

Agenda Date: August 27, 2003
Item Number: **A1 and A2**

Dockets: **UG-031216 and UG-031217**
Company Name: Puget Sound Energy, Inc.

Staff: Merton Lott, Energy Industry Coordinator
Graciela Etchart, Regulatory Analyst

Recommendations:

Suspend the filing in Docket UG-031216 but allow the substitute tariff sheets to become effective on a temporary basis pending entry of further Commission orders.

Allow the substitute tariff sheets implementing changes to Schedule No. 7 in Docket UG-031217 to become effective by operation of law on September 1, 2003.

Background:

On July 25, 2003, in Docket UG-031216, Puget Sound Energy, Inc., (PSE) filed revised and original tariff sheets implementing changes to the Company's tariff rules concerning the extension of gas service. The tariff filing provides for the extension of distribution facilities other than in Kittitas County, the extension of distribution facilities in Kittitas County, and specifically identifies the federal income tax rider on contributions in aid of construction. PSE has separate line extension rules for Kittitas County for the reasons discussed later in this memorandum.

Also on July 25, 2003, in Docket UG-031217 PSE filed revised tariff sheets 107 and 107-A through 107-G implementing changes to tariff Schedule No. 7, Facilities Extension Standards.

After discussion with Staff, PSE filed substitute tariff sheets in both dockets correcting small errors and providing necessary clarifications.

PSE's line extension policy and rates are contained in a series of rules and schedules. Rule Nos. 7 and 7A describe PSE's procedures for gas line extension and the method of calculating the customer's responsibility to pay for the line extension. Rule No. 7 also provides options for the customer to choose how to pay for the customer's responsibility, either through a refundable customer advance, or through non-refundable rates and qualification payments. PSE's method of determining the customer's responsibility relies on the Company's financial investment analysis (FIA). The FIA compares incremental revenues and incremental costs of the project to determine if the project will pay for itself. The cost and therm allowance inputs used in the FIA are identified in Schedule No. 7. If under either Rule No. 7 or Rule No. 7A a customer is required to pay or chooses to pay the customer advance, then the federal income tax rider identified in Rule No. 42 is applied to the customer advance. This rider is intended to cover the

present value of the federal income tax consequences of the customer contribution. Finally, under Rule No. 7, if a customer chooses the new customer rate option, the rates charged to the customer are identified in Schedule No. 107. It should be noted the Company has not proposed any changes in Schedule No. 107.

In last year's general rate case, Docket Nos. UE-011570 and UG-011571, Exhibit A to Gas Settlement Stipulation, paragraph 8 indicated that PSE would withdraw its original filings in Rule No. 7 and Schedule No. 7 with the anticipation that PSE would file them in the near future. The paragraph goes on to implement a temporary surcharge of 15%, to the costs identified in Schedule 7. That temporary surcharge is scheduled to expire September 1, 2003. During the last six months PSE has participated with interested parties to discuss PSE proposed changes. PSE worked with Staff and other parties on two sets of issues; the inputs into the FIA and the rules that guide the determination of customer contributions to PSE for cost of distribution plant.

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PSE's filing in Docket UG-031217 represents the results of PSE's work on the inputs into the FIA. PSE and Staff came to agreement a few months ago on the ultimate cost and therm allowances to be included in Schedule 7. After reaching agreement with Staff, PSE worked with other parties, specifically representatives of the building industry to come up with a phase-in of the new costs. The proposal includes a phase-in with lower initial charges for certain cost items implemented on September 1, 2003, and complete implementation of the Staff/Company levels on September 1, 2004.

The proposed Schedule No. 7 also updates the therm allowance for central space heating (Tables 7.1. and 7.1A) eliminating the distinction between structures constructed pre- and post 1986. In addition, the table relating to multi-family water heating and other end uses (i.e. range, dryer, hot tub, and fireplace) was collapsed. These changes were based on a study combining a customer telephone survey with customer usage information conducted by an independent consultant in 1998. The different therm allowances for Kittitas County (Table 7.1A) were maintained because the survey did not contemplate analysis of usages based on geographical sites.

Kittitas County has separate tariff considerations for several reasons. PSE initiated service in Kittitas County only recently; PSE is still in the early expansion stages of that service. PSE could not serve Kittitas County utilizing the Company's existing capacity and therefore designed its distribution system differently in Kittitas County than in the remainder of PSE's service territories. Further in general, Kittitas County is colder than most of PSE's service territory in the Puget Sound region. These special circumstances require a Kittitas County surcharge of 17 cents per therm, limitations on winter interruptible service, and other differences in PSE's tariff for Kittitas County.

Discussion UG-031216

The filing in Docket UG-031216 does not represent a consensus of the parties. PSE's filing, while obviously attempting to eliminate many concerns Staff expressed, still contains a few policies to which Staff objects. Some of the differences between Staff and PSE are small and do not represent reasons to request suspension of the filing. Such items include the interest rate to be refunded to customers after review of customer advances and the frequency of those reviews. However, one issue, the new customer rate assigned to a customer in a development versus the new customer rate assigned to customers on an extension in an existing neighborhood, is of a more serious nature.

When an extension does not pass the test for free extension, PSE has two methods to receive additional cash flow from the new customers. Those options are the payment of a refundable customer advance, or the agreement to pay a "new customer rate" for five years coupled with a nonrefundable qualification payment, if necessary. Under the customer advance option a new development and an extension into an existing neighborhood are treated the same. However, under the new customer rate option, a residential customer who is part of a new development pays a new customer rate of 11.5 cents per therm for 5 years. In a development, the developer is required to pay the qualification payment if the project does not meet the minimum requirements to qualify for the new customer rate. On the other hand, a small commercial customer in either circumstance or a residential customer in an existing neighborhood is required to pay a new customer rate of 17 cents per therm, and any required qualification payment.

During the collaboration and subsequent to the filing of the tariff, Staff requested information to support the different rates. The only support provided by the Company was a comparison of similar-sized extensions in a development and in existing neighborhoods. What is demonstrated by this comparison is that for these similarly sized extensions the project in the development costs less, the logical result, as the cost per foot is less. The conclusion is that for these similar sized projects the one in the development requires a smaller contribution or a lower new customer rate. The tariff rule however does not determine contribution based on size of a project but rather based on the internal rate of return generated in the FIA model.

What PSE's support does not demonstrate is that two projects with the same average cost per customer require different new customer rates to achieve the same level of cost recovery. The rule as it is written applies equally to the refundable customer advance and the non-refundable qualification payment, however the new customer rate level varies between extensions in new developments and extensions in existing neighborhoods. That rule states that if the internal rate of return (IRR) produced by the FIA before contributions is below PSE's authorized return (8.76%) and equal to or above 75% of the authorized return (8.76 times .25 or 6.57%) then the customers can choose to pay a new customer rate rather than a customer advance. The rule also states that customer(s) or a developer can pay a qualification payment to bring the FIA's IRR to the 6.57 level to then qualify for the new customer rate.

Staff's believes the new customer rate is more appropriately related to the internal rate of return generated by PSE's FIA model rather than the arbitrary assignment based on whether the project is a new development or not. PSE has not yet responded to Staff's data request intended to support this belief.

Even more clearly objectionable is the inconsistent treatment of small commercial customers compared to residential customers both inside a new development.

Conclusions

In Docket No. UG-031217, Staff found that the ultimate rates proposed by PSE to become effective by September 1, 2004, represent the costs PSE is currently incurring. Staff also found the therm allowance proposed by PSE is consistent with the study performed and that study was properly conducted. Further, the phase-in of some of the cost items for the one-year period seems a reasonable approach to mitigating what would be a substantial increase for some new customers who may have already made informal inquiries into the level of these charges.

In Docket No. UG-031216, Staff believes that the proposed changes in the rules in general are an improvement over the currently existing rule. However, Staff has identified certain issues in both the existing rules and proposed rules. Most important among these disagreements is the disparity in new customer rates charged to commercial versus residential customers in new developments, and the disparity between the new customer rate charged in a new development versus either residential or small commercial customers on an extension in an existing neighborhood. Acceptable cost support has not been provided for these distinctions, and Staff data requests on this issue are outstanding. While Staff points out this problem with the proposed tariff filing, it must also be remembered that the current tariffs also contain Staff's identified errors.

Suspend the filing in Docket UG-031216 but allow the substitute tariff sheets to become effective on a temporary basis pending entry of further Commission orders.

Allow the substitute tariff sheets implementing changes to Schedule No. 7 in Docket UG-031217 to become effective by operation of law on September 1, 2003.