor uncertainty, and volatility. These market conditions are important when interpreting the results of the DCF and CAPM analyses. Putting the results of these analyses in the context of current market conditions aids in their interpretation and, ultimately, in recommending an allowed return in this proceeding."³²

This testimony begs the question as to what market movements, investor uncertainty, or volatility he is referring to. Dr. Murry provides no objective evidence as to any of these "market influences." Dr. Murry does not present testimony or evidence regarding how "market movements" are statistically and objectively different during the time period of his study from other periods of time, what exactly a "market movement" is and the criteria used to establish a statistically significant "market movement," or how he has utilized such "market movements" in his analysis.

Dr. Murry does not present testimony or evidence regarding how "investor uncertainty" is statistically and objectively different during the time period of his study from other periods of time, what exactly "investor uncertainty" is and objective criteria or studies used to establish "investor uncertainty," or how he has utilized such "investor uncertainty" in his analysis.

Although volatility in securities prices (assuming Dr. Murry is referring to the volatility

of securities prices) can be readily quantified, Dr. Murry does not present testimony or evidence regarding how “volatility” is statistically and objectively different during the time period of his study from other periods of time, what he considers to be overly volatile (e.g., S&P 500, the prices for his proxy group’s securities, or some other securities index or benchmark) or how he has used “volatility” in his analysis and objectively applied such data to recommend the cost of equity he recommends.

Dr. Murry, in fact, does not testify how “important market influences” such as “recent market movements, investor uncertainty, and volatility” are any different during the period of time he analyzed for the LDC proxy group (or any other pertinent index or benchmark) than these “important market influences” have ever been. Instead of providing objective testimony and evidence as to why TGS’ cost of equity should be approved at a level outside the range established during a current time period, a practice consistently done in rate case proceedings before the Railroad Commission, TGS’ counsel pleads that the Examiners and Commission should rely on Dr. Murry’s subjective opinions and academic credentials which TGS’ counsel deems far superior to Mr. Lawton’s.

Dr. Murry offered the following: “Although I studied historical dividends and earnings, the recent shift in investor confidence and market volatility makes historical data less useful for predicting market expectations.”³³ How? Dr. Murry does not objectively quantify a “recent shift in investor confidence” or a recent shift in “market volatility.” He does not present any objective, quantified data or evidence regarding how a “recent shift in investor confidence” and/or “market volatility” causes historical data to be “less useful for predicting market expectations.” Dr. Murry does not objectively quantify and establish this curious cause and effect relationship in his testimony and evidence.

Dr. Murry testified that current market conditions necessitate a cost of equity higher than his DCF study using current share prices; that current market data is not appropriate to use because of current market conditions; and that a cost of equity in the range of 9.39% to 11.2% is somehow not reasonable. Dr. Murry provides no objective, numerical data as a basis for any of these assertions. Rather, his basis for assigning a cost of equity outside the current range is based on subjective interpretation and opinion. A cost of equity analysis involves subjective opinion and interpretation and is not a “scientific” evaluation comparable to a chemical analysis. However, when Dr. Murry bases his decision to exceed a cost of equity range using current data on “market conditions” he should at least offer objective data regarding how current market conditions are statistically different in order to justify his departure from the current range. Dr. Murry fails to do so in his testimony and evidence.

What is even more troubling about Dr. Murry’s cost of equity study is that he failed to update his data since September, 2003.³⁴ Although Dr. Murry, throughout all his testimony, makes much ado about “current market conditions” he failed to update his DCF study to take into account “current market conditions.” The testimony at the final hearing indicates that more recent market data (from more recent *Value Line* data) would lower the cost of equity range developed by Dr. Murry in his studies.³⁵

Dr. Murry also attempts to justify his departure from the results of current market data by

testifying that interest rates and Federal Reserve Policy require a higher cost of equity than his current market data DCF study indicates. Dr. Murry testified that he considered the possible significance of the Federal Reserve's monetary policy and the likelihood that interest rates will increase during the period when the allowed return in this case is in effect.³⁶ Once again, Dr. Murry presents no objective, quantified basis for exceeding the current market data DCF range. He presents no objective, quantifiable basis on how to apply the "possible significance of the Federal Reserve's monetary policy" or the "likelihood that interest rates will increase" to his recommendation for a cost of equity of 12%.

What is glaringly absent from Dr. Murry's "interest rate analysis" is the public policy implications of his recommendation. Is it sound public policy to set a higher allowed rate of return for a utility because interest rates are forecasted to rise? If the Commission accepts Dr. Murry's recommendation, the risk of a rise in interest rates is shifted from the utility to the rate payers. If interest rates do not rise, and the utility has rates set on forecasted higher interest rates then the utility will accrue a windfall by not only having its rate of return set on a higher than market interest rate but also earn a higher rate of return than what would be established under current market conditions. If interest rates actually decrease, the utility's actual rate of return spread over current market rate of return will increase and yield an even greater return to a monopoly. The Examiners doubt that it is sound public policy to allow a monopoly to effectively shift interest rate risk to its customers. Given the lack of evidence establishing the accuracy of interest rate forecasts, the utility's proposal to shift the risk of rising interest rates to customers is more questionable.

Mr. Lawton's recommended 9.5% cost of equity falls within the range of Dr. Murry's DCF analysis using current market data and thus, to an extent, confirms the results of Dr. Murry's study. The Examiners recommend that the Commission use Dr. Murry's DCF study, updated with current market data, to ascertain an appropriate cost of equity range for TGS. Dr. Murry's DCF study using current market data is reasonable and methodologically sound. It yields a cost of equity range that is reasonable for rate-making purposes. Mr. Lawton's cost of equity recommendation confirms the lower end of Dr. Murry's cost of equity range and Dr. Murry's CAPM (adjusted for size) confirms the upper end of his cost of equity study.

The Examiners recommend a cost of equity of 10.3%. This is the midpoint of Dr. Murry's updated DCF study. The "GRIP" legislation, codified as TEX. UTIL. CODE ANN. §104.301 (Vernon Supp. 2004), theoretically reduces risk to the utility. The statute allows a utility to establish an incremental tariff to earn return on new investment without first filing a statement of intent with a regulatory authority. The statute allows return on new investment without the delays associated with having new rates set. The statute mitigates regulatory lag associated with new investment and allows accelerated cost recovery. TGS has not established that its operations are somehow more risky than other similarly situated natural gas distribution companies. As a result, there is no basis in fact, evidence or testimony that establishes that TGS is more risky than other LDCs and should have a cost of equity higher than the midpoint.

Dr. Murry's testimony does not justify exceeding the cost of equity range indicated in his DCF study using current market data. Given the Commission recently approved a 10% cost of equity in GUD No. 9400, there is no evidence, testimony, facts or circumstances that logically

require TGS' cost of equity to be two hundred (200) basis points higher than the cost of equity recently approved by this Commission.

The Examiners recommend that the Commission approve a capital structure comprised of 53.5% common equity and 46.5% long-term debt. The Examiners recommend that the Commission approve a cost of long-term debt of 6.25% and a cost of equity of 10.3%. Based on the foregoing, the Examiners recommend that the Commission approve a rate of return for TGS of 8.42%.

9. Revenues and Expenses

In the *Statement of Intent* filed at the municipal level, Southern Union Gas requested that test year revenues be set at \$5,612,707.³⁷ In the *June 27, 2003 Update*, TGS requested \$5,582,872.³⁸ TGS adjusted its test year expenses, revenues, and customers for known and measurable changes that occurred through September 30, 2003³⁹ and that figure was revised in the *Petition for Review* where TGS requested \$5,517,390.⁴⁰ The Cities recommend that adjusted test year revenues be set as 6,393,903.⁴¹ Table 9.1 provides a summary.

Table 9.1 Summary of Test Year Revenue calculations and Examiners' Recommendation

TGS Statement of Intent	TGS June 27, 2003 Update	TGS Petition for Review	Cities	Examiners' Recommend ed
\$5,612,707	\$5,582,872	\$5,517,390	\$6,393,903	\$5,763,730

A. Revenues

In the *Petition for Review*, TGS indicated that present revenues were \$5,517,390.⁴² In the *June 27, 2003, Update* that figure was, \$5,582,868,⁴³ adjusted for revenue-related taxes, and in the *Statement of Intent* that figure was \$5,612,707,⁴⁴ adjusted for revenue-related taxes. The Cities argue that present rate revenues should be \$6,393,903.⁴⁵

1. Gross Receipts and Franchise Tax

Applicant's Position

Judson W. Larson testified on behalf of TGS and argued that gross receipts and franchise taxes associated with base sales revenues should be removed from test year revenues. Mr. Larson argued that these taxes should be removed from the revenue requirement as TGS is proposing to move all taxes as a line item on the customer bill. In order to accurately state the revenue requirement for designing rates with these taxes as a line item, any taxes included in test year base revenues are removed. Mr. Larson points out that the change is revenue-neutral and is being proposed in order to simplify the administration and accounting of revenue-related taxes.⁴⁶

Cities Position

The Cities allege that the proposal to reduce present rate revenues by an amount for gross receipts tax, \$107,753, and an amount for franchise tax, \$212,522 is incorrect. They argue that TGS is simply attempting to understate its revenues. While TGS may be proposing to surcharge these amounts in the future, the fact is that these amounts are built in and are part of the existing tariff rate for each customer class. Whether these expenses may be surcharged in the future does not alter the current base rate tariff charge.⁴⁷

Examiners' Recommendation

The Examiners recommend that the proposed adjustment be adopted as stated by TGS. If the Applicant is proposing to treat taxes as a surcharge then it makes sense to exclude them from both the expense calculation and revenue calculation for test year. This is the same treatment accorded to the cost of gas when a utility proposes to recover its costs of gas through a purchase gas adjustment clause, a well-established practice in Texas. Indeed, the Examiners note that a considerable amount of confusion would have been avoided in this case, had the utility filed its *Statement of Intent* using this model.

1. Normalized Weather Adjustment

TGS and the Cities propose that the calculated revenues be adjusted, or normalized, to remove the effect of weather that is colder or warmer than normal. In the *Petition for Review* and in the *June 17, 2003, Update* TGS proposed that test year revenues be reduced by an adjustment to account for the effects of weather. TGS proposed a decrease in the amount of \$122,778.⁴⁸ The Cities agreed that an adjustment was necessary, however, the Cities proposed that an increase was required in the amount of \$4,875.⁴⁹

Applicant's Position

TGS witness Judson W. Larson testified that weather in the SJCSA was 10% colder during the test year. Accordingly, he concludes and an adjustment is required to decrease test year revenue in recognition that volumes and resulting revenues were abnormally high because the test year was colder than normal. By making the adjustment to normalize weather, rates will subsequently be designed to produce the level of revenues anticipated under normal temperature conditions.⁵⁰

Mr. Larson developed a weather adjustment for each customer class using a standard regression analysis.⁵¹ TGS uses an average of the last **ten years** of weather data to derive normal heating degree days. Mr. Larson testified that the ten-year range is appropriate because it is up-to-date, incorporating the last decade of weather experienced. TGS witnesses testified that this ten-year measure is consistent with the weather adjustment calculation in several of the Applicant's other service areas: Austin, El Paso, Galveston, North Texas, Arizona Corporation Commission, the Rhode Island Public Utilities Commission, Vermont Public Service Board. TGS witnesses explained that other regulatory authorities have adopted the 10 year measure including, the Wyoming Public Service Commission.⁵² Mr. Larson also notes that it is consistent the Applicant's last rate case in Appeals of *Southern Union Gas Company from the Actions of*

the City of El Paso, Texas, Docket No. 8878 (Gas Utils. Div. November 17, 1998) (Final Order) (“GUD No. 8878”).⁵³ In that case the Commission found that “[a] weather normalization period based on ten years of weather data best reflects ongoing conditions in the El Paso Service area” and that the “weather normalization analysis, which is based on ten year weather normalization is reasonable.”⁵⁴

Mr. Cummings, testifying on rebuttal on behalf of TGS examines the use of the 30-year period advocated by the Cities. He notes that the Cities’ reliance on NOAA publications is misplaced because NOAA does not publish daily normal heating degree days, it only publishes monthly and annual normal degree days and he does not believe that NOAA publications are intended to provide a basis for normalizing a utility’s revenue for rate making purposes.⁵⁵ TGS also suggests that the Cities reliance on the decision in GUD No. 9400 are misplaced because the 30 year weather normalization adjustment was not challenged in that case.⁵⁶ Mr. Cummings challenges the Cities’ contention that the use of the 30 year period is the norm and contends that a 30 year period is not, in fact, a regulatory “norm.” Mr. Cummings testified that state regulatory Commissions have not restricted themselves to the use of either 10 years or 30 years.⁵⁷ In some jurisdictions the use of 10, 15, 20, or 30 is applied

Finally, TGS takes issue with the assertion made by the Cities that using a longer period such as 30 years eliminates the problems of significant year-to-year changes in expected or normal weather due to annual temperature extremes. Mr. Cummings testifies that the number of years used is not the key issue. He argues that the issue is how best to obtain a representation of ongoing conditions and concludes that weather experience in recent years is the most relevant. He points out that a review of weather experience in recent years shows most years are warmer than the 30-year average. Further, using the 30-year measure captures several years in the early 1970s that were substantially colder than the single coldest year in the decade ending in 2002. The experience in recent decades suggests that the 30-year average is becoming less and less indicative of ongoing weather conditions.⁵⁸ Finally, Mr. Cummings addresses Mr. Lawton’s contention that the Rate Review Handbook provides support of the 30-year measure. Mr. Cummings argues that the Handbook does not advocate the use of 30 years for reviewing weather data, the Handbook merely provides that the Climatological Data is available through publications from NOAA.

Cities’ Position

Mr. Lawton testified that a weather normalization adjustment is a methodology, which adjusts per books sales for a given period to reflect gas sales under normal weather patterns. Gas sales increase when weather is colder than normal because of heating load increases gas demand. Conversely, if weather is warmer than normal, heading load requirements decline and gas demands decline. Mr. Lawton testified that he calculated a normal weather adjustment of the test year based upon the approach used in the Gas Services Division, Natural Gas Rate Review Handbook. He also testified that 30 years of degree day data averaged together constitute a measure of normal weather based on the Department of Commerce, NOAA, and NWS. By applying 30 years as the normal weather measure actual heating degree days during the test year were below normal and revenues need to be increased. Based upon his analysis Mr. Lawton concluded that test-year revenues should be adjusted upwards and an increase in test year

revenues of \$4,875 should be added.

Mr. Lawton testified that TGS's use of 10 year model instead of a 30 year model is flawed. He testified that the norm is to employ 30 years of data in both the gas and electric industries. He noted that in GUD No. 9400 TXU Gas employs 30 years of weather data to measure normal as expected weather. He did note that in recent years, some gas companies, such as TGS' predecessor, Souther Union gas in its El Paso rate case, proposed, and the Commission approved, employing 10 years of data as a measure of normal weather.⁵⁹

Examiners' Analysis and Recommendation

Weather has an obvious impact on sales of gas, which in turn affect revenues as well as income. The Examiners agree that in determining a utility's test year revenue, it is necessary to utilize weather-normalized rates. The Examiners agree that a weather normalization based on 30 years of weather data best reflects ongoing conditions. The Commission has used a 30-year average in the past and other utilities have used it in presenting rate cases before the Commission. The Examiners agree that employing a larger sample such as 30 years eliminates the problems of significant year-to-year changes in expected or normal weather due to annual temperature extremes. Finally, it is important to note that in the last rate case for this service area the Commission approved a weather normalization adjustment made based upon an analysis covering 30 years.⁶⁰

1. Normalized Customer Growth Adjustment

The Cities and TGS agree that an adjustment is necessary to adequately capture changes in test-year customer growth.⁶¹ When TGS made its *June 27, 2003, Update* TGS proposed an adjustment of \$20,376.⁶² In its *Petition For Review*, TGS proposed to reduce test year revenues by \$68,020 to capture this adjustment.⁶³ On rebuttal, TGS revised this figure, to \$47,765.⁶⁴ The Cities contend that the adjustment for normalized customer growth should be \$9,659.⁶⁵

Applicant's Position

TGS witnesses testified that TGS has experienced negative growth in recent years.⁶⁶ TGS proposes an adjustment to capture the pattern with the test year and adjust test year customer counts. For each customer class, the growth adjustment annualizes the decline that occurred during the test year by adjusting bill counts and volume in each month of the test year to the levels that would have been observed had the change seen at the end of the test year occurred in each of the previous months. The change in customers as of December 2002, was calculated by comparing the active customers at December 2001, to active customers at December 2002.⁶⁷

TGS witness Judson Larson then updated the growth adjustment to September of 2003.⁶⁸ Mr. Larson testified that he believed that this was necessary in order to properly match growth with additions to plant and related charges that have been incorporated into the rate case through September 2003.⁶⁹ In the initial analysis Mr. Larson used a calculation that reflected nine month rather than a full twelve month period. In his rebuttal, Mr. Larson proposed a revision based

upon a full twelve month period. He concluded that this was a more accurate method for calculating this adjustment.⁷⁰ This revision resulted in a customer growth adjustment of \$47,765 instead of \$68,020.⁷¹ The ultimate result is that although test year revenues are still adjusted downward, the magnitude of that adjustment has been reduced.

Cities Position

The Cities agree that an adjustment to test year levels of customers is necessary.⁷² Although Mr. Lawton agreed with the need for an adjustment he disagreed with the approach and methodology used by TGS. He disagrees that there is a need to make a continuous adjustment to test year amounts through September 2003. In addition, he alleges a flaw in the analysis, because it is possible to discern an increase in bill levels between December 2002 and September 2003. Nevertheless, TGS calculated a decrease. Mr. Lawton suggests that the problem may be the result of the monthly point estimate selected for normalization rather than declining customer quantities. In any case, Mr. Lawton argues that he has never seen such an adjustment and suggests that it be rejected.⁷³

Mr. Lawton presents his own calculation that he maintains is consistent with the suggestions and guidance from the Natural Gas Rate Review Handbook.⁷⁴ He compared average customer quantities for the year 2001 to the test year 2002. One-half of the difference in average customers between 2001 and 2002 is the adjustment factor for the test year. The change in customers, bills, volumes and revenues resulting from the adjustment is then quantified. He testified that he used average annual customer quantities in the analysis to avoid any problems and unusual variations associated with point estimates for measuring customer change trends.⁷⁵ Mr. Lawton concluded that an adjustment to test year revenues was required in the amount of \$9,659.⁷⁶

Examiners' Recommendation

The Examiners recommend that TGS' proposed normalized customer growth adjustment stated in the Rebuttal Testimony of Judson W. Larson in the amount of \$47,465 be rejected. The Examiners are troubled by the fact that the post-test-year data resulted in varying calculations: \$20,376, \$68,020, and finally \$47,465. Furthermore, the Examiners agree that such varying numbers may be the result of using monthly point estimates instead of the average customer quantities proposed by the Cities. Accordingly, the Examiners recommend that the customer growth adjustment factor of \$9,659 proposed by the Cities be adopted in this case.

4. Load Attrition.

TGS has fewer customers today, both residential and commercial, than it had in SJCSA when rates were adjusted in 1992. The number of residential customers has fallen from 32,634 in the last rate case to 31,334 in this case (a decrease of 4%). The number of commercial customers has decreased from 1,454 to 1,297 over that same period (an even larger drop of 10.8%). In terms of lost load TGS volume of residential sales has fallen from 18.3 million Ccf in the last rate case to 13.2 million Ccf in this case, a loss of almost 28%. The volume of commercial sales over that same period has declined by more than 18%, from approximately 3.3

million Ccf to 2.7 million Ccf.¹

Applicant's Position

TGS proposes a “load attrition adjustment” to quantify future reductions in revenue beyond the test year. Mr. Cummings testified that attrition analyses are the statistical analyses of per bill usage taking into account various factors that may explain usage variations, including a trend factor to capture any attrition effect.² Mr. Cummings explained that residential load attrition may result from improving appliance efficiencies and ongoing customer conservation efforts.³ Using standard regression analyses he attempts to quantify this attrition using data that goes back to July 1995.⁴ Mr. Cummings testified that he believes that this is a known and measurable change.⁵ Mr. Cummings concludes that a “load attrition adjustment” of \$75,065 should be made to Test Year Revenues.⁶ A corresponding adjustment would then be made to test year volumes.⁷ Mr. Cummings suggests that if the Commission considers it appropriate to recognize residential load loss during the first year when new rates are in effect, the revenue reduction should be replaced with \$129,857.

Cities' Position

The Cities argue that this adjustment for “phantom attrition or earnings erosion” is unsupported and should be rejected for several reasons. First, the Commission has never accepted an attrition adjustment. Mr. Lawton argues that this type of attrition is neither known nor reasonably measurable. Loads and demands may increase next week or next year because of higher income, economic recovery, lower gas prices and a number of other reasons. None of these factors were considered in Mr. Cummings’ analysis. In short, Mr. Lawton argues that the analysis is speculative. Mr. Lawton provides data for residential gas use in July of each year from 1995 through 2002 and concludes that if usage level produce a discernable trend of declining usage based on that date over time, “it is not apparent to the naked eye.”⁸

Examiners' Recommendation

The proposed load attrition adjustment should be rejected. The Examiners agree that the analysis is speculative and excludes a host of other factors that may affect usage. Furthermore, the Examiners do not agree that TGS should be permitted to look beyond the test year to determine usage. Customer volumes should be based on test year data. It is undeniable that Mr. Cummings must look past the test year in order to calculate this adjustment and that the coefficients calculated in the regression analysis use non-test year data. This adjustment should be rejected as was done in *Appeals of Souther Union Gas from the Actions of the City of El Paso Texas*, Docket No. 8878 (Gas Utils. Div. November 17, 1998) (Final Order).

5. Rate Annualization

The Cities argue that an adjustment to revenue is required to take into account the revenues that TGS will receive from the City or Port Arthur. Those rates are known and the revenue is measurable.

Applicant's Position

TGS points out that it has calculated rates on a system-wide basis, then spread the revenue required to all customers in the entire service area. The rates will be implemented only in the Cities of Port Neches, Nederland and Groves, in recognition of the fact that the City of Port Arthur has already implemented increased rates. The SJCSA is operated as a single integrated service area, it is not possible to separately identify all of the plant and expenses associated with the three cities.⁹ Ms. McTaggart explained that this is akin to the system used in setting rates in the environs. The utility presents the cost of service, revenue requirement and revenue deficiency for the entire service area. Then the Commission sets a rate on that basis and the rates set by the Commission will only apply to the environs.¹⁰

Cities' Position

The Cities argue that an adjustment is necessary to take into account the additional revenues that will be received from the City of Port Arthur. Mr. Lawton estimated that the amount of the adjustment is \$295,160, which is the amount of revenue to be received from Port Arthur. Mr. Lawton argues that while TGS included all Port Arthur expenses and investment for determining the claimed rate deficiency, TGS failed to include the increased rate revenue from Port Arthur's latest rate increase. He alleges that such an adjustment is consistent with the Commission's Natural Gas Rate Review Handbook.¹¹

Examiners' Recommendation

The Examiners' recommend that the proposed adjustment be rejected. As discussed by TGS in the rebuttal testimony of Mr. Cummings, to do as the Cities suggest is incorrect and results in TGS being unable to recover its revenue requirement.¹²

B. Expenses

Witnesses for TGS testified that since its last rate case in 1992, TGS has managed to reduce its annual operating expenses by more than \$600,000. More specifically, TGS has reduced Distribution Expenses by \$217,000, Customer Account Expenses by \$337,000 and Administrative & General Expenses by \$49,000.¹³ TGS' proposed expenses stated in the *Petition for Review* were calculated as \$4,696,307.¹⁴ The amount originally stated in its *Statement of Intent* was \$4,611,614.¹⁵ That amount was revised in the *Update filed on June 27, 2003*, and estimated as \$4,609,777.¹⁶ Overall, the amount estimated for test year expenses increased by \$85,530 from the *Statement of Intent*. The Cities argue that adjusted test year expenses should be set at \$4,441,895.¹⁷ Table 9.1 summarizes the varying proposals in this case:

Table 9.1 Summary of Expense Request and Examiners' Recommendation

TGS Statement of Intent	TGS June 27, 2003 Update	TGS Petition for Review	Cities	Examiners' Recommendation
\$4,611,614	\$4,609,777	\$4,696,307	\$4,441,895	\$4,635,242

The difference between the Cities' proposal and the Applicant's proposal is made up of two components: (1) Application of the Distrigas allocator and its flow through effects; and, (2) adjustment to Bad Debt Expenses. As discussed in Section 6, above the Examiners recommend that the Cities' proposed Distrigas allocator be rejected. The Examiners recommend, however, that the proposed adjustment to bad debts be adopted. Accordingly, the Examiners recommend that the Expenses be set at \$4,643,042.

1. Payroll Expenses, Employee Benefit Expenses, Payroll Related Taxes, and Injuries and Damages

Applicant's Position

During the hearing, Mr. Phillips testified that since the last rate case TGS has approximately half the number of employees in the SJCSA than it had when the last rate case was filed.¹ Ms. Dembrowski testified that the adjusted payroll expenses were \$1,147,766.² She testified that the adjusted expense represents an annualization of the salaries for direct expenses of the SJCSA and allocated costs from the Gulf Coast Area, Eastern Region and the TGS Region. Ms. Dembrowski made adjustments for incentive compensation and merit increases, overtime, and response pay. Ms. Dembrowski acknowledge that an adjustment to merit increases should be made reducing payroll related expenses by \$7,800.³

Ms. Dembrowski testified that the employee benefits package includes, medical, dental, life, accidental death and dismemberment ("AD&D"), and long-term disability ("LTD") insurance, as well as, a flex plus program, employee matching savings program ("401K"), pension plan, stock options and post-retirement benefits other than pension ("FAS 106"). She testified that adjusted test year employee benefits expense were \$375,035.

Ms. Dembrowski also testified that payroll taxes allocable to South Jefferson County for FICA (social security and medicare taxes), FUTA (federal unemployment tax) and SUTA (state unemployment tax) are calculated by applying the current tax rates and applicable wage limits to the adjusted test year payroll for each employee. She calculated that the adjusted test year payroll tax expense was \$23,185.⁴

Finally, Ms. Dembrowski testified that test year expenses for injuries and damages were \$61,563.⁵ The adjusted injuries and damages expense was calculated using five items: (1) the Joint and Common allocated insurance premiums; (2) TGS' property insurance premium; (3) TGS' workers compensation insurance; (4) TGS' automobile liability insurance; (5) and the self-insured general liability insurance.

Cities Position

During the hearing the Cities pointed out that an adjustment to merit increases was required in the amount of \$7,500.⁶ Ms. Dembrowski agreed that that adjustment was necessary. Otherwise, except for the allocation of indirect costs, the payroll calculations, employee benefits expense calculation, calculations for payroll related taxes and injuries and damages were not

challenged. Instead, the Cities challenge the method used to allocate the indirect costs and argued that the Dstrigas Allocator developed by Daniel J. Lawton should be used to allocate division costs..

Examiners' Recommendation

As discussed in Section 6 above, the Examiners recommend that the Cities' proposed Dstrigas Allocation factor be rejected. Accordingly, payroll proposed by TGS are reasonable and should be approved.

2. **Depreciation Expense**

Thomas J. Sullivan presented the depreciation study of the Applicant.¹ Mr. Sullivan relied on an the Average Life Method in developing depreciation rates.² TGS seeks \$724,261 in depreciation expense.³ The Cities challenge the method used to allocate the indirect costs and argued that the Dstrigas Allocator developed by Daniel J. Lawton should be used to allocate division costs. As discussed in Section 6 above, the Examiners recommend that the Cities' proposed Dstrigas Allocation factor be rejected. Accordingly, payroll proposed by TGS are reasonable and should be approved.

2. **Bad Debt Expense**

A. *Applicant's Position*

The utility has requested \$163,791 in bad debt expenses. This amount was determined by taking the average of the three most recent years up to and including the test year.⁴ Ms. McTaggart testified in her rebuttal testimony that it is more appropriate to use the last three years in computing the average bad debt expense as it represents the actual recent experience of the Company and is a more valid measure of bad debt expense.⁵ Ms McTaggart also testified that the three year average is a method that was approved in GUD No. 8878.

B. *Cities' Position*

Ms. Coleman testified on behalf of the Cities regarding proposed changes to the utility's allowable bad debt expense. Ms. Coleman testified that it is more appropriate to take the previous seven years of data, remove the high and low outliers, and use that average as an appropriate level of bad debt expense.⁶

Ms. Coleman removed bad debt expense for years 2001 and 2002, \$307,926 and \$46,850 respectively, to obtain a recommended bad debt expense level of \$110,525, a \$53,266 reduction from the company's account 904.¹

C. *Examiners' Analysis and Recommendation*

The Commission must decide an appropriate level of bad debt expense for TGS. Both parties agree that an appropriate level of bad debt expense is best determined by determining an average amount over time in order to normalize the results. The issue is what is the appropriate method to determine an appropriate level of bad debt expense for the utility. The following

tables summarizes the data at issue.

TGS - Proposed Bad Debt Expense (Account 904)

Bad Debt Expense (12 months ending September 2001, 2002 and 2003)	TGS - Proposed
2001 - \$342,961	include
2002 - \$37,211	include
2003 - \$111,202	include
Average (mean)	\$163,791

Cities - Proposed Bad Debt Expense (Account 904)

Bad Debt Expense (Calendar Year)	Cities - Proposed
1997 - \$113,782	include
1998 - \$69,020	include
1999 - \$148,563	include
2000 - \$75,689	include
2001 - \$307,926	exclude as outlier
2002 - \$46,850	exclude as outlier
2003 - \$145,571	include
Average (mean)	\$110,525

The Examiners recommend that the Commission approve the Cities proposed amount of \$110,525. The Company's bad debt expense level in 2001 is clearly abnormal as it is more than twice the amount experienced in 1999, the next highest amount experienced during the seven year period 1997 - 2003. Normalizing data to remove abnormal data points is an accepted rate-making methodology. Further, the Company's bad debt expense for the 12 months ended September 2003 (of the test year) is \$111,202. The Cities' proposed bad debt expense of \$110,525 is not inconsistent with the test year level, whereas the utility's proposed bad debt expense of \$163,791 represents a 47.3% change above the test year amount.

9. Rate Design

A. The Rate Structure

Applicant's Position

TGS proposes to completely revise the existing rate design. The current residential rate

structure consists of a customer charge and a five-block volumetric structure. TGS proposes to replace this rate structure with a customer charge and a single volumetric rate for the residential class.¹ The current rate design for commercial consists of a five-block volumetric rate structure, which TGS proposes to replace with a two-block structure.² TGS also proposes to consolidate three classes—public authority, public school, and parochial school—into one new class: Public Authority and Schools.³

The cost-of-service study prepared by Mr. Cummings was the starting point in developing the proposed class revenue allocation.⁴ TGS alleged that the study suggested that the residential increase should be higher than ultimately proposed by the Applicant. This is a consequence of the fact that residential customer account for approximately 87 percent of the revenues generated in the SJCSA.⁵ Mr. Cummings testified that the Applicant proposed to temper the residential increase by not implementing the cost of service study revenue decrease for the transportation class and by implementing rates designed to reduce revenue for the public authority and schools classes as a group by half of the decrease indicated in the cost of service study.⁶

Cities Position

The Cities urge the Commission not to change the rate design and to maintain the existing customer class relationship. The Cities argue that the rate design should not be changed because the proposals on rate design are the result of constantly changing methodological approaches. The original rate request was based upon an equal percentage increase to each customer class.⁷ The Cities contend that in the original proceeding TGS generally designed rates to collect revenues from the customer charge and only a small amount of the revenue require was to be collected from the volumetric charge. The Cities contend that in the *June 27, 2003, Update*, TGS proposed to place the entire burden of the increase on the residential class. Other classes would have no rate change or actually enjoy a rate decrease.

Examiners' Recommendation

The Examiners agree that rates should be designed as proposed by the Applicant. The Applicant began its analysis on a cost-of-service study with the aim to structure rates based upon cost causation. The proposal by the Cities to allocate the rate increase by the same equal percentage as existing rates ignores changes in cost causation that may have occurred since the last rate case. Furthermore, allocating the rates by the same equal percentage would require maintaining an overly complex rate structure. Mr. Cummings proposal to simplify the rate structure, combined with Mr. Larson's recommendation regarding the elimination of certain classes is reasonable.

B. Weather Normalization Adjustment Clause

Applicants' Position

The Applicant is propose a Weather Normalization Adjustment Clause ("WNA") similar to one that is in effect for the City of Port Arthur. Mr. Larson testified that the adjustment

normalizes volumes and revenues for variable weather during the months of September through May and is intended to reduce the impact on customer bills for abnormally cold weather. Conversely it is intended to offer TGS protection against abnormally warm weather.¹ The adjustment is proposed for the residential, commercial and public authority rates only. Mr. Larson testified that these are the classes for which a weather adjustment is developed to normalize test year revenues.² Mr. Larson noted that the WNA is revenue neutral—it will not result in an increase or decrease to the revenue requirement.³ Finally, Mr. Larson explained that during colder than normal billing period, customers will receive a credit on their bill, and in a warmer than normal billing period, customers will receive a debit on their bill. In either case, the WNA adjusts the cost of service portion of customer bills to the level that would occur with normal weather.⁴

Cities' Position

The Cities complain that the WNA was presented for the first time in the Petition for Review. Mr. Larson testified that it was not included in the *June 27, 2003, Update*.⁵

Examiners' Recommendation

Although the WNA was raised for the first time on appeal, the Examiners agree that over a period of time, the WNA is revenue neutral. As discussed in section 5 above, changes in methodology may be considered on appeal, if they do not result in an increase to the rates proposed at the municipal level.

C. Tariff Changes

As discussed in Section 11 (1) above, Mr. Cummings has proposed a rate design that consolidates several classes. Consistent with that recommendation, Mr. Larson proposed that several tariffs be consolidate and/or eliminated.⁶ The Cities are opposed to a change in the current rate design. As noted above the Examiners recommend that the proposed rate design be adopted. Nevertheless, there are certain aspects of the proposed tariffs that Examiners recommend be rejected as inconsistent with Commission rules:

Prompt Payment Provision. The Prompt Payment Provision should be deleted because the provision operates as a penalty and the Quality of Service Rules of the Commission do not provide for the inclusion of a penalty.

Gas Cost Adjustment Clause. The clause in the definition section referring to “the known volumes of gas that may be otherwise accounted for” and the phrase “and accidental discharges of gas from the company’s system during the same period” should be removed. Pursuant to Section 7.5525, Lost and Unaccounted for Gas does not allow for “known” volumes to be included in Lost and Unaccounted for Gas.

10. Rate Case Expenses

The Applicant and the Cities have both filed requests for rate case expenses. Both parties

filed direct testimony regarding rate case expenses and a separate hearing day regarding rate case expenses was conducted on May 4, 2004. The parties likewise addressed rate case expenses in their respective closing briefs and replies thereto.

The Commission rule concerning rate case expenses, published as TEX. ADMIN. CODE §7.5530, provides the following requirements for the reimbursement of rate case expenses:

(a) In any rate proceeding, any utility and/or municipality claiming reimbursement for its rate case expenses pursuant to Texas Utilities Code, §103.022(b), shall have the burden to prove the reasonableness of such rate case expenses by a preponderance of the evidence. Each gas utility and/or municipality shall detail and itemize all rate case expenses and allocations and shall provide evidence showing the reasonableness of the cost of all professional services, including but not limited to:

- (1) the amount of work done;
- (2) the time and labor required to accomplish the work;
- (3) the nature, extent, and difficulty of the work done;
- (4) the originality of the work;
- (5) the charges by others for work of the same or similar nature; and
- (6) any other factors taken into account in setting the amount of the compensation.

(b) In determining the reasonableness of the rate case expenses, the Commission shall consider all relevant factors including but not limited to those set out previously, and shall also consider whether the request for a rate change was warranted, whether there was duplication of services or testimony, whether the work was relevant and reasonably necessary to the proceeding, and whether the complexity and expense of the work was commensurate with both the complexity of the issues in the proceeding and the amount of the increase sought as well as the amount of any increase granted.

A. Applicant's Position

Ms. Susan Westbrook, Ms Stacy McTaggart, and Ms. Kay Trostle testified on behalf of Texas Gas Service on the issue of recoverable rate case expenses.¹ TGS requests a total of \$812,323.47 in rate case expenses for reimbursement.² The following table summarizes the amounts of rate case expenses requested by the utility:

TGS Requested Rate Case Expenses³

Of the \$487,321.09 legal services Liddell & Sapp, are estimated costs to further litigate this case at the Commission and on further appeal. TGS proposes to recover rate case expenses through a volumetric surcharge over a four year period.⁴ The utility did not contest the rate case expenses requested by the Cities.

in expenses related to provided by Lock, \$134,320 of that total

B. Cities' Position

Mr. Lawton testified on behalf of the Cities regarding rate case expense issues.⁵ The Cities have similarly requested estimated rate case expenses necessary for further litigation of this case.

Cities Requested Rate Case Expenses

Service Provider	Actual	Estimated	Total
Law Firm Wright & Pitre	\$10,917.26	\$0.00	\$10,917.26
Hays & Owens	\$74,816.07	\$79,800.00	\$154,616.07
Diversified Utility Consultants, Inc.	\$107,351.66	\$13,000.00	\$120,351.66
TOTAL	\$193,084.99	\$92,800.00	\$285,884.99

The Cities argue that the Commission should disallow all of the utility's rate case expenses on basis that TGS has failed to satisfy the requirements of 16 TAC §7.5530.⁶ Mr. Lawton testified that TGS' rate case expenses are not recoverable because TGS did not publish notice of its intent to recover them.⁷ Mr. Lawton also recommended that any rate case expenses the Commission allows should be recovered through a surcharge over a four (4) year period of time.⁸

The Cities argue several reasons as to why the utility's rate case expenses should be denied or reduced substantially:⁹

1. TGS failed to establish that it is entitled to a rate increase, therefore under §7.5530 TGS is not entitled to a rate increase;
2. The Commission should disallow all Company rate case expenses because the TGS did not give public notice that it would seek reimbursement;
3. TGS has failed to meet its burden of proving the reasonableness of its rate case expenses;
4. TGS failed to appropriately manage its rate case expenses by not budgeting appropriately;
5. The confusing nature of the filings resulted in unnecessary litigation and the rate payers should not have to pay expenses as a result of the utility's failures to properly file and prosecute this case initially;
6. Costs directly associated with the acquisition of the system by ONEOK should not be born by the rate-payers;
7. Witness training workshop and associated legal fees should not be recovered as rate case expenses;
8. The legal fees are excessively high due to "over-lawyering" and unnecessary attendance of more than one or two lawyers during certain proceedings;
9. The legal fees associated with work by Mr. Compton are in effect "rain-making" or legal marketing fees and not related to the prosecution of this rate case and should be denied; and
10. TGS' publication of notice on appeal was unnecessary, not required by rule or statute and therefore the costs associated therewith should not be born by the rate-payers.

C. Examiners' Recommendation

The rate case expenses sought to be recovered by the parties in this case are higher than the overall revenue increase recommended by the Examiners. The Examiners recommend a revenue increase of \$708,852 for total revenue of \$6,472,582. The total rate case expenses requested are \$1,098,209.46 — \$285,884.99 from the Cities and \$812,324.47 from TGS. Total requested rate case expenses are 16.95% of the Examiners' total recommended revenue requirement and 148.4% of the Examiners' recommended revenue increase.

The utility did not contest the rate case expenses requested by the Cities. The Examiners find that the Cities submitted all information required under §7.5530 to justify its rate case expenses, that the rate case expenses actually incurred by the Cities were reasonable and necessary to participate in this proceeding, and that the Cities should be allowed to recover its actual rate case expenses incurred to date. The recommended increase is substantially less than the increase proposed by TGS in its *Petition for Review*. A substantial portion of the Cities' rate case expense request (\$92,800, 32.5%) is related to costs estimated for further litigation of this rate proceeding. The Commission has allowed the recovery of reasonable rate case expenses estimated to be necessary for further litigation of a rate proceeding before the Commission or

before a Court on appeal.¹ The Examiners recommend approval of this amount subject to subsequent verification of actual incurrence of these estimated costs.

The most litigated rate case expense issues concern the utility's requests. The Cities vigorously contest the utility's rate case expenses on several grounds. The Examiners disagree with the Cities' position that TGS is not entitled to the reimbursement of any rate case expenses because it did not prove it is entitled to a rate increase as the Examiners recommend an ultimate increase in the utility's revenues. Likewise, the Examiners disagree with the Cities arguments that the utility must publish notice of an intention to seek reimbursement for rate case expenses. There is no such requirement in GURA or the Commission's rules.

The Examiners find that the applicant submitted all information required under §7.5530 to justify rate case expenses that are otherwise determined to be reasonable and necessary. The Examiners disagree with the Cities' argument that the lack of a formal budget for rate case expenses requires the Commission to deny reimbursement for all or part of the utility's rate case expenses. Much of the litigation involved in this proceeding could not have been "foreseen" and the Examiners find that the testimony and evidence indicate that a budget would have been of little merit. Further, the testimony and evidence establish that the utility did employ some oversight of the expenses incurred in this case.

The Examiners agree with the Cities that rate case expenses incurred as a result of the ONEOK acquisition should not be borne by the rate payers and are not recoverable under §7.5530. The Examiners recommend that all rate case expenses, \$80,480.00 in total, requested by TGS for consulting services provided Dively & Associates be denied. The evidence and testimony in this case indicate that the work that was performed by Ms. Dively was needed primarily as a result of ONEOK's acquisition of TGS. The testimony indicates that she spent a considerable amount of time ascertaining the appropriate allocation of accounts as a result of the ONEOK acquisition of TGS.² The evidence indicates that Ms. Dively's work was necessary as a result of the ONEOK acquisition and not independently required in order to pursue this rate proceeding. Therefore the Examiners recommend the Commission reduce TGS' reimbursable rate case expenses by \$80,480.00.

The Examiners recommend that all rate case expenses, \$11,890.00 in total, requested by TGS for witness consulting services provided M.J Berns be denied. A witness training workshop is not a necessary expense for the utility to process its rate case / appeal before the Commission. This expense is not necessary for setting the utility's rates because it is not established that as a direct result of attending the workshop the utility's witnesses provided more relevant data, evidence, and information necessary to set the utility's rates. Further, at a hearing the Examiners are not concerned with a witness' performance but rather obtaining more technical data and evidence. An administrative hearing is not a jury trial where the emotional and subjective reactions to a witness' testimony may have a substantial effect on an ultimate verdict. It has not been established that the witness workshop contributed to a more complete presentation of the technical data and evidence necessary to set rates for the utility. Therefore the Examiners recommend denial of all expenses related to the witness training provided by M.J. Berns.

The Examiners recommend that all rate case expenses, \$54,943.33 in total, requested by

TGS for rate case expenses incurred during the first phase of the rate case be denied. The first phase of the rate case represents the period of time preparing the initial statement of intent filed by Southern Union Gas with the various cities in the South Jefferson County Service Area. The evidence and testimony indicate that the initial filing was incomplete. The system was sold shortly after the initial filing and the Cities required an update of the initial filing. The costs incurred in the first phase should be treated as sunk costs as a result of the initial filing being incomplete and the short period of time after which the system was sold to a different utility. The costs incurred during the first phase were not reasonable and necessary to the present owner of the system pursuing a rate increase before the Cities or an appeal before the Commission because the acquisition necessitated the substantial update that the Cities required or alternatively, a new statement of intent. Therefore, the Examiners recommend denial of all rate case expenses incurred during the period of time when Southern Union Gas owned the utility system.

The Examiners agree with the Cities' position that a substantial portion of rate case expenses were incurred as a direct result of the confusion from the utility's filings. A central part of the *Statement of Intent* that was filed in this case was the treatment of revenue-related taxes. During the hearing and in the Rebuttal Testimony of Stacey L. McTaggart, a considerable amount of time was spent clarifying that the calculation of test year revenues included revenues from revenue-related taxes. Several problems resulted from this approach.

Frankly, it is not clear why a pass through amount was treated in this fashion. The cost of gas, which is often treated as a surcharge, did not receive similar treatment. Furthermore, it is impossible to ascertain from the Statement of Intent the amount of revenue-related taxes incorporated into the revenue number. Although, documents presented to the Cities reveal that amount, without that information, the Statement of Intent filed with the cities cannot be viewed as a stand alone document. The Cities gave TGS the opportunity to repair that flaw with the updated filing of June 27, 2003.

The legal issues raised in the motions to dismiss filed in this proceeding are a direct result of the confusion and inconsistency inherent in the utility's original statement of intent, the updated statement of intent, and the petition for review filed with the Commission. The confusing nature of the utility's filings are another basis for denying certain rate case expenses as discussed above. Therefore, based on the foregoing, the Examiners recommend that TGS be allowed to recover rate case expenses actually incurred by TGS to date in the amount of \$530,690.75 and that this amount was reasonable and necessary. A substantial portion of the TGS' rate case expense request (\$134,320, 20.2%) is related to costs estimated for further litigation of this rate proceeding. The Examiners recommend approval of this amount subject to subsequent verification of actual incurrence of these estimated costs.

The appropriate period of time to recover rate case expenses is also at issue. The Cities propose a six year period and the utility proposes a four year period of time. Given the large amount of rate case expenses that are being proposed the Examiners recommend that rate case expenses be recovered over a four year period of time.

Respectfully submitted,

Gene Montes
Hearings Examiner
Office of General Counsel

John Chakales
Hearings Examiner
Office of General Counsel

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Technical Examiner
Gas Services Division

¹ Cities' Exhibit 1, Testimony of Daniel J. Lawton, p. 7, lns. 1-2; TGS Exhibit 23A, p. 4 -5, TGS Exhibit 20, Rate Filing Package of November 15, 2003.

¹ TGS Exhibit 3, Testimony of Stacey L. McTaggart , p. 4 5, lns. 19 - 23.

² Cities Exhibit 6, Affidavit of Publication.

³ TGS Exhibit 2, Testimony of Greg A. Phillips, p 4, lns 6 - 8, and p. 5, lns. 2 - 4.

⁴ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 5, ln. 4.

⁵ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 4, lns. 5 - 18.

⁶ Cities Exhibit 1, Testimony of Daniel J. Lawton, p. 8, lns 14 - 17.

⁷ Examiners' Exhibit 2, (hereinafter referred to as the "June 27, 2003, Filing").

⁸ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 11, ln. 1.

⁹ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 11, lns. 17 - 20.

¹⁰ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 11, lns. 21 - 22.

¹¹ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 12, lns. 3 - 6; TGS Exhibit 6, Testimony of Nicole S. Simmons, p. 1, lns. 9 - 13.

¹² TGS Exhibit 2, Testimony of Greg A. Phillips, p. 12 lns. 7 - 8.

¹³ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 12, lns. 9 - 12.

¹⁴ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 12, lns. 13 - 14.

¹⁵ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 10, lns. 15 - 19.

¹⁶ Cities Exhibit 1, Testimony of Daniel J. Lawton, p. 10, ln 7; and, Cities Exhibit 2, Testimony of Sara E. Coleman p. 2, ln. 10.

¹⁷ The Cities challenge various aspects of the Commission's jurisdiction in this case which are discussed more fully below in section 5.

¹⁸ TGS Exhibit 2, Testimony of Gregg A. Phillips, p. 3, lns. 6 - 7.

¹⁹ TGS Exhibit 2, Testimony of Gregg A. Phillips, p. 3, lns. 10 - 12.

²⁰ TGS Exhibit 3, Testimony of Stacey L. McTaggart , p. 12, lns. 9 - 23 & p. 13, lns. 1 - 20.

²¹ TGS Exhibit 3, Testimony of Stacey L. McTaggart , p. 4, lns. 20 - 22.

²² TGS Exhibit 3, Testimony of Stacey L. McTaggart , p. 5, lns. 10 - 12..

¹ Can ONEOK prosecute a rate case that was filed by Southern Union Gas without reissuing notice and filing a new Statement of Intent; Did TGS timely file its appeal; Is TGS attempting to circumvent municipal jurisdiction over gas rates by claiming a higher revenue requirement on appeal, than the revenue requirement covered by its Statement of Intent and public notice; May TGS base its claim for a greater revenue requirement on changed methodologies and the selection and arbitrary use of known and measurable changes. *Closing Argument and Initial Brief of the Cities of Port Neches, Nederland, and Groves*, p. 2. Is TGS rate request capped by the Statement of Intent. *Id* at 10. Did TGS timely perfect its appeal; The manner in which TGS has filed and presented its case raises issues concerning the jurisdiction to consider the amount of the increase requested by TGS. *Id* at 11. Does the Commission have jurisdiction to consider items that are not changes, that is, cost of service items that were known or should have been known to the utility but were not requested by the utility at the municipal level; Does the Texas Utilities Code give the Commission jurisdiction over attempts by utilities to change rate making methodologies in midstream at the local level or jurisdiction to consider such changes on appeal; can the overall revenue requirement which may be considered on appeal to the Commission be greater than the level requested by the utility in its statement of intent and for which notice was published; can TGS be authorized a rate increase higher than it originally filed for and noticed request; does the Commission have jurisdiction to consider a rate increase request beyond the original and noticed amount. *Id* at 15. Does the ruling in *Entex v. Railroad Commission*, 18 S.W.2d 858 (Tex. App. --- Austin 2000, pet. denied) preclude TGS from stepping into the SUG's shoes. *Cities Reply to TGS Post - Hearing Brief*, pp. 4 - 5.

¹ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 10, lns. 12 - 17.

² TGS Exhibit 20, Statement of Intent filed with the municipalities, November 15, 2002. *Cities Exhibit 1, Testimony of Daniel J. Lawton*, p. 1, ln. 1.

³ TGS Exhibit 3, Testimony of Stacey L. McTaggart, p. 8, lns. 5 - 6.

⁴ TGS Exhibit 20, Statement of Intent filed with the municipalities, November 15, 2002, Rate Case Summary, p. 1.

⁵ *Cities Exhibit 1*, p. 7, ln. 3.

⁶ TGS Exhibit 20, Statement of Intent filed with the municipalities, November 15, 2002, Rate Case Summary, p. 2.

⁷ TGS Exhibit 20, Statement of Intent filed with the municipalities, November 15, 2002, Rate Case Summary, p. 4.

⁸ TGS Exhibit 20, Statement of Intent filed with the municipalities, November 15, 2002, Rate Case Summary, p. 3.

⁹ TGS Exhibit 23, Rebuttal Testimony of Stacey L. McTaggart, p. 23, ln. 16.

¹⁰ TGS Exhibit 23, Rebuttal Testimony of Stacey L. McTaggart, p. 15, lns. 7 - 13.

¹¹ TGS Exhibit 23, Rebuttal Testimony of Stacey L. McTaggart, p. 16, ln. 3.

¹² TGS Exhibit 23, Rebuttal Testimony of Stacey L. McTaggart, p. 16, lns. 3 - 4. It is important to note that the actual increase will be higher, because there will also be revenue-related taxes on the amount of the increase. TGS Exhibit 23, Rebuttal Testimony of Stacey L. McTaggart, p. 16, lns. 7- 10.

¹³ *Cities Exhibit 3*, p. 3.

¹ *Cities' Exhibit 1, Testimony of Daniel J. Lawton*, p. 7 lns 18 - 21 & p. 8, lns. 1 - 17.

² TGS Exhibit 3, Testimony of Stacey L. McTaggart, p. 4, lns. 21 - 23. TGS Exhibit 2, Testimony of Greg A. Phillips, p. 10, lns. 1 - 6.

³ Tr. Vol. 1, 31, lns 21 - 25.

⁴ *Cities Exhibit 1, Testimony of Daniel J. Lawton*, p. 8, lns. 19 - 24. TGS Exhibit 2, Testimony of Greg A. Phillips, p. 10, lns. 17 - 21.

⁵ *Closing Argument and Initial Brief of the Cities of Port Neches, Nederland, and Groves*, p. 9.

⁶ TGS Exhibit 23, Testimony of Stacey L. McTaggart, Attachment SLM-2R, Agreement in Principle.

⁷ *Examiners' Exhibit 2, Rate Case Update* filed June 27, 2003.

⁸ TGS Exhibit 3, Testimony of Stacey L. McTaggart, p. 5, lns. 5 - 5 p. 8, lns. 5 - 6.

⁹ *Examiners' Exhibit 2, Rate Case Update* filed June 27, 2003, Schedule A, ln. 17.

¹⁰ *Examiners' Exhibit 2, Rate Case Update* filed June 27, 2003, Schedule A, ln. 12.

¹¹ *Examiners' Exhibit 2, Rate Case Update* filed June 27, 2003, Schedule A, ln. 16.

¹² Although this was referred to as the Total Base Rate Revenue Requirement in the initial filing, in the updated filing, TGS simply referred to it as Total Revenue Requirement. Compare, TGS Exhibit 20, Statement of Intent filed on November 15, 2002, Schedule A, ln. 17, with *Examiners' Exhibit 2, Updated Update*, June 27, 2003, Schedule A, ln. 17.

¹³ Although this was referred to as the Total Base Rate Revenue Deficiency in the initial filing, in the updated filing,

TGS simply referred to it as Total Revenue Deficiency. Compare, TGS Exhibit 20, Statement of Intent filed on November 15, 2002, Schedule A, In. 16 with Examiners' Exhibit 2, Updated Update, June 27, 2003, Schedule A, In. 16.

¹⁴ TGS Exhibit 3, Testimony of Stacey L. McTaggart, p. 16, In. 3.

¹ This figure represents the difference between the two filings without the adjustment regarding revenue-related taxes: \$692,728 - \$518,950 = \$173,778.

² Examiners' Exhibit 2, *June 27, 2003, Update*, Cover Letter, p. 1.

¹ TGS Exhibit 3, Testimony of Stacey L. McTaggart, p. 5, In. 2-5.

² TGS Exhibit 1, Petition for Review, November 1, 2003.

³ Although this was referred to as the Total Base Rate Revenue Requirement in the initial filing, in the updated filing, TGS simply referred to it as Total Revenue Requirement. Compare, TGS Exhibit 20, Statement of Intent filed on November 15, 2002, Schedule A, In. 17 with Examiners' Exhibit 2, *June 27, 2003, Update*, Schedule A, In. 17.

⁴ Although this was referred to as the Total Base Rate Revenue Deficiency in the initial filing, in the updated filing, TGS simply referred to it as Total Revenue Deficiency. Compare, TGS Exhibit 20, Statement of Intent filed on November 15, 2002, Schedule A, In. 16 with Examiners' Exhibit 2, *June 27, 2003, Update* Schedule A, In. 16.

⁵ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 4, In. 10 - 14.

⁶ TGS Exhibit 10, Testimony of F. Jay Cummings, p. 30, In. 10, Attachment FJC - 7.

⁷ TR Vol. 1, p. 32, In. 1- 10.

¹ Post-Hearing Brief of Texas Gas Service Company, pp. 11 - 12.

² Reply Brief of Texas Gas Service Company, p. 1.

³ *Id.*

⁴ TGS Exhibit 23, Rebuttal Testimony of Stacey L. McTaggart, p. 15, In. 14 - 16.

⁵ Cities Exhibit 5.

⁶ Cities Exhibit 1, Testimony of Daniel J. Lawton, p. 29, In. 14 - 20.

⁷ Cities Exhibit 1, Testimony of Daniel J. Lawton, p. 6, In. 10 - 12.

⁸ TGS Exhibit 23, Rebuttal Testimony of Stacey L. McTaggart, p. 14, In. 16 - 16 and p. 17, In. 11 - 12..

⁹ Tex. Utils. Code Ann. §§ 104.101, 104.102(c)(2), and 104.103 (a).

¹⁰ Tr. Vol. 1, p. 35 - 36; TGS Exhibits 15 & 16. A considerable portion of the testimony on the first day was dedicated to the proposition that TGS seeks a revenue increase of \$905,581. Tr. Vol. 1, pp. 1 - 40.

¹¹ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 5, In. 10.

¹² TGS Exhibit 10, Testimony of F. Jay Cummings, p. 30, In. 6 - 13.

¹ TEX. UTIL. CODE ANN. § 103.051 (Vernon 1998 & Supp. 2004).

² TEX. UTIL. CODE ANN. § 103.054 (a) (Vernon 1998 & Supp. 2004).

³ TEX. UTIL. CODE ANN. § 103.055 (a) (Vernon 1998 & Supp. 2004).

⁴ TEX. UTIL. CODE ANN. § 103.055 (b) (Vernon 1998 & Supp. 2004).

¹ TGS Exhibit 23, Rebuttal Testimony of Stacey L. McTaggart, Attachment SLM - 2R.

¹ TGS Exhibit 23, Rebuttal Testimony of Stacey L. McTaggart, p. 6, In. 14 - 17.

² Reply Brief of Texas Gas Service Company, p. 3; TGS Exhibit 23, Testimony of Stacey L. McTaggart, p. 17, In. 18 - 22; p. 18, In. 1 - 8.

³ TGS Exhibit 19, Tr. Vol. 2, 114 - 121.

⁴ Cities Exhibit 1, p. 22, In. 1 - 3.

⁵ Cities Exhibit 1, p. 18, In. 6 - 27.

¹ Application of Central Power and Light Company for Authority to Change Rates; Petition of Central Power and Light Company to Continue Deferred Accounting for Unit 1 of the South Texas Project Beyond February 15, 1990; PUC Docket Nos. 8646 and 9141, 16 P.U.C. Bull. 1388, 1626 - 1627 (October 19, 1990).

² Application of Fort Bend Telephone Company, Inc. for Tariff Revisions for Private Pay Telephone Service, Docket No. 7989, 14 P.U.C. Bull. 404 (June 30, 1988). ("Fort Bend Telephone Company, Inc. (Fort Bend) is hereby LIMITED in this case to a rate of \$32.40 for the monthly access charge because that is the maximum request it published."); Application fo ABC Wells, Inc. for a Rate Increase within Brazoria county, Docket No. 5287, 9 P.U.C. Bull. 296 (January 25, 1984) (Ruling that the amount of any rate increase that may be granted to a utility is limited

by the amount of its published request even when all parties agree that the published request will not fully cover the utility's cost of service.); Application of Gulf States Utilities Company for a Rate Increase, Docket No. 5560, 10 P.U.C. Bull. 405 (July 13, 1984) (“[T]he amount of the requested rate increase appearing in GSU’s published notice and customer notice was understated, and that the proper remedy was not to require republication and re-notification as the Examiner had ordered, but merely to limit the rate increase that may be granted to the amount stated in the notice.”); and, Application of Vacation Village Sewer Co. for a Tariff change, Docket No. 6149, 11 P.U.C. Bull. 363 (October 1, 1985).

¹ PFD, p. 3

² Tex. Util. Code Ann. § 103.055 (a) (Vernon 1998 & Supp. 2004).

³ Tex. Util. Code Ann. § 103.555 (b) (Vernon 1998 & Supp. 2004).

⁴ As noted above, in Section ___, that amount is \$1,013,007 when revenue-related taxes are removed from Test Year Adjusted Revenues.

¹ Cities’ Reply to TGS Post-Hearing Brief, pp. 4 - 5.

² *Entex v. Railroad Commission of Texas*, 18 S.W.2d Tex. 858, 864 (Tex. App. — Austin 2000, pet. denied)

¹ **Examiners’ Letter No. 6**, February 20, 2004.

² See, TEX. ADMIN. CODE ANN. §§ 1.2 and 1.25.

³ T.R.C.P 45 & 47, *Horizon v. Auld*, 34 S.W.2d 887, 896 (Tex. 2000).

⁴ Post-Hearing Brief of Texas Gas Service Company, p. 15.

⁵ TGS Exhibit 1, *Petition for Review*, p. 3.

⁶ TGS Exhibit 1, *Petition for Review*, p. 4.

¹ TGS Exhibit 1, *Petition for Review*, Exhibit TGS-1, Schedule A.

² TGS Exhibit 1, *Petition for Review*, Exhibit TGS-2: (1) Rate Schedule C-1; (2) Rate Schedule CNG-1; (3) Rate Schedule 10; (4) Rate Schedule 20; (5) Rate Schedule 40; (6) Rate Schedule T-3; (7) Rate Schedule T-4; and (8) Rate Schedule T-5.

³ Cummings, pp. 26-30.

⁴ TGS Exhibit 1, *Petition for Review*, p. 4.

⁵ TGS Exhibit 4, Testimony of June M. Dively, p. 3, ln. 3 - 6.

⁶ TGS Exhibit 4, Testimony of June M. Dively, p. 5, lns. 5 - 15.

⁷ TGS Exhibit 3, Testimony of Stacey L. McTaggart, p. 12, lns. 9 - 17.

⁸ TGS Exhibit 3, Testimony of Stacey L. McTaggart, p. 12, lns. 19 - 22 & p. 13, lns. 1 - 4.

⁹ TGS Exhibit 3, Testimony of Stacey L. McTaggart, p. 13, lns. 13 - 20.

¹⁰ Cities Exhibit 1, Testimony of Daniel J. Lawton, p. 59, lns. 4 - 5.

¹¹ Cities Exhibit 1, Testimony of Daniel J. Lawton, p. 58, lns. 1 - 8.

¹² Cities Exhibit 1, Testimony of Daniel J. Lawton, p. 59, lns. 5 - 13.

¹³ Cities Exhibit 1, Testimony of Daniel J. Lawton, p. 59, lns. 15 - 21.

¹⁴ TGS Exhibit 21, Rebuttal Testimony of June M. Dively, p. 7, lns. 5 - 18.

¹⁵ Natural Gas Rate Review Handbook, p. 16.

¹⁶ See, Finding of Fact 286 (a).

¹⁷ TGS Exhibit 3, Testimony of Stacey L. McTaggart, p. 14, lns. 1 - 4; 21 -22, p. 15, lns. 1 -2, p. 20, ln 18. P. 24, lns. 14 -16, lns. 22 - 23; p. 25, ln. 1.

¹ TGS Exhibit 1, Testimony of Greg A. Phillips, p. 12, lns. 3 - 6; TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 2, lns. 14 - 22 & p. 3, lns 5 - 14.

² TGS Exhibit 1, *Petition for Review*, Schedule B, ln. 15.

¹ TGS Exhibit 6, Testimony of Nicole A. Simmons, pp. 3- 7.

² TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 4, lns. 4 - 12..

³ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 6, lns. 1 - 5.

⁴ TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 6, ln.21.

⁵ TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 7, ln. 13.

⁶ Total TGS Division Joint and Common Plant costs, \$6,117,882 multiplied by Cities Distrigas Allocator of 4.5367%.

- ¹ TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 8, ln.11.
- ² TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 9, ln. 21.
- ¹ TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 10 - 12.
- ² TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 11, lns. 7 - 11.
- ³ TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 12, ln 17.
- ⁴ TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 11, lns. 14 - 15.
- ⁵ TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 9, ln. 21.
- ⁶ Total TGS Division Joint and Common Reserves, \$10,646,690 multiplied by Cities Distrigas Allocator of 4.5367%.
- ¹ TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 15, lns. 1 - 15.
- ² Total TGS Division Prepayments, \$685,624 multiplied by Cities Distrigas Allocator of 4.5367%.
- ¹ TGS Exhibit 5, Testimony of June M. Dively, p. 22, ln. 14.
- ² TGS Exhibit 1, Petition for Review filed by TGS, November 12, 2003.
- ³ Total TGS Division Prepayments, \$933,811 multiplied by Cities Distrigas Allocator of 4.5367%.
- ¹ TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 13, lns. 15 - 19.
- ² TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 13, lns. 19 - 21.
- ³ TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 14, lns 1 - 20.
- ⁴ TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 15, lns. 1 - 15.
- ⁵ TGS Exhibit 3, Testimony of Stacey L. McTaggart, pp. 26 - 31, SLM - 1.
- ⁶ TGS Exhibit 3, Testimony of Stacey L. McTaggart p. 26, lns 19 - 23; p. 28, ln. 5; and SLM -1.
- ¹ TEX. UTIL. CODE ANN. § 104.051 (Vernon 1998).
- ² TEX. UTIL. CODE ANN. § 104.052 (Vernon 1998).
- ³ *Railroad Commission of Texas v. Lone Star Gas Company*, 599 S.W.2d 659 (Tex. App. – Austin 1980).
- ⁴ *Id.*
- ⁵ *Id.*
- ⁶ TGS Exhibits 8 (Direct), 22 (Rebuttal); Transcript Volumes 1 and 2.
- ⁷ TGS Exhibit 8, Testimony of Donald A. Murry pp. 7-23.
- ⁸ TGS Exhibit 8, Testimony of Donald A. Murry p. 6.
- ⁹ TGS Exhibit 8, Testimony of Donald A. Murry p. 7.
- ¹⁰ TGS Exhibit 8, Testimony of Donald A. Murry p. 8.
- ¹¹ TGS Exhibit 8, Testimony of Donald A. Murry p. 8.
- ¹² TGS Exhibit 8, Testimony of Donald A. Murry p. 8.
- ¹³ TGS Exhibit 8, Testimony of Donald A. Murry, Schedule DAM 13.
- ¹⁴ TGS Exhibit 8, Testimony of Donald A. Murry pp. 17-18.
- ¹⁵ TGS Exhibit 8, Testimony of Donald A. Murry p. 17.
- ¹⁶ TGS Exhibit 8, Testimony of Donald A. Murry p. 22-23.
- ¹⁷ TGS Exhibit 8, Testimony of Donald A. Murry, pp. 22-23.
- ¹⁸ Cities Exhibit 1, Testimony of Daniel J. Lawton, pp. 60-74, Transcript Volume 2.
- ¹⁹ Cities Exhibit 1, Testimony of Daniel J. Lawton, pp. 73.
- ²⁰ Cities Exhibit 1, Testimony of Daniel J. Lawton, pp. 66.
- ²¹ Cities Exhibit 1, Testimony of Daniel J. Lawton, pp. 61.
- ²² Cities Exhibit 1, Testimony of Daniel J. Lawton, pp. 61.
- ²³ Cities Exhibit 1, Testimony of Daniel J. Lawton, pp. 61.
- ²⁴ Cities Exhibit 1, Testimony of Daniel J. Lawton, pp. 62-65.
- ²⁵ Cities Exhibit 1, Testimony of Daniel J. Lawton, pp. 62.
- ²⁶ Cities Exhibit 1, Testimony of Daniel J. Lawton, pp. 62.
- ²⁷ Cities Exhibit 1, Testimony of Daniel J. Lawton, pp. 65.
- ²⁸ Cities Exhibit 1, Testimony of Daniel J. Lawton, pp. 67-73.
- ²⁹ Cities Exhibit 1, Testimony of Daniel J. Lawton, pp. 73.

- ³⁰ TGS Exhibit 22, Rebuttal testimony of Donald A. Murray, pp. 7-15.
- ³¹ *Id.*
- ³² TGS Exhibit 8, Testimony of Donald A. Murray, p. 9.
- ³³ TGS Exhibit 8, Testimony of Donald A. Murray, p. 12.
- ³⁴ Transcript Volume 1 at 162.
- ³⁵ Transcript Volume 1 at 162-170.
- ³⁶ TGS Exhibit 8, Testimony of Donald A. Murray, p. 18.
- ³⁷ TGS Exhibit 20, Statement of Intent, Exhibit 1, ln. 12. Test year adjusted revenues stated in that schedule where \$5,947,518. Revenue-related taxes were \$334,811. See, TGS Exhibit 23, Rebuttal Testimony of Stacey L. McTaggart, p. 16, ln. 3.
- ³⁸ Examiners' Exhibit 2, Schedule A, ln. 12. Test year adjusted revenues stated in that schedule where \$5,903,147. Revenue-related taxes were \$320,275. See, TGS Exhibit 23, Rebuttal Testimony of Stacey L. McTaggart, p. 16, ln. 3.
- ³⁹ TGS Exhibit 6, Testimony of Nicole A. Simmons, p. 5, lns. 1 - 3.
- ⁴⁰ TGS Exhibit 1, Petition for Review, Schedule A. ln. 12.
- ⁴¹ Cities' Exhibit 2, Testimony of Sara E. Coleman, Schedule SEC - 2, Page 1, ln. 14.
- ⁴² TGS Exhibit 1, Petition for Review, Schedule A, ln. 12.
- ⁴³ Examiners' Exhibit 2, *June 27, 2003, Update* Schedule A, ln. 12 indicates that Test Year Adjusted Revenues were \$5,903,147. TGS Exhibit 23, Testimony of Stacey L. McTaggart, p. 16, ln. 3, indicates that revenue-related taxes were \$320,275.
- ⁴⁴ TGS Exhibit 20, Statement of Intent, Schedule A, ln. 12 indicates that Test Year Adjusted Revenues were \$5,947,518. TGS Exhibit 23, Testimony of Stacey L. McTaggart, p. 16, ln. 3, indicates that revenue-related taxes were \$334,811.
- ⁴⁵ Cities Exhibit 2, Testimony of Sara E. Coleman, Schedule SEC - 2, ln. 14.
- ⁴⁶ TGS Exhibit 9, Testimony of Judson W. Larson, p. 3, lns. 15 - 23.
- ⁴⁷ Cities Exhibit 1, Testimony of Daniel J. Lawton, p. 53, lns. 13 - 28.
- ⁴⁸ TGS Exhibit 1, Petition for Review, Schedule G - 2, ln 7.
- ⁴⁹ Cities' Exhibit 1, Testimony of Daniel J. Lawton, p. 45, ln. 8.
- ⁵⁰ TGS Exhibit 9, p. 4, lns. 12 - 20.
- ⁵¹ TGS Exhibit 9, Testimony of Judson W. Larson, p. 5, ln. 1
- ⁵² TGS Exhibit 9, Testimony of Judson W. Larson, p. 5, lns. 11 - 17; TGS Exhibit 23, Rebuttal Testimony of F. Jay Cummings, p. 17, lns. 11 - 14
- ⁵³ TGS Exhibit 9, Testimony of Judson W. Larson, p. 6, lns. 10 - 17.
- ⁵⁴ GUD 8878, FOF Nos. 124 & 126.
- ⁵⁵ TGS Exhibit 25, Testimony of F. Jay Cummings, p. 16, lns. 1 - 16.
- ⁵⁶ TGS Exhibit 25, Rebuttal Testimony of F. J. Cummings, p. 16, lns. 1 -3; Post - Hearing Brief of Texas Gas Service Company, p. 49.
- ⁵⁷ TGS Exhibit 25, Rebuttal Testimony of F.J. Cummings, p. 18, lns. 1 - 2 & FN 15.
- ⁵⁸ TGS Exhibit 25, Rebuttal Testimony of F.J. Cummings, pp. 19 -20.
- ⁵⁹ Cities Exhibit 1, Testimony of Daniel J. Lawton, p. 42, lns. 10 - 19.
- ⁶⁰ *Appeal of Souther Union Gas Company from the Action of the Cities of Groves, Nederland, Port Arthur, and Port Neches, Texas*, Docket No. 8033 (Gas Utils. Div. April 1, 1998) (Final Order).
- ⁶¹ TGS Exhibit 9, Testimony of Judson W. Larson, p. 7, lns 8 - 10; Cities' Exhibit 1, Testimony of Daniel J. Lawton, p. 47, lns. 10 - 15.
- ⁶² Examiners' Exhibit 1, TGS Rate Case Update, June 27, 2003, Schedule G - 2, ln. 8.
- ⁶³ TGS Exhibit 9, Testimony of Judson W. Larson, p. 8, ln. 11.
- ⁶⁴ TGS Exhibit 24, Rebuttal Testimony of Judson W. Larson, p. 7, ln. 7.
- ⁶⁵ Cities Exhibit 1, Testimony of Daniel J. Lawton, p. 50, lns. 12 - 22.
- ⁶⁶ TGS Exhibit 9, Testimony of Judson W. Larson, p. 7, ln. 7.
- ⁶⁷ TGS Exhibit 9, Testimony of Judson W. Larson, p. 7, lns. 12 -19.

- ⁶⁸ TGS Exhibit 9, Testimony of Judson W. Larson, p. 7, lns. 21 -23.
- ⁶⁹ TGS Exhibit 9, Testimony of Judson W. Larson, p. 7 lns. 21 - 23 & p. 8, lns. 1 - 3; TGS Exhibit 24, Rebuttal Testimony of Judson W. Larson, p. 5, lns. 5 - 11.
- ⁷⁰ TGS Exhibit 24, Rebuttal Testimony of Judson W. Larson, p. 6, lns. 6 - 16.
- ⁷¹ TGS Exhibit 24, Rebuttal Testimony of Judson W. Larson, p. 7, lns. 4 -7.
- ⁷² Cities Exhibit 1, p. 47, lns. 10 - 15.
- ⁷³ Cities Exhibit 1, p. 49, lns. 1 - 14.
- ⁷⁴ Cities Exhibit 1, p. 49, lns. 16 - 20.
- ⁷⁵ Cities Exhibit 1, p. 50, lns. 1 - 10.
- ⁷⁶ Cities Exhibit 1, Testimony of Daniel J. Lawton, p. 50, ln., 17 - 22.
- ¹ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 6, lns 13 - 22; TGS Exhibit 20, Statement of Intent filed with the municipalities, November 15, 2002, Rate Case Summary, p. 2. The Rate Case Summary is at variance with the testimony of Mr. Phillips and indicates that in 1991 there were 32,213 residential customers compared to 31,514 customers as of the date of the study. The resulting decrease is 699, or a little over 2 percent.
- ² TGS Exhibit 10, Testimony of F. Jay Cummings, p. 4, lns. 2 - 8.
- ³ TGS Exhibit 10, Testimony of F. Jay Cummings, p. 5, lns. 1 - 4.
- ⁴ TGS Exhibit 10, Testimony of F. Jay Cummings, p. 6, lns. 1 - 4.
- ⁵ TGS Exhibit 10, Testimony of F. Jay Cummings, p. 10, lns. 21 - 23.
- ⁶ TGS Exhibit 10, Testimony of F. Jay Cummings, p. lns. 10 - 15.
- ⁷ TGS Exhibit 10, Testimony of F. Jay Cummings, p. 9, lns 4 - 11.
- ⁸ Cities Exhibit 1, Testimony of Daniel J. Lawton, pp. 53 - 56.
- ⁹ TGS Exhibit 23, Testimony of Stacey L. McTaggart, p. 23, lns. 1 - 15 & p. 24 lns. 12 - 23.
- ¹⁰ TGS Exhibit 23, Testimony of Stacey L. McTaggart, p. 23, lns. 1 - 11
- ¹¹ Cities' Exhibit 1, Testimony of Daniel J. Lawton, p 51 lns. 7 - 29 & p. 52, lns. 1 - 9.
- ¹² TGS Exhibit 25, Testimony of F. Jay Cummings, pp. 28 - 29.
- ¹³ TGS Exhibit 2, Testimony of Greg A. Phillips, p. 7, lns 6 - 10.
- ¹⁴ TGS Exhibit 1, Petition for Review, Schedule G, ln. 29.
- ¹⁵ TGS Exhibit 20, Statement of Intent, Schedule H, ln. 29.
- ¹⁶ Examiner Exhibit 2, Update Filed June 27, 2003, Schedule G, ln. 29.
- ¹⁷ Cities Exhibit 2, Testimony of Sara E. Coleman, Schedule SEC - 2, ln. 48.
- ¹ Tr. 24, lns. 20 -24.
- ² TGS Exhibit 4, Testimony of Denise E. Dembowsky, p. 3, ln. 22.
- ³ Tr. Vol. 1, p. 150 lns. 1 - 4.
- ⁴ TGS Exhibit 4, Testimony of Denise E. Dembowski, p. 9, lns. 12 - 23.
- ⁵ TGS Exhibit 4, Testimony of Denise E. Dembowski, p. 10, ln. 8.
- ⁶ Tr. Vol. 1, pp. 148 - 152 & Cities' Exhibit 14.
- ¹ TGS Exhibit 7, Testimony of Thomas J. Sullivan.
- ² TGS Exhibit 7, Testimony of Thomas J. Sullivan, p. 4, lns. 17 - 22.
- ³ TGS Exhibit 1, Petition for Review, Schedule A, ln. 4.
- ⁴ TGS Exhibit 23 at 25.
- ⁵ TGS Exhibit 23 at 25.
- ⁶ Cities Exhibit __ at 8-10.
- ¹ Cities Exhibit 2, Testimony of Sara E. Coleman, pp. 8-10.
- ¹ TGS Exhibit 10, Testimony of J. Jay Cummings, p. 25, lns. 2 - 8.
- ² TGS Exhibit 10, Testimony of F. Jay Cummings, p. 27, lns. 8 - 10.
- ³ TGS Exhibit 10, Testimony of F. Jay Cummings, p. 28, lns. 8 - 13.
- ⁴ TGS Exhibit 10, Testimony of F. Jay Cummings, p. 23, lns 10 - 12; Tr. Vol. 2, pp. 26 - 27.
- ⁵ Tr. Vol. 2, p. 27, lns. 21 - 25.
- ⁶ TGS Exhibit 10, Testimony of F. Jay Cummings, p. 23, lns. 11 - 15.

⁷ Cities Exhibit 1, Testimony of Daniel J. Lawton, p. 11, lns. 5 - 6.

¹ TGS Exhibit 9, Testimony of Judson W. Larson, p. 10, lns. 10 - 21.

² TGS Exhibit 9, Testimony of Judson W. Larson, p. 11, lns. 10 - 12.

³ Tr. Vol. 3, pp. 18 - 19.

⁴ TGS Exhibit 9, Testimony of Judson W. Larson, p. 11, lns. 14 - 17; Tr. Vol. 3, pp. 19 - 21.

⁵ Tr. Vol. 3, p. 20, lns. 6 - 8..

⁶ TGS Exhibit 10, Testimony of Judson W. Larson, pp. 11 - 13.

¹ TGS Exhibits 27 (Westbrook Direct); 28 (McTaggart Rate Case Expense Direct); and 29 (Trostle Direct); Transcript Volume 4.

² TGS Exhibit 28, SLM-1.

³ *Id.*

⁴ TGS Exhibit 28 at 2 and SLM-4.

⁵ Cities Exhibit

⁶ Cities' Closing Argument and Initial Brief at 42.

⁷ Cities Exhibit 25 at 16.

⁸ Cities Exhibit 25 at 18.

⁹ Cities' Closing Argument and Initial Brief at 42-52; Cities' Reply to TGS Post-Hearing Brief at 20-27.

¹ *Appeal of TXU Gas Distribution from the Action of the City of Dallas, City of University Park, and the Town of Highland Park, Texas and the Statement of Intent filed by TXU Gas Distribution to Increase Rates Charged in the Environs of the City of Dallas*, Docket No. 9145 (Gas Utils. Div. November 20, 2000) (Final Order).

² Transcript Volume 4 at 43 - 47.