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GUD No. 9988

Petition of the De Novo Review of the Denial of the Statements of Intent filed by Texas Gas Service Company by the Cities of El Paso, Anthony, Clint, Horizon City, Socorro, and Village of Vinton, Texas

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PROPOSAL FOR DECISION

I. OVERVIEW AND PROCEDURAL HISTORY

Texas Gas Service Company ("TGS" or the "Company") has filed appeals of the denial of rate requests before the Cities of El Paso, Anthony, Clint, Horizon City, Socorro, and Vinton, Texas. The rates at issue are for the Company's El Paso Service Area. TGS did not file a corresponding environs statement of intent with these appeals. In the Company's initial filing, TGS sought a base revenue increase of \$5,122,193. After making certain corrections to its cost of service model and severing rate case expense issues into a separate docket, TGS seeks a base revenue increase of \$4,405,630. The City of El Paso, Texas seeks a base revenue reduction of approximately (\$3,768,149). After conducting the final hearing on the merits in this docket, reviewing all the evidence submitted and the arguments and briefs of the parties, the Examiners recommend that \$1,036,354.

This docket was initiated by Texas Gas Service Company ("TGS") on May 12, 2010, when it filed a Petition for Review with the Railroad Commission of Texas ("Commission") which appealed the rate-setting action of the City of El Paso, Texas ("El Paso" or the "City") denying TGS' request for a rate increase within the jurisdiction of the City. This Petition for Review was docketed by the Commission as Gas Utilities Docket No. 9988. On May 24, 2010, TGS filed a second Petition for Review appealing the rate-setting actions of the municipalities of Anthony, Clint, Horizon City, Socorro, and Vinton, Texas, which denied TGS' requests for rate increases within their respective municipal boundaries, and was docketed by the Commission as Gas Utilities Docket No. 9992. TGS has not filed a corresponding statement of intent to increase the rates in the environs areas that are adjacent to and part of the Company's service area for these respective municipalities. The Hearings Examiner consolidated these two Petitions for Review into one docket pursuant to TEX. ADMIN. CODE §1.125 (1991) on June 3, 2010.

On June 3, 2010, Staff of the Railroad Commission of Texas ("Commission Staff") intervened in this proceeding. On June 17, 2010, the State of Texas' agencies and institutions of higher learning, represented by the Attorney General of Texas, Consumer Protection Division, intervened in this proceeding. On June 25, 2010, ArcelorMittal Vinton, Inc., intervened in this proceeding. No other parties and or individuals files letters of protest, objections, moved to intervene, or otherwise participated in this docket before the Commission.

On August 20, 2010, TGS, El Paso and the Commission Staff filed a joint motion to sever rate case expenses into a separate proceeding for consideration by the Commission. During the final hearing on the merits, the Hearings Examiner granted this motion and severed rate case expense issues into a separate proceeding, docketed as Gas Utilities Docket No. 10016.

The final hearing in this matter was conducted in Austin, Texas on August 31, 2010 through September 3, 2010. By written agreement and as stated at the hearing TGS agreed to extend the statutory deadline for Commission action on this docket until December 16, 2010.

II. JURISDICTION AND NOTICE

The Commission has jurisdiction over the matters at issue in this proceeding under TEX. UTIL. CODE ANN. §§ 102.001(a), 121.051, and 121.151 (Vernon 2007). The statutes and rules involved include, but are not limited to TEX. UTIL. CODE ANN. §§ 103.022, 103.054, & 103.055, 104.003, 104.051, 104.052, 104.102, & 104.103 (Vernon 2007) and 16 TEX. ADMIN. CODE §7.205, 7.210, and 7.220 (2002). The Notice of Hearing was issued in this Docket on July 27, 2010, and satisfied the requirements of 16 TEX. ADMIN. CODE § 1.45 and TEX. GOV'T CODE ANN. § 2001.052 (Vernon 2000 & Supp. 2007).

III. RATE BASE

A. Post Test Year Adjustments

Stacey L. McTaggart, Manager of Rates and Regulatory Affairs for Texas Gas Service Company, testified on behalf of TGS.¹ Ms. McTaggart supports TGS' rate base with her testimony. Rate Base is the invested capital used by TGS to provide gas utility service to its customers. Rate Base has three components: (1) Gross Plant in Service, (2) Non-Investor Supplied Funds, and (3) Other Rate Base Items.² TGS requested inclusion in rate base of gross plant-in-service of \$217,958,918 and net plant-in-service of \$139,061,986. TGS adjusted its cost of service model for known and measurable changes through December 31, 2009.³ The company included in its filing projected plant additions through June 30, 2010, and filed on June 25, 2010 revised schedules and explanatory and supplemental testimony updating its May filings by substituting actual plant-in-service balances for the months of April and May for the budgeted amounts, and removed budgeted June additions from the rate request. The June 25, 2010, filing reduced the Company's requested base rate revenue increase by \$195,617 and reduced gross plant to \$216,424,630 and net plant to \$138,018,261.⁴

Mr. Pous testified that "the Company's filings, both at the City level and in this proceeding, have been inconsistent between the time frame associated with plant and ADFIT compared to other rate base components."⁵ The Commission, in GUD No. 9902, "limited CenterPoint's request, in part, due to the fact that parties did not have adequate time to review and analyze the request beyond the end of the calendar year."⁶ The facts in this case are similar and TGS "has presented a moving target, with its most recent update filed a little over a month prior to the finalization of my testimony."⁷ Mr. Pous recommends adopting for ratemaking purposes plant in service and other rate base components through December 31, 2009. Mr. Pous' recommendation "results in a \$210,723

¹ TGS Exhibit 15, McTaggart Direct Testimony.

² *Id.* at 7.

³ TGS' Initial Brief at 9-10.

⁴ *Ibid.*

⁵ El Paso Exhibit 2, Pous Direct Testimony at 10.

⁶ *Id.* at 11.

⁷ *Id.* at 11.

increase in rate base and a corresponding \$74,907 reduction in associated depreciation expense, property taxes, customer accounting expense, and income taxes, ... a \$130,602 reduction in revenues. The combined revenue requirements impact of rate base, and expense, and revenue changes results in a \$74,119 increase to the Company's EPSA revenue requirements."⁸

Commission Staff witness Ms. Lynne LeMon testified on behalf of Staff regarding TGS' post test year adjustments.⁹ In general, Ms. LeMon recommends some "policy directives" and a rule-making by the Commission in order to remedy several deficiencies regarding TGS' adjustments to test year data. Ms. LeMon recommends disallowing TGS' adjustments to test year data. She testified that Commission Rule §7.205 "neither acknowledges nor sanctions the filing of an updated application that renders the initial application obsolete. Instead the rule requires that all applicable adjustments to test year data be filed on the same date the test year data is filed."¹⁰ Ms. LeMon testified that the Commission addressed this issue in GUD Nos. 9902 and 9869. She testified that "TGS' 44-day update period should not be accepted because it cuts into the Commission's 185-day review period, unnecessarily complicates the record, and adds significantly to rate case expenses."¹¹ Ms. LeMon testified that TGS' proposed adjustments to test year data violate the matching principle.¹² Ms. LeMon recommends that the Commission adopt the following directives in the final order approved by the Commission in this docket:

The Commission interprets its final Orders in Docket Nos. 9869, 9902 and 998 and Rule §7.205(b) to mean that a natural gas utility's first and only application in a Statement of Intent To Increase Rates must include the utility's petition, direct evidence, testimony, and exhibits in their entirety, with all applicable updates for known and measurable changes.¹³

If a natural gas utility files, on its own initiative, an updated Statement of Intent application that renders the initial application obsolete, it is the Commission's practice that the proceeding on the initial application will continue without consideration of the updated application, as if the updated application had not been filed.¹⁴

The Commission interprets its final Orders in Docket Nos. 9791, 9869, 9902 and 9988 and the definition of 'test year' in the Texas Utilities Code to mean that the first filing in a natural gas utility's Statement of Intent application must be based upon actual book values from the test year, adjusted for known and measurable changes

⁸ *Id.* at 12.

⁹ Staff Exhibit 1, LeMon Direct Testimony.

¹⁰ *Id.* at 5.

¹¹ *Id.* at 6.

¹² *Id.* at 13-28.

¹³ *Id.* at 7.

¹⁴ *Id.* at 8.

that are based upon actual book values.¹⁵

For any case involving a test year, the Commission recognizes that revenues, investments and expenses are to match test year-end actual book values, to the greatest extent possible. Test year-end actual book values may be adjusted to account for known and measurable changes that the utility becomes aware of during a reasonable period following the test year, generally, a period not to exceed six months.¹⁶

She recommends a rule-making to remedy the sorts of problems in future rate cases.

“For long-term resolution, a formalization of the Commission’s requirements on the matching of accounts, the timing of updates to applications, the use of estimates, and the inclusion of test year amounts and adjustment amounts in rate case schedules is preferable. I recommend the Commission consider initiating a rule-making to develop standardized rate filing package requirements. By adopting standardized rate filing package requirements, rate case expenses will be minimized and the Staff and intervenors will be able to focus on other issues of interest to the Commission.”¹⁷

The Company argues that the findings in GUD Nos. 9869 and 9902 are distinguishable from the facts in this case as in those dockets the adjusted data disallowed by the was submitted at such a period of time that the Commission and intervenors would not be able to examine the adjustments. “In contrast, TGS in this case did present evidence in its original May filing that three of the five months of post-2009 plant additions were already in-service, and presented additional evidence in its June 25th update that the April and May additions were also now in-service. This was in accordance with GURA and the agreed-upon procedure deadline established for the very purpose of updating with actual plant balances. It was also before the discovery period had ended, 6 weeks before intervenor testimony was due, and 9-1/2 weeks – not three working days – before the hearing on the merits.”¹⁸

Examiner Analysis and Recommendation

Post test year adjustments to date have been major issues in the last three major rate cases, GUD Nos. 9791, 9869, and 9902. The Commission allowed post test-year adjustments in GUD No. 9791, whereas certain post test year adjustments were disallowed by the Commission in GUD Nos. 9869 and 9902. This case is distinguishable from the facts in both GUD Nos. 9869 and 9902 when post test year adjustments were disallowed because of the timing of the updates. TGS filed the updates early enough in the proceeding to allow time for review by the Examiners and intervenors. TGS’ filing substituted actual data for previously estimated data and contained certain rate base

¹⁵ *Id.* at 13.

¹⁶ *Id.* at 26.

¹⁷ *Id.* at 28.

¹⁸ TGS Initial Brief at 12.

additions that are in use providing gas service to TGS' customers. This is distinct from the post test year adjustments denied by the Commission in GUD Nos. 9869 and 9902.

In regards to Staff's argument that Commission Rule §7.205 prevents updating financial data after the original filing date of a statement of intent or petition for review, the Commission has not interpreted the rule to prevent such updates. The Examiners agree with the argument put forth by TGS on this issue that the "rule merely requires that the utility's direct evidence, testimony, and exhibits be filed on the same date that it files its petition for review" and that "the underlying intent is to require that the utility's rate filing package be a complete one when filed, not that the utility's request for rate relief is thereafter immutable, with no opportunity to request recognition of known and measurable changes."¹⁹

With respect to the allegations that the post-test year updates somehow violate the matching principle, the Examiners do not find any persuasive evidence in the record that the matching principle is somehow violated by TGS' updates to test year data. TGS used the test year presented to the municipality and then updated every plant, expense and revenue balance to the twelve months ended December 31, 2009.²⁰ Then TGS made additional adjustments from known and measurable changes to items such as plant, payroll, pension expense and pipeline integrity expense. Finally, known and measurable changes were made to gross plant, accumulated depreciation and ADFIT in the June 25, 2010, update. The matching principle is essentially that the costs and revenues of a utility should be matched as of the same time period so as to facilitate the setting of just and reasonable rates. Neither Staff nor the City cite any rule, statute or case law that they allege are violated by TGS' proposed adjustments. The Commission has allowed certain accounts to be updated beyond the test year for known and measurable changes so the resulting rates are more representative of actual operating conditions of the company. Further, the testimony of Ms. McTaggart establishes that the updates are reasonable and necessary and were made for known and measurable changes.

With respect to Staff's proposed "policy directives," the Examiners agree with TGS that these recommendations would essentially create rules of general application in a contested case and would be more appropriately considered through a rule-making under the Texas Administrative Procedure Act where all stakeholders can participate under procedures specifically designed for the development of rules of general applicability. The Examiners do agree with Staff's recommendation that the Commission initiate a rule-making to formalize the Commission's requirements on the matching of accounts, the timing of updates to applications, the use of estimates, the inclusion of test year amounts and adjustment amounts in rate case schedules, and develop standardized rate filing package requirements. By adopting standardized rate filing package requirements, rate case expenses will be minimized and the Staff and intervenors will be able to focus on other issues of interest to the Commission.

¹⁹ *Id.* at 16.

²⁰ TGS Exhibit 24, McTaggart Rebuttal at 6.

The Examiners find that the evidence submitted by TGS shows that the post-test year adjustments were submitted early enough to allow an effective review of the data and was reasonable. The Examiners recommend that the Commission deny the City's proposal to deny TGS' proposed post test year adjustments.

B. Cash Working Capital ("CWC")

CWC is the cash flow required to finance day-to-day operations of the TGS' business. TGS is proposing a CWC requirement of zero to avoid the cost and expense of a lead-lag study. Ms McTaggart testified that a zero CWC is a conservative estimate because the last lead lag study of the EPSA resulted in a positive CWC requirement. This approach is consistent with Commission's decision in GUD No. 9770.²¹ Ms. McTaggart testified that the Company's lead lag study usually shows a positive CWC, the City's a negative CWC, and that the two sides typically engage in costly litigation over all aspects of the lead lag and then end up settling with a "black box" settlement. The last lead lag study prepared by the Company for Oklahoma Natural Gas produced a positive CWC of \$8,205,498. "I propose that both sides forgo the time and expense of dueling lead lag studies and agree at the outset to a cash working capital allowance of zero."²²

The City opposes TGS' proposed zero balance CWC. The City's chief witness constructed a CWC study in lieu of TGS' zero balance CWC. Mr. Pous testified that TGS' proposal to have a zero balance CWC and not perform a lead-lag study is improper. He recommends that the Commission either adopt a negative one-eighth CWC requirement, or alternatively use the lead-lag study prepared by him.²³ In the last fully litigated rate proceeding for the EPSA in 1998 the Commission "ordered a \$614,549 negative cash working capital. In other words, the Company's failure to perform a lead-lag study similar to what it has performed in the past is an effort to artificially inflate revenue requirements."²⁴

Mr. Pous testifies a 15.21-day service period is the standard industry practice and recommends that be approved. He recommends a two-day meter reading lag, which is an approximate average of Commission approving one day for Atmos Energy and approving less than three day value approved for CenterPoint. He recommends a 20.638-day payment revenue lag based on an analysis of aging of accounts receivable, excluding inactive accounts. Mr. Pous incorporated a financial float revenue lag component. He recommends a combined level of revenue lag of 38.35 days.²⁵

Mr. Pous recommends an expense lead of 40.21-days for gas purchases based on the industry standard of 25 days and his review of invoices. He recommends a 7.6-day lead for standard payroll based on the most recent lead lag study in Oklahoma. He recommends a 22.81-day lead period for

²¹ TGS Exhibit 15, McTaggart Direct Testimony.

²² TGS Exhibit 24, McTaggart Rebuttal at 39.

²³ *Id.* at 15.

²⁴ *Id.* at 16.

²⁵ *Id.* at 16-18.

overtime pay. He recommends a 130,981-day lead for vacation pay and sick leave. He recommends a 60.61-day expense lead for health and dental. Mr. Pous relies on PUC approval of a 312.55-day expense lead for pension expense. The combined impact of Mr. Pous' lead-lag study is negative \$3.2 million CWC requirement.²⁶

Examiner Analysis and Recommendation

The main issue with regard to Cash Working Capital is whether or not the Commission should allow TGS' proposed zero balance CWC. The City proposes a negative one eighth CWC balance or to use Mr. Pous' alternative lead-lag study. The Commission has recently allowed TGS a zero balance for CWC in GUD No. 9770. The testimony of Ms. McTaggart shows that there are many problematic areas with Mr. Pous' lead-lag study: A two-day billing period is not representative of the Company's billing processes; the collection days calculated is not accurate due to sample problems; the lead days calculations are not representative of TGS' operations and did not use enough data to be accurate. The City's alternate lead-lag study does not establish that TGS would likely have a negative CWC balance and therefore the Examiners do not recommend using the City's proposed CWC balance or imposing a negative one eighth CWC as a result of TGS not performing a lead-lag study. Ms. McTaggart made several corrections to Mr. Pous' lead-lag study and calculated a net positive CWC balance. The evidence shows that it is reasonably possible that TGS could have established a positive CWC balance had the utility conducted its own lead-lag study, and therefore the City's argument that TGS improperly failed to perform a lead-lag study and should have a negative one eighth CWC balance imposed is not supported by the evidence in the record. A zero balance CWC is consistent with the FERC rule regarding the absence of a lead-lag study.²⁷ The Examiners recommend the Commission approve the proposed zero balance CWC requirement. This is reasonable because a zero balance CWC will not allow the utility to over-recover from customers, has a net neutral effect on the utility's revenue requirement, and is consistent with recent Commission decisions.

C. Accumulated Deferred Federal Income Taxes ("ADFIT")

TGS proposes allocating ADFIT using a net plant-based factor. Ms. Simpson testified that this method is consistent with El Paso City Ordinance 15316 which specifies how ADFIT is to be calculated when developing rate base for EPSA rate cases following the sale of the El Paso properties from Southern Union Company to ONEOK.²⁸ "While it is true that the Company and the Commission have historically relied on the customer-based factor to allocate most divisional items, both the Company and the Commission historically used the net-plant based factor to allocate ADFIT."²⁹

²⁶ *Id.* at 16-23.

²⁷ 318 C.F.R. §154.306 (2009).

²⁸ TGS Exhibit 23, Simpson Rebuttal 15-19.

²⁹ *Id.* at 17.

Mr. Pous testified that TGS allocates total direct ADFIT and allocated corporate ADFIT to the EPSA with an allocation factor based on net plant. This is not appropriate because ADFIT is comprised of depreciation related differences associated with gross plant, and it is inconsistent to with previous reliance on a customer allocation factor by both TGS and the Commission. Mr. Pous recommends that the standard customer-based allocation be used to allocate ADFIT to the EPSA. He testifies that the customer-based allocation factor is more appropriate for cost-causation principles and for consistency.³⁰

Examiner Analysis and Recommendation

The issue with regard to ADFIT is which allocation methodology is appropriate. The Examiners find that the evidence establishes that TGS' proposed net-plant allocation of ADFIT is reasonable, appropriate and consistent with previous Commission practice. Because depreciation rates differ among jurisdictions, allocations based on gross plant may be distort the proportion of each jurisdiction's responsibility for the ADFIT balance. The difference between book depreciation and tax depreciation is a primary driver of the calculation of deferred taxes, therefore it is necessary to recognize accumulated depreciation between jurisdictions. Net-plant recognizes these factors and is the more appropriate basis to allocate ADFIT.

D. Tapping Fee Adjustment

Staff recommends an adjustment to TGS' rate base. Ms. Ruiz testified that the Commission previously approved an alternative method for the Company to recoup line extension costs through monthly surcharges billed to specific low-income residences, which is referred to as a tapping fee. These costs are recouped over a longer period of time, on a monthly basis, with a lower rate impact. Because these costs are recovered through monthly tapping fees, they should not be included in TGS' rate base. Removing these costs will reduce plant-in-service by \$203,921.³¹ TGS indicated that has no objection to the post-filing reduction to its plant balances.³² Therefore the Examiners recommend that the Commission approve Staff's proposed adjustment.

³⁰ Pous Direct. at 12-13.

³¹ Staff Exhibit 3, Ruiz Direct at 8-10.

³² TGS Initial Brief at 30.

IV. CAPITAL STRUCTURE AND RATE OF RETURN

A. Introduction

In determining a rate structure in this proceeding, the Commission must establish a reasonable rate of return for TGS that sets overall revenues at an amount that will permit the utility an 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. 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.

As noted by the Austin Court of Appeals in *Railroad Commission of Texas v. Lone Star Gas Company*,³³ to achieve the rate of return that a utility should be allowed to earn, the regulatory agency should consider the cost to the utility of its capital expressed as follows: (1) interest on long term debt; (2) dividends on preferred stock; and (3) earnings on common stock. As stated by the United States Supreme Court, the annual rate that will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and business conditions generally.³⁴

The overall rate of return is calculated by determining a utility's weighted average cost of capital ("WACC") which sums the percent return on cost of debt and cost of equity, and thereby represents a weighted cost of debt and return for equity. Regulated utilities can finance operating assets through long and short term debt and also through issuance of common and preferred stock. Preferred stock and short term debt is sometimes included as a component for a calculation of the combined return. In this case, TGS has proposed two components: the cost of debt and the cost of common equity.

³³ *Railroad Commission of Texas v. Lone Star Gas Company*, 599 S.W.2d 659 (Tex. App. C Austin 1980).

³⁴ *Bluefield Water Works and Improvements Co. v. Public Serv. Comm'n of West Virginia*, 262 U.S. 679 (1923), see also, *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1942).

In applying the weighted average cost of capital calculation, the cost of debt is typically not at issue as it can be readily ascertained from known facts. That is, cost of debt is the utility's actual cost of long-term debt, taken from financial instruments, already executed to finance its capital expenditures and operations. The cost of debt, because it is based on known, measurable factors such as the cost of borrowing instruments is easily identified and not the subject of debate in this case. However, the cost of common equity is typically contentious in rate proceedings because it is subjective in nature. Thus, the essential issues in this case are the capital structure and the cost of equity in determining the overall return.

B. Capital Structure

In his direct testimony, Dr. Fairchild, who testified on behalf of TGS, recommended a capital structure of 40.76% long-term debt and 59.24% common equity based on an unconsolidated capital structure from TGS parent company ONEOK, Inc.³⁵ In applying an actual capital structure ratio to the rate of return calculation for the company, he argued that using a consolidated capital structure for the parent company including financial data from the non-regulated transportation, processing and trading operations of ONEOK Partners L.P. does not allow sources of capital used to finance TGS operations to be directly identified, as ONEOK Partners issues their own debt and has its own publicly traded equity shares.

Alternatively, Dr. Fairchild stated in his testimony that an unconsolidated capital structure for ONEOK, Inc. excluding long term debt and common equity from ONEOK Partners is reflective of ONEOK, Inc.'s core natural gas distribution businesses through its operating divisions. Of these two possible approaches, Dr. Fairchild recommended the unconsolidated capital structure for ONEOK, Inc. be applied as an appropriate capital structure for TGS. Additionally, Dr. Fairchild provided comparative data demonstrating his proposed unconsolidated capital structure was consistent within a range of that of other LDCs.³⁶

City of El Paso witness Mr. Copeland provided a consolidated and calculated unconsolidated capital structure as well. Based on the 2009 10K filing for ONEOK, Inc., Mr. Copeland identified a consolidated capital structure of 67.41% long term debt and 32.59% common equity. Mr. Copeland also calculated an unconsolidated capital structure for ONEOK of 40.16% long term debt and 59.84% common equity.³⁷

The examiners agree that an actual capital structure based on the unconsolidated capitalization of the company is appropriate for determining the company's rate of return in this case.

Mr. Copeland's calculated unconsolidated capital structure for the company does not differ significantly from that provided by Dr. Fairchild, and the examiners find that it is reasonable and consistent with the recent Commission rate case decisions to use the company's actual

³⁵ TGS Exhibit 18, Fairchild Direct, p. 14-18.

³⁶ TGS Exhibit 18, Fairchild Direct, p. 15- 12.

³⁷ City of El Paso Exhibit 3, p. 35 - 20.

unconsolidated capital structure of 40.76% long term debt and 59.24% common equity as provided in Dr. Fairchild's testimony.

C. Cost of Debt

In direct testimony Dr. Fairchild calculated the cost of debt for ONEOK, Inc. based on the company's outstanding debt to arrive at an average embedded cost of debt of 6.21%. Mr. Copeland initially presented a cost of debt for ONEOK, Inc. of 6.20% in his direct testimony which he subsequently changed to 6.21% in hearing testimony.³⁸ The cost of debt for the company can be calculated from the actual reported financial information of the company and the examiners concur that a 6.21% cost of debt for ONEOK, Inc. is reasonable.

D. Cost of Equity

In setting a rate of return using the Weighted Average Cost of Capital (WACC), the first step is determining the appropriate capital structure. Once this is identified, the next step is in determining the costs of debt and equity for the company. In this proceeding all parties providing a cost of equity estimation agree that the cost of debt is directly measured and that a 6.21% cost of debt for TGS is reasonable.³⁹ The essential issue then, lies in establishing the company's cost of equity.

The cost of equity is not readily measurable, and must be estimated using equity valuation models using information from financial markets. The results of two primary methods were presented by the parties in making this inference: (1) the discounted cash flow (DCF), and (2) Capital Asset Pricing Model (CAPM).⁴⁰ Dr. Fairchild additionally presented results derived from the Risk Premium and Comparable Earnings methods in formulating his recommendations, while City of El Paso witness Mr. Copeland provided additional results from a Dividend Discount Model (DDM) method based on the DCF, to supplement his analysis.

In performing his DCF and CAPM analyses, Dr. Fairchild surveyed equity market data from a grouping of ten comparable companies selected from Value Line's listing of publicly traded gas distribution companies whose primary business is natural gas distribution. This grouping of comparable companies also served as the basis for Mr. Copeland's analysis.⁴¹ Dr. Fairchild also provided estimated return on equity data for ONEOK, Inc. based on reported and forecasted financial data.

³⁸ Hearing Transcript Vol. 3, p. 9, ln. 22-23.

³⁹ TGS Exhibit 18, Fairchild Direct, p. 18; GUD No. 9988 Hearing Transcript Vol. 3, p. 9, ln. 22-23.

⁴⁰ TGS Exhibit 18, Fairchild Direct, p. 18; El Paso Exhibit 3, Copeland Direct, p. 22.

⁴¹ El Paso Exhibit 3, Copeland Direct, p. 23.

Using the grouping of comparable companies, both Dr. Fairchild and Mr. Copeland provided an estimated range for a reasonable return on equity based on Discounted Cash Flow and Capital Asset Pricing models. The Discounted Cash Flow (DCF) is a widely used method to analyze the cost of common equity. The DCF in its constant-growth form is expressed in a formula as:

$$K = D/P + g$$

Where: K = cost of common equity
D = dividend per share
P = price per share
G = rate of growth of dividends, or, common stock earnings.

The DCF seeks to quantify a market-based value of common equity based on the present value of a stream of returns. While the formula is relatively straightforward, because it provides an estimated result and relies on variables and assumptions underlying the calculation, its results are subject to debate.

Dr. Fairchild presented DCF analysis results based upon calculated dividend yields of 3.98% for the LDC companies and 3.68% for ONEOK, Inc. To identify the growth factor component of the DCF equation, Dr. Fairchild developed schedules using projected earnings growth rates from analysts, calculated sustainable growth rates, and projected and historical growth rates for net book value of shares, and dividend and price per share. Dr. Fairchild contended that earnings growth drives investor's expectations of growth in share prices and dividends, and therefore provided an appropriate basis for estimating equity returns under the DCF. Based upon his analysis, Dr. Fairchild determined that a cost of equity range between 9.75% and 10.75% for the LDC grouping was reasonable, with a range of 10.7% to 11.7% for TGS.⁴²

Mr. Copeland also applied a DCF analysis. In preparing his DCF analysis, Mr. Copeland used projected growth rate estimates for earnings per share, dividends per share, book value per share and earnings percentage retained to common equity. Applying an average of these projected growth rate indicators, Mr. Copeland developed a DCF-derived cost of equity 8.46%, based on the median value of equity cost rates for the selected companies.

Mr. Copeland further applied a modified version of a DCF analysis, using a Dividend Discount Model, or DDM, with the same metrics, to arrive at a cost of equity estimate. Mr. Copeland argued that a DDM analysis could provide a more accurate and reliable estimate of the cost of equity, since it is not dependent upon assumptions of constant dividend growth as in a standard DCF analysis. Applying DDM methodology, Mr. Copeland arrived at a median return on equity estimate for the subject companies of 8.76%.⁴³

⁴² TGS Exhibit 18, Fairchild Direct, p. 28-31.

⁴³ El Paso Exhibit 3, Copeland Direct, p. 22-25.

The parties also employed the Capital Asset Pricing Model (CAPM) as a method for estimating the cost of equity. The CAPM is simply expressed in a formula as:

$$K = R_f + \beta(R_p)$$

Where: K = the estimated rate of return of the stock
 R_f = risk free rate of interest
 β = Beta value; company specific risk factor
 R_p = risk premium.

While the DCF method is a market-based measure of the cost of capital, the CAPM method uses an explicit risk premium component added to a base "risk free" rate and measures the risk premium between a given portfolio and the market in entirety. It then seeks to identifying a cost of capital based on an investors ability to diversify by combining various securities into an investment portfolio.

Dr. Fairchild applied the CAPM using an "ex-post" or historically-based analysis of equity market data, and an "ex-ante" or forward-looking approach based on projected estimates of equity returns. In his ex-post method, Dr. Fairchild presented the average historical rates of return for the S&P 500 companies as compiled by Morningstar Associates, a widely used investment reporting service, for the period from 1929 through 2009, which were calculated to be 11.8%. From this, he subtracted the income rate of return on 30-year Treasury bonds corresponding to the same period of 5.2%, which yielded a market risk premium of 6.6%. In the ex-ante application, Dr. Fairchild then used analyst's average projected growth rates for the S&P 500 to derive a market rate of return of 11.07% from which he subtracted an average yield on 30-year Treasury bonds of 4.69%, giving a risk premium of 6.38%.⁴⁴

In the further application of the CAPM method, Dr. Fairchild then weighted his two derived risk premia by the average beta, or company-specific risk factors, for the LDC's in the comparable company group of 0.66. Applied with the risk-free rate of 4.69%, the result of this analysis was an estimated return on equity for the LDC grouping of 9.05% and 8.9% under the two approaches. Using the same methodology applied to ONEOK data produced equity cost estimates of 10.96% and 10.75%.

Mr. Copeland's CAPM analysis applied the formula to produce an average cost of equity for the comparable group of 6.68%. These results were based on a risk free rate of 4.4% derived from long-term Treasury bonds and Mr. Copeland calculated the equity risk premium based on a series of historical returns of equities over bonds for a period from 1872 to 2008. Employing a geometric mean, and based on dividend yields, Mr. Copeland's calculated risk premium was 3.5%. This risk premium, when multiplied by the beta values for the LDC proxy grouping produced a range of values of from 6.33% to 7.03%.

⁴⁴ TGS Exhibit 18, Fairchild Direct, p. 32-34.

Beyond the DCF and CAPM analytical methods, Dr. Fairchild additionally provided return on equity estimates using the Risk Premium and Comparable Earnings methods. The Risk Premium method is similar in nature to the CAPM method, consisting of a risk free rate with an added risk premium factor. Dr. Fairchild based this analysis on quarterly reported approved rates of return on equity for natural gas utilities for a period from 1980 to the first quarter of 2010, and then developed a regression equation to depict the relationship of the approved ROEs to utility bond yields. From this equation, Dr. Fairchild calculated a cost of equity for the LDCs of 10.38% and for ONEOK, Inc., a 10.59% equity cost.

The Comparable Earnings method was used in Dr. Fairchild's analysis to survey projected book value return on equity for the comparable LDCs in timeframes for the years 2010, 2011, and the 2013-2015 year period. For these periods, he derived equity cost estimates of 11.5%, 11.8% and 11.6% respectively for the LDCs and 13.9%, 13.0% and 12.5% respectively for ONEOK, Inc.

A summary of Dr. Fairchild and Mr. Copeland's return on equity estimate results and recommendation follows in the tables below.

Fairchild Cost of Equity Estimates and Recommendation

DCF	High - 10.75%	Low - 9.75%	
CAPM	High - 9.05%	Low - 8.90%	
Risk Premium	10.38%		
Comparable Earnings	2010: 11.50%	2011: 11.80%	2013-15: 11.60%
Recommended ROE	11.00%		

Copeland Cost of Equity Estimates and Recommendation

DCF	8.46%
DDM	8.76%
CAPM	6.68%
Recommended ROE	8.00%*

*Subject to a capital structure of 40.16% debt and 59.84% equity.

In addressing Dr. Fairchild's analysis, Mr. Copeland was critical of what he alleged was Dr. Fairchild's reliance on earnings per share (EPS) data in formulating his DCF growth rate, and argued that such an approach would bias the DCF results upward since this ignores growth in dividends, which exhibit a different, and lower, growth rate. Mr. Copeland also took Dr. Fairchild to task for not changing his recommended ROE even though projected earnings growth estimates provided in earlier testimony to the City of El Paso indicated a decline among some estimates for the LDC group.

With reference to Dr. Fairchild's CAPM analysis, Mr. Copeland asserted that Dr. Fairchild's risk premium component was too high, and was inconsistent with his own analysis. Mr. Copeland further argued that the Risk Premium method employed by Dr. Fairchild incorporated approved rates of return from historical rate proceedings, and thus encompassed facts not in evidence, since the circumstances of these rate decisions could not be known, and consequently could not be presented with any validity. Mr. Copeland finally added that the Comparable Earnings approach does not present a reasonable methodology for estimating the cost of equity since it uses the book value of equity as a basis for valuation instead of the market value of equities, and thus does not present a valid market based approach to equity valuation.

In his rebuttal testimony, Dr. Fairchild responded that earnings trends drive dividends, share prices, and ultimately, investor expectations, and that in his DCF model he evaluated a variety of historical and projected growth rates to arrive at a plausible estimate, and thus his analysis was not predicated on earnings growth estimates alone. Dr. Fairchild was then critical of Mr. Copeland's CAPM analysis results as nonsensical, and responded to Mr. Copeland's criticism of his Risk Premium approach as being unfounded, since use of authorized ROEs in the Risk Premium approach reflect the best judgment of regulatory commissions. Dr. Fairchild additionally defended his use of the Comparable Earnings method as a useful benchmark of the level of earnings a utility needs to attract capital and maintain financial integrity, and maintained that his ROE recommendation in this case did not change from that presented in the original City of El Paso case because his recommendation was based on a variety of factors which continued to support his conclusion.⁴⁵

Dr. Fairchild then noted in reference to the academic studies cited by Mr. Copeland in his testimony that although some were seminal research works, many others were from lesser journals and unpublished working papers, and that a broad survey of academic research on the risk premium issue could also produce a body of research supportive of a higher risk premium estimate.

From the results of the analytical methods that he applied, and giving most weight to the DCF results, Dr. Fairchild concluded that a cost of equity of 11.00% was reasonable for TGS, and when applied in the weighted average cost of capital calculation, results in his recommended rate of return of 9.05%.

Mr. Copeland's return on equity recommendations were dependent on the capital structure to be used in calculation of the overall weighted average cost of capital for TGS. As noted previously, it is the opinion and recommendation of the Examiners that the unconsolidated capital structure provided in Dr. Fairchild's recommendation be adopted in determining the rate of return in this case, and given its close congruency with the unconsolidated capital structure as calculated by Mr. Copeland, Mr. Copeland's corresponding recommended rate of return on equity of 8.0% results in a rate of return of 7.28%.

⁴⁵ El Paso Exhibit 3, Copeland Direct, p. 35-42.

Based on the recommended capital structures and returns on equity, a summary of the parties' rate of return recommendations is provided in the tables below.

Fairchild recommended rate of return

	Capital Structure	Debt/Equity Cost	Weighted Average
Long-Term Debt	40.76%	6.21%	2.53%
Common Equity	59.24%	11.00%	6.52%
Rate of Return			9.05%

Copeland recommended rate of return

	Capital Structure	Debt/Equity Cost	Weighted Average
Long-Term Debt	40.16%	6.21%	2.49%
Common Equity	59.84%	8.00%	4.79%
Rate of Return			7.28%

D. *Examiners' Analysis and Recommendation*

The Examiners agree with the grouping of comparable companies used by the parties as providing a reasonable basis for estimating the market value of equity for a large LDC company such as TGS. The use of a proxy group of comparable companies has been the methodology previously applied in a long series of cases before this Commission.

The Examiners further find that TGS did not establish that a cost of equity of 11.00% is reasonable. Dr. Fairchild presented DCF results from his grouping of comparable companies that showed a range of 9.75% to 10.75%, CAPM results of 8.9% to 9.05%, and results from the Risk Premium and Comparable Earnings methods of 10.59% and 11.5% (in the current year) respectively. Dr. Fairchild's recommended range ROEs for his LDC group was 10% to 11%, and Dr. Fairchild also provided results from these methods that were specific to ONEOK Inc., which reflected a generally higher estimated return on equity, in a range of 10.5% to 11.5%. Dr. Fairchild did not accept the results from his own CAPM analysis as credible, and the results of the Risk Premium and Comparable Earnings methods were provided in large measure to reinforce the credibility of the range of results provided by the DCF analysis. While the Risk Premium estimated equity costs were consistent with this range, the Comparable Earnings results were not, and Dr. Fairchild based his 11.0% ROE recommendation, at the top of the range he defined for the LDC grouping, partly on his Comparable Earnings calculation and the higher range of results he obtained for the ONEOK data. While establishing a rate of return on equity must necessarily involve some degree of informed judgment, the Examiners do not agree that the financial model results presented in this case supports a return on equity of 11.0%. The range of equity returns suggested by Dr. Fairchild's analysis of the comparable companies - the range of returns investors might expect for comparable risk - was 10.0%

to 11.0%, with the results of the DCF and Risk Premium methodologies suggesting values at the lower to middle end of this range. Accordingly, the Examiners cannot accept 11.0% as a reasonable rate of return on equity for TGS.

The Examiners also find that cost of equity recommendation of the City of El Paso does not provide a reasonable basis for a return on equity to apply to TGS. Under the unconsolidated capital structure recommended in this proceeding, Mr. Copeland's recommended rate of return on equity of 8.0% is the average of the values he derived from the three analytical methods (DCF, DDM, and CAPM) he used. However, in light of recent rate case decisions by the Commission that have approved returns on equity of over 10 percent for large distribution utilities, the Examiners cannot concur that capital markets will support a return on equity of 8.0% under current economic conditions. Indeed, a return on equity of 8.0% would constitute an equity return of only 179 basis points over the 6.21% cost of debt for TGS in this case, which is not plausible under current capital market conditions. Mr. Copeland framed the presentation of the results from his three methods with considerable discussion referencing academic studies in his direct testimony to argue that the risk premium is lower than typically presented in rate cases, however there is yet no established consensus among academicians and analysts in this area and the state of current financial markets indicating increased bond holdings among investors suggest a low ERP to be counter-intuitive.

While the Examiners accept that the current state of capital markets may have diminished investor expectations downward as reflected in the results of the equity valuation models, the logic of financial theory remains that investors will seek additional returns for holding relatively riskier investments. It is under this rationale that Dr. Fairchild rejected the CAPM results he derived, and the Examiners similarly find limited credibility in the proposition that equity cost estimates that are in such proximity to the cost of debt will provide the utility with the opportunity to attract equity capital.

Dr. Fairchild's derived DCF range for the LDC group provides the strongest methodology presented for making a determination of a reasonable return on equity for TGS, and is generally consistent with the DCF methodologies recently presented before the Commission in large utility rate cases. As Mr. Copeland pointed out in his testimony, it is consistent with regulatory practice to identify a range of returns that investors could earn on investments of commensurate risk, and thus it is the analysis of market conditions for the companies in the comparable LDC group that provides the primary basis for determining a reasonable return on equity. With an equity ratio of 59% as proposed for adoption in this case, TGS would be relatively less risky in terms of its capital structure from the LDC grouping average, and in counterbalancing this with market uncertainty considerations, the Examiners find that a 10.33% return on equity for TGS is reasonable, and results in an overall rate of return of 8.65%. This rate of return does not reflect a specific adjustment for flotation costs which were not quantified in this case, but does allow an upward adjustment from the midpoint of the DCF equity return range Dr. Fairchild presented. This rate of return is also consistent with the rates of return adopted by the Commission in the two most recent rate cases involving large distribution utilities. The Examiner's recommended cost of capital results are summarized in the table below.

Examiner's recommended rate of return

	Capital Structure	Debt/Equity Cost	Weighted Average
Long-Term Debt	40.76%	6.21%	3.61%
Common Equity	59.24%	10.33%	4.83%
Rate of Return			8.65%

V. EXPENSES

A. Incentive Compensation

Stacey R. Borgstadt, Manager of Rates and Regulatory Analysis for the ONEOK distribution companies ("ODC") of ONEOK, Inc., gave testimony on TGS' proposed incentive compensation expenses.⁴⁶ TGS is requesting recovery of \$1,497,452 in expenses incurred for the Company's short term and long term incentive compensation plans. The short term incentive plan provides all full-time, non-bargaining employees the opportunity to earn cash pursuant to a performance formula. The long term incentive plan is available to officers and employees, is awarded pursuant to a performance formula, and awards shares of the Company's common stock.

The award of short term incentive cash is determined, in part, by a company performance factor which is based on return on invested capital, consolidated operating income, earnings per share, total recordable incident rate, and the vehicle incident frequency rate. An individual performance factor assessment is also utilized in determining the award of short term incentive compensation. Long term incentive compensation consists of restricted stock and performance units. Restricted stock is not based on financial performance of the Company but vest three years from the date of grant. Performance units are granted based on the Company's total shareholder return.⁴⁷

The City of El Paso objects to TGS recovering this level of expense and argues that \$1,397,347 of the proposed level for both long term and short term incentive compensation be denied as it is directly attributable to financial metrics.⁴⁸ Mr. Pous testified that short term compensation is 90% tied to financial metrics, while 100% of long term incentive compensation is tied to financial metrics.⁴⁹

Examiners' Analysis and Recommendation

The primary objections to TGS' proposed level of incentive compensation are that it is predominantly determined by the financial performance of the company as opposed to safety, and that because the actual amount of incentive compensation expense to be incurred is determined by the future financial performance of TGS, it is not a known and measurable expense. The Commission recently approved the recovery of incentive compensation expenses for direct employees of CenterPoint in GUD No. 9902. Ms. Borgstadt testified that TGS' total compensation package is generally at or below the median of the market for labor, it is designed to compete for and retain employees, and "ultimately results in better overall customer satisfaction, including lower rates in the future, because the company's incentives produce a very efficient workforce."⁵⁰ The level of incentive compensation paid by the Company will be determined by the future financial

⁴⁶ TGS Exhibits 17, 17A, Borgstadt Direct Testimony, TGS Exhibit 25, Borgstadt Indirect Testimony.

⁴⁷ TGS Exhibit 25, Borgstadt Rebuttal at 28-46.

⁴⁸ City of El Paso's Initial Brief at 17-18.

⁴⁹ City Exhibit 2, Pous Direct at 75-81.

⁵⁰ TGS Exhibit 25, Borgstadt Rebuttal at 39.

performance. The City argues that "incentive compensation levels that might be paid in the future are not known and measurable with reasonable accuracy because they are based on the uncertain future financial performance of the company, they may be impacted by events such as abnormally warm weather outside the control of the Company or its employees, and as the Company admits, these incentive plans may be discontinued at any time."⁵¹ It is not clear from the evidence in the record the degree to which TGS' actually incurred labor expense can vary due to short and long term incentive compensation. There is no evidence in the record that the overall level of compensation is unnecessary, too high, or otherwise unreasonable. The evidence indicates that the overall level of compensation is at or below the median of the industry. It is unclear the extent to which the level of expense may vary in the future. The extent to which the Commission will allow a utility to structure employee compensation based on financial performance metrics is an important policy question that has not been considered and clearly set by the Commission to date. Ms. Borgstadt testifies that the short term and long term incentive compensation expense is incurred as part of the TGS' compensation package for attracting and retaining qualified employees. However, the evidence does not clearly indicate that the expense in and of itself is necessary for the provision of gas service. Both plans are predominantly designed so that employees have a vested interest in the financial performance of ONEOK, Inc. Further, the safety metric component of the plans can arguably be viewed as a financial metric in that vehicle incidents are more directly correlated to resulting insurance and liability expenses rather than the safe provision of gas service. To what extent this is necessary for the provision of safe and reliable gas service is not clear from the evidence in the record. The Examiners recommend approving ten percent (10%) of TGS' proposed short-term incentive compensation.

B. Supplemental Executive Retirement Plan (SERP)

TGS is requesting recovery of \$168,386 in expenses incurred for the Company's Supplemental Executive Retirement Plan ("SERP"). SERP is a benefit plan for certain officers that pays a benefit equal to at least the benefit that would be payable to the plan participant under a qualified pension plan without Internal Revenue Code limitations.⁵² Ms. Borgstadt testified that SERPs are a typical component in compensation plans and widely used by other utilities and energy companies to attract and retain employees in a competitive job market and are necessary costs of doing business. She testified that TGS' SERP request is just and reasonable because it allows the Company to provide a comprehensive compensation package, and that there is no evidence that the expense has been unreasonably incurred.⁵³

The City opposes TGS' proposed SERP expense and argues that they are "top-hat plans for key company employees that provide benefits above and beyond those covered in other retirement plans, and whose purpose is to allow those key employees to maintain their current standard of living

⁵¹ City of El Paso's Initial Brief at 18

⁵² TGS Exhibit 25, Borgstadt Rebuttal at 46-47.

⁵³ *Id.* at 48.

in retirement.”⁵⁴

Examiners' Analysis and Recommendation

The primary objection to TGS' proposed SERP expense appears to be that it is essentially unnecessary, additional executive compensation paid to a limited number of employees. The City argues that the Commission denied a portion of Atmos' requested SERP in GUD No. 9670 and should do so in this docket. Ms. Borgstadt testifies that TGS' compensation is essentially at the median. However, SERP is provided to a limited number of employees. Her testimony does not establish that the SERP expense is necessary for the provision of gas service to TGS' customers and that, but for TGS' SERP, the Company would be unable to retain certain key employees and TGS would be unable to continue providing safe and reliable gas service to its employees. TGS has not clearly established that its SERP is necessary. The Examiners recommend disallowing this expense.

C. Employee Stock Purchase Plan (ESPP)

TGS is requesting recovery of \$113,091 in expenses incurred for the Company's Employee Stock Purchase Program ("ESPP"). The ESPP is a benefit, similar to a medical or dental benefit offered to TGS employees, in which they may elect to participate. Employees may purchase shares of ONEOK, Inc. common stock at a discounted price. Ms. Borgstadt testified that the ESPP is just and reasonable because its part of the total compensation package offered to employees, encourages employee ownership, allows the Company to attract and retain qualified personnel, and there is no evidence that it is unreasonable.⁵⁵

The City opposes TGS' proposed ESPP expense and argues that it is an incentive for "employees to have a financial stake in the Company's operations, and thus the related Company expense is directly associated with financial matters that benefit shareholders. In this respect, ESPP costs are no different than long-term incentive compensation which is also tied completely to the financial metrics of the Company.”⁵⁶

Examiners' Analysis and Recommendation

The primary objection to TGS' proposed ESPP expense appears to be that it is essentially unnecessary for the provision of gas service and its primary purpose is to align Company employees' interests with the financial performance of the Company and thus its benefits shareholders as opposed to ratepayers. Ms. Borgstadt testifies that the SEPP expense is incurred as part of the TGS' compensation package for attracting and retaining qualified employees. However, the evidence does not clearly indicate that the expense in and of itself is necessary for the provision of gas service. The SEPP expense is clearly designed to encourage employees to have a vested interest in the financial

⁵⁴ City Exhibit 2, Pous Direct at 83; City of El Paso's Initial Brief at 18-19.

⁵⁵ TGS Exhibit 25, Borgstadt Rebuttal at 49-50.

⁵⁶ City Exhibit 2, Pous Direct at 83; City of El Paso's Initial Brief at 19.

performance of ONEOK, Inc. To what extent this is necessary for the provision of safe and reliable gas service is not clear from the evidence in the record. Therefore the Examiners recommend denying this expense. TGS has not clearly established that its ESPP is necessary. The Examiners recommend disallowing this expense.

D. Pipeline Integrity Testing Expense

TGS is requesting recovery of \$617,821 in expenses incurred for the Company's Pipeline Integrity Testing program. Pipeline Integrity testing is required under a combined federal and state regulatory initiative that requires regularly testing the structural integrity of pipelines. The program requires utilities to test certain facilities during the first 10 years of the program and then retest the same facilities at least once every seven years after the initial test. Baseline assessment is still underway, but there is some overlap of baseline and seven-year testing that complicates the testing schedule.⁵⁷ TGS intends to use hydrostatic testing, but given the testing schedule for the EPSA (there will be no integrity testing during 2012 pursuant to the schedule), providing cost estimates of expenses are difficult. Ms. Simpson performed a pro forma estimate of the costs likely to be incurred over during this process. Ms. Simpson testified that "there are three main issues impacting the amount of pipeline integrity testing to include in cost of service - calculation of total cost; number of years to use in computing the average annual amount; and whether to include that amount in base rates or in a separate recovery factor."⁵⁸

TGS alternatively proposed to utilize a Pipeline Integrity Expense Rider in its rates, as opposed to recovering pro forma expenses in base rates, to recover the actual costs of pipeline integrity testing. Mr. Limon testified that "this may be one of those circumstances where an expense normally recovered through base rates should instead be recovered through a specific tariff rider that would precisely track and recover the costs actually incurred by the Company, at least until it obtains additional cost experience from competitive bidding on future projects I believe that this alternative should be given serious consideration by the Commission in this case."⁵⁹

The City opposes TGS' proposed recovery of Pipeline Integrity Expense of \$617,821 through base rates. Mr. Pous testified as to why the City does not agree with TGS' estimated costs for this expense item. "The Company sought an annual revenue requirement of \$347,500 for anticipated future pipeline integrity expense. However, now the Company seeks an amount 2.2 times the level it sought earlier this year in its case at the City level."⁶⁰ Mr. Pous performed his own cost estimation based on certain bids received by the Company and proposes a \$236,000 Pipeline Integrity Expense level.⁶¹ The City does not directly address TGS' alternative recommendation to recover expenses associated with Pipeline Integrity Testing through a separate tariff rider.⁶²

⁵⁷ TGS Exhibit 13, Limon Direct at 13-14.

⁵⁸ TGS Exhibit 23, Simpson Rebuttal at 2.

⁵⁹ TGS Exhibit 13, Limon Direct at 20.

⁶⁰ City Exhibit 2, Pous Direct at 88.

⁶¹ City Exhibit 2, Pous Direct at 91; City of El Paso's Initial Brief at 39.

⁶² See City's Reply Brief at 15.

Examiners' Analysis and Recommendation

The primary objections to TGS' proposed level of Pipeline Integrity expense are that the bids that TGS' estimated costs are inaccurate in that they are significantly higher than the costs experience historically and are higher than current bids to perform the testing. The evidence in the record indicates that the actual level of pipeline integrity expense to be incurred in the future by TGS is not known and measurable to a high degree of accuracy. All parties apparently agree that pipeline integrity testing is necessary and that the company should recover its reasonable and necessary costs associated therewith. Given that TGS is still in the bid phase and that the actual costs cannot be simply summed up and instead must be estimated using a pro forma calculation performed by Ms. Simpson or Mr. Pous, the Examiners don't find that these expenses should be recovered in base rate revenue. The Examiners agree with TGS' alternative suggestion that a separate tariff rider, coupled with regulatory review of the reasonableness and necessity of the costs incurred and passed through, is the best mechanism for recovery of these expenses. Therefore the Examiners recommend that the Commission deny the proposal to recover pipeline integrity expenses in base rates and approve expense recovery through a separate tariff rider.

E. Allocated Corporate and Division Costs

Stacey R. Borgstadt, Manager of Rates and Regulatory Analysis for the ONEOK distribution companies ("ODC") of ONEOK, Inc., testified on behalf of TGS regarding the allocation of costs.⁶³ There are two types of expenses for the EPSA: (1) Expenses that are directly incurred in the EPSA; and (2) Expenses incurred by TGS Division and ONEOK Corporate which are allocated to the EPSA. Division and corporate expenses are allocated to the EPSA because they represent the EPSA's proportionate share of total TGS Division and ONEOK Corporate costs incurred supporting the company's multiple service areas. The proportionate share is determined either directly, using a causal relationship, or by the Modified Distringas Cost Allocation Methodology.⁶⁴

TGS Division provides executive guidance, financial accounting and regulatory compliance, legal management, human resources, central purchasing, technical services, facilities management, gas supply, and engineering services to the EPSA. Division level expenses for such services are allocated to the EPSA based on the ratio of EPSA customers relative to the total number of TGS customers.⁶⁵ TGS Division costs were adjusted to: (1) remove non-billed gas sales, transport revenue, and cost of gas items; (2) removal reclassification of depreciation, and amortization expenses; (3) costs relating to legislative and governmental relations, charitable contributions and donations, and other expenses not necessary for the provision of gas service; and (4) adjustments for known and measurable changes. The allocated portion of TGS division expense to be recovered annually through rates in the EPSA is \$3,306,116.⁶⁶

⁶³ TGS Ex.17, Borgstadt Direct Testimony.

⁶⁴ *Id.* at 3-5.

⁶⁵ *Id.* at 6.

⁶⁶ *Id.* at 7.

At the corporate level, ONEOK provides corporate governance services related to publicly held corporations to the EPSA: corporate strategic planning; executive oversight and direction; resource allocations; performance management; legal and regulatory compliance services. ONEOK Corporate provides financial control activities such as risk management, internal audit functions, and corporate budgeting. ONEOK Corporate provides information technology, human resources management and communication functions to the EPSA.⁶⁷ The allocated expense from ONEOK Corporate to be recovered annually through rates in the EPSA is \$4,983,377.⁶⁸ Each of the regulatory agencies having jurisdiction over ONEOK distribution companies has accepted the ONEOK Modified Distringas Cost Allocation methodology, including the FERC, the Oklahoma Corporation Commission, the Kansas Corporation commission, and the Railroad Commission of Texas.⁶⁹

Depreciation expense related to ONEOK corporate capital expenditures is allocated to the divisions and service areas. The Banner System customer service software was designed for exclusive use of three ONEOK local distribution companies and costs, including depreciation, are allocated based on the relative number of customers of each division and service area. Depreciation for general corporate plant is allocated using the Modified Distringas Cost Allocation Methodology ("MDCA") since they benefit all ONEOK business entities.⁷⁰ Incentive compensation program ("ICP") costs are allocated to the EPSA. Incentive compensation is based on company performance targets and individual employee performance targets. It uses financial, safety, and other criteria. The IPC is designed to provide employees a direct interest in achieving core goals and parallel goals of sound utility regulation. The ICP costs are reasonable because: (1) the level of employees' total compensation is reasonable after considering base and incentive pay on an aggregate basis; (2) without an incentive component the overall compensation package would not be competitive; (3) incentive pay is additionally based on the performance of individuals in areas that directly impact the quality, cost, and safety of gas utility service; and (4) the achievement of these goals benefits ONEOK customers in addition to shareholders.⁷¹

Total corporate plant in service was adjusted to make the allocated amounts reflect capital used to provide gas service. Capital investment relating to corporate aircraft, artwork and other investment not necessary to provide utility service was removed. TGS adjusted the amounts for the increase in the ONEOK Modified Distringas Cost Allocation percentages that result from known and measurable changes that occurred through the end of December 31, 2009. The amount of Corporate Plant in Service allocated to EPSA and recovered in rates is \$7,141,931. The amount of Division Plant in Service allocated to EPSA and recovered in rates is \$673,920.⁷² The amount of corporate investment that the company has included in its rate filing is reasonable and necessary, is used and

⁶⁷ *Id.* at 8-9.

⁶⁸ *Id.* at 11.

⁶⁹ *Id.* at 14.

⁷⁰ *Id.* at 15-16.

⁷¹ *Id.* at 16-17.

⁷² *Id.* at 18-19.

useful in the provision of gas utility service, and plainly benefits the customers in the EPSA.⁷³

1. General Issues

The City advances several general objections to TGS' proposed allocations of TGS Division Expenses and ONEOK Corporate Expenses to the EPSA. The City argues that the allocated expense data "is at best an unsupported attempt to show an allocation of costs that are not really costs or allocated according to a transparent system, and at worst an attempt to improperly assign costs to Texas ratepayers."⁷⁴ The City argues that based on the following facts, TGS is not entitled to a presumption of reasonableness for its corporate allocations, TGS did not use appropriate allocation factors and did not meet its burden of proof.⁷⁵ The City alleges:

- There are no corporate costs in the books and records of the EPSA as evidenced by information missing from Schedules G, G-14, and others;
- Ms. Parker testified that the financial reports she reviews have no corporate allocated amounts;
- "The amounts requested in this case are not even ONEOK amounts for the year ending June 30, 2009. The amounts are apparently based on a year ending December 31, 2009";
- Starting values for amounts allocated to TGS and ultimately the EPSA were not provided;
- "The amounts shown as Corporate Allocations were not numbers on the books of the Company. The only values provided were adjusted numbers."
- "The basis for allocation other than the Modified Distringas was not disclosed."
- A review of the propriety of the expenses was not made.⁷⁶

Mr. Pous testified that there are inappropriate charges from the corporate parent or TGS Division to the EPSA and that TGS has not adequately supported its request for corporate overhead costs allocated or assigned to the EPSA.⁷⁷ He recommends adjustments to eliminate these charges. Mr. Pous states that Ms. Borgstadt generally describes the concept of why corporate overhead costs are necessary and the allocation process but that TGS has relied on a modification of the Distringas formula and unidentified or arbitrary allocations.⁷⁸ That Ms. Borgstadt fails to provide detailed calculations demonstrating the starting level of dollars before any allocation, the specific cost-causation relationship she alludes to in her testimony, or the appropriate determination of what is considered direct assignments.⁷⁹ "Based on the information available, the commission does not have the capacity to make the finding that each and every cost allocated or assigned through a process that allocates costs to TGS and affiliates is both reasonable and necessary. The same general failure of

⁷³ *Id.* at 22.

⁷⁴ City of El Paso's Initial Brief at 26.

⁷⁵ City of El Paso's Initial Brief at 27.

⁷⁶ *Ibid.*

⁷⁷ Pous Direct at 58-61.

⁷⁸ Pous Direct at 58.

⁷⁹ Pous Direct at 58.

support for the company's request exists whether the transactions are deemed to be affiliate related or not."⁸⁰ However, he does not recommend a one hundred percent (100%) denial of these expenses.

Examiner Analysis and Recommendation

TGS argues that the City's allegations are provocative, inflammatory, and "notably thin on factual support."⁸¹ The Examiners have reviewed all the witness testimony, pleadings, spreadsheet workpapers, and the hearing transcript with respect to this issue. The Examiners are not persuaded by the City's arguments and are of the opinion that expense allocation data submitted by TGS was adequate to support the Company's proposed allocation of TGS Division expenses and ONEOK corporate expenses. The Examiners are unable to find any previous Commission decision in which it found expense allocations were improper or not supported without filing all of the original corporate expense line item prior to allocation. The evidence and testimony shows that this data was available to the intervenors upon request.

2. Application of Rule §7.503 to Corporate Allocations

The City argues that TGS' cost allocation data does not satisfy the requirements of Commission Rule §7.503 and that TGS is not entitled to the presumption of reasonability of its corporate expense amounts and therefore the portions allocated to the EPSA are not presumed reasonable. "TGS neither offered nor introduced into evidence either the amounts included in the books and records of ONEOK, nor excerpts or summaries of the books and records. The only evidence introduced was the amount shown on Schedule G-14 and translated to Schedule G, page 1. Specifically, there was no introduction of the amounts shown on the books of the company, in the direct case or in the rebuttal."⁸² TGS argues that §7.503 contemplates that the book values be produced as part of the direct case filing of the utility. "There was no presentation of the amounts recorded in the direct case. Thus, contrary to the rebuttal testimony TGS is not entitled to any presumption concerning amounts allocated from ONEOK corporate."⁸³

TGS argues that the City's position is that for an allocated expense to be entitled to the rule's presumption of reasonableness, the booked value from which the expense is allocated, must be part of the Company's evidence. That the Commission has never held §7.503 to require this treatment. "Indeed, the rule provides the presumption to the amounts reflected in the books and records of the Company, so long as they are kept in accordance with the FERC USOA. As company witness Stacey Borgstadt repeatedly testified, the Company's allocated expenses are records of the Company and they are derived directly from the Company's books."⁸⁴

⁸⁰ Pous Direct at 58-59.

⁸¹ TGS' Reply Brief at 50.

⁸² City of El Paso's Initial Brief at 28.

⁸³ *Id.* at 28.

⁸⁴ TGS' Reply Brief at 51.

Examiner Analysis and Recommendation

Ms. Borgstadt's testimony shows that the ONEOK corporate general ledger and income statement contain the per book starting values that are allocated to the EPSA. Under the City's theory the utility would have to file along with the statement of intent the corporate line items for each amount ultimately allocated to the EPSA. The Examiners' opinion is that §7.503 does not require this in order for the EPSA data to qualify for the presumption of reasonableness and necessity.⁸⁵ First of all the Examiners interpret §7.503 to mean that because the FERC USOA standards are used by TGS, the numbers presented to the Commission as the appropriate EPSA cost data, including the allocated cost data, satisfy the requirements of the rule. Second, that Ms. Borgstadt's description of how she obtained and derived the allocated data rebuts any challenge that the cost allocation data was derived inappropriately. The Examiners have not found any previous Commission decision interpreting §7.503 as argued by the City. The Examiners recommend that Commission deny the City's request to hold the allocated amounts to be prima facie unreasonable under Commission Rule §7.503.

3. ONEOK Cost Increases

The City objects to the overall increase in costs allocated from ONEOK. The City argues "that there were drastic changes in the nature and allocations of corporate costs between the 2007 case filed with the City, the current case as filed at the City levels and the costs requested in the Appeal."⁸⁶ The City alleges a lack of disclosure and transparency in the Company's approach to allocating costs and requests that if the entire portion of allocated costs is not to be disallowed, TGS should be ordered to provide, in future filings, the initial level of all costs prior to assignment or allocation and to provide complete support for the assignment of costs allocation factors. The City alleges that TGS provided no explanation of the activities of the cost centers with little to no explanation of the basis for some of the costs.⁸⁷ Mr. Pous testified that TGS "has employed a new allocation model that, prior to Ms. Borgstadt's deposition, was not identified. At this time, TGS has not supported or provided any of these factors."⁸⁸ He testified that the "TGS Division has fewer customers than the other two sister gas utilities, has less plant in service than the other two sister gas utilities, and has less net operating income than the other two sister gas utilities; yet, based on some internal decisions, which were not presented in testimony, TGS has over-assigned substantial levels of costs to TGS."⁸⁹

⁸⁵ (a) In any proceeding before the Commission involving a gas utility that keeps its books and records in accordance with Commission rules, the amounts shown on its books and records as well as summaries and excerpts therefrom shall be considered prima facie evidence of the amount of investment or expense reflected when introduced into evidence, and such amounts shall be presumed to have been reasonably and necessarily incurred;

⁸⁶ City of El Paso's Initial Brief at 29.

⁸⁷ *Id.* at 32.

⁸⁸ Pous Direct at 63.

⁸⁹ Pous Direct at 63.

not driven by the relative number of customers in each jurisdiction, rather by the nature of the demands each jurisdiction places on the resources of ONEOK distribution companies' executives.⁹⁵

Examiner Analysis and Recommendation

The Examiners find that TGS' proposal to allocate ODC Executive Costs is reasonable. The testimony and evidence introduced indicates that allocating these costs on a 1/3 basis between jurisdictions is fair and does not disproportionately assign costs to TGS' customers. The Examiners recommend Commission approval of TGS' proposed allocation.

5. Distring Allocators

The City opposes TGS' use of its proposed Modified Distring Allocation Methodology. Mr. Pous testified that TGS proposes its own Modified Distring Allocation Factor, which has three components: (1) gross property, plant and investments; (2) operating income; and (3) labor expense. TGS did not provide adequate information to perform all necessary investigations as to the reasonableness and necessity of each of the components. "Indeed, meaningful and critical information was knowingly withheld."⁹⁶ Mr. Pous recommends that the gross plant component to be further modified to include the remainder of gas in storage owned by the various entities of ONEOK that is not already reflected in plant in service.⁹⁷ For operating income, he recommends reliance on TGS' proposed allocation factor effective September 30, 2008, in order to normalize for the unusual economic impact that has temporarily impacted TGS' non-regulated entities and resulted in a disproportionate increase in assignment of corporate overhead costs to regulated utilities. He recommends that the labor expense factor be expanded to capture contractor charges because "the vast majority of the entities that form the components to which corporate overhead costs are to be charged substitute a portion of potential direct labor charges by employing contractors."⁹⁸

Mr. Crisp testified that TGS' Modified Distring Cost Allocation Methodology has been accepted by the Federal Energy Regulatory Commission for natural gas and oil pipelines in ONEOK Westex Transmission, L.P., the Oklahoma Corporation Commission, the Kansas Corporation Commission, and the Railroad Commission of Texas in GUD Nos. 9465 and 9770.⁹⁹ "The objective ONEOK has attempted to achieve is to adopt a methodology that is based on clear cost causation principles and is generally accepted by ONEOK's regulatory agencies, as resulting in just and reasonable rates."¹⁰⁰

Mr. Crisp testified that Mr. Pous' proposal to include gas in storage in the overall computation of Plant, Property and Equipment should be rejected because gas in storage is volatile

⁹⁵ TGS Exhibit 26, Crisp Rebuttal at 21-22.

⁹⁶ Pous Direct at 64.

⁹⁷ *Id.* at 64.

⁹⁸ *Id.* at 63-64.

⁹⁹ TGS Exhibit 26, Crisp Rebuttal at 24-25.

¹⁰⁰ *Id.* at 25.

and not representative of cost causation and is more representative of a cost of doing business rather than a long-term asset or investment.¹⁰¹ He testified that Mr. Pous' recommendation to normalize non-utility business units' operating income upward should be rejected because natural gas prices were at their peak during this time period and operating income of ONEOK's liquids, natural gas processing and energy services business were impacted upward, this trend is not likely to continue, and the Modified Distrigas Cost Allocation methodology ensures that distribution companies like TGS benefit from the relationship with other business units' operating incomes.¹⁰² That Mr. Pous' proposal to include contract labor expense is problematic because other expenses such as materials expense would be improperly included, and that contract labor costs are not a primary cost driver. "Contractor costs are generally incurred to provide a stop-ga because of the inability to fill our current employee complement on a very short term basis or because we have a specific special project outside the scope of general business activities."¹⁰³

Examiner Analysis and Recommendation

The Examiners find that TGS' proposed Modified Distrigas Cost Allocation Methodology is a reasonable method to allocate costs. The weight of the evidence and testimony submitted indicates that TGS' proposed method is reasonable. The three changes proposed by the City do not offer any substantial improvement over TGS' proposed allocation method. Therefore, the Examiners recommend that the Commission deny the City's proposals to change the Modified Distrigas Allocation Methodology and approve this cost allocation process in this docket.

6. IT Services

The City opposes TGS' proposed allocation IT Service Costs. Mr. Pous testified that TGS has not presented the direct and causal basis for IT Services. TGS requests \$4,076,871 of IT costs for the TGS Division with \$1,225,653 assigned to the EPSA. Mr. Pous testified there is no evidence supporting that this expense is reasonable and necessary and should be denied.¹⁰⁴

Mr. Crisp testified that Banner, ONEOK's customer service system, generates customer bills and provides information on customer accounts and has a cost causal relationship based on the number of customers because the cost of the system is driven by the cost to provided service to each customer. Therefore it is reasonable to allocate these costs based on the number of customers.¹⁰⁵

Examiner Analysis and Recommendation

The Examiners find that TGS' proposed allocation of IT Services is reasonable. The weight of the evidence and testimony submitted indicates that TGS' proposed method is reasonable. The

¹⁰¹ *Id.* at 25-27.

¹⁰² *Id.* at 27-30.

¹⁰³ *Id.* at 30.

¹⁰⁴ Pous Direct at 61-62.

¹⁰⁵ TGS Exhibit 26, Crisp Rebuttal at 18.

record evidence supports TGS' need for IT Services, incurrence of IT Services expense, and the proposed allocation of these costs to the EPSA. The Examiners find no support in the record for the City's proposal to disallow these costs. Therefore, the Examiners recommend that the Commission deny the City's proposal.

F. Depreciation Expense

Ronald E. White, Chairman and Senior Consultant of Foster Associates, Inc., testified on behalf of TGS regarding depreciation.¹⁰⁶ Dr. Whites's testimony concerns the 2008 depreciation study for plant in the EPSA and for common facilities shared among all TGS service areas. Total plant in the 2008 study at December 31, 2007 for TGS was \$624,243,357. El Paso represents \$179.0 million, or 28.7 percent of the total TGS Division. Foster and Associates conducted a net salvage analysis and an analysis of recorded depreciation reserves.

The City opposes three aspects of TGS' depreciation study for this docket and recommends three adjustments. First of all the City objects to the TGS' treatment of computed reserve imbalance. Second, the City objects to TGS' requested rates for Account 376 Mains and Account 380 Distribution Services in order to reflect net negative salvage for these accounts. Third, the City argues that the Commission should order 20 year amortization periods for general plant Accounts 391.1 Office Furniture and Fixtures and Account 294 Tools, Shop and Garage Equipment.¹⁰⁷

1. Amortization of Excess Reserve Imbalances

The depreciation study performed by Foster and Associates yielded a \$42,358,798 theoretical reserve. TGS has booked depreciation expense of \$66,213,065, resulting in an excess reserve of \$24,053,697 (or reserve imbalance). The City proposes a hybrid amortization scheme to reduce the reserve imbalance. The City's proposal is to amortize one half of the reserve imbalance over an eight year period and the remainder over the lives of the assets. The net result of the City's recommendation is a reduction in the revenue requirement of approximately \$1,166,961.

TGS proposes amortizing the reserve imbalance over the remaining lives of the assets. The net result of TGS' recommendation is an approximate 19 percent reduction in depreciation expense, or \$856,446 in the revenue requirement.¹⁰⁸

Examiner Analysis and Recommendation

When conducting a new depreciation study, one estimates future depreciation and future net salvage value. These estimated future values are subtracted from existing plant balances to yield the theoretical reserve. Then these values are amortized over the remaining lives of the assets in order

¹⁰⁶ TGS Exhibit 19, White Direct.

¹⁰⁷ City of El Paso's Initial Brief at 19.

¹⁰⁸ TGS Exhibit 19, White Direct at 12.

to calculate the appropriate depreciation levels and amounts. This is the standard practice and the practice that has been approved by the Commission in numerous rate cases and is embedded in the Commission's rules on depreciation. 16 TEX. ADMIN. CODE § 7.5252(a) (2002) provides that "Book depreciation and amortization for ratemaking purposes shall be computed on a straight-line basis over the useful life expectancy of the item of property or facility in question." The City's proposal to amortize one half the imbalance reserve over an eight year period and the remainder thereafter violates this rule because the assets will not be depreciated on a straight-line basis over their life expectancy. On this basis, the Examiners recommend denial of the City's proposal. Further, TEX. UTIL. CODE ANN. § 104.054 (b) (Vernon 2007 & Supp. 2009) provides that § 102.152 depreciation accounts shall be used uniformly and consistently throughout rate-setting and appeal proceedings. It is likely that a hybrid amortization scheme established on an appeal before the Commission, and which violates the Commission's rule mandating straight-line depreciation, would be found to violate this statute.

The City argues that this adjustment is needed to prevent inter-generational inequity. That because TGS has not performed a depreciation study in the EPSA for 18 years, too much depreciation expense has been embedded in the rates paid by its customers during that time period and that as a result, current customers should have their rates reduced. The Examiners agree with the general proposition that depreciation rates should not be skewed so that current customers pay disproportionately more for the depreciation of the utility's assets. Although it is reasonable to assume that if TGS had performed several depreciation studies over the preceding time period the reserve imbalance would have been different, there is no evidence that establishes the extent of such a difference. Depreciation studies are snapshots and estimates at that particular point in time and there is no evidence that indicates prior studies would have yielded depreciation rates yielding a lower reserve imbalance calculated in the 2008 study. If the Commission were to approve the City's hybrid amortization scheme, there is no evidence that it would be any more accurate at minimizing a reserve imbalance determined any subsequent depreciation study conducted by the Company. There are a multitude of variables that can affect the estimated future depreciation and future net salvage values for TGS' assets up until the time the next depreciation study is conducted. There is no evidence that convinces the Examiners that performing a hybrid amortization will be more accurate. The Examiners recommend that the Commission deny the City's proposal for hybrid amortization in order to reduce depreciation reserve imbalances.

2. Account 376 Mains and Account 380 Distribution Services

The City opposes the net negative salvage values assigned by TGS to these two accounts. For Account 376 Mains, TGS is proposing a negative 20 percent net salvage value. For Account 380 Distribution Services, TGS is proposing a negative 30 percent net salvage value. The City proposes a negative 5 percent net salvage value for Account 376 Mains and a \$278,308 reduction in depreciation expense.¹⁰⁹ The City proposes a negative 15 percent net salvage value for Account 380

¹⁰⁹ City Exhibit 2, Pous Direct at 37-43.

Distribution Services and a \$191,476 reduction in depreciation expense.¹¹⁰

Examiners' Analysis and Recommendation

The primary issues raised by the City relate to the data used in establishing the overall negative salvage values for these two accounts. The City argues that Account 376 Mains analysis is based on a subjective approach, state-wide data was inappropriately used instead of EPSA specific data, the study was general and not specific, and that it fails to address the abandonment of underground investment when retired.¹¹¹ The City argues that Account 380 Mains analysis is based on questionable data, an overly general approach, and that the historical data does not support the negative 30 percent value determined by Dr. White.¹¹²

The Examiners find that testimony provided by Dr. White and Mr. Limon establishes that the net salvage value calculations for Account 376 Mains and Account 380 Distribution Services are reasonable and should be approved by the Commission. Dr. White testified that

The 2008 depreciation study explains that a five-year moving average analysis of the ratio of realized salvage and cost of removal to associated retirements was used for all depreciable categories to a) estimate realized net salvage rates; b) detect the emergence of historical trends; and c) establish a basis for estimating future net salvage rates. The study further explains that cost of removal and salvage opinions obtained from Company personnel were blended with judgment and historical net salvage indications in developing estimates of the future.¹¹³

There is no evidence that the statewide data unreasonably skews the results. In general, increasing the size of a data set will tend to increase the accuracy of a statistical study based thereon. Further, the testimony of Mr. Limon indicates that there are no significant differences between the EPSA and the Company's other Texas service areas that affect the retirement of mains or services. The evidence establishes that TGS' data is sound and that the determination of net salvage values for these two accounts is reasonable. The Examiners recommend Commission approval of a negative 20 percent net salvage value for Account 376 Mains and a negative 30 percent net salvage value for Account 380 Distribution Services.

3. Amortization of General Plant Accounts

TGS is proposing to switch to amortization accounting for six (6) general plant accounts: Accounts 391.1 Office Furniture and Fixtures; 391.90 Computers and Electronic Equipment; 393.00 Stores Equipment; 394.00 Tools, Shop and Garage Equipment; 397.00 Communication Equipment;

¹¹⁰ City Exhibit 2, Pous Direct at 44-46.

¹¹¹ City Exhibit 2, Pous Direct at 37-43; City of El Paso's Initial Brief at 22-24.

¹¹² City Exhibit 2, Pous Direct at 44-46; City of El Paso's Initial Brief at 24.

¹¹³ TGS Exhibit 28, White Rebuttal at 19.

and, 398.00 Miscellaneous Equipment. A reserve for each account is established so that the investment in any vintage will be fully amortized (with no reserve imbalance) when a vintage achieves an age equal to the amortization period.¹¹⁴ The City agrees that amortization accounting should be adopted for these six (6) general plant accounts.¹¹⁵ However, the City proposes that for two accounts (Account 391.1 Office Furniture and Equipment, and Account 394.00 Tools, Shop and Garage Equipment) the amortization period be increased from fifteen (15) years to twenty (20) years. The City also proposes that a net salvage value of five percent (5%) be included.¹¹⁶ The combined effect of the City's proposal is to reduce depreciation expense by \$47,959.

Examiners' Analysis and Recommendation

First of all, amortization accounting is appropriate for the six proposed accounts because they consist of items for which it is difficult, costly, and nearly impossible to maintain plant records with sufficient accuracy to conduct meaningful statistical life studies necessary to do proper depreciation accounting. The City and TGS both agree that amortization accounting for these six accounts is reasonable. The evidence in the record indicates that amortization accounting for these six accounts is reasonable. The Examiners recommend that the Commission approve amortization accounting for the six general plant accounts proposed by TGS.

Regarding the issue of what is the appropriate amortization period for Accounts 391.1 and 394.00, Dr. White testified that an amortization period must be based on judgment, operational experience, and common sense. He found that for Account 391.1 there were 14 vintages, the oldest of which is 15.5 years. He found that for Account 394 there were 16 vintages, the oldest of which is also 15.5 years. As a result he recommended 15 year amortization periods. The City argues that Dr. White recommended longer periods of amortization before other state utility agencies and that therefore twenty years is more appropriate. Based on all of these recommendations, Mr. Pous recommends a twenty year amortization. The evidence in the record is that the longest vintages are 15.5 years for both accounts, and on that basis the Examiners find TGS' proposal reasonable recommend that the Commission approve the 15 year amortization period for these two accounts. Although Dr. White has recommended longer different amortization periods for approval by other state agencies, the individual circumstances of those cases are not specified. Given that the longest vintages are 15 years, we don't see the necessity of lengthening the amortization period solely on the basis that a different state agency approved a different period for another utility.

Regarding the addition of a five percent net salvage, TGS argues that the City's proposal is not appropriate because it is essentially adding a depreciation accounting function to amortization account and under such a hybrid system it is possible that the utility will not recover all its expenses. When performing amortization accounting, the entire amount is amortized over the appropriate period of time. The City's proposal is not consistent with the amortization of these accounts. The

¹¹⁴ TGS Exhibit 28, White Rebuttal at 4.

¹¹⁵ City Exhibit 2, Pous Direct at 47-52; City of El Paso's Initial Brief at 24-26.

¹¹⁶ *Ibid.*

Examiners recommend that the Commission deny the City's proposed five percent net salvage as being inconsistent with amortization accounting.

G. Injuries and Damages Expense

TGS is requesting recovery of \$189,645 in expenses related to Injuries and Damages. Ms. Simpson proposes a six year normalization period in order to equitably spread the costs to ratepayers over time.¹¹⁷ The City opposes TGS' proposed level of Injuries and Damages expense. Mr. Pous recommends the use of a three year normalization period and a reduction of \$149,882 in the level of expense.¹¹⁸ Staff opposes TGS's proposed level of Injuries and Damages expense. Ms. Ruiz recommends the use of a four year normalization period and reducing Injuries and Damages expense \$146,638.¹¹⁹

Examiners' Analysis and Recommendation

The primary issue raised by the parties in regards to injuries and damages expense relates to the appropriate normalization period. TGS proposes a six year normalization, Staff a four year period, and the City a three year period. The evidence in the record shows that an abnormal claim occurred in 2004. Factoring in this claim significantly increases the average level of this expense category. There is no evidence in the record that indicates a similar claim is probable in the foreseeable future or during the time period for which the proposed rates are expected to be utilized by TGS for the EPSA. TGS argues that omitting the 2004 claim year from the normalization period will artificially lower the Company's true cost over time. The Examiners find no evidence in the record to indicate that such costs are likely to be incurred again or that the 2004 award is anything but atypical. The Examiners recommend that the Commission approve a four year normalization period as recommended by Staff and that this injuries and damages expense be reduced by \$146,638 for establishing the Company's cost of service.

H. Travel and Meal Expenses

TGS is requesting recovery of \$217,741 in hotel and meals expenses as part of its cost of service. All intervenors in this proceeding oppose TGS' recovery of hotel and meals expenses. Mr. Pous testified that TGS' ceilings for hotel expense of \$400 per night and meals of \$75 per person far exceed the limits placed on companies and cities in the rate case expense phase of rate cases. He testified that TGS has not justified the reasonableness and necessity of these charges and that TGS' did not present the expense data in such a manner that it can be reviewed in a cost effective manner. Mr. Pous recommends denial of the entire \$217,741.¹²⁰ Staff witness Ms. Rose Ruiz testified that TGS has not met its burden of proof on the issue of employee travel and meal expenses and,

¹¹⁷ TGS Exhibit 23, Simpson Rebuttal at 13-14.

¹¹⁸ City Exhibit 2, Pous Direct at 87

¹¹⁹ Staff Exhibit 3, Ruiz Direct at 5.

¹²⁰ City Exhibit 2, Pous Direct at 84-86

therefore, all of the Company's requested expenses in this category should be removed from the revenue requirement.¹²¹

Ms. Borgstadt testified that Mr. Pous' and Ms. Ruiz's recommendation to remove the entire amount of travel and meal expense is unreasonable. She testified that TGS' business travel policy requires that lodging and meal expenses be reasonable given the circumstances and that these types of expenses are a necessary part of providing gas service.¹²² She testified that there is no specific limit on hotel or meal expenses but that TGS' policy is that costs must be "reasonable, while providing the employee a certain level of service and comfort."¹²³ For example, it may be more efficient for an employee to stay in a more expensive hotel downtown and walk across the street to a meeting as opposed to staying further out and incurring taxi, rental car, parking and time expense.¹²⁴ With respect to meals, TGS' "meals policy is that meals should be ordinary, necessary, reasonable, and directly related to or associated with business. The cost of meals fluctuates between the geographic locations to which the employees are required to travel."¹²⁵ Direct supervisors are responsible for verifying and approving that all charges are business related and properly supported by receipts or other documentation.

Examiners' Analysis and Recommendation

The primary issue raised by the parties in regards to meals and travel expense is whether or not the Commission can and should exclude the entire amount from the Company's cost of service revenue requirement. The intervenors argue that TGS does not have a satisfactory method to exclude improper meals and travel expenses which are too expensive, or include alcohol, or are not satisfactorily explained within TGS' records. The City argues that "TGS made no real effort to review the expenses for reasonableness."¹²⁶ TGS does not keep records of the itemized bills which show what comprised the meals. There was evidence introduced at the hearing which shows that upon further scrutiny, it cannot be readily ascertained from the specific charges how the expense is directly related to the provision of gas services for customers located within the EPSA. Some of the meal expenses cited by the City are a dinner for twelve in New York for \$2,055 or \$171 per person; \$29,167 for meals in New York for an unknown number of persons; a \$488 leadership meeting dinner in Austin at Z-Tejas Café for four persons, and others. Staff argues that TGS never quantified the percentage of travel by TGS El Paso employees to eastern cities, and that TGS is not able to verify that alcoholic beverage expenses are included.

TGS takes the position that this category of expenses cannot be denied under Rule §7.503. TGS takes exception to pointing TGS argues that "there is in a fact a policy that limits hotel and meal expenses. The fact that it relies on the reason and judgment of its employees in lieu of a

¹²¹ Staff Exhibit 3, Ruiz Direct at 8.

¹²² TGS Exhibit 25, Borgstadt Rebuttal at 51.

¹²³ *Id.* at 51.

¹²⁴ *Id.* at 51.

¹²⁵ *Id.* at 52.

¹²⁶ City of El Paso's Initial Brief at 36.

numerical limit for the expense does not mean that there is no policy for limiting these expenses.”¹²⁷ TGS argues that the City’s and Staff’s proposal should be rejected because it is overly broad and potentially confiscatory. TGS argues that the travel and meal expenses are reasonable and necessary because the Company’s policies are that they must be reasonable in relation to the nature and location of the business being conducted. That GURA serves as a substitute for competition and the Company’s policies are appropriate for unregulated businesses.¹²⁸ TGS excluded from its rate filing meals over \$75 per person and hotels over \$400 per night. TGS argues that neither Commission Staff nor the City failed to show these expenses were unreasonably incurred and that therefore they are presumed reasonable. TGS also proposes that the Commission promulgate a rule establishing what travel and meal expenses are reimbursable under gas utility rates.¹²⁹

The Examiners find that the evidence introduced by the City and Staff establishes that TGS’ records of travel and meal expenses do not allow for regulatory scrutiny as to whether or not the expenses are reasonable, necessary, and directly related to the provision of gas services for customers in the EPSA. The intervenors demonstrated several charges that are not satisfactorily explained by the Company’s witnesses and who could not establish how those expenses were reasonable and necessary for the provision of gas services. Further, the evidence shows that TGS does not have receipt data for these expenses. The evidence submitted by Staff and the City clearly rebuts the presumption of reasonableness of all these expenses and therefore the Commission should deny TGS’ request to include \$217,741 in travel and meal expenses in its cost of service. The Examiners find the evidence to establish that there is no way to ascertain how and to what extent TGS’ meal or travel expenses are directly related to the provision of gas services in the EPSA.

I. Payroll Expenses Charged to Other Service Areas

TGS is requesting recovery of \$637,673 in expenses related to Payroll Expenses Charged to Other Service Areas. This expense is an adjustment for payroll paid by TGS to employees in the EPSA when services are performed for other service areas. Ms. Simpson proposes to use the test year amount for this level of expense.¹³⁰

The City opposes the use of the test year amount for this expense. Mr. Pous testified that 2009 was the highest level of this expense item during the 2007-09 period and therefore it should be normalized by taking a three year average. He recommends that the “average percentage level of payroll charged to other TGS divisions for the three-year period 2007-2009 be employed as a normalization adjustment to the Company’s request. The three-year average remaining payroll to charged to the EPSA is 94.7788% compared to the Company’s requested level of 95.9474%.”¹³¹ Mr. Pous recommends a \$110,080 downward adjustment based on a three year average. Alternatively, Ms. Simpson testified that Mr. Pous calculated his proposed adjustment incorrectly, and that if the

¹²⁷ TGS’ Reply Brief at 59.

¹²⁸ TGS’ Initial Brief at 92.

¹²⁹ TGS’ Initial Brief at 100-101.

¹³⁰ TGS Exhibit 23, Simpson Rebuttal at 9-12.

¹³¹ City Exhibit 2, Pous Direct at 93.

Commission normalizes this expense the correct normalized reduction is \$35,653.¹³²

Examiners' Analysis and Recommendation

The primary issue raised by the City is whether or not TGS should normalize this expense. TGS argues that normalization of an expense is proper when there is evidence that the test year amount is not representative of ongoing costs and that in this case there is no evidence that the test year amount is atypical and non-representative of ongoing costs. We agree. There is no evidence in the record that suggests the test year expense amount is unreliable, atypical, and not likely to be representative of the level of expense likely to be incurred in the future. Therefore the Examiners recommend that the Commission approve the test year amount for this expense and deny the City's proposed normalization adjustment.

J. Interest on Customer Deposits.

TGS, Staff and the City agree that the appropriate level of interest expense on customer deposits is \$16,797, which reflects a downward adjustment of \$86,458 in order to reflect the 0.34 percent interest rate set by the Commission for 2010.¹³³ The Examiners agree and recommend Commission approval of this level of expense for TGS' cost of service model.

¹³² TGS Exhibit 23, Simpson Rebuttal at 9-12.

¹³³ TGS' Post Hearing Brief at 103; City of El Paso's Initial Brief at 17; Staff's Closing Brief at 5.

VI. REVENUE ADJUSTMENTS

A. Weather Normalization Adjustment

Ms. McTaggart testified that the Company proposes adjusting revenues by normalizing for weather. Weather was approximately 8.2 percent warmer than normal during the test year ended December 31, 2009. Actual heating degree days during the test year were 2053 as compared to 2247 heating degree days in a normal year. An average of daily weather calculated over the ten years ending December 2009 to derive normal HDDs was used. The ten year period is consistent with GUD Nos. 8878 and 9465. The weather adjustment was developed separately for each customer class in order to accurately reflect the different usage patterns among classes and to price the adjustment at the applicable tariff rates for each class. The weather normalization adjustment results in an increase of \$138,567 to base sales revenues.¹³⁴

The City opposes TGS' proposed 10-year normalization period. Dr. Dismukes testified on behalf of the City in regards to the Company's proposed weather normalization.¹³⁵ Dr. Dismukes testified that the standard regulatory weather normalization period is a 30-year period. That the National Oceanic and Atmospheric Administration ("NOAA") defines normal weather periods for 30 years. Dr. Dismukes "recommendation is that a 30-year normalization period should be used since it is consistent with how NOAA defines normal weather. The company has provided no information or evidence that a 10-year adjustment is better or more appropriate."¹³⁶ He proposes 2,392 Heating Degree Days ("HDD") and a test year adjustment of \$108,217.

Dr. Cummings and Ms. McTaggart offered rebuttal testimony to Dr. Dismukes proposed 30-year normalization period.¹³⁷ Dr. Cummings testified that NOAA updates its normal HDDs only once every decade and that this evidences the fact that the 30-year period should only be used to measure long-term trends and patterns. That in rate-making rates should be set on weather conditions expected during the time when rates are in effect and therefore the 10-year period is more appropriate for rate-making purposes. He testified that the 30-year HDD average is unduly influenced by a number of cold years from the eighties in which eight consecutive years were colder than the 30-year average. He testified that during the 10-year period from 2000-2009, the sum of the deviations based on the 10-year measure of normal is zero. In contrast, the sum of the deviations during the 2000-2009 period based on the 30-year measure of normal is negative 1,563 HDDs. Therefore the 10-year period is a more reasonable measure of ongoing weather conditions than the 30-year period.¹³⁸

Examiner Analysis and Recommendation

¹³⁴ TGS Exhibit 15, McTaggart Direct at 16-19.

¹³⁵ City Exhibit 4, Dismukes Direct, at 5-8.

¹³⁶ *Id.* at 7-8.

¹³⁷ TGS Exhibit 24, McTaggart Rebuttal at 60-63; TGS Exhibit 29, Cummings Rebuttal at 66-71.

¹³⁸ TGS Exhibit 29, Cummings Rebuttal at 70.

The issue is what normalization period to utilize when normalizing TGS' revenues for weather. The Commission has approved a 10-year normalization period in GUD Nos. 8878 and 9465. Dr. Cummings testimony shows that the 10-year period is more representative of short-term weather patterns given that the sum of the deviations based on the 10-year measure of normal is zero. TGS' proposed 10-year period is reasonable for rate-making purposes and there is no evidence that such a normalization period will lead to unreasonable rates. Ms. McTaggart testified that if the Commission approves a 30-year period it will expose TGS to revenue volatility and require a weather normalization clause. The Examiners recommend that the Commission approve the 10-year normalization period as reasonable given the statistical data cited by Mr. Cummings.

B. Adjustments to Account 4880 Service Fee Revenues

TGS proposes to use the test year amount, updated to December 31, 2009, of \$1,192,680 in account 4880, Service Fees. The City opposes using the updated test year amount and proposes using a three year average. Mr. Pous testified that because one component of the updated amount is unusually low he recommends normalization.¹³⁹ The test year filed with the City "the Company had identified a comparable level of \$1,314,423. In other words, during the six-month period that reflects the change between the City level and the appeal level for this other revenue category, the amount of Service Fees had declined by approximately \$150,000."¹⁴⁰ Mr. Pous recommends a three year average.

Ms. McTaggart testified that the 2008 year was an outlier and is due to high collection fees and returned check charges due to the severe economic downturn of that year. She testified that the 2007 year amount was after a rate change, 2008 is an outlier, and the 2009 amount is reasonably representative of expected service fee revenue in the future.¹⁴¹

Examiner Analysis and Recommendation

The issue is whether or not the updated test year amount is reasonable for rate-making purposes. The testimony indicates that service fees increased in 2007 due to an approved rate increase and is supported by evidence of the six years 2004 through 2009 for this account. In 2007 the revenues increased 11.0 percent to \$1,194,524 (from \$1,075,802 in 06'). In 2008 the service fee revenues increased 10.0 percent to \$1,314,123 (a \$119,599 increase). In 2009 the service fee revenues decreased to \$1,192,680 (a -9.2 percent decrease from 08'). The 2009 year amount is a -0.2 percent decrease from the 2007 year amount and supports Mrs. McTaggart's testimony that 2008 was an outlier year caused by the concurrent financial meltdown and that the 2009 test year amount is more representative of expected service fee revenue in the future. The Examiners find that TGS' proposal to use the test year amount, updated to December 31, 2009, is reasonable. The City's testimony doesn't sufficiently explain why their proposed normalization is likely to be more

¹³⁹ City Exhibit 2, Pous Direct. at 12-13.

¹⁴⁰ *Id.* at 97.

¹⁴¹ TGS Exhibit 24, McTaggart Rebuttal at 57-58.

representative of service fee revenue in the future and therefore should be denied.

VII. COST ALLOCATION AND RATE DESIGN

F. Jay Cummings, Senior Economist with Ruhter & Reynolds, Inc., testified on behalf of TGS.¹⁴² Dr. Cummings' testimony concerns the class cost of service study, allocation and rate design proposed by TGS in this docket. The City opposes most, if not all aspects of the Company's class cost of service study, proposed allocation, and rate design. David E. Dismukes, Consulting Economist with Acadian Consulting Group, testified on behalf of the City. Dr. Dismukes testimony addresses TGS' proposed class cost of service study, allocation and rate design and he offers his recommendations with regard to the same.¹⁴³

A. Class Cost of Service Study

1. Distribution Mains and Related Expenses

Dr. Cummings classifies distribution mains and related expenses as both customer-related and demand-related. He determines the split between the customer portion and demand portion of the mains cost with both a zero-intercept analyses and a minimum system analyses. "My cost of service study is based on the results of the zero-intercept analyses rather than on the results of the minimum system study with peak demand adjusted for the small amount of peak demand served by the minimum size system."¹⁴⁴ He used the zero intercept method but also checked those results with a minimum distribution system analysis. He calculates a 63.12 percent customer portion and a 36.88 percent demand portion of the mains investment. Dr. Dismukes opposes this allocation and recommends "that the Commission allocate the Company's distribution mains costs on a 50-50 basis with half being allocated to a customer-based allocation factor and the other half being allocated to a non-customer allocation factor. This recommendation is consistent with allocation levels recognized by other state regulatory commissions, as well as the Commission."¹⁴⁵ Dr. Dismukes further recommends that the non-customer portion be allocated on a 50-50 basis.¹⁴⁶ Dr. Dismukes thus proposes that 50 percent of the mains cost as customer-related, 25 percent as demand-related, and 25 percent as commodity-related. Dr. Dismukes testified that he found several problems with Dr. Cummings data and that it was suspect in many respects.¹⁴⁷

Examiners' Analysis and Recommendation

The Commission has approved both zero-intercept analyses and minimum system studies to classify distribution mains in previous dockets. The issue of what the allocation of distribution

¹⁴² TGS Exhibit 20, Cummings Direct Testimony; TGS Exhibit 29, Cummings Rebuttal Testimony.

¹⁴³ City Exhibit 4, Dismukes Direct Testimony.

¹⁴⁴ TGS Exhibit 20, Cummings Direct at 16.

¹⁴⁵ City Exhibit 4, Dismukes Direct at 26.

¹⁴⁶ *Id.* at 27.

¹⁴⁷ *Id.* at 19-25.

mains should be is primarily a policy issue for the Commission to decide as there is no evidence in the record that establishes that either method will result in unreasonable or illegal rates under the Gas Utilities Regulatory Act. Dr. Dismukes primarily relies on GUD No. 9670 for his recommended allocation factors. Dr. Cummings utilized established rate-making methods by using a zero-intercept analysis and confirming with a minimum system study in order to develop his proposed allocation factors. Dr. Dismukes allocation is essentially based on the Commission's decision in GUD No. 9670 and his factors were not objectively calculated in this proceeding. Dr. Dismukes alleged that the quality of the data sets used by Dr. Cummings is questionable and that there are anomalous costs across various different pipe types and vintages. Dr. Cummings used cost data from TGS' books and records, which is presumed reasonable under §7.503. The allegations of questionable data were thoroughly rebutted by Dr. Cummings testimony.¹⁴⁸ Upon review of the testimony and evidence, the Examiners' opinion is that Dr. Cummings data is reasonable for rate-making purposes because it was the actual cost data of the utility updated with the Handy-Whitman Index, a practice that has been utilized and approved by the Commission in previous rate cases. Therefore the Examiners recommend the Commission approve TGS' proposed use of Dr. Cummings' zero intercept study and resulting allocation of distribution mains as 63.12 percent customer and 36.88 percent demand.

2. Transmission Plant and Related Expenses

Dr. Cummings classifies Transmission Plant as 100 percent demand related. Dr. Dismukes disagrees with this classification and testifies that Transmission Plant includes facilities that deliver gas from production and storage area to the city gate on a year-round basis, not only on a peak-day, therefore some throughput share should allocate this between demand and commodity, and therefore he classifies Transmission Plant as 50 percent commodity driven and 50 percent demand driven.¹⁴⁹ TGS argues that transmission mains are sized to meet peak demand and that the cost is directly related to the size required to deliver all volumes demanded by customers at the system peak, with no additional investment required to deliver volumes throughout the year. Essentially, that Transmission Plant is sized to physically meet the peak demand day and that therefore under true cost causation principals the investments in Transmission Plant are 100 percent demand related.¹⁵⁰

Examiners' Analysis and Recommendation

The issue of the classification of Transmission Plant is primarily a policy issue for the Commission to decide as there is no evidence in the record that establishes that classifying Transmission Plant as 100 percent demand related or, alternatively, as 50 percent demand and 50 percent commodity will result in unreasonable or illegal rates under the Gas Utilities Regulatory Act. Dr. Dismukes did not produce an objective, quantitative basis for his proposed classification. Also, his testimony on this issue does not establish that a 100 percent demand classification is somehow invalid or violates well-known rate-making principles, or is not representative of the actual

¹⁴⁸ TGS Exhibit 29, Cummings Rebuttal at 15-21.

¹⁴⁹ City Exhibit 4, Dismukes Direct at 12.

¹⁵⁰ TGS Initial Brief at 110-111.

investment decisions of the utility when making Transmission Plant investment. Dr. Cummings cites both NARUC's *Gas Distribution Rate Design Manual* and AGA's *Gas Rate Fundamentals* as classifying Transmission Plant as demand related.¹⁵¹ He also cites GUD No. 9770 for approving a classification of Transmission Plant as peak demand-related. The Examiners find Dr. Cummings justifications for a 100 percent demand classification more persuasive and recommend that the Commission approve that classification.

3. Measuring and Regulating Station Equipment and Related Expenses

Dr. Cummings classifies Measuring and Regulating Station Equipment as 100 percent demand related. Dr. Dismukes disagrees with this classification and testifies that a 50-50 demand/commodity allocation is more appropriate.¹⁵² Dr. Cummings testified that a 50-50 demand/commodity allocation does not reflect cost causation, is not consistent with Commission decisions, and that both NARUC's *Gas Distribution Rate Design Manual* and AGA's *Gas Rate Fundamentals* classify these costs as demand related.¹⁵³

Examiners' Analysis and Recommendation

The issue of the classification of Measuring and Regulating Station Equipment is primarily a policy issue for the Commission to decide as there is no evidence in the record that establishes that either proposed classification will result in unreasonable or illegal rates under the Gas Utilities Regulatory Act. Dr. Dismukes did not produce an objective, quantitative basis for his proposed classification. Also, his testimony on this issue does not establish that a 100 percent demand classification is somehow invalid or violates well-known rate-making principles, or is not representative of the actual investment decisions of the utility. Dr. Cummings cites both NARUC's *Gas Distribution Rate Design Manual* and AGA's *Gas Rate Fundamentals* as classifying Measuring and Regulating Station Equipment as demand related.¹⁵⁴ He also testified that in "all cases since GUD No. 9400, the Railroad Commission has classified measuring and regulating station costs either entirely as demand-related, as I have in these appeal dockets, or as customer-related and demand-related based on the distribution mains classification factor. The Examiners find Dr. Cummings justifications for a 100 percent demand classification more persuasive and recommend that the Commission approve that classification. In the alternative we would recommend a classification based on the distribution mains classification factor as having a quantitative basis specific to this docket over a 50/50 classification.

4. Other Classification Issues

Dr. Dismukes testified that there are several other problems with Dr. Cummings cost allocation study. Dr. Dismukes objects to TGS' proposed weighted customer service allocation

¹⁵¹ TGS Exhibit 29, Cummings Rebuttal at 31.

¹⁵² City Exhibit 4, Dismukes Direct at 39.

¹⁵³ TGS Exhibit 29, Cummings Rebuttal at 35-38.

¹⁵⁴ TGS Exhibit 29, Cummings Rebuttal at 31.

utilized and therefore limit the amount of the increase to any customer class to 1.25% of system average.¹⁶¹ Dr. Dismukes testified that TGS' first method simply increases revenues for each class by the amount needed to attain the revenue requirement produced under the study and results in the residential class receiving a 28 percent increase and other rate classes receiving a decrease.¹⁶² The second method allocates any revenue deficiency on an equal percentage basis and results in a uniform, across the board increase to each customer class of approximately 14 percent.¹⁶³ The third method advanced by the Company maintains the current revenue-to-cost relationships for each of the customer classes and is consistent with gradualism principles.¹⁶⁴ Dr. Dismukes recommends his own revenue distribution based on his cost of service study and a variation of the gradualism revenue distribution method recommended by Dr. Cummings. First, Dr. Dismukes limits the residential and Fort Bliss customer classes to 1.25 times the system average. Second, the shortfall is allocated to classes showing a decrease. Third, he allocates a portion of the remaining shortfall "first to the customers which still generated a rate decrease after the Residential and Fort Bliss gradualism adjustment. The balance of \$148,082 was distributed to all customer classes based upon their total revenue requirement."¹⁶⁵

Examiners' Analysis and Recommendation

The revenue allocation portion is probably the most important aspect of a cost allocation study. This involves the policy decisions of how much each customer class is required to pay for the costs of gas service and any revenue deficiency shown to exist. The Commission has expressed in previous dockets the policy of moving toward uniformity in rate design, that is, where all rate classes are equally paying for their respective costs of the gas distribution system in the rates developed and approved.

If the Commission ultimately approves the cost of service recommended by the Examiners (a \$1,060,874 increase in revenues, as opposed to a \$5,122,193 increase requested by TGS) the differences in revenue allocation are mitigated. Because the Examiners have recommended less revenue than originally requested by TGS, they recommend that the Commission approve the revenue allocation proposed by Dr. Cummings. Also implicit in this recommendation is the approval of the minimum charge requested by the Company. The effects of this recommendation are illustrated in the following table.

¹⁶¹ City's Initial Brief at 44.

¹⁶² City Exhibit 4, Dismukes Direct at 45-46.

¹⁶³ *Id.* at 46.

¹⁶⁴ *Id.* at 46-47.

¹⁶⁵ *Id.* at 47-48.

	Total	Residential	Commercial	Industrial	Public Authority	Water Pumping	Fort Bliss
Cummings Recommended	\$5,120,945	\$5,186,290	\$(68,562)	\$(2,638)	\$(18,441)	\$(749)	\$25,045
Examiner Recommended - Cummings Allocation	\$1,060,874	\$2,857,910	\$(1,362,460)	\$(52,418)	\$(366,464)	\$(14,979)	\$(815)

B. Rate Design

TGS proposes a minimum customer charge and volumetric rates in Dr. Cummings' rate design. Dr. Cummings proposes increasing the customer charge to cover approximately 88.5 percent of fixed charges.¹⁶⁶ The City opposes TGS' proposed rate design. In general, the City proposes a lower customer charge and higher volumetric rates than the Company. The following table shows the customer charges proposed by the Company, City and the Examiners:

	TGS Proposed	City Proposed	Current / Examiners Proposed
Residential	12.85	11.40	10.80 / 11.90
Commercial	23.80	17.70	18.30
Commercial Transportation	200.00	150.00	300.50
Commercial Air Conditioning	23.80	17.70	18.30
Cogeneration Transportation	200.00	150.00	300.50
Public Authority	42.50	29.30	32.71
Public Authority Transportation	200.00	75.00	300.50
Public Authority Air Conditioning	42.50	29.30	32.71
Industrial	109.25	67.30	84.01

¹⁶⁶ TGS Exhibit 29, Cummings Rebuttal at 63.

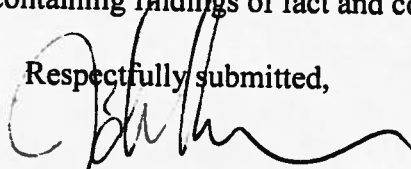
Industrial Transportation	200.00	150.00	300.50
Standby Service	162.50	150.00	125.00
Municipal Water Pumping	121.75	75.00	93.63

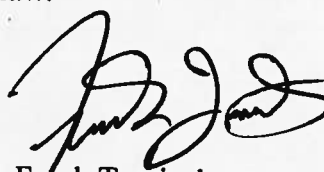
Examiners' Analysis and Recommendation

Both experts testified that their proposed rate designs are superior, more equitable, and promote more energy efficiency. With regard to energy efficiency, there is a recognized regulatory trend to try and decouple revenue recovery from energy usage. One method used to accomplish this goal is to design rates that recover more fixed costs through customer charges. The Commission has been approving higher minimum charges in order to recover more fixed costs. Dr. Cummings testified that if the Commission reduces the overall requested revenue requirement "in designing rates, I recommend that usage charges be adjusted with no change in the recommended customer charges for each customer class."¹⁶⁷ The Examiners are recommending a cost of service revenue requirement that is less than that originally requested. The Examiners are recommending that the Residential minimum customer charge be increased to \$11.90. This will allow for recovery of more fixed costs and the rates will be more decoupled from energy usage. This will prevent more cost volatility during the winter months and is more consistent with Commission trends and policy toward higher customer charges. As a result, the Examiners recommend keeping the same customer charges, except for Residential customers, that are currently in place and adjusting the volumetric rates to recover any revenue deficiency (or alternatively reduce revenues). Alternatively, the Examiners have prepared volumetric rates which maintain all current customer charges, including the current Residential customer charge and reflect volumetric rates based on a constant percentage increase across all customer classes.

The Examiners recommend that the Railroad Commission of Texas approve the attached Proposed Final Order containing findings of fact and conclusions of law.

Respectfully submitted,


John Chakales
Hearings Examiner
Office of General Counsel


Frank Tomicek
Technical Examiner
Gas Services Division

¹⁶⁷ TGS Exhibit 20, Cummings Direct at 51.

RAILROAD COMMISSION OF TEXAS

**PETITION OF THE DE NOVO REVIEW OF THE
DENIAL OF THE STATEMENTS OF INTENT FILED
BY TEXAS GAS SERVICE COMPANY BY THE
CITIES OF EL PASO, ANTHONY, CLINT, HORIZON
CITY, SOCORRO, AND VILLAGE OF VINTON,
TEXAS.**

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**GAS UTILITIES
DOCKET NO. 9988**

FINAL ORDER

Notice of Open Meeting to consider this Order was duly posted with the Secretary of State within the time period provided by law pursuant to TEX. GOV'T CODE ANN. Chapter 551, et seq. (Vernon 2004 & Supp. 2008). The Railroad Commission of Texas adopts the following findings of fact and conclusions of law and orders as follows:

FINDINGS OF FACT

1. Texas Gas Service Company ("TGS") is a utility as that term is defined in the Texas Utility Code, and is subject to the jurisdiction of the Railroad Commission of Texas ("Commission").
2. TGS owns and operates a gas distribution system that provides gas service to customers in its El Paso Service Area ("EPSA").
3. The EPSA includes the Cities of El Paso, Anthony, Clint, Horizon City, Socorro, and Vinton, Texas.
3. On May 12, 2010, TGS filed a Petition for Review with the Railroad Commission of Texas ("Commission") to appeal the rate-setting action of the City of El Paso, Texas ("El Paso" or the "City") which denied TGS' request for a rate increase within the jurisdiction of the City. This Petition for Review was docketed by the Commission as Gas Utilities Docket No. 9988. On May 24, 2010, TGS filed a Petition for Review appealing the rate-setting actions of the municipalities of Anthony, Clint, Horizon City, Socorro, and Vinton, Texas, which denied TGS' requests for rate increases within their respective municipal boundaries, and was docketed by the Commission as Gas Utilities Docket No. 9992.
4. The Hearings Examiner consolidated these GUD Nos. 9988 and 9992 into one docket pursuant to TEX. ADMIN. CODE §1.125 (1991) on June 3, 2010.
5. On June 3, 2010, Staff of the Railroad Commission of Texas ("Staff") intervened in this proceeding. On June 17, 2010, the State of Texas' agencies and institutions of higher learning, represented by the Attorney General of Texas, Consumer Protection Division ("State"), intervened

in this proceeding. On June 25, 2010, ArcelorMittal Vinton, Inc., intervened in this proceeding. No other parties and or individuals files letters of protest, objections, moved to intervene, or otherwise participated in this docket before the Commission.

6. The final hearing in this matter was conducted in Austin, Texas on August 31, 2010 through September 3, 2010.

7. By written agreement and as stated at the hearing TGS agreed to extend the statutory deadline for Commission action on this docket until December 16, 2010.

Rate Base

8. TGS adjusted its cost of service model for known and measurable changes through December 31, 2010. TGS included in its filing projected plant additions through June 30, 2010, and on June 25, 2010 updated this with actual plant-in-service balances for the months of April and May.

9. The June 25, 2010, filing reduced the Company's requested base rate revenue increase by \$195,617 and reduced gross plant to \$216,424,630 and net plant to \$138,008,370.

10. TGS' June 25, 2010, filing was reasonable because it updated projected data with actual in-service amounts, and was filed before the discovery period had ended, 6 weeks before intervenor testimony was due, and 9-1/2 weeks before the hearing on the merits, and therefore gave Staff of the Commission and intervenors appropriate notice of the updated data and time to review the data before the final hearing on the merits.

11. TGS did not conduct a lead-lag study for the underlying municipal rate request or this appeal. TGS proposes to use a zero Cash Working Capital balance and therefore no corresponding adjustment to its Rate Base.

12. It is reasonable under the circumstances of this proceeding for TGS to not conduct a lead-lag study and to utilize a zero Cash Working Capital balance because a zero balance is consistent with the applicable FERC rule regarding the absence of a lead-lag study; will result in lower rate case expenses; and had TGS conducted a lead-lag study there is a higher probability that it would have shown a positive balance as opposed to a negative balance. TGS would likely be able to calculate a positive CWC balance had the Company prepared a lead-lag study for this docket. It is therefore reasonable to request a zero balance CWC in lieu of conducting a lead-lag study and incurring the associated expense.

13. TGS proposal to allocate ADFIT using a net-plant based factor is reasonable because allocations based on gross plant may distort the proportion of each jurisdiction's responsibility for the ADFIT balance. Net-plant recognizes these factors and is the more appropriate basis to allocate ADFIT.

14. It is reasonable to reduce TGS' rate base by \$203,921 because the Commission previously approved an alternative method for the Company to recoup line extension costs through monthly surcharges billed to specific low-income residences. These costs are recouped over a longer period of time, on a monthly basis, with a lower rate impact. Because these costs are recovered through monthly tapping fees, they should not be included in TGS' rate base.

Capital Structure and Rate of Return

14. A capital structure of 40.76% common equity and 59.24% long-term debt is reasonable for TGS.

15. A cost of long-term debt for TGS of 6.21% is reasonable for TGS.

16. A cost of equity of 10.33% for TGS is reasonable.

17. A rate of return on invested capital of 8.65% is reasonable for TGS.

Expenses

18. TGS' proposed short-term incentive compensation expense is unreasonable because it primarily determines the amount of incentive compensation an employee is able to receive using factors that are not related to safety and uses methods related to the financial performance of its parent company, ONEOK, Inc. It is reasonable for TGS to recover 10 percent of its requested short term incentive compensation because 10 percent of the potential award is based on safety metrics.

19. TGS' proposed long-term incentive compensation expense is unreasonable because it primarily determines the amount of incentive compensation an employee is able to receive using factors that are not related to safety and uses methods related to the financial performance of its parent company, ONEOK, Inc.

20. TGS is requesting recovery of \$168,386 in expenses incurred for the Company's Supplemental Executive Retirement Plan ("SERP"). TGS' proposed SERP expense is unreasonable because it is not necessary for the provision of safe gas service to the public.

21. TGS is requesting recovery of \$113,091 in expenses incurred for the Company's Employee Stock Purchase Program ("ESPP"). TGS' ESPP expense is unreasonable because it is not necessary for the provision of safe gas service to the public.

22. TGS' alternative proposal to recover Pipeline Integrity Expenses through a separate tariff rider, coupled with regulatory review of the reasonableness and necessity of the costs incurred and passed through, is the best mechanism for recovery of these expenses and is reasonable.

23. TGS' proposed recovery of allocated corporate and division expenses are reasonable.

24. TGS' proposed use of the modified Distrigas Allocation Methodology is reasonable.
25. TGS proposes amortizing reserve imbalance over the remaining lives of the assets. This approach is reasonable and in accordance with rate-making principles
26. TGS' proposed injuries and damages expense is unreasonable. It is reasonable to normalize this expense over a four-year period of time and to reduce this amount by \$146,638 for establishing the Company's cost of service.

Revenues

27. During the 10-year period from 2000-2009, the sum of the deviations based on the 10-year measure of normal is zero Heating Degree Days for the El Paso Service Area. The sum of the deviations during the 2000-2009 period based on the 30-year measure of normal is negative 1,563 Heating Degree Days for the El Paso Service Area. The 10-year period is a more appropriate measure of ongoing weather conditions than the 30-year period for normalizing gas sales revenues.
28. TGS' proposal to normalize gas sales revenues for weather using a 10-year period is reasonable for the El Paso Service Area.
29. TGS' proposal to use the test year amount, updated to December 31, 2009, of \$1,192,680 for account 4880, Service Fees is reasonable for rate-making purposes because this value is reasonably representative of expected service fee revenue in the future and when the rates set in this proceeding are likely to be in effect.

Rate Design

30. TGS proposed using zero intercept study, checked by a minimum distribution system study, to allocate costs of distribution mains. The proposed methodology is reasonable and the resulting classification of distribution mains investment as 63.12 percent customer-related and 36.88 percent demand-related is reasonable.
31. TGS proposed classifying Transmission Plant as 100 percent demand related. Classifying Transmission Plant as 100 percent demand related is reasonable for the EPSA.
32. TGS's proposed rate designs are not reasonable. The rates, as shown on the attached rate schedule, consisting of a monthly customer charge and volumetric charges are reasonable.

CONCLUSIONS OF LAW

1. Texas Gas Service Company (TGS) is a "Gas Utility" as defined in TEX. UTIL. CODE ANN. §101.003(7) (Vernon 2007) and §121.001(2007) and is therefore subject to the jurisdiction of the Railroad Commission (Commission) of Texas.

2. The Railroad Commission of Texas (Commission) has jurisdiction over TGS and TGS' appeals under TEX. UTIL. CODE ANN. §§ 102.001, 103.022, 103.054, & 103.055, 104.001, 104.001 and 104.201 (Vernon 2007).
3. Under TEX. UTIL. CODE ANN. §102.001 (Vernon 2007), the Commission has exclusive original jurisdiction over the rates and services of a gas utility that distributes natural gas in areas outside of a municipality and over the rates and services of a gas utility that transmits, transports, delivers, or sells natural gas to a gas utility that distributes the gas to the public.
4. The Appeals were processed in accordance with the requirements of the Gas Utility regulatory Act (GURA), and the Administrative Procedure Act, TEX. GOV'T CODE ANN. §§2001.001-2001.902 (Vernon 2000 and Supp. 2004) (APA).
5. In accordance with the stated purpose of the Texas Utilities Code, Subtitle A, expressed under TEX. UTIL. CODE ANN. §101.002 (Vernon 1998), the Commission has assured that the rates, operations, and services established in this docket are just and reasonable to customers and to the utilities.
6. TEX. UTIL. CODE ANN. §104.107 (Vernon 2007) provides the Commission's authority to suspend the operation of the schedule of proposed rates for 150 days from the date the schedule would otherwise go into effect.
7. In accordance with TEX. UTIL. CODE §104.103 (Vernon 2007), 16 TEX. ADMIN. CODE ANN. §7.230 (2002), and 16 TEX. ADMIN. CODE ANN. §7.235 (2002), adequate notice was properly provided.
8. In accordance with the provisions of TEX. UTIL. CODE ANN. §104.102 (Vernon 1998 and Supp. 2003), 16 TEX. ADMIN. CODE ANN. §7.205 (2002), and 16 TEX. ADMIN. CODE §7.210 (2002), TGS filed its Statement of Intent to change rates.
9. TGS failed to meet its burden of proof in accordance with the provisions of TEX. UTIL. CODE ANN. §104.008 (Vernon 2007) on the elements of its requested rate increase identified in this order.
10. The revenue, rates, rate design, and service charges proposed by TGS are not found to be just and reasonable, not unreasonably preferential, prejudicial, or discriminatory, and are not sufficient, equitable, and consistent in application to each class of consumer, as required by TEX. UTIL. CODE ANN. §104.003 (Vernon 1998).
11. The revenue, rates, rate design, and service charges proposed by TGS, as amended by the Commission and identified in the schedules attached to this order, are just and reasonable, are not unreasonably preferential, prejudicial, or discriminatory, and are sufficient, equitable, and consistent in application to each class of consumer, as required by TEX. UTIL. CODE ANN. §104.003 (Vernon 1998).
12. The overall revenues as established by the findings of fact and attached schedules are reasonable; fix an overall level of revenues for TGS that will permit the company a reasonable

opportunity to earn a reasonable return on its invested capital used and useful in providing service to the public over and above its reasonable and necessary operating expenses, as required by TEX. UTIL. CODE ANN. § 104.051 (Vernon 1998); and otherwise comply with Chapter 104 of the Texas Utilities Code.

13. The revenue, rates, rate design, and service charges proposed will not yield to TGS more than a fair return on the adjusted value of the invested capital used and useful in rendering service to the public to the public, as required by TEX. UTIL. CODE ANN. § 104.052 (Vernon 1998).

14. The rates established in this docket comport with the requirements of TEX. UTIL. CODE ANN. § 104.053 (Vernon 1998) and are based upon the adjusted value of invested capital used and useful, where the adjusted value is a reasonable balance between the original cost, less depreciation, and current cost, less adjustment for present age and condition.

15. In accordance with TEX. UTIL. CODE ANN. § 104.054 (Vernon 1998) and TEX. ADMIN. CODE § 7.5252, book depreciation and amortization was calculated on a straight line basis over the useful life expectancy of TGS's property and facilities.

16. In this proceeding, TGS has the burden of proof under TEX. UTIL. CODE ANN. § 104.008 (Vernon 1998) to show that the proposed rate changes are just and reasonable.

17. Rate case expenses for GUD No. 9988 will be considered by the Commission in accordance with TEX. UTIL. CODE ANN. § 104.008 (Vernon 1998), and 16 TEX. ADMIN. CODE § 7.5530 (2002), in a separate proceeding.

18. All expenses for lost and unaccounted for gas in excess of 5.0 percent shall be disallowed, consistent with TEX. ADMIN. CODE § 7.5519 (2002).

19. TGS is required by 16 TEX. ADMIN. CODE § 7.315 (2002) to file electronic tariffs incorporating rates consistent with this Order within thirty days of the date of this Order.

20. The rate setting methodologies set forth in TEX. UTIL. CODE ANN. § 104.051 et seq. were used to set the rates in this proceeding.

IT IS THEREFORE ORDERED that Texas Gas Service Company's proposed schedule of rates is hereby **DENIED**.

IT IS FURTHER ORDERED that the rates, rate design, and service charges established in the findings of fact and conclusions of law and in the Examiners' Recommendation shown on the attached Schedules for Texas Gas Service Company are **APPROVED**.

IT IS FURTHER ORDERED that, in accordance with 16 TEX. ADMIN. CODE § 7.315, within 30 days of the date this Order is signed, Texas Gas Service Company shall file tariffs with the Gas Services Division. The tariffs shall incorporate rates, rate design, and service charges consistent with this Order,

as stated in the findings of fact and conclusions of law and shown in the Examiners' Recommendation on the attached Schedules.

IT IS FURTHER ORDERED that any proposed findings of fact and conclusions of law not specifically adopted herein are **DENIED**. **IT IS ALSO ORDERED** that each exception to the Examiners' Proposal for Decision not expressly granted herein is overruled and all pending motions and requests for relief not previously granted herein are hereby **DENIED**.

IT IS FURTHER ORDERED THAT TGS may begin surcharging rates for rate case expenses on and after the date of this Order. This Order will not be final and appealable until 20 days after a party is notified of the Commission's order. A party is presumed to have been notified of the Commission's order three days after the date on which the notice is actually mailed. If a timely motion for rehearing is filed by any party at interest, this order shall not become final and effective until such motion is overruled, or if such motion is granted, this order shall be subject to further action by the Commission. Pursuant to TEX. GOV'T CODE §2001.146(e), the time allotted for Commission action on a motion for rehearing in this case prior to its being overruled by operation of law, is hereby extended until 90 days from the date the order is served on the parties.

Each exception to the examiners' proposal for decision not expressly granted herein is overruled. All requested findings of fact and conclusions of law which are not expressly adopted herein are denied. All pending motions and requests for relief not previously granted or granted herein are denied.

SIGNED this ____ day of November, 2010.

RAILROAD COMMISSION OF TEXAS

CHAIRMAN VICTOR CARRILLO

COMMISSIONER ELIZABETH A. JONES

COMMISSIONER MICHAEL L. WILLIAMS

ATTEST:

SECRETARY

GUID No. 9988 (Cons)
Texas Gas Service - El Paso Service Area (EPSA) Appeal

Examiners Schedule B
Rate Base

Line No.	Description	From Schedule	Company Proposed Adjusted Test Year	El Paso Proposed	Examiner Recommended
			(a)	(b)	(c)
GROSS PLANT IN SERVICE					
1	Intangible Plant	C	\$195,755	\$195,755	\$195,755
2	Transmission Plant	C	1,205,865	1,205,865	1,205,865
3	Distribution Plant	C	189,692,524	186,980,880	189,488,603
4	General Plant	C	18,303,610	18,252,212	18,100,020
5	Completed Construction Not Classified	C-1	7,026,876	7,805,979	7,026,876
6	Gross Plant in Service		\$216,424,630	\$214,440,691	\$216,017,118
7	Net Depreciation & Amortization Reserves	D	(78,406,369)	(76,794,786)	(78,406,369)
8	Net Plant in Service		\$138,018,261	\$137,645,905	\$137,610,750
OTHER RATE BASE ITEMS					
9	Materials and Supplies Inventory		963,758	963,758	963,758
10	Prepayments		447,207	447,207	447,207
11	Cash Working Capital		0	(2,352,788)	0
NON-INVESTOR SUPPLIED FUNDS					
12	Customer Deposits - Test Year Direct		(4,940,418)	(4,940,418)	(4,940,418)
13	Customer Advances - Test Year Direct		(5,696,204)	(5,696,204)	(5,696,204)
14	Accumulated Deferred Taxes		(27,230,176)	(28,860,082)	(27,230,176)
15	Total Rate Base		\$101,562,430	\$97,207,379	\$101,154,918

GUD No. 9988 (Cons)
Texas Gas Service - El Paso Service Area (EPSA) Appeal

Examiners Schedule C
Capital Structure and Weighted Average Cost of Capital

TGS Proposed:

Line No.	Description	Ratio	Component Cost	Weighted Average Cost
		(a)	(b)	(c)
1	Long-Term Debt	40.76%	6.21%	2.53%
2	Common Equity	59.24%	11.00%	6.52%
3	Rate of Return	1.0000		9.05%

City Proposed:

Line No.	Description	Ratio	Component Cost	Weighted Average Cost
		(a)	(b)	(c)
1	Long-Term Debt	40.16%	6.21%	2.49%
2	Common Equity	59.84%	8.00%	4.79%
3	Rate of Return	1.0000		7.28%

Examiner Proposed:

Line No.	Description	Ratio	Component Cost	Weighted Average Cost
		(a)	(b)	(c)
1	Long-Term Debt	40.76%	6.21%	2.53%
2	Common Equity	59.24%	10.33%	6.12%
3	Rate of Return	1.0000		8.65%

GUD No. 9988 (Cons)
Texas Gas Service - El Paso Service Area (EPSA) Appeal

Examiners Schedule F
Allocation of Rate Increases

TGS Recommended:		Total	Residential	Commercial	Industrial
		\$ 5,120,945	\$ 5,186,290	\$ (68,562)	\$ (2,638)
	% Increase	13.87%	18.11%	-1.24%	-0.38%
City Recommended:					
		\$ (3,785,809)	\$ (1,234,005)	\$ (1,808,985)	\$ (416,522)
	% Increase	-10.24%	-4.35%	-32.37%	-59.17%
Special Contract Subsidy Distribution		\$ 383,338	\$ 113,462	\$ 166,330	\$ 38,298
Redistributed Rate Decrease			\$ (1,120,543)	\$ (1,642,655)	\$ (378,224)
Examiner Recommended:					
Option 1 - Cummings Allocation		\$ 1,060,874	\$ 2,857,910	\$ (1,362,460)	\$ (52,418)
	% Increase	2.87%	9.98%	-24.66%	-7.54%
Option 2 - Constant Rate All Classes		\$ 1,060,874	\$ 822,654	\$ 158,734	\$ 19,977
	% Increase	2.87%	2.87%	2.87%	2.87%

Public Authority	Water Pumping	Fort Bliss	Special Contract
\$ (18,441) -1.17%	\$ (749) -0.59%	\$ 25,045 6.82%	
\$ (633,230) -39.46%	\$ (61,261) -48.63%	\$ (15,144) -3.98%	\$ 383,338 201.31%
\$ 58,223	\$ 5,633	\$ 1,392	
\$ (575,007)	\$ (55,628)	\$ (13,752)	
\$ (366,464) -23.23%	\$ (14,879) -11.72%	\$ (815) -0.22%	
\$ 45,310 2.87%	\$ 3,647 2.87%	\$ 10,552 2.87%	

The Honorable Madeleine Praino
Mayor of the Village of Vinton
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