A. The class cost of service study identifies the revenue requirement by class of service at the requested rate of return. The results of the class cost of service study indicate that the Commercial and Public Authority classes' rates should be decreased and the Residential class requires an increase.

Q. ARE YOU PROPOSING RATES THAT REFLECT THESE CLASS ALLOCATION RESULTS?

A. No. As I previously indicated, NatGas does not possess the design-day nor peak day send-out data required to calculate commonly used capacity related allocation factors. The proportional responsibility allocation method I employed provides a reasonable starting point to design rates, but lack of data supporting the Commission's preferred methodology to allocate capacity costs led me to a more conservative approach to rate design. While the cost of service study indicates that the Commercial and Public Authority class' rates should be decreased I am proposing that no class receive a decrease, which serves to moderate the Residential class increase.

VI. RATE DESIGN

Q. PLEASE SUMMARIZE THE PROPOSED RATES.

A. NatGas proposes no structural changes to the existing gas service rates. That is, NatGas proposes to continue for each customer class a two part base rate consisting of a fixed monthly Customer Charge and a Commodity Charge per MCF used. However, NatGas proposes to increase the levels of the Customer Charges for each class to recover its required cost of service and to provide for more revenue stability.

The proposed Customer Charge for Residential customers was increased from $5.00 per month to $7.35 per month. The proposed Customer Charge for Commercial and Public Authority customers was increased from $5.00 per month to $9.00 per month.

Q. DOES NATGAS PROPOSE ANY CHANGES TO THE CURRENT COMMODITY CHARGES?

A. Yes. The current Commodity Charges include a $3.00/MCF base cost of gas. NatGas proposes that going forward this amount be moved to the Purchased Gas Cost Adjustment and the base rate charges reflect only non-gas costs of the Company. Once the base cost of gas is removed, NatGas proposes no other changes to the Commodity Charges authorized by the Commission in GUD 9951.

Q. PLEASE SUMMARIZE THE PROPOSED CHANGE IN RATES.

A. Table 1 provides a comparison of the present and proposed rates by class of service:

Table 1

Customer Class (1)	Tariffed Rates		Present Base Rates (2)		Proposed Rates	
	Customer Charge $/Month	Commodity Charge $/Mcf	Customer Charge $/Month	Commodity Charge $/Mcf	Customer Charge $/Month	Commodity Charge $/Mcf
Residential	$5.00	$7.03	$5.00	$4.03	$7.35	$4.03
Commercial	$5.00	$7.03	$5.00	$4.03	$9.00	$4.03
Public Authority	$5.00	$6.64	$5.00	$3.64	$9.00	$3.64

(1) Residential and Commercial customers are currently served under the combined Residential & Small Commercial tariff. Public Authority customers are currently served under the Large Commercial tariff.
(2) Excludes $3.00/Mcf base cost of gas.

Q. ON WHAT SCHEDULES ARE THE DEVELOPMENT OF NATGAS' PROPOSED RATES SUMMARIZED?

A. Schedule C provides the billing units and proposed rates by rate schedule and provides the calculation of adjusted revenues under proposed rates. The billing determinants employed to develop the proposed revenues are fully adjusted customer and weather adjusted MCF sales levels. Schedule B, Typical Bill Comparisons, provides bill impact analyses for the proposed rate schedules. The bill impact analyses set forth the dollar and percentage increases associated with various levels of use for customers.

Q. DOES NATGAS PROPOSE ANY CHANGES TO THE MISCELLANEOUS SERVICE CHARGES?

A. No, NatGas is not proposing any changes to its miscellaneous service charges.

VII. RATE CASE EXPENSES

Q. HOW DOES THE COMPANY PROPOSE TO RECOVER RATE CASE EXPENSES IN THIS PROCEEDING?

A. The Company requests recovery of its reasonable and necessary rate case expenses in this case through a surcharge to those customers that are affected by this proceeding. The Company requests that the Commission address the appropriate level of recoverable rate case expenses at a later point during the proceeding when such expenses will be known. In the alternative, the Commission may prefer that the issue of the reasonableness and recovery of rate case expenses associated with this

proceeding be severed from this docket and determined in a separate docket. This approach is consistent with the Commission's handling of this issue in other dockets.

Q. PLEASE DESCRIBE GENERALLY THE TYPES OF EXPENSES THAT WILL BE INCURRED BY NATGAS IN THIS PROCEEDING.

A. The Company will incur direct expenses such a copying, faxing, postage and printing expense, certain expenses of an incremental nature for those Company employees that may travel, as well as the expense associated with providing public notice. NatGas will also incur expenses associated with consulting assistance, and may incur expenses associated with legal assistance, in connection with this case. All of these categories of expenses will continue to be incurred through the duration of this proceeding.

VIII. CONCLUSION

Q. PLEASE SUMMARIZE NATGAS' OVERALL REQUEST IN THIS PROCEEDING.

A. NatGas is requesting to increase annual revenues by $35,504 or 5.3% including gas costs. The Residential class will see a 6.77% increase in average bills, Commercial class a 2.84% increase in average bills, and the Public Authority class a 2.70% increase in average bills.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS REGARDING THE CLASS BILLING DETERMINANTS.

A. NatGas is using test year end plant in service to determine its cost of service. For consistency, booked commodity sales need to be adjusted to show a full year's billing for all customers receiving service at the end of the test year.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS REGARDING THE CLASS COST OF SERVICE STUDY THAT YOU SPONSOR.

A. The cost of service study provides the allocated revenue requirements by class of service. The allocation methods employed to assign costs to customer classes vary depending upon the particular cost item being allocated using the best data available. For example, mains investment costs were allocated to classes on the weighted volumes allocation methodology which weights monthly sales volumes by the cost of gas. Customer related costs were allocated on the basis of the number of customers.

The class cost of service study employs allocation methods that are commonly employed in work of this nature and the results of the allocations are fair and reasonable.

Q. PLEASE SUMMARIZE YOUR RATE DESIGN RECOMMENDATIONS.

A. The rate design proposed by NatGas reflects moderate movement of rates by class towards the cost of providing service.

Q. IN YOUR OPINION, ARE THE ADJUSTED CUSTOMER BILLING DATA, THE CLASS COST OF SERVICE STUDY, AND THE RATE DESIGN

PROPOSED BY NATGAS IN ITS RATE FILING APPLICATION FAIR AND REASONABLE?

A. Yes, they are.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

APPENDIX A
STATEMENT OF QUALIFICATIONS

KARL J. NALEPA

Mr. Nalepa is an energy economist with more than 30 years of private and public sector experience in the electric and natural gas industries. He has extensive experience analyzing utility rate filings and resource plans with particular focus on fuel and power supply requirements, quality of fuel supply management, and reasonableness of energy costs. Mr. Nalepa developed peak demand and energy forecasts for municipal and electric cooperative utilities and has forecast the price of natural gas in ratemaking and resource plan evaluations. He led a management and performance review of the Texas Public Utility Commission, and has conducted performance reviews and valuation studies of a number of municipal utility systems. Mr. Nalepa previously directed the Railroad Commission of Texas' Regulatory Analysis & Policy Section, with responsibility for preparing timely natural gas industry analysis, managing ratemaking proceedings, mediating informal complaints, and overseeing consumer complaint resolution. He has prepared and defended expert testimony in both administrative and civil proceedings, and has served as a technical examiner in natural gas rate proceedings.

EDUCATION

1998	Certificate of Mediation Dispute Resolution Center, Austin
1989	NARUC Regulatory Studies Program Michigan State University
1988	M.S. - Petroleum Engineering University of Houston
1980	B.S. - Mineral Economics Pennsylvania State University

PROFESSIONAL HISTORY

2003 -	ReSolved Energy Consulting President and Managing Director
1997 – 2003	Railroad Commission of Texas Asst. Director, Regulatory Analysis & Policy
1995 – 1997	Karl J. Nalepa Consulting Principal
1992 – 1995	Resource Management International, Inc. Supervising Consultant
1988 – 1992	Public Utility Commission of Texas Fuels Analyst
1980 – 1988	Transco Exploration Company Reservoir and Evaluation Engineer

AREAS OF EXPERTISE

Regulatory Analysis

Electric Power: Analyzed electric utility rate, certification, and resource forecast filings. Assessed the quality of fuel supply management, and reasonableness of fuel costs recovered from ratepayers. Projected the cost of fuel and purchased power. Estimated the impact of environmental costs on utility resource selection. Participated in regulatory rulemaking activities. Provided expert staff testimony in a number of proceedings before the Texas Public Utility Commission.

As consultant, represent interests of municipal clients intervening in large utility rate proceedings through analysis of filings and presentation of testimony before the Public Utility Commission. Also assist municipal utilities in preparing and defending requests to change rates and other regulatory matters before the Public Utility Commission.

Natural Gas: Directed the economic regulation of gas utilities in Texas for the Railroad Commission of Texas. Responsible for monitoring, analyzing and reporting on conditions and events in the natural gas industry. Managed Commission staff representing the public interest in contested rate proceedings before the Railroad Commission, and acted as technical examiner on behalf of the Commission. Mediated informal disputes between industry participants and directed handling of customer billing and service complaints. Oversaw utility compliance filings and staff rulemaking initiatives. Served as a policy advisor to the Commissioners.

As consultant, represent interests of municipal clients intervening in large utility rate proceedings through analysis of filings and presentation of testimony before the cities and Railroad Commission. Also assist small utilities in preparing and defending requests to change rates and other regulatory matters before the Railroad Commission.

Litigation Support

Retained to support litigation in natural gas contract disputes. Analyzed the results of contract negotiations and competitiveness of gas supply proposals considering gas market conditions contemporaneous with the period reviewed. Supported litigation related to alleged price discrimination related to natural gas sales for regulated customers. Provided analysis of regulatory and accounting issues related to ownership of certain natural gas distribution assets in support of litigation against a natural gas utility. Supported independent power supplier in binding arbitration regarding proper interpretation of a natural gas transportation contract. Provided expert witness testimony in administrative and civil court proceedings.

Utility System Assessment

Led a management and performance review of the Public Utility Commission. Conducted performance reviews and valuation studies of municipal utility systems. Assessed ability to compete in the marketplace, and recommended specific actions to improve the competitive position of the utilities. Provided comprehensive support in the potential sale of a municipal gas system, including preparation of a valuation study and all activities leading to negotiation of contract for sale and franchise agreements.

Energy Supply Analysis

Reviewed system requirements and prepared requests for proposals (RFPs) to obtain natural gas and power supplies for both utility and non-utility clients. Evaluated submittals under alternative demand and market conditions, and recommended cost-effective supply proposals. Assessed supply strategies to determine optimum mix of available resources.

Econometric Forecasting

Prepared econometric forecasts of peak demand and energy for municipal and electric cooperative utilities in support of system planning activities. Developed forecasts at the rate class and substation levels. Projected price of natural gas by individual supplier for Texas electric and natural gas utilities to support review of utility resource plans.

Reservoir Engineering

Managed certain reserves for a petroleum exploration and production company in Texas. Responsible for field surveillance of producing oil and natural gas properties, including reserve estimation, production forecasting, regulatory reporting, and performance optimization. Performed evaluations of oil and natural gas exploration prospects in Texas and Louisiana.

PROFESSIONAL MEMBERSHIPS

Society of Petroleum Engineers
International Association for Energy Economics
United States Association for Energy Economics

SELECT PUBLICATIONS, PRESENTATIONS, AND TESTIMONY

"Summary of the USAEE Central Texas Chapter's Workshop entitled 'EPA's Proposed Clean Power Plan Rules: Economic Modeling and Effects on the Electric Reliability of Texas Region,'" with Dr. Jay Zarnikau and Mr. Neil McAndrews, USAEE Dialogue, May 2015

"Public Utility Ratemaking," EBF 401: Strategic Corporate Finance, The Pennsylvania State University, September 2013

"What You Should Know About Public Utilities," EBF 401: Strategic Corporate Finance, The Pennsylvania State University, October 2011

"Natural Gas Markets and the Impact on Electricity Prices in ERCOT," Texas Coalition of Cities for Fair Utility Issues, Dallas, October 2008

"Natural Gas Regulatory Policy in Texas," Hungarian Oil and Gas Policy Business Colloquium, U.S. Trade and Development Agency, Houston, May 2003

"Railroad Commission Update," Texas Society of Certified Public Accountants, Austin, April 2003

"Gas Utility Update," Railroad Commission Regulatory Expo and Open House, October 2002

"Deregulation: A Work in Progress," Interview by Karen Stidger, *Gas Utility Manager*, October 2002

"Regulatory Overview: An Industry Perspective," Southern Gas Association's Ratemaking Process Seminar, Houston, February 2001

"Natural Gas Prices Could Get Squeezed," with Commissioner Charles R. Matthews, *Natural Gas*, December 2000

"Railroad Commission Update," Texas Society of Certified Public Accountants, Austin, April 2000

"A New Approach to Electronic Tariff Access," Association of Texas Intrastate Natural Gas Pipeline Annual Meeting, Houston, January 1999

"A Texas Natural Gas Model," United States Association for Energy Economics North American Conference, Albuquerque, 1998

"Texas Railroad Commission Aiding Gas Industry by Updated Systems, Regulations," *Natural Gas,* July 1998

"Current Trends in Texas Natural Gas Regulation," Natural Gas Producers Association, Midland, 1998

"An Overview of the American Petroleum Industry," Institute of International Education Training Program, Austin, 1993

Direct testimony in PUC Docket No. 10400 summarized in *Environmental Externality,* Energy Research Group for the Edison Electric Institute, 1992

"God's Fuel - Natural Gas Exploration, Production, Transportation and Regulation," with Danny Bivens, Public Utility Commission of Texas Staff Seminar, 1992

"A Summary of Utilities' Positions Regarding the Clean Air Act Amendments of 1990," Industrial Energy Technology Conference, Houston, 1992

"The Clean Air Act Amendments of 1990," Public Utility Commission of Texas Staff Seminar, 1992

APPENDIX B
PREVIOUSLY FILED TESTIMONY

KARL J. NALEPA
TESTIMONY FILED

DKT NO.	DATE	REPRESENTING	UTILITY	PHASE	ISSUES
Before the Public Utility Commission of Texas					
45084	Nov 15	Cities	Entergy Texas, Inc.	TCRF	TCRF Methodology
45083	Oct 15	Cities	Entergy Texas, Inc.	DCRF	DCRF Methodology
45071	Aug 15	Denton Municipal Electric	Denton Municipal Electric	Interim TCOS	Wholesale Transmission Rate
44941	Dec 15	City of El Paso	El Paso Electric	Cost of Service	CEP Adjustments
44677	Jul 15	City of El Paso	El Paso Electric	EECRF	EECRF Methodology
44572	May 15	Cities	CenterPoint Energy Houston	DCRF	DCRF Methodology
44060	May 15	City of Frisco	Brazos Electric Coop	CCN	Transmission Cost Recovery
43695	May 15	Pioneer Natural Resources	Southwestern Public Service	Cost of Service	Cost Allocation
43111	Oct 14	Cities	Entergy Texas Inc.	DCRF	DCRF Methodology
42770	Aug 14	Denton Municipal Electric	Denton Municipal Electric	Interim TCOS	Wholesale Transmission Rate
42485	Jul 14	Cities	Entergy Texas, Inc.	EECRF	EECRF Methodology
42449	Jul 14	City of El Paso	El Paso Electric	EECRF	EECRF Methodology
42448	Jul 14	Cities	SWEPCO	TCRF	Transmission Cost Recovery Factor
42370	Dec 14	Cities	SWEPCO	Rate Case Expenses	Rate Case Expenses
41791	Jan 14	Cities	Entergy Texas, Inc.	Cost of Service	Cost of Service/Fuel
41539	Jul 13	Cities	AEP Texas North	EECRF	EECRF Methodology
41538	Jul 13	Cities	AEP Texas Central	EECRF	EECRF Methodology

DKT NO.	DATE	REPRESENTING	UTILITY	PHASE	ISSUES
41444	Jul 13	Cities	Entergy Texas, Inc.	EECRF	EECRF Methodology
41223	Apr 13	Cities	Entergy Texas, Inc.	ITC Transfer	Public Interest Review
40627	Nov 12	Austin Energy	Austin Energy	Cost of Service	General Fund Transfers
40443	Dec 12	Office of Public Counsel	SWEPCO	Cost of Service	Cost of Service/Fuel
40346	Jul 12	Cities	Entergy Texas, Inc.	Join MISO	Public Interest Review
39896	Mar 12	Cities	Entergy Texas, Inc.	Cost of Service/ Fuel Reconciliation	Cost of Service/ Nat Gas/ Purch Power
39366	Jul 11	Cities	Entergy Texas, Inc.	EECRF	EECRF Methodology
38951	Feb 12	Cities	Entergy Texas, Inc.	CGS Tariff	CGS Costs
38815	Sep 10	Denton Municipal Electric	Denton Municipal Electric	Interim TCOS	Wholesale Transmission Rate
38480	Nov 10	Cities	Texas-New Mexico Power	Cost of Service	Cost of Service/Rate Design
37744	Jun 10	Cities	Entergy Texas, Inc.	Cost of Service/ Fuel Reconciliation	Cost of Service/ Nat Gas/ Purch Power/ Gen
37580	Dec 09	Cities	Entergy Texas, Inc.	Fuel Refund	Fuel Refund Methodology
36956	Jul 09	Cities	Entergy Texas, Inc.	EECRF	EECRF Methodology
36392	Nov 08	Texas Municipal Power Agency	Texas Municipal Power Agency	Interim TCOS	Wholesale Transmission Rate
35717	Nov 08	Cities Steering Committee	Oncor	Cost of Service	Cost of Service/Rate Design
34800	Apr 08	Cities	Entergy Gulf States	Fuel Reconciliation	Natural Gas/Coal/Nuclear
16705	May 97	North Star Steel	Entergy Texas	Fuel Reconciliation	Natural Gas/Fuel Oil
10694	Jan 92	PUC Staff	Midwest Electric Coop	Revenue Requirements	Depreciation/ Quality of Service

DKT NO.	DATE	REPRESENTING	UTILITY	PHASE	ISSUES
10473	Sep 91	PUC Staff	HL&P	Notice of Intent	Environmental Costs
10400	Aug 91	PUC Staff	TU Electric	Notice of Intent	Environmental Costs
10092	Mar 91	PUC Staff	HL&P	Fuel Reconciliation	Natural Gas/Fuel Oil
10035	Jun 91	PUC Staff	West Texas Utilities	Fuel Reconciliation Fuel Factor	Natural Gas Natural Gas/Fuel Oil/Coal
9850	Feb 91	PUC Staff	HL&P	Revenue Req. Fuel Factor	Natural Gas/Fuel Oil/ETSI Natural Gas/Coal/Lignite
9561	Aug 90	PUC Staff	Central Power & Light	Fuel Reconciliation Revenue Requirements Fuel Factor	Natural Gas Natural Gas/Fuel Oil Natural Gas
9427	Jul 90	PUC Staff	LCRA	Fuel Factor	Natural Gas
9165	Feb 90	PUC Staff	El Paso Electric	Revenue Requirements Fuel Factor	Natural Gas/Fuel Oil Natural Gas
8900	Jan 90	PUC Staff	SWEPCO	Fuel Reconciliation Fuel Factor	Natural Gas Natural Gas
8702	Sep 89 Jul 89	PUC Staff	Gulf States Utilities	Fuel Reconciliation Revenue Requirements Fuel Factor	Natural Gas/Fuel Oil Natural Gas/Fuel Oil Natural Gas/Fuel Oil
8646	May 89 Jun 89	PUC Staff	Central Power & Light	Fuel Reconciliation Revenue Requirements Fuel Factor	Natural Gas Natural Gas/Fuel Oil Natural Gas
8588	Aug 89	PUC Staff	El Paso Electric	Fuel Reconciliation	Natural Gas

DKT NO.	DATE	REPRESENTING	UTILITY	PHASE	ISSUES
Before the Railroad Commission of Texas					
10359	Jul 14	Cities Steering Committee	Atmos Energy Mid Tex	Cost of Service	Cost of Service/Rate Design
10295	Oct 13	Cities Steering Committee	Atmos Pipeline Texas	Revenue Rider	Rider Renewal
10242	Jan 13	Onalaska Water & Gas	Onalaska Water & Gas	Cost of Service	Cost of Service/Rate Design
10196	Jul 12	Bluebonnet Natural Gas	Bluebonnet Natural Gas	Cost of Service	Cost of Service/Rate Design
10190	Jan 13	City of Magnolia, Texas	Hughes Natural Gas	Cost of Service	Cost of Service/Rate Design
10174	Aug 12	Steering Committee of Cities	Atmos Energy West Texas	Cost of Service	Cost of Service/Rate Design
10170	Aug 12	Cities Steering Committee	Atmos Energy Mid Tex	Cost of Service	Cost of Service/Rate Design
10106	Oct 11	Gulf Coast Coalition	CenterPoint Energy Entex	Cost of Service	Cost of Service/Rate Design
10083	Aug 11	City of Magnolia, Texas	Hughes Natural Gas	Cost of Service	Cost of Service/Rate Design
10038	Feb 11	Gulf Coast Coalition	CenterPoint Energy Entex	Cost of Service	Cost of Service/Rate Design
10021	Oct 10	AgriTex Gas, Inc.	AgriTex Gas, Inc.	Cost of Service	Cost of Service/Rate Design
10000	Dec 10	Cities Steering Committee	Atmos Pipeline Texas	Cost of Service	Cost of Service/Rate Design
9902	Oct 09	Gulf Coast Coalition	CenterPoint Energy Entex	Cost of Service	Cost of Service/Rate Design
9810	Jul 08	Bluebonnet Natural Gas	Bluebonnet Natural Gas	Cost of Service	Cost of Service/Rate Design
9797	Apr 08	Universal Natural Gas	Universal Natural Gas	Cost of Service	Cost of Service/Rate Design
9732	Jul 08	Cities Steering Committee	Atmos Energy Corp.	Gas Cost Review	Natural Gas Costs
9670	Oct 06	Cities Steering Committee	Atmos Energy Corp.	Cost of Service	Affiliate Transactions/ O&M Expenses/GRIP
9667	Nov 06	Oneok Westex Transmission	Oneok Westex Transmission	Abandonment	Abandonment

DKT NO.	DATE	REPRESENTING	UTILITY	PHASE	ISSUES
9598	Sep 05	Cities Steering Committee	Atmos Energy Corp.	GRIP Appeal	GRIP Calculation
9530	Apr 05	Cities Steering Committee	Atmos Energy Corp.	Gas Cost Review	Natural Gas Costs
9400	Dec 03	Cities Steering Committee	TXU Gas Company	Cost of Service	Affiliate Transactions/ O&M Expenses/Capital Costs
Before the Louisiana Public Service Commission					
U-33633	Nov 15	PSC Staff	Entergy Louisiana, LLC/ Entergy Gulf States Louisiana	Resource Certification	Prudence
U-33033	Jul 14	PSC Staff	Entergy Louisiana, LLC/ Entergy Gulf States Louisiana	Resource Certification	Revenue Requirement
U-31971	Nov 11	PSC Staff	Entergy Louisiana, LLC/ Entergy Gulf States Louisiana	Resource Certification	Certification/Cost Recovery
Before the Arkansas Public Service Commission					
07-105-U	Mar 08	Arkansas Customers	CenterPoint Energy, Inc. & pipelines serving CenterPoint	Gas Cost Complaint	Prudence / Cost Recovery

GAS UTILITIES DOCKET NO. _____

STATEMENT OF INTENT FILED BY ONALASKA WATER & GAS SUPPLY CORPORATION TO CHANGE RATES IN THE ENVIRONS OF THE CITY OF ONALASKA	§ § § § §	**BEFORE THE RAILROAD COMMISSION OF TEXAS**

DIRECT TESTIMONY

OF

KARL J. NALEPA

ON BEHALF OF

ONALASKA WATER & GAS SUPPLY CORPORATION

JANUARY 28, 2013

DIRECT TESTIMONY OF
KARL J. NALEPA

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GAS UTILITIES DOCKET NO. _____

STATEMENT OF INTENT FILED BY ONALASKA WATER & GAS SUPPLY CORPORATION TO CHANGE RATES IN THE ENVIRONS OF THE CITY OF ONALASKA	§ § § § §	**BEFORE THE RAILROAD COMMISSION OF TEXAS**

DIRECT TESTIMONY OF KARL J. NALEPA

I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is Karl J. Nalepa. I am President of ReSolved Energy Consulting, LLC, an independent utility consulting company. My business address is 11044 Research Blvd., Suite D-230, Austin, Texas 78759.

Q. ON WHOSE BEHALF ARE YOU PRESENTING TESTIMONY IN THIS PROCEEDING?

A. I am presenting testimony on behalf of Onalaska Water & Gas Supply Corporation, ("OW&GS" or "Company").

Q. PLEASE OUTLINE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I hold a Bachelor of Science degree in Mineral Economics and a Master of Science degree in Petroleum Engineering, and am a certified mediator. My professional

experience includes eight years in the reservoir engineering department of an exploration company affiliated with a major interstate pipeline company, then four years as a Fuels Analyst with the Texas Public Utility Commission ("PUC"). This was followed by five years with two different consulting firms providing expert advice regarding a broad range of natural gas and electric industry issues. Immediately prior to my current position, I served for more than five years as an Assistant Director with the Texas Railroad Commission ("RRC"). In this position, I was responsible for overseeing the economic regulation of natural gas utilities in Texas. I joined ReSolved Energy Consulting, LLC (formerly RJ Covington Consulting, LLC) in June of 2004. My Statement of Qualifications is attached as Appendix A.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes, I have testified a number of times before both the Texas RRC and the Texas PUC on a variety of regulatory issues. A summary of my previously filed testimony is attached as Appendix B. In addition, I supervised the staff case in proceedings before the RRC and served as a Technical Rate Examiner on behalf of the RRC. I have also provided analysis and recommendations in numerous city-level regulatory proceedings that resulted in settlements without written testimony.

II. PURPOSE AND SCOPE

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to present and support the gas sales, customer growth and weather adjustments, class cost of service study, and proposed rate design for OW&GS.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. Section I summarizes my experience, education, and qualifications. Section II of my testimony provides the scope and purpose of my direct testimony and describes the schedules that I am sponsoring as part of this filing. Section III describes the pro-forma adjustments made to the Company's test year books and records. Section IV discusses the capital structure and requested rate of return. Section V describes the customer usage data and weather adjusted sales by customer class. Section VI provides an explanation of the allocations and results of the gas class cost of service study. Section VII of my direct testimony describes and presents the proposed rates for gas service. Finally, Section VIII summarizes my recommendations.

Q. ARE YOU SPONSORING ANY SCHEDULES TO THE COMPANY'S APPLICATION?

A. Yes, I am sponsoring the entire application which consists of twelve schedules.

Q. PLEASE DESCRIBE SCHEDULE A.

A. Schedule A provides a summary of revenue by customer classification. This schedule identifies the MCF commodity sales and associated revenues per the Company's books, year-end customer and weather adjusted sales and revenue, and the proposed revenue for each retail customer class. The proposed percent change in revenue and the average cost per MCF are also provided on this schedule.

Q. PLEASE DESCRIBE SCHEDULE B.

A. Schedule B provides typical bill comparisons for the proposed rate schedules. The bill comparisons set forth the dollar and percentage change associated with various levels of use for customers.

Q. PLEASE DESCRIBE SCHEDULE C.

A. The development of proposed rates by class is detailed on Schedule C.

Q. PLEASE DESCRIBE SCHEDULE D.

A. Schedule D, the class cost of service analysis, provides the adjusted class cost of service study for the test year ending September 30, 2012. The class cost of service study is used to determine the level of revenues necessary for each class to support its allocated revenue requirement.

Q. PLEASE DESCRIBE SCHEDULE E.

A. Schedule E provides the billing units and present rates by rate schedule and provides the calculation of adjusted revenues under present rates. The billing determinants applied are fully adjusted customers and MCF sales levels.

Q. PLEASE DESCRIBE SCHEDULE F.

A. Schedule F is the bill frequency model which provides the monthly unadjusted billing determinants by customer class. This schedule also develops the year-end and weather

adjusted billing determinants which will be discussed in detail in Section V of my direct testimony.

Q. PLEASE DESCRIBE SCHEDULE G.

A. Schedule G sets forth the weather normalization adjustments. The weather normalization adjustment was made to eliminate the effects of atypical historical temperature conditions that cannot reasonably be anticipated to reoccur. The schedule includes a calculation of the 10 year normal heating degree days using data collected at the National Oceanic and Atmospheric Administration ("NOAA") weather reporting station located in Conroe Texas.

Q. PLEASE DESCRIBE SCHEDULE H.

A. Schedule H provides the rate of return calculation based estimated debt and equity values. The rate of return calculation is discussed in more detail in Section IV of my direct testimony.

Q. PLEASE DESCRIBE SCHEDULE I.

A. Schedule I provides the calculation of federal income tax at the proposed rates. Since OW&GS is a non-profit corporation the federal income tax rate is zero.

Q. PLEASE DESCRIBE SCHEDULE J.

A. Schedule J provides the calculation of allowed interest on customer deposits. The interest rate of 0.12% used in this calculation is per the Railroad Commission of Texas, Gas

Services Division, Gas Utilities Information Bulletin No. 945, dated December 5, 2012. However, since OW&GS does not collect customer deposits there is zero interest due.

Q. PLEASE DESCRIBE SCHEDULE K.

A. Schedule K provides the calculation of allowable advertising expenses pursuant to Commission rule 7.5414.

Q. PLEASE DESCRIBE SCHEDULE L.

A. Schedule L provides a summary of the Company's depreciation rates.

Q. WERE THESE SCHEDULES PREPARED BY YOU OR UNDER YOUR SUPERVISION?

A. Yes, they were.

Q. ARE THESE SCHEDULES TRUE AND CORRECT TO THE BEST OF YOUR KNOWLEDGE AND BELIEF?

A. Yes, they are.

III. PRO-FORMA ADJUSTMENTS

Q. DID THE COMPANY MAKE ANY ADJUSTMENTS TO THE GAS DEPARTMENT BOOKS AND RECORDS?

A. Yes, labor and associated benefits and taxes were adjusted to annualize payroll increases and for a portion of payroll associated with shared administrative and water department

employees providing services to the gas department. In addition adjustments were made to the Company's books and records to include Cash Working Capital, Bad Debt Expenses and Contributions In Aid of Construction.

Q. PLEASE DESCRIBE THE ADJUSTMENT TO ANNUALIZE GAS DEPARTMENT PAYROLL INCREASES.

A. The current employees of the gas department received payroll increases on July 1, 2012. Therefore a known and measurable payroll adjustment was made for nine months (October 2011 through June 2012) of the test year. The calculation of this adjustment is provided on the schedule labeled Adjustment A.

Q. HAS THE COMPANY ENGAGED IN ANY AFFILIATE TRANSACTIONS?

A. No, it has not. There are certain centralized service functions, such as customer billing and accounting, which are performed for both the gas and water departments by the same front office individuals. In addition, water department employees may assist the gas department with construction projects due to the lack of available funds to hire additional gas department employees. The allocation of these costs are described below, but there are no affiliate companies from which OW&GS buys or sells goods or services.

Q. PLEASE DESCRIBE THE ADJUSTMENT TO REFLECT SHARED PAYROLL EXPENSES.

A. Certain administrative duties are performed by general office personnel and the payroll expenses associated with these duties are shared by the gas and water departments.

These duties include Customer Records and Collections which are handled by the general office bookkeeper and clerk. In addition, the General Manager oversees the operations of both the gas and water departments, so his labor and benefits expense are also allocated between the two departments.

The schedule labeled Adjustment B provides the allocation of the General Manager and shared office personnel labor and benefit costs to the gas department. These allocations were made on the basis of the number of customers served by each department.

In addition, water department field service personnel provide construction assistance to the gas department and an allocation of these employees' payroll, benefits and taxes was made on the schedule labeled Adjustment B. These allocations were made based on the three year average number of new installations and the number of hours water department employees were required to assist in those construction efforts.

Q. PLEASE DESCRIBE THE ADJUSTMENT TO EMPLOYEE PENSIONS AND BENEFITS.

A. Two adjustments were made to Employee Pensions and Benefits. The first adjustment was to increase expenses associated with the gas department employee payroll increase. As detailed on Adjustment C, the adjustment was calculated by applying the ratio of test year Pensions and Benefits as a percent of test year payroll to the payroll increase identified in Adjustment A. The second adjustment was to include the allocated pensions and benefits of shared employees calculated in Adjustment B.

Q. PLEASE DESCRIBE THE ADJUSTMENT TO PAYROLL TAXES.

A. In a calculation similar to the Employee Pensions and Benefits adjustment, Adjustment D calculated the increase in payroll taxes associated with the gas department salary increases. The payroll taxes associated with shared labor were allocated on Adjustment B.

Q. PLEASE DESCRIBE THE CASH WORKING CAPITAL ADJUSTMENT.

A. There is normally a time lag between the point when service is rendered and the related operating costs are incurred and the point where the revenues to recover such costs are received. The RRC provides for the use of 45-days or 12.50% of operating expense as a component of rate base to fund these going-concern requirements of business.[1] The Company's rate base was increased by $29,463 on Schedule D, line 2023 to recognize the cash working capital allowance.

Q. PLEASE DESCRIBE THE BAD DEBTS ADJUSTMENT.

A. The Company's balance sheet includes an allowance for bad debts in the amount of $5,000. However, for rate-making purposes actual known and measurable amounts are required. The Company provided actual uncollected accounts for the twelve months ending December 31, 2011 and September 30, 2012. The average of these two amounts was used to normalize bad debt expense and this amount was entered into Schedule D on line 3014.

[1] Railroad Commission of Texas, Gas Services Division, Natural Gas Rate Review Handbook, October 2012, Page 18.

Q. PLEASE DESCRIBE THE ADJUSTMENT FOR CONTRIBUTIONS IN AID OF CONSTRUCTION.

A. The Company's income statement includes revenue associated with Line Extension Charges. Pursuant to the RRC Rate Review Handbook[2] I have included this amount as a Contribution in Aid of Construction, which is a rate base deduction, on Schedule D, line 2030.

IV. RATE OF RETURN

Q. PLEASE DESCRIBE THE CALCULATION OF THE COMPANY'S RATE OF RETURN.

A. In setting a gas utility's rates, the regulatory authority establishes the utility's overall revenues at an amount that will permit the utility an opportunity to earn a reasonable return on the utility's invested capital used and useful in providing service to the public in excess of its reasonable and necessary operating expenses.[3] The overall rate of return is the sum of a weighted cost of debt and return on equity. Generally, regulated utilities have several sources of capital with which to finance their utility assets: issuance of common stock and preferred stock, long-term debt, and common equity. OW&GS however is a non-profit corporation that has debt at zero percent interest and no equity component.

In a recent rate case the RRC found that it was unreasonable for a utility with zero debt to base its total return on the company's cost of equity. Instead, the RRC imputed a

[2] Ibid.
[3] TEX UTIL. CODE §104.051.

weighted cost of capital based upon a RRC historical average of the component parts.[4] As shown on Schedule H, I applied this methodology to arrive at a rate of return on rate base on 9.06%.

V. BILLING DETERMINANTS

Q. PLEASE DESCRIBE ONALASKA WATER & GAS SUPPLY CORPORATIONS CUSTOMER CLASSES.

A. OW&GS served 685 residential and 49 commercial customers at the end of the test year. Booked commodity sales were 19,030.950 MCF in the test year, 62% of which is attributed to residential sales. Schedule F details by customer class the number of customers, MCF sales and sales revenue for each month of the test year.

Q. IS OW&GS PROPOSING ANY ADJUSTMENTS TO TEST YEAR BILLING DETERMINANTS?

A. Yes, OW&GS is proposing growth and weather normalization adjustments. Each of these adjustments is described in more detail below.

Growth Normalization Adjustment

Q. WHY ARE YOU PROPOSING A GROWTH NORMALIZATION ADJUSTMENT?

A. OW&GS is using test year end plant in service to determine its cost of service. For consistency, booked commodity sales and revenue need to be adjusted to show a full

[4] AgriTexGas GUD 10021, FoF 50-54.

years' billing for all customers receiving service at the end of the test year. This adjustment synchronizes the test year-end revenue with the year-end investment.

Q. PLEASE DESCRIBE HOW THIS ADJUSTMENT IS CALCULATED.

A. This adjustment in calculated on Schedule F, lines 128 through 256. The adjustment to commodity sales is calculated on a monthly basis as the ratio of the test year end number of customers minus the historic number of customers in each month of the test year divided by the historic number of customers in each month of the test year. This ratio is multiplied by the monthly unadjusted MCF sales to determine the adjustment to commodity sales. This adjustment to sales is multiplied by the applicable commodity charge to calculate the impact on revenues.

Q. WHAT IS THE ANNUAL IMPACT OF THIS ADJUSTMENT?

A. As a result of this growth normalization adjustment, sales increase by 456.4 MCF and the base rate revenue is adjusted upward by $3,820.44.

Weather Normalization Adjustment

Q. WHY ARE YOU PROPOSING A WEATHER NORMALIZATION ADJUSTMENT?

A. The weather normalization adjustment was necessary to ensure that sales volumes were neither over-stated nor under-stated relative to normal temperatures. Failure to adjust for abnormal temperature conditions would result in OW&GS under- or over-recovering its allowed revenue requirement under temperature conditions that are normally expected to

occur. The weather normalization adjustment submitted in the rate filing adjusts only the effects of abnormal heating degree days ("HDD"). The weather normalization adjustment is provided in Schedule G of the rate application.

Q. PLEASE DESCRIBE HOW THE TEST YEAR SALES BY CLASS OF SERVICE WERE WEATHER NORMALIZED.

A. The procedure for adjusting for abnormal temperature conditions involves determining the temperature sensitive portion of monthly usage and dividing that temperature sensitive usage by the actual degree days for the billing month. The weather normalization for gas customers is made for HDD only since there is little or no effect of cooling degree days ("CDD") upon gas usage. HDD are calculated as the difference between the actual average temperature and a base temperature of 65 degrees. For example, a day with a high temperature of 55 degrees and a low temperature of 35 degrees has an average temperature of 45 degrees and thus 20 HDD (65°- 45°). This is the common practice used to calculate HDD and is the practice employed by NOAA, the source of the temperature data I employed and the temperature information resource most frequently relied upon by the utility industry.

Because NOAA degree days are recorded on a calendar month basis and QW&GS reads its meters on the first of the month there is a perfect match between the degree day data and gas consumption. Therefore, there is no need to further adjust the data to account for staggered billing cycles. The temperature sensitive usage per MCF for the revenue month calculated as described above is then multiplied by the normal (i.e. the expected or average) number of degree days for the revenue month to derive the normal

level of temperature sensitive usage per customer. This normalized temperature sensitive usage per month per customer is then added back to the non-temperature sensitive usage to produce the total normalized usage per customer. Each month's normalized use per customer is multiplied by the year end number of customers to obtain total weather normalized MCF sales for the month.

Q. WOULD YOU PLEASE PROVIDE AN EXAMPLE OF THIS CALCULATION?

A. Yes. The following example illustrates the calculation of the weather normalization adjustment for the Residential Environs gas customers for the month of February 2012. Note that the revenues booked in February are derived from consumption in January.

Actual HDD	379
Normal HDD	418
Difference	39
Actual Use Per Customer	3.48
Less: Non-Temperature Sensitive Use Per Customer	0.55
Equals: Temperature Sensitive Use Per Customer	2.93
Divided by: Actual Heating Degree Days	379
Equals: Temperature Sensitive User Per Customer Per HDD	0.007736
Times: Degree Day Difference	39
Equals:Weather Adjustment Per Customer	.30
Times: Year-end Number of Customers	481
Equals: Weather Normalization Adjustment	143.3

First, in order to calculate actual and normal HDD for a billing month, it is necessary to synchronize calendar month HDD data with the billing months over which sales are recorded. For example, OW&GS reads residential environs customer meters on the 1st of the month. Therefore, the sales amounts booked in any given month reflect consumption that actually occurs during the calendar month preceding the book month.

Residential environs year-end customer adjusted sales booked in February were 1,672.8 MCF and the bill cycle HDD for the month were 379. Bill cycle normal HDD for the month are 418, indicating that actual sales were understated relative to normal conditions. Average use per customer was 3.48 MCF. The non-temperature portion of residential environs use was determined to be the average use per month experienced by residential environs customers during the non-heating summer months. This amount was 0.55 MCF per customer. Therefore, the temperature sensitive portion of load was 2.93 MCF per customer (i.e. 3.48 - 0.55 = 2.93). This temperature sensitive portion of load was divided by the number of HDD and resulted in a temperature sensitive use per customer per degree day of 0.007736. Multiplying this amount by the normal number of HDD results in an adjustment of 0.30 MCF per customer which, when added back to the actual average use per customer produces a normal use per customer of approximately 3.78 MCF. Multiplying this normal use per customer by the test year end number of customers of 481 produces and adjusted class sales amount of 1,816.0 MCF, an increase of 143.3 MCF from the year-end customer adjusted sales amount of 1,672.8. This process was repeated for each month for Residential and Commercial customers using information specific to each month and class. Note that some rounding may have occurred in the calculations set forth above, but that all numbers were carried out to a greater number of decimals in the actual calculations used to develop the weather normalization adjustment set forth on Schedule G.

Q. WHAT IS THE ANNUAL IMPACT OF THIS ADJUSTMENT?

A. As a result of this weather normalization adjustment, total residential and commercial sales increased by 1,605.8 MCF and base rate revenue increased by $9,888.79.

Q. WHAT HISTORICAL PERIOD DID YOU EMPLOY AS THE BASIS FOR COMPUTING NORMAL HEATING DEGREE DAYS?

A. For purposes of this filing, OW&GS used the most recent 10 year average to calculate normal heating degree days.

Q. WHY DID YOU APPLY THE WEATHER NORMALIZATION ADJUSTMENT TO YEAR-END CUSTOMER ADJUSTED SALES INSTEAD OF BOOKED SALES?

A. The Railroad Commission of Texas "Natural Gas Rate Review Handbook" dated October 2012 states on page 47 that when performing the weather normalization adjustment, *"All figures should have already been adjusted for customer growth"*.

VI. GAS CLASS COST OF SERVICE STUDY

Q. WHAT IS A CLASS COST OF SERVICE STUDY?

A. A class cost of service study is an analysis that develops dollar revenue requirements by customer class utilizing causal relationships between cost components and customer characteristics as the basis for assigning costs. A class cost of service study uses the cost elements of the total company revenue requirements and distributes these elements to OW&GS' various customer classes either by direct assignment of by allocating costs if necessary. Any costs that can be specifically identified as being incurred for the benefit

of or as a result of an individual customer or group of customers are directly assigned to that specific customer(s) rate class. Costs that cannot be specifically assigned are allocated to classes of customers using allocation factors that reflect the manner in which costs arise.

To a large extent, the reasonableness of the results of a cost of service study depends upon the reasonableness of the methods by which costs are allocated to classes. When allocating costs, it is important that the most appropriate cost driver for each individual cost is used to allocate that cost. Selecting the most appropriate cost driver is essential to ensuring that costs are allocated to the classes for which the costs are incurred. For this reason, class cost of service studies are said to be based upon the principle of "cost causation." Once the costs are allocated to the various rate classes, the total costs of serving each class can be ascertained. By comparing the costs of service by class to the revenues received from each class, rates can be designed for each class as appropriate.

Q. PLEASE EXPLAIN WHAT YOU MEAN BY THE TERMS "ALLOCATE" AND "ALLOCATION"?

A. "Allocate" and "allocation," in the context of class cost of service and rate design, are terms used to describe the process by which OW&GS' rate base items, expenses, and revenues are apportioned among the various rate classes. This allocation is based on various causal parameters. The choice of the parameter to be used is primarily based upon the notion that "cost responsibility follows cost causation." Apportionment of cost responsibility is accomplished by allocating or assigning various investments or costs

among the rate classes on a basis that represents the usage and, thus, the cost causation of these rate classes.

Q. PLEASE DESCRIBE SCHEDULE D WHICH CONTAINS THE ADJUSTED CLASS COST OF SERVICE STUDY.

A. Schedule D is the class cost of service study using adjusted pro-forma amounts. In this schedule each component of the system revenue requirement is set forth in rows and the allocated portion of the various cost components for each class is set forth in the column associated with the class. Allocation factors and the underlying information from which the allocation factors are calculated are provided in the first two pages of Schedule D. Following the allocation factor information, plant and other rate base items are allocated to classes. Next, operation and maintenance expenses are allocated to classes using either the input allocation factors or allocation factors that were developed based upon previously allocated plant or rate base items. Following the allocation of operation and maintenance expenses is the allocation of depreciation expense and taxes other than income. Next, income is either allocated to classes (as in the case of other revenue) or directly assigned to classes (as in the case of revenues from gas sales) and operating income is calculated using the previously allocated revenues and expenses by class of service. From this information, return by class under present rates is calculated. Finally, using the rate base, expenses, taxes and revenues that have already been allocated to classes, the cost of service study determines the dollars of return for each customer class under the proposed rate of return and the revenue deficiencies by class of service are calculated.

Q. PLEASE IDENTIFY THE RATE CLASSES USED IN THE CLASS COST OF SERVICE AND RATE DESIGN STUDY.

A. The rate classes used in the current gas filing include:

- Incorporated Residential Service
- Environs Residential Service
- Incorporated Commercial Service
- Environs Commercial Service

Q. PLEASE DESCRIBE THE ALLOCATION METHODOLOGIES YOU EMPLOYED IN THE CLASS COST OF SERVICE STUDY TO ALLOCATE COSTS.

A. There are numerous specific allocations made in the cost of service study. The specific allocation of each revenue requirement component is identified by the allocation factor set forth next to the total column. The allocation factors contained in the cost of service study are either externally developed allocation factors (independent) or internally developed allocation factors (dependent). Externally developed allocation factors are calculated using information that is developed externally to the cost of service study, such as sales volumes or number of customer allocation factors. Internally developed allocation factors are calculated within the cost of service study based upon the results of previously allocated items, such as total plant in service.

Commodity sales volumes were used to allocate measurement and regulatory station plant, and distribution mains. OW&GS does not possess the design-day nor peak day send-out data required to calculate demand related allocation factors.

Q. PLEASE DESCRIBE THE OTHER ALLOCATION FACTORS EMPLOYED IN THE GAS COST OF SERVICE STUDY.

A. Customer related costs such as meters, services, and house regulators were allocated to classes using the number of customers by class weighted by the relative costs of meters. Distribution expenses related to plant accounts were allocated to classes on previously allocated distribution plant. Administrative and general expenses were allocated to classes on the basis of previously allocated items. For example, labor related A&G was allocated on the sum of non-labor related distribution expenses, customer accounting and sales-related expenses, and non-labor related A&G expenses. Non-labor related A&G expenses were allocated on the sum of distribution related expenses, customer accounting and sales-related expenses.

Q. PLEASE DESCRIBE THE RESULTS OF THE GAS COST OF SERVICE STUDY.

A. The results of the class cost of service study indicate that the Commercial class requires a greater increase than the system average percentage increase. The Residential class requires an increase less than the system average.

VII. RATE DESIGN

Q. PLEASE SUMMARIZE THE RATES YOU PROPOSE FOR THE OW&GS GAS DEPARTMENT.

A. OW&GS proposes no structural changes to the existing gas service rates. However, OW&GS proposes to increase the levels of the Customer and Commodity Charges for its gas rates to better recover its cost of service and to provide for more revenue stability.

The proposed Customer Charge for Residential customers was increased from $10.00 per month to $12.00 per month. The proposed Customer Charge for Commercial customers was increased from $10.00 per month to $15.00 per month. The proposed Commodity Charge for both Residential and Commercial customers was increased from $6.158 per MCF to $9.321 per MCF.

The following table provides a comparison of the present and proposed rates by class of service:

	Present Rates		Proposed Rates	
Customer Class	Customer Charge $/Month	Commodity Charge $/MCF	Customer Charge $/Month	Commodity Charge $/MCF
Residential	$10.00	$6.158	$12.00	$9.321
Commercial	$10.00	$6.158	$15.00	$9.321

Q. DOES OW&GS PROPOSE ANY CHANGES TO THE PURCHASED GAS ADJUSTMENT (PGA)?

A. No, OW&GS does not propose any changes to the Purchased Gas Adjustment.

Q. WHERE ARE THE DEVELOPMENT OF OW&GS' PROPOSED RATES SUMMARIZED?

A. Schedule C provides the billing units and proposed rates by rate schedule and provides the calculation of adjusted revenues under proposed rates. The billing determinants employed to develop the proposed revenues are fully adjusted customers and weather adjusted MCF sales levels. Schedule B, Typical Bill Comparisons, provides bill impact analyses for the proposed rate schedules. The bill impact analyses set forth the dollar and percentage increases associated with various levels of use for customers.

Q. DOSES OW&GS PROPOSE ANY CHANGES TO THE MISCELLANEOUS SERVICE CHARGES?

A. Yes, the Company proposes revisions to its miscellaneous service charges because the present fees do not recover the cost of providing those services. In addition, the Company proposes to add new service fees. As with all service charges, only customers requesting and receiving the service will be charged for that service. A summary of the existing and proposed service charges is provided on the following table.

No.	ID	Description	Present Fee	Proposed Fee
1	ID-1A	Membership Fee	$100	$100
2	ID-2A	Deposit Fee (none collected)	$0	$0
3	ID-3	Service Tap Fee – Short Side	$175	$300
4	ID-4	Service Tap Fee – Long Side	$225	$350
5	IF-5	Service Reconnect	$25	$25
6	ID-6	Restore Service	$25	$25
7	ID-7	Relocate Meter	$75	$150
8	ID-8	Returned Check Charge	$25	$25
9	ID-9	Excess Flow Valve	$150	$180
10	New	Meter Tampering		$125
11	New	Labor – Other (Normal Business Hours)		$38/Hr
12	New	Labor – Other (After Hours, Weekend, Holidays)		$52/Hr

Q. WHAT IS THE ANNUAL IMPACT OF THESE CHANGES TO THE MISCELLANEOUS SERVICE CHARGES?

A. The proposed changes to Miscellaneous Service Charges increases the revenue recovered from these fees by $2,965. This increase is shown as a credit to the development of base rates in the class cost of service study Schedule D on line number 9009.

VIII. CONCLUSION

Q. WHERE ARE THE PROPOSED REVENUES BY CUSTOMER CLASS SUMMARIZED?

A. Schedule A provides an overall summary of the impact of the adjustments proposed by OW&GS and the impact of rate changes on each of the retail customer classes. The impact of the proposed rate design is shown both with and without the cost of gas. The total revenue increase, including the cost of gas, is 29.88 percent. While the increase in base rates only (excluding the cost of gas) is 39.50 percent.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS REGARDING THE CLASS BILLING DETERMINANTS.

A. OW&GS is using test year end plant in service to determine its cost of service. For consistency, booked commodity sales and revenue need to be adjusted to show a full years billing for all customers receiving service at the end of the test year. This adjustment synchronizes the test year-end revenue with the year-end investment.

The weather normalization adjustment was necessary to ensure that gas sales volumes were neither over-stated nor under-stated in terms of normal temperatures.

Failure to adjust for abnormal temperature conditions would result in OW&GS under- or over-recovering the allowed revenue requirements under temperature conditions that are normally expected to occur.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS REGARDING THE CLASS COST OF SERVICE STUDY THAT YOU SPONSOR.

A. The cost of service study provides the allocated revenue requirements by class of service. The allocation methods employed to assign costs to customer classes vary depending upon the particular cost item being allocated using the best data available. For example, mains investment were allocated to classes on the basis of the sales volumes method. Customer related costs were allocated on the basis of the number of meters or customers weighted by the relative costs of the assets or expenses being allocated (e.g., meters, regulators, customer accounting expense, etc.).

The class cost of service study employs allocation methods that are commonly employed in work of this nature and the results of the allocations are fair and reasonable.

Q. PLEASE SUMMARIZE YOUR RATE DESIGN RECOMMENDATIONS.

A. The rate design proposed by OW&GS reflects a continuation of the current rate structure. The Customer and Commodity Charges have been increased to better reflect the costs of providing service.

Q. IN YOUR OPINION, ARE THE ADJUSTED BILL FREQUENCIES, THE CLASS COST OF SERVICE STUDY, AND THE RATE DESIGN PROPOSED BY THE

OW&GS GAS DEPARTMENT IN ITS RATE FILING APPLICATION FAIR AND REASONABLE?

A. Yes, they are.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

GAS UTILITIES DOCKET NO. _____

STATEMENT OF INTENT OF	§	
BLUEBONNET NATURAL GAS, LLC.	§	**BEFORE THE**
TO INCREASE RATES IN HARDIN,	§	**RAILROAD COMMISSION**
JEFFERSON, LIBERTY,	§	**OF TEXAS**
NACOGDOCHES, RUSK AND TYLER	§	
COUNTIES, TEXAS	§	

DIRECT TESTIMONY

OF

KARL J. NALEPA

ON BEHALF OF

BLUEBONNET NATURAL GAS, LLC.

JULY 20, 2012

DIRECT TESTIMONY OF KARL J. NALEPA

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NACOGDOCHES, RUSK AND TYLER	§	
COUNTIES, TEXAS	§	

DIRECT TESTIMONY OF KARL J. NALEPA

I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is Karl J. Nalepa. I am President of ReSolved Energy Consulting, LLC, an independent utility consulting company. My business address is 11044 Research Blvd., Suite D-230, Austin, Texas 78759.

Q. ON WHOSE BEHALF ARE YOU PRESENTING TESTIMONY IN THIS PROCEEDING?

A. I am presenting testimony on behalf of Bluebonnet Natural Gas, LLC. ("BNG").

Q. PLEASE OUTLINE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I hold a Bachelor of Science degree in Mineral Economics and a Master of Science degree in Petroleum Engineering, and am a certified mediator. My professional experience includes eight years in the reservoir engineering department of an exploration

company affiliated with a major interstate pipeline company, then four years as a Fuels Analyst with the Texas Public Utility Commission ("PUC"). This was followed by five years with two different consulting firms providing expert advice regarding a broad range of natural gas and electric industry issues. Immediately prior to my current position, I served for more than five years as an Assistant Director with the Texas Railroad Commission ("RRC"). In this position, I was responsible for overseeing the economic regulation of natural gas utilities in Texas. I joined ReSolved Energy Consulting, LLC (formerly RJ Covington Consulting, LLC) in June of 2004. My Statement of Qualifications is attached as Appendix A.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes, I have testified a number of times before both the Texas RRC and the Texas PUC on a variety of regulatory issues. A summary of my previously filed testimony is attached as Appendix B. In addition, I supervised the staff case in proceedings before the RRC and served as a Technical Rate Examiner on behalf of the RRC. I have also provided analysis and recommendations in numerous city-level regulatory proceedings that resulted in settlements without written testimony.

II. PURPOSE AND SCOPE

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to present and support the gas sales, customer growth and weather adjustments, class cost of service study, and proposed rate design for BNG.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. Section I summarizes my experience, education, and qualifications. Section II of my testimony provides the scope and purpose of my direct testimony and describes the schedules that I am sponsoring as part of this filing. Section III describes the customer usage data and weather adjusted sales by customer class. Section IV provides an explanation of the allocations and results of the gas class cost of service study. Section V of my direct testimony describes and presents the BNG' proposed rates for gas service. Finally, Section VI summarizes my recommendations.

Q. ARE YOU SPONSORING ANY SCHEDULES TO BNG' APPLICATION?

A. Yes, I am sponsoring the entire application which consists of thirteen schedules.

Q. PLEASE DESCRIBE SCHEDULE A.

A. Schedule A provides a summary of revenue by customer classification. This schedule identifies the MCF commodity sales and associated revenues per the Company's books, year-end customer and weather adjusted sales and revenue, and the proposed revenue for each retail customer class. The proposed percent change in revenue and the average cost per MCF are also provided on this schedule.

Q. PLEASE DESCRIBE SCHEDULE B.

A. Schedule B provides typical bill comparisons for the proposed rate schedules. The bill comparisons set forth the dollar and percentage change associated with various levels of use for customers.

Q. PLEASE DESCRIBE SCHEDULE C.

A. The development of proposed rates by class is detailed on Schedule C.

Q. PLEASE DESCRIBE SCHEDULE D.

A. Schedule D, the class cost of service analysis, provides the adjusted class cost of service study for the test year ending March 31, 2012. The class cost of service study is used to determine the level of revenues necessary for each class to support its allocated revenue requirement.

Q. PLEASE DESCRIBE SCHEDULE E.

A. Schedule E provides the billing units and present rates by rate schedule and provides the calculation of adjusted revenues under present rates. The billing determinants applied are fully adjusted customers and MCF sales levels.

Q. PLEASE DESCRIBE SCHEDULE F.

A. Schedule F is the bill frequency model which provides the monthly unadjusted billing determinants by customer class. This schedule also develops the year-end and weather adjusted billing determinants which will be discussed in detail in Section III of my direct testimony.

Q. PLEASE DESCRIBE SCHEDULE G.

A. Schedule G sets forth the weather normalization adjustments. The weather normalization adjustment was made to eliminate the effects of atypical historical temperature conditions that cannot reasonably be anticipated to reoccur. The schedule includes a calculation of the 10 year normal heating degree days using data collected at Intercontinental Airport Houston.

Q. PLEASE DESCRIBE SCHEDULE H.

A. Schedule H provides the rate of return calculation based on the test year end debt and estimated equity values.

Q. PLEASE DESCRIBE SCHEDULE I.

A. Schedule I provides the calculation of federal income tax at the proposed rates, based on a 15.69% Federal Tax rate.

Q. PLEASE DESCRIBE SCHEDULE J.

A. Schedule J provides the calculation of allowed interest on customer deposits. The interest rate of 0.12% used in this calculation is per the Railroad Commission of Texas Gas Services Division, Gas Utilities Information Bulletin No. 939, dated May 31, 2012.

Q. PLEASE DESCRIBE SCHEDULE K.

A. Schedule K provides the calculation of allowable advertising expenses pursuant to Commission rule 7.5414.

Q. PLEASE DESCRIBE SCHEDULE L.

A. Schedule L provides a summary of the annual Depreciation Expense.

Q. PLEASE DESCRIBE SCHEDULE M.

A. Schedule M provides the development of the proposed Miscellaneous Service Fees.

Q. WERE THESE SCHEDULES PREPARED BY YOU OR UNDER YOUR SUPERVISION?

A. Yes, they were.

Q. ARE THESE SCHEDULES TRUE AND CORRECT TO THE BEST OF YOUR KNOWLEDGE AND BELIEF?

A. Yes, they are.

III. BILLING DETERMINANTS

Q. PLEASE DESCRIBE BLUEBONNET NATURAL GAS COMPANY'S CUSTOMER CLASSES.

A. BNG served 1,125 residential and 70 commercial customers at the end of the test year. Booked commodity sales were 36,046.7 MCF in the test year, 87% of which is attributed to residential sales. Schedule F details by customer class the number of customers, MCF sales and sales revenue for each month of the test year.

Q. IS BNG PROPOSING ANY ADJUSTMENTS TO TEST YEAR BILLING DETERMINANTS?

A. Yes, BNG is proposing growth and weather normalization adjustments. Each of these adjustments is described in more detail below.

Growth Normalization Adjustment

Q. WHY ARE YOU PROPOSING A GROWTH NORMALIZATION ADJUSTMENT?

A. BNG is using test year end plant in service to determine its cost of service. For consistency, booked commodity sales and revenue need to be adjusted to show a full years' billing for all customers receiving service at the end of the test year. This adjustment synchronizes the test year-end revenue with the year-end investment.

Q. PLEASE DESCRIBE HOW THIS ADJUSTMENT IS CALCULATED.

A. This adjustment in calculated on Schedule F, lines 426 through 941. The adjustment to commodity sales is calculated on a monthly basis as the ratio of the test year end number of customers minus the historic number of customers in each month of the test year divided by the historic number of customers in each month of the test year. This ratio is multiplied by the monthly unadjusted MCF sales to determine the adjustment to commodity sales. This adjustment to sales is multiplied by the applicable commodity charge to calculate the impact on revenues.

Q. WHAT IS THE ANNUAL IMPACT OF THIS ADJUSTMENT?

A. As a result of this growth normalization adjustment, residential sales increase by 89.9 MCF and the residential base rate revenue is adjusted upward by $447.21. Commercial sales decreased by 21.8 MCF and commercial base rate revenue decreased by $577.42. Therefore we see a net increase in sales of 68 MCF and a $130.21 decrease is base rate revenue.

Weather Normalization Adjustment

Q. WHY ARE YOU PROPOSING A WEATHER NORMALIZATION ADJUSTMENT?

A. The weather normalization adjustment was necessary to ensure that sales volumes were neither over-stated nor under-stated relative to normal temperatures. Failure to adjust for abnormal temperature conditions would result in BNG under- or over-recovering its allowed revenue requirement under temperature conditions that are normally expected to occur. The weather normalization adjustment submitted in BNG' rate filing adjusts only the effects of abnormal heating degree days ("HDD"). The weather normalization adjustment is provided in Schedule G of the rate application.

Q. PLEASE DESCRIBE HOW THE TEST YEAR SALES BY CLASS OF SERVICE WERE WEATHER NORMALIZED.

A. The procedure for adjusting for abnormal temperature conditions involves determining the temperature sensitive portion of monthly usage and dividing that temperature sensitive usage by the actual degree days for the billing month. The weather normalization for gas customers is made for HDD only since there is little or no effect of

cooling degree days ("CDD") upon gas usage. HDD are calculated as the difference between the actual average temperature and a base temperature of 65 degrees. For example, a day with a high temperature of 55 degrees and a low temperature of 35 degrees has an average temperature of 45 degrees and thus 20 HDD (65°- 45°). This is the common practice used to calculate HDD and is the practice employed by the National Oceanic and Atmospheric Administration ("NOAA"), the source of the temperature data I employed and the temperature information resource most frequently relied upon by the utility industry.

NOAA degree day data were revised so that the data consistently match BNG' billing cycle. Because customer usage occurs over portions of two calendar months while degree days are recorded on a calendar month basis, it is necessary to restate the calendar month degree days on the basis of a billing month to ensure that usage and temperatures are properly matched. The temperature sensitive usage per MCF for the revenue month calculated as described above is then multiplied by the normal (i.e. the expected or average) number of degree days for the revenue month to derive the normal level of temperature sensitive usage per customer. This normalized temperature sensitive usage per month per customer is then added back to the non-temperature sensitive usage to produce the total normalized usage per customer. Each month's normalized use per customer is multiplied by the year end number of customers to obtain total weather normalized MCF sales for the month.

Q. WOULD YOU PLEASE PROVIDE AN EXAMPLE OF THIS CALCULATION?

A. Yes. The following example illustrates the calculation of the weather normalization adjustment for the Residential gas customers located in the Hull Environs for the month of February 2012. Note that the revenues booked in February are derived from consumption in January and February.

Actual HDD (Billing Cycle Adjusted)	234
Normal HDD (Billing Cycle Adjusted)	357
Difference	123
Actual Use Per Customer	3.74
Less: Non-Temperature Sensitive Use Per Customer	0.87
Equals: Temperature Sensitive Use Per Customer	2.87
Divided by: Actual Heating Degree Days	234
Equals: Temperature Sensitive User Per Customer Per HDD	0.0123
Times: Degree Day Difference	123
Equals:Weather Adjustment Per Customer	1.52
Times: Year-end Number of Customers	115
Equals: Weather Normalization Adjustment	174.4

First, in order to calculate actual and normal HDD for a billing month, it is necessary to synchronize calendar month HDD data with the billing months over which sales are recorded. For example, BNG reads customer meters in the Wildwood Environs on the 1st of the month and at other locations, including Hull, between the 23rd and the 26th day of the month. Therefore, the sales amounts booked in any given month reflect consumption that actually occurs during the book month as well as the calendar month preceding the book month. For example, in the Hull Environs 19.35 percent of the February sales actually occurred during the month of January. For purposes of calculating the weather normalization adjustment, it was necessary to adjust the HDD that are recorded on a calendar month basis to match the billing month sales.

Residential Hull Environs year-end customer adjusted sales booked in February were 429.7 MCF and the bill cycle weighted HDD for the month were 234. Bill cycle

weighted normal HDD for the month are 357, indicating that actual sales were understated relative to normal conditions. Average use per customer was 3.74 MCF. The non-temperature portion of Residential use was determined to be the average use per month experienced by Residential customers during the non-heating summer months. This amount was 0.87 MCF per customer. Therefore, the temperature sensitive portion of load was 2.87 MCF per customer (i.e. 3.74 – 0.87 = 2.87). This temperature sensitive portion of load was divided by the number of HDD and resulted in a temperature sensitive use per customer per degree day of 0.012281. Multiplying this amount by the normal number of HDD results in an adjustment of 1.52 MCF per customer which, when added back to the actual average use per customer produces a normal use per customer of approximately 5.25 MCF. Multiplying this normal use per customer by the test year end number of customers of 115 produces and adjusted class sales amount of 604.1 MCF, an increase of 174.4 MCF from the year-end customer adjusted sales amount of 429.7. This process was repeated for each month for Residential and Commercial customers using information specific to each month and class. Note that some rounding may have occurred in the calculations set forth above, but that all numbers were carried out to a greater number of decimals in the actual calculations used to develop the weather normalization adjustment set forth on Schedule G.

Q. WHAT IS THE ANNUAL IMPACT OF THIS ADJUSTMENT?

A. As a result of this weather normalization adjustment, total residential and commercial sales increased by 1,519.3 MCF and base rate revenue increased by $10,604.74.

Q. WHAT HISTORICAL PERIOD DID YOU EMPLOY AS THE BASIS FOR COMPUTING NORMAL HEATING DEGREE DAYS?

A. For purposes of this filing, BNG used the most recent 10 year average to calculate normal heating degree days.

Q. WHY DID YOU APPLY THE WEATHER NORMALIZATION ADJUSTMENT TO YEAR-END CUSTOMER ADJUSTED SALES INSTEAD OF BOOKED SALES?

A. The Railroad Commission of Texas "Natural Gas Rate Review Handbook" dated June 2007 states on page 45 that when performing the weather normalization adjustment, *"All figures should have already been adjusted for customer growth".*

IV. GAS CLASS COST OF SERVICE STUDY

Q. WHAT IS A CLASS COST OF SERVICE STUDY?

A. A class cost of service study is an analysis that develops dollar revenue requirements by customer class utilizing causal relationships between cost components and customer characteristics as the basis for assigning costs. A class cost of service study uses the cost elements of the total Company revenue requirements and distributes these elements to BNG' various customer classes either by allocating costs or by direct assignment if appropriate. Any costs that can be specifically identified as being incurred for the benefit of or as a result of an individual customer or group of customers are directly assigned to that specific customer(s) rate class. Costs that cannot be specifically assigned are

allocated to classes of customers using allocation factors that reflect the manner in which costs arise.

To a large extent, the reasonableness of the results of a cost of service study depends upon the reasonableness of the methods by which costs are allocated to classes. When allocating costs, it is important that the most appropriate cost driver for each individual cost is used to allocate that cost. Selecting the most appropriate cost driver is essential to ensuring that costs are allocated to the classes for which the costs are incurred. For this reason, class cost of service studies are said to be based upon the principle of "cost causation." Once the costs are allocated to the various rate classes, the total costs of serving each class can be ascertained. By comparing the costs of service by class to the revenues received from each class, rates can be designed for each class as appropriate.

Q. PLEASE EXPLAIN WHAT YOU MEAN BY THE TERMS "ALLOCATE" AND "ALLOCATION"?

A. "Allocate" and "allocation," in the context of class cost of service and rate design, are terms used to describe the process by which BNG' rate base items, expenses, taxes, and revenues are apportioned among the various rate classes. This allocation is based on various causal parameters. The choice of the parameter to be used is primarily based upon the notion that "cost responsibility follows cost causation." Apportionment of cost responsibility is accomplished by allocating or assigning various investments or costs among the rate classes on a basis that represents the usage and, thus, the cost causation of these rate classes.

Q. PLEASE DESCRIBE SCHEDULE D WHICH CONTAINS THE ADJUSTED CLASS COST OF SERVICE STUDY.

A. Schedule D is the class cost of service study using adjusted pro-forma amounts. In this schedule each component of the system revenue requirement is set forth in rows and the allocated portion of the various cost components for each class is set forth in the column associated with the class. Allocation factors and the underlying information from which the allocation factors are calculated are provided in the first two pages of Schedule D. Following the allocation factor information, plant and other rate base items are allocated to classes. Next, operation and maintenance expenses are allocated to classes using either the input allocation factors or allocation factors that were developed based upon previously allocated plant or rate base items. Following the allocation of operation and maintenance expenses is the allocation of depreciation expense and taxes other than income. Next, income is either allocated to classes (as in the case of other revenue) or directly assigned to classes (as in the case of revenues from gas sales) and operating income is calculated using the previously allocated revenues and expenses by class of service. Once operating income is calculated, federal income taxes are calculated. From this information, return by class under present rates is calculated. Finally, using the rate base, expenses, taxes and revenues that have already been allocated to classes, the cost of service study determines the dollars of return for each customer class under BNG' proposed rate of return and the revenue deficiencies by class of service are calculated.

Q. PLEASE IDENTIFY THE RATE CLASSES USED IN THE CLASS COST OF SERVICE AND RATE DESIGN STUDY.

A. The rate classes used in the current gas filing include:

- Residential Service
- Commercial Service

Costs are not allocated to non-regulate farm services and a contract ARG rice drying customer. In lieu of allocating costs to these customers, revenue from the farm service and contract ARG rice drying customers are credited back to the residential and commercial customer classes.

Q. PLEASE EXPLAIN YOUR REASONS FOR NOT ALLOCATING COSTS TO THE FARM SERVICE AND ARG RICE DRYING CUSTOMERS.

A. The rationale underlying this procedure is that farm services and contract customer rates are not regulated by the Commission per Section 123 of the Texas Utilities Code. In lieu of allocating costs to these customers, test year revenue is credited to the retail sales classes. The credit decreases costs to these other rate classes.

Q. PLEASE DESCRIBE THE ALLOCATION METHODOLOGIES YOU EMPLOYED IN THE CLASS COST OF SERVICE STUDY TO ALLOCATE COSTS.

A. There are numerous specific allocations made in the cost of service study. The specific allocation of each revenue requirement component is identified by the allocation factor set forth next to the total column. The allocation factors contained in the cost of service

study are either externally developed allocation factors (independent) or internally developed allocation factors (dependent). Externally developed allocation factors are calculated using information that is developed externally to the cost of service study, such as sales volumes or number of customer allocation factors. Internally developed allocation factors are calculated within the cost of service study based upon the results of previously allocated items, such as total plant in service.

Commodity sales volumes were used to allocate measurement and regulatory station plant, and distribution mains. BNG does not possess the design-day nor peak day send-out data required to calculate demand related allocation factors.

Q. PLEASE DESCRIBE THE OTHER ALLOCATION FACTORS EMPLOYED IN THE GAS COST OF SERVICE STUDY.

A. Customer related costs such as meters, services, and house regulators were allocated to classes using the number of customers by class weighted by the relative costs of meters. Distribution expenses related to plant accounts were allocated to classes on previously allocated distribution plant. Administrative and general expenses were allocated to classes on the basis of previously allocated items. For example, labor related A&G was allocated on the sum of non-labor related distribution expenses, customer accounting and sales-related expenses, and non-labor related A&G expenses. Non-labor related A&G expenses were allocated on the sum of distribution related expenses, customer accounting and sales-related expenses.

Q. PLEASE DESCRIBE THE RESULTS OF THE GAS COST OF SERVICE STUDY.

A. The results of the class cost of service study indicate that the Commercial class requires a greater increase than the system average percentage increase. The Residential class requires an increase less than the system average.

V. RATE DESIGN

Q. PLEASE SUMMARIZE THE RATES YOU PROPOSE FOR BLUEBONNET NATURAL GAS, LLC.

A. BNG proposes no structural changes to the existing gas service rates. However, BNG proposes to increase the levels of the Customer and Commodity Charges for its gas rates to better recover its cost of service and to provide for revenue stability.

The proposed Customer Charge for Residential customers was increased from $15.00 per month to $18.00 per month. The proposed Customer Charge for Commercial customers was increased from $25.00 per month to $35.00 per month. The proposed Commodity Charge for both Residential and Commercial customers was changed from $6.98 per MCF to $9.38 per MCF.

The following table provides a comparison of the present and proposed rates by class of service:

	Present Rates		Proposed Rates	
Customer Class	Customer Charge $/Month	Commodity Charge $/MCF	Customer Charge $/Month	Commodity Charge $/MCF
Residential	$15.00	$6.9800	$18.00	$9.4600
Commercial	$25.00	$6.9800	$35.00	$9.4600

Q. DOES BNG PROPOSE ANY CHANGES TO THE PURCHASED GAS ADJUSTMENT (PGA)?

A. No, BNG does not propose any changes to the Purchased Gas Adjustment.

Q. WHERE ARE THE DEVELOPMENT OF BNG' PROPOSED RATES SUMMARIZED?

A. Schedule C provides the billing units and proposed rates by rate schedule and provides the calculation of adjusted revenues under proposed rates. The billing determinants employed to develop the proposed revenues are fully adjusted customers and weather adjusted MCF sales levels. Schedule 2, Typical Bill Comparisons, provides bill impact analyses for the proposed rate schedules on each of the Company's service territories. The bill impact analyses set forth the dollar and percentage increases associated with various levels of use for customers.

Q. DOSES BNG PROPOSE ANY CHANGES TO THE MISCELLANEOUS SERVICE CHARGES?

A. Yes. The current Miscellaneous Services Charges vary by location within the BNG service territory. BNG purchased the gas distribution system from Panther Natural Gas Company, Ltd. ("PNG") on January 1, 2008 and the fees charged by PNG were adopted by BNG. In GUD No. 9810 BNG sought, and the Commission approved, the consolidation of base rate charges so that only one rate applied to each class of service in all territories served by BNG. BNG did not request a modification of Miscellaneous Service Charges in GUD No. 9810 because of the complexity of base rate modifications

in that initial filing by the Company. BNG now desires to take the next logical set and consolidate the Miscellaneous Service Charges. The detailed development of the proposed Miscellaneous Service Charges are provided on Schedule M.

Q. WHAT IS THE ANNUAL IMPACT OF THESE CHANGES TO THE MISCELLANEOUS SERVICE CHARGES?

A. The proposed changes to Miscellaneous Service Charges increases the revenue recovered from these fees by $3,676. This increase is shown as a credit to the development of base rates in the class cost of service study Schedule D on line number 9009.

VI. CONCLUSION

Q. WHERE ARE THE PROPOSED REVENUES BY CUSTOMER CLASS SUMMARIZED?

A. Schedule A provides an overall summary of the impact of the adjustments proposed by BNG and the impact of rate changes on each of the retail customer classes. The impact of the proposed rate design is shown both with and without the cost of gas. The total revenue increase, including the cost of gas, is 19.02 percent. While the increase in base rates only (excluding the cost of gas) is 29.25 percent.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS REGARDING THE CLASS BILLING DETERMINANTS.

A. BNG is using test year end plant in service to determine its cost of service. For consistency, booked commodity sales and revenue need to be adjusted to show a full

years billing for all customers receiving service at the end of the test year. This adjustment synchronizes the test year-end revenue with the year-end investment.

The weather normalization adjustment was necessary to ensure that gas sales volumes were neither over-stated nor under-stated in terms of normal temperatures. Failure to adjust for abnormal temperature conditions would result in BNG under- or over-recovering the allowed revenue requirements under temperature conditions that are normally expected to occur.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS REGARDING THE CLASS COST OF SERVICE STUDY THAT YOU SPONSOR.

A. The cost of service study provides the allocated revenue requirements by class of service. The allocation methods employed to assign costs to customer classes vary depending upon the particular cost item being allocated using the best data available. For example, mains investment and storage costs were allocated to classes on the basis of the sales volumes method. Customer related costs were allocated on the basis of the number of meters or customers weighted by the relative costs of the assets or expenses being allocated (e.g., meters, regulators, customer accounting expense, etc.).

The class cost of service study employs allocation methods that are commonly employed in work of this nature and the results of the allocations appear to be fair and reasonable.

Q. PLEASE SUMMARIZE YOUR RATE DESIGN RECOMMENDATIONS.

A. The rate design proposed by BNG reflects a continuation of the current rate structure. The Customer and Commodity Charges have been increased to better reflect the costs of providing service.

Q. IN YOUR OPINION, ARE THE ADJUSTED BILL FREQUENCIES, THE CLASS COST OF SERVICE STUDY, AND THE RATE DESIGN PROPOSED BY BLUEBONNET NATURAL GAS IN ITS RATE FILING APPLICATION FAIR AND REASONABLE?

A. Yes, they are.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

GAS UTILITIES DOCKET NO. 10021

AGRITEXGAS, INC. STATEMENT OF INTENT TO INCREASE RATES IN ARMSTRONG, BAILEY, BORDEN, BRISCOE, CARSON, CASTRO, COCHRAN, CROSBY, DAWSON, DEAF SMITH, DICKENS, DONLEY, FLOYD, GAINES, GARZA, HALE, HALL, HOCKLEY, KENT, LAMB, LUBBOCK, LYNN, MOTLEY, OLDHAM, PARMER, POTTER, RANDALL, SWISHER, TERRY, AND YOAKUM COUNTIES, TEXAS.	§	BEFORE THE RAILROAD COMMISSION OF TEXAS

DIRECT TESTIMONY

OF

KARL J. NALEPA

ON BEHALF OF

AGRITEXGAS, INC.

OCTOBER 3, 2011

DIRECT TESTIMONY OF KARL J. NALEPA

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GAS UTILITIES DOCKET NO. 10021

AGRITEXGAS, INC. STATEMENT OF INTENT TO INCREASE RATES IN ARMSTRONG, BAILEY, BORDEN, BRISCOE, CARSON, CASTRO, COCHRAN, CROSBY, DAWSON, DEAF SMITH, DICKENS, DONLEY, FLOYD, GAINES, GARZA, HALE, HALL, HOCKLEY, KENT, LAMB, LUBBOCK, LYNN, MOTLEY, OLDHAM, PARMER, POTTER, RANDALL, SWISHER, TERRY, AND YOAKUM COUNTIES, TEXAS.	**§**	**BEFORE THE RAILROAD COMMISSION OF TEXAS**

DIRECT TESTIMONY OF KARL J. NALEPA

I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is Karl J. Nalepa. I am the President of ReSolved Energy Consulting, LLC, ("REC") formerly R.J. Covington Consulting, LLC, an independent utility consulting company. My business address is 11044 Research Blvd., Suite D-230, Austin, Texas 78759.

Q. ON WHOSE BEHALF ARE YOU PRESENTING TESTIMONY IN THIS PROCEEDING?

A. I am presenting testimony on behalf of AgriTexGas, Inc. ("AgriTexGas" or "Company").

Q. PLEASE OUTLINE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I hold a Bachelor of Science degree in Mineral Economics and a Master of Science degree in Petroleum Engineering, and am a certified mediator. My professional experience includes eight years in the reservoir engineering department of an exploration company affiliated with a major interstate pipeline company, then four years as a Fuels Analyst with the Texas Public Utility Commission ("PUC"). This was followed by five years with two different consulting firms providing expert advice regarding a broad range of natural gas and electric industry issues. Immediately prior to my current position, I served for more than five years as an Assistant Director with the Texas Railroad Commission ("RRC"). In this position, I was responsible for overseeing the economic regulation of natural gas utilities in Texas. I joined R.J. Covington Consulting in June of 2003. R.J. Covington Consulting became ReSolved Energy Consulting in August 2011. My Statement of Qualifications is provided in Appendix A.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSISON?

A. Yes, I have testified a number of times before both the Texas PUC and the Texas RRC on a variety of regulatory issues. A summary of my previously filed testimony is provided in Appendix B. In addition, I supervised the staff case in proceedings before the RRC and served as a Technical Rate Examiner on behalf of the RRC. I

have also provided analysis and recommendations in numerous city-level regulatory proceedings that resulted in settlements without written testimony.

II. PURPOSE AND SCOPE

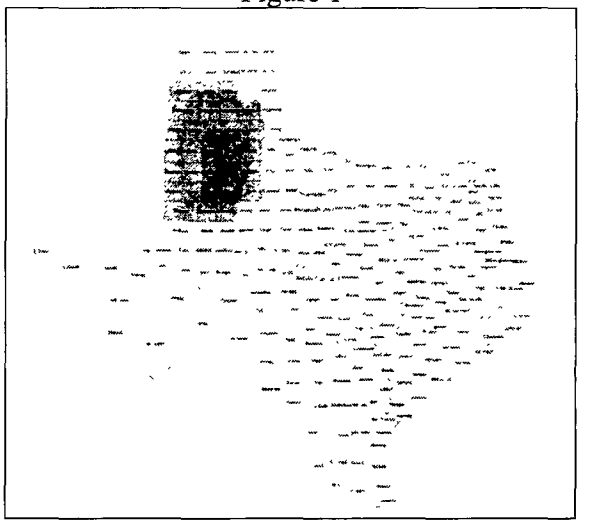
Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to present and support the class cost of service study and proposed rate design for AgriTexGas. The Company initially filed its Statement of Intent to establish rates on October 8, 2010, with a test year ending April 30, 2010. However, the Commission abated the proceeding until October 1, 2011 so that the Company could update its filing to reflect a full year of operating data while under AgriTex' control and to incorporate adjustments identified by the Examiners while evaluating the initial filing.

Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF THE AGRITEXGAS SYSTEM.

A. As illustrated in Figure 1, AgriTexGas distributes natural gas to customers throughout the counties highlighted in the panhandle region of West Texas.

Figure 1



We understand that Atmos Energy developed the AgriTexGas system beginning in the 1950s to serve the agricultural irrigation load in the area. Over time, various non-agricultural customers requested service as they were located near the system. Ibis Gas Services, LLC, a partnership of 4 entities, purchased a portion of the gas pipeline system from Atmos Energy on February 29, 2008. After a series of financial losses and funding issues, two of the entities that owned a total of 75 percent of Ibis bought out the interest of the other two entities on April 30, 2009. Subsequently, the two entities that then owned Ibis sold/transferred their interest to another entity, Gateway Properties, LLC. This sale/transfer happened in May 2009 and resulted in Gateway Properties owning 100 percent of Ibis. On May 1, 2009, Ibis Gas Services, LLC sold the pipeline and other tangible assets (computers, phone systems, etc.) to AgriTexGas, LP for a 60 percent ownership interest in AgriTexGas, LP. In other words, Gateway owns 100 percent of Ibis and Ibis owns 60 percent of AgriTexGas. The operation of the pipeline is managed by the purchasing partners. Ibis is not involved in any of the operations of AgriTexGas.

During the time that Ibis owned the system, Ibis subcontracted with Atmos Energy to provide all field services, including meter reading, leak detection and maintenance of the system. Once AgriTexGas purchased the system, the company continued to subcontract with Atmos for these services through October 2009. Starting in November 2009, AgriTexGas began phasing in field services operations with its own staff. Starting in January 2010, AgriTexGas personnel were reading all meters and fully maintaining the system.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. Section I summarizes my experience, education, and qualifications. Section II of my testimony provides the scope and purpose of my direct testimony and describes the exhibits that I am sponsoring as part of this filing. Section III describes the customer usage data, customer growth and weather adjusted sales by customer class. Section IV provides an explanation of the allocations and results of the gas class cost of service study. Section V of my direct testimony describes and presents the AgriTexGas' proposed rates for gas service. Finally, Section VI summarizes my recommendations.

Q. ARE YOU SPONSORING ANY EXHIBITS TO AGRITEXGAS' APPLICATION?

A. Yes, I am sponsoring the entire application which consists of 8 exhibits.

Q. PLEASE DESCRIBE EXHIBIT KJN-1.

A. Exhibit KJN-1 details the development of proposed regulated rates for the residential, small commercial, industrial and public authority classes.

Q. PLEASE DESCRIBE EXHIBIT KJN-2.

A. Exhibit KJN-2 provides typical bill comparisons for each of the regulated classes of service.

Q. PLEASE DESCRIBE EXHIBIT KJN-3.

A. Exhibit KJN-3, the class cost of service analysis, provides the adjusted class cost of service study for the test year ending March 31, 2011. The class cost of service study is used to determine the level of revenues necessary for each class to support its allocated revenue requirement.

Q. PLEASE DESCRIBE EXHIBIT KJN-4.

A. Exhibit KJN-4 provides the unadjusted billing units by rate code, the calculation of the year end customer adjusted sales volumes, and the calculation of weather adjusted sales volumes. The billing determinants employed in the study are fully adjusted customer and Ccf sales levels. The development of year-end and weather adjusted billing determinants will be discussed in detail in Section III of my direct testimony.

Q. PLEASE DESCRIBE EXHIBIT KJN-5.

A. Exhibit KJN-5 provides the rate of return calculation based on the test year end debt and estimated equity values.

Q. PLEASE DESCRIBE EXHIBIT KJN-6.

A. Exhibit KJN-6 provides the calculation of allowed interest on customer deposits. The interest rate of 0.19% used in this calculation is per the Railroad Commission of Texas, Gas Services Division, Gas Utilities Information Bulletin No. 919, dated April 22, 2011.

Q. PLEASE DESCRIBE EXHIBIT KJN-7.

A. Exhibit KJN-7 provides the calculation of allowable advertising expenses pursuant to Commission Rule 7.5414.

Q. PLEASE DESCRIBE EXHIBIT KJN-8.

A. Exhibit KJN-8 provides detail of plant in service and the proposed annual Depreciation Rates.

Q. WERE THESE EXHIBITS THAT YOU SPONSOR PREPARED BY YOU OR UNDER YOUR SUPERVISION?

A. Yes, they were.

Q. ARE THESE EXHIBITS TRUE AND CORRECT TO THE BEST OF YOUR KNOWLEDGE AND BELIEF?

A. Yes, they are.

III. BILLING DETERMINANTS

Q. PLEASE DESCRIBE AGRITEXGAS' CUSTOMER CLASSES.

A. AgriTexGas served 2,239 residential, 120 small commercial, 2 industrial, 6 public authority and 3,915 agricultural or irrigation customers at the end of the test year. Booked commodity sales were 31,314,857 Ccf in the test year, 92% of which is attributed to agricultural or irrigation sales. Exhibit KJN-4 details by customer class the number of customers and Ccf sales for each month of the test year.

Q. IS AGRITEXGAS PROPOSING ANY ADJUSTMENTS TO TEST YEAR BILLING DETERMINANTS?

A. Yes, AgriTexGas is proposing a customer growth and weather normalization adjustment to sales. Each of these adjustments are described in more detail below.

Growth Normalization Adjustment

Q. WHY ARE YOU PROPOSING A GROWTH NORMALIZATION ADJUSTMENT?

A. AgriTexGas is using test year end plant in service to determine its cost of service. For consistency, booked commodity sales need to be adjusted to show a full years' billing for all customers receiving service at the end of the test year. This adjustment synchronizes the test year-end sales volumes with the year-end investment.

Q. PLEASE DESCRIBE HOW THIS ADJUSTMENT IS CALCULATED.

A. This adjustment in calculated on Exhibit KJN-4, lines 110 through 151. The adjustment to commodity sales is calculated on a monthly basis as the ratio of the test year end number of customers minus the historic number of customers in each month of the test year divided by the historic number of customers in each month of the test year. This ratio is multiplied by the monthly unadjusted Ccf sales to determine the adjustment to commodity sales.

Q. WHAT IS THE ANNUAL IMPACT OF THIS ADJUSTMENT?

A. As a result of this growth normalization adjustment, sales decreased by 18,836.5 Ccf. This is a decrease of approximately one-half of one percent. The base rate revenue adjustment is a decrease of $5,602.

Q. WAS THE GROWTH NORMALIZATION ADJUSTMENT APPLIED TO ALL CUSTOMER CLASSES?

A. The adjustment was calculated for all regulated classes; however, there were no changes in the number of customers within the industrial and public authority classes. While there are monthly variations in the number of customers within agriculture and irrigation classes I did not apply a growth normalization adjustment to these un-regulated classes. Many of these farming customers turn off service when the growing season is over or one farmer may farm a plot of land in one season and another farmer will farm the plot in the next growing season. The change in the number of customers in these agriculture and irrigation classes is not generally due to actual customer growth.

Weather Normalization Adjustment

Q. WHY ARE YOU PROPOSING A WEATHER NORMALIZATION ADJUSTMENT?

A. The weather normalization adjustment was necessary to ensure that sales volumes were neither over-stated nor under-stated relative to normal temperatures. Failure to adjust for abnormal temperature conditions would result in AgriTexGas under- or over-recovering its allowed revenue requirement under temperature conditions that are normally expected to occur. The weather normalization adjustment submitted in the Company's rate filing adjusts only the effects of abnormal heating degree days ("HDD"). The weather normalization adjustment is provided in my workpaper WP-3.

Q. PLEASE DESCRIBE HOW THE TEST YEAR SALES BY CLASS OF SERVICE WERE WEATHER NORMALIZED.

A. The procedure for adjusting for abnormal temperature conditions involves determining the temperature sensitive portion of monthly usage and dividing that temperature sensitive usage by the actual degree days for the billing month. The weather normalization for gas customers is made for HDD only since there is little or no effect of cooling degree days ("CDD") upon gas usage. HDD are calculated as the difference between the actual average temperature and a base temperature of 65 degrees. For example, a day with a high temperature of 55 degrees and a low temperature of 35 degrees has an average temperature of 45 degrees and thus 20 HDD (65°- 45°). This is the common practice used to calculate HDD and is the practice

employed by the National Oceanic and Atmospheric Administration ("NOAA"), the source of the temperature data I employed and the temperature information resource most frequently relied upon by the utility industry.

NOAA degree day data were revised so that the data consistently match AgriTexGas' billing cycle. Because customer usage occurs over portions of two calendar months while degree days are recorded on a calendar month basis, it is necessary to restate the calendar month degree days on the basis of a billing month to ensure that usage and temperatures are properly matched. The temperature sensitive usage per Ccf for the revenue month calculated as described above is then multiplied by the normal (i.e. the expected or average) number of degree days for the revenue month to derive the normal level of temperature sensitive usage per customer. This normalized temperature sensitive usage per month per customer in then added back to the non-temperature sensitive usage to produce the total normalized usage per customer. Each month's normalized use per customer is multiplied by the year end number of customers to obtain total weather normalized Ccf sales for the month.

Q. WOULD YOU PLEASE PROVIDE AN EXAMPLE OF THIS CALCULATION?

A. Yes. The following example illustrates the calculation of the weather normalization adjustment for the Residential gas customers for the month of January 2011. Note that the revenues booked in January are derived from consumption in December and January.

Actual HDD (Billing Cycle Adjusted)	678
Normal HDD (Billing Cycle Adjusted)	712
Difference	34
Actual Ccf Use Per Customer	192.97
Less: Non-Temperature Sensitive Ccf Use Per Customer	19.77
Equals: Temperature Sensitive Ccf Use Per Customer	173.20
Divided by: Actual Heating Degree Days	678
Equals: Temperature Sensitive Use Per Customer Per HDD	.255277
Times: Degree Day Difference	34
Equals: Weather Adjustment Per Customer	8.50
Times: Year-end Number of Customers	2239
Equals: Weather Normalization Adjustment	19,031.3

First, in order to calculate actual and normal HDD for a billing month, it is necessary to synchronize calendar month HDD data with the billing months over which sales are recorded. For example, AgriTexGas begins reading customer meters on the 1st of the month and the reading spans up to two weeks. Therefore, the sales amounts booked in any given month reflect consumption that actually occurs during the book month as well as the calendar month preceding the book month. For purposes of calculating the weather normalization adjustment, it was necessary to adjust the HDD that are recorded on a calendar month basis to match, as closely as possible, the billing month sales.

Residential year-end customer adjusted sales booked in January were 432,068.9 Ccf and the bill cycle weighted HDD for the month were 678. Bill cycle weighted normal HDD for the month are 712, indicating that actual sales were understated relative to normal conditions. Average use per customer was 192.97 Ccf.

The non-temperature portion of residential use was determined to be the average use per month experienced by residential customers during the non-heating summer months. This amount was 19.77 Ccf per customer. Therefore, the temperature sensitive portion of the load was 173.20 Ccf per customer (i.e. 192.97 – 19.77 = 173.20). This temperature sensitive portion of load was divided by the number of HDD and resulted in a temperature sensitive use per customer per degree day of 0.255277. Multiplying this amount by the normal number of HDD results in an adjustment of 8.50 Ccf per customer which, when added back to the actual average use per customer produces a normal use per customer of approximately 201.47 Ccf. Multiplying this normal use per customer by the test year end number of customers of 2,239 produces an adjusted class sales amount of 451,100.2 Ccf, an increase of 19,031.3 Ccf from the year-end customer adjusted sales amount of 432,068.9. This process was repeated for each month for the residential, commercial and public authority customer classes. Note that some rounding may have occurred in the calculations set forth above, but that all numbers were carried out to a greater number of decimals in the actual calculations used to develop the weather normalization adjustment set forth on workpaper WP-3.

The industrial class was not adjusted for weather as their processes are not temperature sensitive, and while there are seasonal variations in agricultural and irrigation customers these variations relate to rainfall and not temperature sensitivities. Therefore, no weather adjustment was applied to the agriculture and irrigation classes.

Q. WHAT HISTORICAL PERIOD DID YOU EMPLOY AS THE BASIS FOR COMPUTING NORMAL HEATING DEGREE DAYS?

A. For purposes of this filing, AgriTexGas used the most recent 10 year average to calculate normal heating degree days. The use of the 10 year average was recently litigated and approved by the Commission in Atmos Energy Corp., GUD 9670, Hughes Natural Gas, GUD 9731 and CenterPoint Entex GUD 9902.

Q. WHY DID YOU APPLY THE WEATHER NORMALIZATION ADJUSTMENT TO YEAR-END CUSTOMER ADJUSTED SALES INSTEAD OF BOOKED SALES?

A. The Railroad Commission of Texas "Natural Gas Rate Review Handbook" dated May 2010 states on page 46 that when performing the weather normalization adjustment, *"All figures should have already been adjusted for customer growth."*

IV. REVENUE REQUIREMENT

Q. PLEASE DESCRIBE THE PROCESS THAT WAS USED TO DEVELOP THE RATE FILING PACKAGE.

A. The Rate Filing Package ("RFP") was developed from the books and records of AgriTexGas. As noted elsewhere in this testimony, AgriTexGas serves regulated residential, commercial, industrial and public authority customers as well as non-regulated agricultural and irrigation customers. I have developed revenue requirements for both the Total Company and the regulated "at-issue" retail classes.

Q. WHAT HISTORIC PERIOD IS THE COMPANY'S COST OF SERVICE BASED ON?

A. The Balance Sheet and Income Statement for the twelve months ending March 31, 2011 provide the data agreed to between the Commission Staff and AgriTexGas pursuant to the abatement period discussed earlier in this testimony.

Q. PLEASE SUMMARIZE AGRITEXGAS' REVENUE REQUIREMENT REQUEST IN THIS PROCEEDING.

A. Table 1 summarizes AgriTexGas's request in this proceeding.

Table 1

Description	Exhibit KJN-3 Line Reference	Total Company	Total Request
Total Operation and Maintenance	6005	$3,424,681	$628,738
Depreciation Expenses	6006	196,950	30,785
Taxes Other Than Income Tax	6007	165,034	27,245
Federal Income Tax	6008	125,435	19,084
Interest on Customer Deposits	6009	29	29
Return on Rate Base	6004	358,386	54,526
TOTAL COST OF SERVICE	**6010**	**$4,270,515**	**$760,408**

V. CLASS COST OF SERVICE STUDY

Q. WHAT IS A CLASS COST OF SERVICE STUDY?

A. A class cost of service study is an analysis that develops dollar revenue requirements by customer class utilizing causal relationships between cost components and

customer characteristics as the basis for assigning costs. A class cost of service study uses the cost elements of the total Company revenue requirements and distributes these elements to AgriTexGas' various customer classes either by allocating costs or by direct assignment if appropriate. Any costs that can be specifically identified as being incurred for the benefit of or as a result of an individual customer or group of customers are directly assigned to that specific customer(s) rate class. Costs that cannot be specifically assigned are allocated to classes of customers using allocation factors that reflect the manner in which costs arise.

To a large extent, the reasonableness of the results of a cost of service study depends upon the reasonableness of the methods by which costs are allocated to classes. When allocating costs, it is important that the most appropriate cost driver for each individual cost is used to allocate that cost. Selecting the most appropriate cost driver is essential to ensuring that costs are allocated to the classes for which the costs are incurred. For this reason, class cost of service studies are said to be based upon the principle of "cost causation." Once the costs are allocated to the various rate classes, the total costs of serving each class can be ascertained.

Q. PLEASE EXPLAIN WHAT YOU MEAN BY THE TERMS "ALLOCATE" AND "ALLOCATION"?

A. "Allocate" and "allocation," in the context of class cost of service and rate design, are terms used to describe the process by which AgriTexGas' rate base items and expenses are apportioned among the various rate classes. This allocation is based on various causal parameters. The choice of the parameter to be used is primarily based

upon the notion that "cost responsibility follows cost causation." Apportionment of cost responsibility is accomplished by allocating or assigning various investments or costs among the rate classes on a basis that represents the usage and, thus, the cost causation of these rate classes.

Q. PLEASE DESCRIBE EXHIBIT KJN-3 WHICH CONTAINS THE ADJUSTED CLASS COST OF SERVICE STUDY.

A. In Exhibit KJN-3 each component of the system revenue requirement is set forth in rows and the allocated portion of the various cost components for each class is set forth in the column associated with the class. Allocation factors and the underlying information from which the allocation factors are calculated are provided in the first two pages of Exhibit KJN-3. Following the allocation factor information, plant and other rate base items are allocated to classes. Next, operation and maintenance expenses are allocated to classes using either the input allocation factors or allocation factors that were developed based upon previously allocated plant or rate base items. Following the allocation of operation and maintenance expenses is the allocation of depreciation expense and taxes other than income. Next, other operating revenue is allocated to classes. Finally, using the rate base, expenses, taxes and revenues that have already been allocated to classes, the cost of service study determines the dollars of return for each customer class at present rates and under AgriTexGas' proposed rate of return by class of service.

Q. PLEASE IDENTIFY THE RATE CLASSES USED IN THE CLASS COST OF SERVICE AND RATE DESIGN STUDY.

A. The rate classes used in the current gas filing include:

- Residential
- Small Commercial
- Industrial
- Public Authorities
- Agricultural Farm Service, and
- Irrigation.

Q. PLEASE EXPLAIN YOUR REASONS FOR ALLOCATING COSTS TO THE NON-REGULATED AGRICULTURAL FARM AND IRRIGATION CUSTOMERS.

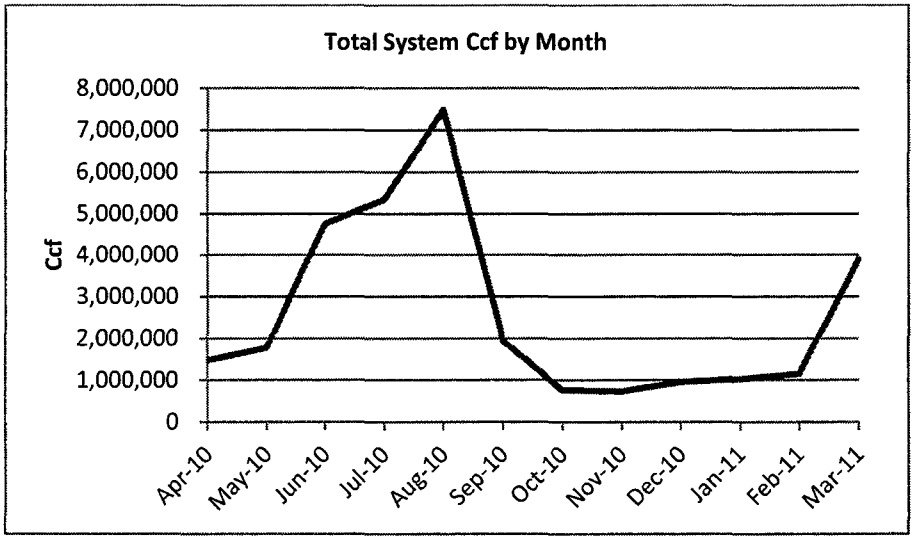
A. Typically costs are not allocated to these customers because the underlying charges relating to these customers are established by contract between the Company and the customer and, accordingly, cannot be adjusted as part of a general rate proceeding. However, because these farm customers account for approximately 92% of AgriTexGas' sales volumes, a fully allocated cost of service study assigning plant and expenses to all classes is necessary to establish the appropriate rates.

Q. PLEASE DESCRIBE THE ALLOCATION METHODOLOGIES YOU EMPLOYED IN THE CLASS COST OF SERVICE STUDY TO ALLOCATE COSTS.

A. There are numerous specific allocations made in the cost of service study. The specific allocation of each revenue requirement component is identified by the allocation factor set forth next to the total column. The allocation factors contained in the cost of service study are either externally developed allocation factors (independent) or internally developed allocation factors (dependent). Externally developed allocation factors are calculated using information that is developed externally to the cost of service study, such as sales volumes or number of customers. Internally developed allocation factors are calculated within the cost of service study based upon the results of previously allocated items, such as total plant in service.

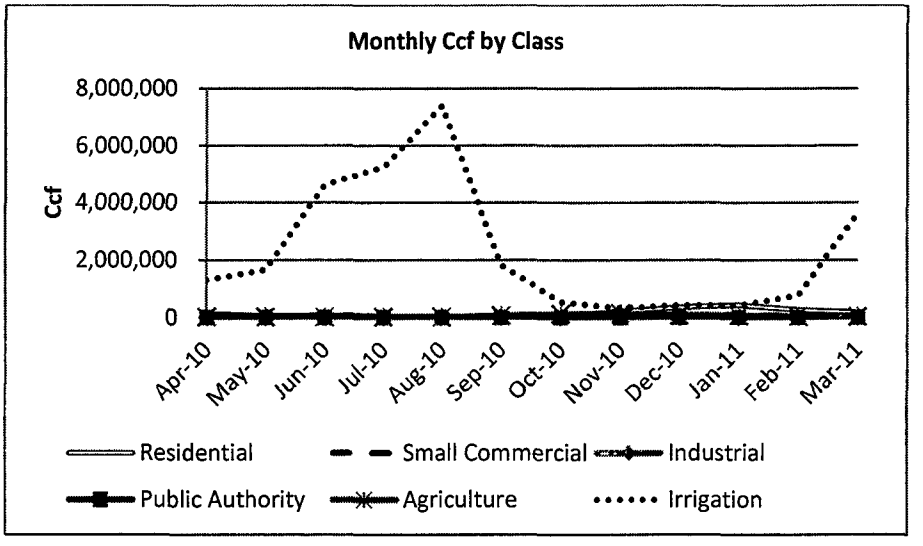
AgriTexGas is unique because it is so heavily influenced by its agricultural load. In fact, the system was originally installed by Atmos Energy to serve only irrigation customers. Only later did various non-agricultural customers request service since they were located near the system. Figure 2 below illustrates the total system sales volumes by month for the test period.

Figure 2



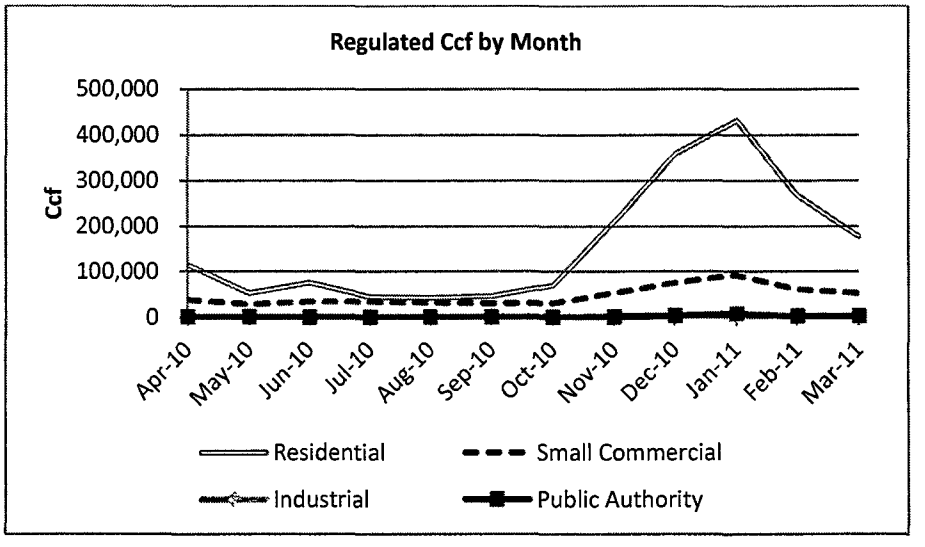
Unlike most gas distribution systems in Texas, AgriTexGas is a summer peaking system. This is due to the dominance of irrigation load as illustrated below in Figure 3.

Figure 3



As shown below in Figure 4, when the agricultural and irrigation loads are removed, the AgriTexGas profile looks similar to other gas distribution systems.

Figure 4



AgriTexGas does not possess the design-day nor peak day send-out data required to calculate commonly used demand related allocation factors. However, because of the dominance of the summer irrigation load, it is not reasonable to simply allocate plant on the basis of commodity sales volumes. Therefore we have utilized an approach identified as proportional responsibility to determine the capacity component to employ in a Commodity and Demand allocation methodology.

Q. COULD YOU DESCRIBE THE PROPORTIONAL RESPONSIBILITY DEMAND ALLOCATION METHOD?

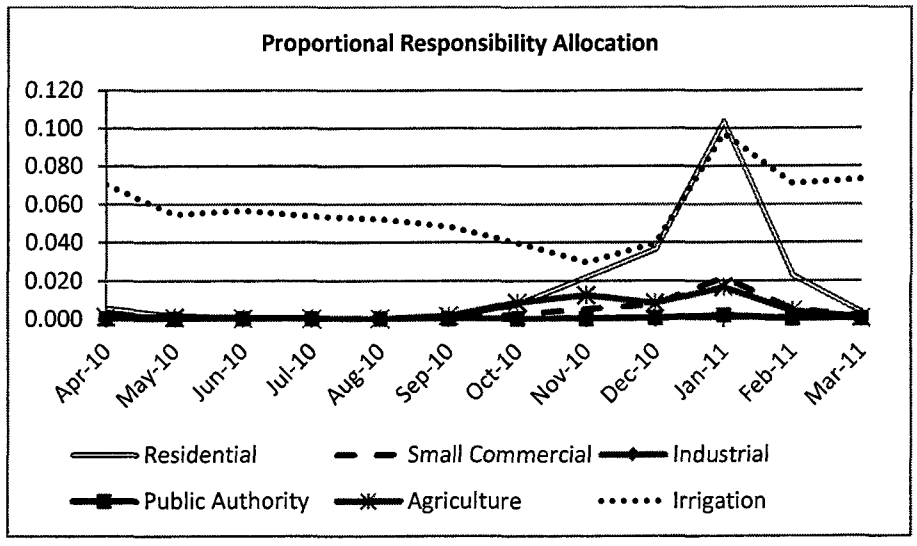
A. The Proportional Responsibility method was originally proposed by Gary H. Grainger in an article entitled "The Proportional Responsibility Method of Capacity Cost Allocation", published in the November 9, 1972 issue of Public Utilities Fortnightly. The method is a capacity allocation procedure which considers the monthly variation in sales by customer class. In contrast, the Design Day allocation method relates all costs to a single day, a hypothetical day where temperature extremes create the greatest load for which the utility can provide firm delivery service. The Design Day allocation method assumes that all costs are attributable to a single day, so by inference, there is no value to capacity at any other time. Non-peaking period customers would have no capacity cost responsibility at any time. In essence, these customers would receive the benefit of free use of the transmission and distribution system. This anomaly is one of the reasons why the FERC has migrated to capacity allocation methods the recognize customer loads throughout the year, such as the Modified Fixed Variable Method.

Q. PLEASE DESCRIBE THE DEVELOPMENT OF YOUR PROPORTIONAL RESPONSIBILITY ALLOCATION FACTORS.

A. First, monthly gas cost weighting factors are developed using the Proportional Responsibility methodology. This calculation is provided on workpaper WP-1 of this filing. The monthly gas cost is ranked as a percentage of the system's maximum monthly cost of gas. This percentage is the demand cost responsibility. Second, the demand cost responsibility is spread over the month(s) it occurs. For example, the lowest demand cost responsibility on WP-1 is .623116 (September). This occurs in 12 months of the year and should be spread over the 12 months, i.e., .051926 per month. The second lowest responsibility is .633166 (August). The difference between .633166 and .623116 (.010050) occurs for 11 months of the year. Therefore, the second lowest demand month gets the cost responsibility of the lowest demand over 12 months (.051926) plus the responsibility of the second lowest demand spread over 11 months (.000914) as shown on WP-1. This calculation continues until the highest demand month is calculated. The cumulative monthly weighting factor is computed by adding the month's individual weighting factors such that the sum of the cumulative weighting factor for all 12 months equals 100%.

The class demand allocation factor is developed by multiplying the customer growth adjusted sales volumes by the respective monthly cumulative proportional responsibility weighting factors. This calculation is provided on lines 198 through 207 on Exhibit KJN-4. Figure 5 graphically depicts this allocation factor.

Figure 5



Q. WHAT ALLOCATION FACTORS WERE USED TO ASSIGN COSTS TO CLASSES?

A. My recommended method assigns weights of 25% to the capacity allocation factor and 75% to commodity sales volumes to allocate distribution mains to the customer classes.

Q. PLEASE DESCRIBE THE OTHER ALLOCATION FACTORS EMPLOYED IN THE GAS COST OF SERVICE STUDY.

A. Meters, services, and house regulators were allocated on the number of customers by class weighted by the current cost of these facilities for each class. General plant was allocated on labor. Distribution expenses related to plant accounts were allocated to classes on previously allocated distribution plant. Administrative and general expenses were allocated to classes on the basis of previously allocated items. For example, labor related A&G was allocated on the sum of non-labor related

distribution expenses, customer accounting and sales-related expenses, and non-labor related A&G expenses. Non-labor related A&G expenses were allocated on the sum of distribution related expenses, customer accounting and sales-related expenses.

Q. PLEASE EXPLAIN THE VALUE OF PLANT INCLUDED IN YOUR COST OF SERVICE MODEL.

A. As previously noted, Ibis Gas Services, LLC purchased the system from Atmos Energy. In its report of this sale to the Commission[1], Atmos Energy provided a schedule of the net plant value by FERC account number. This schedule is replicated in my workpaper WP-2. AgriTexGas, LP subsequently purchased the pipeline and other tangible assets from Ibis on May 1, 2009 for $1,150,000. Using the net plant values provided by Atmos in its filing with the Commission I allocated the AgriTexGas purchase price to the appropriate FERC accounts. To these amounts I have added the AgriTexGas system additions on Exhibit KJN-8.

Q. HOW DID YOU DETERMINE THE ASSOCIATED DEPRECIATION EXPENSE?

A. AgriTexGas has not performed a detailed depreciation analysis of its system. Since the plant was purchased from Atmos Energy, I used the associated depreciation rates of Atmos Energy to calculate the depreciation expense on Exhibit KJN-8.

Q HOW WERE TAXES DETERMINED IN YOUR COST OF SERVICE STUDY?

[1] GUD No. 10107.

A. Payroll and property related taxes are paid directly by AgriTexGas, LP and are reported directly on the Company's Income Statement. However, the State Gross Margin Tax (Franchise Fee) is filed as a combined report with Ibis Gas Services and Federal Income Taxes are paid by the individual partners as part of their personal income tax responsibility. I have calculated the State Gross Margin tax at the statutory rate of 1% of gross revenue. Federal Income Taxes are estimated at the 35% marginal tax rate.

Q. WHY IS IT APPROPRIATE TO INCLUDE THE STATE GROSS MARGIN (FRANCHISE) TAX IN THE AGRITEXGAS REVENUE REQUIREMENT WHEN THESE TAXES ARE PAID BY IBIS?

A. It is appropriate to include the State Gross Margin Tax in the proposed revenue requirement because the tax is based on the gross margin generated by AgriTexGas. The Commission has consistently treated utilities as "stand alone" entities for purposes of tax recovery, even if the entity does not directly pay the tax.[2]

Q. WHY IS IT APPROPRIATE TO INCLUDE ESTIMATED FEDERAL INCOME TAXES IN THE AGRITEXGAS REVENUE REQUIREMENT WHEN THESE TAXES ARE PAID ON THE PERSONAL INCOME TAXES OF THE PARTNERS?

A For the same reason, it is appropriate to include Federal Income Taxes in the proposed revenue requirement because the tax is based on the return generated by

[2] For example, in GUD No. 10041, the Commission found that the federal income tax, state gross margin tax, ad valorem taxes, and payroll taxes were just and reasonable (FoF 49), even though Atmos West Texas was an unincorporated operating division of Atmos Energy Corporation and not a stand alone entity.

AgriTexGas. The Commission has consistently treated utilities as "stand alone" entities for purposes of tax recovery, even if the entity does not directly pay the tax. Furthermore, Texas Utilities Code §104.055(c) requires that income tax expense be computed using the statutory income tax rates.

Q. PLEASE DESCRIBE THE RESULTS OF THE CLASS COST OF SERVICE STUDY.

A. The class cost of service study identifies the revenue requirement by class of service at the requested rate of return.

VI. RATE DESIGN

Q. PLEASE SUMMARIZE THE PROPOSED RATES.

A. In this rate filing, AgriTexGas is consolidating various rate codes of the customers previously served by Atmos Energy.

Table 2 identifies the proposed customer and commodity charge for the regulated customer classes. The commodity charge is applicable to all usage.

Table 2

Customer Class	Customer Charge $/Mo.	Commodity Charge $/Ccf
Residential	$14.75	$0.1256
Small Commercial	$30.00	$0.1104
Industrial	$110.00	
First 1,000 Ccf		$0.1098
Over 1,000 Ccf		$0.0853
Public Authority	$55.00	$0.0945

Q. DOES AGRITEXGAS PROPOSE TO IMPLEMENT PROMPT PAYMENT DISCOUNTS?

A. No, prior to its purchase by AgriTexGas, the system's former owner, Atmos Energy, did impose penalties for late payments. However, our understanding of Title 16 §7.45 (4)(B) of the Texas Administrative Code is that utilities may offer discounts for payment of bills within 10 days after issuance, but may not impose penalties for late payment. We have therefore discontinued this practice.

Q. DOES AGRITEXGAS PROPOSE ANY CHANGES TO THE MISCELLANEOUS SERVICE CHARGES?

A. No, AgriTexGas does not propose any changes to the current charges which are identified on the Miscellaneous Service Charge tariff included in Exhibit A to the Company's Statement of Intent.

Q. HAS THE COMPANY ESTABLISHED QUALITY OF SERVICE STANDARDS IN ITS RATE FILING?

A. Yes, the Company proposes adoption of the Commission's service standards as detailed in 16 T.A.C. §7.45.

Q. HAS THE COMPANY ESTABLISHED A GAS CURTAILMENT PLAN?

A. Yes, the Company proposes adoption of the Commission's Curtailment Standards established in 16 T.A.C. §7.455.

VII. RATE CASE EXPENSES

Q. HOW DOES THE COMPANY PROPOSE TO HANDLE RATE CASE EXPENSES IN THIS PROCEEDING?

A. The Company requests recovery of its reasonable rate case expenses in this case through a surcharge to those customer rates that are affected by this proceeding. The Company requests that the Commission address the appropriate level of recoverable rate case expenses at a later point during the proceeding when such expenses will be known with greater certainty. In the alternative, the Commission may prefer that the issue of the reasonableness and recovery of rate case expenses associated with this proceeding be severed from this docket and determined in a separate docket. This approach is consistent with the Commission's handling of this issue in other dockets.

Q. PLEASE DESCRIBE GENERALLY THE TYPES OF EXPENSES THAT WILL BE INCURRED BY AGRITEXGAS IN THIS PROCEEDING.

A. The Company will incur direct expenses such a copying, faxing, postage and printing expense, certain expenses of an incremental nature for those Company employees that travel, as well as the expense associated with providing public notice. AgriTexGas will also incur expenses associated with consulting expertise, and may incur expenses associated with legal expertise, in connection with this case. All of these categories of expense will continue to be incurred through the duration of this proceeding.

VIII. CONCLUSION

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS REGARDING THE CLASS BILLING DETERMINANTS.

A. AgriTexGas is using test year end plant in service to determine its cost of service. For consistency, booked commodity sales need to be adjusted to show a full year's billing for all customers receiving service at the end of the test year. Commodity sales also need to be adjusted for normal weather temperatures to ensure that the Company does not under- or over-recover its allowed revenue requirement.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS REGARDING THE CLASS COST OF SERVICE STUDY THAT YOU SPONSOR.

A. The cost of service study provides the allocated revenue requirements by class of service. The allocation methods employed to assign costs to customer classes vary depending upon the particular cost item being allocated using the best data available. For example, mains investment costs were allocated to classes on the 75% Commodity and 25% Demand allocation methodology which weights estimated demand levels and actual sales volumes. Customer-related costs were allocated on the basis of the number of customers.

The class cost of service study employs allocation methods that are commonly employed in work of this nature and the results of the allocations are fair and reasonable.

Q. PLEASE SUMMARIZE YOUR RATE DESIGN RECOMMENDATIONS.

A. The rate design proposed by AgriTexGas reflects the costs of providing service.

Q. IN YOUR OPINION, ARE THE ADJUSTED CUSTOMER BILLING DATA, THE CLASS COST OF SERVICE STUDY, AND THE RATE DESIGN PROPOSED BY AGRITEXGAS IN ITS RATE FILING APPLICATION FAIR AND REASONABLE?

A. Yes, they are.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

APPENDIX A
STATEMENT OF QUALIFICATIONS