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Company: Washington Natural Gas

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August 10, 1993

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VIA HAND-DELIVERY

Mr. Paul Curl, Secretary
Washington Utilities and Transportation Commission
Chandler Plaza Building
1300 S. Evergreen Park Drive SW
Olympia, Washington 98504

Re: Washington Natural Gas Company, Docket No. UG-920840

Dear Mr. Curl:

Enclosed please find the original plus 19 copies of the Brief of the Northwest Industrial Gas Users in the above-referenced proceedings. One additional copy is enclosed to file stamp and return for our records.

Thank you for your attention to this matter.

Very truly yours,

Edward A. Finklea

Enc.
cc: All Parties

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STATE OF WASHINGTON

BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION v. THE WASHINGTON NATURAL GAS COMPANY	)	Docket No. UG-920840

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BRIEF
OF
THE NORTHWEST INDUSTRIAL GAS USERS

August 10, 1993

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I. INTRODUCTION

The Washington Utilities and Transportation Commission (WUTC or Commission) has the opportunity to reshape the services offered by Washington Natural Gas Company (WNG or Company) in a manner that benefits all consumers. A significant restructuring has taken place in the natural gas industry both for interstate pipelines and local distribution companies (LDCs) since WNG's last rate case in 1984. In recognition of these changes, this Commission must resolve several fundamental natural gas regulatory issues in this rate proceeding:

1. Will WNG sales and transportation rates be set according to an appropriate cost-of-service analysis as offered by the Company in Exhibit 153, or will this Commission allow the existing subsidies paid by industrial transportation and interruptible sales customers to artificially hold down firm sales customers' rates under the flawed Commission Staff cost-of-service study? The Commission should put the prices WNG charges for selling and transporting gas on a sound economic basis and adopt the cost-of-service principles employed by WNG. The results from WNG's cost-of-service analysis should be used as the foundation for determining class cost responsibility. The Commission should reject Staff's proposed modified "Cascade" cost-of-service methodology study and the proposal to price interruptible transportation as if it were firm transportation and only credit customers when actual interruptions occur. Staff's method fails to allocate costs to customer classes based

on which classes cause WNG to incur the costs and relies on arbitrary allocators unreasonably weighted toward annual throughput to retain the subsidies large volume customers are currently paying in their rates for gas services. The Commission should recognize the operational reality of WNG's system that interruptions for transporters are not rare and allow interruptible transportation service to be provided at rates based upon those costs reflected in WNG's study.

2. Will WNG provide its customers a separate, unbundled, cost-based transportation service so that customers have the legitimate option of buying their own gas on non-discriminatory terms? The Company's rate spread proposal for large volume sales and transportation customers is unduly discriminatory because transportation service would be priced higher than sales service to a similarly sized customer. WNG also seeks authority to impose severe restrictions on transportation customers, yet price the service above the price charged for sales service. WNG's transportation service proposal must be rejected as a blatant price manipulation. For this case, the Commission should set separately stated transportation rates and price transportation service under Schedules 57 and 58 at no higher than the delivery-related component of the corresponding sales schedules, according to the following declining block rate schedules:

Schedule 58 (cents/therm)

First 25,000	14.01
Next 25,000	11.55
Additional	7.89

Schedule 57 (cents/therm)

First 100,000	4.17
Additional	2.97

3. Will this Commission require WNG to offer transportation services upon non-discriminatory terms that are just and reasonable, or will it accept the Company's and Staff's 3% monthly balancing requirement despite the absolute lack of relationship to any cost incurrence by the Company or any balancing requirements of the interconnected pipeline? Instead the Commission should recognize that large industrial loads reduce the possibility of WNG incurring balancing penalties on the pipeline and that the increased throughput from industrial transporters benefits all WNG customers. The Commission should require WNG to mirror the requirements of Northwest Pipeline Corporation's (Northwest's) interstate system and adopt a thirty day balancing for transportation customers under normal conditions with a tolerance band of plus or minus 5% of the monthly nominated volumes and a make-up period of 45 days after notification of a potential penalty situation. At the minimum, the Commission must recognize that the Staff and Company's proposal is inconsistent with industry standards and that operational realities require at least a 10% monthly balancing requirement for transportation service, or the interruptible transportation load will be forced off WNG's system. The Commission should also set just and reasonable operating provisions for transportation service by WNG, including aggregation of sites for balancing purposes for a single customer

with multiple sites on the same city-gate, the limitation of telemetering costs to one-time only charges for equipment with upgrades to be borne by WNG, and to otherwise determine that all provisions requiring a minimum annual throughput or annual minimum bill be cost-justified by WNG. The Commission should approve only cost-based rates and cost-based minimums to provide WNG customers with the opportunity to choose between reasonably priced sales and transportation services, without using non-cost based priced differences to impact the customers' choices. The Company's proposed one year contract period for transportation service is reasonable only if WNG's cost-of-service approach and the Northwest Industrial Gas Users' (NWIGU's) recommended rate design for large volume sales and transportation customers is adopted by the WUTC.

4. Will WNG's revenue requirements be determined at an appropriate level? The Commission should permit the Company to recover only its reasonable cost of providing utility service, plus the opportunity to earn a reasonable return on the investments which were used and useful in providing <u>utility</u> services during the test period. The utility is seeking a $14 million rate increase in this proceeding, while the Commission Staff seeks a $24.2 million reduction in WNG's revenue requirements. With such disparity, NWIGU urges the Commission to closely examine WNG's allowable expenses and claimed rate base and to allow only those items that are reasonable and prudent, and to

disallow all non-utility rate base and related expenses. In particular, the Commission should:

a. Reject WNG's requested attrition adjustment to its revenue requirement;

b. End the practice of WNG ratepayers subsidizing WNG's non-utility ventures;

c. Reject WNG's proposed Safety Tracker and instead allow WNG to recover safety related expenditures, if any, through the normal ratemaking process to the extent the Commission finds that they were reasonably necessary, known and measurable during the test year; and

d. Require WNG to first attempt recovery of its carrying costs on its environmental remediation expenses through its insurance claims.

II. SUMMARY OF ARGUMENT

This Commission has previously determined that it is appropriate for local distribution companies, like WNG, to provide transportation as a separate service, even absent a threat of competition whether from direct connection to Northwest or from alternate fuels. (Ex. 122, WUTC v. The Washington Water Power Co., Docket No. UG 901459, Slip Op. at 9). The Company and the Staff have treated transportation service as a deviation from the "norm" of sales service. The Company has purposely and without cost basis designed its proposal for setting rates, terms

and conditions for transportation service in an attempt to force transportation customers back to sales service. (Cross, Mr. Johnson, TR. Vol. 18, p. 3725, l. 25 to p. 3726, l. 7). The Company's transportation rate design and balancing proposal are unreasonable and unduly discriminatory under Washington law.

This Commission should reject WNG's proposals and recognize that if unbundling is allowed to succeed, no potential gas user will go unserved and all WNG customers will benefit. As noted recently by an Illinois state commissioner:

> The threshold requirement for regulation in the 1990s and beyond is that regulated firms must have rates and services that are responsive to the business realities facing their customers. LDC rates must be unbundled to allow their customers to make rational economic choices in meeting differing service needs. In the unbundling process, it will be necessary to ensure that costs are allocated among the rate classes in an equitable manner. The days of one rate class subsidizing another are over. Not only because it is unfair, but because it is not economical.
>
> Today, users have choices about how to best meet their energy needs. If charges are not cost based, it increases the chance that they will leave the system through bypass, or by choosing an alternative fuel.

R. Kretschmer, "When the Old Way Doesn't Work Anymore," 127 Public Utilities Fortnightly 17, 18-19 (1991). This Commission should respond to these economic realities and encourage non-discriminatory transportation service. All consumers will lose if Washington ignores the changes that have happened in the gas industry and simply tries to preserve sales service as the

"norm." As noted by the Virginia State Corporation Commission in its 1986 generic transportation policy determination:

> The increase in competition in the natural gas industry has clearly been in the public interest. Competition at the wellhead has already served to lower gas costs overall and nondiscriminatory transportation has stimulated that competition. Even nonparticipating customers benefit from transportation due to the increased pressures on utility companies to lower gas costs overall to more effectively compete. Moreover, a company which effectively competes can increase the throughput on its system and again lower costs for all its customers. In addition, transportation provides one more market option which a utility can offer its customers and consequently maximizes the requisite flexibility necessary to compete with a variety of alternatives. We agree . . . that transportation of natural gas is in the public interest.

78 P.U.R.4th at 65. What the Virginia Commission observed in 1986 remains true today. All Washington ratepayers will benefit if cost-based non-discriminatory transportation services are offered by WNG.

III. DETERMINATION OF REVENUE REQUIREMENT ISSUES

A. The Commission Should Not Allow a Positive Attrition Adjustment to WNG's Revenue Requirement in This Rate Case.

None of the evidence in this case supports WNG's claimed need for a positive attrition adjustment. The present economic conditions facing WNG do not justify an attrition adjustment that enhances the Company's opportunity to produce a targeted level of earnings. In a Puget Power rate case, the Commission rejected a proposed attrition adjustment:

> Under the circumstances of this case, we believe that it is proper to deny the requested attrition adjustments in light of recent positive company performance, recent trends toward the abatement of inflation and the effect of such an adjustment to reduce substantially management incentive to achieve efficiencies in operation.

(Ex. T-233, at p. 4, l. 10-15, Ms. Heller-Hughes quoting Cause No. U-81-41, at 20). All of these same factors dictate that a positive attrition adjustment is not appropriate for WNG at this time.

The Company originally sought, as set forth in Exhibit 8 (KRK-5), $5.08 million of its requested $28.4 million total general rate increase based upon an attrition adjustment from July 1, 1993 until June 30, 1994. During the rebuttal portion of this proceeding, the Company revised its proposal to extend the attrition adjustment for another three months (Mr. Karzmar, Ex. T-406, p. 18, l. 8-11), resulting in a claimed $5.2 million attrition allowance. (Ex. 411 (KRK-5 Revised)). This number is based on a WNG regression analysis that attempts to analyze past changes in revenues, expenses and rate base in order to calculate a trended growth rate to apply to the future period.

The need asserted by the Company does not exist given that there is low inflation in the costs of operations and that the Company has increased customer demand for services. The Company's claim for an attrition adjustment assumes that historic growth rates and embedded inflation rates are representative of the future. (Cross of Mr. Karzmar, TR. V. 3, p. 448, l. 12 to p.

449, l. 13). Yet the current growth in WNG's throughput is above historic averages, while current inflation is below average.

WNG claims that the requested adjustment is needed primarily because of the higher cost of putting plant in place compared to its embedded cost of plant, its anticipated growth in plant and inflation. The Company maintains that it is "mostly affected by attrition because of rapid growth." (Mr. Karzmar, Ex. T-406, p. 20, l. 11-12). If the rapid addition of new customers dilutes the Company's earnings, then the solution is to take a more fiscally conservative approach to customer additions not to grant an attrition adjustment that further burdens current ratepayers.

To support its request, WNG also relies heavily on the precedent that the WUTC has granted attrition adjustments to WNG in its last two rate cases, Docket Nos. U-83-27 and U-84-60. The Company's immediately prior general rate case, Docket No. U-84-60, resulted in rate changes in 1985, over eight years ago. The attrition adjustments of the past were approved under conditions that do not exist today (e.g., periods of high inflation and declining gas sales). (Ms. Heller-Hughes, Ex. T-233, at 7).

The evidence also shows that the 1985 attrition adjustment resulted in above-authorized earnings. According to the Company's analysis, as set forth in Exhibit 313 (DWS-1), WNG's actual earned rate of return on common equity in 1985 was 19.13% and its overall return was 14.01%. The Commission authorized rate of return in the case, however, was only 12.88% overall and 16.25% on equity. So, in the first year following the rate

increase with the attrition allowance, the Company earned nearly 3 percentage points more on equity than authorized.

(Mr. Schoenbeck, Ex. T-312, at 6). This point was also noted by Staff Witness Elgin on cross-examination in discussing the policy reasons for Staff's opposition to an attrition adjustment in this case:

> Q (Ms. Pyron). In your examination of the earlier application of attrition analysis did you then look at the rate of return that was actually earned by the company after it was applied?
>
> A (Mr. Elgin). Well, all I can say is that in 1984 as part of the settlement in the last rate case we had there was an attrition adjustment, and we anticipated that there would be this attrition, but as it turns out it seems to me what occurred is the exact opposite occurred. Revenues started growing, costs started coming down and the company actually, if anything, had positive attrition. In other words, revenues were growing faster than costs . . . .

(Cross, Mr. Elgin, TR. Vol. 8, p. 1401, l. 21 to p. 1402, l.8).

The Company's rapid growth in residential service cannot serve as legitimate justification for the positive attrition adjustment that is requested. WNG's anticipated growth is determined by its own exercise of business judgment with each expansion under its current service extension policies. Most importantly, as evidenced by the testimony of both Staff Witness Ms. Heller-Hughes and Mr. Schoenbeck, if attrition was causing any significant deterioration in earnings, WNG could not have survived and prospered for nearly eight years between general rate cases. WNG has failed to justify any request for a positive

attrition adjustment as part of its allowed revenue requirement in this case. (Ms. Heller-Hughes, Ex. T-233, at 6-7 & Mr. Schoenbeck, Ex. T-312, at 7). It should be denied.

B. This Commission Should End the Practice of WNG Ratepayers Subsidizing WNG's Non-Utility Ventures.

On rebuttal in this case, WNG has offered to form a new Merchandising subsidiary as a result of the Staff's investigation into WNG ratepayers' substantial subsidies of non-utility ventures. Whether or not WNG forms a new subsidiary for its Merchandising functions, the Commission should terminate the obvious subsidies that exist (for at least $9.5 million to WNG's non-utility activities). This Commission should not allow continued subsidization of WNG's non-utility business ventures by WNG's ratepayers.

In response to the Staff's investigation of these issues, the study prepared on rebuttal by the Company's own expert witness from Arthur Anderson disclosed an additional $8.6 million in Merchandising costs that the Company had allocated to the utility and $900,000 that should be allocated to other affiliates that the Company had allocated to the utility. (Rebuttal Ms. Thompson, T-323, at p. 9, l. 19-22). On rebuttal, the Company advocates that the Commission use a lower number computed by Arthur Anderson to determine the amount that should be allocated to non-utility activities. The assumption WNG relies on, in its rebuttal case, is that the Merchandising segment of WNG would be spun off into a separate subsidiary that would not utilize any of the Company's functions, services, or facilities.

(Rebuttal Ms. Thompson, T-323, at p. 10, l. 1-14 & Cross, Mr. Thorpe, TR. Vol. 15, p. 2903, l. 14-25 to p. 2904, l. 1-10). Those assumptions are just that, only assumptions.

The Commission Staff's analysis discloses that ratepayers are providing substantial subsidies to WNG's Merchandising and other affiliates, without even considering Staff's proposed disallowances of advertising and marketing expenses. (See Ex. 208, (KLT-2), pp. 3-6). The Commission should not accept the Company's lower reduction of $6.9 million for Merchandising based on future assumptions about how costs could be allocated with a Merchandising subsidiary that hasn't even been formed yet. Whether or not WNG ever forms a new subsidiary for its Merchandising functions, the Commission should terminate the obvious subsidy of at least $9.5 million that exists to WNG's affiliates and non-utility activities from WNG ratepayers.

C. The Commission Should Include Any Legitimate Safety Program Expense in WNG's Cost-of-Service and Should Deny the Requested Tracker.

WNG's filing includes a request to establish a "Safety Tracker" to account for and subsequently recover its safety program costs through an equal cents per therm assessment on all sales and transportation throughput on its system. For the first year, WNG is now seeking 0.225 cents per therm as a surcharge on all customers' rates. (Cross of Mr. Johnson, TR. Vol. 18, p. 3708, l. 22 to p. 3709, l. 2). The Company's revised proposal on rebuttal is, however, no less objectionable than its original request for a 0.717 cents per therm first year assessment.

A tracker ensures 100% cost recovery for the utility. In this case, the Company has failed to demonstrate the need for such extraordinary treatment of its claimed safety expenses as a surcharge above its normal revenue requirement. Deferred accounting mechanisms with the automatic pass-through of charges should be reserved for uniquely varying costs when it is appropriate to hold the utility and its customers whole. Deferred accounting avoids frequent rate changes, yet ensures that cost items are kept track of accurately so that refunds or surcharges can be flowed through to customers. In Washington, this technique has been used generally with local distribution companies only for purchased gas costs and interstate pipeline charges. Unlike these uniquely varying costs, any legitimate safety program expenses can be recovered through the normal ratemaking process for prudently incurred expenses.

The rationale applied by this Commission earlier in its order dismissing the public refueling station tracker equally applies to this proposed Safety Tracker:

> The proposal also runs counter to long-held, sound regulatory policies . . . . Reasonable expenses incurred to operate a prudent investment are a part of the company's cost of doing business, and it is also entitled to the opportunity to recover that cost from ratepayers.
>
> The company's proposal is a radical departure from this pattern. First, the proposal offers a dollar-for-dollar return of company expenses and is a guarantee that the company will recover every penny it spends. The Commission has used tracker-type mechanisms only rarely. Generally, in those instances the expenditures have had one or more of the

> following characteristics: they have been easily measurable; they have been beyond the company's ability to control; and they are substantial expenses, essential to carry out company operations. In addition, the Commission has tended to find a substantial ratepayer benefit when it has authorized a tracker-type mechanism.
>
> Here, the expenses may not be clearly and easily measurable, and may be intertwined with other expenditures. They are within the company's ability to control, as decisions on whether and how to build are discretionary . . . . There is no clear indication under traditional tests that a tracker-type mechanism passing costs through to ratepayers and removing all risk from shareholders or lenders is appropriate for this service.

"Third Supplemental Order Granting Motion to Dismiss Public Refueling Station Schedule (Schedule 117)," Slip Op. at 3-4 (March 12, 1993).

WNG has wholly failed to demonstrate why costs incurred for safety measures should be singled out for deferred accounting treatment. Expenses for providing distribution service should be addressed as part of the Company's revenue requirement and allocated under WNG's cost-of-service study. Mr. Gustafson admitted that reduced future maintenance should be expected as a result of the safety program (Cross Mr. Gustafson, TR. Vol. 18, p. 3554, l. 17 to p. 3555, l. 9), but the Company did not even reflect these savings as an offset from the first year of its supposed safety program expenses. The Commission should not allow this blank check surcharge on ratepayers.

The Company still expects this tracker to increase next year from the 1993 request of $4 million to $7.9 million in 1994 (Ex. 360; Cross Mr. Gustafson, TR. Vol. 18, p. 3554, l. 9-16). If allowed by the Commission, the Company's "best" estimates contemplate substantial increases in this tracker over time:

> Q (Ms. Pyron). Based on these estimates, then, would you anticipate increases in the proposed tracker if this Commission accepts the company's proposal?
>
> A (Mr. Gustafson). Yes, I would expect that the initial tracker would be a certain amount, and it would then gradually increase as this work is completed.
>
> Q. Do your estimates on Exhibit 360 reflect a contingency factor?
>
> A. They are our best estimates of what it would cost to either contract for the work or do it with company crews. There is no specific contingency factor built into it.
>
> Q. Did you do any competitive bidding in deriving your expenses for--through this first that you are seeking through April of '93?
>
> A. No. It is based upon our accumulated knowledge of what it costs to do certain types of work.
>
> Q. Did you use any competitive bidding to derive your estimates for the future?
>
> A. We have done no competitive bidding.
>
> Q. In your calculation of the costs for--through April 1993, is there any reflection in Exhibit 360 of any savings for maintenance?
>
> A. No, there is not. We anticipate that that will be reflected in our level of operating costs as we go forward.

> Q. But you haven't calculated what that savings would be?
>
> A. We have not made an estimate of the savings, no.
>
> Q. Do you know what the anticipated life would be for this proposed tracker?
>
> A. I don't know. The program is projected over the next 15 years. Presumably to the extent that it -- how long after that the tracker would continue, that would be a subject for this Commission to decide at any given point, depending on the amount and a reasonable period to amortize the costs.

(Cross, Mr. Gustafson, TR. Vol. 18, p. 3576, l. 3 to p. 3577, l. 15).

The Company's proposes that this safety surcharge tracker continue indefinitely, and their estimates are based on at least 15 years worth of work. The Company proposes no sunset date or provision for automatic Commission review to determine continuing need.

Commission Staff Witness Elgin also finds this proposed tracker to be objectionable from several policy perspectives:

> Q (Ms. Pyron). On page 23 of your testimony you discuss the safety program and is my understanding correct that the staff recommends rejection of the proposed safety tracker?
>
> A (Mr. Elgin). Yes, that's correct . . . .
>
> Q. Are there policy concerns underpinning a proposed tracker that you would testify to or that your testimony is directed to beyond what Mr. Ramirez covers?
>
> A. Well, I just might add is that one of the problems you might have with any kind of tracker first off is you're dealing with estimated costs so you don't know what the

company is going to spend. The second policy issue is that you would have to then estimate what are the offsetting factors, and then the biggest thing from a policy perspective that has me concerned with a proposal like this is the connection between the incentive for the company to do this in a cost effective manner, so arguably, in this kind of scenario as proposed by the company, it would be very difficult to ascertain whether or not the company did in fact do this at the most efficient way possible to provide these system improvements at the lowest reasonable cost. You don't have the right set-up to do that under this scenario.

Q. It's a structure that creates disincentives from efficiency?

A. Yes.

(Cross, Mr. Elgin, TR. Vol. 8, p. 1402, l. 15 to 19, & l. 24 to p. 1403, l. 21).

Compliance with the Commission's required safety program is an ongoing responsibility of any utility. As such, any prudently incurred, known and measurable safety program expenses from the test year should be treated as a legitimate expenditure for purposes of determining the Company's revenue requirement. Those expenses should then be allocated according to their nature as distribution mains or maintenance expenses according to the Company's cost of service study. (Mr. Schoenbeck, T-312, at p. 9).

If WNG's Safety Tracker were adopted, the Company would have a substantial incentive to classify any actual maintenance expenses as safety program expenses. Based upon the Staff's extensive investigation, that is exactly what has happened.

(Mr. Ramirez, T-166, noting the bulk of the Company's claims are not for incremental new safety program requirements).

The expenses allowed for ratemaking purposes should only be those reasonably necessary for a Commission required safety program and should not include expenditures that are deferred maintenance. WNG needs a financial incentive to hold down and properly categorize these costs. With WNG's proposed Safety Tracker, it has little incentive to hold the line of expenses incurred by consultants and contractors. The lack of incentive is evident from the fact that the Company has not even engaged in any competitive bidding for any of the projects or estimates.

Even if the Commission finds that the Company's safety expenditures are reasonably necessary, known and measurable and are not merely deferred maintenance, the costs should be included in the general rate case or future cases, not given extraordinary treatment through a tracker. These expenses when they are known and measurable should then be allocated to customers based on the results of the Company's cost-of-service study. In no event should the Commission approve an equal cents per therm surcharge for legitimate safety expenses, because such a collection mechanism forces larger volume customers to pay a disproportionate share of the maintenance expenses. An equal cents per therm surcharge, layered on top of cost-based rates, would partially undo what would be accomplished by basing rates on the results of a properly prepared cost study.

NWIGU urges the Commission to reject the proposed Safety Tracker because trackers should not be used to recover these types of expenditures. Ratepayers should not be required to, in essence, write a blank check to WNG to cover these expenses, while diminishing WNG's incentive to limit the expenses. Proper mechanisms exist through the normal ratemaking process to allow WNG to recover prudently incurred ratepayer expenditures on safety improvements.

D. The Commission Should Not Allow WNG an Environmental Working Capital Allowance.

The Commission should not allow a working capital allowance for environmental remediation work at this time. In its pending court case, WNG is seeking recovery for "all of the environmental cleanup costs and should be compensated for interest." (Cross of Mr. Karzmar, TR. V. 18, p. 3768, at l. 4-5). Yet, WNG wants its ratepayers to pay for these costs now, even though they may be covered by insurance. Prior to collecting these costs through rate charges, WNG should first attempt to recover the costs through its pending insurance claims, which are still scheduled for an October, 1993 trial.

In this case, WNG is seeking to recover the carrying costs associated with its environmental remediation expenses for certain manufactured gas plants operated in the past by WNG. In June, 1991, WNG filed a complaint in the Superior Court of King County (Case No. 91-2-13506-1) against 55 of its historic insurance companies seeking coverage of its claims. (Washington Energy Company Annual Report, 1992, Ex. 86, at 23). The trial is

scheduled for October 11, 1993. (Cross of Mr. Thorpe, TR. Vol. 15, p. 2885, at l. 12-15). In its statements to the financial community, WNG has represented that recovery of these environmental expenses through insurance is "probable." (Ex. 86, at 15). If WNG prevails in the insurance coverage litigation, recovery of its interest costs from ratepayers will not be necessary.

Continued deferral of carrying costs incurred after January, 1991 is in the best interests of WNG's ratepayers. WNG was originally seeking to include $11.2 million as part of its cash working capital for the carrying costs associated with its environmental remediation cleanup, in addition to seeking $2.6 million as the test year working capital allowance for environmental remediation work. (Ex. 5 (KRK-2)). On rebuttal, the Company has modified its request to $7,255,790 for environmental costs based on expenses deferred as of April 30, 1993. (Ex. 415, (KRK-9); Mr. Karzmar, Ex. T-406, pp. 37-38). The Staff has recommended a working capital allowance for only those sums expended during the test year, 1991, of $521,051. (Ex. 179 (MPP-8); Mr. Parvinen, Ex. T-171, p. 17, l. 5 to p. 18, l. 4). NWIGU urges the Commission to defer consideration of all of these carrying costs along with the environmental cleanup costs.

WNG is attempting to put into this allowance expenses that were incurred since 1984. (Cross of Mr. Karzmar, TR. Vol. 18, at p. 3775, l. 23 to p. 3776, l. 22). Even if the Commission authorizes a working capital allowance for expenditures incurred

in the test year, under no circumstances should WNG be allowed to recover expenses incurred from 1984 through 1990. Between 1984 and 1992, WNG chose not to file for a general rate increase. The Commission can assume from that fact that during those years WNG determined that its earnings were sufficient to earn a just and reasonable return on the Company's investments. The Company should not be allowed after the fact to isolate one category of expenses (interest on environmental clean-up) and recover those past expenses from future ratepayers.

Pursuant to the Commission's order on January 27, 1993 in this proceeding, WNG must first pursue recovery of these related environmental expenses through its insurance claims before imposing a surcharge. Prior to allowing the inclusion in rates of any of these carrying costs associated with WNG's environmental expenditures, the Commission should likewise require WNG to seek recovery of these carrying costs first through its insurance claims. Recognizing that these expenditures may not be recovered immediately, the Commission should allow WNG to accrue interest in a deferral account for expenses incurred after January, 1991 for later determination in conjunction with any future Commission consideration of any ratepayer recovery of WNG's environmental clean-up costs.

WNG should also have an economic incentive to pursue coverage of these expenses vigorously from its insurance carriers. If WNG's proposed working capital allowance is granted, the risk of a negative outcome in the litigation is

shifted 100% from the Company's shareholders to its ratepayers. WNG's ratepayers should not be the only ones with an economic stake in the outcome of the insurance litigation.

IV. THE COMMISSION SHOULD ADOPT THE COST-OF-SERVICE PRINCIPLES EMPLOYED BY WNG

A. WNG's Study is Based on Proper Cost-Causation Principles While Staff's Johnson/Herbig Model Contains Fundamental Flaws.

Since 1986 this Commission has stated in a series of orders that the results of a properly prepared cost-of-service analysis should provide a guideline for determining the proper rate levels for the various classes of customers served by natural gas LDCs. (Ex. 122 at p. 3; Ex. 135 at p. 5; Washington Water Power, Docket No. U-87-1532-T, Second Supplemental Order (September 30, 1988)). The reason for preparing a cost-of-service study is that those that cause the utility to incur costs should pay those costs. If rates do not reflect cost causation, then some customer classes will be paying less for service than it costs to provide the service, and others will be paying rates that exceed what it costs to serve them.

To provide the necessary guidance in this case, WNG has prepared a detailed cost-of-service study, relying on an outside expert with years of experience in the natural gas industry. WNG's study analyzes in detail how costs are incurred by WNG to provide service to its various classes of customers. (Ex. 153). WNG has determined the cost of providing not only sales services to various classes of customers, but transportation service as well. Relying on the fundamental principle of cost causation,

the study accurately allocates costs to WNG's firm and interruptible sales and transportation customer classes. (Ex. T-312 at p. 11). WNG's cost-of-service study is the only sound and accurate allocation methodology in evidence to apply to WNG's system.

WUTC Staff and Public Counsel ask the Commission to ignore the operating realities of WNG's distribution system when allocating costs and instead fall back on applying the Johnson/Herbig method from the 1986 Cascade case. The so-called Johnson/Herbig model was prepared in 1986 by the Florida consulting firm to allocate costs of a different LDC in a different era. The Johnson/Herbig model in 1986 was premised on the following assumptions: 1) excess capacity existed on both the interstate (Northwest) and intrastate Cascade Natural Gas Corporation (Cascade) delivery systems; 2) the existence of customer "switching" between firm and interruptible rate schedules after costs had been incurred to provide firm service; and, 3) the theoretical or purist economic argument that joint costs cannot be reasonably differentiated and assigned to customer classes. None of these arguments are valid for WNG's system today.

The Commission must reject the Staff's proposed modified "Cascade" methodology of allocating costs. The Commission needs to adopt the WNG cost study and make clear in its order that the era of automatically applying the results of the Johnson/Herbig

model to local distribution company cost of service has ended in Washington.

There are four fundamental flaws in the outmoded Johnson/Herbig model, as advanced by Staff in this case:

1. WNG has allocated costs based on peak responsibility in recognition of the fact that the distribution system is sized to meet peak day requirements, while the Johnson/Herbig approach arbitrarily allocates 50 percent of the costs of the distribution mains and services based solely on annual throughput.

2. WNG has directly assigned the costs of distribution mains where possible, with direct assignment of distribution plant to industrial Schedules 85 and 87. In contrast, the Johnson/Herbig model ignores direct assignments, thus allocating to large volume customers the costs of two inch and smaller mains and service lines that are physically incapable of serving large volume customers.

3. WNG has not assigned interstate pipeline costs or the cost of other gas-related services to its transportation customers, while the Johnson/Herbig model, as it has been applied by this Commission in past cases, assigned interruptible sales and transportation customers demand costs that are incurred solely to ensure the firm delivery of gas from upstream suppliers and Northwest to the city gate.

4. WNG has assigned costs to interruptible transportation customers recognizing the lower quality of service provided to these customers. Staff, on the other hand, relying on

Johnson/Herbig, attempts to ignore the reality that interruptible sales and transportation customers can be curtailed whenever the capacity of the distribution system is required for firm customers, and instead advocates allocating costs to these customers as if they were firm, and then only providing a credit when the customers are actually interrupted.

WNG's cost-of-service analysis, Exhibit 153 (RSJ-1 Revised), should be used by the Commission as the foundation for determining class cost responsibility in this proceeding. It is the only sound and accurate allocation methodology in evidence to apply to WNG's system. If WNG's cost study is adopted by the Commission, WNG's rates can more closely reflect the cost of providing services to its various customer classes. Existing cross-subsidies can be addressed and remedied over time.

B. Staff's Cost-of-Service Study is Skewed by the Arbitrary Use of Annual Throughput Commodity Allocators.

The cost-of-service method WNG has employed recognizes that annual therm usage has virtually no effect on determining how a gas distribution system is sized, and thus has very little to do with what costs are incurred to serve a class of customers. WNG's cost study recognizes, instead, that usage of the distribution system at peak is the primary factor in determining what costs must be incurred to serve a class of customers.

To determine the class contributions to the expected peak for the Residential, Commercial and Firm Industrial classes, the Company derived the expected peak day contributions based on a 10

degree fahrenheit design criteria, the standard by which the system has operated for at least 25 years and for which the system was built to provide firm service to these classes. (Rebuttal, Mr. Johnson, Ex. T-386, at pp. 49-51). For the Large Volume firm customers, the Company employed the summation of the individual contract demands since this is the level of service these customers are guaranteed (and are paying for).

WUTC Staff and Public Counsel want to ignore the fact that peak usage causes WNG to incur a substantial portion of the cost of providing distribution service. They would instead continue using allocators weighted heavily toward annual throughput, thus retaining the cross-subsidies large volume users are currently paying in their rates for gas services. (Rebuttal, Mr. Johnson, Ex. T-386, at p. 36 & Mr. Schoenbeck, Ex. T-312, at p. 23). Even Staff Witness Buckley acknowledged the effect of such allocators on cross-examination:

> Q (Mr. Finklea). I understand there is considerable dispute about the level of revenues including the level of rate base but Mr. Johnson in his RSJ-1 revised which is Exhibit 153 shows a rate base of $502 million. So, first of all you're allocating a different amount of total dollars, correct?
>
> A (Mr. Buckley). Yes.
>
> Q. And the rate base, I take it, is largely what we've been talking about, the distribution facilities, mains -- the company separates between mains and services, you call them all one thing, and then the meters and the regulators at other facilities that are used to provide gas service; is that right?
>
> A. Yes.

> Q. Now, your allocation method results in the residential class being allocated a total of 251 million of the 442 total rate base whereas Mr. Johnson is allocating 302 million out of the 502. So I take it you're allocating a significantly lower percentage of the rate base to the residential class than Mr. Johnson, correct?
>
> A. That's the result of using those allocators, yes . . . .
>
> Q. And an allocation method that allocates the rate base relying heavily on peak usage is going to allocate a larger percentage of the cost to the residential class whereas an allocation method that relies heavily on commodity to allocate is going to allocate more of those costs to the industrial class; is that correct?
>
> A. On its own, yes.
>
> Q. It's a natural result of the allocation method that's chosen?
>
> A. Yes.

(Cross, Mr. Buckley, TR. Vol. 10, p. 1923, l. 21 to p. 1926, l. 2).

To illustrate the difference in these allocation methods, the difference in rate base allocated to Schedule 57 transporters is $33 million. Staff's allocation method results in allocating $45 million of rate base to Schedule 57 transporters, while the Company's method allocates $8.5 million. (Cross, Mr. Buckley, TR. Vol. 10, p. 1926, l. 14-22).

To reject the WNG allocators in favor of Staff's arbitrary allocation of 50 percent of costs based on throughput does not withstand the test of reasonableness. The premise relied on by Johnson/Herbig for classifying distribution mains on the basis of

25% coincident demand, 25% noncoincident demand and 50% on volumetric throughput was the alleged existence of excess capacity on Cascade's distribution network at the time. The Cascade model is also based upon the "apparent" existence of excessive costs related to Cascade's transmission and distribution system.

To justify allocating 50 percent of WNG's distribution mains based on annual therm usage it must be demonstrated that: (1) the Company has excess investment in facilities; and, (2) the Cascade model is more appropriate than that recommended by the Company to assign these excess costs. There has been no showing that WNG has excess investment in facilities. To the contrary, the WNG system is designed for complete curtailment of interruptible sales and transportation customers on a design day. Absent such a quantifiable showing of excess costs, the Johnson/Herbig model should not be used for the Company's class cost assignment.

C. The Company's Cost-of-Service Study Makes Appropriate Direct Assignments of Distribution Mains and Plant.

In this proceeding, WNG has directly and appropriately assigned the costs of distribution mains, with direct assignment of distribution plant to Schedules 85 and 87. (Rebuttal Mr. Johnson, T-386, at p. 28). Staff Witness Buckley, on the other hand, has rejected the use of direct assignments. The Staff, however, "did not do any studies," before rejecting direct assignments, but instead relied solely on an interpretation of Commission precedent. (Cross, Mr. Buckley, Vol. 10, at p. 1914, at l. 19-23). The Commission should approve the specific

assignment of distribution mains in WNG's study. For most of the distribution-related costs, the Company relied on specific studies conducted to ascertain the specific investment needed to serve various categories of customers. As testified to by Company Witness Johnson:

> Q. Why did you attempt to identify plant which was used solely or primarily by individual customers or classes of customers?
>
> A. This was done so that the plant used by these customers would not be allocated to other customers. It was also done to ensure that any mains of two-inch diameter or less used by these customers were fully assigned to them. We did not intend that they not be responsible for any of the common plant.
>
> Q. How was this accomplished?
>
> A. We were able to segregate the distribution mains between these which were three inches or greater in diameter and those which were two inches or less in diameter. This was done to recognize that the Company's growth over the past five to six years has been primarily residential and some small commercial . . . .
>
> Q. How could you be sure that these customers were not served by those smaller mains?
>
> A. We examined the system serving each Rate 85 and 87 customer to determine what size main was installed to their service. A number of the Rate 85 customers were supplied by two-inch mains and in these case, the particular main was traced back to its intersection with a three-inch or larger main. In these case, the entire cost of that main was directly assigned to the Rate 85 class. In fact, Mr. Buckley criticized our methodology by noting that some other customers were served from mains we had directly assigned to Rate 85 customers. If anything, our methodology may overstate the

responsibility of the Rate 85 customers for the directly assigned plant.

(Rebuttal, Mr. Johnson, Ex. T-386, p. 28, l. 21 to p. 30, l. 9).

Moreover this specific assignment of direct costs is strongly endorsed by other regulators. (Rebuttal, Mr. Johnson, Ex. T-386, pp. 31-33, citing NARUC and examples in the electric industry; Mr. Schoenbeck, Ex. T-312, at p. 13 citing other regional LDCs and electric industry examples). The direct assignment of the cost of these mains based upon size is critical. The two inch or smaller mains comprise a significant portion of the total investment in this account--about 43%--hence an additional (and inappropriate) cost assignment of this magnitude to the larger customers would be dramatic and inequitable. The Company has $137 million invested in two inch or smaller mains from which large volume customers are incapable of being served. (Mr. Schoenbeck, Ex. T-312, at p. 12).

D. The Company's Cost-of-Service Assignments to Interruptible Service Reflect Operational Reality on WNG's System.

For the interruptible customers, the Company utilized a concept frequently employed in pipeline proceedings before the FERC by developing transportation rates based on imputed load factors from the firm rates. Rate Schedules 85, 86 and 87, were assigned imputed load factors of 200%, 75% and 300%. By assigning costs in this manner, the cost allocation process is used to directly determine cost responsibility while at the same time recognizing the lower quality of service provided to interruptible customers.

Staff, on the other hand, has attempted to blur the distinction between firm and interruptible service by allocating costs to transportation customers as if they were acquiring firm service, even though they will be subject to interruptions. The technique is a blatant attempt to manipulate the results of a proper cost-of-service study in an effort to justify outrageously high transportation rates.

NWIGU also objects to the proposed elimination of firm sales service as an option under sales schedules 85, 86 and 87 as contemplated by Staff with a reallocated cost study based on Rate 41 being the only firm sales service option for an industrial concern. This Commission should order WNG to offer firm and interruptible sales and firm and interruptible transportation services that are appropriately cost-based under WNG's cost of service method and offered on non-discriminatory terms of service.

The Commission must recognize the reality that interruptible sales and transportation customers can be curtailed whenever the capacity of the distribution system is required for firm customers. (Rebuttal, Mr. Johnson, Ex. T-386, at p. 52). WNG's system is built to provide service only to firm customers during peak weather conditions. (Cross, Mr. Gustafson, TR. Vol. 18, p. 3578, l. 17-20). Further, the allocation method used by the Company's cost method recognizes that by designing a system to serve peak day firm demand, in non-peak weather conditions, both firm and a substantial amount of interruptible throughput can be

serviced. Thus, the Company's allocation method recognizes both peak day and annual throughput. (Mr. Schoenbeck, Ex. T-312, at p. 14).

Collectively this method results in a more accurate cost-causation linkage with quality of service purchased than unadjusted daily, monthly or annual throughput, which could result in weather related deviations. (Id., at 15). WNG's approach properly links the design criteria by which the system was constructed with the quality of service the system can accommodate.

The Staff cost analysis for transportation service has, however, resulted in the allocation of full distribution costs to all transportation customers to the same degree as firm sales customers of WNG because of the faulty assumption that interruptions of transportation service are "extremely rare." (Cross, Mr. Buckley, TR. Vol. 10, pp. 1930-1932, 1944-1946). The record evidence reveals, however, that service interruptions are frequent and have substantially increased in frequency as WNG's residential customer class has grown.

The Commission should resoundingly reject the WUTC Staff proposal to allocate costs to transportation customers as if they were receiving firm service and only grant those customers billing credits when they are actually interrupted. The proposal is blatantly discriminatory, has no cost basis to support it and thus is unlawful. As admitted by Staff Witness Buckley: "From an allocation standpoint, I would have to admit that for the most

part these [transportation] classes are getting allocated as if they're firm customers, I can't deny that." (Cross, Mr. Buckley, TR. Vol. 10, p. 1955, l. 14-17). At the same time, the Staff does not accord these transportation customers priority over interruptible sales customers, much less treat them as the equivalent of firm customers. (Cross, Mr. Buckley, TR. Vol. 10, p. 1953, l. 5 to p. 1954, l. 1).

The facts in this record do not support such a drastic step as eliminating legitimately priced interruptible and firm transportation services as options for WNG's customers to choose. Distribution curtailment on WNG's system is not rare. Exhibit 250 prepared by the Company to detail the number of days of full interruption from 1980 to October, 1992, in fact evidences only those days of full interruption but also shows that this is occurring with increasing frequency with the increased residential growth on WNG's system. Since that analysis was prepared in the fall of 1992, even more frequent partial curtailments have occurred. Mr. Jim Young of Seattle Steam testified upon cross-examination that his company had been interrupted on 34 days in four years of transportation service since 1989 for partial or total disruptions. (Cross, Mr. Young, TR. Vol. 11, p. 2149). Upon cross-examination, the Company's Senior Vice President of Operation testified:

> Q (Ms. Pyron). Based on your experience, taking an average winter, just basically ignoring the weather for those very cold days, would the lack of reserve capacity that's grown in the system over time mean that curtailment would be relatively more

> likely in the future or partial curtailment more likely in the future than in the past?
>
> A (Mr. Gustafson). Yes.

(Cross, Mr. Gustafson, TR. Vol. 18, p. 3580, l. 23 to p. 3581, l. 5).

On examination by Commissioner Casad, Staff Witness Buckley acknowledged that if his assumption about the frequency of interruptions was not upheld by the Commission, then Staff's cost allocations must be revised to reduce the costs that have been allocated to interruptible transportation service. (TR. Vol. 11, p. 2112, l. 17 to p. 2113, l. 2). WNG's customers want the ability to choose between cost-based interruptible and firm transportation service, and the Company wants to offer its customers those options. The Staff's proposal to use billing credits only at times of actual curtailments is an unworkable situation and ignores the operational realities of this system. (Cross, Mr. Gustafson, TR. Vol. 18, at p. 3582-3583). "[A]ny time our mean temperature falls below about 30 degrees Fahrenheit, we will be curtailing some customers." (Cross, Mr. Gustafson, TR. Vol. 18 at p. 3579, l. 3-4).

By having interruptible customers on the system, firm customers have the benefit of those customers' revenues at off-peak periods, without having to size the system to serve those loads at peak periods. In essence, the interruptible customers are providing the firm customers with insurance protection by agreeing to get off the system whenever firm demands require the full capacity of the distribution network. Staff's proposal is

analogous to only having to pay for fire insurance in the event one's property is destroyed by fire. While any property owner would snap at the opportunity to purchase such a policy, obviously insurance companies demand premiums every year in order to cover the possibility of a loss caused by an interruption of service. Transportation customers that can be interrupted whenever there is a capacity constraint cannot be expected to back up the service to firm customers if they only are paid when there is an interruption of service.

Eliminating interruptible transportation, rather than working to make it available in a non-discriminatory manner to the benefit of consumers, would result in substantial damage to the Company's revenue base. Industrial customers make up about one-third of WNG's revenue base. (Cross, Mr. Thorpe, TR. Vol. 15, at p. 2882, l. 3-10). Staff's proposed allocation of costs to transporters and substitute billing credit proposal, should be rejected in favor of adopting cost-based interruptible transportation rates using the results of WNG's cost-of-service study.

E. Staff and the Company Properly Agree that Upstream Demand Costs Should Not be Assigned to Transportation Customers.

The final deviation from the Cascade method WNG relied on was to assign all direct gas-related costs, both commodity and fixed costs, only to sales customers. No gas-related costs, neither demand charges nor commodity costs--except for lost and unaccounted for gas costs (which are a function of all gas coming into the LDC system)--were assigned to transportation customers.

(Redirect Mr. Johnson, TR. Vol. 18, at 3750, l. 3-14). WNG's transportation customers must pay these upstream charges directly to the pipeline. The only costs which should be assigned to transportation customers by the Company are those which are incurred to deliver that gas from the city gate to the burner-tip. By properly assigning up-stream costs only to firm sales customers, the Company has provided a sound foundation for determining a cost-based transportation rate that collects only the costs WNG incurs providing delivery service over its distribution network.

The premise in 1986 that was relied on by this Commission for allocating demand charges to interruptible customers was that excess capacity existed on the interstate pipeline system and thus all customers should pay for that capacity. That factual situation has completely changed since 1986.

In recent years, there have been sustained interruptions on the interstate system. (Mr. Schoenbeck, Ex. T-312, at 15-16). As subsequently discussed, since 1988 Northwest has become an open access carrier and will soon cease its merchant functions as part of the still evolving regulatory changes instituted by FERC. The capacity that became available from the original open-access conversion process was transferred to customers on Northwest's queue for firm service, resulting in Northwest's capacity being fully subscribed. Northwest has also experienced substantial growth in peak and off-peak throughput. In 1986, the pipeline's total throughput--both sales and transportation--was 392 TBtu.

In 1991, Northwest's throughput was 584 TBtu, for an increase of 192 TBtu or **49**%. This ever increasing demand for gas deliverability has caused Northwest to seek and be granted from FERC the authority to expand its existing strained capability. In addition, Northwest has already accepted commitments for a second subsequent expansion. (Ex. T-312, at 17). Therefore, to the extent any excess capacity on the interstate system existed in 1986, that is certainly no longer an accurate characterization.

Further evidence to support WNG not having excess interstate capability is their participation in Northwest's first expansion. In the recently completed expansion, WNG contracted for a maximum daily quantity of 100,000 MMBtu/day, representing 23% of the expansion capability. (Id.) WNG would not have entered into such a substantial commitment if it held excess pipeline capacity.

Customer schedule switching was also discussed by Mr. Johnson in the Cascade proceeding as a reason for allocating interstate pipeline demand charges to interruptible customers. Johnson posited the case where industrial customers on firm schedules had changed to interruptible service after Cascade had committed to purchase firm interstate service under long-term contracts. The contractual commitments existing in 1986 between Northwest and Pacific Northwest LDCs ceased in 1989 because those bundled sales-service contracts expired. In other words, LDCs such as WNG had the opportunity to shed any commitments they had

made in the late 1970's to purchase firm gas supplies and firm pipeline capacity that any customers may have requested in the past. In 1988, when WNG selected transportation and sales contract demand levels, WNG made no capacity commitments to serve its interruptible sales or transportation customers. WNG's expansion volumes were also acquired without any being purchased to serve interruptible sales or transportation customers. Accordingly, to the extent an LDC may have committed for firm capacity to serve industrial load many years ago, it is not relevant today. (Mr. Schoenbeck, T-312, at pp. 18-19). WNG's commitments for its existing and planned interstate capability are for providing reliable service to its firm customers based on the firm design peak day demand. Accordingly, firm customers should be assigned the cost responsibility of this capacity.

The Commission Staff agrees that it is not appropriate to allocate commodity costs and the upstream demand charge costs WNG incurs purchasing pipeline services to WNG's transportation customers because these customers should not pay pipeline demand charges twice. Transportation customers bear their own transportation costs on the pipeline. (Cross, Mr. Buckley, TR. Vol. 10, p. 1939). Thus, on this one cost allocation issue, which has been the subject of disagreement in the past, there is unanimity among the parties that it is no longer appropriate for WNG to assign interstate pipeline costs or the cost of other gas-related services to transportation customers.

F. WNG's Cost-of-Service Methods Should be Adopted in This Case as the Basis for Rate Determinations.

WNG's cost-of-service methods should thus be adopted by the WUTC for determining cost responsibility among WNG's customer classes, with modification only for any legitimate, Commission approved costs related to the safety program. (The effects of an assumed level of hypothetical safety program costs are illustrated by Mr. Schoenbeck at Ex. T-312, at pp. 20-23). The time has come for this Commission to legitimately review the application of the so-called Cascade or Johnson/Herbig model. As noted by the Commission in the most recent Washington Water Power rate case, transportation service was not even offered at the time the Cascade case was heard. (Ex. 122, Slip op. at 9). WNG needs the flexibility to compete with alternative fuels and direct connections to retain its industrial and other customers with competitive alternatives. (Mr. Johnson, Ex. T-55, p. 32-33, Ex. T-386, p. 67). WNG's proposed cost study appropriately assigns costs based on the class requirements which have caused the costs to be incurred. Consequently, the Company's study deviates from the Cascade approach in the assignment of distribution costs, gas-related costs and in the development of peak allocation factors. These deviations are all supported by sound, reasoned approaches.

The Commission's inclination may be to continue relying on Johnson/Herbig because it has the effect of allocating fewer costs to the residential class of customers. This cost study, while supported by the WUTC Staff and Public Counsel, fails to

allocate costs to customer classes based on which classes are causing WNG to incur costs today. The conditions that existed on Cascade's distribution system in 1986 when the Johnson/Herbig model was first advocated do not exist today on WNG's distribution system. Staff has offered no evidence to support the premise that the Johnson/Herbig model accurately allocates the costs WNG incurred during the test period to service its various classes of customers. Johnson/Herbig is outmoded, and its continued use will skew the prices WNG charges its customers, causing it to underprice firm sales service to residential and commercial customers, and overprice interruptible sales and transportation services.

V. RATE DESIGN

A. To Provide Adequate Gas Service in Today's Industry, WNG Must Provide Its Customers a Separate, Unbundled Transportation Service That Is Cost-Based and Provides Customers With the Legitimate Option of Buying Their Own Gas on Non-Discriminatory Terms.

In today's market, WNG must provide its customers with the option of buying their own gas, in order to fulfill the Company's obligation as a utility to provide adequate gas service. The availability of transportation is vital to securing the benefits of the gas-to-gas competition present in the industry for all Washington gas consumers. Otherwise end-users are denied access to competitively priced gas supplies. As recognized by this Commission in a recent Washington Water Power rate proceeding, an LDC should "to the extent possible, make transportation service available to end-use customers without otherwise prejudicing its

obligation to provide service to its core group of sales customers." (Ex. 122, at Slip Op., p. 14).

In this case, WNG attempts to force its transportation customers back to sales service through the imposition of unduly discriminatory conditions on transportation service, coupled with an unduly discriminatory rate design proposal for large-volume sales and transportation customers. WNG's proposal must be altered by this Commission because unnecessarily severe restrictions will otherwise be imposed on transportation customers that will impede the development of a competitive gas market in Washington.

This Commission must provide WNG's customers with the legitimate option of buying their own gas. To do so, the rates and terms for transportation service must be established by the Commission on a non-discriminatory, just and reasonable cost basis. Based on a proper analysis of the costs of transportation service, as embodied in WNG's cost-of-service study, for this case the Commission should set separately stated transportation rates and price the transportation service charges under Schedules 57 and 58 at no higher than the delivery-related component of the corresponding sales schedules, according to the following blocks:

Schedule 58 (cents/therm)

First 25,000	14.01
Next 25,000	11.55
Additional	7.89

Schedule 57 (cents/therm)

First 100,000	4.17
Additional	2.97

The Company's proposed rates for large volumes sales and transportation classes is unduly discriminatory because transportation customers would be required to pay more for WNG's delivery service than similarly sized sales customers.

The Commission must also set just and reasonable operating provisions for transportation service by WNG to provide WNG customers with the opportunity to choose between reasonably priced sales and transportation services, without imposing arbitrary operating conditions whose sole purpose is to impact customers' choices between sales and transportation services. The Commission should mandate that WNG's balancing requirements mirror Northwest's monthly balancing requirements by adopting a 30-day balancing system for transportation customers under normal conditions, with a tolerance band of plus or minus 5% of the monthly nominated volumes and a make-up period of 45 days after notification of a potential penalty situation. At the minimum, the Commission must recognize that the Staff and Company's proposal is inconsistent with industry standards and that operational realities require at least 10% monthly balancing flexibility for transportation service, or interruptible transportation load will be forced off of WNG's system.

The record in this case reflects that the Company's and Staff's 3% monthly balancing requirement has absolutely no relationship to any costs incurred by the Company or any

balancing requirements of the interconnected pipeline. If this 3% balancing proposal and the Company's rate spread proposal are accepted by the Commission, the result would be that transportation service would be effectively denied because the playing field will have been so severely tilted against transportation.

B. Regulatory Reforms Are Benefitting All WNG Customers.

WNG and other LDCs in Washington have been providing transportation service to end users since 1988. The availability of transportation as an unbundled service provided by the LDCs is a vital step in completing a structural reform of the gas industry that is intended to provide consumers with choices and inject competition into the gas industry.

The regulatory reforms began in the gas industry in 1978 when Congress passed the Natural Gas Policy Act, 15 U.S.C. § 3301, et seq. and then deregulated certain categories of natural gas prices at the wellhead. In response to these new conditions in the gas industry, beginning in 1985, the Federal Energy Regulatory Commission (FERC) changed its policies governing the interstate natural gas pipeline industry to foster competition by encouraging easier access between willing buyers and sellers through its Order 436.[1] Order 436 and the following FERC Order 500 provided for open access to interstate pipeline

[1] Order 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 50 Fed. Reg. 42,408 (1985), aff'd in part and vacated in part, Associated Gas Distributors v. FERC, 824 F.2d 981 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988), on remand Order No. 500, 52 Fed. Reg. 30,334 (1987).

systems on a nondiscriminatory basis.[2] The centerpiece of FERC's program was to require pipelines to provide transportation services to all parties who desired access over the system.

Traditionally, prior to these FERC policy changes, in the State of Washington, Northwest purchased natural gas from producers and then sold the gas to LDCs, including WNG, at prices that were regulated by FERC. These LDCs, in turn, purchased the gas from Northwest and resold the gas to residential, commercial and industrial consumers.

The pro-competitive, open-access policies instituted by FERC in the 1980s, however, dramatically changed this traditional relationship between Northwest, the State's LDCs and end-users of natural gas. These "unbundling" policies allowed the LDCs to purchase natural gas directly from producers. Consequently, the LDCs no longer needed to purchase natural gas from Northwest. Rather, the LDC paid Northwest to transport the gas from the producer to the local utility's distribution system. Thus, Northwest has shifted from being a gas merchant that bought gas from producers at the wellhead and sold that gas under regulated prices at the city gate to LDCs. The interstate pipeline industry has been restructured such that Northwest is now predominantly a transporter of gas that has been purchased by LDCs and end users in a competitive market from producers and then carried by the interstate pipeline to the city gate.

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[2] See Northern Natural Gas Co., 48 FERC ¶61,232, at pp. 61,828-29 (1989) (describing policy change at FERC to allow industrial end-users to bypass an LDC).

The FERC's approach from the outset of these reforms, was to foster a regime of open-access, non-discriminatory transportation by allowing competing buyers and sellers to agree among themselves how to allocate and price the commodity.[3] To further advance these policies, in 1992 FERC released its Order 636.[4]

FERC determined that the existing regulatory structure and bundled sales service of pipelines was unduly discriminatory and anticompetitive, and therefore unlawful under the Natural Gas Act. FERC acted under Order 636 to secure a more efficient marketplace, with the underlying premise of fostering market competition to benefit all consumers. Pursuant to Order 636, each pipeline must offer open access firm and interruptible transportation that is equal in quality to the sales service provided by the pipeline.

Northwest's Order 636 compliance filing was initially approved by FERC with modifications on April 28, 1993. (Ex. 314). With this filing, Northwest proposed to terminate its sales service and to convert its remaining sales customers,

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[3] See generally Marston, "Pipeline Restructuring: the Future of Open-Access Transportation," 12 Energy L.J. 53, 53-72 (1991) (historical overview and summary of implementation of Order No. 436).

[4] Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations, Docket No. RM91-11-000, et al. (April 8, 1992), III FERC Statutes and Regulations ¶ 30,939 (1992) (Order 636), Order Denying Rehearing in Part, Granting Rehearing in Part, and Clarifying Order 636, Docket No. RM91-11-002, et al. (August 3, 1992), III FERC Statutes and Regulations ¶ 30,950 (1992) (Order 636-A), Order Denying Rehearing and Clarifying Order Nos. 636 and 636-A, Docket No. RM91-11-004, et al. (November 27, 1992) (Order 636-B).

including WNG, to firm transportation. Northwest's compliance with FERC's unbundling requirement of Order 636 and resolution of its complete sales conversion to transportation is awaiting future FERC determination. When complete, however, Northwest will cease to be a merchant of gas.

By converting to transportation service, the State's LDCs,[5] including WNG, became free to buy their own gas on the open market. These utilities have realized a significant reduction in the cost of acquiring natural gas as a result of converting from sales to transportation service. The savings have been achieved because the LDCs can purchase the commodity in an open, competitive market. All gas consumers, residential, commercial and industrial, have benefitted from the injection of competition in the market.

The FERC policy changes requiring unbundling by interstate pipelines have also resulted in LDCs no longer having complete monopolies over the sale of gas to large industrial customers. Through open access, all end-users have the ability to buy their own gas. End-users are now free to purchase gas as a commodity from an LDC or as a commodity on the open market. An LDC must therefore price its services competitively if it wants large volume customers to be sales customers. In addition, end-users

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[5] In addition to WNG, there are three other LDCs in Washington: Cascade Natural Gas Corporation; Northwest Natural Gas Company; and Washington Water Power Company.

are now free to construct and operate their own distribution pipeline systems when economically justified.[6]

The ability to purchase only transportation service from an LDC, to connect directly to an interstate pipeline, or to switch to another fuel in the current competitive market is no different than a customer's right historically to choose the type of gas sales service it may purchase or its fuel source. For example, consumers have always been free to choose among several fuels, gas, oil, wood or electricity to heat their homes. With the availability of transportation, customers simply have the option of purchasing from the LDC or purchasing gas directly from a producer and then transporting that gas over the LDC's distribution network. Transportation service is simply a disaggregated component of the traditional all-inclusive service involving the utility's "sale and distribution" of gas. The fundamental difference now in the industry is that gas against gas competition exists. All end-users have benefitted from the injection of this competition into the gas industry.

The separate provision of transportation access at the LDC level as an element of natural gas service is apparent from statistics. According to a 1990 survey by the American Gas Association, "92 percent of responding distributors had a

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[6] As part of this unbundling of services, an industrial consumer located near Northwest's interstate pipeline has an opportunity to build its own pipeline to connect its industrial facilities directly to the interstate pipeline. By directly connecting, the industrial consumer may avoid higher transportation fees charged by the LDC. See e.g., Cascade Natural Gas Corp. v. FERC, 955 F.2d 1412, 1415 (10th Cir. 1992).

transportation rate in effect, nearly five times more than the percentage reported six years earlier."[7] With Order 636, the industry nationwide is moving to an even more unbundled environment. Transportation rates have been specifically approved in most states and are nothing new in the state of Washington or in other states in the Pacific Northwest. According to a 1989 Price Waterhouse study, sixteen commissions have developed their transportation policy generically, twenty-two commissions (including the District of Columbia) have approved specific individual distributor tariffs, and thirteen had not taken any action.[8] Since 1985, "no state has resisted the general movement toward distributor transportation."[9] To the contrary the states that have acted by utility commission order and statute have encouraged transportation rates.

There has been a tendency by some parties in this proceeding to portray the regulatory reforms that have occurred in the gas industry as somehow having harmed residential and other firm customers of LDCs. To the contrary, as recognized by FERC in its promulgation of Order 636 in April, 1992, the unbundling of services in the gas industry has resulted in gas to gas competition which has benefitted all gas consumers. "This rule [Order

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[7] American Gas Association, Vol. 1A Regulation of the Gas Industry, § 17.01, at 17-5 (Supp. 1992).

[8] Price Waterhouse, "The Public Utility Industry: Local Distribution Company Bypass--Issues and Industry Responses" 23 (1989).

[9] American Gas Ass'n, Vol. 1A Regulation of the Gas Industry § 18.02(4), at 18-10 (1991).

636] will therefore reflect and finally complete the evolution to competition in the natural gas industry . . . so that all natural gas suppliers, including the pipeline as merchant, will compete for gas purchasers on an equal footing . . . . [T]his promotion of competition among gas suppliers will benefit all gas consumers and the nation . . . ." Order 636, Slip Op. at 2.

The result of this competition has been cheaper sources of gas to the consumer marketplace. These unbundled services must be appropriately priced and offered without unreasonable restrictions, however, or they skew consumers' choices between sales and transport services.

C. WNG Failed to Provide Any Lawful Justification for Pricing Transport Service Above the Rate Charges for the Delivery Component of Comparable Sale Service.

In this case, "[s]imply put, the Company is proposing to charge transportation customers under Transportation Schedules 57 and 58 a substantial premium for providing delivery services as compared to the equivalent delivery service provided to sales customers. To use a gasoline analogy, the Company is effectively trying to charge substantially more for 'self-service' than it is for 'full service.'" (Mr. Schoenbeck, Ex. T-312, at 26; Cross, Mr. Sullivan, TR. Vol. V, p. 899, l. 14 to p. 902, l.22).

The Company's pricing proposal is unduly discriminatory and hence unlawful. A simple comparison of the interruptible transportation delivery service proposed under Schedule 57 with the comparable charges for Schedule 87 illustrates the unduly discriminatory nature of the proposal. Schedule 87 is applicable

to customers purchasing sales service from WNG of about 750,000 therms per year (the annual purchase requirement), while Schedule 57 is for transportation service to customers of about 750,000 therms per year.

Pricing under Schedule 87 includes a contract volume charge of 2.5 cents/therm, applied to the greater of the annual contract volume or the actual volumes purchased during the year, and a two part declining block rate of 20.0 cents/therm for the first 100,000 therms per month and 16.0 cents/therm for all therms in excess of 100,000 therms per month. Further, as can be determined from the Company's cost-of-service study or by reviewing proposed Schedule 101, the charges include the recovery of about 17.0 cents/therm in gas commodity costs and 0.5 cents/therm in gas demand-related costs. The record evidence shows that under the Company's proposed rate structure, the effective delivery-related charge for the first block is less than four cents, and the tail block is priced below the gas-related costs assigned to the schedule. (Ex. T-312, at 28-29). It is important to note that the Schedule 87 tail block as proposed by WNG is actually priced below its calculated cost. At the same time, WNG proposes to charge a similarly sized transportation customer under Schedule 57 4.5 cents for the first block and 3.8 cents for the tail block.

Moreover, despite the Company's reduced revenue requests on rebuttal, the Company is still seeking to maintain this non-cost based disparity in large volume sales and transportation rates.

(Cross, Mr. Johnson, TR. Vol. 18, p. 3713, l. 4 to p. 3715, l. 10). Mr. Johnson agreed on cross-examination that Rate Schedules 87 and 57, and 85 and 58 were comparable in terms of the volumes being moved by blocks and that a proper analytical framework for looking at the delivery-related charge contained in the sales schedules would be to back out the commodity costs from the sales rates and then compare each block. (Cross, Mr. Johnson, TR. Vol. 18, p. 3717-3720). As evidenced in the record, this analysis demonstrates that the Company is proposing to extort a substantial premium--on average 1.6 cents/therm--for delivering volumes purchased by a Schedule 57 transportation customer as compared to providing a higher level of service to a sales customer under Schedule 87. Based on the cost-of-service study, it is evident that the transportation service charges for Schedule 57 are far above a cost-based level and that there is no cost basis that has been proven, or even offered as proof, to support setting transportation rates for Schedule 57 customers at levels that exceed the delivery-component of the Schedule 87 sales rate. This unconscionable proposal by the Company must be rejected by the Commission.

The same discriminatory result is presented with a comparison of Schedules 58 and 85. (Ex. T-312, at pp. 30-31). The Company's proposal results in Schedule 58 customers paying a transportation premium above the delivery-component of Schedule 85 of 2.17 cents/therm in the first block, 3.17 cents/therm in the second block and 5.17 cents/therm for all additional usage

beyond 50,000 therms/month. These premiums for transport service are not cost justified.

There are modest administrative differences in providing sales and transportation services to WNG's customers, but these differences certainly do not result in greater net cost in providing transportation service than in providing sales service. (Ex. T-312, pp. 31-32). To the contrary, WNG proposes providing sales customers with services that it will not be providing to transporters, which should translate into transport service being less expensive than sales service (e.g., the expense of telemetry equipment and rigorous balancing penalties that are imposed on transporters). Sales customers, on the other hand, are not required to even make daily nominations, much less perfectly match nominations and deliveries on a monthly basis. Thus, there could conceivably be a cost basis for charging sales customers a higher price for WNG's delivery service than would be charged a transportation customer, but there is no cost justification for the reverse situation, as is being advocated by WNG. (Ex. T-312, at pp. 31-32; Cross, Mr. Johnson, TR. Vol. 18, pp. 3721-3725).

> Q (Ms. Pyron). Is it true that underlying your rate design that you have advocated for 57, 58, 85, 86 and 87 is a premise on a desire to have significant interruptible sales load on system supply?
>
> A (Mr. Johnson). Yes.
>
> Q. And you carried that through in the rate design proposal?
>
> A. Yes.

(Cross, Mr. Johnson, TR. Vol. 18, p. 3725, l. 25 to p. 3726, l. 7). This degree of price discrimination between similarly situated customers without any cost basis to support that difference is unlawful discrimination under Washington law.

In Washington, utilities have an obligation to serve within the service area granted by the WUTC and to do so on terms that are non-discriminatory. See RCW 80.28.090 & 80.28.110. Utilities in the State of Washington are statutorily precluded from unduly discriminating against any customer in the setting of its rates or in any aspect of its services to its customers. RCW 80.28.090; RCW 80.28.100. It is a policy question for this Commission to determine in this case how WNG's transportation service is priced and what the terms and conditions are for this service. In making these policy determinations, however, the Commission is governed by statutes that require the terms and conditions of service to be nondiscriminatory, just and reasonable.[10]

It is undue discrimination to set different rates for similarly situated customers if there are insufficient

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[10] RCW 80.28.010(2) requires "[e]very gas company . . . [to] furnish and supply such service, instrumentalities and facilities as shall be safe, adequate and efficient, and in all respects just and reasonable." RCW 80.28.100 states that: "[n]o gas company, electrical company or water company shall, directly or indirectly . . . charge, demand, collect or receive from any person or corporation a greater or less compensation for gas, electricity or water, or for any service rendered or to be rendered, . . . than it charges, demands, collects or receives from any other person or corporation for doing a like or contemporaneous service with respect thereto under the same or substantially similar circumstances or conditions."

differences between conditions relating to the different rates.[11] Different rates which are each found to be just and reasonable will be struck down as unduly discriminatory or preferential if they treat similarly situated customers differently. See Towns of Alexandria Minn. v. FPC, 555 F.2d 1020 (D.C. Cir. 1977); City of Montrose v. Public Utilities Comm'n, 590 P.2d 502 (Colo. 1979), appeal after remand on other grounds, 629 P.2d 619 (Colo. 1981) (holding that the differences between municipal resident customers and rural customers were insufficient to justify applying a surcharge to only the residents of municipalities); Iowa Southern Utilities Co. v. Iowa State Commerce Comm'n, 372 N.W.2d 274 (Iowa 1985) (upholding the commission's rejection of a preferential gas rate for employees of a gas utility because it was neither cost-justified nor wise policy); City Gas Co. of Florida v. Florida Public Service Comm'n, 501 So.2d 580, 583 (Fla. 1987) (rate held to be unduly discriminatory since it could not be justified based on cost of service or any other permissible factor).

In this case, WNG's rate proposal results in unduly discriminatory charges for customers with identical volumes (i.e., similarly situated large volume customers) between Rate

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[11] See Earle M. Jorgensen Co. v. City of Seattle, 665 P.2d 1328, 1333 (Wash. 1983), cert. denied 464 U.S. 982 (1983)(purpose of RCW 80.28.090 is to ensure utility rates which are "just and reasonable and nondiscriminatory"); Cole v. W.U.T.C., 485 P.2d 71, 76 (Wash. 1971); ; State ex rel. Puget Sound Power & Light Co. v. Dep't of Public Works, 42 P.2d 424, 426 (Wash. 1935) (disparity between rates charged towns constituted rate discrimination which required remedy).

Schedule 58 transporters and Schedule 85 sales customers and between Rate Schedule 57 transporters and Schedule 87 sales customers. The Company's objective in seeking the authority to discriminate is clear: to force industrial customers back to sales service. The result is blatant and utterly lacking in any cost basis, and thus if adopted, would constitute unlawful discrimination.

D. The Commission Should Require WNG to Mirror the Pipeline's Balancing Provisions. If the Commission Does Not Provide for Balancing That Parallels the Pipeline's, the Minimum Monthly Balancing Tolerance Should Be at Least 10% Before Any Initial Penalty Is Imposed.

Transportation customer balancing should consist of 30-day balancing with a tolerance band of plus or minus 5% of the monthly nominated volume and a makeup period of 45 days after notification of a potential penalty situation. (Mr. Schoenbeck, T-312, at p. 39, Mr. Young, Ex. T-252, at p. 16, and Mr. Betzold, Ex. T-302, at p. 9). WNG, on rebuttal, and the Staff, however, propose a narrow balancing allowance that has no relationship to any cost incurrence by WNG or to any balancing requirements of Northwest, the interconnected pipeline.

The WNG and Staff proposal to needlessly tighten the balancing requirements should be rejected. For several years WNG has offered transportation service on its system under much less restrictive balancing terms than those it now advocates (see Ex. 42, Sheets No. 20-21 providing for a pass-through of Northwest penalties and a ten-day make-up period). If there were real costs associated with transportation customers' imbalances,

then either the Staff or the Company could readily have quantified those from the last several years. Instead, WNG and the Staff advocate a monthly balancing allowance for WNG transportation customers of only 0 to 3% in the current billing period, with immediate penalties for any imbalance volumes in excess of 3% and a requirement to balance any volumes up to the 3% level during the next billing cycle by "going through zero." If the customer fails to go through zero, another substantial penalty is proposed. These monthly penalties are proposed based upon the difference between a transportation customer's total accumulated, confirmed nominations and accumulated, actual delivered volumes.

Background on how transportation gas is nominated, confirmed and then delivered shows why the WNG and Staff proposal is unnecessarily restrictive and impractical. Each day transporters must designate the volumes of gas they desire to transport prior to the start of each gas day (i.e., the day the gas flows). The nomination is made to WNG. WNG then determines the quantity of gas it must nominate to serve its system supply customers and adds that amount to the total volumes nominated by the transporters and supplies this total nomination to Northwest. At a later time, prior to the gas day, Northwest confirms a level of nominations, which is essentially the amount of gas that each transporter is entitled to move on the pipeline system. For each gas day, every transporter's actual use will vary from the confirmed nomination for that day. The difference between the

confirmed level of nominations and actual use is the amount of the gas imbalance, either for undertakes (i.e., excess nominations) or for overtakes (i.e., excess actual deliveries). (Cross, Mr. Sullivan, TR. Vol. V, pp. 813-823). Unless there is a capacity constraint on the pipeline, there is no immediate consequence to WNG if confirmed nominations and actual takes fail to perfectly match.

The Company's penalties are proposed for any net variance at the end of the month between confirmed nominations and actual usage, whether the actual usage results in an overtake or an undertake. The proposed penalties begin at 3% variances, with greater penalties for greater variances for the initial billing cycle as follows: (1) for overtakes, no charge from 0 to 3% at the end of the month; 150% of some standard index, like the Company's weighted average cost of gas (WACOG), for imbalances from 3% to 6%; 200% of WACOG for imbalances greater than 6% to 10%; and $2 per therm for imbalances of 10% or above; (2) for undertakes, no charge from 0 to 3% at the end of the month; 67% of WACOG for imbalances from 3% to 6%; 50% of WACOG for imbalances greater than 6% to 10%; and a confiscation of all gas left on the system with a 10% or greater imbalance; and, (3) an additional penalty of $2 per therm during the next month to the extent the customer does not go through zero in that billing cycle for any accumulated excess volumes between 0 and 3% and a confiscation of that gas for any accumulated undertakes between 0 and 3% that do not go through zero. (Rebuttal, Mr. Sullivan, Ex.

T-374, at pp. 11-14). The only make-up period is for the number of days that service was curtailed during the billing period, on which days a customer is limited to his daily confirmed nominations or is subject to a penalty. (Mr. Sullivan, Ex. T-374, p. 8).

The Company's proposal on rebuttal is premised, like Staff's, upon a requirement that the customer must go through zero to get rid of a 0 to 3% imbalance or incur an onerous $2 per therm penalty. (Cross, Mr. Sullivan, TR. Vol. 18, at p. 3616, l. 22-25).

> Q (Mr. Frederickson). You mentioned a reference to a warning ticket. Is that somewhere in the staff presentation that there would be in effect some grace or one chance for a dog to have a bite before it is subject to a penalty?
>
> A (Mr. Buckley). No, that's the 3 percent range.

(Cross, Mr. Buckley, TR. Vol. 11, p. 2050, l. 22 to 2051, l. 2).

The Company's proposal is unreasonable from technological, efficiency and practical perspectives and is unduly discriminatory as a result of its total lack of cost basis or any other operational necessity.

> Q (Ms. Pyron). On page 22 of your testimony at lines 18 and 19, you state: "By necessity these charges are not and should not be cost based." Would you agree that the company's proposal for balancing on rebuttal doesn't have any cost basis to it?
>
> A (Mr. Sullivan). That's correct.

(Cross, Mr. Sullivan, TR. Vol. 18, p. 3635, l. 11-17). To quote Staff Witness Buckley on cross-examination: "I would say that

it's not a cost-based penalty." (Cross, Mr. Buckley, TR. Vol. 11, p. 2050, l. 11-12).

From a practical perspective, the requirement to pass back through zero with 0 to 3% imbalances in the second month will cause a spiking of overnominations and undernominations at the first of every month. Operationally this type of proposal has to create more problems on the LDC system than a tolerance band of 5% band that mirrors Northwest's balancing requirements.

> Q (Mr. Frederickson). So in effect in some fashion what staff is proposing, without dealing with a mechanics of it, there has to be a daily score kept on the deliveries and the nominations in order to determine how the penalty is going to be applied with respect to the first billing period; is that correct?
>
> A (Mr. Buckley). Yes, in the form of kind of a cumulative keeping of records so that it knows if zero is being approached or when zero is approached on a daily basis. I think as we discussed in deposition that there would be some mechanism that the customer would be notified that they have under- or overtaking to make up for their deficiency from the previous month . . . .
>
> Q. If you assumed a customer at the end of a month is out of balance in the range of a plus 3 to a minus 3 percent, wouldn't it be reasonable for that customer in month two to zero out as soon as possible to be sure that no penalty was imposed?
>
> A. I think it would be in his best interests to do that or whether to try to spread that out over the month -- from a customer standpoint I am looking at his thinking I guess I would prefer to get to zero so that I know where I stand than take the chance of trying to purposefully over nominate or under nominate in an equal value per the month and try to match that way. I guess from an operational standpoint if that's possible but

> to me I would think that would be a prudent think to do.
>
> Q. At least from a theoretical standpoint the customer has a monkey on its back and the sooner it gets it off by hitting zero then it can go on and worry about other problems?
>
> A. Yes, and realizing it makes a difference about what temperature it is at the time and whether they can get there, I am sure they would have something to do with it, the available capacity to bring it in.
>
> Q. From the company's perspective it would encounter sharp overruns, sharp over nominations or sharp undernominations from a reasonable customer attempting to zero out as soon as possible, would it not?
>
> A. I think under our provision that it would have to . . .

(Cross, Mr. Buckley, TR. Vol. 11, p. 2056, l. 6 to p. 2058, l. 4). Mr. Buckley admitted on cross-examination that hitting a tolerance band would mean the compensating nominations would not be as severe as if the customer is being forced to cross through zero. (Id., pp. 2058-2059).

The Company and Staff's balancing proposal ultimately means that an industrial customer will very likely burn less gas. (Cross, Mr. Young, TR. Vol. 11, p. 2153, l. 9-13). This kind of restriction on transportation service creates an artificial incentive to use less gas at the end of the month because to avoid penalties an end-user will be compelled to base load with gas and meet daily swings in its energy needs with alternative fuels, like oil. In addition to this base loading with a minimal amount of natural gas, the Company's balancing proposal fosters an artificial incentive to directly connect to Northwest's

interstate pipeline because Northwest allows greater flexibility. (Cross, Mr. Young, TR. Vol. 11, pp. 2151-2153). Mr. Young aptly described the operational realities of balancing: "[I]t's a matter of degree and if I used the pipeline for the basis for that, yes you should try and balance, and I call it chasing the snake. You're always chasing a goal that moves on you day to day. So, yes it's desirable to balance, but there is a matter of degree of how close you can get." (Cross, Mr. Young, TR. Vol. 11, p. 2142, l. 16-22).

It is also technologically impossible for a customer to comply with the Company balancing proposal without incurring penalties. As set forth by example in Exhibit 245, if a customer that uses 300,000 therms per month is 2% out of balance in the first month, (assume a 6,000 therm overnomination of gas) and then balances perfectly on a daily basis during the second month, the Company and Staff's balancing proposal would impose a $2 per therm penalty, resulting in a total $12,000 penalty assessment to that customer at the end of the second month. (Cross, Mr. Sullivan, TR. Vol. 18, p. 3620). The error built into both WNG's and Northwest's current tariffs is 2 percent in recognition that metering equipment on both Northwest's system and WNG's system cannot be more precise than 2%, even for actual billing purposes. (Id., at 3621). Thus, WNG is trying to impose balancing requirements that are only 1 percent over the current billing error tolerance that is necessary due to the inherent inaccuracies of gas metering equipment. It is outrageous to

penalize transporters for imbalances that could be billing error within this industry standard and still require a restrictive and operationally counterproductive requirement to pass through zero in the second month for any 0 to 3% imbalances. Up to 2% doesn't count for billing but it does for this balancing proposal.

WNG does not even have the necessary equipment in place in order to enable a customer to stay absolutely in balance every thirty days. Only about 6 out of 40 to 50 current transportation customers have telemetry equipment installed, and installation for other customers will take time. (Cross Mr. Sullivan, TR. Vol. 18. pp. 3637-3638). As Mr. Sullivan admitted:
Q (Ms. Pyron: "3 percent would be about one day out of a month?
A (Mr. Sullivan): That's one day." (Id., at l.25 to l. 2). Yet the Company proposes only notifying its transportation customers once per week as to their imbalance status. (Id., at p. 3636, l. 1-7). At the same time, a transporter must make nominations on Thursday for the gas to be used on Friday, Saturday and Sunday. (Cross, Mr. Sullivan, TR. Vol. 18, p. 3653, l. 17-20). What if an industrial plant has minor operational problems for just a couple of days or what if the weather gets colder and it takes a little more heat to make the plant warmer for the people who work there on a Saturday? Under WNG's and Staff's proposal, any imbalance greater than one day's usage will cause the customer to incur severe penalties.

Northwest's current tariffs, at Ex. 128 and proposed tariffs (Ex. 125) accepted by FERC in its restructuring proceeding

(April 28, 1993, order at Ex. 314) provide 30-day balancing with a tolerance band of plus or minus 5% percent and a make-up period of 45 days after notification before WNG incurs any balancing penalty. All transportation customers pay for this balancing service because of the storage service embedded in Northwest's transportation rates. The substantial diversity among WNG's transportation customers allows for monthly balancing provisions under NWIGU's proposed method at no cost to WNG.

Any penalties that result to WNG's customers should be parallel to Northwest's and thereby structured so that the total expected penalties equal the total expected impact of transporter imbalances on the system. (Ex. T-312). The record evidence in this proceeding is that on some occasions a transporter's imbalance benefits the system rather than harming it. On any given day, WNG can be out of balance from its nominations to serve its sales customers and their actual consumption because of a variation in weather from that forecast. WNG then receives the benefit in reducing its Northwest delivery point imbalance by virtue of a transporter's imbalance. Over deliveries by some transportation customers can also be offset by the under deliveries to other transportation customers in any month and on any given day. Yet, WNG would collect penalties from two customers whose minor imbalances may have cancelled each other out.

Daily balancing is not required on Northwest's system. (Cross, Mr. Sullivan, TR. Vol. 18, p. 3623, l. 19-24).

Mr. Sullivan admitted that Northwest's tariffs provide a balancing service, including line pack and storage, that all transporters pay for within their pipeline transportation charges, such that no penalties are imposed on WNG outside of a 45-day make-up period with a 5% monthly imbalance tolerance:

> Q (Ms. Pyron). Are you aware of the pipeline's compliance filing in its restructuring including again the same 45-day balancing with a 5 percent tolerance since your original examination?
>
> A. Yes, I am.
>
> Q. So, it is true that, not only the current tariffs, but as well the pipeline's proposed tariffs include the same monthly balancing provisions? Is that true?
>
> A. That's correct . . . .

(Cross Mr. Sullivan, TR. Vol. 18, p. 3625, l. 2-11). On a non-entitlement day--i.e., a regular operating day (an entitlement day is a pipeline declared daily balancing day for all subject to a $2 per therm penalty for not so balancing when the system requires it), WNG does not incur any penalties for it or transporters behind its delivery point being out of balance collectively and in fact has several viable options that do not cause any costs to WNG:

> Q (Ms. Pyron). Looking at this, you referenced an operation flow order earlier in your testimony, what is an operational flow order from the pipeline?
>
> A (Mr. Sullivan). They would indicate to shippers on the system, either to deliver more gas into Northwest Pipeline or to have the ability to take more gas off Northwest Pipeline.

Q. Does that carry any penalties at all from the pipeline if you don't comply?

A. They could issue entitlements.

Q. But does it carry a penalty?

A. Not that I'm aware of.

Q. Carry any costs to Washington Natural Gas?

A. Not that I'm aware of . . . .

Q. And if an entitlement day is called by the pipeline, then what does that mean for Washington Natural Gas?

A. That we would be held to our confirmed nomination.

Q. Just for that day; is that correct?

A. That's correct.

Q. And that would also be true for each transportation customer, would it not?

A. That's correct . . . .

Q. Isn't it true that an individual transportation customer, if he took unauthorized gas during an entitlement day, would get a $2 per therm penalty?

A. That's correct.

Q. But other than on an entitlement day, let's assume a non-entitlement day, what is Washington Natural Gas's response to an operational flow order?

A. To either bring more gas into the Northwest Pipeline system or to take more gas off than we're having delivered to it.

Q. Could you simply adjust your nominations for the next day?

A. That's one of them.

Q. If you're buying more gas, are you doing so for your system supply customers?

A. It's possible . . . .

Q. . . . . On any given day in advance of the gas day, on the day--Can we define that as the day the gas is going to move?

A. Yes . . . .

Q. -- and you as Washington Natural Gas on your receipt point from where you received the gas from Northwest Pipeline, you accumulate the nominations of the various transporters behind your city gate; is that correct?

A. That's correct.

Q. Then you add to that what you think you need for your system supply customer; is that correct?

A. That's also correct.

Q. And that involves some weather-based estimate for your sales customers, depending on the time of year; correct?

A. That's correct . . . .

Q. Can you just use the line pack on Northwest Pipeline's system?

A. It is possible. But if everybody did that, Northwest Pipeline would issue operational flow orders. There comes a point in time when the deliveries into Northwest Pipeline must match the deliveries off the system . . . .

(Cross, Mr. Sullivan, Vol. 18, p. 3625, l.18 to p. 3630, l. 15).

That time comes and is enforced by the 5% monthly tolerance and 45-day make-up period on Northwest unless there is a problem with operations on the pipeline for which all transporters, including WNG and its transportation customers, must go to daily balancing

or pay $2 per therm for unauthorized gas. NWIGU does not object to strict enforcement of balancing requirements on entitlement days. But, under WNG's proposal, WNG can steal the balancing service that WNG's transportation customers are being provided by Northwest on non-entitlement days, a service those customers are paying for on the Northwest system:

> Q (Ms. Pyron). On the Northwest Pipeline system, Washington Natural Gas and all transporters on that system are paying for the available balancing on that system, that line pack that's there?
>
> A (Mr. Sullivan). Not just line pack. There is storage costs that are all embedded in the transportation rate. We have established again this --
>
> Q. That's embedded in the transportation rate; correct?
>
> A. Yes.

(Cross, Mr. Sullivan, TR. Vol. 18, p. 3632, l. 5-14).

By placing more onerous restrictions on WNG's system downstream of Northwest's city gate, WNG tries to take advantage of what the transporters have paid through Northwest's transport rates for service to that city gate. Normal monthly balancing must be distinguished from pipeline entitlement days. On a declared pipeline entitlement day, pipeline operational problems dictate daily balancing after appropriate customer entitlement notification due to the risk of an entitlement day penalty for every affected pipeline customer. For normal operations, however, the substantial diversity among WNG's transportation customers allows for monthly balancing provisions under NWIGU's

proposed method at no cost to WNG. This load balancing for WNG's transportation customers of up to 5% of monthly nominated volumes should be ordered as a necessary component of transportation service to WNG's customers' with zero net cost to WNG. No credible quantitative evidence has been offered by the Company or Staff to demonstrate that WNG incurs any costs as a result of providing this type of load balancing service to its transportation customers, so long as WNG does not incur a penalty itself from Northwest. Balancing of up to 5 % of monthly volumes should thus be allowed within the transportation rates without any penalty. (T-312).

If WNG receives an operational flow order on a non-entitlement day from Northwest, WNG should notify the transporters behind its system. As admitted by Mr. Sullivan: "Q (Ms. Pyron). Is it your testimony that you're backing up the transportation customer's gas supply? A (Mr. Sullivan). No." (Cross, Mr. Sullivan, TR. Vol. 18, p. 3623, l. 6-8). WNG does not buy gas for these transporters to back up their supply. If WNG has operational problems separately on its own distribution system, it can limit its transporters due to such capacity curtailment. (Cross, Mr. Sullivan, TR. Vol. 18, p. 3633).

Moreover, a balancing provision that mirrors the pipeline is consistent with the basic premise of unbundled transportation service. The activity of supplying gas is separated from the activity of moving that gas. Once the activity of supplying gas is shifted from the utility to the customer, that customer is

taking on the risks of uncertainty and variability of supply that previously the utility has assumed. As long as the customer is willing to take on those risks, the utility should not be obliged to provide those services unless the customer is willing to pay for them. Conversely, the customer should not be obliged to pay for services if he does not want them. WNG's transportation customers are not seeking backup from WNG's system supply. The basic premise of transportation service is that the utility's monopoly on distribution services does not give it the right to prevent customers from purchasing cheaper gas supply elsewhere. Otherwise, the customers who are forced to purchase expensive services that they do not want have a great incentive to find alternatives. This can lead to producers directly connecting to Northwest, temporary fuel switching or to customers changing permanently to an alternate source of energy. (Ex. T-312).

The Company should assess a balancing charge only if one is incurred by the Company as a result of the customer's imbalance. This is equitable since it is simply a passthrough of the penalty paid by WNG to the interstate pipeline for balancing service and has been recently approved by this Commission in Washington Water Power's last rate proceeding. (Ex. 122).

It is unreasonable for an LDC to have a balancing provision more onerous than that which is imposed by the interconnected interstate pipeline. The existence of industrial transportation, with its associated high load factor, actually reduces the potential for an LDC like WNG to incur balancing payments on its

own volumes of gas. This occurs since the pipeline's balancing penalty provisions are based on the entire throughput of the particular LDC--both sales and transportation volumes. It is extremely difficult, if not impossible, to accurately estimate the day-to-day loads of temperature sensitive classes because of the inability to predict weather conditions. Industrial loads, on the other hand, are much less sensitive to weather, and production swings are usually known in advance. Having industrial transportation throughput on the system effectively results in a wider tolerance band for the temperature sensitive sales load of any LDC, including WNG.

Daily usage obviously will fluctuate to some extent even though deliveries of the transportation customers' gas to the utility are typically a fixed amount per day. Load balancing refers to the utility absorbing these relatively small and temporary imbalances. Daily load balancing is an integral and necessary part of transportation service, and the record in this case reflects that it does not really impose any material additional cost to the utility because there is likely to be diversity among users (for example, some customers might be over and some under on any particular day), and the transportation and distribution mains themselves serve as a limited capacity short-term storage device.

The Company and Staff's unreasonable and admittedly non-cost based balancing penalties are a transparent attempt to collect revenues when no costs have been incurred by WNG, and ultimately

to force transportation customers back to WNG sales service. The balancing provisions are so unworkable that most customers would be forced to abandon transportation as an alternative to purchasing bundled sales service.

It is fundamental for this Commission to draw appropriate distinctions between monthly balancing and daily entitlements and to carry these distinctions through in WNG's tariffs. Firm sales customers and firm transportation customers are purchasing equivalent distribution service reliability. It would be inappropriate to discriminate against either group at the expense of the other. A distinction has to be made in WNG's tariffs between curtailment because of inadequate gas supply and curtailment because of inadequate delivery system capacity. Because transportation customers supply their own gas, they should not be curtailed if the distributor's gas supply is reduced. When there is a capacity limitation on the interstate pipeline system and transportation customers have been appropriately notified that entitlement conditions restrict their use of customer-owned gas acknowledged by Northwest for delivery, it is reasonable to require balancing on a daily basis on the LDC system with a penalty comparable to that actually imposed on the LDC by the pipeline. To the extent that WNG incurs localized operational problems on its own distribution system on a non-entitlement day for the pipeline, its own tariffs could contain WNG entitlement periods that encompass not only Northwest entitlement days but also the ability for WNG to declare segment

specific daily entitlements on its system for downstream capacity constraints with appropriate advance notice to its transportation customers on that segment of its system.

This Commission should require WNG's tariffs to reflect adequate notice of a penalty before one can be imposed. Specifically this Commission should order that when a transportation customer's cumulative imbalance in any month is more than 5 percent above or below total nominations for that month, WNG should notify the customer no later than the 15th of the following month. Upon notice from WNG, the customer should be given 45 days to eliminate any imbalances. If the customer remains in a penalty situation at the end of 45 days, an appropriate penalty should be applied to the excess over 5 percent of any remaining imbalance. If a customer's cumulative imbalance comes within the 5 percent allowance, or if the imbalance has moved from negative to positive or positive to negative at the end of a billing month within the balancing period, no penalties should be assessed.

At the minimum, the Commission must recognize that operational realities require at least a 10% monthly balancing tolerance for transportation service under a proposal like Staff's and the Company's. Ten percent tolerance represents only three days of gas usage. Industry standards for 10% monthly balancing have been recognized in other jurisdictions for LDCs, including the New Jersey Board of Regulatory Commissioners for Public Service Electric and Gas Company (1992 Westlaw 510936),

(Docket No. ER91111698J, Slip Op. Dec. 30, 1992) (approving stipulations, including 10% transportation customer balancing reflected on Rate Schedule TSG-NF, Non-Firm Transportation Gas Service Original Sheet No. 63)), and the California Public Utility Commission for both Pacific Gas and Electric and Southern California Gas Company (In re Rulemaking on the Structure of Gas Utilities' Procurement Practices and Refinements to the Regulatory Framework for Gas Utilities, 118 P.U.R.4th 1, 38 & 47 (Calif. PUC 1990); Order Instituting Rulemaking on the Commission's own Motion to Change the Structure of Gas Utilities' Procurement Practices and to Propose Refinements to the Regulatory Framework for Gas Utilities, 1991 Cal. PUC LEXIS 43, 48, 39 CPUC 3d 321 (1991)).

Further this Commission must require that any penalties have to be structured without them being confiscatory. For imbalances greater than 10%, penalties should be no more than 125% of WACOG for overtakes not zeroed out in the next month or 75% for undertakes not zeroed out. NWIGU agrees that penalties should be high enough to give customers a strong economic incentive to stay in balance. Unauthorized use penalties of $2 per therm are beyond the level of providing a strong incentive, and instead are simply punitive. Penalties of that magnitude are more likely to force industrial transportation off of WNG's system than they are to encourage responsible management of transporters' nominations and takes.

E. The Commission Should Also Make Appropriate Modifications to the Company's Proposed Transportation Rate Design Proposal on the One Year Service Election, Telemetering Costs, Minimum Bill or Throughput Requirements and Balancing Aggregation.

In addition, the Commission should set just and reasonable operating provisions for transportation service by WNG with appropriate modifications to the Company's proposed rate design to include: (1) the aggregation of sites for balancing purposes for a single customer with multiple sites on the same city-gate, a concept also supported by PERCC (Cross, Mr. Betzold, TR. Vol. 13, p. 2723); (2) the limitation of telemetering costs to one-time only charges for equipment with upgrades to be borne by WNG; and, (3) to otherwise determine that all provisions requiring a minimum annual throughput or annual minimum bill be cost-justified by WNG. The Commission should approve only cost-based rates and cost-based minimums to provide WNG customers with the opportunity to choose between reasonably priced sales and transportation services, without using non-cost based priced differences to impact the customers' choices.

The Company's proposed one year contract period for transportation service is reasonable only if WNG's cost-of-service approach and NWIGU's recommended rate design for large volume sales and transportation customers is adopted by the WUTC. Without a proper cost study and non-discriminatory rate design, transportation customers would be effectively paying for services to which they do not have access, and should therefore not be

precluded from switching between sales and transportation services.

Provisions requiring a minimum annual throughput or annual minimum bill for transportation service should only be approved by the Commission to the extent there is an actual proven cost justification by WNG. The Company's proposed 240,000 therm minimum for transportation service is not supported by the Commission Staff (Cross of Mr. Buckley, TR. Vol. 11, p. 2044 to 2045). This minimum results in the exclusion of a small number of current transportation customers under current WNG Schedules 31, 36, 41, and 86 without any justification or quantitative evidence for the 240,000 annual throughput requirement. (Ex. T-312, p. 36). The Staff's proposal for a monthly customer charge of $500 for Schedule 57 and $200 for Schedule 58 should be equally rejected by the Commission because even the proponent of the charge admitted on cross-examination that it had no cost-basis (Cross, Mr. Buckley, TR. Vol 11, pp. 2032-2033).

The Commission should also require that any telemetering costs for transportation service customers be limited to a one-time charge for equipment with any equipment upgrades to be borne by WNG. The Company's proposal does not set any limits on the customer's cost exposure, frequency of equipment upgrades that may be imposed, or requirement that any new equipment not be duplicative of that already in place to serve that customer. WNG's requirements are equivalent to a hidden surcharge for transportation service. This blank check approach for charging

for telemetering costs for transporters should not be allowed by this Commission, especially since the Company is installing the identical equipment without charge for Schedule 87 sales customers (Cross, Mr. Sullivan, TR. Vol. 18, p. 3642). Upon cross-examination during rebuttal, the Company's transportation policy witness agreed that NWIGU's limitation of telemetering costs to a one-time only charge was reasonable:

> Q (Ms. Pyron). So, you wouldn't have a problem limiting the telemetry requirement as a result of this case to a one-time only charge. And if you want to do something else later, come back in to this Commission to ask for it?
>
> A (Mr. Sullivan). I think that's our intention.

(Cross, Mr. Sullivan, TR. Vol. 18, p. 3641, l. 5-10).

VI. CONCLUSIONS AND PROPOSED FINDINGS OF FACT

NWIGU urges the Commission to make the following findings, and in doing so, to adopt WNG's cost-of-service study with appropriate allocations for any legitimate safety program expenses, to adopt NWIGU's recommended rate design for large volume sales and transportation service, and to adopt a balancing proposal that appropriately mirrors the actual pipeline penalties incurred by WNG.

The Commission should make the following findings of fact:

1. Under the circumstances of this case, WNG's requested attrition adjustment is denied. Present economic conditions facing WNG do not justify an attrition adjustment that enhances the Company's opportunity to produce a targeted level of earnings, particularly in light of the present low rate of inflation in the costs of operations and the fact that the Company has increased customer demand for services.

If WNG's future investments result in actual overall earnings below the Company's authorized rate of return, the Company can then choose to reduce its expenses, enhance its revenue or request a general rate increase at that time.

2. WNG's ratepayers should not subsidize WNG's non-utility operations or the ventures of its affiliates. Whether or not WNG forms a new separate subsidiary for its Merchandising business in the future, for this rate case, the Commission accepts the adjustments identified by Arthur, Anderson under Scenario A (Ex.T-323) for $8.6 million in allocations to the Merchandising segment of WNG's operations and for $900,000 in allocations to other affiliates of WNG. If WNG forms a new Merchandising subsidiary, appropriate adjustments may be made in a future rate case to reflect known and measurable allocations at that time.

3. WNG's proposed Safety Tracker is rejected. The proposal runs counter to sound regulatory policies. WNG has failed to demonstrate the need for extraordinary treatment of its claimed safety expenses as a surcharge above its normal revenue requirement. WNG has estimated that it will take 15 years to complete its safety program expenditures. Over time, as WNG incurs safety program related expenses, these expenses for providing distribution service should be addressed as part of the Company's revenue requirement in future rate cases and allocated under WNG's cost-of-service study. Any prudently incurred, known and measurable safety program expenses from each test year shall be evaluated for purposes of determining the Company's revenue requirement. The Commission will give due consideration to such expenses when they are shown in the future by the Company to be known and measurable with reflection of all offsetting benefits including reduced future maintenance.

4. The Company's request for an environmental working capital allowance for the carrying costs associated with its environmental remediation expenses for certain manufactured gas plants operated in the past by WNG will not be allowed at this time. Prior to collecting these costs through rate charges, WNG must first pursue recovery of these costs through its pending insurance claims. The Commission authorizes continued deferral of carrying costs incurred after January, 1991 (the beginning of the test year for this rate case) as in the best interest of WNG ratepayers, but will not allow recovery in this case or in any

future rate case for expenses incurred from 1984 through 1990. Expenses incurred before the test year have never received authorization for deferral account treatment and may not be recovered from WNG's current or future ratepayers.

5. With removal of the Safety Tracker and allocation of any allowed expenses as distribution-related expenses, the cost-of-service principles employed by WNG as reflected in Exhibit 153 are adopted by this Commission as an appropriate foundation for determining class cost responsibility in this case and in future local distribution company rate proceedings. The Commission rejects Staff's proposed modified "Cascade" (Johnson-Herbig) model from Docket No. U-86-100 because the conditions that existed when the Cascade model was adopted are no longer applicable to WNG in this case. The Commission finds that WNG's method is a sound and accurate embedded cost study approach with its direct assignment of the costs of distribution mains based upon size according to appropriate detailed studies and the direct assignment of distribution plant to Schedules 85 and 87. The Commission approves of the allocation of demand-related costs upon a peak design day for firm customers, and finds the imputed load factors for interruptible sales classes to be a reasonable basis for cost allocation. By assigning costs in this manner, the cost allocation process appropriately recognizes the lower quality of service provided to interruptible customers and that in non-peak weather conditions, both firm and a substantial amount of interruptible throughput can be serviced. The Commission also approves of the assignment of all direct gas-related costs, both commodity and fixed costs, to sales customers. The Commission finds that no gas-related costs, neither demand charges nor commodity costs with the exception of lost and unaccounted for gas costs, should be assigned to transportation customers.

6. The Commission rejects the Staff's proposed limitation of transportation service to be offered only as firm transportation with credits for curtailment and approves the offering of interruptible and firm transportation service and firm and interruptible sales services that are unbundled, appropriately cost-based and offered on non-discriminatory terms of service to WNG's customers.

7. The Commission finds that the Company's rate spread proposal for large volume sales and transportation customers is fundamentally flawed in requiring

transportation customers to pay more than similarly sized sales customers and rejects the Company's rate spread proposal for large volume sales and transportation customers as unduly discriminatory.

8. For this case, the Commission will set the transportation service charges under Schedules 57 and 58 at no higher than the corresponding delivery-related service included in the sales tariffs under Schedules 85 and 87. The Commission therefore determines that the just and reasonable, non-discriminatory separately stated transportation rates under Schedules 57 and 58 shall be set according to the following declining block rate schedules:

Schedule 58 (cents/therm)

First 25,000	14.01
Next 25,000	11.55
Additional	7.89

Schedule 57 (cents/therm)

First 100,000	4.17
Additional	2.97

9. The Commission approves the Company's proposed one year contract period for transportation service as reasonable in conjunction with WNG's cost-of-service approach and NWIGU's recommended rate design for Large Volume Sales and Transportation customers adopted in paragraph 8.

10. The Commission finds that all provisions requiring a minimum annual throughput or annual minimum bill for transportation service should only be approved by the Commission to the extent there is an actual proven cost justification by WNG. Accordingly the 240,000 therm limit for transportation service is rejected as are the Staff's proposed customer charges for Schedules 57 and 58. The minimum transportation volume should be set to allow all current WNG transportation customers under current WNG Schedules 31, 36, 41 and 86 to continue receiving service under Schedule 58.

11. All telemetering costs for transportation service customers shall be limited to a one-time charge for equipment. Any equipment upgrades should be borne by WNG.

12. The Commission rejects the Company's and Staff's 3 % monthly balancing proposal for transportation customers as unreasonable because it bears no relationship to any operational constraint or cost incurrence faced by the Company or any balancing requirements WNG must meet from its interconnected pipeline. The Commission adopts a 30-day balancing for transportation customers under normal conditions as follows. When a transportation customer's cumulative imbalance in any month is more than 5 percent above or below total nominations for that month, WNG should notify the customer no later than the 15th of the following month. Upon notice from WNG, the customer should be given 45 days to eliminate any imbalances. If the customer remains in a penalty situation at the end of 45 days, an appropriate penalty mirroring the current Northwest Pipeline Corporation penalty should be applied to the excess over 5 percent of any remaining imbalance. If a customer's cumulative imbalance comes within the 5 percent allowance, or if the imbalance has moved from negative to positive or positive to negative at the end of a billing month within the balancing period, no penalties should be assessed.

13. The Commission further finds that single customers with multiple sites on the same city-gate of WNG shall be allowed to aggregate their volumes for purposes of compliance with the balancing provisions for transportation service.

The Commission should adopt the above findings of fact and resolve the revenue requirement, cost of service and rate design issues as urged by NWIGU.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all parties of record in this proceeding by placing a true copy of the document properly addressed to each party in the United States mail first class postage prepaid.

Dated at Portland, Oregon, this 10th day of August, 1993.

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