REVISED MEMORANDUM

Agenda Date: August 8, 2001
Item Number: **2C**

Docket: **UG-010957**
Company Name: Cascade Natural Gas Corporation (Cascade)

Staff: Graciela Etchart, Utilities Rate Research Specialist
Hank McIntosh, Regulatory Consultant
Merton Lott, Energy Coordinator

Recommendation:

Lift the suspension and approve the revised Special Contract between Cascade Natural Gas Corporation and E-Next Generation LLC (E-Next) in Docket No. UG-010957.

Discussion:

On July 2, 2001, Cascade Natural Gas Corporation (Cascade) filed a Special Contract with E-Next Generation LLC., with Enron as the development agent, for service to E-Next's facility to be located in Longview, Washington. On July 25, 2001, the Commission suspended the contract based on Staff's recommendation at that time.

The original contract called for a primary term of thirty years, renewable automatically from year to year thereafter unless terminated by E-Next, without allowing Cascade an option to reevaluate the cost effectiveness of the contract in future periods. Staff believes that the original contract with an indefinite term constituted a violation of the requirement for a "definite term." Additionally, while such a contract might have covered costs during the initial term, cost of replacement or refurbishment in the out years is unknown and could easily be extremely expensive in future nominal dollars. As a result Cascade's future customers may have been required to subsidize the contract rate. E- Next and Cascade have now modified the contract language giving Cascade the ability to protect core customers during that extended contract period. The revised contract allows Cascade to seek modification or termination of the contract after 30 years, when conditions during the extended period require use of the facilities for core customers, or require refurbishment of the facilities.

The length of this contract is not common in Staff's experience. However, there have been long-term contract provisions, and CNG's basic Schedule 665 Customer agreement calls for 20-year minimum terms. There is some risk that the subsidiary company can be sold to a party without the financial backing of Enron, and so counter-party risk could increase over time. This is not uncommon in the utility business, however, where 30- year operating leases for power plants have been seen.

Under the proposed special contract, Cascade will provide distribution and transportation service only. The contract provides a monthly facilities charge of $40,000 during the first 30 years, and a commodity charge of $0.001 per therm. The $40,000 is reduced to $20,000 during the extended period of the contract. The commodity charge is subject to escalation based on the percentage change in the Consumer Price Index reported in the U.S. Department of Labor, Bureau of Statistics Report for the All Urban Consumers-U.S. City Average-all Items, for the twelve months ending on the date immediately prior to July 1. E-Next will also pay the Dispatching Service Charge as provided in Rate Schedule 663.

Except as otherwise provided, the contract requires E-Next to comply with the Operating Obligations and Conditions provisions of Cascade's Optional Supply Schedule No. 681 through 684. Cascade states that the contract provides for service to E-Next proposed facilities at a negotiated rate equivalent to E-Next's bypass alternative. The Company presented evidence that E-Next has viable alternatives to Cascade's services. Staff's review of the bypass expenses supports the position that bypass is economically viable, and that a special contract is preferable to the bypass option for Cascade's other customers.

After it was determined that the customer has a viable bypass option Staff reviewed the special contract following general guidelines established by the Commission in Orders UG-930511 and UG-901459, and WAC 480-80-335. A special contract must satisfy the following criteria:

- it does not result in undue discrimination between customers receiving like and contemporaneous service;
- it provides for the recovery of costs associated with the service;
- it is above the long run incremental cost (LRIC) and provides some contribution to the common costs for the company;
- it does not prejudice the competitive business relationship between customers with the special contract and those without;
- other ratepayers will receive lower rates because of the special contract;
- the utility must show that it has bargained effectively with the customer.

<u>Discrimination</u>: Similarly situated customers are allowed to negotiate similar contracts. Cascade has numerous special contracts with large gas users, which vary with proximity to the interstate pipeline and their opportunity and desire to install a bypass facility.

<u>Cost Recovery</u>: The special contract rate must be great enough to cover the utility's costs of serving the customer. Previous Commission orders established the use of utility long run incremental cost and customer standalone cost for this review. If the rates do not cover the long run cost then it would be economically optimal for the customer to build the bypass. Staff's analysis shows that the revised contract, like the original, imposes fees during the initial term that will be greater than the long run cost of providing gas to the customer. In addition, the revised contract guarantees recovery of costs beyond the original term.

Staff also reviewed Cascade's analysis of the probable bypass costs for E-Next. While neither Staff nor Cascade know E-Next's maximum willingness to pay, the analysis indicates that the contract rates appear to be close to, if not greater, than E-Next's maximum alternative costs.

Prejudiced Competition: The special contract would not give E-Next any unfair advantage over its competitors which it does not already enjoy.

Lower Rates: The tariff rate would provide more support of common costs, than do the special contract rates, thus reducing the revenue requirement for Cascade's other rate payers. However, E-Next has the freedom to choose between two other options: (1) build the bypass or (2) try to get a special contract. If E-Next builds the bypass it will contribute nothing to Cascade's common costs whereas the special contract will cover the cost of service and contribute something to common costs. The special contract will result in lower rates for the other rate payers vis-a-vis E-Next's building of the bypass.

Effective Bargaining: There is proof of effective bargaining. Cascade states that the special contract rates are equivalent to the customer's cost of the bypass, which is the optimal level for this situation.

Conclusion:

Staff recommends that the Commission lift the suspension and approve the revised Special Contract with E-Next Generation LLC in Docket No. UG-010957. However, as per WAC 480-80-335 (6), approval of a special contract is not determinative with respect to the expenses and revenues of the utility for ratemaking considerations.