Exhibit ___ (JL-T-Rebuttal)

Before the
Washington Utilities and Transportation Commission

Northwest Natural Gas Company General Rate Case
Docket No. UG-000073

Rebuttal Testimony of

Jim Lazar
Consulting Economist

On Behalf of
Public Counsel

September, 2000

I. INTRODUCTION

Q. Please state your name, address, and occupation.

A. Jim Lazar, 1063 Capitol Way S. #202, Olympia, Washington, 98501.

Q. Are you the same Jim Lazar who submitted direct testimony in this proceeding?

A. Yes.

Q. What exhibits are you sponsoring in this rate design testimony?

A. There are two exhibits, denoted Exhibit ___ (JL-REB-1) and ___ (JL-REB-2). The first shows the daily cost of gas at the Canadian border over a recent two-year period. The second computes the appropriate level of increases for each customer class, based on the Staff revenue requirement and a uniform percentage of margin rate spread.

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

A. There are five points I address in rebuttal. The first is a correction to my direct testimony on rate design, where I made one error in interpreting the Company?s cost of service methodology. The second is to indicate my continuing concern with a couple of elements of the Staff cost of service study. The third is it indicate that the Staff cost of service study, despite its minor shortcomings, is a reasonable guide to the relative cost of serving NWNG?s customers. The fourth is to recommend rejection of the staff-proposed rate spread, and urge the Commission to adopt a different rate spread which I believe is justified by the staff cost of service study. The last is to address the staff?s proposed 1.5% late fee.

II. CLASSIFICATION v. ALLOCATION IN COMPANY AND STAFF COST OF SERVICE STUDIES

Q. What was the error in your original testimony?

A. At pages 6-9 of my rate design testimony, I criticize the Company for having misclassified certain costs, including administrative and general costs and storage costs. I further asserted that this misclassification led to improper allocation of these costs between customer classes. Staff witness Dr. Mariam has assisted me in understanding the Company?s cost of service model, and I now understand that while the Company (and staff) have misclassified these costs, they have both applied allocation factors which follow the previous direction of the Commission with respect to these type of costs. Therefore, while my original statement about misclassification is accurate, and this should be corrected in future cost studies, the concern I raised about misallocation is apparently incorrect.

Q. How does this error in misclassification manifest itself in the results presented by the Company and Staff?

A. This problem is primarily manifest in the calculation of unit costs for ?customer,? ?demand,? and ?energy? in the presentations of Mr. Ferguson and Dr. Mariam. For example, Mr. Ferguson?s calculation of customer-related costs of $24.90, shown in

Supplemental Exhibit 10 (FPF9), is severely affected by the misclassification of costs; only a small portion of these costs are actually customer-related, and I have calculated the correct customer-related costs in my direct testimony. Similarly, Dr. Mariam?s exhibit YKGM-4 reflects the same problem of classification.

This error only affects the distribution of costs between the demand, customer, and energy categories; in the case of Dr. Mariam?s exhibit, it does not appear to affect the overall rate of return, nor the revenue to cost ratio which Mr. Russell develops.

Q. What should the Commission do in order to not be misled by this error in classification of costs?

A. The Commission should completely disregard the unit costs developed by the cost of service studies for demand, energy, and customer categories. As I discuss below, with a couple of minor exceptions, the overall results of Dr. Mariam?s study are generally reasonable, and should be relied on for rate spread purposes. Mr. Russell has largely ignored the unit cost results in his rate design recommendations, and the Company?s original rate design proposal did not reflect these unit costs.

III. STAFF COST OF SERVICE STUDY LEAVES MINOR CONCERNS

Q. Please turn to the second area of your rebuttal testimony, the staff cost of service study. Should it be relied on by the Commission?

A. While it is generally reasonable, the staff study contains two areas where I would take exception, and so it should not be relied on as a precise measurement of the relative cost of serving the customer classes. The first area of concern is the treatment of storage costs; the second area is the treatment of customer service, information, and sales expense.

Q. Begin with the treatment of storage rate base and expense. How has staff treated these costs?

A. Staff has allocated these costs on the basis of incremental winter volumes. The effect is that none of these costs are allocated to transportation customers. Since transportation customers benefit from storage, in the role it plays in providing balancing service, this has the effect of assigning too little cost to transporters, and too much cost to sales service classes.

Q. What methods have other utilities proposed and the Commission accepted with respect to classification and allocation of storage costs?

A. In Docket UG-940814, Washington Natural Gas, now a part of Puget Sound Energy, proposed, and the Commission accepted, treating 20% of these costs are relating to balancing, and allocated among all classes on a usage basis, and 80% as serving the winter seasonal needs of sales service customers. In Docket UG-901459, Washington Water Power proposed classifying these costs as 77% commodity-related, and 23% demand-related; Avista proposed the same methodology in their pending rate case, Docket UG-991607. In the latter case, Staff, together with Public Counsel and NWIGU reached agreement on a rate spread methodology without addressing the cost of service study particulars.

Q. Why should a portion of the costs of storage be assigned to balancing?

A. The Company provides transportation customers with the flexibility to take somewhat more or less gas, on a daily basis, than their gas supplier actually delivers to the Company. Other types of transportation service do not offer this option, and this flexibility has value. In other proceedings, the Commission has ruled that some costs must be assigned to this service, and a portion of storage was treated as balancing-related in the WNG proceeding, UG-940814. Staff has previously supported the assigment of storage costs to transportation service, in order to have the costs of providing balancing service accurately included.

Q. Why should a portion of the costs of storage be assigned to commodity?

A. The cost of gas varies significantly from day to day and from month to month. My Exhibit _____ (JL-REB-1) shows the daily cost of gas at Sumas over a recent two-year period. Storage allows the Company to buy gas when it is cheap, and to sell it when it is more valuable. Customers using gas during the higher-cost months pay a lower price because of the presence of storage (for which they also pay a premium, in the form of the cost of the storage facilities), and it is therefore appropriate to treat a portion of these costs as commodity-related. Otherwise the benefits, but not the costs, of the storage facilities are enjoyed by customers whose seasonal use does not lead to a direct allocation of the costs of storage facilities.

Q. What would the impact be of using the WNG or Avista methods for classification and allocation of storage costs?

A. A larger percentage of these costs would be allocated to the transportation customers if a portion were treated as balancing costs. A larger percentage of these costs would be allocated to the lower load factor classes if a portion were treated as commodity costs. In both cases, the residential class would be allocated fewer costs.

Q. Turning to the treatment of customer service, customer assistance, and sales expenses, what method has the Staff used?

A. Staff has treated these costs as 100% customer-related.

Q. What method has the Commission previously approved for allocation of these costs?

A. The Commission approved the staff proposal in the Cascade proceeding, U-86-100, to treat these costs as 50% customer-related, and 50% commodity-related. In the WNG UG-940814 proceeding, the Company proposed a 100% customer-related classification of these costs. In the 7th Supplemental Order in that proceeding, the Commission explicitly clarified that it had NOT adopted the Company proposal:

> *?As to the other accounts [907, 909 - 916], the Commission has made no prescription for the parties to follow. As both Public Counsel and Commission Staff note, the parties should look for guidance to determinations made in earlier orders, such as Commission orders in the Cascade (U-86-100) and Washington Water Power Company (UG-901459) cases. Should these*

accounts remain an issue among the parties in future proceedings, they can bring the question to the Commission.? [Ug-940814, 7th Supp. Order. P. 4]

Q. What was the treatment of these costs in the Washington Water Power case, UG-901459?

A. The Commission Order in that Docket states:

> *?The Commission staff cost-of-service study in this case has incorporated the Cascade principles, while making appropriate modifications to the methodology to reflect changes in the industry. The Commission staff study is accepted in this case.?* [Docket UG-901459, 3rd Supp. Order, P. 28]

The ?changes? noted by Staff in the WWP case related to the emergence of competitive forces for large volume customers, but did not address treatment of these relatively minor costs. I interpret this decision as generally ratifying the 50% customer / 50% commodity classification proposed by Staff and approved by the Commission in the Cascade proceeding.

Q. What was the staff recommendation with respect to these costs in the Avista proceeding just completed, Docket UG-991607?

A. Staff recommended in Mr. Russell?s portion of the Joint Testimony on Rate Spread that a ?better allocator? would use a combination of customers, throughput, and revenues. This was clarified in the Staff?s reponse to Avista Data Request #162, which became Exhibit 670 in that proceeding. That position of Staff is consistent with the customer/throughput methodology previously advocated by Staff and previously accepted by the Commission, and which I recommend be reaffirmed in this proceeding. Staff has given no explanation for the proposed change in the methodology which they have previously used and defended, and which the Commission has previously approved.

Q. What is your recommendation with respect to these accounts?

A. The Commission should reaffim its position in U-86-100, that these costs are partly related to the number of customers served, and partly related to the amount of gas delivered to customers.

Q. What would the effect of this type of classfication be on the cost of service results?

A. The effect would be to assign more cost to larger-volume customers, and less to residential and small commercial customers. Because the amount of expense in these accounts is relatively minor, the rate impact would not be very significant. Nonetheless, the principle remains important to preserve.

IV. STAFF COST PHASE-IN APPROACH IS APPROPRIATE

Q. Staff has proposed that the shift of costs between jurisdictions that they have found appropriate be phased in over a three year period. Is this appropriate?

A. Yes. In my direct testimony, I proposed a phase-in if the Commission approved a double-digit rate increase. Staff?s proposal meets that threshold, and conforms with that recommendation.

Q. Are you familiar with similar cost phase-in approaches in the past?

A. Yes. In Cause U-86-02, Pacific Power and Light was directed to phase-in an interstate cost allocation methodology over a four year period to mitigate the effect on neighboring states. Washington ratepayers received the full benefit of the revised methodology only after a period of years. The Staff proposal in this docket would similarly phase in a new interstate cost allocation methodology.

V. BOTTOM LINE RESULTS OF STAFF COST OF SERVICE STUDY PROVIDE A REASONABLE GUIDE IN THIS CASE

Q. You have identified two areas of concern with the Staff cost of service study, the treatment of storage costs and the treatment of customers service, customer assistance, and sales expense. In spite of these concerns, do you think that the Staff cost of service study is a reasonable guide to estimating the relative costs of serving the different customer classes?

A. Yes, although I believe the Staff study slightly overstates the cost of serving residential and small commercial customers, the amount of this deviation is not very large.

Q. What is the ratio of revenue to cost shown in the Staff cost of service study for each customer class?

A. The table below shows the ratio of revenue to cost at current rates for each of the major customers classes, taken from data in Mr. Russell?s Exhibit ___(JMR-5).

Schedule	Class	Revenue:Cost Ratio
2	Residential	94%
24	Residential	94%
3	Commercial	113%
4	Large Firm	104%
21	High Load Factor	110%
55	LT Interruptible	90%
90	Transportation	106%

Q. What conclusion do you draw from this analysis?

A. Only the Schedule 3 Commercial class is outside the 90% - 110% revenue to cost ratio range that the Commission has previously relied upon in determining if classes should receive a disproportionate increase in cases where a cost of service study is not completely adopted. For example, in Cause U-84-65, the Commission explicitly considered the ?range of reasonableness? for cost of service results, and rejected a Company proposal to restructure rates between classes when the major classes fell within the 90% - 110% range. As with the current situation, only the commercial class was outside the range of reasonableness.

Q. Has staff or the Company presented any evidence that ?unity? or a uniform rate of return by class is the appropriate ?target? for setting rates?

A. No. There is no evidence that all customer classes impose the same level of risk, or should provide the same rate of return. Therefore there is no basis for moving rates mechanically toward the result of any particular cost study, which is effectively what Mr. Russell has done.

Q. Is there recent evidence that large-volume customers pose special risks to utilities?

A. Yes. First, on Northwest Natural Gas?s system, several large volume customers have left the system entirely, including the paper mill in Camas. In many proceedings, including the development of Puget Sound Energy?s Schedule 48 rate and the consideration of special contracts for both gas and electric consumers, the Commission has had to deal with the special risks that large volume customers can pose to a utility system, including the potential for creating stranded cost exposure for the remaining customers.

Q. What rate spread did the Company originally propose in this case?

A. The Company proposed a uniform percentage of margin applied to each class.

Q. What rate spread did the Staff propose in this case?

A. Staff proposed that the residential class receive a much larger increase than any other class. The table below shows the Staff?s proposed increase for each major rate schedule, expressed on both a percentage of margin and a cents per therm basis; this is derived from Mr. Russell?s Exhibit JMR-5 and Dr. Mariam?s Exhibit YKGM-4:

Staff-Proposed Increases By Major Class of Customer

Schedule	Class	% of Margin	?/therm
2	Residential	25%	8.2
24	Residential	26%	7.6
3	Commercial	6%	2.0
4	Large Firm	15%	3.3
21	High Load Factor	7%	1.7
55	LT Interruptible	37%	2.8
90	Transportation	12%	1.5

Q. In your opinion, is a rate spread of this range reasonable based on the staff cost of service study?

A. No. The only class outside the 90% - 110% range of reasonableness is the Schedule 3 Commercial class, and this is the only class that should reasonably expect to receive a below-average rate increase.

Q. What position has Staff taken most recently on gas rate spread?

A. In the Avista proceeding, we had a similar situation, with most classes falling within the 90% - 110% revenue to cost ratio, and Staff agreed in joint testimony with Public Counsel and ICNU that within this range, an equal percentage of margin increase should apply.

Q. What is your recommendation in this proceeding?

A. I continue to recommend, as I did in my Direct testimony, that this rate increase be phased in and be spread on a uniform percentage of margin basis. First, the major classes are all close to the 90% - 110% range of reasonableness that the Commission has adopted in other proceedings, and even the Commercial Schedule 3 is not far outside that range. Second, coupled with the recent tracking increase which raised rates by 22%, the rate shock that would be experienced by some customers would be unacceptable. The Company?s original rate spread and rate design recommendation, applied to the staff revenue requirement and phase-in approach, leads to the fairest rates of any proposals. My Exhibit ___(JL-REB-2) shows the rate effect of applying the Company?s rate spread proposal to the Staff?s proposed revenue requirement, and compares this to the staff?s rate spread proposal.

VI. LATE FEE

Q. Do you have any comment on the late fee of 1.5% that Staff is supporting?

A. Yes. Public Counsel supported the imposition of a 1% late fee for Puget Sound Energy in Cause U-89-2688-T. That was in recognition that large volume customers were using the utility for cash-flow management, and in the residential sector, with bimonthly meter reading and billing, and a disconnection policy that waited until after the subsequent bill was issued, customers could go 4 months before receiving a disconnect notice. Approval of a late fee for Northwest Natural should be conditioned on approval of the bimonthly residential billing proposal that I discussed in my revenue requirement testimony, and the amount of the late fee should be limited to 1% per month, not 1.5%. There is no particular reason the Company should earn above its allowed rate of return on this aspect of service, particularly when low-income consumers are likely to be the most frequently affected.

Q. Does this complete your testimony in this phase of the proceeding?

A. Yes.