ORIGINAL

0000141282

BEFORE THE ARIZONA CORPORATION C

COMMISSIONERS
BOB STUMP - Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

AZ CORP COMMISSION
DOCKET CONTROL

2013 JAN 7 P 2 00

IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	DOCKET NO. E-01933A-12-0291 **STAFF'S NOTICE OF ERRATA**

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") files this notice of errata regarding the direct testimony of Ralph C. Smith:

1. Attachment RCS-5, Copies of Regulatory Commission Order Excerpts Addressing Sharing of Directors & Officers Liability Insurance Cost Between Shareholders and Ratepayers.
2. Attachment RCS-6, Excerpts from Southwest Gas Corporation's August 31, 2012 Rebuttal Testimony of Theodore K. Wood in Nevada Public Utilities Commission Case Nos. 12-02019 and 12-04005.

The attachments were inadvertently omitted when Ralph Smith's direct testimony was filed on December 21, 2012.

RESPECTFULLY SUBMITTED this 7th day of January, 2013.

Arizona Corporation Commission
DOCKETED
JAN 07 2013
DOCKETED BY TM

Robin R. Mitchell, Staff Attorney
Charles H. Hains, Staff Attorney
Brian E. Smith, Staff Attorney
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Original and thirteen (13) copies of the foregoing were filed this 7th day of January, 2013 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Copies of the foregoing were mailed and/or emailed this 7th day of January, 2013 to:

Bradley S. Carroll
Tucson Electric Power Company
88 E. Broadway Blvd., MS HQE910
P.O. Box 711
Tucson, Arizona 85702
Attorney for Tucson Electric Power
bcarroll@tep.com

Michael W. Patten
ROSHKA DEWULF & PATTEN, PLC
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004
Attorney for Tucson Electric Power
mpatten@rdp-law.com

Lawrence V. Robertson, Jr.
Attorney at Law
P.O. Box 1448
Tubac, Arizona 85646
Attorney for Southern Arizona Homebuilders Association (SAHBA) and EnerNOC, Inc. and Southern Arizona Water Users Association (SAWUA)
TubacLawyer@aol.com

Daniel Pozefsky
Chief Counsel
Residential Utility Consumer Office
1110 West Washington, Suite 220
Phoenix, Arizona 85007
dpozefsky@ruco.gov

C. Webb Crockett
Patrick J. Black
FENNEMORE CRAIG, P.C.
3003 North Central Avenue
Suite 2600
Phoenix, Arizona 85012-2913
Attorneys for Freeport-McMoRan and AECC
wcrockett@fclaw.com
pblack@fclaw.com

Kevin C. Higgins, Principal
Energy Strategies, LLC
215 South State Street
Suite 200
Salt Lake City, Utah 84111
Consultant to Freeport-McMorRan and AECC
KHiggins@Energystrat.com

Kurt J. Boehm
Jody M. Kyler
BOEHM, KURTZ & LOWRY
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202
Attorneys for Kroger
kboehm@BKLlawfirm.com
jkyler@BKLlawfirm.com

John William Moore, Jr.
MOORE, BENHAM & BEAVER
7321 North 16th Street
Phoenix, Arizona 85020
Attorney for Kroger Co.
jmoore@mbmblaw.com

Stephen J. Baron
J. Kennedy & Associates
570 Colonial Park Drive, Suite 305
Roswell, Georgia 30075
Consultant to Kroger Co.
sbaron@jkenn.com

Thomas L. Mumaw
Melissa Krueger
Pinnacle West Capital Corporation
P.O. Box 53999, MS 8695
Phoenix, Arizona 85072-3999
Thomas.Mumaw@pinnaclewest.com
Melissa.Krueger@pinnaclewest.com

Leland Snook
Zachary J. Fryer
Arizona Public Service Company
P.O. Box 53999, MS 9708
Phoenix, Arizona 85072-3999
Leland.Snook@aps.com
Zachary.Fryer@aps.com

Timothy M. Hogan
ARIZONA CENTER FOR LAW IN THE PUBLIC INTEREST
202 E. McDowell Road, Suite 153
Phoenix, Arizona 85004
Attorneys for SWEEP and Vote Solar Initiative
thogan@aclpi.org

Jeff Schlegel
SWEEP Arizona Representative
1167 W. Smalayuca Drive
Tucson, Arizona 85704-3224
schlegelj@aol.com

Annie C. Lappe
Rick Gilliam
The Vote Solar Initiative
1120 Pearl Street, Suite 200
Boulder, Colorado 80302
annie@votesolar.org
rick@votesolar.org

Nicholas J. Enoch
Jarrett J. Haskovec
LUBIN & ENOCH, P.C.
349 North Fourth Avenue
Phoenix, Arizona 85003
Attorneys for IBEW Local 1116
Nick@lubinandenoch.com
Jarrett@lubinandenoch.com

Travis Ritchie
Sierra Club Environmental Law Program
85 Second St., 2nd Floor
San Francisco, CA 94105
Attorney for Sierra Club
travis.ritchie@sierraclub.org

Terrance A. Spann
General Attorney
Regulatory Law Office (JALS-RL/IP)
Office of the Judge Advocate General
U.S. Army Legal Services Agency
9275 Gunston Road, Suite 1300
Fort Belvoir, VA 22060-5546
terrance.a.spann.civ@mail.mil

Michael M. Grant
GALLAGHER & KENNEDY, P.A.
2575 East Camelback Road
Phoenix, AZ 85016-9225
Attorneys for AIC
mmg@gknet.com

Gary Yaquinto
President and CEO
Arizona Investment Council
2100 North Central Avenue, Suite 210
Phoenix, AZ 85004
gyaquinto@arizonaic.org

Cynthia Zwick
1940 E. Luke Avenue
Phoenix, AZ 85016
czwick@azcaa.org

Court S. Rich
ROSE LAW GROUP, PC
6613 N. Scottsdale Road, Suite 200
Scottsdale, AZ 85250
Attorney for Solar Energy Industries Association (SEIA)
crich@roselawgroup.com

Michael L. Neary
Executive Director
Arizona Solar Energy Industries Association (AriSEIA)
111 W. Renee Dr.
Phoenix, AZ 85027
mneary@arizonasolarindustry.org

Ashley Hodge

ATTACHMENT RCS-5

Tucson Electric Power Company
Docket No. E-01933A-12-0291
Attachment RCS-5
Copies of Regulatory Commission Order Excerpts Addressing Sharing of Directors & Officers Liability Insurance Cost Between Shareholders and Ratepayers

Jurisdiction	Docket No.	Order Date	Utility	No. of Pages	Page No.
Florida	090079-EI; 090144-EI; 090145-EI	March 5, 2010	Progress Energy Florida, Inc.	4	2 - 5
Connecticut	08-07-04	February 4, 2009	United Illuminating Company	3	6 - 8
Connecticut	07-07-01	January 28, 2008	Connecticut Light and Power Company	3	9 - 11
Connecticut	05-06-04	January 27, 2006	United Illuminating Company	3	12 - 14
Connecticut	03-07-02	December 17, 2003	Connecticut Light and Power Company	3	15 - 17
Connecticut	98-1-02	February 5, 1999	Connecticut Light and Power Company	2	18 - 19
Connecticut	99-09-03	May 25, 2000	Connecticut Natural Gas Corporation	3	20 - 22
Arkansas	06-101-U	June 15, 2007	Entergy Arkansas, Inc.	3	23 - 25
Arkansas	04-121-U	September 19, 2005	Centerpoint Energy Resources Corp	3	26 - 28
Arkansas	04-176-U	October 31, 2005	Arkansas Western Gas Company	3	29 - 31
			Total Pages Including this Page	31	

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for increase in rates by Progress Energy Florida, Inc.	DOCKET NO. 090079-EI
In re: Petition for limited proceeding to include Bartow repowering project in base rates, by Progress Energy Florida, Inc.	DOCKET NO. 090144-EI
In re: Petition for expedited approval of the deferral of pension expenses, authorization to charge storm hardening expenses to the storm damage reserve, and variance from or waiver of Rule 25-6.0143(1)(c), (d), and (f), F.A.C., by Progress Energy Florida, Inc.	DOCKET NO. 090145-EI ORDER NO. PSC-10-0131-FOF-EI ISSUED: March 5, 2010

The following Commissioners participated in the disposition of this matter:

NANCY ARGENZIANO, Chairman
LISA POLAK EDGAR
NATHAN A. SKOP
DAVID E. KLEMENT
BEN A. "STEVE" STEVENS III

APPEARANCES:

R. ALEXANDER GLENN, JOHN T. BURNETT, ESQUIRES, Progress Energy Service Company, LLC, P.O. Box 14042, St. Petersburg, Florida 33733-4042; JAMES MICHAEL WALLS, DIANNE M. TRIPLETT, and MATTHEW BERNIER, ESQUIRES, Carlton Fields, P.A., Post Office Box 3239, Tampa, Florida 33601-3239; RICHARD D. MELSON, ESQUIRE, 705 Piedmont Drive, Tallahassee, Florida 32312
On behalf of Progress Energy Florida, Inc. (PEF).

CHARLES REHWINKEL, Associate Public Counsel, CHARLIE BECK, Deputy Public Counsel, and PATRICIA A. CHRISTENSEN, Associate Public Counsel, ESQUIRES, Office of the Public Counsel, c/o the Florida Legislature, 111 West Madison Street, Room 812, Tallahassee, Florida 32399-1400
On behalf of the Citizens of the State of Florida (OPC).

STEPHANIE ALEXANDER, ESQUIRE, 200 West 200 West College Avenue, Suite 216, Tallahassee, Florida 32301
On behalf of the Florida Association for Fairness in Rate Making (AFFIRM).

costs have been removed. Accordingly, we find that PEF has made the appropriate adjustments to remove aviation cost for the test year.

H. Advertising Expenses

PEF removed promotional advertising costs in the amount of $3,388,000, as reflected in MFR Schedule C-2. The jurisdictional amount, net of tax, is $2,081,000. The explanation given by PEF is to exclude the cost of promotional advertising in order to comply with our guidelines.

We note an excerpt from the procedures followed by our auditors for the 2008 base year:

> We reviewed additional samples of utility advertising expenses, industry dues, economic development expenses, outside services, sales expenses, customer service expenses and administrative and general service expenses to ensure that amounts supporting non-utility operations were removed.

The Company's advertising expense is one of the areas specifically examined by our auditors. There were no findings with respect to this issue. Therefore, we find that PEF has made the appropriate adjustments to remove advertising expenses for the test year.

I. Directors and Officers (D&O) Liability Insurance

PEF argued that OPC witness Schultz is incorrect in his assertion that D&O liability insurance does not benefit ratepayers, and thus should be disallowed. PEF cited to the most recent TECO case in which this Commission decided that D&O liability insurance is a necessary and reasonable business expense and is appropriately included in customers' rates.[40] PEF asserted that we have already rejected the argument that Mr. Schultz raises in other cases and there is no valid reason for us to depart from its previous findings in this case.

OPC witness Schultz questioned whether the cost of D&O liability insurance is a necessary and appropriate expense to pass on to ratepayers. He stated that the expense protects shareholders from the decisions they made when they hired the Company's Board of Directors and the Board of Directors in turn hired the officers of the Company. He noted that the Company included $2.2 million in Account 925 for D&O liability insurance, but he believes the correct amount to be $2,750,650 for $300,000,000 in coverage. He disagreed with our recent Peoples Gas case in which the expense was allowed as a legitimate business expense.[41] The witness testified that the pertinent issue is whether the cost is beneficial to ratepayers, not whether it is a legitimate business expense. He stated that we have disallowed the cost in the past.

OPC witness Schultz testified that other jurisdictions have disallowed the expense. He stated, for example, that a Connecticut decision limited recovery by Connecticut Light and

[40] Order No. PSC-09-0283-FOF-EI, issued April 30, 2009, in Docket No. 080317-EI, In re: Petition for rate increase by Tampa Electric Company, p. 64.
[41] Order No. PSC-09-0411-FOF-GU, issued June 9, 2009, in Docket No. 080318-GU, In re: Petition for rate increase by Peoples Gas System, p. 37-38.

Power to thirty percent, because ratepayers should not be required to protect shareholders from the decisions they make in electing the Board of Directors. He added that Consolidated Edison was not allowed to recover the full amount in a New York case. He explained that the disallowance was due to excessive coverage in part, and that a portion of the amount found to be reasonable was also disallowed. He stated the reason for the additional disallowance was that D&O Liability insurance provides protection to shareholders from matters in which the customers have no influence.

OPC witness Schultz recommended disallowance of the total cost of D&O liability insurance of $2,750,650 ($2,412,100 jurisdictional) because the purpose of the insurance is to protect shareholders, not ratepayers. He stated that he does not take the position that the Company should not have the insurance, but that it should be paid for by those who benefit from the insurance; that is, the shareholders.

OPC argued that PEF did not offer any testimony in rebuttal to OPC witness Schultz that the D&O liability insurance should be disallowed. OPC stated that, in each of the cases cited by witness Schultz in his testimony, the Company argued that D&O liability insurance is a necessary and prudent cost required to attract and retain competent directors and officers, yet a disallowance was made. OPC challenged the cost for $300,000,000 of coverage as being excessive, and questioned whether the cost for that level of coverage is appropriate to pass on to ratepayers.

OPC noted in particular a Consolidated Edison Company Case. OPC stated that in the final decision, the New York Commission (NYC) ruled that $300,000,000 of coverage was excessive based on the comparisons to similar companies and disallowed the premium associated with $100,000,000 excess, and then disallowed 50 percent of the premium associated with the $200,000,000 that was determined to be reasonable. OPC stated that, in the discussion, the NYC noted that D&O insurance provides substantial protection to shareholders who elect directors and have influence over whether competent directors and officers are in place, while customers have no influence. OPC noted that the NYC further stated at page 91 of its order that:

> We find no particularly good way to distinguish and quantify the benefits of D&O insurance to ratepayers from the benefits to shareholders, especially taking into account the advantage that shareholders have in control over directors and officers. We believe the fairest and most reasonable way to apportion the cost of D&O insurance therefore is to share it equally between ratepayers and shareholders.

FIPUG argued that the amount should be disallowed, because the expense directly benefits only PEF's shareholders.

We agree with OPC witness Schultz that this Commission has disallowed D&O insurance in water and wastewater cases in the past.[42] We do not agree with OPC that the ratepayers do not

---

[42] See Order Nos. PSC-09-0385-FOF-WS, issued May 29, 2009, in Docket No. 080121-WS, In re: Application for increase in water and wastewater rates in Alachua, Brevard, DeSoto, Highlands, Lake, Lee, Marion, Orange, Palm

benefit from D&O liability insurance. We believe that D&O liability insurance has become a necessary part of conducting business for any company or organization and it would be difficult for companies to attract and retain competent directors and officers with out it. We also believe that ratepayers receive benefits from being part of a large public company, such as easier access to capital which may result in lower rates. As stated in the TECO order:

> We find that [D&O liability] insurance is a part of doing business for a publicly-owned Company. It is necessary to attract and retain competent directors and officers. Corporate surveys indicate that virtually all public entities maintain [D&O liability] insurance, including investor-owned electric utilities. . . . We do not agree with OPC that the ratepayers do not benefit from [D&O liability] insurance. It is not realistic to expect a large public company to operate effectively without [D&O liability] insurance.[43]

We agree with PEF that the amount of the D&O liability insurance provided in discovery responses is $2.2 million, not $2.75 million as adjusted by OPC witness Schultz. However, we note that the amount of the premium for the test year is projected to be higher than the premium for 2008-2009, but lower than the previous three years, even though the amount of coverage was increased from $280 million to $300 million.

In summary, we believe that D&O liability insurance has become a necessary part of conducting business for any publicly owned company and it would be difficult for companies to attract and retain competent directors and officers without it. We also believe that ratepayers receive benefits from being part of a large public company including, among other things, easier access to capital. Because D&O liability insurance benefits both the ratepayer and the shareholder, it should be a shared cost. Thus, we find that O&M expense shall be reduced by $964,913 jurisdictional to reflect the sharing of costs between the ratepayers and the shareholders.

J. Injuries and Damages Expense

PEF stated that FERC Account 925 on MFR Schedule C-4, p. 44 of 48, reflects an expense of $8,882,000 for injuries and expenses. PEF stated that the numbers were audited by our auditors who reconciled the amounts on the MFRs for 2008 expenses to the Company's actual book and records. PEF stated that it based its 2010 budget for injuries and damages expense on the Company's actual historical 2008 expenses. PEF argued that it is, therefore, entitled to recover this expense.

Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc., p. 81; PSC-07-0505-SC-WS, issued June 13, 2007, in Docket No. 060253-WS, In re: Application for increase in water and wastewater rates in Marion, Orange, Pasco, Pinellas, and Seminole Counties by Utilities, Inc. of Florida, p.44; PSC-03-1440-FOF-WS, issued December 22, 2003, in Docket No. 020071-WS, In re: Application for rate increase in Marion, Orange, Pasco, Pinellas, and Seminole Counties by Utilities, Inc. of Florida, p. 84; and PSC-99-1912-FOF-SU, issued September 27, 1999, in Docket No. 971065-SU, In re: Application for rate increase in Pinellas County by Mid-County Services, Inc., p. 20-22.

[43] Order No. PSC-09-0283-FOF-EI, issued April 30, 2009, in Docket No. 080317-EI, In re: Petition for rate increase by Tampa Electric Company, p. 64.

STATE OF CONNECTICUT

**DEPARTMENT OF PUBLIC UTILITY CONTROL
TEN FRANKLIN SQUARE
NEW BRITAIN, CT 06051**

DOCKET NO. 08-07-04 APPLICATION OF THE UNITED ILLUMINATING COMPANY TO INCREASE ITS RATES AND CHARGES

February 4, 2009

By the following Commissioners:

John W. Betkoski, III
Donald W. Downes
Anthony J. Palermino

DECISION

TABLE P/R - 5

CORRECTED TABLE

(in $000s)

Compensation Expense	2009	2010
Proposed Base Payroll	$56,627	$59,115
Department Adjustment	($3,880)	($4,565)
Allowed Base Payroll	$52,747	$54,550
Overtime and Premium Pay	$6,754	$7,024
Department Adjustment	($1,672)	($1,942)
Allowed O/T and Premium Pay	$5,082	$5,082
Capitalized Overhead Pay	($4,083)	($4,207)
Department Adjustment	$80	$63
Allowed Cap. O/H	($4,003)	($4,144)
Incentive Compensation	$7,665	$7,791
Department Adjustment	($3,671)	($3,797)
Allowed Incent. Comp.	$3,994	$3,994
Total Compensation Proposed	**$66,963**	**$69,723**
Total Dept. Adjustments	**($9,143)**	**($10,241)**
Total Allowed Compensation	**$57,820**	**$59,482**
Allocated Incentive Comp.	**$1,154**	**$1,146**
Total Department Adjustments	**($553)**	**($559)**
Allowed Alloc. Inc. Comp.	**$601**	**$587**
Total Compensation Adjustments	**($9,696)**	**($10,800)**

To address the public's concern that customers are paying 100% of the compensation paid to the top officers of the Company, the Department offers that, for example, the adjustments made in this Decision reduce the amount of compensation paid to the Company President and Chief Operating Officer, that are actually included in rates and paid by customers, by approximately 33% and 31%, respectively.

2. Directors and Officers Liability Insurance

In its Application UI requested the Department authorize $844 thousand for 2009 and 2010 Directors and Officers Liability Insurance (DOL) ($852 thousand less $8 thousand allocated to non-regulated entities). Schedule WP C-3.31 A&B. The Company's position is that DOL is a business expense of having a public corporation, and the customers pay for all of the ordinary business expenses that a company would incur. Tr. 10/14/08, pp 62 and 63.

The OCC stated that in the past two rate decisions involving UI, the Department has determined that a portion of UI's DOL insurance costs should be funded by ratepayers. Despite this fact, UI is proposing to recover 100% of its DOL insurance costs in this proceeding. The OCC cited its previous arguments that corporate scandals have increased costs dramatically, that ratepayers do not elect the Board of Directors (BOD) and officers of the Company, and that shareholders, who are protected by the insurance, should not be subsidized by ratepayers for DOL insurance costs that are designed to protect shareholders from their own decisions. The facts and circumstances regarding the DOL insurance have not changed since UI's last rate case. The OCC recommends that the DOL insurance be reduced by 75% with only 25% being passed on to customers, but stated that its absolute preference would be to disallow the cost completely. OCC Brief, pp. 79 and 80.

The AG indicates that the amount requested is roughly six times the amount that the Department approved in the 2006 Decision. In the 2006 Decision, the Department specifically agreed with both the AG and OCC that "DOL insurance protects only shareholders from the actions of management that they selected." Although the Department allowed UI to collect one-quarter of its requested amount in the 2006 Decision, the Company requested the entire amount be funded by ratepayers. The AG stated that this bold act of indifference to the Department's clear precedent and to the financial stresses facing its customers should be firmly rejected. At the very most, the Department should authorize only the levels for DOL insurance that it approved in the 2006 Decision. AG Brief, p. 18.

In the 2006 Decision, the Department noted the OCC's and AG's positions, as well as the position of the Company who stated that if there was no insurance and there was a huge claim, it could put the Company in financial peril, which would potentially impair its ability to serve. Therefore, the Department allocated 75% of DOL costs to the shareholders, with the residual 25% to be funded by ratepayers. 2006 Decision, pp. 46 and 47. The Department rejects the Company's current proposal that ratepayers fund 100% of DOL insurance costs, and reconfirms the precedent afforded by the 2006 Decision. Accordingly, the Department allows $211 thousand of DOL insurance costs to be funded by ratepayers in years 2009 and 2010 ($844 thousand times 25%). This results in DOL insurance expense decreases of $633 thousand in each of years 2009 and 2010.

3. Fringe Benefits

a. Compensation Adjustment to Fringe Benefits

In Section III.1.f., the Department made adjustments to compensation of $12.033 million and $13.655 million in 2009 and 2010, respectively. This also results in an adjustment to fringe benefits that accompany compensation. The Company indicates that its composite fringe benefit rate for 2009 and 2010 is 45%. Responses to Interrogatories EL-30-2; EL-31-2; and EL 33-1.

In its Written Exceptions, the Company argues, against its own filed and sworn record evidence of a 45% fringe benefit expense related to compensation, that the "correct compensation-driven benefits loader from an expense standpoint" is 20.6% and attempts to justify that amount by listing greatly reduced expense amounts for certain "Compensation Driven Employee-Related Benefits Loader." UI Exceptions, pp. 29 and 30. The Department notes that the Company's Response to Interrogatory EL-33 that

STATE OF CONNECTICUT

DEPARTMENT OF PUBLIC UTILITY CONTROL
TEN FRANKLIN SQUARE
NEW BRITAIN, CT 06051

DOCKET NO. 07-07-01 APPLICATION OF THE CONNECTICUT LIGHT AND POWER COMPANY TO AMEND RATE SCHEDULES

January 28, 2008

By the following Commissioners:

Anthony J. Palermino
Anne C. George
John W. Betkoski, III

DECISION

expenses by $2.232 million to remove the non payroll projected costs in excess of the original budget.

2. Insurance Expense

The test year expense for insurance expense was $6.817 million. The Company proposed a rate year increase of $.65 million or a rate year expense of $7.467 million. Application, Schedule C-3.10. CL&P revised the request and reduced the insurance expense by $17,000. The revision was a result of recent premium information. The change is a combination of increases and decreases in different types of insurance. Response to Interrogatory EL-80-SP01.

The Department accepts the Company's revisions except for the Directors and Officers insurance expense and capital allocation as discussed in detail below.

a. Director and Officer Insurance Expense

The test year expense for Director and Officer (D&O) insurance expense was $1.423 million. The Company proposed a rate year increase of $0.164 million or a rate year expense of $1.587 million. Application, WP C-3.10. As indicated above, CL&P revised its rate year insurance expense and decreased the rate year D&O insurance expense amount by $.270 million to $1.317 million. Response to Interrogatory EL-80-SP01 and Late Filed Exhibit No. 112SP-01.

CL&P claims that D&O insurance is a legitimate and customary operating expense and that no director or officer with the necessary knowledge and experience would take the risks associated with serving CL&P without this type of protection. CL&P states that the Sarbanes-Oxley Act requires that certain skill-sets be reflected in the Board of Directors (BOD), and in order to attract and retain individuals that meet these requirements CL&P must offer D&O coverage to its BOD. CL&P indicated that the Department has already confirmed that D&O is a necessary operating expense that is recoverable. CL&P Brief, p. 39.

The AG argues for the removal of the entire $1.587 million. The AG states that it is inappropriate to force customers to fund a plan that benefits only shareholders. D&O insurance protects shareholders from their own decisions and is intended to protect directors and officers from lawsuits brought by shareholders. AG Brief, p. 20.

The OCC states that premiums for insurance excluding D&O insurance decreased from $9.4 million to $8.41 million while D&O insurance is estimated to increase 11.5% from $1.423 million to $1.587 million. Further, the OCC believes that the D&O insurance requested amount is excessive, ignores the Department's prior rulings, and ratepayers should not be required to protect shareholders from the decisions they make in electing the BOD. The OCC argues that Sarbanes-Oxley merely requires officers & directors who have a fiduciary duty to acknowledge responsibility by signing their names. It was not the implementation of Sarbanes-Oxley that caused an increase in premiums, it's the claims filed that caused the increase. The OCC adds that D&O insurance has drastically increased from 5.67% of the aggregate insurance amount in 2002 to 13.15% in 2006 and projected to cost 15.87% in the rate year. The OCC recommends a D&O insurance reduction of $1.202 million to $0.385 million. The OCC calculated this amount by using the 2002 test year amount increased by inflation. OCC Brief, p. 44.

In Docket No. 03-07-02, CL&P requested a rate year amount of $1.043 million and was allowed the test year amount of $.330 million. 03-07-02 Decision, pp. 48-49. This allowed 33% of the requested amount. In that decision, the Department indicated that it does allow some level of D&O insurance expense in rates to assure some level of ratepayer protection from lawsuits. In the UI Decision, the Department allowed 25% of the D&O insurance expense to be allocated to customers. In the Decision dated February 5, 1999, n Docket No. 98-01-02, DPUC Review of the Connecticut Light and Power Company's Rates and Charges – Phase II, the Department took the OCC approach and calculated the 1999 expense by inflating the 1996 level. This allowed 46.7% of the requested amount. In the Decision dated May 25, 2000, in Docket No. 99-09-03, Application of Connecticut Natural Gas Corporation for a Rate Increase, the Department allowed 20% of the premium amount.

The Department agrees in part with the OCC that ratepayers should not be required to protect shareholders from the decisions they make in electing the BOD. However, the Department historically has allocated a percentage to ratepayers to protect from catastrophic lawsuits. Accordingly, the Department finds it appropriate to allocate 30% to ratepayers and 70% to shareholders. This allocation is fair and consistent with the level allowed in Docket No. 03-07-02. Therefore, the Department allows $.395 million ($1.317 million x 30%) and disallows $.922 million to be collected in rates.

b. Insurance Expense - Capital Allocation

CL&P originally proposed a rate year capitalization factor of 25.3%. Application, Schedule WPC-3.10. The Company revised this amount to 26.6% in order to reflect updates based on recent invoices. Response to EL-80-SP01 and Late Filed Exhibit No. 112. The test year before pro forma adjustment was 35.6%. Application, Schedule WPC-3.10. A majority of the pro forma adjustment was to remove a non-recurring charge for the public liability reserve. This adjustment was based on an independent study performed by Mercer, Inc. The remaining pro forma adjustment included the addition of $284,000 that was for a non-recurring credit or refund received from USICO, a mutual property insurance company. Response to Interrogatory EL-43.

The OCC claims that CL&P has included a significant increase in the percent of costs being charged to expense as opposed to capital. Specifically, the Company's proposed reduction of more than 10% to the capital allocation is significant considering CL&P's focus on system improvements. The OCC argues that the Company did not present any evidence to justify an allocation change. OCC Brief, p. 41. The OCC recommends using the test year capitalization factor of 35.6%. That capitalized amount reduces the aggregate insurance expense to $5.802 million for a total disallowance of $1.665 million. OCC Brief, pp. 43-44.

As indicated below, the Company's insurance capitalization percents have ranged from a low of 25.6% to a high of 40.5% in the years 2002 through 2006.

STATE OF CONNECTICUT

DEPARTMENT OF PUBLIC UTILITY CONTROL
TEN FRANKLIN SQUARE
NEW BRITAIN, CT 06051

DOCKET NO. 05-06-04 APPLICATION OF THE UNITED ILLUMINATING COMPANY TO INCREASE ITS RATES AND CHARGES

January 27, 2006

By the following Commissioners:

John W. Betkoski, III
Donald W. Downes
Jack R. Goldberg
Anne C. George
Anthony J. Palermino

DECISION

Description	2006	2007	2008	2009
Benchmarking studies	$ 72,000	$ 72,000	$ 73,000	$ 74,000
BPL	$ 98,000	$ 98,000	$ 98,000	$ 98,000
Regulatory consulting	$ 131,000	$ 138,000	$ 145,000	$ 152,000
Client services support	$ 275,000	$ 296,000	$ 311,000	$ 329,000
Total professional services expense disallowed	$ 576,000	$ 604,000	$ 627,000	$ 653,000

8. Outside Services - Audit and Accounting Expense

UI originally projected $533,000, $552,000, $573,000 and $594,000 for audit and accounting expense for rate years 2006 through 2009, respectively. Schedule C-3.16 A–D. UI later increased the projected expenses by $149,000, $164,000, $177,000 and $194,000 for rate years 2006 through 2009, respectively, citing the Company's response to Interrogatory EL-159. Late Filed Exhibit No. 1, Revised.

However, the response to Interrogatory EL-159 only identified a potential increase of $100,000 for 2006. The Company's response to Interrogatory EL-159 and the testimony on 10/14/05 state that the original projection was strictly an estimate and that UI is in negotiations with Pricewaterhouse Coopers for a new contract. UI is seeking to enter into a long term fixed price contract for SEC reporting audit services to mitigate the potential increase. UI testified that the Company is still negotiating and trying to get the price increase down, but, the increase could be greater than the original estimate. Response to Interrogatory EL-159; Tr. 10/14/05, pp. 174 and 175. UI later testified that they negotiated a new contract and the increases in Late Filed Exhibit No. 1 are based on the cost of the new contract. Tr. 11/9/05, p. 2394.

The OCC believes that the response to Interrogatory EL-159 does not support the amount of increase apparently requested by UI in Late Filed Exhibit No. 1 and leaves unanswered questions regarding the certainty of the projected increases. Therefore, the OCC has removed the increases identified in Late Filed Exhibit No. 1. OCC Brief, pp. 63 and 64, Exhibit 5.

The Department takes into account the entire record evidence on a given expense in determining if it is proper for the rate year. Therefore, based on the testimony given during the late filed exhibit hearing, the Department approves the increase to accounting and audit expense as shown in Late Filed Exhibit No. 1, Revised.

9. Directors and Officers Liability Insurance

The Company proposes expenses for Directors and Officers Liability Insurance (DOL) of $533,879 for 2006, and $559,612 for each of the years 2007 through 2009. Response to Interrogatory OCC-104. UI contends that it could not attract a director if it didn't have DOL. It is a cost of doing business. Tr. 10/12/05, p. 868. Further, the Company asserts that, taken to the extreme, "if there was no insurance and there was a huge claim, it could put the company in financial peril, which would potentially impair its ability to serve." Tr. 10/11/05, p. 801.

The OCC indicates that "the numerous corporate scandals since 2001 has caused the cost of the DOL insurance to skyrocket." Schultz and DeRonne PFT, p. 48. Further, "DOL insurance provides shareholders protection from their decision. Ratepayers in general do not elect the Board of Directors and do not appoint officers to run the Company. Shareholders are protected by this insurance against their own decision in the selection of management. Ratepayers should not pay for the cost of insurance designed to protect shareholders from their own decisions." OCC Brief, p. 93; Tr. 10/12/05, pp. 867 and 868. Therefore, the OCC recommends that all of the DOL amounts during the rate period be excluded from rates and be covered completely by shareholders, not ratepayers.

The AG agrees with the OCC's reasoning that DOL insurance protects only shareholders from the actions of management that they selected. Thus, DOL insurance expense should be eliminated from UI's rates entirely. AG Brief, pp. 24 and 25.

The Department partially agrees with the OCC, the AG and the Company. In the 03-07-02 Decision, the Department allowed a portion of that company's proposed expense and stated that "the Department has historically allowed some level of expense for D&O Insurance in rates to assure some level of ratepayer protection from catastrophic lawsuits." 03-07-02 Decision, p. 49. The Department also notes that the annual gross DOL premium (before credits and allocations) was $134, 430 in years 2001 and 2002, increasing to $1,029,516 in years 2007 through 2009, lending credence to the OCC's assertion regarding corporate scandals, above. The Department agrees with the OCC that the shareholders should bear the weight of their decisions in appointing directors (who appoint the officers of the Company). Accordingly, the Department allows $140,000 of DOL expense, or approximately ¼ of the total company expense, to be collected in rates as the customers' responsibility.

The Department, therefore, disallows DOL expenses of $393,879 in 2006, and $419,612 in each of 2007, 2008 and 2009.

10. Postage Expense

UI projected postage expense in the amounts of $1,475,000, $1,479,000, $1,485,000, and $1,491,000 for rate years 2006 though 2009, respectively. UI increased the test year expense of $1,361,000 by $74,000 for an anticipated 5.4% increase from the USPS and $31,000 for volume and usage increase. Schedule C-3.20 A – D.

The Governors of the U.S. Postal Service have accepted the recommendation to increase most postal rates and fees by 5.4% effective January 8, 2006, including an increase in the rate for first-class mail from 37 cents to 39 cents. See http://www.usps.com/ratecase/welcome.htm.

UI states that the volume and usage increase is due to items such as increase in collection letters due to higher disconnect for nonpayment activity, new program mailings and increased economic development activity. Response to Interrogatory EL-220.

STATE OF CONNECTICUT

DEPARTMENT OF PUBLIC UTILITY CONTROL
TEN FRANKLIN SQUARE
NEW BRITAIN, CT 06051

DOCKET NO. 03-07-02 APPLICATION OF THE CONNECTICUT LIGHT AND POWER COMPANY TO AMEND ITS RATE SCHEDULES

December 17, 2003

By the following Commissioners:

Donald W. Downes
Jack R. Goldberg
John W. Betkoski, III
Linda J. Kelly
Anne C. George

DECISION

The Department, therefore, accepts the Company's revision to computer and other expenses as indicated in the Response to Interrogatory OCC-93. Accordingly, the Department reduces computer expenses by $.348 million ($10.119 million less $9.771 million) and other O&M expenses related to the test year processing and storage balance of $.596 million, for a total O&M adjustment for these items of $.944 million ($.348 million plus $.596 million).

2. Insurance Expense

a. Directors and Officers Liability Insurance

The Company requested Directors & Officers Liability Insurance Expense (D&O Insurance) of $1.043 million in the rate year. This included a test year pro forma adjustment of $.029 million and a rate year adjustment of $.684 million above the test year actual amount of $.330 million based on the actual renewal premiums for the policy period 4/23/03 to 4/23/04. Schedule WP C-3.12; Response to Interrogatory OCC-101.

The OCC argues for the removal of the entire $1.043 million of D&O Insurance expense. The OCC states:

> Ratepayers should not be forced to pay a cost that protects shareholders from the shareholders' own decisions. Shareholders determine who the Board of Directors are and the Board of Directors are responsible for appointing officers of the Company. The officers are highly compensated to provide quality leadership with the utmost integrity. Ratepayers are responsible for paying for the directors and officers services. The shareholders, not ratepayers, determine who the directors and officers are. Therefore, the shareholder should assume the risk associated with their decision regarding the management of the Company. The cost to obtain insurance to protect the shareholders investment from their choice of management should be the responsibility of the shareholders.

OCC Brief, p. 64

The OCC also cites that the escalation in D&O Insurance rates stem from the insurers' need to continue to reserve for litigation and settlement expenses in connection with an influx of claims arising from such entities as Worldcom, Enron, Kmart, etc. Response to Interrogatory OCC-101. The increases in D&O Insurance and the related costs are due to the failures of directors and officers to ensure the Company operated prudently and reasonably. An alternative to total disallowance of cost would be to allow the test year cost of $.330 million. OCC Brief, p. 65.

The Department is sympathetic with OCC's arguments and generally agrees that the increased premiums are, at least in part, caused by Officer/Director mismanagement or misconduct in major corporations. Further, the Department notes that CL&P's recent claims experience includes settlement of eight federal and state shareholder class action lawsuits that stemmed from the Nuclear Regulatory Commission's Watch List of problems at its Millstone Nuclear Plant in 1996 that resulted in a $20.050 million settlement by its insurer. Further, a $33 million settlement was reached with the non-NU joint owners of Millstone 3 related to the Company's operation of that plant. Late Filed Exhibit 73 and 73-SP01. However, the Department has historically allowed some level of expense for D&O Insurance in rates to assure some level of ratepayer protection from catastrophic lawsuits. Therefore, the Department will allow the test year cost of $.330 million and reduce the Company's D&O Insurance expense by $.713 million ($1.043 million less $.330 million).

b. Public Liability Expense

The Company requested Public Liability Expense of $2.591 million in the rate year in Account 925.02. This Account includes the cost of the reserve accrual to protect the utility against injuries and damages claims of employees or others, losses of such character not covered by insurance, and expenses incurred in settlement of injuries and damages claims. It also includes the cost of labor and related supplies and expenses incurred in injuries and damages activities. Uniform System of Accounts prescribed for Electric Utilities, Public Utilities Control Authority State of Connecticut, 1/1/63, p. 177 (USOC). In its calculation of this expense, CL&P removed $1.497 million of test year expense that was capitalized, thus reducing the overall test year expense of $2.591 million to $1.094 million. Schedule WP C-3.12.

In response to an OCC data request, the OCC questioned why CL&P should no longer treat the public liability expense as an overhead cost, subject to capitalization. In the Company's response it indicated "[u]pon further review it was determined that public liability insurance is an appropriate cost to be capitalized under the FERC Electric Plant instructions." CL&P determined that the payroll overhead rate is the best vehicle for capitalizing these costs and changed the overhead rate for the remainder of 2003 to include these costs. Response to Interrogatory OCC-99. Accordingly, the OCC recommends that $1.497 million of public liability expense be capitalized, thereby reducing CL&P's proposed expense.

The Department agrees with the OCC and the Company that a portion of public liability expense, particularly as it relates to construction projects, is properly capitalizable. The USOC provides, for example, that the cost of injuries and damages or reserve accruals capitalized shall be charged to construction directly or by transfer to construction work orders from this account. USOC, p. 177. The Department also notes that it has been CL&P's consistent practice to capitalize a portion of public liability expense. Response to Interrogatory OCC-100. The Company provided a revised schedule that calculated the capitalized portion of Public Liability Expense using a capitalization rate of 38.5% that resulted in a capitalization amount of $.998 million. Schedule WP C-3.12 Revised. The Department notes that the capitalization percentage is consistent with other payroll-related capitalizations. Schedule WP C-3.28a. The Department, therefore, reduces public liability expense by $.998 million to reflect such capitalization.

STATE OF CONNECTICUT

DEPARTMENT OF PUBLIC UTILITY CONTROL
TEN FRANKLIN SQUARE
NEW BRITAIN, CT 06051

DOCKET NO. 98-01-02 DPUC REVIEW OF THE CONNECTICUT LIGHT AND POWER COMPANY'S RATES AND CHARGES - PHASE II

February 5, 1999

By the following Commissioners:

Glenn Arthur
Jack R. Goldberg
Linda Kelly Arnold
Donald W. Downes
John W. Betkoski, III

DECISION

amount. OCC analyzed the storm expense data and found that there is no relationship between total storm expense and inflation. For example, storm expenses were higher in 1992 and 1993 compared to 1994 and expenses in 1995 and 1996 were higher compared to 1997. Therefore, OCC also believes that there is no justification for an escalation factor in the storm budget. PRO Brief, pp. 9 and 10; OCC Brief, pp. IV-52 and 53.

The Department often uses a historical average, excluding the highest and lowest years' costs, to calculate a rate year expense and believes that is the appropriate method for storm expense. The Department agrees with OCC's analysis on the escalation factor. The Department calculates 1999 storm expense to be $8.483 million by averaging storm costs for 1992 - 1997, excluding the lowest and highest costs in 1994 and 1996. Therefore, the Department reduces expenses by $3.169 million ($11.652 million - $8.483 million).

27. Directors' and Officers' Insurance

CL&P has requested $1.391 million in directors' and officers' (D&O) liability insurance premiums for the rate year. Response to Interrogatory OCC-70. D&O insurance expenses for the years 1994 - 1997 were $497,000, $456,000, $630,000 and $1,022,000, respectively. Expenses increased due to claims paid and higher liability limits. CL&P projects 1999 expenses will be higher for the same reasons. Responses to Interrogatories OCC-312 and PRO-6; Late Filed Exhibit No. 5, AR-DPUC-14. The Company indicated that the two reasons were actually one and the same. As claims are paid, the insurance available in the future is reduced by that amount. Because of the claims already paid and potential claims, the Company purchased higher limits to restore its liability coverage to previous amounts. This would give the Company enough coverage for potential future claims. Tr. 10/20/98, pp. 4005 and 4006; Late Filed Exhibit No. 162. A Company witness testified that all of the shareholder lawsuits are well known to CL&P and the Department and any damage claims would be borne by shareholders. Tr. 9/10/98, pp. 430-432.

PRO, AG and OCC argue that D&O costs have increased from 1995 to 1997 as a direct result of management imprudence and the nuclear outages. The claims paid and pending relate to the nuclear outages. OCC and PRO believe the expense should be reduced to the 1996 level. Even though the outages occurred during 1996, PRO believes this would allow for some increase due to inflation. OCC Brief, p. IV-39; PRO Brief, p. 12; AG Brief, p. 15.

Ratepayers should not have to fund higher liability limits for directors and officers when it is those directors and officers who failed to ensure that the Company operated prudently and reasonably. The Department reduces D&O liability insurance premiums to a level that does not reflect the nuclear outages. The Department agrees that the 1999 expense should be based on the 1996 level. However, the Department also believes that this is an expense that is typically influenced by inflation and sets the 1999 allowed expense at $.65 million, which is the 1996 actual expense adjusted for inflation. Therefore, 1999 expenses are reduced by $.741 million ($1.391 million - $.65 million).

STATE OF CONNECTICUT

DEPARTMENT OF PUBLIC UTILITY CONTROL
TEN FRANKLIN SQUARE
NEW BRITAIN, CT 06051

DOCKET NO. 99-09-03 APPLICATION OF CONNECTICUT NATURAL GAS CORPORATION FOR A RATE INCREASE

May 25, 2000

By the following Commissioners:

Glenn Arthur
Jack R. Goldberg
Linda Kelly Arnold

<u>DECISION</u>

tax rate of 8.3% in the rate year. Tr. 2/16/00, p. 1775. Accordingly, the Department will reduce payroll taxes by an additional $42,746 ($515,017 x 8.3%).

In Version B, CNG made a vacancy adjustment of $160,493. However, the Company failed to make a corresponding adjustment for payroll taxes and the O&M allocation factor of 83.6%. Schedule WPC-3.28. Accordingly, the Department will further reduce this expense by $13,321 ($160,493 x 8.3%). The Department's total reduction to payroll taxes is $255,260 ($199,193 + $42,746 + $13,321).

c. Gross Receipts Tax

Gas distribution companies are subject to the Connecticut gross receipts tax (GRT). GRT rates of 4% and 5% apply to residential customers and commercial/industrial customers, respectively. CNG's initial application projected a pro forma GRT expense of $10,599,786 for pro forma taxes at present rates. Schedule WPC-3.41. The Company's request for a $15,738,284 increase in its revenue requirement added $675,684 for a total pro forma GRT of $11,275,470. Schedule C1/C2. Subsequently, the Company increased its pro forma revenues by $8,010,815. Late Filed Exhibit No. 4, Version B. This increased pro forma GRT by $343,924. Together, the changes increased pro forma GRT by $709,958 to $11,619,394.

The Company calculated a 4.29% blended GRT rate by combining the calculated taxes on residential revenues and commercial revenues. Schedule WPC-3.41. CNG's calculation of its blended GRT rate properly excluded taxes on non-taxable interruptible service revenues. Tr. 1/11/00, p. 137.

In Section II.C, above, the Department adjusted CNG's revenues for firm transportation by $58,700, and for an additional customer by $109,000. The Department will make an adjustment to GRT at the rate of 4.29%. Therefore, the Department will increase CNG's GRT by $7,194 ([$58,700 + $109,000] x 4.29%).

d. Summary of Other Tax Adjustments

The Department's total adjustment for other taxes is $(1,055,804), $(255,260) for payroll tax, $(807,738) for property tax, and $7,194 for gross receipts tax.

9. Insurance

a. Directors and Officers Liability

CNG has included the cost of D&O liability policies in pro forma insurance expense. The D&O insurance provides the Company with coverage for certain types of wrongful acts by directors or officers of the corporation. Its intent is to safeguard the assets of the corporation so that the Company can continue to provide service to its customers and earn a fair return for its shareholders. The Company has two such policies. The first provides regular coverage and has a $84,100 annual premium. The Company included $70,308 of that premium (83.6%) in its pro forma expense. The second policy provides excess coverage and has a $87,900 annual premium. The

Company included $73,397 of that premium in its pro forma expense for a total pro forma D&O insurance cost of $143,705 ($70,308 + $73,397). Schedule WPC-3.32.

OCC recommends that CNG's adjusted expenses be reduced by $81,807 to reflect the allocation of 20% of regular D&O liability insurance and 100% of the excess D&O liability insurance to shareholders. OCC would prefer that the cost be split equally between ratepayers and shareholders. Not withstanding that action, the OCC believes it appropriate to remain consistent with the Previous Rate Decision where 20% of the regulated premium was disallowed. OCC Brief, pp. 11, 37. Based on CNG testimony, PRO recommends a $7,031 reduction to this expense. PRO Brief, p. 11.

In the Previous Rate Decision, the Department found that the Company needed D&O insurance to attract and keep qualified directors and officers. However, because shareholders could also initiate suits against the directors and officers, the Department disallowed 20% of the premium of regular coverage. Additionally, the Department found that the Company had not justified allowance of premiums of excess D&O coverage in rates. Decision, p. 33.

The Company has not presented any evidence in the instant docket to warrant dissimilar treatment. Accordingly, the Department again disallows the cost of the excess coverage policy premium in its entirety and 20% of the regular policy. Accordingly, the Department will reduce this expense by $14,062 (20% x $70,308) to eliminate costs attributable to shareholders. The resultant allowed premium of $56,246 requires an adjustment of $14,062. Adding that to the disallowed excess coverage premium of $73,397 produces a total reduction to D&O insurance expense of $87,459.

b. Weather Stabilization Insurance

CNG seeks to recover $993,063 in premiums for a weather stabilization insurance (WSI) policy covering the 2000/2001 heating season. Schedule C-3.32. This approximates the cost of the policy for the 1999/2000 season but is more than the cost of the policy in the 1998/1999 season. The witness stated that the Company obtained this insurance coverage to mitigate large swings in the Company's earnings in periods of extremely warm weather. CNG also proposed to set up a deferred account to allow true-ups of insurance premium costs in future rate proceedings. Bolduc PFT, pp. 7, 10.

AG proposes that the Department reject CNG's proposal to recover any costs associated with WSI because it is not a cost that ratepayers should bear. Additionally, AG points out that shareholders have already been compensated for weather in the allowed ROE. Furthermore, the Company has failed to show that the WSI provides any real benefits to ratepayers. Brief, p. 6.

OCC opposes the inclusion of WSI premiums above the line. Brief, p. 44. OCC agrees with AG that weather related risks are reflected in a company's ROE, and further states that eliminating that risk would require a fundamental reassessment of the cost of doing business. Cotton PFT, p. 12.

ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION OF)
ENTERGY ARKANSAS, INC. FOR APPROVAL)
OF CHANGES IN RATES FOR RETAIL)
ELECTRIC SERVICE)

DOCKET NO. 06-101-U
ORDER NO. 10

ORDER

<u>Summary</u>

On August 15, 2006, Entergy Arkansas, Inc. ("EAI") filed in this Docket its Application seeking an increase in the rates it charges its Arkansas retail electric customers. As later amended, EAI seeks a retail revenue requirement increase of $106,534,000 or approximately 11.79% above its current authorized retail revenue requirement. However, based upon the evidence presented in this Docket, the Commission finds that EAI's retail revenue requirement is excessive and should be reduced by approximately $5.67 million effective as of June 15, 2007. Among other adjustments the Commission denied EAI's request for an 11.25% return on equity. Instead, the Commission set EAI's return on equity at 9.9%.

The Commission also denied EAI's request to recover a number of expenses from its ratepayers, including reducing the level of incentive pay and stock options requested by EAI by over $21 million, and by rejecting EAI's request for its ratepayers to pay for entertainment expenses which included tickets to sporting events and concerts, golf balls and golf tournament expenses, and dinners and alcohol to entertain political figures.

Further, the Commission approved EAI's request to recover costs relating to projects and organizations that promote new technologies and research and

Having found no direct or measurable benefit to ratepayers of these types of incentives, the Commission directs that these costs not be included in rates.

As to Mr. Marcus' recommendation to disallow certain perquisites provided EAI's Chief Executive Officer and the five top executives at Entergy Corp. which include club dues, financial counseling, the corporate airplane, and a tax "gross-up", the Commission finds no substantial evidence to support the recovery of such expenditures from EAI's ratepayers. The Commission finds that, as noted by Mr. Marcus, these types of expenditures are unreasonable in light of the salaries paid Entergy's top executives. The Commission therefore disallows these perquisites.

Director and Officer Liability Insurance

EAI's application included $191,580[38] in expenses for Director and Officer Liability ("D&O") Insurance. Staff witness Plunkett recommends a 50% sharing of these costs, pursuant to past Commission practice and based on the benefits that D&O insurance provides for both stockholders and ratepayers. (T. 1472) Ms. Plunkett further testifies that her recommendation does not presuppose that this expenditure is unreasonable nor does it imply it is not useful in shielding officers and directors from shareholder litigation. Rather, she continues, her recommendation recognizes that the protection afforded officers and directors is primarily a benefit to shareholders, with EAI providing little evidence of benefits to ratepayers. (T. 1505)

AG witness Marcus, noting similar Commission findings in other dockets, also recommends that these costs be shared equally between shareholders and ratepayers,

[38]Ms. Plunkett removed $95,790 in D&O Insurance from EAI per book, representing 50% of actual expenses. Actual per book expenses would be twice that amount or $191,580.

testifying that the shareholders are the beneficiaries of such policies when mismanagement is the subject of litigation by shareholders. (T. 702, 767)

Mr. McDonald recommends that the Commission reject the Staff's and the AG's proposed adjustment, arguing that the cost is "a reasonable and legitimate cost...to encourage qualified individuals to serve as a member of the board of directors." Mr. McDonald also testifies that the positions taken by Staff and the AG, on this and other similar recommendations would, if carried to every EAI cost, result in leaving EAI without "its legal right to recover the reasonable costs it incurs to provide electric service to its customers." (T. 155)

The Commission agrees that ratepayers, as well as shareholders, benefit from good utility management, which D&O Insurance helps secure. However, as found in prior dockets, the direct monetary benefits of D&O Insurance flow to shareholders as recipients of any payment made under these policies. That monetary protection is not enjoyed by ratepayers. The Commission therefore finds that, because shareholders materially benefit from this insurance, the costs of D&O Insurance should be equally shared between shareholder and ratepayer.[39]

Civic Dues, Donations, and Club Memberships

Both Staff witness Plunkett and AG witness Marcus recommend disallowance of all costs related to civic club dues, club memberships, donations, and other costs such as "institutional advertising, lobbying, and donations, including support and sponsorship of local community organizations and local events." (T. 695.697, 1471) Ms. Plunkett notes that both FERC, which requires these items be listed as non-utility expenses, and

ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF AN APPLICATION FOR A GENERAL CHANGE OR MODIFICATION IN CENTERPOINT ENERGY ARKLA, A DIVISION OF CENTERPOINT ENERGY RESOURCES CORP'S RATES, CHARGES, AND TARIFFS	)	DOCKET NO. 04-121-U ORDER NO. 16

ORDER

On November 24, 2004, CenterPoint Energy Arkla ("Arkla" or the "Company") filed an Application for approval of a general change or modification in its rates and tariffs.[1] Arkla's initial Application reflects that it was seeking a non-gas rate increase of $33,996,382 based on an overall non-gas revenue requirement of $182,525,265. Order No. 4, entered on December 16, 2004, suspended Arkla's proposed rates, charges, and tariffs pending further investigation by the Commission.

The parties to this proceeding are Arkla, the General Staff of the Arkansas Public Service Commission ("Staff"), the Attorney General of Arkansas ("AG"), Arkansas Gas Consumers ("AGC"), and the Commercial Energy Users Group ("CEUG").

Arkla filed the written testimonies of Jeffrey A. Bish, Charles J. Harder, F. Jay Cummings, Samuel C. Hadaway, Alan D. Henry, Michael TheBerge, Gerald W. Tucker, Steve Malkey, Michael J. Adams, Walter L. Fitzgerald, Michael Hamilton, and John J. Spanos. The Staff filed the written testimonies of Robert Booth, Alice D. Wright, Alisa Williams[2], Don E. Martin, Gail P. Fritchman, Don Malone, L.A. Richmond, Gayle Frier, Johnny Brown, Robert H. Swaim, and Adrienne R.W. Bradley. The AG filed the written testimony of William B. Marcus.

---

[1] Arkla filed additional revisions to its Application on December 27, 2004, January 10, 2005, and January 13, 2005.
[2] On August 3, 2005, the Staff filed Notice that Jeff Hilton, Manager of Staff's Audit Section, was adopting the pre-filed testimony of Staff witness Alisa Williams.

adjustments were calculated by applying the contribution rate to each party's respective payroll adjustments.

The Commission finds that the employee savings plan contribution rate should be applied to the amount determined for regular salaries and wages, overtime, and incentive pay consistent with the Commission's decision on these issues. The Commission accepted Arkla's position on regular salaries and wages, and overtime, and the Staff's position on incentive pay. (Adjustment No. IS-20).

Director's and Officer's Insurance ("D&O")

The purpose of D&O insurance is to protect officers and directors of a corporation from liability in the event of a claim or lawsuit against them asserting wrongdoing in connection with the Company's business. AG witness Marcus has two concerns with Arkla's treatment of this expense: (1) Arkla's revised allocation methodology from an asset-based to an O&M-based allocation has doubled Arkla's costs; and (2) the costs should be split on a 50-50 basis to recognize that shareholders are the major beneficiaries of policy payouts when something goes wrong. (T. 1376-1377) Arkla Witness Harder testified that the use of an O&M allocation factor is appropriate for an expense that bears no relation to the level of plant. He contended that this is a necessary business expense which enables the Company to attract and retain qualified management. (T. 152-153) Mr. Marcus disagreed, stating that the expense is not related to O&M expense either, the allocation shifts the cost to Arkla away from Arkla's electric affiliate, and utility profits are asset-based. Also, since shareholders receive the benefit of insurance payouts, they should bear a portion of the cost of buying the insurance. (T. 1465-1466) Mr.

Harder responded, contending that: (1) the AG cites no evidence to show shareholders are the primary beneficiaries of these insurance proceeds; (2) litigation often involves past stockholders, in which instance they are no different than other individuals filing tort claims; and (3) when current shareholders are involved, payments are made to the corporation in which case customers are the ultimate beneficiaries. (T. 1227-1229)

The Commission finds that Arkla has not justified its change in allocation factors nor has it justified why this expense should not be split equally between stockholders and ratepayers. Arkla did not adequately explain why, at this time, it changed from a asset-based to an O&M expense-based allocation factor. Arkla's explanation that it is an expense to attract qualified management does not establish a justifiable relationship between the cost and the cost expense allocation factor the Company used. Mr. Marcus testified that D&O insurance costs are part of general corporate overhead to protect Company profits which are largely asset-based for a utility. (T. 167-169) Mr. Marcus' testimony that this insurance protects corporate profits also lends support for sharing the insurance costs between shareholders and ratepayers. The news (T. 1040) is replete with stories about companies experiencing lawsuits by shareholders. The Commission agrees with the AG that more often than not it is the current shareholders who sue management and who receive a large portion of the proceeds from the D&O insurance payouts. Accordingly, the Commission finds that Arkla's existing asset-based allocation for D&O insurance should be maintained and that the expense for D&O insurance should be shared on a 50-50 basis between shareholders and ratepayes.

ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION OF ARKANSAS WESTERN GAS COMPANY FOR APPROVAL OF A GENERAL CHANGE IN RATES AND TARIFFS	))))	**DOCKET NO. 04-176-U** **ORDER NO. 6**

ORDER

PROCEDURAL HISTORY

On December 29, 2004, Arkansas Western Gas Company ("AWG" or the "Company") filed an application for approval of a general change or modification in its rates and tariffs. AWG requested that its rates be increased by $9,739,459 annually. Order No. 2, entered January 10, 2005, suspended AWG's proposed rates, charges, and tariffs pending further investigation by the Commission. Order No. 2 also established a procedural schedule for the purposes of investigating AWG's application.

The parties to this proceeding are AWG, the General Staff of the Arkansas Public Service Commission ("Staff"), the Attorney General of Arkansas ("AG"), Northwest Arkansas Gas Consumers ("NWAGC"), and the Commercial Energy Users Group ("CEUG").

On December 29, 2004, AWG filed the Direct Testimony and Exhibits of Alan N. Stewart, Executive Vice-President of AWG, Donna R. Campbell, Manager, Rates and Regulation Department of AWG, Ricky A. Gunter, Vice President of Rates and Regulation for AWG, Glenn M. Morgan, Controller and Treasurer for AWG, and Dr. Roger A. Morin,[1] Principal, Utility Research International, in support of its application.

[1]Professor of Finance, Georgia State University and Professor of Finance for Regulated Industry at the Center for the Study of Regulated Industry at Georgia State University, Atlanta, Georgia.

3. **Payroll Taxes**:

Differences between Staff's and the Company's calculation of payroll taxes and that of the AG relate entirely to the differences between the parties regarding the appropriate level of payroll to include in revenue requirement.

In view of the foregoing findings on payroll, the Commission finds that Staff's adjustments for FICA and other payroll taxes is appropriate and should be adopted.

C. Fringe Benefits

As with payroll taxes, any differences among the parties for fringe benefits, including worker's compensation, medical insurance, pension expense, and employee savings plan/life insurance relate to the level of proposed payroll. Therefore, as with payroll taxes, in view of the foregoing findings on payroll, the Commission finds that Staff's adjustments for any fringe benefits should be adopted.

D. Directors and Officers Insurance ("D & O")

The AG and AWG also disagree about inclusion in revenue requirement of 100% of the liability insurance provided by AWG and SWN for its directors and officers. Mr. Marcus argues that the major beneficiaries of this type of insurance will be the stockholders and its issuance provides no assurances of better management or decision making by officers and directors for the benefit of ratepayers. He also testifies that, in AWG's last rate case, Docket No. 02-227-U, the Commission approved a sharing of the cost between ratepayers and stockholders and he recommends that the Commission require equal sharing here. (Tr. at 72-73) Mr. Morgan disputes the AG's view of the benefits provided by this expense, noting that this type of insurance is essential to the operation of AWG, without which it could not attract the necessary management personnel to operate the Company. (Tr. at 350)

As it has held in previous rate cases, most notably in AWG's last rate case in Docket No. 02-227-U, the Commission finds that D&O insurance benefits both stockholders and ratepayers. Therefore, as recommended by AG witness Marcus this expense should be split 50/50 between stockholders and ratepayers.

E. Uncollectible Accounts Expense

Uncollectible accounts expense has been calculated by the parties, each using a percent of uncollectible accounts to revenues applied to pro forma operating revenues as explained by Staff witness Williams. (Tr. at 1442) As discussed in the following section on the revenue conversion factor, the calculation of that percent remains in dispute. The Commission has found in its discussion of the revenue conversion factor that Staff's calculated factor for uncollectible accounts expense is appropriate. In view of that finding, the Commission, therefore, also approves Staff's calculated level of uncollectible accounts expense.

F. Revenue Conversion Factor

Revenue conversion factor issues still in contention among the parties include: the term over which uncollectible accounts as a percent of revenues are averaged in order to estimate a normal level; a proposal to incorporate late payment charge revenues in the conversion factor as a percent of revenues; and a proposal to calculate and apply separate conversion factors by class to recognize each class's distinctive level of uncollectible accounts.

ATTACHMENT RCS-6

Attachment RCS-6

Excerpts from Southwest Gas Corporation's August 31, 2012 Rebuttal Testimony of Theodore K. Wood in Nevada Public Utilities Commission Case Nos. 12-02019 and 12-04005 (Southwest Gas' Most Recent Nevada Rate Case) Illustrating How the Fair Value Increment Effectively Translates Into a Higher Authorized Return on Equity on Original Cost Rate Base

IN THE MATTER OF

SOUTHWEST GAS CORPORATION

Consolidated Docket Nos. 12-02019 and 12-04005

PREPARED REBUTTAL TESTIMONY

OF

THEODORE K. WOOD

ON BEHALF OF

SOUTHWEST GAS CORPORATION

AUGUST 31, 2012

Table of Contents
of
Prepared Rebuttal Testimony
of
<u>THEODORE K. WOOD</u>

Southwest Gas Corporation
Consolidated Docket Nos. 12-02019
12-04005

BEFORE THE PUBLIC UTILITIES COMMISSION OF NEVADA

Prepared Rebuttal Testimony
of
Theodore K. Wood

I. INTRODUCTION

Q. 1 Are you the same Theodore K. Wood who presented direct and certification testimony on behalf of Southwest Gas Corporation (Southwest Gas or the Company) in this proceeding?

A. 1 Yes.

Q. 2 Are there any changes to your education or business experience summarized in the Prepared Direct Testimony previously filed in this proceeding?

A. 2 No.

Q. 3 What is the purpose of your rebuttal testimony?

A. 3 The purpose of my rebuttal testimony is to respond to specific aspects of the direct testimony presented by Dr. Yasuji Otsuka, witness for the Regulatory Operations Staff of the Public Utilities Commission of Nevada (Staff) and Mr. Daniel J. Lawton, witness for the Bureau of Consumer Protection (BCP), regarding their recommendations and comments concerning the overall allowed rate of return, and BCP's recommended decoupling adjustment. I will also respond to BCP witness Ralph C.

Q. 5 Please summarize your rebuttal testimony.

A. 5 My rebuttal testimony will address the following key issues:

- Staff's and the BCP's overall recommended allowed rate of return in regard to the Company's ability to attract capital and its credit ratings;
- BCP's proposed GRA decoupling mechanism adjustment to the allowed return on common equity (ROE) and why it should be rejected;
- Staff's comments on the allowed fair value return on common equity (FVROE) of 9.50 percent in the Company's last Arizona general rate case, Decision No. 72723, and demonstrate that the FVROE is equivalent to a 10.36 percent allowed ROE under an original cost rate

base methodology, as utilized in Nevada;

IV. THE COMPANY'S ARIZONA GENERAL RATE CASE SETTLEMENT ROE IS EQUIVALENT TO A 10.36 PERCENT UNDER AN ORIGINAL COST RATE BASE (OCRB) METHODOLOGY

Q. 21 Does the Arizona Corporation Commission employ a fair value rate base methodology?

A. 21 Yes. Under the Arizona Constitution, the Arizona Corporation Commission must establish and use the fair value of a utility's rate base for the purpose of calculating what are just and reasonable rates for utility ratemaking.

Q. 22 Did Dr. Otsuka cite the Company's allowed FVROE in its recent Arizona rate case as a factor to demonstrate the

8 Direct Testimony of Company witness Robert B. Hevert, p.47, line 18-23.

reasonableness of the Staff's recommended ROE?

A. 22 Yes, Dr. Otsuka referenced the 9.50 percent FVROE utilized as part of the settlement agreement in the decision for the Company's last Arizona general rate case.[9] However, it is important to point out the FVROE is not directly comparable to an authorized ROE established using an OCRB methodology, as utilized in Nevada.

Q. 23 What is the equivalent OCRB ROE for the FVROE established in the Company's last Arizona rate case?

A. 23 The equivalent ROE, based on an OCRB methodology, is 10.36 percent. Rebuttal Exhibit No.__ (TKW-2) displays the calculation of this equivalent OCRB ROE. First, the fair value rate base (FVRB) was computed as a weighted average of the OCRB and the reconstruction cost new depreciated rate base, using a 50 percent weight for each. The resulting FVRB was established at $1,452,932,391, which is 1.36 times greater than the OCRB of $1,070,115,558. Second, the authorized capital structure for the OCRB was established at 52.3 percent common equity and 47.7 percent long-term debt. Third, the fair value rate of return (FVROR) was calculated. The capital component amounts used to compute the FVROR were composed of the common equity and long-term debt amounts used to finance the OCRB, plus an amount equal to

9 Direct Testimony of Dr. Yasuji Otsuka, p. 4, lines 3-8.

the increment of the FVRB above the OCRB. The cost components were 9.5 percent for common equity, 8.34 percent for long-term debt, and an inflation-adjusted risk-free return of 1.25 percent for the FVRB increment above the OCRB, resulting in a FVROR of 6.92 percent. Finally, the resulting net operating income is computed by multiplying the FVRB by the FVROR, which equates to $100,525,025, and subtracting the interest expense of $42,571,123 results in a net income of $57,953,902. Dividing the net income by the common equity of $559,670,437, results in an ROE of 10.36 percent.

Q. 24 Why is it important to recognize the differences in the OCRB and FVRB ratemaking methodologies?

A. 24 It is important to recognize the significant difference in the FVROE used as an input and the resulting equivalent OCRB ROE. Under the OCRB methodology, the ROE used as an input to the ratemaking process will be the same ROE computed based on the output of the ratemaking process. Under the fair value ratemaking methodology used in Arizona, the FVROE is an input to compute the FVROR, which results in a higher actual ROE due to the additional return assigned to the increment of the FVRB above the original cost rate base. Failure to recognize this important difference in methodology would be just as erroneous as applying the same cost of debt to the Southern and Northern Nevada rate jurisdictions, without taking into account the actual differences due to the lower cost tax-exempt IDRBs assigned to the Southern Nevada jurisdiction. The point is that it is important to understand both the inputs and outputs of these different methodologies, thereby realizing that the ROEs cannot be compared unless they are placed on an equivalent apples-to-apples basis.

Q. 25 Please summarize how Dr. Otsuka's ROE recommendation compares to the Company's Arizona general rate case settlement ROE.

A. 25 Posited on the basis of an equivalent OCRB methodology, Dr. Otsuka's recommended ROE of 9.10 percent is 126 basis points below the Company's Arizona general rate case settlement ROE of 10.36 percent.

SOUTHWEST GAS CORPORATION
Arizona Corporation Commission Decision No. 72723
Equivalent Original Cost Rate Base Allowed Rate of Return

Line No.		Amount	Ratio	Cost	FVROR	Line No.
	Authorized Fair Value Rate Base					
		Amount				
1	Original Cost (OCRB)	$ 1,070,115,558				1
2	Reconstruction Cost New Depreciated (RCND)	1,835,749,225				2
3	Fair Value Rate Base (FVRB)	$ 1,452,932,391 [1]				3
4	FVRB/OCRB Multiple	1.36				4
	Capital Structure OCRB					
		Amount	Ratio			
5	Common Equity	$ 559,670,437	52.30%			5
6	Long-Term Debt	510,445,121	47.70%			6
7	Total Capital	$ 1,070,115,558	100.00%			7
	Authorized Fair Value Rate of Return (FVROR)					
		Amount	Ratio	Cost	FVROR	
8	Common Equity	$ 559,670,437	38.52%	9.50%	3.66%	8
9	Long-Term Debt	510,445,121	35.13%	8.34%	2.93%	9
10	FVRB Increment Above OCRB	382,816,833	26.35%	1.25%	0.33%	10
11	Total Capital	$ 1,452,932,391	100.00%		6.92%	11
	Authorized Net Income and Equivalent OCRB Allowed ROE					
		Amount				
12	Net Operating Income [2]	$ 100,525,025				12
13	Interest Expense [3]	42,571,123				13
14	Net Income	$ 57,953,902				14
15	Common Equity	$ 559,670,437				15
16	Equivalent OCRB Allowed ROE [4]	10.36%				16

Notes:
[1] FVRB = 0.5 X OCRB + 0.5 X RCND
[2] Net Operating Income = FVRB X FVROR = $1,452,932,391 X 6.92% = $100,525,025
[3] Interest Expense = Long-Tarn Debt X Cost of Debt = $510,445,121 X 8.34% = $42,571,123
[4] ROE = Net Income / Common Equity = $57,953,902 / $559,670,437 = 10.36%

AFFIRMATION

STATE OF NEVADA)
: ss.
COUNTY OF CLARK)

Theodore K. Wood, being first duly sworn, deposes and says:

That he is the person identified in the Rebuttal Testimony on file in Docket Nos. 12-02019 and 12-04005, and the exhibits applicable to his testimony; that such testimony and exhibits were prepared by or under his direction; that the answers and information set forth therein are true to the best of his own knowledge and belief; and that if asked the questions set forth therein, his answers thereto would, under oath, be the same.

THEODORE K. WOOD

SUBSCRIBED and SWORN to before
me this 29th day of August, 2012.

Notary Public

NOTARY PUBLIC
STATE OF NEVADA
County of Clark
AURORA DAWN HERMAN