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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: G. Nanette Thompson, Chair
Bernie Smith
Patricia M. DeMarco
Will Abbott
James S. Strandberg

In the Matter of an Investigation into the 2000 Revenue Requirement and Cost of Service Studies Filed by ENSTAR NATURAL GAS COMPANY and ALASKA PIPELINE COMPANY) U-00-88
ORDER NO. 12

ORDER ESTABLISHING REVENUE REQUIREMENT, REQUIRING FILINGS, SCHEDULING PREHEARING CONFERENCE, AND AFFIRMING ELECTRONIC RULINGS

BY THE COMMISSION:

Summary

We establish a revenue requirement of \$107,603,164 for ENSTAR Natural Gas Company, a division of SEMCO Energy, Inc. (ENSTAR), and Alaska Pipeline Company (APC), a wholly owned subsidiary of SEMCO Energy, Inc., collectively referred to as ENSTAR. We approve an overall rate of return of 9.97 percent on an approved rate base of \$156,112,135. We computed the return on a hypothetical capital structure of 47.0 percent debt, 1.6 percent preferred stock, and 51.4 percent equity, with a 12.55 percent return on equity. We require ENSTAR to file updated cost-of-service and rate design data to the extent necessary to reflect these determinations, and we set a prehearing conference to schedule proceedings to determine the outstanding rate design issues. We affirm our electronic procedural rulings.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

1 Background

2 In compliance with Order U-99-93(1)/U-99-94(1), dated October 19,
3 1999, ENSTAR filed a 3 AAC 48.275(a) revenue requirement study (275(a) filing) and
4 3 AAC 48.275(h) cost-of-service and rate design studies based on test year 1999.¹
5 We later permitted ENSTAR to substitute test year 2000 data.² ENSTAR made its
6 275(a) filing based on test year 2000 on June 13, 2001 and subsequently updated its
7 filing on November 26, 2001 just prior to hearing.

8 We designated the PAS as a party to this proceeding.³ We also
9 permitted Aurora Power Resources (Aurora), Marathon Oil Company, and Marathon
10 Alaska Natural Gas Company to intervene as parties to this proceeding.⁴ We granted
11 the motion of the Public Advocacy Section (PAS) to bifurcate the proceedings to
12 consider the revenue requirement and the cost of service and rate design portions of
13 the case separately.⁵ Neither Aurora nor Marathon Oil Company participated in the
14 revenue requirement hearing although they informed us of their intent to participate in
15 the rate design portion of the proceeding.⁶

16 ¹Docket U-99-93 is entitled *In the Matter of the Application for Transfer of the*
17 *Certificate of Public Convenience and Necessity No. 4 to Operate as a Natural Gas*
18 *Distribution Public Utility from Ocean Energy, Inc. to SEMCO ENERGY, INC.* Docket
19 *U-99-94 is entitled In the Matter of the Application for Approval of the Transfer of*
20 *Control of Alaska Pipeline Company, Holder of Certificate of Public Convenience and*
Necessity No. 141 To Operate as a Natural Gas Pipeline, from Ocean Energy, Inc., to
SEMCO ENERGY, INC.

21 ²Order U-00-88(3), issued March 5, 2001.

22 ³Order U-00-88(1), issued November 8, 2000.

23 ⁴Order U-00-88(2), issued February 5, 2001.

24 ⁵Order U-00-88(7), issued May 1, 2001.

25 ⁶See Aurora's *Statement in Lieu of Prefiled Testimony and Witness List*, filed
26 September 26, 2001, and *Notice of Intervenor Marathon Oil Company's Letter*
Agreement to Address Gas Balance Issues and Intent Not to Participate in Revenue
Requirement Phase of Proceeding, filed December 3, 2001.

1 In support of its filings, ENSTAR filed the direct testimony and reply
2 testimony of Anthony M. Izzo,⁷ direct testimony of Steven W. Warsinske,⁸ direct
3 testimony and reply testimony of Daniel M. Dieckgraeff,⁹ and direct testimony and
4 reply testimony of Bruce H. Fairchild.¹⁰

5 The PAS filed responsive testimony of Timothy F. McConnell¹¹ and
6 Katherine C. Koch.¹²

7 With its statement of issues on November 26, 2001, ENSTAR made an
8 updated revenue requirement filing incorporating the PAS positions that ENSTAR
9 accepted.

10 The public hearing on this matter convened on December 4, 2001 and
11 adjourned on December 7, 2001. No members of the public appeared to offer
12 comments. During the hearing, ENSTAR and the PAS submitted Exhibit H-2
13 (Exh. H-2) to show adjustments the parties agreed upon to the revenue requirement
14 computed by the PAS.

15 We issued various electronic rulings extending filing deadlines and
16 allowing telephonic appearances at hearing.

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⁷T-1 and T-2 with Ex. AMI-1 through AMI-3.

⁸T-3 with Ex. SWW-1 through SWW-3.

⁹T-4 and T-5 with Ex. DMD-1 through DMD-12.

¹⁰T-6 and T-7 with Ex. BHF-1 through BHF-8.

¹¹T-8 with Ex. TFM-1 through TFM-5.

¹²T-9 with Ex. KCK-1 through KCK-22.

1 sometimes refer to costs appearing in more than one PAS schedule. For clarity of
2 analysis, we add back the \$35,905 ENSTAR removed.⁵¹ We address Schedules
3 KCK-6 through KCK-9 in the following sections.

4
5 Employee Appreciation Costs

6 ENSTAR argued that some of the expenses the PAS proposed to
7 exclude from both A&G and sales expense (Schedules KCK-9 and KCK-6,
8 respectively) are employee appreciation costs. ENSTAR argued that such measures
9 promote employee retention in a competitive environment, support employee morale,
10 and fall within the discretion of management.⁵²

11 The PAS argued that such expenses are not used and useful in
12 providing utility services.⁵³ The PAS stated that "intangible benefits" that are not
13 contractually defined could be discontinued after being used to inflate the revenue
14 requirement.⁵⁴

15 We disallow employee appreciation costs and intangible benefits that are
16 provided at the discretion of management. Such benefits and employee appreciation
17 costs are not the equivalent of salary increases or bonus payments and are not
18 necessary to provide utility service. Employee benefits that are not part of a
19 compensation package may be distributed or discontinued at the discretion of
20 management. Management decisions to grant or withhold such benefits, or the
21 generosity of those benefits, are subject to control of shareholders, but ratepayers
22 have no voice in those decisions. Therefore, we determine that employee

23 ⁵¹Appendix A, Schedule 4.

24 ⁵²T-5, pp. 3-4.

25 ⁵³T-9, p. 20.

26 ⁵⁴Tr. 658.

1 appreciation costs outside of salary or compensation benefits packages should be a
2 shareholder expense.

3
4 Meals and Bottled Water

5 ENSTAR contended that disallowance of meals and bottled water as
6 proposed by the PAS in schedules KCK-6 and KCK-9 is a radical departure from past
7 practice. ENSTAR argued that meals, snacks and bottled water should be allowed at
8 management discretion.⁵⁵ ENSTAR also argued that certain costs on schedule
9 KCK-9, such as bottled water in Soldotna where the supply is inadequate, were
10 necessary for employee health and safety.⁵⁶ ENSTAR also contended that its union
11 contract called for ENSTAR to supply meals in certain circumstances.⁵⁷

12 We have previously disallowed the costs of meals for ratemaking
13 purposes because they are not expenses associated with utility service.⁵⁸ In this
14 category, rates should include only costs that ENSTAR has justified as necessary by
15 showing, for example, that the expenses are required for the health and safety of
16 employees or are required by ENSTAR's union contract.

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20 ⁵⁵T-5, pp. 2-3.

21 ⁵⁶Tr. 349.

22 ⁵⁷T-5, p. 3.

23 ⁵⁸Orders Re: Simplified Rate Filings; Imposing Additional Reporting
24 Requirements; Affirming Bench Ruling Re: Confidentiality; and Denying Motion to
25 Supplement the Record, Order U-99-130, issued January 12, 2001 at p. 17.

26 Docket U-99-130 is entitled *In the Matter of the Investigation into the 1998
revenue Requirement Study Filed by MATANUSKA ELECTRIC ASSOCIATION, INC.,
and its Use of the Simplified Rate Filing Process under AS 42.05.381(e) and
3 AAC 48.700-3 AAC 48.790.*

