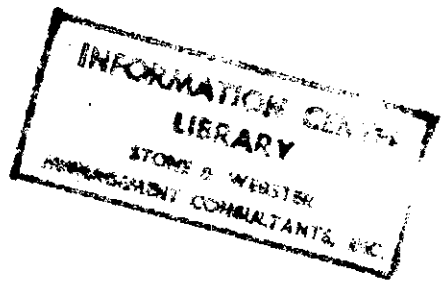
Q. On page 3 of Mr. Greneman's Evidence, he referred to the functionalization of General Plant as being based on generation, transmission, distribution and customer-related expenses. Please provide all studies, documents and worksheets that would support this change in the functionalization of General Plant in Hydro's COS study instead of the use of direct plant ratios; special attention should given to explain why labour costs are now used in the functionalization.

A. The recommendation to change the functionalization of general plant in Hydro's COS study to be based on expense rather than direct plant ratios was based on Mr. Greneman's observations that in the absence of a detailed study of general plant the use of labour ratios as a basis for the functionalization of general plant is more widespread than direct plant ratios. This is based on: (1) the notion that general plant includes many administrative and supervisory functions that exist to support field labour; and (2) the fact that there are no plant accounts to capture costs associated with meter reading, billing and collecting. These costs are therefore not able to be recognized in a plant factor, but are readily picked up by use of an expense factor.

The attached reference titled "A Guide to FERC Electric Utility Ratemaking" (1989) supports use of labour as a means of functionalizing general plant and administrative and general expenses in cost of service filings. The National Association of Regulatory Commissioners (NARUC) "Electric Utility Cost Allocation Manual" (1992), also attached, discusses the use of both methods.

A Guide to FERC Electric Utility Ratemaking

Michael E. Small
Wright & Talisman, P.C.
Washington, D.C.



AIS Atlantic Information Services, Inc.
1050 17th Street, N.W., Suite 480 • Washington, D.C. 20036 • (202) 775-9008

While functionalization for most items is relatively straightforward, and not usually litigated, problems do arise with respect to the functionalization of administrative and general expenses (A&G) [97] and general plant expenses. [98] FERC recently stated that:

> The Commission normally requires that A&G and General Plant expenses be allocated on the basis of total company labor ratios. Under such allocation method, A&G and General Plant expense items are 'functionalized,' or segregated into...production, transmission, distribution, customer accounts, customer service, information, and sales. This 'functionalization' is in proportion to the ratio of the labor cost in each major function to total labor costs less A&G and General Plant labor. Each functionalized component is allocated to customer groups.

Utah Power & Light Co., Opinion No. 308, 44 FERC ¶61,166, p. 61,549 n.11 (1988). *See also Minnesota Power & Light Co.*, Opinion No. 20, 4 FERC ¶61,116, p. 61,268 (1978) (general plant will be functionalized by labor ratios unless it is shown that the use of labor ratios produces unreasonable results). Thus, labor ratios have been used to functionalize general plant in many cases. *See, e.g., Utah Power & Light Co.*, Opinion No. 308, 44 FERC at 61,549; *Kansas City Power & Light Co.*, 21 FERC ¶63,003, p. 65,034 (1982), *aff'd*, 22 FERC ¶61,262 (1983); *Delmarva Power & Light Co.*, 17 FERC ¶63,044, p. 65,204 (1981), *aff'd*, Opinion No. 185, 24 FERC ¶61,199 (1983); *Philadelphia Elec. Co.*, 10 FERC ¶63,034, p. 65,355-56, *aff'd*, 13 FERC ¶61,057 (1980). Similarly, FERC has required that most A&G expenses be functionalized on the basis of labor ratios. *Missouri Power & Light Co.*, Opinion No. 31, 5 FERC ¶61,086, pp. 61,137-38 (1978); *Kansas City Power & Light*, 21 FERC at 65,035; *Delmarva*, 17 FERC at 65,204. An exception to this has been established for property insurance which has been functionalized on plant ratios. *Pacific Gas & Elec. Co.*, 16 FERC ¶63,004, pp. 65,015-16 (1981), *aff'd*, Opinion No. 147, 20 FERC ¶61,340 (1982); *Kansas-Nebraska Natural Gas Co.*, Opinion No. 731, 53 F.P.C. 1691, 1722 (1975). Common plant and intangible plant have also been analogized to general plant and functionalized on the basis of labor ratios. *Kansas City Power & Light*, 21 FERC at 65,035; *Delmarva*, 17 FERC at 65,204; *Philadelphia Electric*, 10 FERC at 65,355-56.

Another issue that has arisen is the calculation of the labor ratios. Usually, the labor ratio consists of total labor costs in the denominator with the labor costs associated with a particular category in the numerator. In a number of proceedings, companies have attempted to change the ratio by only including production, transmission, and distribution-related labor costs in the denominator, thus excluding customer service-related labor costs. This has been rejected in at least one case. *Kansas City Power & Light*, 21 FERC at 65,033-34.

Classification

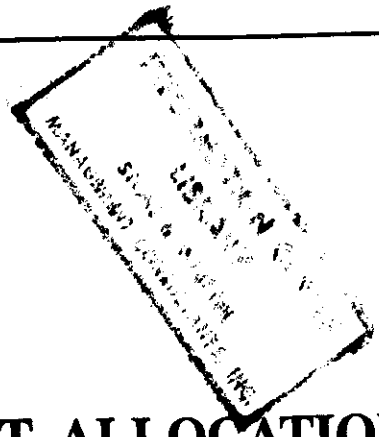
After functionalizing, the next step is to classify those expenses or costs into one of three categories (1) demand, (2) energy, or (3) other. *See* 18 C.F.R. §35.13(h)(8)(ii)(A). The classification issues most frequently litigated are (1) whether the predominance method should be used; that is, if an account is predominantly energy (or demand) related, should it be classified as 100% energy (or demand) or some lesser percentage; and (2) the proper classification scheme for production O&M accounts.

FERC's staff for a number of years has used a method called the predominance method for classifying production O&M accounts. Under this method if an account is *predominantly*

97 A&G expenses include salaries of officers, executives, and office employees, employee benefits, insurance, etc.

98 General plant includes office furniture and equipment, transportation vehicles, lockers, tools, lab equipment, etc.

PUB-2 NLH
Attachment B



ELECTRIC UTILITY COST ALLOCATION MANUAL

NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

January, 1992

CHAPTER 8

CLASSIFICATION AND ALLOCATION OF COMMON AND GENERAL PLANT INVESTMENTS AND ADMINISTRATIVE AND GENERAL EXPENSES

This chapter describes how general plant investments and administrative and general expenses are treated in a cost of service study. These accounts are listed in the general plant Accounts 389 through 399, and in the administrative and general Accounts 920 through 935.

I. GENERAL PLANT

General plant expenses include Accounts 389 through 399 and are that portion of the plant that are not included in production, transmission, or distribution accounts, but which are, nonetheless, necessary to provide electric service.

One approach to the functionalization, classification, and allocation of general plant is to assign the total dollar investment on the same basis as the sum of the allocated investments in production, transmission and distribution plant. This type of allocation rests on the theory that general plant supports the other plant functions.

Another method is more detailed. Each item of general plant or groups of general and common plant items is functionalized, classified, and allocated. For example, the investment in a general office building can be functionalized by estimating the space used in the building by the primary functions (production, transmission, distribution, customer accounting and customer information). This approach is more time-consuming and presents additional allocation questions such as how to allocate the common facilities such as the general corporate computer space, the Shareholder Relation Office space, etc.

Another suggested basis is the use of operating labor ratios. In performing the cost of service study, operation and maintenance expenses for production, transmission, distribution, customer accounting and customer information have already been functionalized, classified, and allocated. Consequently, the amount of labor, wages, and salaries assigned to each function is known, and a set of labor expense ratios is thus available for use in allocating accounts such as transportation equipment, communication equipment, investments or general office space.