

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)
UPPER PENINSULA POWER COMPANY)
for authority to increase retail electric rates.)
_____)

Case No. U-16417

DIRECT TESTIMONY AND EXHIBITS OF

SETH S. DEMERRITT

FOR

UPPER PENINSULA POWER COMPANY

June 30, 2011

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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**QUALIFICATIONS
OF
SETH S. DEMERRITT
PART I**

1 **Q. Please state your name, business address and position.**

2 A. My name is Seth S. DeMerritt. My business address is Integrys Business Support,
3 LLC ("IBS"), 700 North Adams Street, P.O. Box 19001, Green Bay, WI 54307-9001. I
4 am a Rate Case Consultant in the Regulatory Affairs Department of Integrys Energy
5 Group, Inc ("Integrys"). Both IBS and Upper Peninsula Power Company ("UPPCO")
6 are wholly-owned subsidiaries of Integrys.

7

8 **Q. For whom are you providing testimony?**

9 A. I am providing testimony on behalf of UPPCO.

10

11 **Q. Please describe briefly your educational, professional, and utility background.**

12 A. I have a Bachelors Degree from the University of Wisconsin Green Bay, in
13 Accounting, and a Bachelors Degree from the University of Wisconsin Green Bay, in
14 Business Administration with an emphasis in Finance. I also have a Masters in
15 Business Administration Degree ("MBA") from the University of Wisconsin-Oshkosh.
16 I began my career with Integrys subsidiary Wisconsin Public Service Corporation
17 ("WPS Corp") in May 2002 in the Budget Department first as a Budget Analyst, and
18 then as a Financial Analyst. In March of 2007, I accepted a position in the Regulatory

1 Affairs Department as a Senior Rate Case Analyst, and in June 2010, I assumed my
2 current role as Rate Case Consultant.

3

4 **Q. Have you previously testified before any regulatory agency?**

5 A. Yes, I have. I have testified before the Public Service Commission of Wisconsin
6 ("PSCW") on behalf of Wisconsin Public Service Corporation ("WPS Corp") in rate
7 case docket 6690-UR-117; before the Minnesota Public Utilities Commission
8 ("MPUC") on behalf of Minnesota Energy Resources Corporation ("MERC") in rate
9 case dockets G007,011/GR-08-835 and G007,011/GR-10-977; and before the
10 Michigan Public Service Commission ("MPSC") in UPPCO's rate cases Case Nos. U-
11 15988 and U-16166.

**SETH S. DEMERRITT
DIRECT TESTIMONY
PART II**

1 **Q. What is the purpose of your pre-filed direct testimony?**

2 A. The purpose of my pre-filed direct testimony is to provide an explanation of the
3 methodology used to the develop UPPCO's revenue deficiency for the 2012
4 projected test year.

5

6 **Q. Are you sponsoring any exhibits in this proceeding?**

7 A. Yes, I am. I am sponsoring:
8
9 1. Exhibit A-1 (SSD-1), Schedules A1 and A2,
10 2. Exhibit A-2 (SSD-2), Schedules B1-B10,
11 3. Exhibit A-3 (SSD-3), Schedules C1-C21,
12 4. Exhibit A-7 (SSD-4),
13 5. Exhibit A-8 (SSD-5),
14 6. Exhibit A-10 (SSD-6),
15 7. Exhibit A-11 (SSD-7), Schedule A1,
16 8. Exhibit A-12 (SSD-8), Schedules B1-B4, and
17 9. Exhibit A-13 (SSD-9), Schedules C1-C11.
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27 **Q. Were these exhibits prepared by you or under your direction and supervision?**

28 A. Yes, they were.
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30 **Q. Please describe Schedule A1 of Exhibit A-1 (SSD-1).**

31 A. Schedule A1 of Exhibit A-1 (SSD-1) calculates UPPCO's 2012 projected test year
32 revenue deficiency based on its rate base, adjusted net operating income, rate of
33 return, and revenue conversion factor.

34

1 **Q. Please describe Schedule A2 of Exhibit A-1 (SSD-1).**

2 A. Schedule A2 of Exhibit A-1 (SSD-1) bridges UPPCO's 2010 retail revenue deficiency
3 to UPPCO's 2012 forecasted retail revenue deficiency.

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5 **Q. Please describe Schedule B1 of Exhibit A-2 (SSD-2).**

6 A. Schedule B1 of Exhibit A-2 (SSD-2) calculates UPPCO's 2012 projected test year
7 rate base.

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9 **Q. Please describe Schedule B2 of Exhibit A-2 (SSD-2).**

10 A. Schedule B2 of Exhibit A-2 (SSD-2) calculates UPPCO's 2012 projected test year
11 utility plant.

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13 **Q. Please describe Schedule B3 of Exhibit A-2 (SSD-2).**

14 A. Schedule B3 of Exhibit A-2 (SSD-2) depicts UPPCO's 2012 projected test year
15 accumulated provision for depreciation.

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17 **Q. Please describe Schedule B4 of Exhibit A-2 (SSD-2).**

18 A. Schedule B4 of Exhibit A-2 (SSD-2) calculates UPPCO's 2012 projected test year
19 working capital.

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21 **Q. Please describe Schedule B5 of Exhibit A-2 (SSD-2).**

22 A. Schedule B5 of Exhibit A-2 (SSD-2) identifies the major reasons for the increase in
23 rate base from the 2010 historic test year to the 2012 projected test year on a 13-
24 month average basis.

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26 **Q. Please describe Schedule B6 of Exhibit A-2 (SSD-2).**

27 A. Schedule B6 of Exhibit A-2 (SSD-2) identifies the capital projects with expenditures

1 greater than \$500,000 forecasted from July 2010 through December 2012.

2

3 **Q. Please describe Schedule B7 of Exhibit A-2 (SSD-2).**

4 A. Schedule B7 of Exhibit A-2 (SSD-2) are documents from the Federal Energy
5 Regulatory Commission ("FERC") to UPPCO approving a schedule and plan to
6 replace the penstock at UPPCO's McClure hydroelectric facility, as required by
7 FERC. Several documents are confidential because they contain Critical Energy
8 Infrastructure Information, which cannot be released publicly.

9

10 **Q. Please describe Schedule B8 of Exhibit A-2 (SSD-2).**

11 A. Schedule B8 of Exhibit A-2 (SSD-2) are documents from FERC to UPPCO requiring
12 UPPCO meet the probable maximum flood capacity at UPPCO's Bond Falls
13 hydroelectric facility before the next consultant safety inspection report is due.
14 Several documents are confidential because they contain Critical Energy
15 Infrastructure Information, which cannot be released publicly.

16

17 **Q. Please describe Schedule B9 of Exhibit A-2 (SSD-2).**

18 A. Schedule B9 of Exhibit A-2 (SSD-2) are documents from FERC to UPPCO approving
19 a schedule to proceed with UPPCO's required improvements of the Victoria
20 hydroelectric facility spillway. Several documents are confidential because they
21 contain Critical Energy Infrastructure Information, which cannot be released publicly.

22

23 **Q. Please describe Schedule B10 of Exhibit A-2 (SSD-2).**

24 A. Schedule B10 of Exhibit A-2 (SSD-2) are documents from FERC to UPPCO
25 discussing the Prickett hydroelectric facility drain system and spillway adequacy
26 project. Several documents are confidential because they contain Critical Energy
27 Infrastructure Information, which cannot be released publicly.

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Q. Please describe Schedule C1 of Exhibit A-3 (SSD-3).

A. Page 1 of Schedule C1 of Exhibit A-3 (SSD-3) calculates UPPCO's 2012 projected test year adjusted net operating income. Page 2 of Schedule C1 of Exhibit A-3 (SSD-3) calculates UPPCO's 2012 projected test year interest synchronization.

Q. Please describe Schedule C2 of Exhibit A-3 (SSD-3).

A. Schedule C2 of Exhibit A-3 (SSD-3) calculates UPPCO's 2012 projected test year gross revenue conversion factor.

Q. Please describe Schedule C3 of Exhibit A-3 (SSD-3).

A. Schedule C3 of Exhibit A-3 (SSD-3) calculates UPPCO's 2012 projected test year total revenue.

Q. Please describe Schedule C4 of Exhibit A-3 (SSD-3).

A. Schedule C4 of Exhibit A-3 (SSD-3) calculates UPPCO's 2012 projected test year total fuel and purchased power cost.

Q. Please describe Schedule C5 of Exhibit A-3 (SSD-3).

A. Schedule C5 of Exhibit A-3 (SSD-3) calculates UPPCO's 2012 projected test year total operation and maintenance ("O&M") expense.

Q. Please describe Schedule C6 of Exhibit A-3 (SSD-3).

A. Schedule C6 of Exhibit A-3 (SSD-3) depicts UPPCO's 2012 projected test year total depreciation and amortization expense.

1 **Q. Please describe Schedule C7 of Exhibit A-3 (SSD-3).**

2 A. Schedule C7 of Exhibit A-3 (SSD-3) calculates UPPCO's 2012 projected test year
3 total for taxes other than income taxes.

4

5 **Q. Please describe Schedule C8 of Exhibit A-3 (SSD-3).**

6 A. Schedule C8 of Exhibit A-3 (SSD-3) depicts UPPCO's 2012 projected test year
7 federal income taxes.

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9 **Q. Please describe Schedule C9 of Exhibit A-3 (SSD-3).**

10 A. Schedule C9 of Exhibit A-3 (SSD-3) depicts UPPCO's 2012 projected test year state
11 income taxes.

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13 **Q. Please describe Schedule C10 of Exhibit A-3 (SSD-3).**

14 A. Schedule C10 of Exhibit A-3 (SSD-3) depicts UPPCO's 2012 projected test year local
15 taxes.

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17 **Q. Please describe Schedule C11 of Exhibit A-3 (SSD-3).**

18 A. Schedule C11 of Exhibit A-3 (SSD-3) depicts UPPCO's 2012 projected test year
19 AFUDC.

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21 **Q. Please describe Schedule C12 of Exhibit A-3 (SSD-3).**

22 A. Schedule C12 of Exhibit A-3 (SSD-3) develops the Non-Fuel O&M costs for
23 UPPCO's 2012 projected test year.

24

25 **Q. Please describe Schedule C13 of Exhibit A-3 (SSD-3).**

26 A. Schedule C13 of Exhibit A-3 (SSD-3) calculates the "Known and Measurable"
27 ("K&M") adjustment for the Victoria Hydro Unit 2 Overhaul.

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Q. Please describe Schedule C14 of Exhibit A-3 (SSD-3).

A. Schedule C14 of Exhibit A-3 (SSD-3) calculates the K&M adjustment for removal of October 2010 storm costs.

Q. Please describe Schedule C15 of Exhibit A-3 (SSD-3).

A. Schedule C15 of Exhibit A-3 (SSD-3) calculates the K&M adjustment associated with reading customer meters on a monthly basis.

Q. Please describe Schedule C16 of Exhibit A-3 (SSD-3).

A. Schedule C16 of Exhibit A-3 (SSD-3) calculates the K&M adjustment associated with Uncollectibles expense.

Q. Please describe Schedule C17 of Exhibit A-3 (SSD-3).

A. Schedule C17 of Exhibit A-3 (SSD-3) calculates the K&M adjustment associated with independent audit costs required for UPPCO to comply with MCL 460.11(7).

Q. Please describe Schedule C18 of Exhibit A-3 (SSD-3).

A. Schedule C18 of Exhibit A-3 (SSD-3) calculates the K&M adjustment associated with Injuries and Damages.

Q. Please describe Schedule C19 of Exhibit A-3 (SSD-3).

A. Schedule C19 of Exhibit A-3 (SSD-3) calculates the K&M adjustment associated with the depreciation and carrying charges of the Peoplesoft Finance and Human Resource system upgrade at IBS.

Q. Please describe Schedule C20 of Exhibit A-3 (SSD-3).

1 A. Schedule C20 of Exhibit A-3 (SSD-3) calculates the amortization expense related to
2 the deferral of the loss on the sale of the Cataract hydroelectric generation facility.

3

4 **Q. Please describe Schedule C21 of Exhibit A-3 (SSD-3).**

5 A. Schedule C21 of Exhibit A-3 (SSD-3) calculates the expense and ratebase impact
6 related to the reduction in Wholesale load.

7

8 **Q. Please describe Exhibit A-7 (SSD-4).**

9 A. Exhibit A-7 (SSD-4) calculates the inflation factors for 2011 and 2012 that were
10 applied to the 2010 historic test year Non-Fuel O&M expenses to determine 2012
11 projected test year Non-Fuel O&M expenses, exclusive of K&M items.

12

13 **Q. Please describe Exhibit A-8 (SSD-5).**

14 A. Exhibit A-8 (SSD-5) identifies, by FERC Account, the bonuses, incentives, and
15 Supplemental Executive Retirement Plan, which was required by order point P of the
16 Final Order in Case No. U-16166.

17

18

19 **Q. Please describe Schedule A1 of Exhibit A-11 (SSD-7).**

20 A. Schedule A1 of Exhibit A-11 (SSD-7) calculates UPPCO's 2010 historic test year
21 revenue deficiency based on its rate base, adjusted net operating income, rate of
22 return, and revenue conversion factor.

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24 **Q. Please describe Schedule B1 of Exhibit A-12 (SSD-8).**

25 A. Schedule B1 of Exhibit A-12 (SSD-8) calculates UPPCO's 2010 historic test year rate
26 base.

27

- 1 **Q. Please describe Schedule B2 of Exhibit A-12 (SSD-8).**
- 2 A. Schedule B2 of Exhibit A-12 (SSD-8) calculates UPPCO's 2010 historic test year
3 utility plant.
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- 5 **Q. Please describe Schedule B3 of Exhibit A-12 (SSD-8).**
- 6 A. Schedule B3 of Exhibit A-12 (SSD-8) depicts UPPCO's 2010 historic test year
7 accumulated provision for depreciation.
- 8
- 9 **Q. Please describe Schedule B4 of Exhibit A-12 (SSD-8).**
- 10 A. Schedule B4 of Exhibit A-12 (SSD-8) calculates UPPCO's 2010 historic test year
11 working capital.
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- 13 **Q. Please describe Schedule C1 of Exhibit A-13 (SSD-9).**
- 14 A. Schedule C1 of Exhibit A-13 (SSD-9) calculates UPPCO's 2010 historic test year
15 adjusted net operating income.
- 16
- 17 **Q. Please describe Schedule C2 of Exhibit A-13 (SSD-9).**
- 18 A. Schedule C2 of Exhibit A-13 (SSD-9) calculates UPPCO's 2010 historic test year
19 gross revenue conversion factor.
- 20
- 21 **Q. Please describe Schedule C3 of Exhibit A-13 (SSD-9).**
- 22 A. Schedule C3 of Exhibit A-13 (SSD-9) calculates UPPCO's 2010 historic test year
23 total revenue.
- 24
- 25 **Q. Please describe Schedule C4 of Exhibit A-13 (SSD-9).**
- 26 A. Schedule C4 of Exhibit A-13 (SSD-9) calculates UPPCO's 2010 historic test year
27 total fuel and purchased power cost.

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Q. Please describe Schedule C5 of Exhibit A-13 (SSD-9).

A. Schedule C5 of Exhibit A-13 (SSD-9) calculates UPPCO's 2010 historic test year total O&M expense.

Q. Please describe Schedule C6 of Exhibit A-13 (SSD-9).

A. Schedule C6 of Exhibit A-13 (SSD-9) depicts UPPCO's 2010 historic test year total depreciation and amortization expense.

Q. Please describe Schedule C7 of Exhibit A-13 (SSD-9).

A. Schedule C7 of Exhibit A-13 (SSD-9) calculates UPPCO's 2010 historic test year total for taxes other than income taxes.

Q. Please describe Schedule C8 of Exhibit A-13 (SSD-9).

A. Schedule C8 of Exhibit A-13 (SSD-9) depicts UPPCO's 2010 historic test year federal income taxes.

Q. Please describe Schedule C9 of Exhibit A-13 (SSD-9).

A. Schedule C9 of Exhibit A-13 (SSD-9) depicts UPPCO's 2010 historic test year state income taxes.

Q. Please describe Schedule C10 of Exhibit A-13 (SSD-9).

A. Schedule C10 of Exhibit A-13 (SSD-9) depicts UPPCO's 2010 historic test year local taxes.

Q. Please describe Schedule C11 of Exhibit A-13 (SSD-9).

A. Schedule C11 of Exhibit A-13 (SSD-9) depicts UPPCO's 2010 historic test year

1 Allowance of Funds Used During Construction (“AFUDC”).

2

3 **Background**

4 **Q. Are you familiar with the application of UPPCO for authority to increase retail**
5 **electric rates?**

6 A. Yes, I am.

7

8 **Q. Please provide a brief description of UPPCO and the area it serves.**

9 A. UPPCO is a corporation organized under the laws of the state of Michigan, with its
10 principal office located at 500 N. Washington Street, Ishpeming, Michigan 49849,
11 and is authorized to transact business in the state of Michigan. UPPCO is a
12 subsidiary of Integrys, and a sister utility company to Michigan Gas Utilities
13 Corporation (“MGUC”) and WPS Corp, both of which are also regulated by this
14 Commission. UPPCO is also a sister utility company to, among others, MERC, The
15 Peoples Gas Light and Coke Company (“PGL”), and North Shore Gas Company
16 (“NSG”), none of which are regulated by this Commission.

17

18 UPPCO is a public utility engaged in the generation, purchase, distribution and sale
19 of electric energy to approximately 53,000 retail customers in 118 communities in the
20 Upper Peninsula of Michigan. UPPCO serves certain cities, villages and townships
21 located in the counties of Alger, Baraga, Delta, Houghton, Iron, Keweenaw,
22 Marquette, Menominee, Ontonagon and Schoolcraft. UPPCO’s primary service area
23 is known as its “Integrated System” serving, directly or indirectly, various communities
24 and localities in each of the above-named counties except Iron County. In Iron
25 County, UPPCO serves in and about the City of Iron River, such service area being
26 known as its “Iron River System.”

27

28 UPPCO’s service territory covers approximately 4,460 square miles.

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In 2010 UPPCO furnished wholesale electrical energy to four municipalities and one cooperative. In 2012 UPPCO is forecasting to provide no wholesale electrical energy.

UPPCO's retail customer density is approximately 12 customers per square mile.

UPPCO owns approximately 3,526 miles of primary and secondary distribution lines, and approximately 851 miles of service lines, located throughout its service area.

Substantially all of UPPCO's electric transmission assets were transferred to the American Transmission Company LLC ("ATCLLC") on June 29, 2001.

Integrys and its subsidiaries have been recognized as superior performers in the utility industry, as summarized on Exhibit A-10 (SSD-6).

Q. Please describe the most recent rate relief obtained by UPPCO.

A. In the most recent rate case, Case No. U-16166, UPPCO used a 2011 test year. A settlement was reached and approved by the Commission granting rate relief of \$8,868,706, based on an overall rate of return of 7.1240%, and a return on common equity of 10.30%, effective January 1, 2011.

Q. Please explain, generally, why rate relief is sought at this time.

A. First, the 2010 historic test year indicates that UPPCO suffered a revenue deficiency of \$1,266,760 in the Michigan retail jurisdiction. This corresponds to a 9.72% return on common equity for the Michigan retail jurisdiction. This value is below UPPCO's 2010 authorized return on common equity of 10.90% for the Michigan retail

1 jurisdiction authorized in UPPCO's rate case proceeding in Case No. U-15988. Even
2 with the 2011 authorized rate increase, UPPCO expects to suffer a significant
3 revenue deficiency in the Michigan retail jurisdiction in 2012.

4
5 Second, general inflation is expected to increase costs at a rate of about 3.37% from
6 2010 to 2012. UPPCO's estimate for inflation for 2011 and 2012 was calculated
7 using a methodology similar to that used by MPSC Staff witness, Kavita B. Bankapur,
8 in UPPCO's last case, Case No. U-16166.

9
10 Third, FERC mandated safety improvements are required at several of UPPCO's
11 hydroelectric generation facilities. A portion of the costs of improving the McClure,
12 Bond Falls, Victoria, and Prickett facilities are included in UPPCO's 2012 revenue
13 requirement. Hydroelectric facility improvements contribute largely to the 18.86%
14 increase in Net Utility Plant from the 2010 historic test year to the 2012 projected test
15 year.

16
17 Fourth, based on the requirements of the Commission's orders in Case No. U-16064,
18 without an extension of UPPCO's current waivers, UPPCO must begin to read
19 customer meters monthly as compared to its current practice of reading customer
20 meters bi-monthly. If the Commission extends UPPCO's current waivers to continue
21 to read customer meters bi-monthly, these increased costs can be avoided.

22
23 Fifth, an increase in employee benefits expense as described in the Direct Testimony
24 of Ms. Christine Phillips.

25
26 Lastly, Schedule A2 of Exhibit A-1 (SSD-1) bridges UPPCO's 2010 retail revenue
27 deficiency to UPPCO's 2012 forecasted retail revenue deficiency.

1 **Q. Have recent revisions to Michigan’s tax structure been reflected in the instant**
2 **general rate case filing?**

3 A. No, they have not. The instant general rate case filing reflects the tax laws in effect
4 as of the filing date. Because revisions to Michigan’s tax structure were not enacted
5 until late May 2011, there was insufficient time for UPPCO to understand and
6 integrate these revisions into UPPCO’s operations. Therefore, it was impossible for
7 UPPCO to reflect these tax structure revisions into the instant general rate case filing.

8
9 On May 25, 2011, Governor Snyder signed into law a number of new tax bills to
10 revise Michigan's tax structure. Specifically, the new laws include the elimination of
11 the Michigan Business Tax (“MBT”), elimination of the Michigan Modified Gross
12 Receipts Tax (“MGRT”), and the creation of a Michigan Corporate Income Tax. All
13 three of the provisions of this legislation will be effective January 1, 2012.

14
15 As a result of the change in measurement of deferred tax balances caused by the
16 revisions to Michigan's tax structure, on June 21, 2011 in Case No. U-16820, UPPCO
17 and other Integrys utilities filed an application proposing to account for these changes
18 by following the principles of full normalization and using the average rate
19 assumption method (“ARAM”). Applying the principals of full normalization and using
20 ARAM would result in the re-measurement of deferred taxes caused by the revisions
21 Michigan's tax structure being offset by a regulatory deferral. The Integrys Utilities
22 proposed that both the resulting deferred tax balance and the offsetting regulatory
23 deferral be normalized through the provision for income taxes based on the ARAM
24 method, beginning on the effective date of the legislation, which is January 1, 2012.
25 This method of accounting would be applicable to the normalization of all MGRT and
26 MBT deferred taxes created out of prior law through the effective date of the new law,
27 and would be based on an average rate computed using the cumulative book-to-tax

1 differences created by the new Michigan tax structure as of the effective date of the
2 new laws.

3
4 UPPCO will be able to quantify the 2012 revenue requirement impacts of the
5 revisions to Michigan's tax structure after the Commission acts on UPPCO's pending
6 application in Case No. U-16820.

7
8 **Q. What has UPPCO and Integrys done to reduce costs for its customers?**

9 A. UPPCO and its parent, Integrys, have identified six items that will reduce costs for
10 UPPCO customers in 2012 and beyond.

- 11 1. UPPCO and Integrys implemented a workforce reduction plan in 2010.
12 During 2010, UPPCO's active employee count was reduced by 14 full-time
13 equivalents ("FTE"), or 9.6%, as a direct result of the workforce reduction.
14 Also, during 2010, IBS' active employee count was reduced by approximately
15 148 FTEs, or 11.1%, as a direct result of the workforce reduction. These cost
16 savings have been reflected in UPPCO's 2012 test year revenue requirement.
17
- 18 2. As discussed in the pre-filed direct testimony of Mr. Charles W. Severance
19 and Mr. Steven J Daavettila, UPPCO pursued alternate management options
20 to avoid costly improvements at the Cataract hydroelectric generation facility.
21
22
- 23 3. Integrys has implemented changes in the methods of tax accounting related
24 to the capitalization of repairs and overheads for tax purposes that it will be
25 using in its state and federal income tax filings. These cost savings have
26 been reflected in UPPCO's 2012 test year revenue requirement.
27
- 28 4. With the construction work being completed, and generation re-commencing,
29 in 2010 at the McClure hydroelectric generation facility, UPPCO customers
30 will benefit from an approximate \$1.9 million reduction in 2012 Power Supply
31 Cost Recovery ("PSCR") costs.
32
- 33 5. UPPCO has also entered into a contractual agreement to sell Renewable
34 Energy Certificates to Detroit Edison Company that will reduce UPPCO's
35 PSCR costs by approximately \$1.1 million in 2012.
36
- 37 6. Finally, a portion of the White Pine capacity purchase contract expires in
38 2011, which will reduce UPPCO's PSCR costs by approximately \$2.6 million
39 in 2012 relative to capacity payments made to White Pine in 2010.
40

41 While items 4, 5, and 6 do not have a direct impact on the base rate change that is
42 being addressed in the instant general rate case, it is important to note these are cost

1 savings that will lower overall costs for customers in 2012.

2

3 **UPPCO Witnesses**

4 **Q. Please identify the UPPCO witnesses, and indicate the subjects they will**
5 **address in their testimony.**

6 A. I provide testimony and evidence regarding:

- 7 1. The revenue deficiency, including
8 a. O&M Expenses,
9 b. K&M Items,
10 c. Amortization of Cataract sale deferral,
11 d. Common equity adjustments,
12 e. Capital structure adjustments,
13 f. Rate base, including hydroelectric facility safety upgrades,
14 g. Operating Income,
15 h. Historical test year, and
16 i. Deferred Taxes
17
18 2. Changes associated with Real Time Market Pricing (“RTMP”) rate
19 schedule,
20
21 3. UPPCO’s “de-coupling” mechanism, or Revenue Stability Mechanism
22 (“RSM”)
23
24 4. Gains from sales of non-utility lands,
25
26 5. Self-Implemented rates pursuant to MCL 460.6a(1), and
27
28 6. The matching of PSCR Costs and Revenues.
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30 7. A cost summary of Employee Bonus, Incentive Compensation, and
31 Supplemental Employee Retirement Plans.
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33

34 Mr. James M. Beyer provides testimony on rate design, including the proposed rate
35 design for unifying the Integrated and Iron River Systems, self-implemented rates,
36 and rate realignment.

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38 Ms. Noreen E. Cleary provides testimony on the updated incentive plan design for
39 non-executive employees.

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41 Mr. Steven J. Daavettila provides testimony on the economic analysis related to the

1 Cataract hydroelectric generation facility.

2

3 Ms. Lisa J. Gast, CPA, provides testimony on UPPCO's capital structure and
4 requested return on common equity.

5

6 Mr. John G. Guntlisbergen provides testimony on the PSCR Base Rate, the PSCR
7 factor, and the PSCR Loss factor.

8

9 Ms. Joylyn C. Hoffman Malueg, CMA, provides testimony on the class cost of service
10 studies.

11

12 Ms. Tracy L. Kupsh provides testimony on IBS cross-charge methodology.

13

14 Mr. Harry W. John provides testimony on the sales forecast.

15

16 Mr. Paul R. Moul provides testimony on the required return on common equity.

17

18 Ms. Christine M. Phillips, CPA, provides testimony regarding employee benefits.

19

20 Mr. Charles W. Severance provides testimony on the sale of the Cataract
21 hydroelectric generation facility, as well as the loss of wholesale load.

22

23 **The Revenue Deficiency**

24 **Q. What is the amount of rate relief UPPCO is seeking in this proceeding?**

25 A. UPPCO's jurisdictional study for the test year ending December 31, 2012, supports
26 an annual rate increase of \$7,701,288, or 7.65%, for the Michigan Retail jurisdictions.

27 This increase is based on a return on common equity of 10.75%, which is supported
28 by the pre-filed direct testimony of Mr. Paul R. Moul.

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The rates sponsored by Mr. James M. Beyer are designed to produce the requested revenue requirement, and to move toward the UPPCO goal of a rate design where each rate schedule will return the overall allowed rate of return, consistent with UPPCO’s cost of service study, UPPCO’s rate design general principles, and existing law.

Q. What test period is UPPCO’s proposed rate increase based on?

A. UPPCO has used a projected test year ending December 31, 2012.

O&M Expenses

Q. Please describe how UPPCO developed 2012 O&M expenses.

A. UPPCO started with 2010 actual O&M expenses, and inflated them to 2012 using inflation factors developed by a methodology similar to that used by MPSC Staff witness, Kavita B. Bankapur, in Case No. U-16166, UPPCO’s 2011 general rate case. The inflation factors used were 1.462% for 2011, and 1.880% for 2012, as developed on Exhibit A-7 (SSD-4). UPPCO then adjusted this 2012 O&M expense value for certain “K&M” items, as shown on Schedule C12 of Exhibit A-3 (SSD-3), and as described later in this testimony.

K&M Items

Q. Please describe the K&M adjustments included in the 2012 projected test year O&M expenses.

A. There are eight K&M adjustments. Six are K&M increases, and two are K&M decreases.

UPPCO has defined K&M items to be any O&M cost item that was increased (or decreased) at a rate other than the rates of inflation calculated on Exhibit A-7 (SSD-

1 4).

2

3 The six K&M increases are associated with:

- 4 1. Normalized costs from the overhaul of Victoria Hydro Unit #2,
- 5
- 6 2. Reading customer meters monthly,
- 7
- 8 3. Uncollectible expenses,
- 9
- 10 4. The independent audit costs required for UPPCO to comply with MCL
- 11 460.11(7),
- 12
- 13 5. PeopleSoft Finance and Human Resources upgrade, and
- 14
- 15 6. Employee benefit costs.
- 16

17 The two K&M decreases are associated with:

- 18 1. Injuries and Damages,
- 19
- 20 2. Contractor cost for October 2010 storm,
- 21
- 22

23 Each of these K&M adjustments are discussed in further detail later in this testimony,
24 or in the pre-filed direct testimony of Ms. Tracy L. Kupsh, or Ms. Christine M. Phillips.

25

26 **Q. Please explain Schedule A1 of Exhibit A-1 (SSD-1).**

27 A. Schedule A1 of Exhibit A-1 (SSD-1) calculates UPPCO's 2012 projected test year
28 revenue deficiency based on its rate base, adjusted net operating income, rate of
29 return, and revenue conversion factor. This schedule indicates that the 2012 Total
30 Company revenue deficiency is \$8,088,629. The 2012 Integrated retail revenue
31 deficiency is \$6,439,862, and the Iron River revenue deficiency is \$1,261,426, for a
32 total retail revenue deficiency of \$7,701,288 as shown on Line 16, using a 10.75%
33 return on equity. The component parts of this schedule are taken from the various
34 sources indexed to the left of each value.

35

1 **Common Equity Adjustments**

2 **Q. What adjustments were made to the equity portion of UPPCO's capital**
3 **structure?**

4 A. UPPCO has removed several accounts both from the 2010 historic test year and the
5 2012 projected test year. For both the 2010 historic test year and the 2012 projected
6 test year, Non-Utility Plant, Non-Operating Deferred Taxes, and Investments in the
7 ATCLLC were removed from UPPCO's Equity balance. This resulted in a reduction
8 of equity of \$14,342,078 in 2010, and \$16,161,062 in 2012, which tends to reduce
9 UPPCO's revenue requirement.

10

11 **Capital Adjustments**

12 **Q. What adjustments were made to UPPCO's overall capital structure?**

13 A. For both the 2010 historic test year and the 2012 projected test year, Non-Utility
14 working capital was removed from capital structure to prevent UPPCO from earning a
15 return on these items. This adjustment included items related to:

- 16 1. The Silver Lake incident deferral,
- 17
- 18 2. Gains from the sale of the JH Warden Plant,
- 19
- 20 3. Losses from the sale of Au Train and Cataract,
- 21
- 22 4. ATCLLC Receivables,
- 23
- 24 5. PSCR Over/Under Collections,
- 25
- 26 6. Customer Deposits, and
- 27
- 28 7. Non-Utility accounts.
- 29

30 This resulted in a capital structure increase of \$2,082,113 in 2010, and a reduction of
31 \$2,651,303 in 2012, which reduces UPPCO's 2012 revenue requirement.

32

33 **Q. Please explain Schedule A2 of Exhibit A-1 (SSD-1).**

34 A. Schedule A2 of Exhibit A-1 (SSD-1) bridges UPPCO's 2010 retail revenue deficiency
35 to UPPCO's 2012 forecasted retail revenue deficiency.

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Rate Base

Q. Please explain Schedule B1 of Exhibit A-2 (SSD-2).

A. Schedule B1 of Exhibit A-2 (SSD-2) calculates UPPCO's 2012 projected test year rate base. The 2012 Total Company rate base is \$178,632,306. The 2012 Integrated retail rate base is \$162,132,731, and the Iron River rate base is \$13,902,733, as shown on Line 21. The component parts of this schedule are taken from the various sources indexed to the left of these amounts. Also, all values shown are 13-month averages.

Q. Please explain Schedule B2 of Exhibit A-2 (SSD-2).

A. Schedule B2 of Exhibit A-2 (SSD-2) depicts UPPCO's 2012 projected test year utility plant. To arrive at the 2012 projected test year utility plant, the June 30, 2010 actual balance of utility plant was projected forward using UPPCO's 2010, 2011, and 2012 construction budgets. The 2012 Total Company utility plant is \$262,549,668. The 2012 Integrated retail utility plant is \$236,014,528, and the Iron River utility plant is \$21,921,639, as shown on Line 13. Also, all values shown are 13-month averages.

Q. Please explain Schedule B3 of Exhibit A-2 (SSD-2).

A. Schedule B3 of Exhibit A-2 (SSD-2) depicts UPPCO's 2012 projected test year accumulated provision for depreciation. To arrive at the 2012 projected test year accumulated provision for depreciation, the June 30, 2010 actual balance of accumulated provision for depreciation was projected forward using UPPCO's 2010, 2011, and 2012 construction budgets. The 2012 Total Company accumulated provision for depreciation is \$100,778,535. The 2012 Integrated retail accumulated provision for depreciation is \$88,897,582, and the Iron River accumulated provision for depreciation is \$9,721,155, as shown on Line 2. Also, all values shown are 13-month averages.

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Q. Please explain Schedule B4 of Exhibit A-2 (SSD-2).

A. Schedule B4 of Exhibit A-2 (SSD-2) calculates UPPCO's 2012 projected test year working capital. The 2012 Total Company working capital is \$16,861,173. The 2012 Integrated retail working capital is \$15,015,785, and the Iron River working capital is \$1,702,249, as shown on Line 43. Also, all values shown are 13-month averages.

Q. Please explain Schedule B5 of Exhibit A-2 (SSD-2).

A. Schedule B5 of Exhibit A-2 (SSD-2) identifies the major projects contributing to the increase in UPPCO's 2012 projected test year rate base as compared to the 2010 historic year rate base. The total 13-month average increase from the 2010 historic test year to the 2012 projected test year is \$25.3 million, as shown on Line 2.

The major reasons for the \$25.3 million increase in rate base include, on a 13-month average:

1. \$17.5 million for FERC mandated safety related upgrades at UPPCO's hydroelectric generation facilities, including:
 - a. \$6.8 million to replace the penstock at the McClure hydroelectric facility. In November 2007, one of the steel penstock expansion joints ruptured, resulting in an uncontrolled release of water from the pipe and a complete shutdown of the pipeline and the McClure generating facility. An engineering analysis in 2008 of the entire penstock system determined that the penstock had reached the end of its useful life, as the penstock had been overstressed. This project replaced the existing penstock, such that the 8.5 MW generating unit at McClure is operational once again. Please see Schedule B7 of Exhibit A-2 (SSD-2) for documents from FERC to UPPCO approving a schedule and plan to replace the penstock at UPPCO's McClure hydroelectric facility. Because the complete exhibit contains Critical Energy Infrastructure Information, it will be filed pursuant to a Protective Order.
 - b. \$5.1 million for an engineering study, physical model testing, and replacement of the spillway gates at the Bond Falls project. The Bond Falls project was operating with a reduced reservoir elevation as a risk mitigation measure associated with compliance with a FERC dam safety issue with meeting the Probable Maximum Flood level. Please see Schedule B8 of Exhibit A-2

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(SSD-2) for documents from FERC to UPPCO requiring UPPCO to meet the probable maximum flood capacity at UPPCO's Bond Falls hydroelectric facility before the next consultant safety inspection report is due. Because the complete exhibit contains Critical Energy Infrastructure Information, it will be filed pursuant to a Protective Order.

c. \$1.8 million for engineering studies of spillway adequacy at the Victoria project, as the current spillway cannot safely pass the Probable Maximum Flood. The Victoria project is currently operating with a reduced reservoir elevation as a risk mitigation measure associated with compliance with a FERC dam safety issue with meeting the Probable Maximum Flood level. Completing these studies will provide valuable information for future design and construction activities needed to restore the full reservoir level and continue generation at this facility. Please see Schedule B9 of Exhibit A-2 (SSD-2) for documents from FERC to UPPCO approving a schedule to proceed with UPPCO's requested improvements of the Victoria hydroelectric facility spillway. Because the complete exhibit contains Critical Energy Infrastructure Information, it will be filed pursuant to a Protective Order.

d. \$3.8 million for a penstock replacement and spillway adequacy project at the Prickett project. The need for a new drain system has been indentified by the FERC and UPPCO operations. The currently installed system is a dam safety concern because of the poor condition of the piping system. The spillway improvements consist of raising the dam embankments and tainter gate walkway. Also included are three new electric gate hoists. The new system will ensure that all gates can be lifted to accommodate the Probable Maximum Flood. Please see Schedule B10 of Exhibit A-2 (SSD-2) for documents from FERC to UPPCO regarding these projects. Because the complete exhibit contains Critical Energy Infrastructure Information, it will be filed pursuant to a Protective Order.

- 2. \$5.7 million for miscellaneous routine or "blanket" distribution plant projects, such as line extensions, line transformers, electric reject poles, and miscellaneous jobs.
- 3. \$1.7 million related to general plant projects such as fleet purchases and building and structure improvements.

45 **Q. Please explain Schedule B6 of Exhibit A-2 (SSD-2).**

46 A. Schedule B6 of Exhibit A-2 (SSD-2) identifies the projects that have capital
47 expenditures greater than \$500,000 for the time period of July 2010 through June
48 2012. These expenditures were forecasted in UPPCO's 2011 budget process which
49 occurred in the fall of 2010, and then updated in January 2011. Each of the hydro

1 electric upgrade projects has already been discussed earlier in this testimony.

2

3 **Q. Please explain the Winona – New 69/12KV Feeder and the Winona Feeder Exit**
4 **to Twin Lake projects shown on Schedule B6 of Exhibit A-2 (SSD-2).**

5 A. These two projects go hand-in-hand, as both are required to address updated
6 electrical code requirements at the existing Twin Lakes Substation, and to provide
7 better access to the substation, as this substation is located on a golf course fairway.
8 The updated National Electrical Safety Code (“NESC”) requires a safety clearance
9 zone of 11’ 7” for 69 kV lines. These facilities do not meet this requirement, as they
10 were constructed prior to this updated requirement becoming effective.

11

12 **Q. Please explain the Purchase GSU’s project shown on Schedule B6 of Exhibit A-**
13 **2 (SSD-2).**

14 A. Neither the McClure or Hoist hydro-electric generation facilities have a spare
15 generator step-up transformer (“GSU”). In the event of a failure of a GSU at either of
16 these sites, the associated generation would be unavailable for an extended period
17 of time while a replacement GSU is located or manufactured, delivered to UPPCO,
18 and installed. While tests of the currently installed GSUs indicate that failure is not
19 imminent, these GSUs have been in-service for over 55 years. Based on their
20 advanced age, the GSUs are nearing the end of their useful life. To minimize the risk
21 of an extended interruption in service as the result of a GSU transformer failure at
22 either of these sites, and to increase the reliability of the UPPCO system, UPPCO
23 plans to purchase a single spare GSU which is compatible with both sites.
24 Purchasing a single spare that is compatible with both sites will significantly reduce
25 the risk of an extended interruption in service, and help to minimize the overall cost to
26 UPPCO’s customers.

27

1 **Q. Please explain the McClure – Upgrade Protection System project shown on**
2 **Schedule B6 of Exhibit A-2 (SSD-2).**

3 A. This project provides new protective relays and controls at the McClure hydro-electric
4 generation facility, replacing the existing equipment which is over 40 years old. This
5 upgrade allows for remote operation of the McClure facility from the Energy Supply
6 and Control Center in Green Bay, and also includes self-diagnostics which will
7 improve reliability through better coordination and protection from faults.

8

9 **Q. Please explain the Chassell CKT 336 Broemer to Chassell project shown on**
10 **Schedule B6 of Exhibit A-2 (SSD-2).**

11 A. This project upgrades 4.1 miles of distribution line from Broemer Road to Chassell -
12 Painesdale Road. This project is required to correct low voltage on this portion of the
13 UPPCO system due to customer growth, in order to be in compliance with the voltage
14 limits established by Rule 460.3702(2)(a).

15

16 **Q. Please explain the Routine Projects shown on Schedule B6 of Exhibit A-2**
17 **(SSD-2).**

18 A. The “Routine Projects” shown on Schedule B6 of Exhibit A-2 (SSD-2) are “blanket”
19 construction projects which individually do not meet the \$500,000 threshold set for
20 this exhibit. Each of these line items is forecasted based on historical values.

21

22 **Operating Income**

23 **Q. Please explain Schedule C1 of Exhibit A-3 (SSD-3).**

24 A. Schedule C1 of Exhibit A-3 (SSD-3) calculates UPPCO’s 2012 projected test year
25 adjusted net operating income. The 2012 Total Company adjusted net operating
26 income is \$7,344,486. The 2012 Integrated retail adjusted net operating income is
27 \$7,216,899, and the Iron River adjusted net operating income is \$185,603, as shown
28 on Line 22. The interest synchronization calculation is shown on page 2.

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Q. Please explain Schedule C2 of Exhibit A-3 (SSD-3).

A. Schedule C2 of Exhibit A-3 (SSD-3) calculates UPPCO's 2012 projected test year gross revenue conversion factor. The 2012 gross revenue conversion factor is 1.637, as shown on Line 20.

Q. Please explain Schedule C3 of Exhibit A-3 (SSD-3).

A. Schedule C3 of Exhibit A-3 (SSD-3) calculates UPPCO's 2012 projected test year total revenue. The 2012 Total Company total revenue is \$114,603,427. The 2012 Integrated retail total revenue is \$104,146,326, and the Iron River total revenue is \$9,496,093, as shown on Line 6.

Q. Please explain Schedule C4 of Exhibit A-3 (SSD-3).

A. Schedule C4 of Exhibit A-3 (SSD-3) calculates UPPCO's 2012 projected test year total fuel and purchased power cost. The 2012 Total Company total fuel and purchased power cost is \$52,861,056. The 2012 Integrated retail total fuel and purchased power cost is \$47,873,751, and the Iron River total fuel and purchased power cost is \$4,987,305, as shown on Line 6.

Q. Please explain Schedule C5 of Exhibit A-3 (SSD-3).

A. Schedule C5 of Exhibit A-3 (SSD-3) calculates UPPCO's 2012 projected test year total O&M expense, exclusive of fuel and purchased power. The 2012 Total Company total O&M expense is \$36,368,839. The 2012 Integrated retail total O&M expense is \$32,571,459, and the Iron River total O&M expense is \$2,927,674, as shown on Line 10.

Q. Please explain Schedule C6 of Exhibit A-3 (SSD-3).

1 A. Schedule C6 of Exhibit A-3 (SSD-3) depicts UPPCO's 2012 projected test year total
2 depreciation and amortization expense. The 2012 Total Company total depreciation
3 and amortization expense is \$9,355,966. The 2012 Integrated retail total
4 depreciation and amortization expense is \$8,309,302, and the Iron River total
5 depreciation and amortization expense is \$926,935, as shown on Line 6.
6 Depreciation on Line 3 was calculated based upon projected plant balances and
7 closings for the 2012 test year, using the depreciation rates approved in Case No. U-
8 15989.

9
10 **Q. Please explain Schedule C7 of Exhibit A-3 (SSD-3).**

11 A. Schedule C7 of Exhibit A-3 (SSD-3) calculates UPPCO's 2012 projected test year
12 total for taxes other than income taxes. The 2012 Total Company total for taxes
13 other than income taxes are \$5,837,331. The 2012 Integrated retail total for taxes
14 other than income taxes are \$5,244,402, and the Iron River total for taxes other than
15 income taxes are \$485,346, as shown on Line 29.

16
17 **Q. Please explain the increase between the 2010 historical test year and the 2012
18 projected test year in taxes other than income taxes.**

19 A. Taxes other than income taxes increased \$751,903 from the 2010 historical test year
20 to the 2012 projected test year. Of this amount, \$724,290 is related to property taxes
21 due to the significant capital projects completed in 2010 at the McClure and Bond
22 Falls hydro generation facilities.

23
24 **Q. Please explain Schedule C8 of Exhibit A-3 (SSD-3).**

25 A. Schedule C8 of Exhibit A-3 (SSD-3) depicts UPPCO's 2012 projected test year
26 federal income taxes. The 2012 Total Company federal income taxes are
27 \$1,717,025. The 2012 Integrated retail federal income taxes is \$1,857,017, and the

1 Iron River federal income taxes is (\$69,412), as shown on Line 43.

2

3 **Q. Please explain Schedule C9 of Exhibit A-3 (SSD-3).**

4 A. Schedule C9 of Exhibit A-3 (SSD-3) depicts UPPCO's 2012 projected test year state
5 income taxes. The 2012 Total Company state income taxes are \$1,140,727. The
6 2012 Integrated retail state income taxes are \$1,093,203, and the Iron River state
7 income taxes are \$54,566, as shown as the sum of Lines 14 on both pages 1 and 2.

8

9 **Q. Please explain Schedule C10 of Exhibit A-3 (SSD-3).**

10 A. Schedule C10 of Exhibit A-3 (SSD-3) depicts UPPCO's 2012 projected test year local
11 taxes. The 2012 Total Company local taxes are \$0, as shown on Line 2.

12

13 **Q. Please explain Schedule C11 of Exhibit A-3 (SSD-3).**

14 A. Schedule C11 of Exhibit A-3 (SSD-3) depicts UPPCO's 2012 projected test year
15 AFUDC. The 2012 Total Company AFUDC is \$0, as shown on Line 5.

16

17 **Q. Please explain Schedule C12 of Exhibit A-3 (SSD-3).**

18 A. Schedule C12 of Exhibit A-3 (SSD-3) develops the O&M costs for UPPCO's 2012
19 projected test year. This schedule starts with 2010 actual O&M amounts, excluding
20 fuel. The 2010 expenses were first inflated at the estimated inflation factors of
21 1.462% for 2011 and 1.880% for 2012, as calculated on Exhibit A-7 (SSD-4). O&M
22 was then adjusted for K&M items.

23

24 **Q. Please explain Schedule C13 of Exhibit A-3 (SSD-3).**

25 A. Schedule C13 of Exhibit A-3 (SSD-3) calculates the \$469,000 K&M adjustment for
26 the normalized costs of the Victoria Hydro Unit 2 Overhaul.

27

1 **Q. Why was Victoria Unit 2 in need of an overhaul?**

2 A. Victoria unit 2 generator stator electrical tests indicate elevated insulation power
3 factor values. Generators with this type of insulation should exhibit insulation power
4 factor values of 4% or less. Insulation power factor values as high as 6.6% have
5 been measured on Victoria Unit 2.

6

7 In March 2007, Victoria Unit 1 power factor values were measured at 4.0% to 4.6%.

8 Victoria Unit 1 subsequently failed, and was rewound in late 2007.

9

10 Insulation power factor measurement is a good indicator of dielectric losses and the
11 general condition of the insulation system. As insulation ages or becomes more
12 contaminated, it become more resistive, resulting in changes in the insulation power
13 factor measurements. This testing is also commonly called "Doble testing".

14

15 Planning and scheduling a rewind on Victoria Unit 2 is the best method to reduce risk
16 and rewind costs. An "in-service" failure would likely result in additional generator
17 stator core damage. A scheduled rewind also results in lower rewind vendor costs.

18

19 In addition to the generator stator issues discussed above, the Victoria Unit 2
20 generator field coil has shorted field pole coils. Without overhaul, the risk of a
21 catastrophic field coil failure significantly increases. A coil shorting to ground can
22 damage the rotor pole steel, resulting in an outage and an expensive repair.

23

24 **Q. Were the costs related to the Victoria Unit 2 Overhaul included in the revenue
25 requirement in UPPCO's general rate case in Case No. U-16166?**

26 A. Yes, they were. UPPCO requested recovery \$1,406,404 of costs associated with the
27 Victoria Unit 2 Overhaul as part of its 2011 projected test year revenue requirement in

1 Case No. U-16166. However, in Order Point “Q” in the Commission’s December 21,
2 2012 Order Approving Settlement Agreement in Case No. U-16166, Commission
3 finds that recovery of costs are to be normalized over 3 years:

4 “The costs to overhaul Victoria Unit #2 should be normalized for
5 rate-making purposes over a three-year period at \$469,000 per
6 year, on a corporate basis, commencing January 1, 2011.”
7

8 Therefore, the Commission has authorized UPPCO to recover of one-third of the total
9 cost of the Victoria Unit 2 Overhaul, or \$469,000, in each of the three years 2011,
10 2012 and 2013. Therefore, UPPCO is including \$469,000 of Victoria Unit 2 Overhaul
11 costs in its 2012 test year revenue requirement.
12

13 **Q. Please explain Schedule C14 of Exhibit A-3 (SSD-3).**

14 A. Schedule C14 of Exhibit A-3 (SSD-3) calculates the (\$376,663) K&M adjustment for
15 contractor costs associated with the outages that occurred as the result of a storm in
16 the UPPCO service territory in October 2010. UPPCO considers these costs as
17 unique in nature, and does not anticipate that the so called “Storm of the Century” will
18 re-occur in 2012. Therefore, the contractor costs that UPPCO incurred to assist its
19 own line crews are being excluded from the 2012 test year.
20

21 **Q. Please explain Schedule C15 of Exhibit A-3 (SSD-3).**

22 A. Schedule C15 of Exhibit A-3 (SSD-3) calculates the \$926,198 K&M adjustment
23 associated with reading customer meters on a monthly basis. UPPCO has been
24 granted waivers from the Commission in Case Nos. U-14851, U-15603, U-16064,
25 and U-16449 that exempt UPPCO from having to read customer meters monthly as
26 required under R460.1608(1) and R460.113(1). The waivers granted in Case No. U-
27 16449 expire on September 29, 2011 for Non-Residential customers, and on
28 November 8, 2011 for Residential customers. These waivers must be renewed
29 annually. If these waivers are not extended, UPPCO will be required to hire

1 additional meter readers, which will increase UPPCO's 2012 projected test year
2 meter reading costs to \$1,910,711. This creates a K&M adjustment of \$926,198 over
3 the 2010 inflated amounts in Account 902, as shown on Line 7.

4
5 If UPPCO is granted a long-term extension of these monthly meter reading waivers,
6 UPPCO will forego this portion of the requested rate increase.

7
8 **Q. Please explain Schedule C16 of Exhibit A-3 (SSD-3).**

9 A. Schedule C16 of Exhibit A-3 (SSD-3) calculates the \$277,904 K&M adjustment
10 associated with uncollectibles expense. UPPCO has forecasted its 2012 projected
11 test year uncollectibles expense to equal its 3-year historical average, which is
12 \$527,863. This results in a total K&M of \$277,904 in Account 904, as shown on Line
13 7 of page 2 of Exhibit A-3 (SSD-3), Schedule C16.

14
15 **Q. Please explain Schedule C17 of Exhibit A-3 (SSD-3).**

16 A. Schedule C17 of Exhibit A-3 (SSD-3) calculates the \$25,000 K&M adjustment
17 associated with independent audit costs required for UPPCO to comply with MCL
18 460.11(7), which states:

19 "The commission shall annually retain an independent consultant
20 to verify that the requirements of this section are being satisfied
21 for each electric utility. The costs of this service shall be
22 recoverable in the utility's electric rates. This subsection does not
23 apply after December 31, 2015." (emphasis added).
24

25 Based on billings paid by UPPCO regarding the audits of Case Nos. U-15988 and U-
26 16616, UPPCO has included \$25,000 as a K&M adjustment for 2012.

27
28 **Q. Please explain Schedule C18 of Exhibit A-3 (SSD-3).**

29 A. Schedule C18 of Exhibit A-3 (SSD-3) calculates the (\$110,914) K&M adjustment
30 associated with Injuries and Damages. UPPCO has forecasted its 2012 projected

1 test year Injuries and Damages expense to equal to be its 5-year historical average,
2 which is \$290,161 as shown on line 14. This results in a total K&M reduction of
3 \$110,914 in Account 925, as shown on Line 7.

4
5 **Q. Please explain Schedule C19 of Exhibit A-3 (SSD-3).**

6 A. Schedule C19 of Exhibit A-3 (SSD-3) calculates the \$361,138 K&M adjustment for
7 the PeopleSoft Finance and Human Resources upgrade as described in the Direct
8 Testimony of Ms. Tracy L. Kupsh.

9
10 **Q. Please explain Schedule C20 of Exhibit A-3 (SSD-3).**

11 A. Schedule C20 of Exhibit A-3 (SSD-3) calculates the \$380,263 annual amortization
12 related to the loss associated with the sale of the Cataract hydroelectric facility.
13 Please see the pre-filed direct testimony of Charles W. Severance and Steven J.
14 Daavettila for more information on this issue. The Commission authorized deferred
15 accounting for the loss on the sale of the Cataract facility in its July 27, 2010 Order
16 Approving Settlement Agreement in Case No. U-16208. UPPCO is requesting to
17 amortize the deferred costs related to the loss on the sale of Cataract, over a 5 year
18 period. This rate treatment is consistent with the rate treatment authorized by the
19 Commission for the loss on the sale of the Au Train hydroelectric facility in Case No.
20 U-16166.

21
22 **Q. Please explain the components of the Cataract deferral.**

23 A. The Cataract deferral is comprised of three components:
24 1. The book value of the Cataract facility,
25 2. The net amount paid from UPPCO to UP Hydro, and
26 3. The associated transaction costs.

27

1 The book value of the Cataract facility was \$845,215. This amount was removed
2 from utility plant and placed into a non-rate base balance sheet asset account in
3 December 2009 when the decision was made to explore alternative management
4 options.

5
6 The payment from UPPCO to UP Hydro was \$1,000,000. UP Hydro will use these
7 funds to help bring the Cataract facility into compliance with FERC requirements.

8
9 Transaction costs incurred in the sale were \$56,100.

10
11 **Q. Please explain Schedule C21 of Exhibit A-3 (SSD-3).**

12 A. Schedule C21 of Exhibit A-3 (SSD-3) calculates the cost impacts resulting from the
13 loss of wholesale load. As described and illustrated in the pre-filed direct testimony
14 of Charles W. Severance, UPPCO is experiencing a loss of Wholesale load as the
15 historic Wholesale customers choose other providers.

16
17 The net result is a decrease in the Wholesale revenue requirement, and an increase
18 in the retail revenue requirement, of \$3,696,866.

19
20 Lastly, while Wholesale energy sales are decreasing, Ontonagon, Negaunee, and
21 L'Anse will still be using UPPCO's distribution system to deliver energy to their
22 systems. Therefore, the Non-Coincident Peak ("NCP") demands of these customers
23 are still included in the development of the distribution allocator, even though they are
24 not purchasing energy from UPPCO. The revenues for distribution service are
25 recorded in Miscellaneous Revenue FERC Account 456, and direct assigned to the
26 Wholesale jurisdiction. The Wholesale distribution revenues were \$1,089,932 for
27 2010, and are forecasted to be \$929,860 for 2012.

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Q. Please explain Exhibit A-7 (SSD-4).

A. Exhibit A-7 (SSD-4) calculates the inflation factors for 2011 and 2012 that were subsequently applied to 2010 historic year O&M expenses to calculate 2012 projected test year O&M expenses. The schedule calculates the simple average of five independent inflation forecasts, and results in an inflation factor of 1.462% for 2011, and 1.880% for 2012, as shown on Line 6.

This methodology is similar to that used by MPSC Staff witness, Kavita B. Bankapur, in UPPCO's 2011 general rate case, Case No. U-16166.

Historical Test Year

Q. Please explain Schedule A1 of Exhibit A-11 (SSD-7).

A. Schedule A1 of Exhibit A-11 (SSD-7) calculates UPPCO's 2010 historic test year revenue deficiency based on its rate base, adjusted net operating income, rate of return, and revenue conversion factor. This schedule develops the 2010 Total Company revenue deficiency of \$2,878,819. The 2010 Integrated retail revenue deficiency is \$304,038, and the Iron River revenue deficiency is \$962,722, as shown on Line 16, using a 10.90% return on equity. The component parts of this schedule are taken from the various sources indexed to the left of these amounts.

Q. Please explain Schedule B1 of Exhibit A-12 (SSD-8).

A. Schedule B1 of Exhibit A-12 (SSD-8) calculates UPPCO's 2010 historic test year rate base. The 2010 Total Company rate base is \$153,345,322. The 2010 Integrated retail rate base is \$129,396,975, and the Iron River rate base is \$10,668,640, as shown on Line 21. The component parts of this schedule are taken from the various sources indexed to the left of these amounts.

1 **Q. Please explain Schedule B2 of Exhibit A-12 (SSD-8).**

2 A. Schedule B2 of Exhibit A-12 (SSD-8) calculates UPPCO's 2010 historic test year
3 utility plant. The 2010 Total Company utility plant is \$226,390,196. The 2010
4 Integrated retail utility plant is \$191,235,274, and the Iron River utility plant is
5 \$17,590,343, as shown on Line 13.

6

7 **Q. Please explain Schedule B3 of Exhibit A-12 (SSD-8).**

8 A. Schedule B3 of Exhibit A-12 (SSD-8) depicts UPPCO's 2010 historic test year
9 accumulated provision for depreciation. The 2010 Total Company accumulated
10 provision for depreciation is \$90,289,081. The 2010 Integrated retail accumulated
11 provision for depreciation is \$76,863,110, and the Iron River accumulated provision
12 for depreciation is \$7,587,818, as shown on Line 2.

13

14 **Q. Please explain Schedule B4 of Exhibit A-12 (SSD-8).**

15 A. Schedule B4 of Exhibit A-12 (SSD-8) calculates UPPCO's 2010 historic test year
16 working capital. The 2010 Total Company working capital is \$17,244,207. The 2010
17 Integrated retail working capital is \$15,024,811, and the Iron River working capital is
18 \$666,115, as shown on Line 47.

19

20 **Q. Please explain Schedule C1 of Exhibit A-13 (SSD-9).**

21 A. Schedule C1 of Exhibit A-13 (SSD-9) calculates UPPCO's 2010 historic test year
22 adjusted net operating income. The 2010 Total Company adjusted net operating
23 income is \$9,538,509. The 2010 Integrated retail adjusted net operating income is
24 \$9,347,076, and the Iron River adjusted net operating income is \$197,868, as shown
25 on Line 22.

26

27 **Q. Please explain Schedule C2 of Exhibit A-13 (SSD-9).**

1 A. Schedule C2 of Exhibit A-13 (SSD-9) calculates UPPCO's 2010 historic test year
2 gross revenue conversion factor. The 2010 gross revenue conversion factor is
3 1.637, as shown on Line 20.

4
5 **Q. Please explain Schedule C3 of Exhibit A-13 (SSD-9).**

6 A. Schedule C3 of Exhibit A-13 (SSD-9) calculates UPPCO's 2010 historic test year
7 total revenue. The 2010 Total Company total revenue is \$115,399,905. The 2010
8 Integrated retail total revenue is \$95,091,024, and the Iron River total revenue is
9 \$8,527,211, as shown on Line 6.

10
11 **Q. Please explain Schedule C4 of Exhibit A-13 (SSD-9).**

12 A. Schedule C4 of Exhibit A-13 (SSD-9) calculates UPPCO's 2010 historic test year
13 total fuel and purchased power cost. The 2010 Total Company total fuel and
14 purchased power cost is \$59,436,071. The 2010 Integrated retail total fuel and
15 purchased power cost is \$45,229,263, and the Iron River total fuel and purchased
16 power cost was \$4,706,310, as shown on Line 6.

17
18 **Q. Please explain Schedule C5 of Exhibit A-13 (SSD-9).**

19 A. Schedule C5 of Exhibit A-13 (SSD-9) calculates UPPCO's 2010 historic test year
20 total O&M expense. The 2010 Total Company total O&M expense is \$31,719,781.
21 The 2010 Integrated retail total O&M expense is \$27,244,711, and the Iron River total
22 O&M expense is \$2,534,537, as shown on Line 10.

23
24 **Q. Please explain Schedule C6 of Exhibit A-13 (SSD-9).**

25 A. Schedule C6 of Exhibit A-13 (SSD-9) depicts UPPCO's 2010 historic test year total
26 depreciation and amortization expense. The 2010 Total Company total depreciation
27 and amortization expense is \$6,497,773. The 2010 Integrated retail total

1 depreciation and amortization expense is \$5,415,762, and the Iron River total
2 depreciation and amortization expense is \$636,455, as shown on Line 6.

3

4 **Q. Please explain Schedule C7 of Exhibit A-13 (SSD-9).**

5 A. Schedule C7 of Exhibit A-13 (SSD-9) calculates UPPCO's 2010 historic test year
6 total for taxes other than income taxes. The 2010 Total Company total for taxes
7 other than income taxes is \$5,085,428. The 2010 Integrated retail total for taxes
8 other than income taxes is \$4,303,868, and the Iron River total for taxes other than
9 income taxes is \$407,985, as shown on Line 29.

10

11 **Q. Please explain Schedule C8 of Exhibit A-13 (SSD-9).**

12 A. Schedule C8 of Exhibit A-13 (SSD-9) depicts UPPCO's 2010 historic test year federal
13 income taxes. The 2010 Total Company federal income taxes is \$2,901,206 The
14 2010 Integrated retail federal income taxes is \$3,215,491, and the Iron River federal
15 income taxes is \$90,527, as shown on Line 2.

16

17 **Q. Please explain Schedule C9 of Exhibit A-13 (SSD-9).**

18 A. Schedule C9 of Exhibit A-13 (SSD-9) depicts UPPCO's 2010 historic test year state
19 income taxes. The 2010 Total Company state income taxes is \$701,722. The 2010
20 Integrated retail state income taxes is \$724,569, and the Iron River state income
21 taxes is (\$5,984), as shown on Line 2.

22

23 **Q. Please explain Schedule C10 of Exhibit A-13 (SSD-9).**

24 A. Schedule C10 of Exhibit A-13 (SSD-9) depicts UPPCO's 2010 historic test year local
25 taxes. The 2010 Total Company local taxes is \$0, as shown on Line 2.

26

27 **Q. Please explain Schedule C11 of Exhibit A-13 (SSD-9).**

1 A. Schedule C11 of Exhibit A-13 (SSD-9) depicts UPPCO's 2010 historic test year
2 AFUDC. The 2010 Total Company AFUDC is \$0, as shown on Line 5.

3

4 **Deferred Taxes**

5 **Q. Have there been any significant changes in deferred tax balances between the**
6 **2010 historical test year, and the 2012 proposed test year?**

7 A. Yes, there have. In December 2010, Federal Bonus Depreciation was extended and
8 enhanced, retroactively to September 2010. Therefore, in accordance with prevailing
9 federal law, UPPCO has forecasted 100% bonus depreciation on all projects placed
10 in-service in 2011, and 50% bonus depreciation for projects placed in-service in
11 2012.

12

13 This increased bonus depreciation results in increased deferred tax balances during
14 the 2012 projected test year. As such, UPPCO's deferred tax balances have
15 increased from \$20,975,191 in 2010, to \$30,361,184 in 2012, as shown on Exhibit A-
16 14 (LJG-2), Schedule D-1; and Exhibit A-4 (LJG-1), Schedule D-1. This increase in
17 the deferred tax balance reduces UPPCO's required rate of return, as deferred taxes
18 are considered zero-cost capital in UPPCO's capital structure. A reduction in the
19 required rate of return reduces UPPCO's revenue requirement, benefitting UPPCO's
20 customers.

21

22 **Changes Associated with the RTMP Rate Schedule**

23 **Q. What is changing regarding the RTMP rate schedule?**

24 A. In his rate design testimony, Mr. James M. Beyer will be addressing changes to the
25 distribution charges (the System Demand Charge, the Customer Charge, and the
26 Scheduling Charge) associated with the RTMP rate schedule. In previous general
27 rate case proceedings, no changes to RTMP distribution charges were proposed.

28

1 **Q. How have RTMP energy and transmission charges been reflected in the instant**
2 **general rate case proceeding?**

3 A. As shown on Exhibit A-10 (JGG-2), because RTMP costs are directly linked to the
4 prevailing market price of energy, the revenues from RTMP energy and transmission
5 charges will continue to be netted against PSCR costs, consistent with UPPCO's
6 previous general rate case proceedings.

7

8 **Q. How does that change the allocations?**

9 A. First, the RTMP rate schedule currently consists of 1 customer with 12 monthly
10 customer counts. Therefore, 12 monthly RTMP customer counts were included in
11 the calculation of the customer allocation factors within the jurisdictional models.

12

13 Second, because the sole RTMP customer owns their own distribution facilities and
14 purchases energy at prevailing market prices, RTMP energy and demand was
15 excluded from the calculation of the associated energy and demand allocators.

16

17 Third, Ms. Hoffman-Malueg will address cost of service study allocation changes
18 associated with the RTMP rate schedule in her pre-filed direct testimony

19

20 **Revenue Decoupling Mechanism**

21 **Q. Does UPPCO propose to update the parameters used in the UPPCO RSM in**
22 **this proceeding?**

23 A. Yes, we do. UPPCO requests the authority from the Commission to update the
24 parameters used in UPPCO's RSM, which was authorized by the Commission in
25 Case No. U-15988 and updated in Case No. U-16166, to be consistent with the
26 instant general rate case proceeding. The proposed updated parameters are found
27 in Schedule F3 of Exhibit A-6 (JMB-1) of the pre-filed direct testimony of Mr. James
28 M. Beyer.

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Non-Utility Land Sales

Q. Have any gains from the sale of UPPCO non-utility land been included in the calculation of the 2012 revenue requirement?

A. No, they have not, as the thresholds established in Case No. U-14378 to record land sale gains as Utility Income in 2012 will not be met.

Self-Implemented Rates

Q. Does UPPCO intend to self-implement rates in this general rate proceeding?

A. Yes. In accordance with MCL 460.6a(1), UPPCO intends to self-implement rates for service rendered on and after January 1, 2012. The self-implemented rate design is discussed in the pre-filed direct testimony of Mr. James M. Beyer.

Matching of PSCR Costs and PSCR Revenues

Q. Has UPPCO matched PSCR costs and PSCR revenues in the calculation of the revenue deficiency in this general rate case proceeding?

A. Yes. The PSCR factor used to calculate Revenues on Present Rates in this general rate case proceeding was calculated such that PSCR costs equaled PSCR revenues, resulting in one-for-one recovery of PSCR costs. The calculation of this PSCR factor is shown on Exhibit A-10 (JGG-2) of Mr. John G. Guntlisbergen's pre-filed direct testimony.

A cost summary of Employee Bonus, Incentive Compensation, and Supplemental Employee Retirement Plans

Q. Has UPPCO provided a cost summary of the employee bonus, incentive compensation, and supplemental employee retirement plans as required by Order Point "O" of the Commission's December 14, 2010 Order Approving Settlement Agreement in Case No. U-16166?

A. Yes. Please see Exhibit A-8 (SSD-5).

1 Q. Does this conclude your pre-filed direct testimony?

2 A. Yes, it does.