

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

**DOCKETS UE-170033 and
UG-170034 (Consolidated)**

**SUPPLEMENTAL CROSS-ANSWERING TESTIMONY OF EDWARD A. FINKLEA
ON BEHALF OF
THE NORTHWEST INDUSTRIAL GAS USERS**

August 15, 2017

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 **A.** My name is Edward Finklea. My business address is 545 Grandview Drive, Ashland,
3 Oregon 97520. I am the Executive Director of the Northwest Industrial Gas Users
4 (“NWIGU”).

5 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND**
6 **EXPERIENCE.**

7 **A.** My resume is included as Exhibit No. EAF-2 with this testimony.

8 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?**

9 **A.** No.

10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

11 **A.** I am responding to the supplemental testimony of Washington Utilities and
12 Transportation Commission (“Commission”) Staff Witness Jason Ball (“Staff”)
13 regarding his proposal on Puget Sound Energy’s (“PSE”) Special Contract class of
14 customers in this proceeding.

15 **Q. WHAT DOES STAFF NOW RECOMMEND FOR SPECIAL CONTRACT**
16 **CUSTOMERS?**

17 **A.** Staff believes that the rate paid by the Special Contract class is not consistent with WAC
18 480-80-143 because, according to Staff, the rate is too low and the rate of return for the
19 class is negative 4.89 percent, based on Staff’s measure of cost of service.¹ Staff
20 recommends imputing revenues for the Special Contract class to achieve full recovery
21 of costs, including PSE’s authorized rate of return.² Staff recommends that this shortfall
22 in revenue be absorbed by PSE shareholders which Mr. Ball opines would incentivize

¹ Exhibit No. JLB-8T, p.3 line 7.

² Exhibit No. JLB-8T, p.4 line 8.

1 PSE to renegotiate contracts with customers at new (presumably higher) rates.³ In the
2 alternative, if the Commission rejects this proposal, Staff recommends a 58.83 percent
3 increase in the Special Contract class rate.⁴

4 **Q. DO YOU AGREE WITH STAFF'S RECOMMENDATION?**

5 **A.** No. I fundamentally disagree with Staff's proposal to have the Commission unilaterally
6 order the modification of Special Contracts before the Term of the Special Contract
7 expires. It is my understanding that neither PSE nor the Special Contract customers
8 support amending the Special Contracts. This proposal is extreme and seeks to unwind
9 Special Contracts that were previously reviewed by Staff and approved by the
10 Commission.

11 **Q. WHAT ARE SPECIAL CONTRACTS AND WHAT IS THEIR PURPOSE?**

12 **A.** Special Contracts are negotiated agreements between a local distribution company
13 ("LDC") and a large customer that has a competitive alternative to service under
14 standard tariff rates. The purpose of a Special Contract is to allow an LDC to negotiate
15 with a customer to keep the customer on the system. This is an important regulatory
16 tool to retain large customers recognizing that Special Contracts benefit all customers
17 and the LDC because of the continued contribution to fixed costs.

18 **Q. ARE SPECIAL CONTRACTS TYPICALLY PRICED AT TARIFF RATES?**

19 **A.** No. Special Contracts are expected to depart from traditional tariff service. When a
20 customer has a competitive alternative to service from an LDC, by definition the
21 "fully embedded cost of service rate", or tariff rate, will be higher than the competitive

³ Exhibit No. JLB-8T, p.4 line 12.

⁴ Exhibit No. JLB-8T, p.6 line 3.

1 alternative after the customer's initial investment in gas facilities. The difference can
2 be significant. Special Contracts offer a discount from tariff service to incentivize
3 these types of customers to remain on the system. Staff's objection to the Special
4 Contract class appears to be that the class is served below the fully embedded cost of
5 service rate, using Staff's method of calculating fully embedded cost of service (which
6 NWIGU's disagrees with). Staff's proposal undermines the purpose of Special
7 Contracts and is inconsistent with WAC 480-180-143. Staff has not identified a flaw
8 in the Special Contracts, rather, Staff has merely identified the reason Special
9 Contracts exist and now wishes to unwind an agreement previously approved by the
10 Commission.

11 **Q. HOW DO SPECIAL CONTRACTS IMPACT OTHER CUSTOMERS?**

12 A. It is important to note that Special Contracts actually lower the overall rates on the
13 system for all customers classes, because Special Contracts are designed to pay the
14 actual variable cost of service to the Special Contract customer in addition to some
15 contribution to the utility's fixed costs. Absent the Special Contract contribution to
16 fixed costs, other customers would be required to pay this amount in the event a
17 Special Contract customer left the system. Staff improperly ignores the standard in
18 WAC 480-80-143 and argues that other customers are subsidizing the rate for Special
19 Contract customers by comparing the Special Contract rate to a fully embedded cost of
20 service rate using Staff's allocation method that allocates a significant portion of
21 PSE's fixed costs based on volume.

22

1 **Q. STAFF SAYS PSE’S SPECIAL CONTRACT CUSTOMERS DO NOT COVER**
2 **THEIR FULL LEVEL OF ALLOCATED EXPENSES AND CONTRIBUTE**
3 **LESS THAN NOTHING TOWARD RETURN ON RATE BASE. DO YOU**
4 **AGREE WITH THIS OPINION?**

5 **A.** No. I absolutely disagree with Staff’s assertion that PSE’s Special Contract customers
6 do not cover their full level of allocated expenses and that they contribute “less than
7 nothing toward return on rate base.”⁵ Staff’s suggestion that PSE is losing money
8 serving the Special Contract class of customers and that other customers are
9 subsidizing this class is false. PSE and other customers are better off keeping the
10 Special Contract class of customers on the system because there is a significant
11 contribution to fixed cost recovery from the Special Contract customer class.

12 **Q. STAFF SAYS A 58.83 PERCENT INCREASE IS NECESSARY TO BRING**
13 **THE SPECIAL CONTRACT CLASS INTO COMPLIANCE WITH WAC 480-**
14 **180-143(5)(c). DO YOU AGREE?**

15 **A.** No. This is just not correct and turns the standard for Special Contracts on its head.
16 WAC 480-180-143(5)(c) provides that the Special Contracts must “[d]emonstrate, at a
17 minimum, that the contract charges recover all costs resulting from providing the
18 service during its term, and, in addition, provide a contribution to the gas, electric, or
19 water company's fixed costs.” The variable costs to serve the Special Contracts are
20 being fully recovered from the Special Contracts, and in addition, there is a
21 contribution to fixed costs on the system. As explained in the Supplemental Cross

⁵ Exhibit No. JLB-8T, p.3 line 7.

1 Answering Testimony of Brian Collins, based on PSE’s cost of service study provided
2 in response to Kroger data requests number 05, the Special Contract class total
3 revenue is \$1,370,309, the variable cost to serve the Special Contract class is
4 \$670,229, and the class contributes \$700,080 towards fixed costs on the system—a
5 number well above PSE’s variable cost of serving the class.⁶ Thus, the economic
6 standard established in WAC 480-80-143 is being met by PSE’s Special Contract
7 customer class based on PSE’s cost of service model.

8 **Q. IS THERE ANYTHING UNUSUAL ABOUT THE FACT THAT PSE HAS A**
9 **“SPECIAL CONTRACT” CLASS OF CUSTOMERS?**

10 A. No. WAC 480-80-143 provides the rule under which gas, electric, and water
11 companies can enter into Special Contracts. The Commission must approve every
12 Special Contract that PSE or any other LDCs have negotiated with customers to keep
13 them on the system. As mentioned above, the rule explicitly provides that there must
14 be a demonstration that “at a minimum, that the contract charges recover all costs
15 resulting from providing the service during its term, and in addition, provide a
16 contribution to the gas, electric or water company’s fixed costs.” The Special
17 Contracts met the standards established in WAC 480-80-143 or the Commission
18 would not have approved the Special Contracts. Mr. Collins’ testimony shows that
19 PSE’s Special Contract class continues to meet that standard, as variable costs are
20 completely covered and there is a contribution to fixed costs made by the class.

⁶ Exhibit No. BCC-6T, p.4 Table 1.

1 Q. **IN YOUR EXPERIENCE, HOW DO THE COMMISSION, UTILITIES AND**
2 **CUSTOMERS DETERMINE WHEN A SPECIAL CONTRACT IS**
3 **APPROPRIATE?**

4 A. In my experience, the threshold question is whether the customer has a real
5 competitive alternative, backed by evidence, showing that the utility is at risk of losing
6 the customer. After that, the LDC and customer must negotiate a rate that is above the
7 variable costs of serving the customer, such that there is some contribution to fixed
8 cost recovery under the Special Contract rate. Further, the Special Contract must meet
9 the requirements in WAC 480-80-143. Finally, the Special Contract must be approved
10 by the Commission, after discussions and input from the LDC, the Special Contract
11 customer and Commission Staff.

12 Q. **WHAT TYPES OF COMPETITIVE ALTERNATIVES DO NATURAL GAS**
13 **CONSUMERS HAVE COMPARED TO TAKING DELIVERY SERVICE**
14 **FROM AN LDC?**

15 A. In my experience, the typical competitive alternative is to directly connect the
16 customer's facility to the interstate pipeline, in this case to Williams Northwest
17 Pipeline.

18 Q. **WHAT HAPPENS TO LDCS WHEN A CUSTOMER DECIDES TO**
19 **DIRECTLY CONNECT TO AN INTERSTATE PIPELINE?**

20 A. When a customer directly connects to the interstate pipeline, the LDC loses a large
21 customer forever, and other customers will end up paying more over time because the

1 departing customer no longer contributes to the fixed costs on the system. This is the
2 very reason Special Contracts exist—to keep customers on the system to benefit other
3 customers and the LDC by making some contribution towards system fixed costs.

4 **Q. HOW DO YOU COMPARE A COMPETITIVE ALTERNATIVE TO TARIFF**
5 **SERVICE?**

6 A. If a customer can obtain direct service (by investing in its own natural gas piping and
7 metering facilities) to deliver natural gas from the interstate pipeline to the customer's
8 facility at a cost that is less than the LDC can offer tariffed service, the LDC risks
9 losing the customer. This is a simple mathematical calculation.

10 **Q. ARE THERE CUSTOMER OWNED DIRECT CONNECTIONS TO**
11 **INTERSTATE PIPELINES IN THIS REGION?**

12 A. Yes. There are multiple end users of natural gas in the State of Washington that take
13 delivery service directly from the interstate pipeline. I have personally assisted
14 customers in Oregon and Washington to directly connect to an interstate pipeline.
15 Direct connections became possible when open access to interstate pipeline services
16 was ordered by the Federal Energy Regulatory Commission in the early 1990s. The
17 right of a natural gas consumer to directly connect to the interstate pipeline is part and
18 parcel to the fact that interstate pipelines must provide open access service, including
19 the right to connect to the interstate pipeline if the customer pays for the gate station
20 that enables the tap into the pipeline.

1 **Q. ONCE A SPECIAL CONTRACT IS APPROVED, SHOULD THE**
2 **COMMISSION SIGNIFICANTLY REVISE THE AGREEMENT WITHOUT**
3 **THE PARTIES' CONSENT BEFORE THE TERM HAS EXPIRED?**

4 A. No. The Commission should not order a significant change to any material term of
5 the agreement during the term of the Special Contract. In approving Special Contracts,
6 the Commission must determine if the agreement is fair, just, reasonable and sufficient
7 and meets the special contract provisions specified in WAC 480-80-143. Further, the
8 Commission must find the Special Contract to be consistent with the public interest.
9 The Commission previously made these findings when it approved the Special
10 Contracts and absent a material mistake when the Special Contracts were approved,
11 the Special Contracts should be honored for their Term.

12 **Q. WHAT KIND OF MESSAGE DOES STAFF'S PROPOSAL SEND TO**
13 **CUSTOMERS CONSIDERING A DIRECT CONNECTION OR SPECIAL**
14 **CONTRACT?**

15 A. Special Contracts are an important regulatory tool the Commission has used to
16 regulate LDCs since open access in the natural gas industry. If the Commission
17 materially modifies the rate and other material terms of the Special Contract class as
18 Staff recommends, the policy signal, apart from the legal implications, is that
19 customers cannot rely on a Special Contract approved by this Commission. A
20 customer in the future would be very unlikely to forgo a competitive alternative if
21 there was a risk that the Special Contract rate will not be honored over the term of the
22 contract. Such an uncertainty hanging over the Special Contract process in

1 Washington will incentivize customers to terminate service with an LDC and exercise
2 their competitive alternatives rather than enter into Special Contracts. That is not a
3 good policy if the regulatory goal of maximizing fixed cost recovery for Washington
4 LDCs is to be maintained.

5 Implementing Staff's recommendation would, in my opinion, have repercussions for
6 the entire natural gas industry in Washington, and could have implications in the
7 electric industry and water companies, as the Special Contract rule applies to all three
8 industries. To the extent Special Contracts are used to address competitive
9 alternatives in the electric industry and with water companies, Staff's recommendation
10 would have far reaching impacts among industries regulated by the Commission. The
11 negative policy implications far outweigh any short-term revenues other customers
12 would gain from Staff's dramatic rate increase to PSE's Special Contract customer
13 class.

14 **Q. WHAT DOES STAFF'S ANALYSIS SHOW ABOUT THE PEAK AND**
15 **AVERAGE METHODOLOGY USED TO ALLOCATE COSTS?**

16 A. The Special Contract class is a very high volume, high load factor class. Since Staff
17 uses the peak and average methodology rather than the coincident peak methodology
18 based on Design Day Demand to allocate fixed costs associated with mains, the
19 Special Contract class gets a very heavy allocation of fixed costs in Staff's cost of
20 service study. I note that Mr. Collins shows in his responsive testimony that the
21 Special Contract class rate is above cost of service when Mr. Collins coincident peak
22 method based on Design Day Demand is used for cost allocation.

1 Staff only came to the decision to file supplemental testimony because the volumes
2 reported in PSE data requests were incorrect. Nothing changed about the capital plant
3 used to provide transportation service to the class of customers. More volumes meant
4 more fixed costs allocated to the class, according to Staff's logic and its use of a cost
5 of service study that allocates the costs of mains partially on volumes.

6 Mr. Collins shows that if the cost of service method recommended by NWIGU is
7 adopted, the Special Contract class should actually qualify for a slight rate decrease of
8 0.29 percent.⁷ The point of showing that difference is not that NWIGU is seeking a
9 decrease in the Special Contract rate, but only that the class fully contributes to fixed
10 and variable costs actually incurred to serve the class, as measured using a cost of
11 service study that allocates fixed costs based on coincident Design Day Demand.

12 **Q. DOES THE SPECIAL CONTRACT CLASS CONTRIBUTE TO FIXED COSTS**
13 **UNDER THE PEAK AND AVERAGE METHODOGY FOR DETERMINING**
14 **THE COST OF SERVICE?**

15 A. Yes. Even using the peak and average methodology used by PSE and Staff, Mr.
16 Collins identifies a range from \$565,862 (Staff) to \$700,080 (PSE) in fixed costs
17 being recovered from the Special Contract class during the test year.⁸ The Special
18 Contract customer class is contributing far more than nothing toward the recovery of
19 fixed costs in compliance with WAC 480-80-143. PSE is not losing money serving
20 this class of customers in any traditional economic sense, and other customers are not

⁷ Exhibit No. BCC-3, p. 1.

⁸ Exhibit No. BCC-6T, p.3 Table 1.

1 subsidizing the Special Contract class. PSE simply is not collecting as much as Staff
2 would like to collect using his volumetric allocator of fixed costs.

3 **Q. STAFF'S PRIMARY ARGUMENT IS THAT PSE SHAREHOLDERS SHOULD**
4 **ABSORB THE DIFFERENCE BETWEEN THE SPECIAL CONTRACT RATE**
5 **AND THE FULL RECOVERY OF COSTS. IF THE COMMISSION REJECTS**
6 **THAT PROPOSAL, STAFF RECOMMENDS A 58.83 PERCENT INCREASE IN**
7 **THE SPECIAL CONTRACT CLASS RATE. HOW DO YOU RESPOND TO**
8 **THESE PROPOSALS?**

9
10 **A.** Both of these proposals are extreme and should be rejected for the reasons described
11 above in my testimony. In addition to the arguments described above, I take issue with
12 Staff's alternative suggestion for the Special Contract class to receive a 58.83 increase.
13 This proposal is aggressive, punitive and ignores gradualism and the concept of rate
14 shock.

15 **Q. IF THE COMMISSION DETERMINES THAT THE SPECIAL CONTRACTS**
16 **CLASS SHOULD RECEIVE A RATE INCREASE IN THIS PROCEEDING,**
17 **HOW SHOULD THAT BE DETERMINED?**

18 **A.** In the event the Commission determines that rates should be increased for the Special
19 Contract class, the Commission should use the methodology included in the Special
20 Contracts that tie any increase in the Special Contract Customer Charge, Firm Demand
21 Charge and Commodity/Block Structure to increases in rate schedule 87T.

- 1 **Q. DOES THIS CONCLUDE YOUR CROSS-ANSWERING TESTIMONY?**
- 2 **A.** Yes, it does.