NOVEMBER 1976

CAROLINA POWER & LIGHT COMPANY
FPC DOCKET NO. ER76-495
PREPARED TESTIMONY OF J. BERTRAM SOLOMON

Q PLEASE STATE YOUR NAME AND ADDRESS.

A My name is J. Bertram Solomon. My business address is 1000 Crescent Avenue, N.E., Atlanta, Georgia 30309.

Q PLEASE OUTLINE YOUR FORMAL EDUCATION.

A I received the degree of Master of Business Administration from Georgia State University in 1973. My area of concentration was Finance. I also received the degree of Bachelor of Science in Industrial Management from the Georgia Institute of Technology in 1972.

Q PLEASE STATE YOUR PROFESSIONAL EXPERIENCE.

A As a Cooperative student at Georgia Tech, I gained approximately two years' work experience as an assistant engineer in an industrial production setting. After my graduation from Georgia Tech in 1972, I worked approximately one and one-half years as a program manager for a management consulting firm and for another one and one-half years as a project analyst for a resort development firm. I was employed by the Southern Engineering Company of Georgia, my present employer, in January 1975. Since that time, I have had assignments in both the retail and wholesale rate departments of my Company, primarily in the area of electric utility rates. In the retail area I have participated in the preparation of rate increase filings for both G & T and distribution rural electric membership cooperatives as well as the determination of revenue requirements and the proper rate design for unregulated rural electric membership cooperatives. My primary activities, however, have been in the wholesale area where I have participated in the analysis of approximately one dozen Federal Power Commission filings of private utilities operating in eight different states. I have also participated in the preparation of testimony and exhibits for several of these rate filings. Additionally, I have participated in the preparation of retail and wholesale allocated cost of service studies and power cost projections.

Q HAVE YOU EVER TESTIFIED IN OTHER COMMISSION PRODEEDINGS?

A Yes, I have testified before the Public Service Commission of Kentucky. I have also testified before the Federal Power Commission in proceedings involving the Public Service Company of Indiana, FPC Docket No. ER76-149; and Georgia Power Company, FPC Docket Nos. E-9091 and E-9521.

Q BY WHOM IS SOUTHERN ENGINEERING COMPANY OF GEORGIA RETAINED IN THIS PROCEEDING?

A Southern Engineering is retained by North Carolina Electric Membership Corporation and Four County Electric Membership Corporation (Cooperative Intervenors). Witnesses Gross, Whigham, Ewert, and I will be the Cooperative Intervenors' Witnesses in this proceeding. Dr. Livingstone is testifying for both the Cooperative and Municipal Intervenors.

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Q WHAT WAS YOUR ASSIGNMENT IN THIS PROCEEDING?

A My assignment was twofold: First, I was to review the direct testimony and exhibits and other available information of the Carolina Power & Light Company (CP&L) concerning the cost to serve CP&L's wholesale Cooperative customers. Specifically, I was to consider whether the methods employed by CP&L for Period II to develop and allocate the rate base and operating expenses shown in the Company's cost of service study were proper and in accord with Commission precedent and sound rate making procedures. Secondly, I was to prepare an allocated cost of service study which includes the adjustments to the Company's cost of service found to be necessary by all of the Cooperative Intervenor Witnesses, and which accurately reflects the rates of return which would be earned under the Company's wholesale electric tariff RS-10 during the Period II test period.

Q WOULD YOU PLEASE SUMMARIZE THE TESTIMONY THAT WILL BE GIVEN BY THE OTHER COOPERATIVE INTERVENOR WITNESSES IN THIS PROCEEDING.

A Mr. Gross is providing testimony on rate design. Mr. Whigham's testimony concerns the cost burdens which historically have been placed upon the Cooperatives by unilateral decisions made by CP&L in their system planning. Dr. Livingstone testifies on the issue of comprehensive income tax normalization, on the Company's inflation of the rate base due to current and prior use of an improper AFUDC rate, on the syncronization of interest expense for income tax purposes and the debt component of the weighted cost of capital, and on the Company's improper method of normalizing the taxes related to interest during construction. Finally, Dr. Ewert provides testimony on the appropriate cost of capital for CP&L and the Company's erroneous inclusion of minimum bank balances in its Period II rate base.

Q PLEASE PLACE THE COMPANY'S FILING IN THE INSTANT DOCKET IN PERSPECTIVE WITH REGARD TO THE COMPANY'S PRIOR WHOLESALE RATES APPLICABLE TO THE COOPERATIVE INTERVENORS.

A In July, 1974, CP&L filed for an increase in its wholesale rate using the calendar year 1974 as its Period II test period. The rate proposed in that filing (FPC Docket No. E-8884), RS-10, was placed into effect in January of 1975 subject to refund. According to the data filed by the Company in that docket, RS-10 produced an increase in Cooperative revenues of 97% annually or approximately double the revenues collected under the predecessor rate.

The Company's filing in the instant proceeding was made in January, 1976, using the calendar year 1976 as its Period II test period. The proposed rate, RS-11, was estimated by the Company to produce a 34% annual increase to its Cooperative customers. In plain language, this means that within a period of less than two years this Company has requested rates which would produce more than one and one half times (approximately 165%) the annual revenues received from its Cooperative customers from the rates which were in effect during 1974.

Q WOULD YOU BRIEFLY SUMMARIZE THE CONCLUSIONS WHICH YOU AND THE OTHER WITNESSES FOR THE COOPERATIVE INTERVENORS HAVE REACHED AS A RESULT OF STUDYING CP&L'S COST OF SERVING ITS WHOLESALE CUSTOMERS.

A The cost of service study presented by the Company in this proceeding significantly overstates the cost of providing service to the Cooperative customers. The following major errors have been made by CP&L in its Period II cost of service study, necessitating adjustments:

1. CP&L's use of the average of beginning and end of year electric plant in service account balances to determine the plant investment level for the test year does not accurately reflect the overall average investment in CP&L's plant in service for the Period II test period. The most accurate method is the use of the thirteen month average plant in service balances.

2. As testified to by Dr. Ewert and myself, CP&L improperly included in its rate base amounts for compensating bank balance requirements as a component of its cash working capital.

3. In calculating its cash working capital allowance, CP&L used the standard formula of 12.5% of total O & M expenses less purchase power in lieu of conduction a lead/lag study. I have conducted a lead/lag study of the fuel component of O & M expenses which constitutes 66% of the total (O & M less purchase power) and have found there to be a net lag of only sixteen rather than fortyfive days on this item. Thus the Company's cash working capital has been greatly overstated.

4. The Company has improperly allocated administrative and general expenses and general plant investment for Period II. This results in excessive amounts of A & G expense and general plant investment being assigned to the wholesale class.

5. A portion of sales expense has been allocated to the wholesale class. The wholesale customers are not seeking any form of sales promotion from CP&L and such expense is related only to retail sales. Such sales expense, thus, should be deleted from the wholesale cost of service.

6. CP&L has been inconsistent in the allocation of its deferred income taxes and the income tax deductions giving rise to those taxes. This error results in an excessive amount of taxes charged to the wholesale customers.

7. CP&L has computed its power supply production and power supply transmission demand allocation factors using the four summer month coincident peak demands. I have instead used the twelve month allocators proposed by Municipal Intervenor Witness Saffer.

8. As shown by Staff Witness Craig, the Company has overstated its depreciation expense for the test period. I have utilized Mr. Craig's revised salvage value factor in recomputing the test period depreciation expenses.

9. As shown by Mr. Gross, the Company has made errors of both omission and comission in its rate design. First, while forcing its wholesale Cooperative customers to take service at increasingly higher voltage levels, CP&L has neglected to reflect the differences in the cost of serving transmission versus distribution voltage delivery points. Secondly, the Company made an error in calculating the KW billing determinants used in its rate design. Finally, CP&L has proposed an exceptionally high summer based ratchet which Mr. Gross shows is unjustified.

10. As further support of Mr. Gross' recommended voltage differential, Mr. Whigham describes some of the ways in which the Company has forced its Cooperative customers into investing in additional facilities to enable them to obtain power which the Company would only make available at higher voltage levels.

11. As testified to by Dr. Livingstone, the Company has unjustly inflated its rate base by using improperly calculated rates for capitalizing Allowance For Funds Used During Construction.

12. In estimating its interest expense for tax purposes, the Company has been inconsistent with the weighted cost of debt used by its rate of return witness. Dr. Livingstone has revised this interest expense to synchronize this expense with the debt component of Dr. Ewert's cost of capital.

13. In justifying its use of comprehensive normalization, the Company has assumed a static environment with no additions to plant in future years. Dr. Livingstone shows that, under more realistic circumstances, many of the items normalized by the Company would constitute actual tax savings as opposed to a simple deferral of taxes, and therefore, these savings should be passed along to the wholesale customers.

14. The Company in its treatment of taxes relating to interest during construction, has "tried to have its cake and eat it too". That is, it has charged the wholesale customers the taxes relating to IDC while not following the Commission's accounting instructions by not utilizing account 283 to accumulate these taxes and has, therefore, not deducted this accumulation from its Period II rate base. Dr. Livingstone has removed these accumulated deferred income taxes from retained earnings for the years 1970 through 1976 pro forma and placed them in account 283 for proper credit to the rate base.

15. As testified by Dr. Ewert, CP&L has overestimated the return on common equity necessary to allow it to maintain its coverage requirements and to attract capital.

I have prepared an exhibit, Cooperative Intervenors' Exhibit No. ___ (JBS-1), which shows the combined effect of the cost of service adjustments listed above.

Q WILL YOU PLEASE EXPLAIN WHY YOU USED THE AVERAGE OF THE THIRTEEN MONTHLY BALANCES INSTEAD OF THE AVERAGE OF THE BEGINNING AND END OF YEAR BALANCES IN DETERMINING THE TOTAL RATE BASE FOR PERIOD II?

A In determining the rate base, CP&L has used the beginning and end of year average for electric plant in service during the year. However, it is generally recognized that the proper synchronization of revenues, expenses and electric plant in service is best accomplished through the use of the thirteen month average method. Billing is done on a monthly basis. Therefore, a monthly average is the most accurate method for the synchronization of expenses during the month, the energy produced during the month, and the revenues collected during the month. The average of the thirteen electric plant in service end of month balances accomplishes this monthly averaging, since the beginning balance and the ending balance for each month during the test period are weighted equally in the computation. The Company has estimated the other important ingredients in its Period II cost of service on a monthly basis since the expenses are directly related to additions and retirements of property as well as the scheduling of maintenance. The monthly gross plant balances were shown in the work papers in Volume V, but they were not used in the Company's determination of its Period II rate base.

FPC precedent dictates the use of the thirteen month average plant balance method. The Commission has required the use of the thirteen month average in United Fuel Gas Company, 12 FPC 251 (1953), Mississippi Fuel Corporation, 11 FPC 288 (1952), and most recently in Connecticut Light & Power, FPC Docket No. E-7743, Opinion No. 761 (1976) and Appalachian Power Company, FPC Docket No. E-7775, 5 Federal Power Service 5-843 (1975).

Clearly both logic and precedent, as well as sound ratemaking procedures require the use of the thirteen month average net electric plant in service balances in CP&L's cost of service study.

Q HAVE YOU PREPARED AN EXHIBIT WHICH SHOWS THE DEVELOPMENT OF THE THIRTEEN MONTH AVERAGE PLANT THAT YOU EMPLOYED IN YOUR COST OF SERVICE STUDY?

A Yes, Cooperative Intervenors' Exhibit No. ___ (JBS-2) contains the monthly account balances which have been used for gross plant in service and accumulated reserve for depreciation is on Exhibit No.____(JBS-5), page 7.

Q WHY DO YOU DISAGREE WITH THE COMPANY"S TREATMENT OF MINIMUM BANK BALANCES?

A There are several reasons why there is disagreement with the Company's inclusion of minimum bank balances as a component of rate base. Dr. Ewert and I both will give reasons why minimum bank balances should not be included in CP&L's rate base.

I have carefully reviewed the testimony and exhibits of the Company's witnesses, and I find no justification presented by the Company for the inclusion of minimum bank balances. Witness Bradshaw states that the propriety of including the Statement "F" working capital items in the rate base would be testified to by Mr. Davis. In reviewing Mr. Davis' testimony, I find no mention of the necessity for the inclusion of minimum bank balances in the rate base. The Company has provided no lead/lag study, or any other justification, yet it is including cash working capital amounts over and above the 45-day allowance already included in the rate base. The Commission has rejected the specific addition of compensating bank balances in some cases because of the availability of counterbalancing amounts of cash routinely available through certain accruals. Along this line, CP&L has not made a showing that funds generated from tax or other accruals were not continually available during the test year for bank deposit and thus act to satisfy any requirements for compensating bank balances.

Q ARE CAROLINA POWER AND LIGHT COMPANY'S MONTHLY TAX ACCRUALS OF A SUFFICIENT AMOUNT TO COUNTERACT THE APPROXIMATELY $9,000,000 CLAIMED BANK BALANCE REQUIREMENT?

A From the information provided by the Company in its monthly operating reports, I find that the tax accrual balances for the 13 month period ending August 1976 averaged $23,597,000 as I have shown on Cooperative Intervenors' Exhibit No. ___(JBS-3). These balances are the result of CP&L booking tax expense on a current basis but with the actual payment to the taxing entity usually not due until a later date. Since rates are based on current tax expense, a cash leading situation develops as cash inflows from revenues are received well prior to the actual cash disbursement to the taxing entity.

It is obvious from this data that CP&L has a substantial amount of interest free capital available which could be and which most probably is deposited in bank accounts and which acts to fulfill any compensating bank balance requirements.

Q BESIDES DISCOVERING THE $23,597,000 IN AVERAGE TAX ACCRUALS WHICH MORE THAN OFFSETS THE CLAIMED NEED FOR APPROXIMATELY $9,000,000 IN BANK BALANCE REQUIREMENTS, WHAT STUDIES HAVE YOU CONDUCTED REGARDING CP&L'S NEED FOR CASH WORKING CAPITAL?

A As shown in Cooperative Intervenors' Exhibit No. _____(JBS-4), I have conducted a lead/lag study on the Company's fuel expense which constitutes 66% of total operation and maintenance expense less purchased power.

Q PLEASE EXPLAIN THIS EXHIBIT.

A This exhibit was prepared from the information contained in CP&L's feild Volume V and its responses to intervenor data requests (primarily Cooperative Intervenors' Data Request No. 1, Item B-5). The purpose of this exhibit is to show the calculation of the average number of days

working capital which is required by CP&L to carry its expenditures for fuel from the time it renders payment until it receives revenues to cover those payments. For purposes of this calculation, the expected purchases of fuel during the test year from the Company's various suppliers have been grouped according to terms of payment in column b. There are four groups of suppliers and another subdivision for freight and other fuel costs. Column c lists the total number of days lag between receiving (or burning) the fuel and making payment for it. Since CP&L has included its fuel stock in its rate base for Period II, and thus, earns a return on it, I have assumed that fuel is burned on a first-in-first-out basis for purposes of calculating the payment lag time. I have also assumed that fuel is consumed relatively evenly throughout the month. So for fuel received from the suppliers in Group A whose terms call for payment on the 25th of the month following the month of shipment, I have used 34 days as the lag between the time the fuel is consumed and the time payment is made. This 34 days is made up of a negative 6 days for shipment, 15 days from average consumption date until the end of the month and 25 days from the end of the month. The payment lag for the other suppliers was determined in the same manner. The lag on freight charges and other fuel costs has not yet been provided by CP&L, and thus, I have made a conservative assumption of only 5 days. Column d contains the Period II expected dollar purchases from each supplier and the estimated cost of freight and other fuel costs. The relative expenditures are shown in column e as percentages and then multiplied by the days lag in column c to obtain the weighted average number of days lag in the Company's payment as shown in column f. The weighted average lag in payment enjoyed by the Company is 24 days (column f, line 33).

In order to obtain the requirement for working capital, I have subtracted the 24 days from the 40 day lag the Company experiences in receiving payment from its customers. This yields the 16 days net lag on line 35 column f. The 40 day revenue lag includes 15 days from average rendition of service until the end of the month, 10 days to render a bill and 15 days for payment. This lag period is admittedly liberal since CP&L intends to have installed magnetic tape metering devices on all its wholesale delivery points by the end of this year (1976). This added mechanization will surely trim the time required to read meters and submit bills to well below the 10 days I have allotted.

Q HOW HAVE YOU ADJUSTED YOUR COST OF SERVICE TO REFLECT THIS WORKING CAPITAL ADJUSTMENT?

A I have adjusted the cash working capital included in rate base on Schedule 2, sheet 1 to reflect the actual 16 days net lag on fossil fuel. This attributes the same lag to oil which is conservative since oil contracts generally carry the same terms as gas which provides roughly the same lag in payment as the lag in revenue receipts, or a net lag of zero. Thus, as with gas and purchased power, there should probably be no working capital provided for oil. I have also adjusted rate base to totally eliminate cash working capital on nuclear fuel. Unlike other fuel, nuclear fuel is treated as a plant investment.

When it is placed in service, the total investment in nuclear fuel (including AFUDC) is added to rate base. It is then amortized, or depreciated, just as any other piece of property. It is even subject to accelerated amortization. Thus the Company is allowed to earn a return on the nuclear fuel over its useful life and certainly should not be allowed to claim an additional return because of a bookkeeping practice which is equivalent to depreciation.

Q WHAT OTHER ADJUSTMENTS HAVE YOU MADE TO THE COMPANY'S CLAIMED CASH WORKING CAPITAL?

A On the basis of Municipal Intervenor Witness Saffer's complete lead/lag study I have removed the remainder of the Company's claimed cash working capital.

Q WOULD YOU PLEASE COMMENT ON THE COMPANY'S ALLOCATION OF ADMINISTRATIVE AND GENERAL EXPENSES AND GENERAL PLANT INVESTMENT.

A CP&L has divided its administrative and general expense into two categories - regulatory expense and other A & G expense. Approximately 98% of the total A & G expense has been classified as other and allocated on the basis of the payroll allocation method. The remaining 2%, approximately $466,000, has been specifically assigned, $177,604 to wholesale and $288,915 to retail. Such an arbitrary treatment can certainly not be "just" and/or "reasonable". There can be no justification for specifically assigning one item of A & G expense unless all A & G items are evaluated individually and allocated in the manner most appropriate for that item. Here, however, the Company has taken a single A & G expense item and assigned it specifically while allocating the vast majority on the basis of its allocated payroll. The Company has not even specifically assigned those items which can be obviously so assigned. As shown in the Company's response to Item No. 18 of the Municipal Intervenors' Data Request No. 1, CP&L has included approximately $345,000 in contributions to the LMFBR demonstration project in its A & G expenses. Contributions to this program were solicited on the basis of kilowatthour sales to ultimate consumers. Thus these contributions were not made on behalf of the Company's wholesale customers. This is a voluntary program and the Company's wholesale customers have the opportunity, which many have taken, to participate in the program directly. Thus, the total amount of this contribution obviously should have been assigned to the retail class and this is what should be done if the Company is allowed to pluck out regulatory expenses for specific assignment. In my cost of service, however, rather than specifically assigning a selected few items, I have treated A & G expense items equally by applying the wage and salary allocator to the total amount of the administrative and general expense.

Turning now to allocation of general plant investment, the Company first made "an analysis" which functionalized the general plant primary accounts into production, transmission, distribution, joint transmission and

distribution, customer accounts, and sales for Period I. The beginning and end of the year average general plant for Period II was then prorated into the functional categories according to this Period I analysis. This "analysis" has not been shown or described in any detail by the Company in its filing. Since the approximately $6,000,000 in Period II additions to general plant could have changed the functionalization significantly, and in order to be consistent with my allocation of administrative and general expenses, I have allocated the Company's general plant investment with the labor allocator.

Q WHY HAVE YOU DELETED CP&L'S ASSIGNMENT OF SALES INVESTMENT AND SALES EXPENSE TO THE WHOLESALE CUSTOMERS IN YOUR COST OF SERVICE STUDY?

A CP&L has specifically assigned approximately $45,000 of sales expense and approximately $10,000 of sales investment to the wholesale class. The Uniform System of Accounts specifies that sales expenses cover only activities such as demonstrating, selling, or advertising the object of which is to promote or retain the use of a utility service by present and prospective customers. Clearly, these types of activities are related to the retail class of service. Any sales expenditures for programs initiated by Carolina Power and Light are solely for the benefit of its retail jurisdictional loads, are not requested by the wholesale customers, and are not desired by them. It is no more proper for the Company to assign a component of sales expense to its wholesale customers than for it to ask an interconnected company to share in CP&L's sales expenses. It is plainly the responsibility of the distributing utility to bear its burden of stimulating its own retail loads through sales activities, if that is what it desires to do. The wholesale customer may have an entirely different goal than Carolina Power and Light in regard to stimulating retail loads. To ask the wholesale customer to subsidize the Company's sales activity would be improper and unreasonable, Therefore, sales related expense and investment has been exclusively assigned to the retail class in my cost of service study.

Q PLEASE EXPLAIN HOW CP&L ERRED IN ITS ALLOCATION OF DEFERRED INCOME TAXES AND INCOME TAXES DEFERRED IN PRIOR YEARS.

A The total tax expense attributable to a particular class of customer includes that amount which is actually paid by the Company to the taxing entity plus an amount for deferred taxes which arise from utilizing deductions in the current period for tax purposes, but capitalizing the same deductions for book or cost of service purposes. In determining the first portion of tax expense; i.e., that portion actually paid by the Company to the taxing entity, CP&L has allocated its tax deductions on the basis of net rate base. However, in allocating its deferred federal tax items, which arist from the same tax deductions, CP&L has first functionalized the amount into production, transmission, distribution, and general plant related components and then used separate allocators to obtain

the deferred taxes by customer group. Obviously, to achieve consistency it is necessary to match the allocation of deferred income taxes with the tax deductions from which they arise. Therefore, deferred income taxes and income taxes deferred in prior periods have also been allocated on the basis of net rate base.

Q HOW HAVE YOU ALLOCATED THE DEMAND AND ENERGY RELATED COSTS IN YOUR COST OF SERVICE STUDY?

A I have used the Company's energy allocation factor for allocating the energy related costs. To allocate demand related costs, I have used the twelve month average demand allocation factors developed by Municipal Intervenor Witness Saffer. The twelve month average method is backed by sound Federal Power Commission precedent and was used by the Staff also. Mr. Saffer has developed allocation factors which differ from those used by the Staff only because he has reestimated the coincident peak demands of the wholesale customers to reflect actual 1975 coincident peak load factors.

Q HAVE YOU USED THE RESULTS OF STAFF WITNESS CRAIG'S DEPRECIATION STUDY TO ADJUST THE COMPANY'S ESTIMATED PERIOD II DEPRECIATION EXPENSE?

A Yes, and I have also recalculated the Period II depreciation expense to reflect the Company's estimated monthly depreciable plant balances.

Q HOW DOES YOUR APPLICATION OF MR. CRAIG'S ADJUSTED SALVAGE RATIO DIFFER FROM THAT OF THE STAFF?

A My treatment is different from that of the Staff in two respects. First, I have applied Mr. Craig's methodology and his salvage ratio to the composite depreciation rate I calculated using the Company's proposed rates and the thirteen monthly depreciable plant balances. To obtain the total company depreciation expense adjsutment, I applied the adjustment rate as shown on Cooperative Intervenors' Exhibit No. ___ (JBS-5), page 1 to the average of the Period II thirteen monthly depreciable plant balances rather than the 1974 year end amount used by Staff. The other area of difference is in the functionalization of the adjustment amount. Mr. Craig has assumed that positive salvage value will result from plant retirements in three functions: transmission, distribution, and general plant. I have functionalized my adjustment accordingly; however, I have used depreciable plant ratios rather than the total gross plant ratios used by Mr. Shulman.

Q IN COMPLETING THE SECOND PART OF YOUR ASSIGNMENT IN THIS PROCEEDING HOW HAVE YOU INCLUDED THE ADJUSTMENTS RECOMMENDED BY THE OTHER COOPERATIVE INTERVENORS' WITNESSES IN A COST OF SERVICE STUDY?

A I have prepared a revised cost of service study which I have attached as Cooperative Intervenors' Exhibit No. ____ (JBS-1). This exhibit is made up of two summaries and seven schedules. The first

summary page shows the results of my cost of service study under present rates, the Company's proposed rates, and the rates found to be just and reasonable by the Cooperative Intervenors' Witnesses using comprehensive "interperiod" income tax normalization. The second summary page (on page 11 of 26) shows the same thing using a flow-through treatment of the "interperiod" income tax items. Moving to the end of this exhibit, Schedule 5 contains the demand allocation factors, the energy allocation factor, and labor allocation factors used in this cost of service study. Schedule 4 shows the allocation of original cost of plant in service and the accumulated provision for depreciation. Schedule 3 contains the allocated operating expenses. The remaining rate base items are shown on Schedules 2A and 2B. Schedules 1A and 1B, rate of return under normalization and flow-through respectively, utilize the computations made in the other schedules, compute the allocated income taxes, and summarize the foregoing showing the adjusted rate of return under the Company's present rate (RS-10) at the bottom of the page on line 26.

Q HOW DID YOU INCORPORATE THE TWELVE MONTH AVERAGE ALLOCATION FACTOR PROPOSED BY MR. SAFFER?

A I replaced the Company's power supply production and power supply transmission demand allocation factors with those recommended by Mr. Saffer. I also used these allocation factors to recompute the labor allocator. These computations are shown on Cooperative Intervenors' Exhibit No. ___ (JBS-6).

Q HOW DID YOU MAKE THE ADJUSTMENTS RECOMMENDED BY DR. EWERT?

A As Dr. Ewert suggested I removed bank balances from the Company's working capital. I also utilized Dr. Ewert's suggested 9.262% rate of return in determining the Company's allowable revenues as shown in the two summaries of Cooperative Intervenors' Exhibit No. ___ (JBS-1).

Q PLEASE EXPLAIN HOW YOU INCORPORATED THE ADJUSTMENTS RECOMMENDED BY DR. LIVINGSTONE.

A I replaced the Company's $96,498,000 interest expense with the $86,615,142 recommended by Dr. Livingstone in my cost of service reflecting the flowthrough approach on "interperiod" income tax items. I used $56,723,821, rather than the Company's $63,643,000 in my cost of service reflecting the normalization of "interperiod" income tax items. Dr. Livingstone's AFUDC adjustments entail reducing the original cost of plant, reducing accumulated provision for depreciation, increasing the provision for deferred income taxes, and reducing the current year's depreciation expense. The first three of these are rate base adjustments and are reflected as such on sheet 4 of both Schedule 1A and 1B. The current year's depreciation expenses were adjusted as shown on Schedule 3, sheet 3. Of course, as a result of the reduced current year's depreciation, there is an increase in current year's income

tax expense. This increase is automatically accomplisned in the calculation of the income taxes. The remaining adjustment recommended by Dr. Livingstone is an increase in account 283, accumulated deferred income taxes, used as a credit to rate base. I have included this adjustment on sheet 2 of Schedule 2A as an additional deduction from rate base. The $70,263,710 is made up of $62,022,710 from prior years and one half of the $16,482,000 from 1976. The total company amount was functionalized on the basis of classified gross plant and then allocated to the customer groupes.

Q WHAT WAS THE EFFECT ON THE COOPERATIVE INTERVENORS OF MAKING THESE CHANGES TO THE COMPANY'S COST OF SERVICE?

A As can be seen on page 2 of Cooperative Intervenors' Exhibit No. ___ (JBS-1), using comprehensive income tax normalization, the adjusted rate of return under the present rates (RS-10) during Period II (calendar year 1976) would be 6.550%. Before the corrections recommended by the Cooperative Intervenors' witnesses, the Company showed an earned rate of return of 4.75%. Using the rate of return recommended by Dr. Ewert, my adjusted cost of service shows an allowable increase in revenues of $5,278,439 (14.14%) for the Cooperative Intervenors as opposed to the Company's requested increase of $12,847,732 or 34.1%.

The comparable figures using the flowthrough of income tax savings on "interperiod" income tax items rather than "normalizing" these savings are shown on page 11, Summary With Flowthrough. The adjusted rate of return under present rates is 7.820% and the allowable increase in revenues is $2,950,377.

Q HOW HAVE YOU SEPARATED DISTRIBUTION COSTS IN YOUR COST OF SERVICE FOR USE IN MR. GROSS' RATE DESIGN?

A The Company separated most items of investment and expense into the individual functions; however, there were a few items for which a broad allocator was used including several functions and in some cases transmission and distribution was lumped together. In these instances I have separated the distribution portion from the other functions. In this manner I have been able to obtain the expense and return portions of revenue requirement. To get the remaining ingredient, income and gross receipts taxes, I have used the formula shown on Cooperative Intervenors Exhibit No. ___ (JBS-7) which assigns tax deductions on the basis of rate base thus allowing the calculation of taxes on a functional basis. My calculation of revenue requirements for distribution service under my "normalization" cost of service are also shown on this exhibit.

Q DOES THIS CONCLUDE YOUR TESTIMONY?

A Yes, it does.