

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter of the application of)
MICHIGAN GAS UTILITIES CORPORATION)
for authority to increase retail natural gas rates.)
_____)

Case No. U-15990

DIRECT TESTIMONY OF

LINDA M. KALLAS

FOR

MICHIGAN GAS UTILITIES CORPORATION

July 1, 2009

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**QUALIFICATIONS
OF
LINDA M. KALLAS
PART I**

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

2 A. My name is Linda M. Kallas. My business address is Integrys Business Support,
3 LLC ("IBS"), 130 East Randolph Drive, Chicago, Illinois 60601. I am Vice President
4 – Finance and Accounting Services in the Finance and Accounting Department of
5 Integrys Energy Group, Inc. ("Integrys"). Both IBS and Michigan Gas Utilities
6 Corporation ("MGUC") are wholly-owned subsidiaries of Integrys. Integrys resulted
7 from the February 21, 2007 merger between WPS Resources Corporation and
8 Peoples Energy Corporation.

9
10 **Q. For whom are you providing testimony?**

11 A. I am providing testimony on behalf of MGUC.

12

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

14 A. I graduated from the University of Illinois at Chicago in 1981 and received a Bachelor
15 of Science degree in accounting. I became a Certified Public Accountant in 1982. In
16 1988 I received a Masters of Business Administration degree from DePaul
17 University. My business experience with The Peoples Gas Light and Coke Company
18 ("PGL") and Peoples Energy Corporation ("PEC"), the predecessors of Integrys,

1 began in 1981. From that time until 1990, I was involved in various accounting
2 activities in the Property Accounting and General Accounting Departments. I was
3 named Supervisor of Financial Reporting in 1990, and from 1992 until 1995 was
4 involved in various activities in the Typing and Duplicating Department, Chairman's
5 office, and Cash Management Department. I became Manager of General
6 Accounting in 1998, and Director of Corporate Accounting in 1999. In 2000, I
7 became Assistant Controller, Diversified Accounting, and in October 2002 I became
8 Vice President and Controller. I was named IBS's Vice President –Finance and
9 Accounting Services in April of 2007. My present responsibilities include oversight of
10 all accounting activities of IBS and the regulated utilities owned by Integrys. I am in
11 charge of the recording of financial activity and the related accounting records,
12 accounting information systems and reports, and the executive supervision of
13 accounts payable. I am also responsible for certain regulatory reporting
14 requirements.

15
16 **Q. Have you previously testified before any regulatory agency?**

17 A. Yes, I have. I have testified in various cases, including general rate case
18 proceedings on behalf of PGL and North Shore Gas Company before the Illinois
19 Commerce Commission in Docket Nos. 07-0241/07-0242, and on behalf of
20 Minnesota Energy Resources Corporation before the Minnesota Public Utilities
21 Commission in Docket No. G007,011/GR-08-835. I have also presented testimony
22 before the Michigan Public Service Commission ("MPSC") in MGUC's 2006-2007
23 Gas Cost Recovery reconciliation in Case No. U-14715-R, and in Upper Peninsula
24 Power Company's ("UPPCO") general rate case proceeding in Case No. U-15988.

**LINDA M. KALLAS
DIRECT TESTIMONY
PART II**

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

2 A. The purpose of my pre-filed direct testimony is to describe the services provided by
3 IBS under the Regulated Affiliated Interest Agreement (“Regulated AIA”) between
4 IBS and its regulated utility affiliates. I also describe how costs are allocated to
5 regulated utility affiliates under the Regulated AIA, as well as the accounting,
6 reporting and recordkeeping methodologies that IBS follows.

7

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

9 A. Yes, I am. I am sponsoring Exhibit A-3 (LMK-1), Schedules C21 and C22.

10

11 **Q. Was this exhibit prepared by you or under your direction and supervision?**

12 A. Yes, it was.

13

14 **Q. Please describe Exhibit A-3 (LMK-1), Schedule C21.**

15 A. Exhibit A-3 (LMK-1), Schedule C21 is the IBS “Master Regulated Affiliated Interest
16 Agreement.”

17

18 **Q. Please describe Exhibit A-3 (LMK-1), Schedule C22.**

19 A. Exhibit A-3 (LMK-1), Schedule C22 describes the various assets owned by IBS.

20

21 **Q. Has the Regulated AIA between IBS and its regulated utility affiliates been the
22 subject of a proceeding before the MPSC previously?**

23 A. Yes, it has. The Regulated AIA between IBS and its regulated utility affiliates was
24 submitted to the MPSC in connection with MGUC, Wisconsin Public Service

1 Corporation (“WPS Corp”), and UPPCO seeking waivers from the Code of Conduct
2 and Affiliate Transaction Guidelines in Case No. U-15325.

3

4 **Q. Have other state commissions approved the cost allocation methodologies**
5 **established in the Regulated AIA?**

6 A. Yes, they have. The Regulated AIA, including the cost allocation methodologies and
7 formulas established therein, has been approved by the Public Service Commission
8 of Wisconsin in Docket No. 05-UI-111, the Illinois Commerce Commission in Docket
9 No. 07-0361, and the Minnesota Public Utilities Commission in Docket No. G-
10 007,011/AI-07-779.

11

12 **Q. Does MGUC seek to recover the costs charged to MGUC under the Regulated**
13 **AIA in this rate case proceeding?**

14 A. Yes, it does. The 2010 revenue requirement includes the amounts incurred in 2008,
15 inflated to 2010, and adjusted for Known and Measurable changes. This resulting
16 amount was included in the 2010 test year for the services to be provided to MGUC
17 by IBS, including the costs that are directly assigned, those assigned using cost-
18 causal allocators, and amounts assigned using the general/corporate allocator. The
19 2010 revenue requirement is explained by Ms. Katherine A. De Cramer in her pre-
20 filed direct testimony.

21

22 **The Basic Philosophy of IBS**

23 **Q. Please describe the philosophy and goals underlying the operation of IBS.**

24 A. IBS strives to be a leading service company provider of innovative and cost-effective
25 support services and solutions to its affiliates. IBS focuses on the following four
26 areas:

27 1. **Customer Focus:** Maintaining and demonstrating an in-depth understanding
28 of Integrys’ businesses, developing and delivering innovative, high-value

- 1 services that address business issues and assisting the businesses in
2 achieving their goals;
3
- 4 2. **Service Delivery**: Delivering high-quality and cost-effective services in a
5 timely manner; proactively developing, in partnership with its internal
6 customers, new and innovative services and solutions that address business
7 needs, leveraging technology and process excellence across its various
8 service categories;
9
- 10 3. **Cost Management and Value Creation**: Continually seeking ways to
11 improve processes and reduce costs, opportunities to invest in people,
12 processes and technology that will result in meaningful value creation for our
13 business partners and stakeholders; and
14
- 15 4. **Employee Engagement**: Maintaining a high-performance culture and staff
16 that exhibit strong technical skills, an in-depth knowledge of the business,
17 and a business mindset.
18

19 Integrys operates six utilities across four states, and has a number of non-regulated
20 subsidiaries. A centralized service company can achieve economies of scale by
21 leveraging employees and management across many affiliates and businesses.
22 Such leveraging reduces the holding company's system-wide costs and allows those
23 costs to be shared among a larger number of "customers."
24

25 **Q. These services appear to be typical A&G functions, except for some that are**
26 **provided by the Gas Group. Why are these Gas Group services provided by**
27 **IBS?**

28 A. The Integrys Gas Group provides the administrative oversight of the gas
29 engineering, gas supply and certain customer relations functions to Integrys' gas
30 utilities. These services are not provided to Integrys' non-regulated subsidiaries.
31 The Gas Group does not own any gas storage assets, or gas supply or pipeline
32 transportation contracts -- these contracts and assets continue to be owned
33 separately by the utility that contracted for those services or that own the storage
34 assets. Each operating company will continue to select and maintain its own
35 separate portfolio. IBS does, however, manage these various commodity and
36 capacity contracts. Combining these functions into a single entity provides for more

1 cost effective and consistent processes across companies.

2

3

II. IBS Structure and Services Provided

4 **Q. Please briefly describe these various units of IBS.**

5 A. Below I show the various IBS units along with examples of the Administrative &
6 General services offered by each unit:

- 7 • **Administrative** -- Facility services, security services, work space
8 management services.
- 9
- 10 • **Environmental** -- Environmental planning, permitting, licensing,
11 compliance services.
- 12
- 13 • **Financial Services** -- Accounting, treasury, tax, internal audit and
14 related financial services.
- 15
- 16 • **Human Resources** -- Payroll processing, labor relations, recruiting
17 and staffing.
- 18
- 19 • **Information Technology** -- Desktop, website, project, infrastructure
20 and telephony services.
- 21
- 22 • **Legal Services** -- General legal services, insurance, claims and
23 compliance services.
- 24
- 25 • **Supply Chain** -- Sourcing, fleet and materials management services.
- 26
- 27 • **Gas Group** -- Gas engineering, gas supply (Administrative and
28 General (“A&G”) and ministerial) services, and gas customer relations
29 services such as meter reading, billing, call center operations,
30 customer relations and market research, to the gas operating utilities.
- 31
- 32 • **External Affairs** -- Government and public relations, analysis and
33 formulation of company-wide policies and objectives, rate case
34 management, preparation and dissemination of information for
35 employees, government officials, media and the public.
- 36
- 37 • **Corporate Functions** -- Executive management and oversight,
38 corporate secretary services, corporate-level human resources
39 services, corporate-level business development services.
- 40

41 **Q. Please describe the Regulated AIA, pursuant to which IBS provides “shared”**
42 **or “inter-company” services to the utility operating companies within the**
43 **Integrus holding company system.**

1 A. IBS and its regulated operating company affiliates are the parties to the Regulated
2 AIA, which is attached as Exhibit A-3 (LMK-1), Schedule C21. Under the Master
3 AIA, IBS provides a wide range of services as listed and described in part on Exhibit
4 B to the Regulated AIA, as well as additional services that the “Client Companies”
5 may request, and which IBS can reasonably provide, in a cost-effective manner
6 consistent with applicable law.

7

8 IBS recovers all of its costs of providing these services by direct billing the Client
9 Companies whenever practicable. Where direct billing is not practicable, IBS will bill
10 Client Companies pursuant to the cost Allocation Factors described on Exhibit C of
11 the Master AIA. Services are provided “at cost,” including direct and indirect labor
12 and overheads and other cost loaders. The cost of maintaining assets, the
13 associated depreciation, and a return on the net assets are based on the factors
14 identified in Exhibit A-3 (LMK-1), Schedule C22.

15

16 **Q. Does IBS provide services to its non-regulated affiliates?**

17 A. Yes, it does, pursuant to a separate, Non-Regulated AIA that is substantially similar
18 to the Regulated AIA. As explained below, the Gas Group provides services only to
19 the regulated operating companies. The Gas Group’s operations, as required by
20 law, are kept separated from the regulated gas and electric business of Integrys and
21 its non-regulated subsidiaries.

22

23 **Q. Are the parties to the non-Regulated AIA charged “at cost” for services
24 rendered as are the parties to the Regulated AIA?**

25 A. Yes, they are. The allocation factors relevant to the provision of services by IBS is
26 the same under both AIAs – “at cost”- which cost is to be regularly demonstrated by
27 IBS, as part of its annual cost study or study-update work, to not be above market

1 price. In addition, I am advised that many of the affiliated parties to the Non-
2 Regulated AIA are “public utilities” under Section 201(e) of the Federal Power Act,
3 and therefore Federal Energy Regulatory Commission’s (“FERC”) “at cost”
4 requirement for the pricing of services provided by IBS will apply equally to both
5 AIAs. Therefore, IBS’s bills to non-regulated affiliates are based on either direct or
6 allocated cost, just like its bills to regulated affiliates. The Allocation Factors are the
7 same under both AIAs. Thus, non-regulated affiliates will be charged a “like cost” as
8 regulated affiliates. The non-regulated businesses of IBS cannot subsidize its
9 regulated affiliates, and the opposite is also true. IBS developed the Allocation
10 Factors to ensure that all costs incurred by IBS are recovered from the entity or
11 entities who originated such costs, and in proportion to their share of the whole.

12

13 **Q. What services does IBS provide to its regulated affiliates under the Regulated**
14 **AIA?**

15 A. These are listed and described, by category, in Exhibit B to the Regulated AIA.
16 Generally these services comprise common A&G business activities that each
17 affiliate would need to internally provide or procure to operate its business.

18

19 **III. AIA Cost Allocation Approach and Methodology**

20 **Q. What is the underlying goal that guides the allocation of costs incurred by a**
21 **centralized service company?**

22 A. The basic premise underlying the allocation methodology and factors we developed
23 is to regularly zero-out each “home center” (a departmental or operational unit of
24 IBS) – that is, each month (or in any event on a regular basis), all operating costs
25 incurred by IBS shall eventually be recovered, in total, from its regulated and non-
26 regulated affiliates. This occurs by direct billing whenever appropriate, and
27 otherwise by allocating costs on a cost-causal basis to the service takers within the

1 holding company system.

2

3 The Allocation Factors described in Exhibit C to the Regulated AIA are designed to
4 match the costs of the services performed with the entity or entities for whom the
5 services are performed. The Allocation Factors only come into play for costs which
6 are not directly billed to a Client Company.

7

8 **Q. How are these goals, assumptions and concepts applied to form your**
9 **allocation approach and methodology?**

10 A. The result is that we assign or allocate costs incurred by IBS using a three-tiered
11 approach. First and foremost, direct labor and outside services costs are directly
12 charged whenever appropriate (i.e., a full, 100% assignment of the costs associated
13 with a specific service to the one customer taking such service from IBS) and
14 practical. These costs include overhead charges to reflect the complete cost of
15 providing the service. An example of this would be direct labor charges for an IBS
16 environmental engineer who is assigned to a specific project for one of the Client
17 Companies. Those costs would be directly charged and billed to that Client
18 Company for each month that the service was being provided.

19

20 In cases where direct charging is not appropriate or practical, costs are allocated
21 using cost/causation principles linked to the relationship of that type of service. This
22 allocation methodology reflects operational aspects of the charge and applies costs
23 in a meaningful and impartial way that allocates costs to the entities for whom a
24 given service is provided. The remaining allocations are broad based, using the
25 General/Corporate Allocation Factor that I describe later in my testimony.

26

27 The primary focus of this methodology is to direct charge as many costs as

1 reasonably possible.

2

3 **Q. Can you give examples of each of the allocation tiers?**

4 A. Yes, I can. I will do so by describing three typical services that IBS provides. The
5 first service is provided by the Property Accounting cost center. It is expected that
6 most activity in this cost center will be allocated through direct billing. However,
7 certain activities, such as processing the automated depreciation calculation each
8 month, may benefit all companies. Therefore time spent on that activity would be
9 recorded in a general departmental activity “bucket” that would be allocated based
10 on each company’s Property Plant & Equipment (“PP&E”) balances.

11

12 The Accounts Payable cost center is expected to allocate most of its costs through a
13 cost-causal factor: the number of invoices processed. Although invoice processors
14 could technically track their time based on the owner of each invoice, that approach
15 would not be practical because it would require processors to incur unnecessary
16 costs to track their time. Instead, the time spent on invoice processing generally is
17 recorded in the general departmental activity “bucket” and allocated based on the
18 number of invoices. If an employee of Accounts Payable was working on a
19 significant separate project, that time would be tracked and billed directly to the
20 project, and those costs would be excluded from the total bucket of costs allocated
21 through the cost-causal factor.

22

23 Finally, the cost of Investor Relations activity is allocated via the General/Corporate
24 Allocation Factor. The activities performed by this cost center benefit all companies.

25 Therefore, the General/Corporate Allocation Factor is used as the most appropriate
26 cost allocator.

27

1 For these three services, as in all services, the labor billed to Client Companies,
2 whether direct or allocated, includes a labor loading. Home centers within IBS may
3 also procure products and services for the benefit of an individual Client Company,
4 and in such cases the associated costs are billed directly to the Client Company.
5 Contracted labor and professional services procured to assist a home center in
6 providing services are billed based on work performed, similar to internal labor
7 allocations but excluding labor overhead.

8

9 **Q. What costs are added or loaded into the labor allocations?**

10 A. There are two labor-related loaders. The first is a benefits loader and includes costs
11 for pension, personal insurance, vacation, disability, payroll taxes and other similar
12 or related costs. The second loader is designed to capture the cost of providing
13 work space for the employees performing the service. These costs include lease
14 costs or operating costs if the space is owned, depreciation and return on the
15 building or leasehold improvements, depreciation and return on furniture, PCs,
16 common printers/copiers, etc. If another entity is sharing this space with IBS, then
17 an adjustment for billing to that entity would take place prior to calculating a work
18 space overhead.

19

20 In addition to labor and contract labor being allocated based on the Allocation
21 Factors, each cost center incurs general costs related to running a department. This
22 includes office supplies, professional licenses, administrative time and training,
23 among other costs. These costs are allocated to the Client Companies in the same
24 proportion as the direct and cost-causal activities that are allocated to them – that is,
25 the costs are accumulated at the higher-level cost/service categories, and then
26 allocated based on the percentage of billings to each of the Client Companies at
27 each of the high levels. By doing this, these “general costs” are charged to the

1 Client Companies in a cost-causal manner.

2

3 **Q. What other costs are allocated to Client Companies?**

4 A. In addition to general use office space and equipment, other assets including
5 systems and special use assets (e.g., print shop assets) are owned and used by IBS
6 to provide services to its affiliates. Depreciation and a return on assets, along with
7 the cost to maintain these assets, are allocated based on appropriate factors as
8 indicated on Exhibit A-3 (LMK-1), Schedule C22.

9

10 Each operational level home center also needs to perform services for other home
11 centers within IBS. The cost of that activity is charged to an IBS entity level cost
12 center. The total cost charged to this cost center is then allocated each month to
13 each Client Company based on the ratio of all other charges to each Client Company
14 as compared to the whole of such charges. This allocation happens after the other
15 cost centers have billed but before the final billing is calculated, as described below.
16 In this manner, IBS's own internal "cost of doing business" is allocated and charged
17 to the Client Companies in a cost-causal manner – in proportion to all other billings in
18 a given billing period.

19

20 In addition to the above costs, a return on working capital is allocated to all Client
21 Companies, and Integrys may also incur miscellaneous costs not related to specific
22 services. The working capital return, miscellaneous costs, any operational home
23 centers not fully "zeroed out", and any differences between actual overhead costs
24 incurred and overhead costs billed, are allocated to Client Companies each month
25 based on the ratio of all other charges to each Client Company as compared to the
26 whole of such charges.

27

1 **Q. How are labor costs and related loaders tracked?**

2 A. When the Client Companies are billed, labor costs are “loaded” to calculate the
3 average cost per hour actually worked by any given employee. All Integrys
4 personnel who “bill” any time to customers as a provider of IBS services maintain
5 time records in order to reflect actual hours worked on each service provided by or
6 on behalf of IBS as well as all other, non-IBS projects for its primary employer.

7

8 Our ultimate goal, and one which FERC also requires of centralized service
9 companies, is to be as transparent as possible in accurately reflecting all costs
10 reasonably incurred by or on behalf of IBS in its provisions of services to its
11 customers. This is particularly true with respect to labor costs, which comprise a
12 significant portion of IBS's monthly expenses.

13

14 **Q. Please describe the General/Corporate Allocator.**

15 A. The General/Corporate Allocation Factor is used for the allocation of costs across
16 the Integrys holding company system in cases where a service provides system-wide
17 benefits, or in any event where the cost is driven by the holding company system as
18 a whole rather than any particular entity.

19

20 **Q. What cost factors go into calculation of the General/Corporate Allocation
21 Factor?**

22 A. There are two factors that are calculated for each entity within the Integrys holding
23 company system (including IBS): (1) total assets, and (2) total non-fuel operations
24 and maintenance (“O&M”) costs. These factors are determined for each entity, and
25 then weighted accordingly in order to develop percentages of the total, by entity.

26 The average of these two percentages for an entity is that entity's allocation
27 percentage, or factor, for the General/Corporate Allocation Factor.

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I should note here that in all cases where direct billing is not utilized, and thus an Allocation Factor must be utilized, this same “percentage of the whole” determination, whether a percentage of dollars, employees, customers or any other “units,” is calculated for each entity with that entity’s units in the numerator, whereas the denominator is the sum total of such units for all entities within the holding company system who take the particular service for which the Allocation Factor is being utilized.

Q. In calculating the total assets, how do you account for derivative assets, goodwill and other “non-ordinary” assets?

A. These types of assets are excluded from the total assets amounts for purposes of these calculations. In the case of derivative assets, accounting rules require the valuation of these contracts for each reporting period prior to actual settlement of the contract. As commodity prices change, the value of this asset will also change with no real change in the relative value of each affiliate to the other affiliates. In the same way, certain companies may have goodwill assets due to the fact that they were acquired by Integrys. Other companies may have a similar but unrecorded intrinsic value, therefore such items are excluded from this in order to result in a more appropriate cost allocation.

Q. Please describe the factors that go into the Non-Fuel O&M calculation.

A. All O&M costs (whether regulated or non-regulated) are included in this category. Examples of such costs include O&M labor, materials, and outside services. As noted earlier, fuel, cost of goods sold, purchased power and similar costs are not included in these calculations. Additionally, marked-to-market gains or losses recorded in O&M, if any, are excluded.

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Q. Why does Integrys believe this methodology is appropriate for the General/Corporate Allocation Factor?

A. There is no “right answer” that works for every holding company system. Instead, the appropriate general allocator depends on the unique facts and circumstances of each holding company system. In addition, FERC’s USOA (e.g., 18 CFR 367.28) requires that IBS create a cost accumulation system and identify methods of allocation to be used, and further that it notify its customers before changing any method of allocation, but the FERC does not prescribe any specific allocation methodology.

The two factors that were chosen are considered a proxy for the relative size of each Client Company as well as the activities that support each Client Company. While the corporate oversight and compliance required for any individual entity has both fixed and variable aspects, a large asset base can add specific risk and oversight needs as well as access to capital markets. In a similar manner, the overall costs to run a business (O&M) requires differing degrees of oversight (e.g., larger and more complex contracts, more employees, etc.). Integrys believes that these inputs provide a fair allocation of the costs to be allocated using this Allocation Factor.

Q. How regularly are these percentages re-calculated?

A. As with the Allocation Factors, the cost factors/inputs used for any calendar year are calculated during the preparation of the annual budget for that year. Most of these factors/inputs are based on the most recent month-end balance or last twelve full months of activity, as appropriate. Labor overhead rates, however, are based on projections of labor and overhead costs in the budgeted calendar year.

1 These factors would only change during the calendar year if some significant
2 changes in actual or anticipated activity were to occur.

3

4 **Q. Is there anything you want to mention in particular with respect to the**
5 **allocation of costs for services that are performed for Integrys itself (e.g.,**
6 **services related to the fact that it is a publicly-traded entity)?**

7 A. Yes, there is. For the sake of efficiency these costs are allocated by IBS to the
8 Client Companies (including Integrys itself) because the functions (which are
9 provided “for or on behalf of” the holding company) are, due to our organizational
10 structure, performed by IBS instead of by the holding company itself. However, as
11 has always been the case, any costs that are not allocable by Integrys to its
12 subsidiaries (for example, most business development costs) are charged to and
13 remain at the holding company level.

14

15 Another option would be to first charge such costs to Integrys and then have Integrys
16 bill its various subsidiaries, but this would not be consistent with our centralized
17 service company approach, nor with the fact that we have structured our shared
18 services organization such that Integrys officers and personnel are IBS employees.

19

20 Additionally, Integrys is allocated a portion of all other relevant and applicable costs
21 that are allocated via the appropriate Allocation Factor (including the
22 General/Corporate Allocation Factor for many services), and such allocated costs
23 are also charged to and remain at the holding company level.

24

25 **Q. You indicated that IBS is allocated certain costs as part of the**
26 **General/Corporate Allocation Formula. Are those costs then re-allocated by**
27 **IBS to the Client Companies, so that it can “zero-out” all of its costs? If so,**

1 **why?**

2 A. Yes, IBS recovers, from its Client Companies, the costs allocated to it under any
3 Allocation Formula. This occurs as part of the final calculation of the various
4 percentages (adding up to 100% in every case) that I described earlier.

5

6 This is appropriate because IBS was formed to provide cost-effective inter-company
7 services. IBS allows Integrys customers to optimize the level of net savings and
8 benefits that will result from a centralized service company. Therefore, it is
9 appropriate for IBS to recover its reasonably incurred costs from the Client
10 Companies.

11

12 **Q. Please provide an overview of the books and records that IBS maintains, and**
13 **any annual reports it must file.**

14 A. IBS is a “centralized service company” subject to FERC regulation and regulatory
15 requirements, including the USOA promulgated by FERC for such entities. This
16 exhaustive USOA, modeled after that used by utilities, is found in 18 CFR Part 367.
17 IBS must also follow the detailed record retention requirements promulgated by
18 FERC at 18 CFR Part 368. Finally, IBS must file a detailed annual report with FERC,
19 the FERC Form No. 60 (18 CFR Part 369), the annual report required of all
20 centralized service companies containing financial reporting tied to USOA accounts
21 as well as reporting various other matters and transactions. In addition to the
22 Commission’s broad authority to request information from MGUC, I am advised that
23 the Commission also has supplemental federal statutory authority which provides
24 access to books and records of companies throughout the holding company system
25 under section 1265(a) and the Energy Policy Act of 2005, if necessary to determine
26 the reasonableness of the costs.

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IV. Conclusion

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Q. Does MGUC believe that the cost of services rendered by IBS are equal to or less than if MGUC performed the same services on a stand-alone basis?

A. Yes, it does. The services provided by IBS represent activity that any company would need to perform to function as a separate company. By providing the same services to the complete Integrys family, the costs of these activities can be shared among all of the companies. Although some costs are variable to the size of the company, many of these costs are fixed and therefore a smaller company would pay a higher amount in proportion to their relative size if the service was provided by an outside party or fully staffed at the company to perform the functions.

Q. Is the arrangement between IBS and MGUC a benefit to MGUC and its customers?

A. Yes it is. In addition to the economies of scale described above, MGUC also gets the benefit of in house experts that can be developed in larger companies. For example, many of the same requirements that one utility may face from an environmental compliance perspective will impact other companies within the Integrys family. Having one group provide the support and research needed not only brings down the costs but helps to ensure strong compliance programs.

Q. Based on the IBS cost allocation procedures described in your testimony and documented in the Regulated AIA, are the IBS costs reasonably and equitably allocated among the IBS affiliated companies?

A. Yes, they are. The Regulated AIA to which MGUC is a party with IBS accurately and transparently assigns and allocates IBS costs to MGUC and among the other IBS affiliated companies, and provides reasonable assurance to the Commission that costs related to MGUC's Michigan gas operations are fairly and accurately

1 determined.

2

3 **Q. Does this complete your pre-filed direct testimony?**

4 A. Yes, it does.