EXHIBIT NO. ___ (JOINT-3T)
DOCKET NO. UE-011570 and UG-011571
WITNESSES: RONALD J. AMEN
MERTON LOTT
JIM LAZAR
DONALD SCHOENBECK

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY, INC.

Respondent.

JOINT TESTIMONY OF RONALD J. AMEN, MERTON LOTT, JIM LAZAR, AND DONALD SCHOENBECK IN SUPPORT OF THE NATURAL GAS RATE SPREAD AND RATE DESIGN SETTLEMENT

August 19, 2002

JOINT TESTIMONY OF RONALD J. AMEN, MERTON LOTT, JIM LAZAR, AND DONALD SCHOENBECK

NATURAL GAS RATE SPREAD AND RATE DESIGN SETTLEMENT

QUALIFICATIONS OF RONALD AMEN

Q: Mr. Amen, would you please state your name and business address.

A: My name is Ronald J. Amen. My business address is 200 Wheeler Road, Suite 400, Burlington, MA 01803.

Q: By whom are you employed and in what capacity?

A: I am a Principal with Navigant Consulting, Inc. ("NCI"), formerly Metzler & Associates, and a member of the Regulatory and Litigation Support Practice Area of the Firm. NCI is a leading nationwide provider of consulting services to electric and gas utilities and other energy-related and network businesses.

Q: Please describe NCI's business activities.

A: NCI is a global management consulting firm that provides strategic, financial, management, and expert services to energy-based, network and other regulated industries. From an industry-wide perspective, NCI has extensive experience in all aspects of the North American natural gas and electric industries. Included in NCI's relevant experience are the areas of utility costing and pricing, gas supply and transportation planning, competitive market analysis and regulatory practices and policies gained through management and operating responsibilities at transmission and distribution, gas pipeline and other energy-related companies, and through a wide variety of client assignments. NCI has assisted numerous utility companies located in the U.S. and Canada.

Q: What has been the nature of your work in the utility consulting field?

A: I have over twenty-four (24) years of experience in the utility industry, the last five (5) years of which have been in the field of utility management and economic consulting. Specializing in the gas industry, I have advised and assisted utility management and energy marketers in matters pertaining to costing and pricing, regulatory planning and policy development, strategic business planning, organizational restructuring, new business development, and load research studies. Further background information summarizing my education, presentation of expert testimony and other industry-related activities is included in prefiled Exhibit No. ___(RJA-2).

Q: Have you testified previously before the Washington Utilities and Transportation Commission ("the Commission")?

A: Yes. I have testified in Docket Nos. UG-931405 (General Rate Case of Washington Natural Gas Company ("WNG")), UG-940814/UG-940034 (Cost of Service and Rate Design Proceeding of WNG), UG-941246/UG-950264 (WNG Line Extension Policy), UG-950278 (General Rate Case of WNG), UE-960195 (Merger of Washington Energy Company and Puget Sound Power and Light Company) and UG-960520 (WNG Propane Service). I have also previously appeared before the Commission on numerous occasions regarding various rate, customer contract and tariff matters.

Q: For what purpose has NCI been retained by Puget Sound Energy, Inc. ("PSE" or the "Company")?

A: NCI has been retained by PSE as a consultant in the area of utility costing and rate design and related regulatory matters. Specifically, PSE requested that we assist the Company in conducting a cost of service study to determine the embedded costs of serving its natural gas retail customers, in addition to various costing and pricing studies related to the provision of gas distribution, transportation and storage-related services.

Q: What is the purpose of your testimony in this proceeding?

A. I have participated on behalf of the Company in the gas collaborative concerning Rate Spread and Rate Design matters. I will testify about the settlement with respect to those topics.

<u>QUALIFICATIONS OF MERTON LOTT</u>

Q. Have you testified in this proceeding on behalf of Commission Staff?

A. Yes. My qualifications were presented in Exhibit 451.

<u>QUALIFICATIONS OF JIM LAZAR</u>

Q. Have you testified in this proceeding on behalf of Public Counsel?

A. Yes. My qualifications were presented in Exhibit 551.

<u>QUALIFICATIONS OF DONALD SCHOENBECK</u>

Q: Have you testified previously in this proceeding?

A. Yes, as I testified on behalf of Industrial Customers of Northwest Utilities with my qualifications presented in Exhibit 272.

Q. Would you submit these same qualifications from Exhibit 272 with your testimony now on behalf of the Northwest Industrial Gas Users?

A. Yes.

JOINT TESTIMONY ON RATE SPREAD:

Q: Please describe rate spread and its importance.

A: Rate spread allocates revenue recovery to each of the Company's customer classes. It is important to the Company that the recovery of revenue from a class of customers corresponds to the costs incurred to serve that class. If there is an imbalance, changes in revenues to a class of customers will not appropriately track changes in costs. Rate spread is important to the Company's customers because customers want to be treated fairly, and the allocation of revenue responsibility among the various classes of customers needs to be done in a fair manner.

Q: Please identify what policy interests are important in addressing rate spread issues?

A: Rate spread should recognize that rates must be just and reasonable and not cause undue discrimination, that is, it should be based on established principles of fairness, equity, and sufficiency. Any shifting of rate responsibility from one rate class to another should be based on the relative cost structures of the classes, the impact of the shift on these customers, and the likelihood that the customers will be able to absorb the shifted costs.

Q: What is the basis for rate spread decisions?

A: Typically, rate spread decisions are based on cost of service analysis, tempered with considerations of customer impacts. Starting from the cost of service analysis, rate spread decisions then take into consideration the timing of the impact of changes in rates on customers, with the possibility that necessary changes might better be implemented gradually.

Q: What are the basic elements of the settlement?

A: The key components of the settlement are shown in Exhibit B of the Settlement Stipulation for Remaining Natural Gas Issues and Application for Commission Approval of Settlement dated August 15, 2002 ("Gas Settlement Stipulation").

Q: What Cost of Service Methodology did the collaborative use to form its consensus recommendation to the Commission?

A: For settlement purposes, the parties agreed to rely upon the cost of service methods approved by the Commission in Docket No. UG-940814 and as demonstrated in the Cost Study Appendix ("Appendix 1") attached to Exhibit B to the Gas Settlement Stipulation. For settlement purposes, this is a reasonable approach as the policy considerations have been considered by the Commission in the past, though each party reserved the right to propose alternative approaches in future proceedings.

Q: How did the collaborative use the cost of service results to derive the proposed rate spread?

A. Using results of the cost of service analysis, the parties agreed to generally spread the rate increase differently to three broad groups of customers. To those customer classes that, according to the cost of service analysis, are paying substantially more than their allocated costs (i.e. are above parity), the collaborative assigned a smaller than average rate increase. To those customer classes that, according to the cost of service analysis, are paying substantially less than their allocated costs (i.e. are below parity), the collaborative assigned a larger than average rate increase. The remaining group of customers received an equal percentage rate increase to recover the remaining revenue requirement. The customer classes that were above parity according to the study (and received the smaller percentage rate increase) were the C&I Heating (Schedules 31, 36 and

51), Interruptible Sales (Schedule 85), and the Transportation classes (Schedules 57, 99, 199 and 299).

Q. What other adjustments are being proposed?

A. With the above as an overall framework, several other adjustments are proposed:

An offsetting adjustment was made to the increases assigned to Schedules 87 (Large Interruptible Sales) and 57 (Transportation) in order to facilitate equalizing their respective rate margins, as customers are able to migrate between these two schedules.

The Limited Interruptible Service Class (Rate 86), the non-residential interruptible heating class, including many school facilities, exibited the lowest revenue-to-cost ratio of the customer classes, notwithstanding the two specialty service classes discussed below. The increase assigned to this class was limited to 150% of the system average increase, with consideration given to the impact of the increase on these customers.

The CNG class (Compressed Natural Gas for Vehicle Fuel) was assigned an increase of 125% of the system average increase, based upon that class being significantly below parity while recognizing the need for CNG to be competitive with other vehicular fuels.

The rental equipment service class (Schedules 71,72 and 74), another class significantly below parity, was assigned an increase equivalent to the average of the remaining classes. A portion of the revenue requirement stipulation provides for a minimum level of depreciation of the rental equipment investment resulting from the current depreciation deficiency for rental property. The test year level of depreciation on rental property is to be maintained over the next three years. This treatment is anticipated to result in a decrease or elimination of the depreciation deficiency on rental property thus resulting in the rental revenues covering rental costs at the end of the three-year period contained in the stipulation during which the Company is not allowed to request an increase in the revenue requirement associated with the existing gas water heater and conversion burner rental programs. Recognition was given to the competitive nature of water heating equipment, the largest component of the Company's rental equipment program, and the interest in preventing significant attrition in rental customers.

Q. How does this settlement address the policy interests addressed above?

The rate spread is based on cost of service analysis, though parties may advocate different methodologies in future cases. The new rates generally reflect costs. The settlement also addresses the issue of the rate differential between Schedules 87 and 57, which is a concern as customers may migrate between these two schedules. Further, the settlement reduces the disparity between the classes above and below parity.

<u>JOINT TESTIMONY ON RATE DESIGN:</u>

Q Please describe the importance of rate design.

A: Rate design is the pricing mechanism for the Company to recover its costs, which consists of both the recovery of the revenue requirement from within the various customer classes and the determination of rate structures within tariff schedules. Rate design determines the rates that each individual customer actually pays. As a result, rate design is important for the same reasons that rate spread is important.

Q: Please identify what policy interests are involved in addressing rate design issues?

A: A reasonable balance between the various cost guidelines and other criteria must be established in the process of designing rates. There are a variety of interests that need to be addressed. Rates should be designed to correctly reflect costs and to provide for revenue collection within customer classes that is fair and reasonable. It is also important to provide customers with appropriate price signals, as individual consumption and conservation decisions will be affected by the prices customers are charged. Another important regulatory policy interest is to minimize rate shock for customers, that is, a sudden and severe change in utility rates. Such an unexpected and dramatic occurrence can place a strain on household budgets and the operational planning of businesses related to energy costs. Finally, rates should not be overly complex, so that most customers can readily understand how they are charged for gas service.

Q. Were these principles applied in order to develop the proposed rate structures?

A. Yes.

Q. What rate design was adopted for the residential customer class (Schedule 23)?

A. A $5.50 / month customer charge was agreed upon based on the unit cost results from the cost of service study. This is the same customer charge as the Commission has approved for PSE electric service. The remainder of the rate increase was applied to the single block volumetric rate.

Q. What agreement was reached regarding structural changes to the two residential Schedules 23 and 24?

A. Residential customers served under the current Schedules 11, 23 and 24 will be consolidated under Schedule 23.

Q: Are the number of other non-residential rate schedules reduced under the settlement proposal?

A: Yes. The settlement proposes to eliminate Rate Schedule 11, General Gas Service and Rate Schedule 43, Large Volume Armed Forces Service. Schedule 11 is a general gas service rate used primarily for cooking in apartment complexes utilizing either central heating and water heating systems or another source of energy for heating purposes, as well as other special small uses of gas, including outdoor cooking events. Schedule 11 has been closed to new customers since October 9, 1993. Of the 905 customers that remain under the schedule, 829 are residential customers and are paying the same monthly service charge and nearly equivalent volumetric rates as residential customers served under Rate Schedule 23 (Residential General Service), which was authorized by the Commission in Docket No. UG-940814. Three customers are classified as Industrial, while 73 are Commercial. With the elimination of this schedule, the Company will complete the transition of the customers to their appropriate respective service schedules, Rate Schedule No. 23 and Rate Schedule No. 31 (Commercial and Industrial General Service).

Rate Schedule 43 is currently limited to military installations served as of October 9, 1993 and no customers are presently receiving service under this schedule.

Q. Were common rate design structural elements applied to the remaining non-residential rate schedules?

A. Yes. Monthly customer charges were added to Rate Schedule 41, Large Volume High Load Factor Service, as well as to each of the three Interruptible Gas Service Schedules 85, 86 and 87. With the addition of monthly customer charges to these schedules, all of the company's gas service schedules will employ monthly service charges for recovery of customer-related costs of providing gas distribution service.

Q: What was the basis for the level of the proposed new monthly customer charges for Rate Schedules 41, 85, 86 and 87?

A: In structuring the proposed level of monthly customer charges for these and all other rate schedules, the unit cost report from the cost of service study was used as a guide to identify costs related to providing monthly service to the respective service classes. For the unit cost analysis, as with our reliance on the cost study results generally, the parties reserve the right to present alternative methods of measuring cost in future proceedings. The results from the unit cost study are found in Appendix 1 page 4 of 4 to Exhibit B. Bill impact analysis was also employed to insure that customers within these schedules were not severely impacted by the level of the new customer charges. The settlement provides the Company with the latitude to file subsequent annual revenue neutral adjustments to the rate components of Schedule 41. This phased-in approach will gradually adjust the rate design to be better aligned with cost while addressing the interest in preventing rate shock for the customers currently receiving service under Schedule 41. At this time, the Company will retain a modified form of the minimum charge on Schedule 41 until such time as a higher customer charge level is reached.

Q. Were new levels established for the existing customer charges in the remaining non-residential rate schedules under the settlement proposal?

A. Yes. The settlement proposal sets the customer charges for the C&I Heating Schedules 31 and 36 at $10.00 and $20.00 per month, respectively. Schedule 51 (Multiple Unit Housing Service) will have a monthly customer charge of $5.50 per dwelling unit, identical to that charged other residential customers. The monthly customer charge for CNG Service, Schedule 50, will be raised to

$150.00. The balance of the revenue increases to these schedules will be recovered in their single block volumetric charges.

Q: A change has also been proposed in the monthly customer charge under Schedule 57. Please describe this customer charge in more detail.

A: Under the settlement, the Schedule 57 monthly customer charge of $643.50 is proposed to increase to $800.00. Like the other customer charges discussed earlier, this customer charge is based upon customer-related costs from the cost of service study, and in particular, the incremental administrative costs related to the provision of transportation service.

Q. Were other structural changes made to any of the schedules?

A: Yes. A demand charge has been introduced into Schedule 41, Large Volume High Load Factor Service. The basis for the minimum charge on Schedule 41 has also been revised, as mentioned earlier. The monthly minimum charge will be the sum of the customer charge, the demand charge, a distribution charge equivalent to 500 therms of usage ($81.50), and a customer's consumption related gas costs.

Q: Please explain the basis for the Schedule 41 demand charge proposal.

A: As suggested by the title of the tariff, service under Schedule 41 ("R-41") is intended for large, high load factor firm commercial or industrial loads. Because of the favorable pricing provided by this high load factor schedule, including the price of the gas commodity, it has for many years attracted migrating customers from Rate Schedule 31 ("R-31") and, to a lesser extent, Schedule 86 ("R-86"), an interruptible schedule with its own firm service option. However, as more and more of the low load factor R-31 (heating loads) and R-86 customers (primarily steam or boiler heating loads) migrate to R-41, the underlying favorable economics disappear. An attempt to stem the migration was made by the

Company with the support of the Commission staff in 1995, when a minimum load factor requirement was added to the eligibility criteria for R-41. This eligibility "fence" requires at least annual review of R-41 customer consumption patterns by the Company, an unnecessary administrative burden when the use of a demand charge could make the tariff more self-policing. The reason for this is the price signal provided by a demand charge will raise the average cost to a low load factor R-31 or R-86 customer and ultimately make it uneconomic to remain on R-41.

Q. Is the addition of a demand charge to Schedule 41 consistent with the structure of the Company's other large non-residential service schedules?

A. Yes. Demand charges have been employed in Schedules 57, 85, 86 and 87 since the Company's rate restucturing proceeding, UG-940814.

Q: Please describe the Contract Volume Charge contained in Rate Schedule 87 and the proposal to modify the basis for this rate in the schedule?

A: The Contract Volume Charge, currently $0.0099 per therm, is the rate applied to a customer's annual contract volume, a quantity of interruptible gas set forth in the customer's service agreement as a minimum purchase volume during the contract year. Application of the Contract Volume Charge insures the recovery of a minimum level of margin from the interruptible customers served under this schedule. However, recovering a portion of the distribution margin in this separately stated volumetric rate has evolved over time to its present state whereby the remaining commodity charge tail block of Schedule 87 (currently $0.54071 per therm) is less than the gas cost component of the rate (currently $0.54592 per therm). The proposed remedy is to collapse the margin recovery heretofore provided by the Contract Volume Charge into the commodity charge block rates and apply the minimum contract volume requirements to the revised tail block of the commodity charge. In other words, the minimum contract volume requirement will remain for Schedule 87 customers but will be billed using the tail block of the distribution charge instead of a separately stated rate. This will also facilitate the equalizing of the block rates between Schedules 87 and 57, Transportation Service, an important consideration given the relative ease with which customers can migrate between these two schedules.

Q: Does the settlement propose any changes to the conditions for the monthly balancing service contained in its transportation service schedule?

A: No. However, a modest increase is proposed to the unit cost of balancing service resulting from the cost of service study. This increase in balancing costs is an increase in gas cost recovery and is in addition to the general rate increase in this proceeding. While this increase represents a rate increase to Schedule 57, it does not result in a revenue increase to PSE as this increase will be offset by a corresponding change in PGA rates to other customers.

Q. Were there other changes to the balancing provisions of Transportation Service Schedule 57?

A. Yes. The optional *daily* balancing service, originally intended to provide a lower cost of balancing to those transportation customers who were particularly adept at managing their daily gas deliveries with daily consumption, is being eliminated. This optional feature of the balancing service has not been selected by a single transportation customer since it was implemented in 1995.

Q. Were there any other changes to the terms and conditions for Transportation Service under Schedule 57?

A. Yes. The stipulation also provides that the Company will pay for required telemetry equipment installed for new Schedule 57 customers (but not the telephone line or services necessary to read the meter), which was formerly the responsibility of the customer.

Q. Does this conclude your joint testimony?

A. Yes.