BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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In the Matter of the Application of Questar Gas Company for a General Increase in Rates and Charges	)))	DOCKET NO. 02-057-02

Prepared Direct Testimony of

Michael J. McFadden

30 August, 2002

Q. Please state your name and business address.

A. My name is Michael J. McFadden and my business address is 625 South York Street, Denver, Colorado 80209-4642.

Q. By whom and in what capacity are you employed?

A. I am president of McFadden Consulting Group, Inc. (McFadden Consulting).

Q. Have you prepared a statement of your prior experience and qualifications?

A. Yes. It is attached as Appendix A to my testimony.

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

A. McFadden Consulting has been retained by the Utah Committee of Consumer Services (Committee) to review Questar Gas Company's (QGC or Company) application to increase general rates. Specifically, the Committee requested that we review:

- The Company's cost allocation and rate design method;
- The Company's recommended rate spread;
- The Company's proposed changes to its extension policy; and
- The recovery and spread of CO_2 processing expenses.

Q. **Please provide a brief overview of your testimony.**

A. My testimony first addresses cost allocation and rate design issues that can be broken into two distinct groups. The first group relates to general

concerns regarding QGC's methodology, while the second group relates to specific cost allocation and rate design concerns.

The general concerns include:

- The GS-1 customer class is allocated a disproportionately large share of distribution system costs;
- Residential, commercial and even some industrial customers are lumped together in a single customer class (GS-1);
- The Company's recommendation to increase rates paid by transportation customers and interruptible sales customers one-third of the way toward cost-based levels fails to establish specific deadlines to further increase rates for those customer classes to full cost-of-service levels.

The specific concerns include:

- Treating FT-1 revenues as a credit to the cost of service;
- Failing to allocate a portion of peak day capacity costs to interruptible sales and transportation customers; and
- Recovery and spread of CO2 processing expense.

After I have discussed cost allocation and rate design issues, I will address several issues related to the Company's extension policy, New Premise Fee ("NPF") and Contributions in Aid of Construction ("CIAC"), including:

- Elimination of the New Premise Fee ("NPF");

- Treating Contributions in Aid of Construction ("CIAC") as a reduction to rate base as opposed to revenue; and
- Increasing the level of the CIAC.

In addition, we have several issues related to proposed changes that QGC included in its tariff but did not address in its testimony, including:

- Calculation of the default payment for mains extensions;
- Construction allowance for firm commercial customers' mains extensions;
- The breakdown of the service line, meters and regulators extensions; and
- Excess construction costs of service line, meters and regulators extensions.

General Cost Allocation and Rate Design Concerns

Q. Please discuss your concerns relating to the allocation of costs to the GS-1 class[1].

A. The Company's allocated cost of service is summarized on Exhibit QGC 5.5. On the surface, the Company's allocation methodology appears to be precise. The Company uses ten[2] allocation factors to allocate nine[3]

[1] GSS customers are subsumed within the GS-1.
[2] There are actually eleven allocation factors because the Company modifies Allocation Factor #1 for purposes of allocating Gathering Demand Expenses.
[3] Costs are categorized into On-Premise Service, Meter Read Expense, Gathering, Network Cost, Large Diameter Main, Feeders, Administrative & General, Production, and CO2 Removal Costs.

categories of costs and four[4] categories of revenue credits to six different rate classes. Based on the results produced by the Company's allocation methodology, however, it is apparent the Company allocates a disproportionately large share of the distribution costs to the GS-1 class.

CCS Exhibit 6.1 shows the degree to which the costs are over-allocated to the GS-1 class. Page 1 of CCS Exhibit 6.1 is a recreation of the Company's Exhibit QGC 5.5. We have added an additional line after each cost category that shows how much of the costs are allocated to each of the rate classes. For example, 99.53% of the On-Premise Service costs are allocated to the GS-1 class. As shown on line 20, 95.32% of total distribution costs are allocated to the GS-1 class.

Page 2 of CCS Exhibit 6.1 summarizes the peak day and annual allocation factors by rate class. Columns (c) through (f) contain the allocation factors as filed by the Company and used in its cost allocation. As shown on line 1 column (d) the GS rate class represents 92.6445% of the peak day throughput and as shown in column (f) it represents 67.0176% of annual throughput. In most circumstances, the amount allocated to the GS-1 customer class should not exceed its percentage of peak-day throughput and should not be less than its percentage of annual throughput. Typically, the costs allocated to a customer class would fall between the two extremes. However, QGC's allocation exceeds what should be the maximum amount.

[4] The four categories of revenue credits are NGV, FT1 & FTE, MT, and 487, 488 & I-C.

The key problem involves the Company's allocation of Network Costs. As shown on page 1, line 5 of CCS Exhibit 6.1, $125.8 million or 98.97% of Network Costs have been allocated to the GS-1 class. Basically, the Company's cost-of-service proposal has the GS-1class responsible for 99% of the costs associated with operating the distribution system, yet the GS-1 class is only utilizing 92.6% of the system's peak day capacity and 67% of its annual capacity.

While the Company's allocation methodology appears to be precise, it is flawed and inaccurate. The Company allocates operating costs based on an allocation of plant. The allocation of the plant is based on a sample of 600 customers, which was taken approximately 17 years ago. While the Company has updated the costs associated with the 600 customers, it has not updated the sample itself. In his testimony, Committee Witness Yankel discusses problems with the Company's allocation methodology in greater detail.

Q. Please address the issue relating to combining residential and commercial customer into one rate class.

A. Residential and commercial customers may have gas usage characteristics that are similar, but there can also be significant differences. Some small commercial customers use gas for more than heating purposes. For example, restaurants can use it for cooking and drycleaners use it for laundering clothes. Moreover, the type and quantity of equipment within small offices and retail stores can significantly impact

an individual customer's load factor, thereby reducing gas usage except in extremely cold conditions.

By lumping residential and commercial customers together in a single rate class, it is somewhat difficult to determine if there are distinct enough differences between residential and commercial customers' usage patterns to warrant separate rate classes. Committee Witness Yankel addresses this issue in his testimony, and has also developed a proposal to move the GS-1 rate design toward a flat rate. Mr. Yankel's proposal seems to be a step in the right direction.

Q. Please address your concern relating to the Company's proposal to increase rates one-third of the way toward cost-based rates.

A. The Company's cost-of-service method, though flawed, would increase rates significantly to certain rate classes. It believes such increases would cause "rate shock" which would be "inadvisable and inconsistent with the regulatory principle of gradualism." The Company's recommendation is to increase rates to a level that would reduce the difference between the proposed rates and the cost-based rates by one-third.

I agree with the Company that increasing rates immediately to the cost-based levels could cause rate shock for transportation and interruptible sales customers. The Company's proposal to decrease the difference between the cost-based rates and the proposed rates by one-third is a step in the right direction. However, the Company fails to set

forth a specific timetable to move the transportation and interruptible sales classes to cost-based rates.

Q. Do you have any recommendations relating to these concerns?

A. Yes. I believe the Company's cost allocation and rate design methodology requires thorough review, unencumbered by statutory time constraints that exist when the Company files for a change in revenue requirement. I recommend that the Company be required to make a cost allocation and rate design (only) filing based on actual calendar year 2002 data by November 1, 2003.

In that filing I also recommend the Commission require the Company to provide further analysis and information (usage patterns, load factors, etc.) related to splitting residential and commercial customers into two separate classes. In the meantime, Committee Witness Yankel's proposal could serve as an interim approach for addressing this important issue.

Implementing these two recommendations addresses my concern regarding the lack of a timetable for moving to cost-based rates. With a specific filing to determine an appropriate cost allocation and rate design methodology, the Commission should understand with more certainty the difference between cost-based rates and the Company's then-current rates. As part of the proposed proceeding, I further recommend that the Commission establish a specific timetable for moving to cost-based rates.

FT-1 Allocation

Q. Let's turn to your specific concerns. Please discuss your concern relating to firm transportation service and the cost of service treatment of the FT-1 rate.

A. Firm transportation service is provided by QGC under the tariff sheets FT-1 and FT-2. Service under the FT-1tariff is applicable to customers that have an annual minimum usage of 4,000,0000 Dth, or 100,000 Dth if the customer is located within 5 miles of an interstate pipeline. All other customers desiring firm transportation service are served under the FT-2 tariff.

CCS Exhibit 6.2 provides some comparative 2001 test year statistics for the various rate classes which on line 6 indicates that the FT-1 customers' annual usage is approximately five times greater than the FT-2 rate class. Line 5 of this exhibit also shows that the revenue per Dth for the FT-1 rate is approximately one-half the revenue per Dth for the FT-2 rate.

In discussions with the Company, it indicated the transportation service provided to FT-1 and FT-2 customers was the same. Furthermore, QGC indicated the usage and mileage qualifications associated with the FT-1 tariff were based on judgment, rather than a rigorous economic study of individual customer costs and benefits associated with bypassing QGC's distribution system. By relying on

judgment without a cost/benefit analysis for justifying the discount, we believe the FT-1 rate is arbitrary and therefore, unjust and unreasonable.

Q. Is it important for a local distribution company to address a potential bypass of its system?

A. Yes. If it can be demonstrated that the benefits of retaining a large customer outweigh the costs, all customers on the system potentially benefit by avoiding a bypass situation.

Q. How is Firm Transportation service treated within the QGC cost allocation study?

A. The FT-1 rate is treated as a credit to the cost allocation, whereas the FT-2 rate is an allocated cost within the study. Since the FT-1 rate class is treated in this manner, QGC does not calculate the actual cost to provide FT-1 service.

Q. What is your reaction to this disparate approach?

I believe it is extremely important to calculate the fully allocated cost of service so that the amount of the discount involved in avoiding a bypass situation can be accurately determined. Once the amount of the discount is determined, it can be evaluated for reasonableness when compared to benefits achieved for the other customers on the system when the bypass situation is avoided. Since QGC has not provided an economic analysis to support the level of its FT-1 rate, it may be setting a discounted rate that exceeds the value of keeping a customer on the system.

Q. What is your recommendation on the treatment of the FT-1 rate class?

A. The FT-1 rate class should be treated exactly the same as the FT-2 rate class in the cost allocation study, thereby eliminating the credit to the cost of service. To show the impact of this recommendation, I modified Exhibit QGC 5.5 to include the FT-1 rate class within the cost allocation study. All the data necessary for this modification were taken from the work papers of Exhibit QGC 5.5. The results of this change are shown on CCS Exhibit 6.3, which indicates that the amount of discount is about equal to the current revenues of the FT-1 rate class [line 4 column (g)]. Stated differently, the FT-1 rate class would require slightly more than a 100% increase in revenues to cover the cost of providing service on a fully allocated cost basis. CCS Exhibit 6.3 also shows that the costs allocated to other classes would be reduced in amounts varying from (0.4%) to (3.2%).

Q. Do you have other recommendations with respect to Firm Transportation service?

A. Yes, I have several recommendations. Due to the varying nature and costs associated with individual bypass situations, it is difficult to develop a single rate structure that would be appropriate for all potential bypass customers. In view of these facts, I recommend the FT-1 rate be eliminated and be replaced by special contract rates that would enable the Company to address the nature and costs associated with each individual

customer's bypass situation. QGC should be required to file, under reasonable confidentiality provisions, appropriate supporting documentation for a proposed special contract rate for each customer it believes should qualify for special treatment.

I further recommend that in future cost allocation studies potential bypass customers, as a group, be treated the same as any other firm transportation rate class on the Company's system. This will ensure the amount of any discount calculated to avoid a potential bypass situation is examined for its impact on other customers.

I recommend that the Commission eliminate the FT-1 tariff and replace it with a general tariff relating to special contract service (SCS-1). To ensure that no customer bypasses the system during the transition to special contract service, I propose that the initial SCS-1 rate be set at the same level as the current FT-1 rate. I further recommend that the Commission establish an expiration date of November 1, 2003 for the initial SCS-1 rate. This provides the Company adequate time to analyze individual customer requests for special contract rate treatment and file individual special contracts (e.g., SCS-2, SCS-3, etc.) for potential bypass customers.

I believe the above recommendations will minimize the amount of rate discounts given to avoid a bypass situation based on an individual customer's circumstances and will therefore maximize the amount of load retention benefit to all other customers on QGC's system. Adoption of

the above recommendations also eliminates my concern regarding the arbitrary nature of the FT-1 tariff.

Interruptible Service Allocation

Q. Please describe interruptible service.

A. In the past, local distribution companies provided interruptible service to customers that were willing and able to have their service interrupted by the utility at any time. Providing this service was beneficial to the utility and its other customers because the utility could avoid buying expensive peak day gas supply and upstream pipeline capacity to serve the maximum loads of the system.

Q. Is interruptible service also dependent upon capacity being available on the local distribution company's system?

A. Yes, most distribution system planners assert that the distribution system design does not provide capacity to serve interruptible loads. However, it is rare that any local distribution company suffers a capacity shortage on its system to serve any customer.

Q. Has QGC experienced interruptions recently on its distribution system?

A. Yes, discussions with QGC revealed that a least one interruption occurred due to capacity limitations during the 2001-2002 heating season. The Company also indicated that there were two other interruptions in the 2000-2001 heating season. Prior to that the Company stated there had not been any interruptions for many years.

Q. What is your recommendation regarding the allocation of costs to interruptible service?

A. As I previously stated, interruptions of service due to capacity constraints on a distribution system are rare. Because interruptions are infrequent, interruptible customers actually receive firm service and should be allocated an appropriate share of peak day capacity costs. Therefore, I recommend a portion of peak day capacity be allocated to interruptible service.

Q. How do you propose to accomplish this?

A. Instead of allocating costs based on actual peak day usage, I recommend allocating peak day capacity costs to these groups by using the average daily usage. This is calculated by dividing the Interruptible Sales and Interruptible Transportation rate classes' annual usage by 365 days. This methodology allocates a portion of peak day capacity costs to these rate classes. The impact of the proposed modification is shown on CCS Exhibit 6.4. According to this exhibit, Interruptible Sales rates would increase 16.5%; Interruptible Transportation rates would increase 22.2%; GS-1 rates would decrease by 0.05%; and decreases to other customer classes would range from zero to (4.8%).

Q. Have you prepared an analysis of the combined impacts of your recommendations?

A. Yes. CCS Exhibit 6.5 reflects the recommendations for combining the FT-1 and FT-2 rate classes and allocating a portion of peak day capacity costs to Interruptible Sales and Interruptible Transportation service.

CO_2 Cost Recovery

Q. Please address the recovery of CO_2 costs.

A. On behalf of the Committee, McFadden Consulting spent considerable time and effort in this proceeding reviewing the operations of the CO_2 plant and the gas quality and gas interchangeability issue. Our review and analysis reaffirmed our belief that the CO_2 processing costs should not be borne by QGC's customers. That said, the Committee recognizes that the Commission has approved the settlement agreement between the Division of Public Utilities (Division) and the Company in Docket No. 99-057-20. In addition, the Committee also recognizes that the Utah Supreme Court, in Docket No. 98-057-12, remanded the treatment of the CO_2 costs in the pass through filing. Furthermore, the Commission has raised questions regarding how to handle the remand of Docket No. 98-057-12 in light of the CO_2 spread settlement agreement involving the Company, the Division, and other parties, which was approved by the Commission in Docket No. 99-057-20.

I believe the outcome of the Commission's decision in the remand docket may impact or be impacted by the Commission's action in this rate case docket, because the Company's proposed rates include $5 million of

CO_2 processing costs. For this reason, I believe the Commission should address how the CO_2 costs should be recovered and spread in this case, so as to ease the coordination of the various dockets. If the Commission fails to address the recovery and spread issues in this proceeding, depending on what it decides in the remand docket, the Company may need to re-file all its tariffs in this case.

Q. Do you have a proposal that addresses the above concerns?

A. Yes. I believe the Commission should remove the $5 million of CO_2 costs from QGC's Distribution Non- Gas Costs ("DNG") rates and establish a separate rider to recover the remaining balance of CO_2 costs. I also recommend the CO_2 costs be spread to all customers based on annual throughput.

Determining a CO_2 rider based on total company annual throughput is very straightforward. The $5 million of CO_2 cost is divided by total annual throughput to derive a per-Dth rider. Total annual throughput for all customers amounts to 137,024,216 Dth. Dividing the $5 million of costs by the 137,024,216 Dth yields a rider of $0.0365 per Dth. The per-Dth rider would be applied to each customer's throughput.

I do not recommend that the rider be broken out on a customer's bill, only that it be billed as part of the DNG increment. I recommend that the rider be placed on a separate tariff sheet that applies to all rate

classes. This would allow the Company to simply eliminate the rider tariff sheet when it has collected the $25 million cap contemplated in the settlement agreement, making the recalculation of DNG and re-filing amended tariff sheets unnecessary.

Q. Is your proposed rider consistent with the spread of the CO_2 costs agreed to in the settlement in Docket No. 99-057-20?

A. No. However, Lowell Alt, Jr., the Division principal witness in the hearing addressing the CO_2 settlement, indicated that the settlement only applied to that proceeding and was not binding in future rate proceedings.

The Commission approved the recovery of the CO_2 costs as the most appropriate method of addressing the gas quality (i.e. safety) issue. Since gas quality affects all customers, not just firm sales customers, the costs should be evenly apportioned among all customers.

Q. What is the difference in the recovery methods you are recommending and the method the Company has included in its request?

A. CCS Exhibit 6.6 is a recreation of the Company's Exhibit QGC 4.4, page 2. I have simply added line 22 that divides the CO_2 costs on line 18 by each customer class throughput. The results on line 22 are calculated in the exact same manner as the Company's calculation of total cost per Dth shown on line 21.

CCS Exhibit 6.7 compares the proposed uniform per-Dth rider with the Company's per-Dth amount that differs for each rate class. As this

exhibit shows, my proposal spreads the costs equally to all classes, while the Company's method allocates the vast majority of the costs to the GS-1 class. Because the Commission allowed QGC to recover costs associated with the CO_2 plant to address safety concerns, it is unreasonable that the costs should largely be borne by just one rate class.

Issues Regarding Extension Policy

Q. Turning to the area of extension policy, would you please identify the issues you intend to address?

A. Yes. We have identified several issues relating to the extension policy. The three main issues are:

- Elimination of the Company's New Premise Fee ("NPF");
- Treating Contributions in Aid of Construction ("CIAC") as a reduction to rate base as opposed to revenue; and
- Increasing the level of the CIAC.

In addition, we have identified several issues related to proposed changes that QGC included in its tariff but did not address in its testimony, including:

- Calculation of the default payment for mains extensions;
- Construction allowance for firm commercial customers' mains extensions;
- The breakdown of the service line, meters and regulators extensions; and

- Excess construction costs of service line, meters and regulators extensions.

Q. Please describe the NPF and when it was implemented.

A. The NPF is charged to customers in new premises and amounts to $144 paid in equal installments ($12 per month) for the first 12 months of service. According to Company Witness McKay (line 14, page 5 of his direct testimony), the purpose of the NPF is to:

> …provide a means for new customers to pay a larger share of the up-front costs incurred in adding them to the system. The fee is imposed on customers who actually receive the benefits of gas service, rather than on developers who merely install the facilities. At the time, it was thought that a monthly fee would serve the same purpose as a traditional contribution except that the amount could be collected in installments to ease the burden on the customer.

The Commission authorized the NPF in the Company's 1995 rate case in Docket No. 95-057-02.[5] Although Mr. McKay in his testimony indicated that the purpose was to serve as a "traditional contribution," in response to data request CCS 4.42 the Company states the NPF "is not a contribution in aid of construction, but a fee similar to the Connection Fee that is charged to customers and reported as income." It is my understanding that implementing the NPF was part of a settlement in the 1995 rate case, which avoided an increase in general rates. Presumably treating the NPF as revenue was not perceived as an issue.

I believe the NPF is really a form of CIAC and not a fee similar to a reconnect fee. A reconnect fee is generally intended to reimburse for

employee time required to turn service on at an existing location. I also question whether the NPF should have been recognized as revenue.

As part of its proposed changes to extension policy, the Company recommends eliminating the NPF extensions for new service. I support the elimination of the NPF because I agree, as discussed below, that there should be changes to the Company's current extension policy. In addition, eliminating the NPF renders questions regarding its treatment as revenue moot.

Q. Please discuss the Company's proposal to treat CIAC as a reduction in rate base rather than recognizing it as revenue.

A. The Company currently treats CIAC as revenue when they are received. According to the Company, it does not know of any other local distribution company that treats these types of contributions as revenue. Similarly, I am not aware of any other local distribution company or, for that matter, any electric utility company that treats contributions as revenue. For ratemaking purposes I support the Company's proposal to treat CIAC as an offset to rate base.

Q. Do you agree with the Company's proposal to increase the CIAC by $100?

A. No. I believe the Company's recommended increase in the CIAC is too small. As shown on Exhibit QGC 5.2 column (b), there is currently $232 of investment in mains, $205 in services lines, and $134 in meters and

[5] Response to Data Request CCS 14.22.

regulators reflected in the Company's existing rates. QGC is proposing a construction allowance comprised of two components. The first component relates to mains. For this component the Company proposes a construction allowance of $730, although the amount included in rates is only $232. This results in a shortfall of $498 for every additional customer, which will eventually be reflected in all customers' rates. I believe such an intergenerational subsidy in which existing customers subsidize new customers is inappropriate.

The second component relates to services lines, meters and regulators. For this component the Company proposes a construction allowance of $570, while the amount included in rates is $339. Again, the shortfall results in a subsidy, in this case of $231.

To ensure that intergenerational subsidies are minimized, the Company should require a CIAC to recover the difference between the total cost of new facilities and the amount that is embedded in rates. In this case the construction allowance for mains should be $232, instead of $730, and the construction allowance for service lines, meters and regulators should be $339, instead of $570.

Q. The Company proposes increasing the CIAC by only $100 because collecting the full amount of $828 would "be too large of a shock for new customers." Do you agree?

A. No. I disagree with this logic for a number of reasons. First, in many instances it is not the customer that pays the CIAC. It is the contractor

that builds the new home. Second, assuming the contractor reflects the additional costs in the price of the home, an additional $828 on a home that costs $200,000 has a minimal impact on a customer's mortgage. Assuming a mortgage rate of 6.00%, an additional $828 would increase the customer's principal and interest payment from $1,199.10 to $1,204.07, which is an increase of $4.96 per month or less than a ½% increase. Given that the NPF is $12 per month, it is doubtful that an increase in the CIAC level would cause sticker shock to the customer purchasing a new house.

Other forces that might affect the level of the CIAC include the extension policies of competing gas utilities and competing fuels located in the same general vicinity. If there are areas in which another gas utility was located, significant differences in extension policies may cause a developer to locate in the service territory of the local distribution company with the more generous allowance. In this case, QGC is the largest local distribution company in the state, which greatly minimizes this concern.

Regarding competition among fuels, this also would be an insignificant issue in QGC's service territory. The Company estimates that 99% of its customers use gas for heating purposes.[6] The only real competition would be electric service, which is still priced significantly higher than gas for heating purposes.

For these reasons, the construction allowance for mains should be set at the amount reflected in the rates approved in this case, which the

Company indicates is $232. The construction allowance for service lines, meters and regulators should also be established at the amount reflected in the rates approved in this case, which the Company indicates is $339. If these amounts are changed as a result of the Commission's decision in this case, the construction allowances should be adjusted accordingly.

If the Commission feels uncomfortable about moving immediately to establish construction allowances that reflect the costs embedded in the current rates, I would suggest a phased-in approach over three years in which the construction allowance is gradually decreased to the amount embedded in rates. I have calculated such a timetable in CCS Exhibit 6.8. Pursuant to this alternative, I propose the following construction allowance levels:

- $1,171 effective January 1, 2003;
- $871 effective January 1, 2004; and
- $571 effective January 1, 2005.

In addition, I propose the construction allowance be updated during every rate case proceeding to reflect the actual embedded investment in mains, service lines, meters, and regulators in the rates approved by the Commission. I also recommend that the Company update its estimated cost of investment per customer on an annual basis, and file it with the Commission. This would provide parties with the information necessary to

[6] Response to Data Request UEO 1.9

determine if the Company is charging the appropriate cost of extending service to new customers.

Q. You indicated that there were several changes the Company included in its proposed tariffs but did not address in their testimony. Would you please identify those again?

A. Yes. The following changes to the tariffs governing extensions that were not discussed in QGC's testimony, included:

- Calculation of the default payment for mains extensions;
- Construction allowance for firm commercial customers' mains extensions;
- The breakdown of the service line, meters and regulators extensions; and
- Excess construction costs of service line, meters and regulators extensions.

Q. Please describe the issue with the calculation of the default payment for mains extensions.

A. If a mains extension is intended to serve multiple customers, the allowance is based on all of the anticipated customers receiving service. If customers fail to initiate service within two years, the Company requires a non-refundable default payment for each customer not initiating service. Such a default payment includes interest. The provisions do not specify how the interest will be treated. I believe it should be treated as part of the CIAC and be used to reduce rate base.

Q. Please describe the issue relating to Firm Commercial Mains Extensions.

A. The Company proposes changes to the Firm Commercial Mains Extensions portion of the tariff. I have a number of concerns regarding extensions to firm commercial customers. First, they have the same rate as residential customers. Presumably, the embedded cost of construction in the rates is the same for both. Second, the Company did not indicate anywhere in its testimony that the cost of extending service to commercial customers was any different than extending service to residential service. Finally, since the Company provided no support in its testimony for the change, I find it difficult to determine its reasonableness.

I recognize that commercial customers may have different load characteristics and have a higher level of usage than residential customers. However, because they are lumped with residential customers in the GS-1 rate schedule, it is difficult to determine any differences. I have previously recommended that the Commission establish a different rate schedule for residential customers. This is another reason for pursuing separate rate schedules.

The lack of information provided by the Company in its case puts us in a difficult position. On the one hand, the Company did not provide any support for the change. On the other hand, leaving the commercial customers on existing footage allowance is not advisable. Therefore, by default we are left with the Company's recommendation of a construction

allowance of 2½ times the estimated non-gas cost revenue. While we are uncomfortable with this approach, it is preferable to the existing tariff for the time being.

To rectify this situation, I recommend that the Commission order the Company to establish separate accounts for the purpose of tracking the cost of extensions for residential customers and commercial customers to the maximum extent possible. This will enable parties to identify the costs associated with extending services to the different classes. It will also permit the parties to determine the reasonableness of the firm commercial extension policy. I also recommend that the Company be required to file a report with the Commission identifying the costs of extending services to new customers on an annual basis.

Q. Please discuss the issue related to the breakdown of the construction allowance.

A. In the tariff language applicable to both mains extension and service lines extension, the Company identifies the type of gas appliances for the construction allowance. Regarding the mains extension, the Company simply indicates that extensions providing service to space and water heaters should have a $730 allowance. Regarding the service lines extension, the Company's proposed allowance of $570 was split between space and water heaters, dryers, and ranges, with an allowance of $470 if there is only a space and water heater. If there is a dryer or a range, the allowance is increased by $50 for each type of appliance. Presumably, if

a customer had all three, he or she would qualify for the $570 construction allowance.

The Company does not provide any support for the different allowances for the different types of gas appliances. I assume that the difference for the allowance is based on the Company's belief that the absence of a specific appliance will reduce the customer's usage. I do not necessarily disagree with such a premise. However, I find it interesting that in the current provisions space heating and water heating have separate allowances, while they are combined in the new tariff provisions. I suggest the Company separate the allowance for space and water heating purposes, and that the same split be used for mains and for service lines extensions. The proportional difference between a water heater and the dryer/range in the current tariff provisions is 1.5 to 1, i.e., 15 feet for a water heater and 10 feet for a dryer/range. In the new tariff, a dryer/range is given an additional $50 allowance. Using the same proportion the water heater would get a $75 allowance. This would leave $395 for a furnace.

It would also be appropriate to use the same proportion for the mains extension. Under this scenario, a furnace would qualify for a $505 allowance, the water heater would qualify for $95, and the dryer/range would qualify for $65 each. I recommend these differences be incorporated into the new tariff in recognition of the possibility that while

the cost of the extension may be the same, the customer's usage will be less, and therefore the construction allowance should be less.

Q. What would the construction allowance by appliance be if the Commission agrees with your proposal to reduce the construction allowance to the amount of investment embedded in rates?

A. To determine the construction allowance per appliance based on our proposal, I used the same percentages as contained in the Company's proposed construction allowance by appliance. CCS Exhibit 6.9 shows the percentage allowance by appliance in the Company's proposed tariff. Columns (c) and (d) contain the calculation for mains extension and columns (e) and (f) show the calculation for the service lines, meters, and regulators. The totals are shown in column (g) and (h). I applied the percentages shown in column (h) of Exhibit 6.9 to our proposed allowances to develop the allowance per appliance. The calculation is shown on CCS Exhibit 6.10. If the Commission decides to permit a construction allowance equal to the investment embedded in rates, the construction allowance per appliance is shown in column (f) of Exhibit 6.10. If the Commission decides to phase in the construction allowance the allowance per appliance for each time period is shown in columns (d), (e), and (f).

Q. Please discuss the issue related to excess construction costs.

A. In both the mains extension and the service lines extension tariffs, there is language relating to excess construction costs. In the mains extension

provisions, the language appears on page 76 and in the service line provisions it appears on page 80. In both instances the language states, "If, in the Company's judgment…" an extension requires excess costs the customer will pay an additional amount as a contribution. With the changes in the extension policy from a per foot basis to a cost basis, I believe the language "in the Company's judgment" should be stricken. Since the cost of the construction will be calculated and the amount of the allowance is known this language is unnecessary.

Q. Does this conclude your testimony?

A. Yes.