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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	)	DOCKET NO. UG-940034
Complainant,	)	DOCKET NO. UG-940814
v.	)	
WASHINGTON NATURAL GAS COMPANY,	)	FIFTH SUPPLEMENTAL ORDER REJECTING TARIFF FILING; AUTHORIZING REFILING
Respondent.	)	

PROCEEDINGS: This proceeding involves two matters presented by Washington Natural Gas Company that have been consolidated for hearing. The first, Docket No. UG-940034, involves a filing for compressed natural gas service. The second, Docket No. UG-940814, is a proceeding in which the Company seeks to restructure its rates based upon a cost of service study undertaken to review rates for transportation. The Commission suspended the tariff revisions pending hearings on the justness and reasonableness of the rates requested in the filings. The Company waived the suspension date of the filing in Docket No. UG-940034 to coincide with the suspension date in Docket No. UG-940814.

HEARINGS: Hearings were held on August 10 and October 5 and 6, 1994 and on January 30 and 31 and February 1 and 3, 1995 before Chairman Sharon L. Nelson, Commissioner Richard Hemstad, Commissioner William R. Gillis, and Administrative Law Judge Lisa A. Anderl of the Office of Administrative Hearings. The Commission gave proper notice to all parties.

APPEARANCES: David Scott Johnson, attorney, Seattle, represented Washington Natural Gas Company (WNG or Company). Robert D. Cedarbaum and Anne Egeler, assistant attorneys general, Olympia, represented the Staff of the Washington Utilities and Transportation Commission (Commission Staff). Donald T. Trotter, assistant attorney general, public counsel section, Seattle (Public Counsel), represented the public. Paula E. Pyron and Edward A. Finklea, attorneys, Portland, Oregon, represented intervenor Northwest Industrial Gas Users (NWIGU). Carol S. Arnold, attorney, Seattle, represented intervenor Partnership for Equitable Rates for Commercial Customers (PERCC). Frederick O. Frederickson, attorney, Seattle, represented intervenor Seattle Steam Company (Seattle Steam).

SUMMARY: In Docket UG-940034, the Commission rejects the proposed compressed natural gas tariff. In Docket No. UG-940814 the Commission rejects the Company's filed tariffs but allows the Company to present tariffs consistent with the terms of this Order, including a revision to the tariff amendment that was suspended in Docket No. UG-940034. The Commission orders that implementation of rate changes required by this Order be delayed until the Commission's ruling in Docket No. UG-950278 on the Company's request for interim rate relief.

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I. SCOPE OF PROCEEDINGS

This proceeding consolidates two matters for hearing. One, the "cost of service" case, Docket No. UG-940814, involves how the Company's costs of conducting business should be allocated among customers, and ultimately how rates for service should be spread among those customers. The other, the "CNG" case, Docket No. UG-940034, involves the narrow question of whether the Company's proposed rate for Compressed Natural Gas service is appropriate.

A. Cost of Service

The Commission instructed Washington Natural Gas in several prior orders[1] to determine its cost of providing transportation service. The Company's cost to provide one type of service is properly determined in a larger study because all services share portions of common costs, and allocations of common costs must be made in part on the basis of judgment. Therefore the Company prepared a general cost study.[2] It submitted tariffs to implement changes in the Company's rates and charges to move toward the cost ratios demonstrated by the study. The Commission suspended the proposed tariffs and began this proceeding to review the cost study. In this Order, the Commission accepts or modifies various cost study elements and offers suggestions for future cost studies.

The changes the Commission has directed to the cost study mean that the precise relationships among the costs and returns of various classes of service are not known. It is clear from the general relationships, however, that some classes are producing substantially more, or substantially less, revenue than appropriate at existing rates, considering what we know about the costs of providing the service. The Commission determinations on cost study issues most closely follow the recommendations of Commission Staff. The Commission will allow the Company to recalculate pertinent rates and to refile tariffs consistent with our decision, using the spread of rates recommended by Commission Staff, subject to limitations that are described in this Order.

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[1]Docket Nos. UG-900210; UG-910871; and UG-920840.

[2]The Company's cost study was presented by witness Feingold, an executive with consultant R. J. Rudden Associates. It may be referred to in this Order as the Rudden Study or Rudden Model.

B. Compressed Natural Gas Rate

In a prior proceeding[3], the Company presented a proposal to secure direct ratepayer funding for its costs of expanding sales to the public of compressed natural gas (CNG) for motor vehicle use in natural gas-equipped vehicles (NGVs). The Commission rejected the direct funding proposal but authorized the Company to continue marketing CNG so long as the rate covered the costs of providing the service. The Company submitted a tariff for CNG sales; Commission Staff opposed it; and we suspended the tariff for further review. After again reviewing the accounting and the policies relevant to CNG sales, the Commission approves the tariff and authorizes it to become effective.

C. Witnesses

The parties presented the following witnesses: For the Company in its direct case, Ronald E. Davis, WNG vice president, rates and planning, addressing the objectives of the cost of service filing and policy considerations; Russell A. Feingold, vice president, R. J. Rudden Associates, regarding a proposed cost of service study; Ronald J. Amen, WNG Director, Rates and Special Studies, regarding tariffs and revenue responsibility; and Laren R. Berdan, manager of natural gas vehicles for WNG. Commission Staff witnesses were Jaime Ramirez, regarding cost of service studies, rate design proposals, and tariffs; and James M. Russell, regarding revenue requirements and cost allocation.

Intervenor Seattle Steam Company presented James G. Young, its President and Chief Executive Officer; PERCC presented Joel S. Woodruff, systems engineer, Multicare Health Services, Tacoma; Intervenor NWIGU presented Steven R. Lavigne of Associated Gas Services, a supplier to NWIGU members, and Donald W. Schoenbeck, consultant, regarding rate design and rate spread; and Public Counsel presented Jim Lazar, consulting economist.

II. COST OF SERVICE

As utility markets become more competitive, the Commission policy must become more sensitive to the relationship between costs and utility prices. In each of the industries it regulates, cost studies can be an important consideration in determining the proper charges for service and the proper relationships of revenues among the Company's various classes of service.

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[3]Docket No. UG-920840.

While cost studies do not dictate rates, they can provide a useful reference point for analysis. To the extent that one goal of ratemaking is to adopt rates for each customer class that reflect the cost of serving that class, cost of service studies are a useful tool. To the extent that such studies must allocate historical and common costs, the studies can only approximate cost relationships. Market conditions and public policy considerations may dictate that returns vary between customer classes. The Commission therefore may depart from the indications of an acceptable study in allocating revenue requirements.

Cost of service studies can be very technical but, because of the need to allocate joint and common costs among various services, they depend to a great extent on principle, policy, and common sense. In the absence of detailed studies demonstrating responsibility for fixed costs, which would allow direct assignment of portions of the costs to particular classes of customers, allocation must depend on principled judgment rather than science. A central issue in every recent natural gas cost study case has been the extent to which common plant and other costs will be allocated to customer classes based on annual usage (i.e., "throughput" or "commodity") or on each class' responsibility for the Company's resources to provide service to all firm customers at periods of peak usage (i.e. "peak" or "demand").[4]

A. The "Cascade" Methodology

In an order involving Cascade Natural Gas (U-86-100, "Cascade") and modified in an order involving the Washington Water Power Company (UG-901459, "Water Power") the Commission adopted several cost allocation principles: Cost studies should allocate some fixed costs on the basis of annual use since the gas system exists to provide gas on a year-round basis. Fixed costs incurred in the past do not necessarily match current use patterns. Some costs cannot be separately attributed to specific customer groups. Embedded cost studies are important tools for comparing the relative contributions of different customer classes to a company's overall costs, but should be only one consideration in determining rate spread and rate design. Finally, discounting for competitive purposes should be done explicitly.

In these orders, the Commission also stated specific cost allocation approaches it believed appropriate in the allocation of distribution mains: half to annual gas volume, reflecting all customers' responsibilities to pay for service provided by the system; and half to each class' contribution to peak usage (half of that to coincident peak and half to non-coincident peak) reflecting the need to size the system to handle peak customer needs.

[4]How to define peak is another issue common to the cases.

In a prior WNG rate case (UG-920840), the Commission rejected all cost of service studies presented, including Staff's (based on Cascade) and the Company's (a peak responsibility method similar to that now advocated by NWIGU). The Commission noted that the Cascade approach can reflect actual usage of the system, but the fact that transportation was not a distinct function of a natural gas local distribution company (LDC) when Cascade was decided suggests that the classification factors and allocation ratios that fit Cascade might not be directly applicable to another system today.

In this proceeding, no party urges the Commission to adopt the "Cascade" principles without change. Most parties' presentations, however, acknowledge the validity of the basic underlying principle -- that customers are responsible for the costs of providing benefits they receive from the system not only at peak times, but also throughout their entire year's usage. The proposals in general suggest variations on the Cascade approach rather than its rejection.

The Company notes that the Commission itself has acknowledged that including transportation service as a separate consideration in a cost of service study could affect the choice of the appropriate methodology. The Company argues for the Modified Peak and Average Approach as a replacement methodology. NWIGU continues to argue for a Peak Responsibility allocation factor, assigning fixed costs exclusively upon peak usage, a position that we will address below.

The parties agree that some gas mains should be allocated directly to the customer classes that use them, through special studies, and that large customers' meters should be directly allocated to their use.

The parties disagree about the overall approach to be used for allocating costs of both gas supplies and distribution mains, and further disagree on how to define the most appropriate measure of peak demand. Both Staff and the Company propose variations of the Peak and Average method. There are also a number of other allocation issues, including how best to allocate Administrative and General (A&G) expenses; meters and services; and customer contributions.[5]

B. Defining the Peak for Allocation Purposes

All parties agree that costs should be allocated at least partially on the basis of customers' peak usage. They do not agree on how the peak should be defined.

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[5]These are customers' direct payments for company facilities needed to serve them, such as line extensions.

1. Design Day Peak

The Company, supported by NWIGU, urges that the "design day"[6] is the best measure of peak usage for allocation purposes. because that is the load that its system is designed to serve. "Design day" assumes that no interruptible customer will use gas on the design day. The Company proposal results in a peak of 6,787,680 therms.

The Company uses this concept in its Least Cost Plan (LCP) as a basis for planning. It suggests that the concept is appropriate also for allocation purposes in a cost study.

Commission Staff opposes the Company proposal. It says that, because the Company's design day has occurred only once in the past 50 years, it is an inappropriate measure of peak usage. Commission Staff argues that the Company's exclusion of interruptible volumes is wrong, since interruptible customers do in fact use the system on peak days. Commission Staff contends that planning standards are not an appropriate basis for cost allocation. Staff also argues that because the Commission rejected a single peak in the Water Power order, it should do the same here.

The Company responds that the design day is not hypothetical, contending that it represents the actual basis upon which the Company determines peak demand and it is exactly the same calculation specified in the Company's least cost plan. It argues also that the alternatives are a "floating target", that they result in a mismatch between cost causation and cost allocation, and that Staff agrees that the design day calculation would be more stable.

NWIGU supports the Company's use of the design day. It contends that only the design day accurately allocates costs based on how -- and why -- WNG's system was built. It urges that cost allocation should follow cost causation, and that all costs are caused by the customers responsible for peak usage, because the system is built and sized to serve peak needs.

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[6]WNG's design peak day requirements are based on the historic coldest day measured at SeaTac Airport, experienced in January, 1950. The day had an average temperature over 24 hours of 10 degrees Fahrenheit. That equals 55 heating degree days, or HDDs.

Public Counsel contends that WNG's design day proposal is improper because the design day weather is unlikely to occur, and because the Company doesn't actually know what would happen on a design day. Public Counsel asserts that the Company double-counted hypothetical weather effects, and that its "design day" calculation is without support from load research. Public Counsel argues that any "stability" gained from design day peak is at the cost of fairness, reason and propriety.

The Commission rejects design day as a basis for calculating peak usage. The arguments against it are persuasive: actual use on the design day is unknown and speculative, and the design day fails to consider actual use by all classes on real peak days and thus the classes' actual responsibility for the fixed costs of providing service.

Design day would offer stability -- but a part of our concern in requiring periodic cost studies is that they reflect actual usage patterns as they change over time. The design day fails to reflect those changing patterns. The peak usage calculated from design day changes, too, as the number of customers grows and as installed technology affects gas use on the HDD. It may be prudent for the Company to oversize some of its facilities to accommodate reliability and reasonable growth expectations. The design day analysis is less likely to consider future use and growth patterns than alternative measures of peak. Finally, the record fails to show a sufficient relationship between design day usage and embedded costs to support its use as a cost allocator.

The Commission believes that the appropriateness of the design day for planning purposes has no necessary bearing on its appropriateness for cost allocation purposes. The purposes are indeed very different and the selection of an appropriate measure is made in each instance for widely different reasons and policy considerations. The design day should be rejected as a criterion for cost allocation.

2. Average or Sustained Peak

If the design day peak is not to be used, what calculation of peak is appropriate?

Commission Staff and Public Counsel offer alternative ways to consider actual peak usage: Commission Staff recommends an Average Peak based on the five highest-use days in each year of a three-year period, and Public Counsel a Sustained Peak based on the average of the highest use in a consecutive five-day period during three consecutive years.

The Commission Staff urges that the Commission calculate peak based on the average of the 5 highest peak days for 3 years, resulting in a peak of 4.96 million therms for 91-93, and 5.07 million therms for 92-94. Staff contends that its approach is consistent with Commission use of averaging to avoid wide swings. Use of the actual peak apportions responsibility for excess capacity among all who use the system, since interruptible customers

have in fact taken gas historically even on very cold days. A goal of regulation is to match revenues with actual costs; actual peaks accomplish that better than the design peak. The Commission Staff argues that although the calculated peak will vary, it will always reflect actual use and it will reflect changes in the Company's load patterns.

The Company responds that Commission Staff's approach is flawed by considering the warmest three-year period in the Company's history, and that it creates a mismatch between the way customers cause costs and the allocation of responsibility for those costs.

Public Counsel urges use of a "Sustained peak", a 3-year average of the highest annual 5-day sustained peak in each year, resulting in a peak of 4,778,867 therms. It contends that the Commission has consistently used a sustained peak for purposes of cost studies, and that a sustained peak best reflects matching principles since actual peaks are the basis of revenues. Public Counsel contends that sustained peaks are more stable over time than a single peak, and limit wide swings. He argues that sustained peaks reflect actual usage patterns on a continuing basis. He urges that any peaks that are not captured in his proposal do not affect the calculation's validity. Public Counsel's proposal is better than Staff's, he says, because the Company's peaking resources can meet several days' peak capacity requirements. The sustained peak therefore reflects the way the system is used.

NWIGU opposes Staff and Public Counsel recommendations and argues that they are unstable because they are based on fluctuating usage. NWIGU says that neither Commission Staff nor Public Counsel methods match test period customers, revenues, or associated usage. The result, according to NWIGU, is to dilute allocations that should be assigned to customer classes experiencing growth. NWIGU argues that the Commission Staff and Public Counsel proposals fail to adjust historical demand to test period weather.

<u>The Commission prefers and accepts</u> the Commission Staff proposal from among those offered on this record. It best considers peak usage, accounts for the usage of different classes, including actual use of interruptible customers, and reflects historical peak usage patterns.

The average peak proposed will vary over time, but will reflect customer class growth and changing real-world usage patterns including test-year weather. The proposed averaging will moderate wide swings. This proposal best reflects various classes' actual peak usage of the WNG system.

The Commission Staff proposal offers the best balance among stability, validity, usage trends, and actual use during experienced weather conditions. It meets the objectives of the measurement for cost study requirements, and the Commission adopts it for use in this proceeding.

This does not mean that we are convinced that the measure is perfect. The proposed years are appropriate in concept -- the three most recent years for which data are available -- but recent years are relatively warm. We do not know whether they will be representative of future years. We believe it is preferable to use data from a longer period of time, to remove variations due to unusual weather and to achieve greater stability. The Commission uses "rolling" averages of longer periods in other contexts, and may delete years with the highest and lowest temperatures. We are not comfortable establishing a length of time for this purpose in future matters on the record of this proceeding. Instead, we expect that the parties to a future proceeding will agree upon -- or demonstrate on a contested record -- the appropriate period and methodology to use.

C. Results of Operations

Every cost study is completed with reference to the studied company's results of operations. A cost study relies upon relationships within a history of expenses and revenues.

Because the most recent general rate case ended in a stipulation, the Commission has not recently reviewed a general rate case to determine appropriate results of operations. The Company and the Commission Staff have run the cost study and produced their proposed results on different basic information.

The Company uses the results of operations that it presented in its rebuttal case in Docket No. UG-931405. It contends that this information is the latest available.

Public Counsel contends that the Commission should not use any of the results of operations available on this record, as the Commission cannot have confidence that it understands the consequences of decisions when none of the studies is based on Commission-approved results of operations from a full record and detailed findings during a recent period. He urges that the Commission instead adopt principles for the cost study, but wait to implement it in rate spread until the Company's next general rate case. If the Commission is to move toward application immediately, Public Counsel would start with the Company proposal, but would adjust it in some scenarios for proposed savings in meter reading and billing. The Company and Commission Staff oppose those adjustments because they are not now in effect and are unlikely to affect costs in the near future.

Commission Staff uses information from its direct case in Docket No. UG-931405. It contends that this information is most accurate, because it produces a revenue requirement very close to the level producing the stipulated rates.

The Commission accepts the Commission Staff proposal. It is not demonstrated to be "accurate" in the sense that the result would be exactly the same upon a complete record in a new contested general rate proceeding. It is, however, the most accurate from among the choices available in that it alone reflects recent changes in WNG staffing and structure and it most closely matches the revenue requirement of the settlement.

We are satisfied that the accepted results of operations demonstrate a reasonably reliable relationship between revenues and expenses. Given the magnitude of the rate adjustments that are necessary, we conclude that waiting for "better" data could adversely affect all classes of customers.

D. Distribution Main Cost Allocation

In the past, the Commission approved allocating the cost of distribution mains one-half to throughput, because the system provides service during the entire year, and one-half to peak, because they must be sized to accommodate peak usage.

In this proceeding, the parties recognize actual use of some mains by large customers and suggest direct allocations of those mains that can be identified. The parties agree on those allocations.

The parties differ, however, on the appropriate methodology by which to allocate costs of the remaining distribution mains.

1. Mains under 4" in Diameter

Smaller mains serving large customers are allocated to those customer classes. The parties agree that the remainder should be allocated to other classes (excluding Schedules 85, 87, and Transportation).

The Company would allocate smaller mains using a Modified Peak and Average (MPA) method. That would result in 36% of costs being commodity-related, and 64% demand-related. The Company states that MPA better reflects Commission-adopted principles; has a good conceptual and theoretical basis; is compatible with prevailing economics and cost structure of energy marketplace; and reflects regulatory considerations used by the Commission. It contends that throughput-related allocation does not accurately reflect cost causation and that it is only weakly correlated with the Company's investment in distribution mains, and thus does not measure cost causation as well as customer or demand based factors, and it cites several asserted deficiencies of relating costs to commodity.

Commission Staff would also use a Peak and Average methodology, similar to the Company, but would substitute its peak for that of the Company. Commission Staff quotes the Commission from prior orders, noting that plant is built to deliver gas year-round, not just on the peak day. Staff allocates distribution mains 49% to commodity and 51% to demand.

Public Counsel would classify small diameter mains as 100% commodity-related and allocate them to smaller use classes based on throughput.

The Commission adopts the Commission Staff proposal. While we note that the Company and Commission Staff proposals were similar, we find that the Commission Staff proposal is preferable. The Staff proposal uses an appropriate peak for reference, and the Company's does not.

2. Mains 4" and Larger in Diameter

In general, the Company and Commission Staff approach this issue much the same as they approach allocation of costs of smaller mains. They agree that large customers should be included in the allocation, but disagree on the methodology to accomplish allocation. Public Counsel suggests an "oversizing" treatment of mains that are not directly allocated, while NWIGU and Seattle Steam support the Peak Responsibility methodology.

Public Counsel proposes an "oversizing" incremental cost methodology, which classifies mains 53.5% to commodity and 46.5% to peak demand. Public Counsel contends that his proposed methodology recognizes the small incremental cost of sizing facilities to meet peak demand; it reflects the basis for which distribution plant is deployed; and it refines and confirms the Commission's previous policy. NWIGU argues that this proposed methodology inappropriately inflates use of throughput allocations for distribution mains.

NWIGU/Seattle Steam propose a Peak Responsibility (PR) test to assign large mains. NWIGU would adopt the Company's cost study, modified by using NWIGU's PR methodology for transmission and distribution costs. These intervenors argue that because the system must be sized to meet peak needs, only customers who use at the peak ("causing" the costs of a system able to meet peak capacity) should be responsible for system costs. NWIGU contends that rates are severely misaligned and, if not corrected, will force large users off the system.

The Company opposes NWIGU's Peak Responsibility proposal, as conflicting with prior Commission orders. Public Counsel argues that Peak Responsibility is a complete failure, contending that its flaws include ignoring the fact that a gas company is not economically viable if it serves only on a peak day; mistakenly assuming that a customer can avoid contributing to fixed costs simply by not using gas on the "design day" that occurs once every 45 years or so; and having been consistently rejected by the Commission in every context it has been proposed.

The Commission accepts the Commission Staff proposal, consistent with our decision regarding smaller mains. We note Public Counsel's proposal with interest and think it may have promise in a future proceeding. It is a creative approach that does recognize the relatively lower cost of the incremental capacity that the Company reasonably builds into the system.

We are not convinced that it is demonstrated to be an accurate means of allocation, however, and we believe that there is value in maintaining a general consistency of approach among similar assets to simplify the cost study unless there is a demonstrated reason for the departure.

The Commission unequivocally rejects the suggestions of NWIGU and Seattle Steam that the Peak Responsibility methodology has any general application in local natural gas distribution company cost studies. The patterns of use demonstrated here are similar to those in the Cascade and Water Power cases. It is inconceivable to us that this Commission could approve a cost study methodology that refuses to apportion any overhead or capital responsibility to regular and consistent users of the system, merely because they can avoid use at the peak.

Use of the PR methodology at the federal level, as NWIGU noted, is for the purpose of driving users off the pipelines at the peak. Here, there is little need for such a policy, as many peak users have no other realistic option and application of the policy would be grossly unfair in operation.

We must consider all relevant evidence. However, we should send a send a strong signal that the Commission believes the Peak Responsibility proposal to be unfair in its consequences. Moreover, PR is dissonant from a common sense evaluation of responsibilities for system costs. Consequently, we cannot anticipate giving PR realistic consideration in the future, absent some significant change in underlying usage patterns or market realities.

E. Gas Supply Costs

Some costs of gas are commodity-related and can be readily allocated among user groups based on consumption. Others are fixed costs, including long term firm pipeline transportation capacity contracts; long term firm supply contracts; storage costs; and liquified natural gas peaking supplies.

1. Commodity Costs

The Company proposes to allocate peak day commodity costs on peak, winter firm on a seasonal allocator, and the remainder on annual throughput.

Commission Staff would assign all commodity costs to customers based on annual volume. Commission Staff contends, first, that flexibility in the Company's gas supply portfolio allows it to acquire supplies at relatively stable commodity prices throughout the year. Second, Staff points out that the commodity costs in this case are estimates of prospective gas expenses, rather than actual amounts. Finally, Staff's method avoids adding unnecessary and unjustified complexities to the PGA and gas cost deferral procedures. Commission Staff also notes that there appears to be a flaw in the Company proposal resulting in an allocation of more therms to seasonal than were actually used.

The Commission accepts the Commission Staff proposal. Commission Staff's approach is simpler and it is the most accurate among the approaches presented.

2. Fixed Costs of Gas Supply

The parties divide gas supply costs among annual, seasonal and peak resources.

In Cascade, when excess capacity existed, the Commission accepted the allocation of fixed production costs on the basis of throughput. In the Water Power case, when excess capacity was not at issue, the Commission accepted an allocation of 90% of fixed baseload production costs on throughput and 10% on sustained peak demand. In the Water Power order, 23% of fixed seasonal costs were classified as peak-related, and the balance as commodity related.

The Company presentation assigns baseload costs to peak and average, assigns seasonal costs to seasonal use, and assigns peak costs to peak use. NWIGU accepts the Company's allocation.

Commission Staff categorizes the fixed costs of supply resources as baseload, seasonal, or peak related. Baseload includes fixed gas supply and pipeline capacity contracts, which are also used to serve peak and seasonal requirements. Seasonal includes costs of winter firm, Clay Basin demand and capacity, and a share of WNG's pipeline capacity. LNG storage is classed as peak-related. Commission Staff would allocate baseload costs by its BLOAD allocator, a weighted average of annual commodity, seasonal load, and peak usage. Staff would allocate seasonal costs on its SEASLOAD allocator, a weighted average of seasonal load and peak usage. Peak costs would be allocated on the peak allocator. Although the Company prefers its proposal, it would accept the Staff proposal if it were amended to avoid an "arbitrary" peak in "BLOAD" factor.

Public Counsel advocates a Peak Credit methodology, allocating costs to peak, seasonal, and baseload use based on the relative cost of peak, seasonal and peak resources. He argues that Peak Credit best reflects relative costs of resources, how the resources are used by customers, and how they should be allocated. He contends that the

Commission has accepted Peak Credit in the past -- in essence, in the Water Power order and, explicitly, in prior electric company proceedings. The Company responds that the Peak Credit method is contrary to trends after FERC 636 and isn't used by any state Commission. NWIGU argues that an analogy with the electric industry is invalid because the electric analysis looks at total costs and this proposal only at fixed costs.

The Commission accepts the Commission Staff approach, finding that it best allocates fixed gas supply costs to use.

The peak credit method proposed by Public Counsel cannot be translated directly from its use in the electric industry, because there it considers all costs and here it is proposed to consider only some.

F. Administrative and General Costs

The Company's Administrative and General (A&G) costs are about one-third of the Company's non-gas expenses. They include salaries, office supplies, outside services, pensions, benefits, insurance, regulatory expenses, maintenance of general plant, etc. In Cascade, the Commission allocated all administrative and general costs on the basis of operations and maintenance expenses, including gas costs for all customers. In Water Power, A&G costs that were directly labor-related were allocated on labor expense; property insurance on allocated plant; regulatory expenses based on revenue; and the balance (including most major accounts) 50% on throughput and 50% on O&M less cost of gas.

The Company would allocate labor-related costs on the same basis as directly allocated labor. It would allocate plant-related costs on the same basis as directly allocated plant. It would allocate all remaining A&G costs on the average of those two allocators.

Commission Staff would allocate A&G generally on the basis of allocated O&M less gas cost; property insurance and maintenance on plant; and regulatory fee on revenue. Staff argues that the Commission accepted the approach in a Puget case, and that it best reflects WNG operations.

Public Counsel recommends the approach that the Commission used in the Water Power case: he would allocate 50% of A&G to O&M (less gas cost) and 50% on gas throughput; pensions on labor; and property insurance and maintenance on plant expenses. He argues that the Company does not incur A&G expenses in relation to the distribution of plant investment. He also argues that Company executives, consultants, and attorneys do not spend their time supervising meter readers or distribution mains maintenance personnel, who are the majority of non-gas O&M expense. He contends that executives, consultants, and attorneys do spend their time on regulation, gas supply, pipeline negotiations, and rate design to accommodate competitive forces for large-volume customers, and other volume-related activities.

The Commission accepts Public Counsel's proposal. The Commission finds persuasive Public Counsel's observation that A&G functions are not devoted to O&M activities. It believes that the Public Counsel proposal best matches expense to benefit.

G. Meters and Services

Meters: The parties apparently agree on the direct assignment of meters to large customers, allocating the remainder of meters on a weighted average cost approach.[7]

Services:[8] **The Company** uses a study prepared by Mr. Feingold to allocate services directly to large customers, and the remainder on a weighted average analysis. **Commission Staff** supports the Company. **Public Counsel**, through Mr. Lazar, accepts direct allocation to large customers and allocates remaining services to smaller customers (50% customer, 25% demand, 25% commodity).

The Commission accepts the Company's approach. It best matches costs to use.

H. Jackson Prairie Balancing

The Company uses natural gas storage facilities at Jackson Prairie to meet its sales customers' seasonal needs and to "balance" system loads and nominations. All parties agree that 80% of the costs associated with Jackson Prairie facilities reflect seasonal needs of sales customers and should be allocated to them, and that the remaining 20% is associated with balancing.

Public Counsel advocates direct allocation to transportation customers for the remaining 20% of costs. He argues that sales customers are already paying heavily for a variable gas supply and that these costs should not be directly attributed to them. The Company, supported by the other parties, contends that the balancing function serves sales customers as well as transportation customers, and that its cost should reflect that service.

The Commission finds that the Company's proposal most accurately allocates costs. We allocate 20% of Jackson Prairie costs to sales and transportation customers for the costs of balancing.

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[7]Public counsel accepts this method of allocation but rejects the company proposal to treat meter or service costs as 100% customer-related for purposes of rate design.

[8]A "service" is the connection between a distribution main and the customer's premises.

I. Customer Contributions

Customer contributions referred to here are contributions in aid of construction (CIAC), largely payments required by the Company to support the extension of gas lines to serve a customer or a development.

The Company would allocate these payments using its modified peak and average approach, resulting in an allocation of 64% to residential classes. It supports its allocation by noting that residential customers provided 77% of CIAC in one year that it studied.

Commission Staff would allocate all CIAC to the residential class, noting that the majority of contributions are made by the residential class and that the Company failed to provide data regarding actual contributions despite a Commission Staff request.

The Commission accepts the Commission Staff proposal to allocate all CIAC to the residential class. In the absence of historical data showing actual distribution, we observe that the bulk of the Company's growth is in residential load, note that CIAC is largely growth-related, and believe that allocation to residential is supported both by the record and by common sense. While we would expect small commercial customers also to be represented, we have insufficient information as to the appropriate breakdown.

J. Transportation Service Costs

The Commission has asked WNG to identify its costs of transporting gas, for both sales and transportation customers. Company and Staff took different approaches to this request.

The Company bases its costs on an undifferentiated look at sales and transportation classes. It contends that the costs of transportation can't be independently measured because customers may drift back and forth between sales and transportation service.

Commission Staff, on the other hand, would separate the classes for study. It contends that only its study can determine the contribution to system cost recovery is made by each distinct class of service. Staff contends that because the Company failed to provide requested information, Staff had to make some assumptions in its calculations -- but that its presentation is the more accurate and the more appropriate.

The Commission accepts the Commission Staff approach. Making allocations between sales and transportation customers may be difficult -- but it would appear no more difficult than some distinctions among classes of sales service. It is essential that the cost study identify costs of gas for sales customers and the fixed or variable costs that are unique to transportation service.

III. SPREAD OF RATES

The second major element of this "Cost of Service" case is determining an appropriate spread of rates -- that is, deciding in light of the cost study how the Commission should assign responsibility among classes for the Company's overall revenue requirement.

As the Commission has noted repeatedly, it is not obligated to translate any given cost study into rates, merely adding the Company's rate of return to the study's indicated cost of providing service. There are several reasons for this.

First, while any cost study looks as precisely as possible at actual expenses, many allocation decisions are made on the basis of judgment and from available alternatives. While we can say that a particular study is sufficient, or that its components are the best among the alternatives presented, because of the judgment inherent in any such study we cannot say that it "perfectly" reflects "actual" costs of providing service. We must still exercise our own judgment in translating cost study results into rates.

Second, the validity of cost study results are affected by the validity of the underlying data. Here, the cost study does not review actual results of operations, but uses proxies instead. Although trends may be clearly apparent, cost study results could change depending on the results of operations that are used to provide cost and revenue input to the study.

Third, the Commission may consider non-cost factors in determining whether rates are fair, just, reasonable, and sufficient. These statutory tests do not inherently connote the strict application of cost study results. Instead, they not only suggest but require the exercise of judgment. Other non-cost elements that the Commission may consider include "rate shock", or the need of an affected class of customer to bear required increases gradually, and susceptibility of a customer or a class to receiving competitive service. Sometimes pertinent factors lead in different, even opposite, directions.

Rate spread and rate design,[9] therefore, call forth the exercise of Commission judgment in light of the best cost information available.

The Company explains that the filing is revenue neutral, overall,[10] but that it shifts responsibility for revenue among the classes of service. Some classes would see an increase in rates under the Company's proposal, while other classes would see decreases.

[9]"Rate design" is the structure of rates within each class or schedule.

[10]Increased numbers of customers since the prior proceeding make it likely that the actual revenues collected under the proposed rates would increase.

The Company spreads rate increases to residential customers, and to small commercial and industrial classes. It would reduce the rates for commercial and industrial schedule No. 41 and for large-volume sales and transportation customers.

Commission Staff notes that under its results of operations and cost study assumptions, some customer classes produce more and other classes produce less than the average return. It would spread increases to residential schedules 23 and 24, and to commercial and industrial schedules 11, 16, and 61. Interruptible customers on Schedule 85 should have their rates lowered. The Commission Staff proposal would narrow the gap between the average return and those earning more or less than the average.

Public Counsel suggests waiting to implement the results of this Order until the Company's next general rate increase proceeding in order to set rates by a cost study methodology that incorporates Commission-directed principles and that uses relevant results of operations. Public Counsel also notes that the record does not contain evidence of the financial or other risks associated with serving each class. If the study must be implemented, Public Counsel suggests establishing a band of reasonableness, which he defines as within 10% of cost-study revenue requirement.

NWIGU would accept the Company's proposed tariff changes as a first step, moving about half-way toward cost-based rates. It urges moving fully to cost-based rates in the next proceeding involving the Company.

PERCC notes all parties' agreement that commercial and industrial customers are paying more than the costs of serving them, and urges a reduction in those classes' rates.

The Commission here lacks a cost study that reflects all of its decisions.[11] Public Counsel's observation may be correct that service to different classes may pose different risk to the Company, and use of the average rate of return for all classes is not necessarily appropriate. It would clearly be inappropriate to establish interclass relationships in this proceeding, expecting them with confidence to be either precise or stable. As several parties note, however, the trend and general magnitude of the study are clearly apparent.

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[11]The Commission appreciates the efforts that the Company has undertaken toward cost study development. It has undertaken collaborative efforts and has provided training in use of the present model. The model's chief drawback appears to be its complexity, requiring extensive training and experience before manipulation is possible. As Public Counsel notes, it is so complex in operation that it effectively bars some parties from its use. We encourage the Company to pursue changes to the Rudden model, or to pursue a different model, permitting easier manipulation.

The apparent magnitude and the direction of the over- or under-earnings of several classes argue strongly against waiting until the final order in the Company's next proceeding. Therefore, we reject Public Counsel's first preference, waiting to implement changes based on the cost study, until a subsequent proceeding. To the extent that rates are sending substantially incorrect signals, rates at current levels and in existing proportions may promote inefficient behavior. Waiting for later proceedings could also amplify the magnitude of later rate changes and lead to rate shock.

The Commission accepts the Commission Staff rate spread, as shown in Exhibit 54, Col. L,[12] subject to any class-specific instructions in this Order.[13] The Commission's decisions regarding the cost study most closely follow the Commission Staff position. The Commission Staff-proposed cost study variations in turn support the Commission Staff-proposed rate spread.

The adopted rate spread includes both the impact on gas costs and the change in marginal revenue. Increases shall be applied as indicated on the exhibit, and any revenue deficiency shall be accomplished by moderating decreases by an equal percentage.

In the concluding section of this Order we address issues regarding implementation.

IV. RATE DESIGN

Rate design is the third major issue presented in this proceeding. Once the contribution of a customer class is determined in the spread of rates, the design of the rate will determine how responsibility will be apportioned among customers within the class. Several issues are presented.

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[12]The exhibit reflects the following. Decreases are shown in parentheses; others are increases. Residential -- Rate 23, 2.673%; Rate 24, 3.118%; Rate 55, 3.148%; Commercial and industrial -- Rate 11, 36.392%; Rate 16, 53.227%; Rate 61, 50.000%; Rate 31, (1.164%); Rate 36, (1.244%); Rate 51, (1.128%); Rate 41, (11.793%);; Rate 43, (0.150%); Rate 50, per instructions in this Order; Large volume sales and transportation -- Rate 85, (8.349%); Rate 58, (38.261%); Rate 86, 0.907%; Rate 87, 3.928%; Rate 57, (38.261%); Rate 99, no change.

[13]In particular, without limiting the effect of any other specific instruction, we approve the Company proposal for Schedule 50, compressed natural gas.

A. Residential and Commercial Monthly Service Charges

1. Commercial Service Charge

All parties agree that the monthly service charge for commercial customers may be increased from $4.50 to $10. The parties agree, and the Commission finds, that the increased charge is cost-justified and that commodity charges should be reduced to achieve the rate spread ordered within the revenue requirement. The proposed customer charge increase is approved.

2. Residential Service Charge

In Docket No. UG-920840, the Commission directed the Company to decrease its monthly service charge for residential customers to $4, based on our acceptance of cost estimates in that range. The parties have presented various proposals in this proceeding to change the service charge.

The Company would now increase the charge to $5. It contends that its monthly cost of service is actually $14.45.

The Commission Staff would retain the existing monthly service charge, and assign any necessary class revenue increases to the commodity charge. It says that doing so is more practical and will increase incentives toward energy conservation.

Public Counsel maintains his position from the prior rate case, urging that the cost estimates remain valid; that the Commission should not undo the decrease it provided customers in the recent past; and that the Company's result is skewed by the improper assignment of $6.7 million of A&G expenses. The Company urges that Public Counsel underestimates the costs of providing service.

The Commission -- on the evidence in this proceeding -- believes that the costs of serving customers exceed $4.50 per month. It will authorize a return of the monthly service charge to $4.50. Doing so is a slight increase for each customer and offers some small measure of improved stability to the Company's revenues. The remaining increase needed to achieve the revenue requirement should be applied to the commodity charge.

B. Schedule 11 Monthly and Other Charges

Schedule 11 governs charges for general gas service, including some multifamily residential units and some commercial customers. Access to this schedule has been frozen since 1993. This schedule has about 4,800 customers, compared with the Company's 380,000 residential customers.

Commission Staff urges that the Commission set the rates on this schedule at parity with residential schedules, resulting in an increase in the monthly charge and a decrease in the commodity charge.

Public Counsel asks that the Commission increase the monthly service charge to $2 and order the Company to transfer all Schedule 11 customers into Schedule 23 or the lowest other schedule for which the customer qualifies.

The Commission accepts the Commission Staff proposal to align the rates in this schedule with the residential schedules. The service is generally residential in character, and customers should be charged an amount equivalent to the residential rates. The service will remain frozen to new customers.

C. Interruptible Rates

1. Curtailment Frequency Rate

Interruptible rates are allowed for customers who agree that they will stop all consumption of gas on the interruptible rate[14] when asked to do so by the Company.

Public Counsel contends that interruptions are so rare for so many customers that the customers are in fact receiving firm service but are only paying the discounted interruptible rate. He suggests that the interruptible rate be redesigned, and that customers be charged the firm rate but credited both for agreeing to accept interruptions (a curtailment reservation credit) and for any interruptions actually imposed.

The Company opposes the proposal as unworkable. The Company identifies numerous practical problems with the proposal, including the lack of demonstration of equivalency between alternative fuel costs and customer savings; difficulty in administering monitoring and billing; anticipated large metering costs; and the need that the Company plan and support the customers as firm. The Company does not reject the concept out of hand, and expresses willingness to study the matter further.

The Commission rejects the proposal as having too many unanswered questions for use at present. We are encouraged, however, by the Company's willingness to explore the matter further. If the concept is pursued, the presenters should identify and resolve as many concerns as possible and should come forward with a specific proposal, with its total effects quantified, preferably with support of others, including customers.

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[14]Some interruptible customers take a quantity of gas on the firm rate for minimum needs that they cannot suspend or convert to alternative fuels during periods they are interrupted.

The Commission commends Public Counsel and witness Lazar for identifying, and proposing a creative approach to solving, an issue of concern. We are not convinced, however, that their proposal meets all of the requirements of the Company and its customers for this service. In particular, it is not clear that the proposal offers more equity than the present rate structure, or that it would operate to the same extent to keep on the system those contributing customers who have the option to switch fuels or suspend operations at uneconomic levels.

2. Contract Demand Charge

The Company, Commission Staff, and Public Counsel all agree that the Contract Demand Charge, a fee assessed to interruptible customers who choose to receive a portion of their gas on a firm basis, should rise from $1.50 to $2.00; the Commission accepts the proposal.

3. Schedules 85, 86, and 87

Commission Staff suggests that Schedule 86 customers, including schools, receive an increase of about 1c per therm in the initial block and a decrease of about 2c per therm in the tail block of the pertinent rate schedule.

Public Counsel supports the Commission Staff, noting that the proposed rate for Schedule 87 would provide a negative margin in the tail block. He asks that the Company increase rates on Schedule 87 in the tail block no lower than 2c above the commodity cost of gas.

The Commission believes that the structure of the margin rate for interruptible customers should parallel the structure of the schedule for transportation customers. The Company should revise its interruptible rate schedules to do so, within the limitations of the available revenue requirement.

D. Transportation Rates

Until recent years, natural gas companies offered only a "bundled" service -- that is, they both transported gas and sold it to consumers. Changes in the industry's structure have been occurring with increasing rapidity over the past decade. Today many customers are in a position to purchase gas directly from producers. Pipelines and local distribution companies offer transportation without the sale of gas. The Company filed its proposal in Docket No. UG-940814 to comply with Commission instructions that it examine its transportation service costs.

1. Rate design; Number of Rate Blocks; Tail Block Price

The Company proposes to combine Schedules 57 and 58 into a single tariff with a 6-block rate structure, with the tail block (over 300,000 therms) set at 1 cent per therm. The Company says that its bill frequency analysis shows a logical break in consumption at 300,000 therms a month. It contends that the marginal cost of providing service varies between 3/10c and 1c per therm, so the requested tail block would recover its marginal cost of service. It argues that transportation customers must receive correct economic signals through a rate structure that reflects and recovers the marginal cost of service. NWIGU supports the Company position.

Commission Staff proposes a 5-block rate structure for transportation, with a tail block rate of 2.5c per therm. Commission Staff contends that customers should be able to make meaningful comparisons between sales and transportation rates, so the schedules should have identical structures. The Company responds that Commission Staff is wrong in claiming that a 5-block rate structure is necessary to be consistent with sales service in schedules 85 and 87, since the Company designed these rates to match the relative margins in those sales tariffs. The Company and NWIGU agree that if identical structures are appropriate, the Commission should add a sixth step to schedule 87.

Public Counsel supports the Commission Staff position. He argues that the Company's cost of service study shows a unit margin revenue requirement for Schedule 87 of 1.6c per therm, and that this understates commodity-related costs. For comparison, Public Counsel notes that the floor of the banded rate set for the Washington Water Power Company in a recent proceeding was 2.091c per therm. Public Counsel argues that a tail block as low as 1c per therm would appear to be justified only for a large customer located very near the pipeline.

The Commission accepts the Company's suggestion to add a sixth block to the schedule and accepts the elements of the Commission Staff rate structure within the schedule.

Rationalization of transportation rates is the purpose of this proceeding. It is abundantly clear under any reasonable view of the cost information that, particularly in the later blocks, the service is recovering substantially more than its costs. The Commission has above identified an appropriate rate spread among classes. Rate design, however, remains an issue.

The Commission accepts the Company proposal to use six blocks in the transportation rate and to extend the parallel sales rate to six blocks as well.

The Company's proposed "natural" break at 300,000 therms, however, would put more than half the gas transported into the tail block. We think a more appropriate break for this proceeding would be 500,000 therms, based on bill frequency and gas volume. The Company may realign blocks within the schedule, if it wishes.

The schedule should move toward cost. The Commission does not accept the Company's proposal to set the tail block at 1c for the following reasons. First, we reject the Company's cost study and the cost information we have is imprecise. Second, we are not attempting to match rates with the results of any cost study. Third, the revenue requirement for the class will not allow reductions in this schedule to the extent proposed by the Company.

The Company shall set the sixth or tail block rate at 2.0c. That rate is related to cost; it represents a reduction from existing rates for affected customers, and it is comparable to the rate last authorized for similarly situated Washington Water Power Company customers. It should retain the first block at the proposed level. Doing that will require the Company to change the rates and potentially the sizes of various middle blocks in order to generate sufficient revenue to meet the class revenue requirement.

2. Monthly Transportation Customer Charge

The existing customer charge for transportation customers is $500 for customers on Schedule 57 and $100 for customers on Schedule 58. The Company proposes to increase the charge to $650 per month for all customers. It contends that its actual costs of providing transportation service for its existing customers exceeds $900 per month, but believes enough customers will enter the market so that the $650 will allow cost recovery. Commission Staff and Public Counsel both support the proposal.

PERCC opposes the increase. It suggests that $400 would be an appropriate monthly service charge, contending that the Company proposal is not cost-justified. It urges that two full-time staff positions are not justified by the current customer load, and it cites a lack of audit for relevant cost information and evidence from Public Counsel that the Company's actual costs of serving transportation customers are not reasonable. It also cites to Company tariff provisions, calling it irrational and unfair to ask transportation customers to pay a customer charge of the magnitude proposed.

The Commission accepts the Company proposal. PERCC raises points that could be valid, and it challenges the support for the Company's proposal. But it offers insufficient basis for its alternative. It noted the Commission Staff's failure to audit this element and Public Counsel's contentions regarding efficiency. It did not cast sufficient doubt upon the proposal to prevent its use, nor did it identify an alternative approach with supportable cost figures. Consequently, the Commission will accept the Company proposal.[15] The Commission believes that complete and accurate information on this topic, including, if needed, fact-based estimates of reasonable costs to perform the functions, must be provided in future proceedings.

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[15]The Commission asks that in the Company's next general rate proceeding, the Company, Commission Staff, and the parties examine closely the reasonable costs of providing transportation service, to the end that the parties do agree that the inquiry, the basis for the conclusions, and the methodology warrant confidence.

3. Transportation Rates -- Distance Component

The Company's proposed rates are "postage stamp" rates that provide transportation on the system per volume carried irrespective of the distance travelled. **Public** Counsel suggests that the Commission direct the parties to study distance rates, varying with customers' bypass potential.

The Company, Commission Staff, NWIGU, and Seattle Steam all oppose the proposal. **The Company** says that it is served from multiple city gates, so determining distance would be administratively difficult and implementing it would be impossible. Commission **Staff** contends that existing options meet all regulatory needs. **NWIGU** and **Seattle Steam** oppose the proposal as too complex and too expensive to implement. They charge that it could be counterproductive, as customers farthest from the city gate may be those whose interruptibility provides the greatest benefit to the system.

The Commission acknowledges that Public Counsel has presented a creative approach. The multiplicity of city gates and the complexity inherent in the proposal do not bode well for it, however, and the Commission rejects it. We are not aware of problems that are not being met through the existing options, including special contracts.

E. Transportation Service, Terms, and Conditions

1. Minimum Contract Term and Notification

All the parties acknowledge that customers' unfettered ability to switch between sales and transportation service would place unwarranted burdens upon the Company. All parties thus offer proposals for tariff provisions requiring minimum contract terms and minimum notification of a customer's switch from one service to the other. A minimum contract term offers stability to the Company's services, and the minimum advance notice of a switch allows the Company time to plan for changing gas supply requirements.

PERCC proposes a one-year minimum contract term with 30-day notice, provided that a switch could not be accomplished during winter months. **NWIGU** also asks a 1-year term, but suggests 6-month notice, contending that gas supply contracts tend not to be long term.

Public Counsel proposes a 3-year minimum term with a 12-month notice provision, contending that the proposal offers the least burden on sales customers who stay on the Company's system. Because large customers use a volume equivalent to three years' system growth, Public Counsel contends, three-year term would allow the Company the greatest ability to manage its resources. Public Counsel urges that the Commission require exploration of reentry fees and fees for standby service.

The Company proposes a two-year contract term with a 90-day renewal period and 180-day notice for conversion. It argues that the contracts must exceed one planning season to allow the Company to consider projected loads when arranging gas resources. Merely because some supplies are bought on short-term contracts does not mean that the Company has the flexibility to endure a shorter contract period. **Commission Staff** supports the Company, seeing NWIGU's proposal as shifting unnecessary costs to sales customers and Public Counsel's as placing an unnecessary burden on customers. PERCC opposes the Company's proposal, arguing in part that longer term gas contracts are out of step with industry realities.

The Commission finds that the Company proposal best balances the interests of the Company, its firm sales customers, and its present and potential transportation customers. We accept the proposed two-year minimum contract term, the 90-day renewal provision, and the 180-day notice for conversion.

2. Balancing and Balancing Penalties

Transportation customers must "nominate" in advance to the Company the volume of gas that they will use -- generally, during the following day. The Company tallies these nominations, adds its sales customers' expected consumption, and makes a nomination to the pipeline to designate the gas volumes it should draw from producers. For many reasons, the nomination seldom exactly predicts the actual consumption. When customers use less gas than nominated, the Company may need to absorb gas into its system, including its own storage facilities. When transportation customers use more gas than nominated, the Company may need to withdraw the gas from its facilities. These circumstances are called imbalances.

The parties have made a wide range of proposals for balancing. They include (1) tolerance bands, make-up periods, and penalties; (2) penalty revenue allocation (3) optional daily balancing; (4) imposing seasonal gas imbalance penalties; and (5) including balancing in PGA mechanisms. Exhibit 141 offers a comparison of the parties' positions.

a. Tolerance Bands and Penalty Levels

All of the parties acknowledge that it is necessary to keep imbalances within a range permitting the system to function well. They disagree as to what the pertinent range is and what consequences should result from imbalances outside the range.

The Company would allow a grace band of five per cent monthly, plus or minus, difference between nominations and consumption, without penalty. Differences greater than five per cent may be "cleared" within the next billing period. If the imbalance is not cleared, the customer will be billed $1 per therm for overtakes between 5 and 10%, and will lose title to undertakes over 5% that it has nominated but not used. Overtakes

above 10% will be charged $2 per therm. Undertakes exceeding 10% for a month will result in the Company's taking of title to all unused gas. The Company offers the proposal to provide customers greater opportunity to clear imbalances than presently offered. NWIGU contends that the "taking" of gas is an unduly harsh penalty.

Commission Staff supports the Company proposal. Staff contends that the proposal offers a reasonable time for customers to clear imbalances, and that the penalties are appropriate to provide incentives to avoid imbalances. Although the penalties may sound harsh in the abstract, they are structured that way in the expectation that harsh penalties will modify behavior to the point where no penalties will be assessed.

Public Counsel would "forgive" imbalances only within a 3% band, and would add immediate charges for imbalances outside that band. The lending and storage of gas imposes costs on the system. Public Counsel contends that all customers pay those costs, but that only some derive benefit from the service. Public Counsel contends that his proposal requires transportation customers to pay for the services that they are actually ordering and using.

NWIGU advocates a system mirroring that of Northwest Pipeline -- offering a 60-day period to clear imbalance, with billing for 150% of the weighted average cost of gas for gas loaned and 50% of WACOG for gas stored. It contends that because transportation customers already pay pipeline balancing costs in the pipeline rates they pay, the WNG proposal would be a second billing for the same service. The Company contends that NWIGU's proposal fails to recognize that the Company's balancing challenges differ from the pipeline's, and that NWIGU members' substantial compliance with existing balancing requirements indicates that the proposal would impose little or no added burden on them.

The Commission adopts the Company proposal. It is based upon a current system that is working. The proposal is designed to provide incentive for accuracy and to prevent the need to loan or store gas. It is not unduly inflexible nor burdensome, and should be accepted as an effective way to meet the stated goals.

b. Balancing Penalty Revenue Allocations

Any balancing penalty revenues are considered in the Company's periodic Purchase Gas Adjustment proceedings. The parties disagree as to how those revenues should be allocated for purposes of the Adjustment.

Commission Staff urges that the penalties flow to the benefit of sales customers only, because they are the ones who bear the burden when the system is out of balance. Transportation customers are not burdened, as gas is either withdrawn from storage of sales customer gas, or injected into that storage. **Public Counsel** would allocate penalty revenue to all sales and transportation customers in the same manner as storage costs; NWIGU would flow back the revenue to all customers except those using its proposed daily/monthly balancing service, as all customers pay for the service.

The Commission accepts the Commission Staff approach as the most fair, and directs that any balancing penalty revenue be flowed to sales customers in PGA proceedings.

c. Daily Balancing

The Company now includes a charge for balancing service -- within the range permitted without penalty -- by including a small amount in the charge for sale or transportation of each therm.

The Company proposes an optional daily balancing service at a fee of $.0241/therm for each therm out of balance for the day and would provide a credit of $.001/therm for each therm transported. It suggests that customers should have a six month window following approval of rates to evaluate whether or not to choose this service. **Commission Staff** supports the Company proposal.

Public Counsel agrees with the Company's rate proposal for daily balancing, but suggests that the request be modified to allocate 20% of Jackson Prairie to transportation customers.

The Commission accepts the Company's proposal. It will allow customers the freedom to select the program most suitable for their particular consumption pattern. We expect the Company to maintain sufficient records to determine whether the plan has any effect on the need for balancing services, on balancing patterns, or on revenues.

3. Seasonal Storage

Public Counsel contends that net winter imbalances should be penalized more than off-season imbalances. Transportation customers could be able to "game" the system by putting excess gas into storage in the off-season, when it's cheap, up to the 10% limit, then slowly draw back down to below the tolerance band during peak periods.

The Company asks that the Commission reject the proposal. It urges that the nomination system would be difficult or impossible to "game." **Commission Staff** also opposes the proposal as an overreaction to an unlikely situation.

The Commission rejects the proposal. There is no demonstration that a real problem exists or that there is harm to any person or group. If customer use patterns indicate that they are in fact using the system in this manner, and that doing so is detrimental to the Company or to other ratepayers, the Commission is willing to examine the proposal again.

V. COMPRESSED NATURAL GAS

In Docket No. UG-920840, the Company asked for a ratepayer surcharge to fund construction of compressed natural gas (CNG) infrastructure. The Commission denied that request on a motion for summary decision. Its final order, however, accepted the Commission Staff position that the Company must file a compensatory rate but rejected the Commission Staff position that the Company should entirely stop selling CNG. This tariff resulted; Staff objected to it and the filing was suspended. The Company later offered an adjusted tariff in Docket UG-940814 to reflect the findings of its cost study.

The Company contends that it should be able to offer CNG service and that the legislature has encouraged the Commission to support efforts in that direction.[16] It contends that any subsidy at the proposed rate based on embedded costs is minimal. It contends that the proposed rate is fully compensatory of incremental costs to WNG. It contends that CNG offers environmental benefits that are reflected in the 1991 Washington Clean Air Act[17] and the National Energy Policy Act of 1992, which both encourage use of CNG as a vehicle fuel. The Company argues that its proposal will make CNG more widely available. The Company states that it intends to leave the market when the market becomes competitive. The Company points out that other regulatory commissions allow natural gas utilities to sell CNG. Finally, it notes that existing customers would be stranded if it is forced to cease sales.

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[16]The Company cites RCW 80.28.290:

> The commission shall identify barriers to the development of refueling stations for vehicles operating on compressed natural gas, and shall develop policies to remove such barriers. In developing such policies, the commission shall consider providing rate incentives to encourage natural gas companies to invest in the infrastructure required by such refueling stations.

[17]RCW 80.28.280 reads in part as follows:

> The legislature also finds that well-developed and convenient refueling systems are imperative if compressed natural gas is to be widely used by the public. The legislature declares that the development of compressed natural gas refueling stations are in the public interest.

Commission Staff argues that the Company should not be selling CNG at all. It notes that the prior order requires the Company to file a fully compensatory rate, which it and the Company agree is one that "will recover all its direct costs, plus provide a return on rate base." It contends that the Commission has no legal authority under RCW 80.28.240[18] to approve sales requiring a subsidy, and the Company admits that there is no market for CNG at a fully compensatory rate.

Commission Staff contends that a subsidy of any magnitude is illegal and that the Commission has already forbidden the Company from expanding its program through a direct subsidy. Commission Staff argues that the Company's contention, that nurturing will make a vibrant market, is stale because no market yet exists after years of nurturing. Finally, Commission Staff contends that non-CNG customers will never reap benefits from CNG sales to repay the burdens they must bear under WNG's proposal.

Commission Staff urges that WNG's participation in the market creates an artificial demand from artificially low, subsidized rates and hinders development of a true market for the service. Others' reluctance to enter the market, Staff contends, should be a signal to WNG that providing this service does not make economic sense. The Company responds that Commission Staff's arguments have no basis: no investor has been discouraged from investing in CNG because of Company participation in the market.

The Commission does not believe that the Company's offering of CNG is necessarily inimical to the Company, to its ratepayers, to the public, or to potential competition or competitors in the CNG market.

We are satisfied that the statutory reference to subsidy does not require us to use embedded cost, including system average rate of return, as the measure. No witness challenged Mr. Amen's statement that the service meets its incremental costs, a concept supported by Public Counsel witness, Mr. Lazar. When the service meets its incremental costs, no subsidy of any kind is required by other customers, who thus bear no "burden" from the offering. The Commission has authorized incremental cost as an appropriate measure for rates in other contexts, particularly in telecommunications.

The Company should have the opportunity, especially considering the statutory provisions, to offer CNG at rates that do not harm other customers. We accept the Company's contention that it earnestly seeks other vendors' participation in creating and serving a market and do not believe that the proposed rate will bar other vendors from the market.

[18]The statute reads in relevant part as follows:

> Nothing in this section and RCW 80.28.290 is intended to alter the regulatory practices of the commission or allow the subsidization of one ratepayer class by another.

While we accept the Company's proposal to maintain rates temporarily at this minimum level to encourage development of the industry, we must make the point that we do not expect rates at this level to continue indefinitely. The Company shall bring this schedule back to the Commission, either in a generic filing or as part of a general rate case, within three years from the date of this Order. The purpose of that filing shall be to review whether the service is providing an increasing contribution to the Company's operation and whether there is continuing need to offer the service below embedded cost plus an appropriate return.

Procedurally, we note that in Docket No. UG-940814 the Company would alter the rate it proposed in Docket No. UG-940034. Therefore, this Order will reject the earlier filing. The Commission accepts the Company's proposal in Docket No. UG-940814 for Schedule 50.

VI. IMPLEMENTATION

The Company shall calculate the rates resulting from the instructions in this Order and shall present compliance tariffs to the Commission and to the parties no later than the close of business on Monday, April 17. The proposed tariffs shall bear no effective date.

The Commission takes official notice of Washington Natural Gas' filing for a general rate case, and its application for interim rates, in Docket No. UG-950278. The Commission believes that it is inappropriate to authorize tariffs resulting from this Order to take effect before the Commission determines whether an interim increase will be granted.

The Commission will therefore enter a further order in this proceeding, contemporaneously with its order on the Company's pending request for interim rates, authorizing an effective date for the "permanent" tariffs authorized by this Order.

Accruals for purposes of Purchase Gas Adjustment proceedings shall not be modified to the gas cost determined herein with the date of this Order, but with the date the rates become effective.

FINDINGS OF FACT

Having discussed above in detail both the oral and documentary evidence concerning all material matters, and having stated findings and conclusions, the Commission now makes the following summary of the facts as found. Those portions of the preceding detailed findings pertaining to the ultimate findings are incorporated herein by this reference.

1. The Washington Utilities and Transportation Commission is an agency of the state of Washington vested by statute with authority to regulate rates, services, facilities, practices, rules, accounts, and transfers of public service companies, including gas distribution companies.

2. Respondent Washington Natural Gas Company is engaged in the business of furnishing natural gas to customers in the state of Washington as a public service company.

3. On January 7, 1994, the Company filed a tariff for its Compressed Natural Gas service, to be effective January 10, 1994. The filing was made for compliance with instructions in the Commission's Order in Docket No. UG-940840. The Commission suspended the proposed tariff. The tariff revisions that the Company filed in Docket No. UG-940034 contain rates that are not fair, just, or reasonable.

4. On June 15, 1994, the Company filed a tariff to implement a cost of service study undertaken to comply with instructions in the Commission's Order in Docket No. UG-940840. The Commission suspended the proposed tariff.

5. On August 11, 1994, the Commission consolidated the two proceedings for hearing and order. The Company waived the suspension date of the filing in Docket No. UG-940034 to coincide with the suspension date of Docket No. UG-940814.

6. Incremental cost is an appropriate measure to determine whether a tariff schedule requires a subsidy from other ratepayers for purposes of RCW 80.28.240. The Company's filed schedule is in furtherance of goals sanctioned by statute and does not require a subsidy.

7. The Commission accepts the Company's cost study with the modifications required in the text of this Order, as an indication of the Company's costs to serve its various classes of customers.

8. The Commission accepts the Commission Staff proposed results of operations for purposes of the cost study in this proceeding.

9. The Commission Staff proposed spread of rates, with the modifications adopted in the text of this Order, is an appropriate spread of rates for purposes of this proceeding.

10. The tariff revisions that the Company filed in Docket No. UG-940814 contain rates that are not fair, just, or reasonable. Tariffs consistent with the terms of this Order will contain rates that are fair, just, reasonable, and sufficient.

11. The Company has pending before the Commission a request for interim rate relief. Implementation of the "permanent" rate changes authorized in this Order should be delayed until the Commission determines the result of the Company's request for interim rates. Accruals for purposes of Purchase Gas Adjustment proceedings shall not be modified to the gas cost determined herein with the date of this Order, but with the date the rates become effective.

From the foregoing findings of fact, the Commission enters the following conclusions of law.

CONCLUSIONS OF LAW

1. The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of and the parties to this proceeding.

2. The tariff revisions now under suspension should be rejected. The Company should be directed to refile tariff revisions prepared in accordance with the terms of this Order. Tariff revisions prepared in accordance with this Order will result in rates that are fair, just, reasonable and sufficient.

On the basis of the foregoing findings of fact and conclusions of law, the Commission hereby makes and enters the following Order.

O R D E R

THE COMMISSION ORDERS:

1. The tariff revisions filed by respondent on January 7, 1994, now under suspension in Docket No. UG-940034 are rejected entirely.

2. The tariff revisions filed on June 15, 1994, now under suspension in Docket No. UG-920814, are rejected entirely.

3. Respondent is authorized to refile tariff revisions in Docket No. UG-940814 as described in the text of this Order, including a revision to the tariff amendment suspended in Docket No. UG-940034.

4. Respondent is directed to file the authorized tariff revisions no later than the close of business on April 17, 1995, and to serve them on all parties to be received no later than that date. The Company shall provide a chart with its filing showing, for each schedule and for each step of each schedule, the existing rate; the filed rate; and the percentage change.

5. The filing authorized in this Order shall bear no effective date. The Commission will review the filing and determine by future order the appropriate date for it become effective.

6. The tariff revisions shall bear the notation on each sheet thereof, "By Authority of the Washington Utilities and Transportation Commission in Docket No. UG-940814".

7. Notice of the filing authorized in this Order shall be posted at each of respondent's business offices in the territory affected by the filing, on or before the date of filing with the Commission. The notice shall state that the filing is to become effective by further order of the Commission. The notice shall state that a copy of the filing is available for public inspection at each such office. This notice shall remain posted until the Commission has acted on the filing.

8. The Commission retains jurisdiction to effectuate the provisions of this Order.

DATED at Olympia, Washington, and effective this 11th day of April 1995.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

SHARON L. NELSON, Chairman

RICHARD HEMSTAD, Commissioner

WILLIAM R. GILLIS, Commissioner

NOTICE TO PARTIES:

This is a final order of the Commission. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-09-810, or a petition for rehearing pursuant to RCW 80.04.200 or RCW 81.04.200 and WAC 480-09-820(1).