

STATE OF ALASKA

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BEFORE THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

Robert M. Pickett, Chairman
Paul F. Lisankie
T.W. Patch
Norman Rokeberg
Janis W. Wilson

In the Matter of the Consideration of the Revenue)
Requirement Designated as TA 262-4 Filed by)
ENSTAR NATURAL GAS COMPANY, A)
DIVISION OF SEMCO ENERGY, INC.)

Docket No. U-14-_____

PREFILED DIRECT TESTIMONY
OF
BRUCE H. FAIRCHILD

Date: 6-9-17 Exh # H-46
Regulatory Commission of Alaska

By: APS U-16-066
Northern Lights Realtime & Reporting, Inc.
(907) 337-2221

1 Q. Please state your name and business address.

2 A. Bruce H. Fairchild, 3907 Red River, Austin, Texas 78751.

3 Q. By whom are you employed and in what position?

4 A. I am a principal in Financial Concepts and Applications, Inc. (FINCAP), a firm engaged
5 in financial, economic, and policy consulting to business and government.

6 Q. Describe your educational background, professional qualifications, and prior
7 experience.

8 A. I hold a BBA degree from Southern Methodist University and MBA and PhD degrees
9 from the University of Texas at Austin. I am also a Certified Public Accountant. My
10 previous employment includes working in the Controller's Department at Sears,
11 Roebuck and Company and serving as Assistant Director of Economic Research at the
12 Public Utility Commission of Texas (PUCT). I have also been on the business school
13 faculties at the University of Colorado at Boulder and the University of Texas at Austin,

II. 3 AAC.275(h) Filing

1 Q. Please describe the purpose of this section of your testimony.

2 A. As indicated earlier, the purpose of this section is to present a COS study that allocates
3 ENSTAR's requested revenue requirement among its customer classes. Using the
4 results of the COS study, specific rates for ENSTAR's customer classes are developed.

A. Overview

5 Q. Would you briefly describe a COS study?

6 A. A COS study is an engineering, accounting, and economic analysis designed to allocate
7 a utility's total cost of providing service to specific customers or customer classes.
8 Many of a utility's operating expenses and much of its capital investment are incurred
9 to serve all customers, to a greater or lesser extent. Because these joint and common
10 costs cannot be directly tied to specific customers, they must be apportioned among
11 customers and/or customer classes. This apportionment is accomplished through a COS
12 study, in which operating and capital costs are allocated using factors developed from
13 various operating data reflecting cost causation. The sum of the costs allocated to each
14 customer and/or customer class in the COS study represents class revenue requirements,
15 or that portion of the utility's total costs for which a particular customer or customer
16 class is responsible.

17 Q. What guided ENSTAR's present 275(h) filing?

18 A. Because ENSTAR's current rates were arrived at through a negotiated settlement, the
19 present COS studies follows the methodology adopted in ENSTAR's last rate design
20 case, Docket U-00-88, which was generally patterned after that ordered in its previous
21 rate design case, Docket U-87-2.

22 Q. Please describe how the COS study was conducted.

1 A. The first step in conducting the COS study is to assign the components of ENSTAR's
2 requested revenue requirement and rate base to Federal Energy Regulatory Commission
3 (FERC) accounts. The next step is to examine each account to judge its nature and
4 cost-causal characteristics. This initially involves classifying a particular account as
5 primarily customer-related (*i.e.*, varying with the number of customers),
6 capacity-related (*i.e.*, varying with the need to meet peak demands), or
7 commodity-related (*i.e.*, varying with the amount of gas delivered). The manner in
8 which each operating and capital account is classified is identified in the COS studies
9 under the heading "Cost Classification."

10 The next step is to develop various allocation factors to reflect the responsibility
11 of each customer class for different costs based on cost-causal relationships. These
12 allocation factors are derived from usage, operating, and other data for the normalized
13 test year, and are intended to capture the relative contribution of each customer class to
14 the system as a whole. The allocation factor used to apportion each operating and
15 capital account between customer classes is identified in the COS studies under the
16 heading "Alloc. Factor." The details underlying the derivation of each allocation factor
17 are contained in separate pages of each COS study.

18 Finally, the amounts in each operating and capital account are allocated among
19 customer classes using the indicated allocation factor. The amounts allocated to each
20 customer class are then summed to calculate class revenue requirements.

21 **Q. Are there any features of the COS studies that are particularly noteworthy?**

22 A. Yes, there are three. *First*, most of ENSTAR's capacity-related costs, which are
23 primarily related to its transmission activities, are apportioned between customer classes
24 using an allocation factor calculated by weighting equally the relative contributions of

1 each customer class to the test year coincident system peak demand and the average day
2 demand, which is the equivalent of volumes. This is the same allocation used in
3 Dockets U-00-88 and U-87-2. The rationale for using an allocation factor reflecting
4 both coincident peak demand and average day demand is that ENSTAR's transmission
5 facilities were intended not just to meet customers' demands on peak days, but also to
6 improve access to gas supplies.

7 *Second*, in Docket U-87-2 approximately \$4.6 million of investment in Account
8 376 (Distribution Mains) was ascribed to power customers (*e.g.*, ML&P). This same
9 amount was carried forward and assigned to power and large volume transport
10 customers in the present COS studies, although it is now fully depreciated. Under the
11 premise that depreciation expense is intended to recover the original investment in
12 plant, large transmission customers no longer have responsibility for any depreciation
13 expense on Accounts 376 and 377 because the amount assigned them has been fully
14 recovered. Accordingly, a new allocation factor was developed that does not allocate
15 any Accounts 376 and 377 depreciation expense to large transmission customers.

16 *Third*, all general service customers, regardless of whether they are a sales
17 customer or served via transport, are included in their corresponding class for cost
18 allocation purposes. The reason for this is to maintain a uniform margin (*i.e.*, rate net of
19 gas costs) and avoid creating artificial incentives for customers to switch from one type
20 of service to another (*i.e.*, sales to transport, or *vice versa*).

21 **Q. What revenue requirement and rate base are allocated among ENSTAR's**
22 **customer classes in the COS study?**

23 **A.** The basis for the COS study is ENSTAR's requested revenue requirement and rate base
24 is summarized on page 4 of the 275(a) filing. However, these amounts are adjusted for