

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the Commission's own motion)
ordering **THE DETROIT EDISON COMPANY**)
to show cause why its retail rates for the sale)
and distribution of electric energy should not)
be decreased.)

Case No. U-14838

QUALIFICATIONS
AND
DIRECT TESTIMONY
OF
MARTIN L. HEISER

THE DETROIT EDISON COMPANY
QUALIFICATIONS OF MARTIN L. HEISER

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1 **Q. What is your name and business address, and by whom are you**
2 **employed?**

3 A. My name is Martin L. Heiser. My business address is 2000 Second Ave.,
4 Detroit, Michigan 48226. I am employed by The Detroit Edison Company.

5

6 **Q. What is your current position with Detroit Edison?**

7 A. I am a Consultant, Regulatory Economics in the Pricing Department of the
8 Regulatory Policy and Operations Organization.

9

10 **Q. What is your educational background?**

11 A. I graduated from the University of Michigan, Ann Arbor with a Bachelor of
12 Science Degree in Civil Engineering in 1981. In addition, I hold the degree
13 of Master of Business Administration with a concentration in Finance from
14 the University of Michigan, Dearborn, which I received in 1991.

15

16 **Q. Have you completed any other courses of study or attended any**
17 **professional seminars?**

18 A. Yes, I have completed numerous professional-level training courses
19 including the Edison Electric Institute's ("EEI") Fundamental and Advanced
20 Rate courses, National Economic Research Associates' Marginal Cost
21 Methods, the Financial Accounting Institute's General Finance and Utility
22 Finance & Accounting for Financial Professionals courses, Depreciation
23 Programs' Basic Depreciation Concepts course, EEI's Transmission Pricing
24 School, the University of Chicago's seminar on Pricing Strategy and Tactics,
25 and the University of Wisconsin's mini-course titled "The Wires Business."

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1

2 **Q. Do you belong to any professional organizations?**

3 A. Yes, I am a member of the Engineering Society of Detroit.

4

5 **Q. What is your employment history with Detroit Edison?**

6 A. I joined Detroit Edison in 1985 as an Associate Engineer in the Project
7 Controls Department at the Fermi 2 Nuclear Power Plant. I was responsible
8 for tracking the engineering budget and measuring the effectiveness of
9 management programs.

10

11 I was promoted to Engineer in 1987 and performed various functions
12 including the scheduling of daily maintenance, forced outage, and refueling
13 outage activities.

14

15 In 1991, I was promoted to the position of Senior Cost Analyst, Cost of
16 Service, which was part of Revenue Requirement until February of 1993
17 when the Cost of Service function was transferred to the Marketing & Sales
18 Organization. In 1994 my job was redefined as Pricing Analyst and included
19 in a new organization called Customer Energy Solutions. In March of 1998,
20 I returned to the Revenue Requirement Department and was promoted to
21 Principal Financial Analyst. In April of 2001, I joined the Pricing Department
22 and in November of 2002 was promoted to my current position.

23

24 **Q. What are your responsibilities in your current position in the Pricing**
25 **Department?**

26 A. I am responsible for performing cost of service studies, revenue requirement

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1 studies, economic analyses, depreciation studies, rate design and other
2 short and long-term financial evaluations. I am responsible for performing
3 embedded and marginal cost studies, and fully allocated class cost of
4 service studies.

6 **Q. Have you had any involvement in ratemaking activities?**

7 A. Yes. I have sponsored testimony before both the Michigan Public Service
8 Commission ("MPSC") and the Federal Energy Regulatory Commission
9 ("FERC"). At FERC, I sponsored testimony and exhibits in Docket No.
10 ER04-14-000 regarding the costs associated with Ancillary Services under
11 Detroit Edison's Ancillary Services Tariff ("DE AST"). I sponsored testimony
12 and exhibits in Docket No. ER00-3295-000 supporting the transmission
13 related revenue derived from Detroit Edison's bundled retail rates. I
14 supported testimony and exhibits in Docket No. OA96-78-000 regarding the
15 costs associated with Detroit Edison's Open Access Transmission Tariff
16 ("DE OATT"). In addition, I prepared portions of the cost of service study
17 filed in FERC Docket No. ER93-91-000 regarding a reduction in rates for
18 Detroit Edison's wholesale for resale customers.

20 At the MPSC, I have sponsored testimony and exhibits in Case No. U-
21 14399 regarding unbundling and realignment of rates, Case No. U-14474
22 regarding 2004 net stranded costs, Case No. U-13350 regarding net
23 stranded costs, Case No. U-13286 regarding unbundling of rates, Case No.
24 U-11724 regarding accounting approval of depreciation practices for the
25 Ludington Pumped Storage Plant, and during the rebuttal phase of Case
26 No. U-11722 regarding general depreciation practices for Detroit Edison. In

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1 support of other witnesses, I helped prepare exhibits and workpapers for
2 Detroit Edison's cost studies filed in the most recent general rate
3 proceeding, Case No. U-13808, as well as Detroit Edison's prior general
4 rate proceeding, Case No. U-10102, experimental retail wheeling Case No.
5 U-10176, and Detroit Edison's request for approval of a direct access tariff,
6 Case No. U-11452.

7

8 .

THE DETROIT EDISON COMPANY
DIRECT TESTIMONY OF MARTIN L. HEISER

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1 **Q. What is the purpose of your testimony?**

2 A. The purpose of my testimony is to present Cost of Service Studies for
3 Detroit Edison's 2005 Historic and 2007 Test years. These studies have
4 been prepared in response to the Commission's show cause order in Case
5 No. U-14838, issued March 23, 2006. I support jurisdictional separation on
6 certain revenue deficiency, income statement and rate base exhibits. In
7 addition, I supplied the Rider 2 revenue included by Mr. VanHaerents as
8 2007 Other Revenue to determine the change in revenue from 2005 to
9 2007.

10

11 **Q. Which Exhibits are you supporting?**

12 A. I am sponsoring in whole or in part, the following Exhibits:

13 **Section A - Historic Year Exhibits**

14	<u>Exhibit</u>	<u>Schedule</u>	<u>Description</u>
15	DE-1	A1	Revenue Deficiency (Sufficiency) – Total Electric and
16			Jurisdictional Electric
17	DE-2	B1	Rate Base – Total Electric and Jurisdictional Electric
18	DE-3	C1	Adjusted Net Operating Income – Total Electric and
19			Jurisdictional Electric
20	DE-5	E1	Cost of Service Summary - 2005
21	DE-5	E2	Functionalization Overview

22 **Section B - Projected Test Year Exhibits**

23	<u>Exhibit</u>	<u>Schedule</u>	<u>Description</u>
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1	DE-9	A1	Revenue Deficiency (Sufficiency) – Total Electric and
2			Jurisdictional Electric – for Year 2007
3	DE-10	B1	Rate Base – Total Electric and Jurisdictional Electric –
4			Average for Year 2007
5	DE-11	C1	Adjusted Net Operating Income – Total Electric and
6			Jurisdictional Electric for Year 2007
7	DE-13	E1	Cost of Service Summary – 2007

8

9 **Q. Were the portions of these exhibits for which you are responsible**
10 **prepared by you or under your direction?**

11 A. Yes, they were.

12

13 **Q. Did the Commission provide any direction regarding cost of service?**

14 A. Yes. The Commission stated that "For purposes of this filing, the parties
15 shall use the Cost of Service methodology used in the Commission's
16 December 22, 2005 order in Case No. U-14399."¹

17

18 **Q. Have you used the Cost of Service allocation methodology used in the**
19 **Commission's December 22, 2005 order in Case No. U-14399?**

20 A. Yes. The Commission adopted the Staff's Cost of Service Study
21 methodology in Case No. U-14399, and I have used that methodology in
22 this case.

23

¹ Order issued March 23, 2006 in Case No. U-13808 et. al., page 5.

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1 **Q. What is meant by “jurisdictional separation”?**

2 A. Jurisdictional separation is a product of the allocation process whereby the
3 revenue and costs associated with Detroit Edison's wholesale for resale
4 sales to wholesale requirements customers² (regulated by the FERC) are
5 separated from those associated with sales that fall under the jurisdiction of
6 the MPSC. These wholesale for resale customers are Michigan municipal
7 and cooperative utilities that purchase their power supply requirements from
8 Detroit Edison for resale to Michigan retail customers. The jurisdictional
9 electric column within the cost of service contains the portion of Detroit
10 Edison's total electric costs that fall under the MPSC jurisdiction.

11

12 **Q. What method was used for jurisdictional separation in Case No. U-**
13 **14399?**

14 A. Case No. U-14399 used as its starting point the jurisdictional revenue
15 requirement from the Order in Case No. U-13808. The jurisdictional
16 separation in that case was based on the 12 CP 75/25 allocation method for
17 allocating production plant as specified in the filing requirements from the
18 Order in Case No. U-4771. Also used in the U-13808 jurisdictional
19 separation were allocation methods that were not specified in the filing
20 requirements but had been longstanding accepted practice.

21

² Wholesale for resale sales requirements sales are included in the Company's Summer Capacity Plan.

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1 **Q. What method have you used to determine the jurisdictional separation**
2 **in this case?**

3 A. Consistent with the Commission's March 23rd order in this case, I have used
4 the same method adopted in case U-14399 to determine the jurisdictional
5 separation. The final jurisdictional separation is achieved via a jurisdictional
6 separation adjustment, the mechanics of which will be explained later in my
7 testimony. By means of this jurisdictional separation adjustment, I have
8 effectively used the same methodology that has been used for jurisdictional
9 separation in Detroit Edison's general rate cases³ filed with the MPSC over
10 the 30 years that have elapsed since the MPSC Order in Case No. U-4771.

11

12 **Q. Is there another reason to make the jurisdictional separation**
13 **adjustment?**

14 A. Yes, there is. Detroit Edison has long term contacts with its Wholesale for
15 Resale customers, most of which run to 2010/2011. Changing the
16 allocation methodology for jurisdictional separation would result in the
17 entrapment of costs. Also, the FERC uses a coincident peak methodology
18 (usually 12 CP or 4 CP) for allocating production costs within cost of service
19 studies, and to my knowledge has never accepted a 25%(4CPMH)/50%(On
20 Peak Energy)/ 25% (Total Energy) allocation of production costs.

21

22 **Q. Can you describe the Staff's Cost of Service allocation method?**

23 A. Yes. The Staff's allocation methodology determines how jurisdictional costs

³ MPSC Case Nos. U-13808, U-10102, U-8789, U-7660, U-6949, U-6006, U-5502, U-5108.

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1 are spread to the retail rate classes. The Staff's allocation methodology
2 changes adopted in Case U-14399 impacted the allocators used for power
3 supply and left unaltered those used for allocating distribution.
4 Specifically, production plant and the demand component of purchased
5 power expense were allocated using an allocation schedule consisting of 3
6 weighted components: 1) the average of the 4 monthly coincident peak
7 multi-hour demand⁴ (4CPMH) weighted 25%; 2) Detroit Edison's energy use
8 at point of system output coincident to the Midwest Independent System
9 Operator's (MISO's) on-peak period (7 am –11 pm) weighted 50%, and; 3)
10 Detroit Edison's total energy use at point of system output weighted 25%.
11 Further, the portion of each production O&M expense account that Detroit
12 Edison originally allocated using the average of the 12 monthly coincident
13 peak (CP) single hour demands was changed such that 33% was allocated
14 based on the average of the 4 monthly CP multi-hour demands and 67%
15 was allocated using Detroit Edison's energy use at point of system output
16 corresponding to MISO's on-peak period. In addition, 10% of fuel expense
17 was allocated using the average of the 4 monthly CP multi-hour demands
18 and the remaining 90% was allocated using energy⁵.

19

20 Section A – Historic Period

21 **Q. What is the source of the information used in the 2005 Historic Cost of**
22 **Service Study?**

⁴ The 4 peak months include June, July, August, and September. The multi-hour peak consists of an 8-hour period (noon – 8 pm).

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1 A. The books and records of the Company serve as the source of information
2 used in the 2005 Historic Cost of Service Study.

3

4 **Q. What is a fully allocated embedded unbundled cost of service study**
5 **(UCOS)?**

6 A. A UCOS allocates all items of utility property and cost to determine the fully
7 allocated embedded cost of service for each customer class of service and
8 shows each customer class' share of costs by major function (Power Supply
9 and Distribution).

10

11 **Q. What is the objective of a UCOS?**

12 A. The objective of a UCOS is to apportion all costs required to serve
13 customers among each customer class in a fair and equitable manner. This
14 is defined to be that allocation of costs which best reflects the engineering
15 and operating characteristics of the electric utility system and results in the
16 costs of the system being allocated to those who caused the costs to be
17 incurred.

18

19 **Q. How did you perform the UCOS for this case?**

20 A. The typical process to perform a UCOS consists of three steps:
21 functionalization, classification, and allocation. Functionalization assigns all
22 costs to the major functions, i.e. Power Supply and Distribution.
23 Classification divides these costs into customer-related costs, demand-

⁵ See Detroit Edison's response to Staff's Case No. U-14399 discovery request, STDE2.

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1 related costs, and energy-related costs. The sum of these three types of
2 costs within a given class is the cost to serve that class. In this case, I have
3 not formally classified the costs because the allocation methods employed
4 within the cost of service recognized and properly accounted for whether the
5 item being allocated was customer, demand, or energy related. Also,
6 classification beyond that implicit in the allocation methods was not required
7 for Mr. Falletich's rate design. The last step, allocation, apportions the cost
8 classifications to the respective classes of service based upon the class'
9 responsibility for the incurrence of these costs.

10

11 **FUNCTIONALIZATION**

12 **Q. After determining the inputs in the proper detail, what is the next step**
13 **in the UCOS?**

14 A. As I generally explained earlier in my testimony, the next step in performing
15 the UCOS is the process of functionalization.

16

17 **Q. What functions did you use in the cost study you are presenting?**

18 A. The major utility functions used in the cost study are Power Supply
19 (Generation and Transmission), and Distribution. Power Supply includes
20 costs associated with the Company's generating plants, fuel, purchased
21 power and the expense associated with transmission services provided to
22 Detroit Edison by the MISO and the International Transmission Company
23 (ITC). Distribution includes the costs associated with the Company's
24 distribution system that generally operates at voltages of 40 kV and below

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1 and includes customer service expenses.

2

3 **Q. How does the UCOS functionalize Detroit Edison's Costs?**

4 A. On Exhibit DE-5, Schedule E2, titled "Overview of Functionalization
5 Methodology," I present the approach I used to functionalize Edison's costs.
6 The MPSC Uniform System of Accounts (USofA) governs utility accounting
7 for ratemaking purposes and served as the basis for categorizing costs as
8 either direct or indirect. For example, the USofA requires utilities to record
9 generating plant costs in accounts 310 through 359 and the associated
10 O&M expense in accounts 500 through 557. These costs are directly
11 assigned to the power supply function. Similarly, there are accounts in
12 which the USofA requires utilities to record distribution plant and O&M costs
13 that are directly assigned to the distribution function.

14 The O&M cost in accounts associated with providing customer service
15 were directly assigned to distribution because they apply whether a
16 customer receives power supply from Detroit Edison or an alternative
17 electric supplier ("AES"). Because Detroit Edison has divested its
18 transmission plant, all that remains in the USofA's accounts designated for
19 transmission are the plant costs associated with generator step up
20 transformers. These costs are directly assigned to power supply. In
21 addition, power supply includes the expense charged to account 565
22 "Transmission of Electricity by Others" including MISO charges. The
23 property tax associated with production plant was directly assigned to power
24 supply based on tax information provided by the Property Tax Department.

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1 A share of the property tax associated with general and software plant was
2 allocated to power supply in proportion to the power supply-related general
3 and software plant and the remaining balance was assigned to distribution.
4 Indirect costs are comprised of general and intangible (software) plant costs
5 recorded in accounts 303 and 389 through 399, O&M expense in accounts
6 920 through 935, taxes, and working capital. The cost study also includes a
7 credit for miscellaneous revenue, which was applied to the appropriate
8 functional component based on a combination of direct assignment and
9 allocation.

10

11 **Q. How were the indirect costs functionalized?**

12 A. Indirect costs were functionalized using various methods depending on the
13 type of cost. General and software plant costs were functionalized using a
14 combination of direct assignment and allocation. Direct assignment of
15 general and software plant costs was based on the "business unit" field
16 found in the Company's property records. General and software plant for
17 which there was no assigned business unit was functionalized in proportion
18 to direct labor cost. Administrative and general ("A&G") expense was
19 functionalized using the same method as General plant and software. A&G
20 expense includes costs associated with corporate support. Working capital
21 was functionalized using allocators appropriate to each of the current asset
22 and liability line items. For example, fuel inventory was directly assigned to
23 power supply and accounts receivable was functionalized based on net
24 plant. Miscellaneous revenue was functionalized using a combination of

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1 direct assignment and allocation.

2

3 **Q. Why did you choose the method you used to functionalize general**
4 **plant and software costs?**

5 A. The National Association of Regulatory Utility Commissioners' 1992 Electric
6 Utility Cost Allocation Manual offers some alternative methods for allocating
7 general plant:

8 "One approach to the functionalization, classification, and
9 allocation of general plant is to assign the total dollar investment
10 on the same basis as the sum of the allocated investments in
11 production transmission and distribution plant. This type of
12 allocation rests on the theory that general plant supports the
13 other plant functions... Another suggested basis is the use of
14 operating labor ratios."⁶

15 The method I have selected directly assigns general and software plant
16 based on property records and uses labor ratios to assign the balance. This
17 method better represents the utilization of the resources being
18 functionalized than any single method suggested in the manual.

19

20 **Q. What method did you use to functionalize general and administrative**
21 **costs?**

22 A. I applied the same method used in Case No. U-14399. Specifically, I used
23 the allocator developed for general plant and software functionalization.

24

25 **Q. Were unbundled rates in effect for 2005?**

26 A. No, the unbundled rates approved by the Commission in Case No. U-14399

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1 did not become effective until February 1, 2006.

2

3 **Q. How were 2005 unbundled revenues derived?**

4 A. The 2005 unbundled revenues were provided by Mr. Falletich and were
5 estimated by multiplying 2005 billing determinants by the current unbundled
6 rates.

7

8 **ALLOCATION**

9 **Q. How does the UCOS you performed allocate costs to the various**
10 **customer classes?**

11 A. In general, the allocation schedules used for each function are intended to
12 reflect the load that utilizes the infrastructure associated with that function.
13 Specifically, the 2005 Power Supply Allocation Schedules conforming to the
14 Staff methodology were used to allocate power supply costs while the 2005
15 Distribution Allocation Schedules were used to allocate distribution costs.

16

17 **Q. What was the source of the allocation schedules used in the 2005**
18 **UCOS?**

19 A. The allocation schedules were supplied by Mr. Williamson pursuant to my
20 request.

21

22 **Q. Did the UCOS develop costs for each individual rate class?**

23 A. No, it did not. At Mr. Falletich's direction, some classes were consolidated.

⁶ National Association of Regulatory Utility Commissioners, January, 1992, page 105.

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1

2 **Q. Can you explain the allocation schedules used in the cost of service?**

3 A. Yes. The allocation schedules in the cost of service are either externally or
4 internally generated. The externally generated allocation schedules are
5 based on customer class parameters, such as the number of customers,
6 customer energy use and customer demand, and serve as inputs to the cost
7 of service. The internally generated allocation schedules were based on
8 previously allocated plant and/or expense. An example of an internal
9 allocation schedule is schedule 520 "Distribution plant in service." This
10 schedule reflects the sum of the class allocations of distribution plant in
11 service from each USofA account, some of which are further subdivided by
12 voltage level.

13

14 **Q. Did Mr. Williamson supply all of the externally generated allocation**
15 **schedules used in the cost of service?**

16 A. No, he did not. The cost of service utilizes ten basic externally generated
17 allocation schedules. Eight of these were developed and supplied by Mr.
18 Williamson and described in his testimony. I developed the other two
19 schedules. The first schedule that I developed is based on the number of
20 customers in each class, identified as Schedule 800. I based this schedule
21 on data taken from the billing system. The second schedule that I
22 developed is a meter allocation schedule 370. I developed this schedule
23 based on the number of meters associated with each class and the
24 approximate average cost of the metering equipment associated with each

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1 class.

2

3 **Q. Have you developed any other allocators for this case?**

4 A. Yes. In order to properly allocate the weather normalization adjustment, I
5 developed schedule 604. This schedule apportions the weather
6 normalization adjustment for each of the major classes identified on Exhibit
7 DE-3, Schedule C14, among the rates that comprise them. In addition, I
8 developed schedule 904 that represents the proportion of nuclear
9 decommissioning paid by each class. This schedule is used to allocate
10 nuclear decommissioning related items.

11

12 **Q. How did you allocate Distribution System costs within the UCOS?**

13 A. Generally, the direct distribution costs are allocated based on Schedules
14 201-205, and 300. The plant-related costs are allocated on the schedule
15 appropriate to the voltage level at which the equipment operates.
16 Generally, distribution O&M expense is allocated based on the
17 corresponding plant-related cost. For example, overhead lines maintenance
18 expense (account 593) is allocated based on the sum of plant-in-service for
19 poles and fixtures (account 364A), overhead conductors (account 365A),
20 and overhead services (account 369A). The cost of some components
21 within distribution, such as those associated with street lighting, are directly
22 assigned.

23

24 **Q. How did you allocate the indirect costs within the UCOS?**

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1 A. As stated in my discussion of functionalization, indirect costs are comprised
2 of general and software plant costs recorded in accounts 303 and 389
3 through 399, O&M expense in accounts 920 through 935 (A&G), taxes, and
4 working capital. The functionalized general and software plant costs were
5 allocated based on the corresponding functional plant in service. In other
6 words, the general and software plant costs associated with power supply
7 were allocated based on production plant in service and the general and
8 software costs associated with distribution were allocated based on
9 distribution plant in service. The functionalized A&G was allocated based
10 on the corresponding functional labor ratios. Property tax was allocated
11 based on the corresponding functional plant in service. Payroll taxes were
12 allocated based on the corresponding functional labor ratios. The working
13 capital allocations were driven by the numerous allocators associated with
14 each of the line items that comprise working capital, many of which are the
15 sum of several other lines.

16

17 **Q. Can you describe the portion of Exhibit DE-1 Schedule A1, "Revenue**
18 **Deficiency (Sufficiency) – Total Electric and Jurisdictional Electric" for**
19 **which you are responsible?**

20 A. Yes. I support the jurisdictional electric figures that appear in column (d).
21 These figures are based on the 2005 UCOS that is summarized in Exhibit
22 DE-5, Schedule E1. Line 16, column (d) shows that the Company
23 experienced an unadjusted jurisdictional electric revenue deficiency of \$29.1
24 million in 2005. Line 23, column (d) shows that the Company experienced

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1 an electric jurisdictional electric revenue deficiency of \$50.1 million for 2005
2 when adjusted for jurisdictional separation.

3

4 **Q. Can you describe the jurisdictional separation adjustment that**
5 **appears on line 21 of the Exhibit DE-1 Schedule A1?**

6 A. Yes. This adjustment is necessary to maintain the jurisdictional separation
7 methodology adopted in Case No. U-14399. That separation was
8 determined in Case No. U-13808 and was based on the allocation methods
9 specified in the filing requirements set forth in Case No. U-4771.

10

11 **Q. How did you determine the jurisdictional separation adjustment?**

12 A. I ran the cost of service using the allocation methods used in U-13808 and
13 in conformance with the U-4771 filing requirements. I then recorded the
14 revenue requirement associated with the Wholesale class. Next, I ran the
15 cost of service using the 4CP/25/50/25 methodology adopted by the
16 Commission in its Final Order in Case No. U-14399. The jurisdictional
17 separation adjustment of \$21.8 million is the amount necessary to restore
18 the Wholesale class revenue requirement to the level that results when the
19 jurisdictional separation is based on allocation methods consistent with that
20 in Case No. U-14399 (i.e. The methods used in U-13808 and consistent
21 with the U-4771 filing requirements.)

22

23 **Q. Can you describe the portion of Exhibit DE-2 Schedule B1, "Rate**
24 **Base" for which you are responsible?**

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1 A. Yes. I support the jurisdictional electric figures that appear in column (c).
2 These figures are based on the 2005 UCOS that is summarized in Exhibit
3 DE-5, Schedule E1.

4

5 **Q. Can you describe the portion of Exhibit DE-3, Schedule C1, “Adjusted**
6 **Net Operating Income – Total Electric and Jurisdictional Electric” for**
7 **which you are responsible?**

8 A. Yes. I support the jurisdictional electric figures that appear in column (m).
9 These figures are based on the 2005 UCOS that is summarized in Exhibit
10 DE-5, Schedule E1.

11

12 **Q. Can you describe Exhibit DE-5, Schedule E1, titled “Cost of Service**
13 **Summary - 2005”?**

14 A. Yes. Exhibit DE-5, Schedule E1, summarizes the results of the 2005
15 UCOS. It shows the cost of service associated with each major rate class.

16

17 **Q. Do the levels of investment shown in each of the distribution accounts**
18 **tie out to those shown in the Company’s 2005 P-521?**

19 A. Not entirely. Although the total distribution investment matches the
20 Company’s 2005 P-521, the levels of investment shown for some
21 distribution accounts do not. These accounts do not match because I had
22 to break out separately the cost of equipment that operates at
23 subtransmission voltage (24/40 kV) and apply allocation methods that
24 reflect the engineering and operating characteristics of the associated

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1 equipment and expense. This redistribution of investment to the accounts in
2 which it was classified prior to the Company's reclassification of 24/40 kV
3 from 350 series accounts (Transmission) to 360 accounts (Distribution) was
4 necessary to properly allocate the associated costs because a
5 reclassification for accounting purposes does not change the engineering
6 and operating characteristics of the associated equipment and expense.

7

8 **Q. Why did the Company reclassify the 24/40 kV investment in the first**
9 **place?**

10 A. This reclassification was the result of MPSC Case No. U-11337 and was
11 pursued to comply with the Company's interpretation of FERC Order 888.

12

13 **Q. Do you believe that the Exhibits you are supporting accurately follow**
14 **the Commission's prescribed methodology?**

15 A. Yes, I do.

16

17 **FORECAST PERIOD**

18 **Q. Can you generally describe your approach to conducting the 2007 Test**
19 **Year Cost of Service?**

20 A. Yes. The 2007 Test Year Cost of Service uses as its starting point the
21 Normalized 2005 Historic year Cost of Service. In order to produce revenue
22 deficiency/(sufficiency) values by function and rate class, I modified the
23 Normalized 2005 Historic Cost of Service as follows. I incorporated Mr.
24 Williamson's 2007 allocation schedules. I added the known and measurable

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1 changes to ratebase comprised of additions to net utility plant and a decline
2 in working capital. I used the 2007 weighted average cost of capital and
3 revenue multiplier supported by Mr. Horgan. I added the net operating
4 income adjustments associated with the known and measurable changes
5 identified by Mr. VanHaerents and supported by other witnesses.

6

7 **Section B - Functionalization of Known & Measurable Changes**

8

9 **Q. How did you functionalize the additions to net utility plant?**

10 A. I functionalized the additions to net utility plant based on the business unit
11 that made the capital expenditures. Power Supply was assigned the capital
12 expenditures associated with Nuclear Generation, Fossil Production, Fuel
13 Supply, and Environmental. Distribution was assigned the capital
14 expenditures associated with Distribution Operations. Corporate Support
15 was functionally allocated in a manner consistent with the methodology
16 used in Case No. U-14399.

17

18 **Q. How did you functionalize the decline in working capital?**

19 A. I functionalized the decline in working capital by splitting the change in each
20 working capital line item from the balance sheet in a manner consistent with
21 the methodology used in Case No. U-14399.

22

23 **Q. How were the changes in total revenue-related net operating income**
24 **(NOI) functionalized?**

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1 A. The change in base revenue was functionalized such that the sum of the
2 2005 distribution revenue and the change in distribution revenue equaled
3 Mr. Falletich's 2007 present distribution revenue. The change in
4 Interconnection, MERC, Wholesale, and Other revenue (comprised primarily
5 of the provision for PSCR refunds) were directly assigned to Power Supply.
6 Rider 2 revenue was assigned to distribution.

7

8 **Q. How was the change in normalizing revenue NOI adjustments**
9 **functionalized?**

10 A. Both the NOI adjustment to reflect the base rate portion of Residential Rate
11 Caps removal and for Weather Normalization were functionalized based on
12 2005 revenue. The NOI adjustment to reflect the PSCR portion of
13 Residential Rate Caps removal, the Elimination of Regulatory Asset
14 Operating Income, and the elimination of Securitization Tax were all directly
15 assigned to Power Supply. This direct assignment of the change in
16 normalizing revenue NOI adjustments to Power Supply matches the
17 functional assignment of associated costs for these items.

18

19 **Q. How were the remaining known and measurable changes to NOI**
20 **functionalized?**

21 A. The changes in Fuel and Purchased Power, Net Regulatory Assets, and
22 AFUDC were directly assigned to Power Supply. The change in O&M was
23 functionalized using a combination of direct assignments and allocations.
24 Direct assignments were made based on the organization reporting the

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1 change in O&M. Specifically, the changes associated with Nuclear
2 Generation, Fossil Production, Environmental, and MERC were assigned to
3 Power Supply. The changes associated with Distribution Operations and
4 Customer Service were assigned to Distribution. The changes in benefits
5 fall into two categories; the change in benefits associated with the
6 performance excellence process (PEP) and those associated with special
7 projects. The changes in benefits associated with PEP were functionally
8 allocated based on the directly assigned changes in O&M. The changes in
9 benefits associated with special projects and those associated with
10 Corporate Support were allocated in a manner consistent with the
11 methodology used in Case No U-14399.

12 The changes associated with Depreciation and Amortization, Property
13 and Other Taxes, Income Tax Effect of Interest, and Interest
14 Synchronization were all functionalized based on the functional percentage
15 of capital expenditures. The change in federal income tax was functionally
16 allocated based on functional revenue.

17

18 **Q. Can you describe the portion of Exhibit DE-9, Schedule A1, "Revenue**
19 **Deficiency (Sufficiency) – Total Electric and Jurisdictional Electric –**
20 **for Year 2007" for which you are responsible?**

21 A. Yes. I am responsible for the jurisdictional electric values that appear in
22 column (d) of this exhibit. These figures are based on the 2007 UCOS that
23 is summarized in Exhibit DE-13, Schedule E1. Line 16, column (d) shows
24 that the Company will experience an unadjusted jurisdictional electric

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1 revenue deficiency of \$20.4 million in 2007. Line 23, column (d) shows that
2 the Company will experience a jurisdictional electric revenue deficiency of
3 \$45.3 million when adjusted for jurisdictional separation. The 2007
4 jurisdictional separation adjustment of \$24.9 million appears on line 21,
5 column (d). This adjustment was determined in the same manner as that
6 for Section A, (i.e. I re-ran the cost of service consistent with the allocation
7 methods used in Case No. U-13808 and in conformance with the U-4771
8 filing requirements. I then compared the resulting Wholesale class revenue
9 requirement to that which results using the 4CP/25/50/25 methodology
10 adopted by the Commission in its Final Order in Case No. U-14399). The
11 \$24.9 million is the amount necessary to restore the Wholesale class
12 revenue requirement to the level that results when U-4771 filing
13 requirements are utilized. As described in my discussion of Exhibit DE-1,
14 Schedule A1, in Section A, this adjustment is necessary to maintain the
15 jurisdictional separation that was adopted in Case No. U-14399.

16

17 **Q. Can you describe the portion of Exhibit DE-10, Schedule B1, “Rate**
18 **Base – Total Electric and Jurisdictional Electric – Average for Year**
19 **2007” for which you are responsible?**

20 A. Yes. I am responsible for the jurisdictional electric values that appear in
21 column (d) of this exhibit. These figures are based on the 2007 UCOS that
22 is summarized in Exhibit DE-13, Schedule E1.

23

24 **Q. Can you describe the portion of Exhibit DE-11, Schedule C1, “Adjusted**

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1 **Net Operating Income – Total Electric and Jurisdictional Electric for**
2 **Year 2007” for which you are responsible?**

3 A. Yes. I am responsible for the jurisdictional electric values that appear in
4 column (d) of this exhibit. These figures are based on the 2007 UCOS that
5 is summarized in Exhibit DE-13, Schedule E1. The line 2, column (m), 2005
6 normalized jurisdictional NOI used as the starting point is different than that
7 found in Section A. This is due to the re-allocation of costs using 2007
8 allocation factors. This reallocation was necessary in order to properly
9 reflect the changes in class consumption that accompany the return to full
10 service in 2007 by customers that were participating in the Electric Choice
11 program in 2005.

12

13 **Q. Can you describe the Exhibit DE-13, Schedule E1, “Cost of Service**
14 **Summary – 2007”?**

15 A. Yes. Exhibit DE-13 summarizes the results of the 2007 UCOS. It shows
16 the cost of service associated with each major rate class.

17

18 **Q. Does this conclude your testimony?**

19 A. Yes, it does.

20