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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

Stephen McAlpine, Chairman  
 Rebecca L. Pauli  
 Robert M. Pickett  
 Norman Rokeberg  
 Janis W. Wilson

In the Matter of the Tariff Revision Designated as )  
 TA285-4 Filed by ENSTAR NATURAL GAS )  
 COMPANY, A DIVISION OF SEMCO ENERGY, )  
 INC. )  
 \_\_\_\_\_ )

U-16-066

ORDER NO. 19

**ORDER RESOLVING REVENUE REQUIREMENT AND  
 COST-OF-SERVICE ISSUES AND REQUIRING FILINGS**

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1 As can be seen, it is an average that is included in prepayments in rate  
2 base. When the prepaid insurance is booked at the beginning of the year, each month  
3 thereafter, the amortization expense (one month of the expense) is removed from  
4 prepayments in rate base, and booked as an increase to insurance expense. The amount  
5 paid by removing it from prepayments (and rate base) in any month is not collected for  
6 approximately 40 days (a net lead lag of 16.63 days is used in the lead-lag study).

7 We find that the AG's allegation of double counting of prepaid expenses is  
8 not supported by the record. We find that ENSTAR's testimony demonstrates that there  
9 is no double counting of prepaid expenses by their inclusion in rate base and the lead-lag  
10 study. After considering the record on this issue, we decline to adopt the AG's proposal  
11 to remove \$1.66 million in prepayments from rate base.

12 Homer Extension

13 The Homer Extension is a 22-mile distribution pipeline transporting natural  
14 gas from ENSTAR's transmission system at Anchor Point, through Homer, and  
15 terminating at the eastern boundary of Kachemak City.<sup>158</sup> Construction began in 2012  
16 and was completed in the fall of 2013.<sup>159</sup> The construction costs of the Homer Extension  
17 were \$11.8 million.<sup>160</sup> Of this amount, \$8.2 million was funded by a State grant to the City  
18 of Homer (Homer) committed to ENSTAR as a contribution-in-aid of construction (CIAC)  
19 while the remaining \$3.6 million was to be funded by a \$1 per Mcf surcharge (surcharge  
20 CIAC) to customer bills in the Homer Extension area.<sup>161</sup> The \$1 per Mcf surcharge was  
21 to be treated as a delayed recovery from customers of the CIAC required by tariff for

22 <sup>158</sup>T-10 (Dieckgraeff Direct) at 37.

23 <sup>159</sup>T-10 (Dieckgraeff Direct) at 37.

24 <sup>160</sup>T-10 (Dieckgraeff Direct) at 38 (\$11,780,072).

25 <sup>161</sup>T-10 (Dieckgraeff Direct at 37-38 (\$8,150,000 state grant, \$3,630,072 surcharge  
26 CIAC).

1 ENSTAR to build its line extension from Anchor Point to Homer.<sup>162</sup> The surcharge CIAC  
2 was to be in place for approximately 10 years.<sup>163</sup>

3 ENSTAR states that the \$1 per Mcf surcharge has been insufficient to cover  
4 the carrying costs on its net investment in the Homer Extension and it does not appear  
5 that the surcharge will be sufficient to retire the entire amount of the \$3.6 million surcharge  
6 CIAC balance.<sup>164</sup> ENSTAR asserts that this is because customer conversions to natural  
7 gas are lower than anticipated.<sup>165</sup> ENSTAR proposes to remove the surcharge CIAC and  
8 related amortization recorded since October 2013 from ENSTAR's books and include it  
9 in ENSTAR's general rate base.<sup>166</sup> ENSTAR also proposes to create a \$1.1 million  
10 regulatory asset that would be the net of (1) the surcharge collections (\$308,190); (2)  
11 CIAC amortization; (3) rate of return; and (4) income taxes recorded from October 2013  
12 through December 2015.<sup>167</sup> ENSTAR proposes to amortize the regulatory asset over 7.5  
13 years, beginning December 31, 2015, which represents the time remaining on the original  
14 ten-year period to collect the surcharge.<sup>168</sup> ENSTAR proposes to continue to collect the  
15 \$1 per Mcf as it was integral for Homer to secure the State grant.<sup>169</sup> ENSTAR states that  
16 it will treat the amounts as additional Miscellaneous Income to help offset the impact of

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<sup>162</sup>T-10 (Dieckgraeff Direct) at 37 n.19 (citing and quoting Order U-03-084(7) at 7).  
<sup>163</sup>H-41 (TA226-4) at 4. See also, H-40 (TA125-4) at 4, Attachment B at 11; Order U-03-084(7) at 7.  
<sup>164</sup>T-10 (Dieckgraeff Direct) at 38.  
<sup>165</sup>Tr. 364-65 (Green).  
<sup>166</sup>T-10 (Dieckgraeff Direct) at 38.  
<sup>167</sup>T-10 (Dieckgraeff Direct) at 38.  
<sup>168</sup>T-10 (Dieckgraeff Direct) at 38.  
<sup>169</sup>T-10 (Dieckgraeff Direct) at 39.

1 moving the surcharge CIAC amount and regulatory asset into rate base and the  
2 amortization of the regulatory asset.<sup>170</sup>

3 The AG agrees that the surcharge is not accomplishing what it was  
4 originally intended to do, i.e. recover the capital costs and return allowance.<sup>171</sup> The AG  
5 supports the proposal to move the original surcharge CIAC capital costs into rate base,  
6 but disagrees with continued collection of the surcharge and disagrees with the proposed  
7 creation of a regulatory asset.<sup>172</sup>

8 JL Properties did not file affirmative testimony, but engaged in cross-  
9 examination<sup>173</sup> and argument advocating against the inclusion of the Homer Extension in  
10 rate base.

11 ENSTAR developed its original proposal for a \$1 per Mcf surcharge CIAC  
12 based on an economic analysis that concluded placing the Homer Extension into rate  
13 base “would place an undue burden on existing customers and that a contribution in aid  
14 of construction is in order.”<sup>174</sup> The original proposal was developed in 2003 and was  
15 based on capital costs of \$3.5 million.<sup>175</sup> The line extension proposed in 2003 was an 11-  
16 mile, 4” pipeline from Anchor Point to Homer and Kachemack City.<sup>176</sup> ENSTAR did not  
17 modify the amount, reasoning behind, or length of time over which the surcharge CIAC  
18 was expected to be collected when the tariff provisions for the Homer Extension as they  
19 exist today were proposed and approved.<sup>177</sup>

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21 <sup>170</sup>T-10 (Dieckgraeff Direct) at 39.

22 <sup>171</sup>T-14 (Fairchild-Hamilton) at 96.

23 <sup>172</sup>T-14 (Fairchild-Hamilton) at 97-99.

24 <sup>173</sup>See, e.g. Tr. 967-997.

25 <sup>174</sup>H-40 (TA125-4) at 4.

26 <sup>175</sup>H-40 (TA125-4) at 4.

<sup>176</sup>H-41 (TA226-4) at 2.

<sup>177</sup>H-41 (TA226-4) at 1.

1 We approved the \$1 per Mcf surcharge CIAC based on ENSTAR’s  
2 representations that placing the Homer Extension into rate base would place an “undue  
3 burden on existing customers.” The record in this proceeding is clear that customer  
4 conversions in the Homer Extension area are less than projected by ENSTAR. And the  
5 anticipated approximate 10-year time frame for collection of the CIAC surcharge was  
6 vastly under-estimated. However, the testimony has not demonstrated a change to the  
7 premise underlying our approval of the CIAC surcharge in the first place, namely inclusion  
8 of the Homer Extension in rate base would place an “undue burden on existing  
9 customers.” We deny ENSTAR’s proposal to place the costs associated with the Homer  
10 Extension in rate base.

11 ENSTAR states that if we determine not to put the Homer Extension into  
12 rate base it will evaluate raising the \$1 per Mcf surcharge.<sup>178</sup> ENSTAR may propose a  
13 revised surcharge amount. We will evaluate the proposal if and when it is made.

14 Cost of Capital

15 ENSTAR, the AG, and MEA each filed testimony that presented their  
16 calculation of the appropriate cost of capital for ENSTAR. ENSTAR proposed a capital  
17 structure of 48.32% debt and 51.68% equity, a cost of debt of 5.03%, a return on equity  
18 (ROE) of 12.55%, and an overall rate of return of 8.92%.<sup>179</sup> The AG recommended a  
19 capital structure of 48.32% debt and 51.68% equity, a cost of debt of 5.06%, ROE of  
20 9.825%, and an overall rate of return of 7.52%.<sup>180</sup> MEA recommended a capital structure  
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24 <sup>178</sup>Tr. 485 (Green).

25 <sup>179</sup>T-12 (Hevert Direct) at 66-67.

26 <sup>180</sup>T-16 (Parcell) at 6.