— BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH —

IN THE MATTER OF THE APPLICATION OF MOUNTAIN FUEL SUPPLY COMPANY FOR AN INCREASE IN RATES AND CHARGES.	)))))	<u>DOCKET NO. 95-057-02</u> <u>REPORT AND ORDER</u>

<u>ISSUED: October 17, 1995</u>

SYNOPSIS

By this Order, the Commission authorizes an increase in Mountain Fuel Supply Company's annual revenues of $3.7 million and a return on rate base within a range of 10.22% to 10.34%. The $3.7 million is to be collected as follows: $2 million from a new premises fee and $1.7 million from capacity release credits. The Commission authorizes the collection of the revenue deficiency through implementation of a new premises fee of $12.00 per month to be assessed on new GS-1 and GSS residential premises for 12 months. Mountain Fuel is further authorized to record 20% of capacity release credits as part of the $3.7 million increase, as distribution non-gas revenues. Mountain Fuel is further authorized to implement a weather normalization adjustment (WNA) to be applied as of September 1, 1995, to Equal Payment Plan customers and non-residential GS-1 and GSS customers. Mountain Fuel is authorized to implement a voluntary WNA at its option for all remaining residential customers prior to the 1999-2000 winter heating season. The SNG cost assignment now imposed on IT, IT-S and FT rates, and as originally ordered in Docket No. 95-057-01, is phased out over a two-year period. This order accepts stipulations entered into on August 1, 1995, and August 9, 1995, by the parties in this case.

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APPEARANCES:

Laurie Noda, Assistant Attorney General	For	Division of Public Utilities
Kent Walgren, Assistant Attorney General	"	Committee of Consumer Services
Charles Greenhawt Jonathan Duke	"	Mountain Fuel Supply Company
Mark Moench	"	Kern River Gas Transmission Company
Gary Dodge	"	Energy Strategies, Inc. on behalf of various transportation customers
Gordon Smith	"	Associated Gas Services, Inc.

I.

INTRODUCTION AND PROCEDURAL HISTORY

Procedural History

On March 3, 1995, Mountain Fuel Supply Company (Mountain Fuel or Company) applied for a general increase in its rates and charges for natural gas service rendered in the State of Utah in the annualized amount of $9,559,000. In its application, the Company represented that its revenue deficiency resulted from increased rate base and operating expenses. Mountain Fuel's application was accompanied with prefiled testi-mony and exhibits from eight company witnesses and one expert witness. The Division of Public Utilities (Division), the Committee of Consumer Services (Committee), Associated Gas Services, Inc. (Associated Gas), Kern River Gas Transmission Company (Kern River), and Energy Strategies, Inc. (ESI), representing several transportation customers, intervened in this case. On March 21, 1995, the Commission held a prehearing conference to resolve scheduling and procedural issues, including the scheduling of a hearing on the choice of test-year.

On March 30, 1995, the Commission held a hearing to determine the appropriate test year to use in this proceeding. Position statements on the appropriate test year were submitted on March 24, 1995, by the Company, the Division and the Committee.

During the March 30, 1995, test-year hearing, Alan K. Allred testified for the Company, Carl L. Mower testified for the Division and Sandy Mooy testified for the

Committee. Mr. Allred argued that a 1995 projected test-year, rather than a 1994 historical test-year, would more closely approximate the conditions when rates from this case will be in effect. Mr. Allred's principal reasons for advocating a future test-year were that the 1995 test-year would reflect the cost and revenue implications of the additional customer growth the Company expects, as well as cost containment measures such as the early retirement program the Company implemented in April 1995. Mr. Allred also testified that an historical test-year unadjusted for known and measurable post-test year events would not be just and reasonable because it would not reflect these conditions.

Mr. Mower testified that the Division's general position was that a test-year should be decided on a case-by-case basis. The Division took the position that the appropriate test-year for this case was an historical test-year with no post-test-year adjustments based on the Commission's preferences ordered in recent cases and stable economic conditions. Mr. Mower testified that although the Division has at times supported the inclusion of known and measurable post-test-year adjustments, there is no evidence to support any post-test-year adjustments in this case.

Mr. Mooy also argued that the appropriate test-year was a 1994 historical test-year with no post-test-year adjustments. Mr. Mooy testified that an historical test-year would be simpler to use and would produce fairer results.

In our Report and Order issued on April 10, 1995, we reiterated our preference for an historical test-year and our practice of frequently disallowing post-test-year adjustments to the test-year to avoid a mismatch of revenues, expenses, and investments. We also noted that the Commission can amend its position under different economic circumstances where an historical test year would not adequately reflect conditions of the rate-effective period. The Commission determined that Mountain Fuel did not meet the burden of showing both the need for the adjustments and any offsetting revenues. Based on its findings and conclusions, the Commission ordered that the appropriate test year for use in this case was an historical 1994 test year with no post-test year adjustments.

In response to the April 10, 1995, Order on test year, the Company submitted its compliance filing on April 13, 1995, which revised the testimony and exhibits of five Mountain Fuel witnesses and reported that the 1994 test year resulted in a deficiency of $11,389,000.

On June 19, 1995, the Division, Committee, and ESI filed direct testimony. On July 26, 1995, the parties filed rebuttal testimony. On August 1, 1995, the Company, Division, and Committee filed a motion requesting a prehearing conference to discuss a stipulation into which they had entered. A prehearing conference was held on August 2, 1995, to consider the stipulation and its rate design implications for transportation customers. While ESI did not oppose the stipulation, they requested that the Commission hold hearings on the supplier non-gas (SNG) cost assignment to transportation customers and other rate-design issues dealing with transportation service. Kern River and Associated Gas did not take a position on the stipulation.

In a bench ruling during the August 2, 1995, prehearing conference, the Commission ordered that the hearings would begin on August 9, 1995. The

Commission ordered that testimony regarding the SNG cost assignment and modifications to the tariff sections dealing with interruptible service would be heard at that time. The Commission directed that it would hear testimony regarding the stipulation. The Commission further ordered that a notice be published describing the stipulation and informing the public of public witness day on August 11, 1995. A notice was subsequently published for two days in the *Salt Lake Tribune* and the *Deseret News* as ordered.

At ESI's request, the August 9, 1995, hearing was moved to August 10, 1995. At the beginning of the hearing on August 10, 1995, a second Stipulation was presented resolving ESI's rate-design issues. It was supported by the Division, Committee, and ESI and unopposed by Associated Gas. Kern River took no position. The Stipulation was submitted to the Commission for its consideration in conjunction with the prior stipulation as a complete settlement of all contested issues.

The Commission received considerable testimony concerning the stipulations at the prehearing conference held on August 2, 1995, and during the two days of hearings on August 10 and 11, 1995. The Commission conducted a lengthy inquiry into the terms and conditions of the proposed settlement and the underlying basis of the agreement between the parties. The entire stipulations, together with the tariff revisions, are attached. The testimony and Commission inquiry is summarized by issue below.

II.

REVIEW OF THE PARTIES' POSITIONS

The positions taken by the parties in their direct, rebuttal, and surrebuttal testimony on each of the contested issues are summarized as follows:

A. COST OF CAPITAL ISSUES

Company witness, Dr. R. Charles Moyer, employed a number of alternative approaches to determine the cost-of-equity capital. He first used a discounted cash flow model (DCF) of firm valuation and applied it to a group of eight natural gas distribution companies of similar size and risk. He then applied the capital asset pricing model (CAPM) to provide an independent gauge of the cost-of-equity capital. He performed a comparable earnings analysis based on expected returns on common equity for the same group of eight natural gas distribution companies, and he verified the reasonableness of his cost-of-equity estimates by comparing it to historical equity risk premiums in the utility industry. Based on his analysis, he determined that the cost-of-equity capital for Mountain Fuel was in the range of 11.7% to 13.7% as of December 1994, the end of the test period. He weighed the results of the various approaches used to estimate the cost-of-equity to arrive at a final recommended return on common equity (ROE) of 12.5%. Dr. Moyer determined that Mountain Fuel's actual capital structure was well within the bounds of a reasonable and prudent capital structure for a firm in the natural gas distribution industry, especially considering the increased business risk facing that industry under FERC Order No. 636. His overall return recommendation was 10.89%.

Division witness, Judith Johnson, recommended that Mountain Fuel be allowed a return-of-equity of 11.0%. She relied on two DCF models to reach this conclusion and used the CAPM as a way to check the reasonableness of the DCF results. Ms. Johnson applied the two DCF models to the same eight representative natural gas companies used by Dr. Moyer. The first DCF model was a familiar DCF model where the cost of capital was the sum of the expected yield plus expected growth. The price used to calculate the yield was the spot price for June 1, 1995, and the dividend figure used was the latest indicated dividend from the March 31, 1995, Value Line. The growth was estimated by using the Institutional Brokers Estimation Service (IBES) mean five-year earnings growth forecast. This model produced a cost-of-equity capital estimate of 11.3%. Ms. Johnson's second DCF model was a non-constant-growth model based on Value Line estimates. This resulted in cost-of-equity capital of 10.6%. Ms. Johnson testified that the midpoint of the two DCF model estimates is 11.0%, which equated to the Division's recommendation.

Ms. Johnson supported the reasonableness of her recommendation in two ways. First, she noted that the 11.0% cost-of-equity recommendation represents a premium of 3.2% over 30-year utility A-rated bonds. She also used the CAPM as another check of her DCF estimates. Under the CAPM, she used the 30-year treasury bond rate as an estimate of the risk-free rate. The market premium was the average premium taken from the 1995 Ibbotson's yearbook. Ms. Johnson's CAPM analysis produced a cost-of-equity capital of 11.0%. Ms. Johnson accepted the Company's actual capital structure. Based on this analysis, she recommended that Mountain Fuel be allowed an overall return of 10.06%.

Committee witness John B. Legler also recommended that Mountain Fuel's return-on-equity be set at 11.0%. He relied on four different DCF models. These models were based on various assumptions about the growth rate. The average of these models was 10.08% for average prices and 10.18% for current prices. Dr. Legler also presented two risk premium analyses, one based on longer-term premiums which showed a 10.77% to 11.10% result and one based on five-year premiums which showed a 9.67% result. He also used a CAPM methodology, which produced results from 8.87% to 11.93%. Based on his entire analysis, Dr. Legler established a 10.4% to 11.1% ROE range and recommended 11.0%. His overall return recommendation was 10.06%. Dr. Legler also provided a DCF analysis of companies with and without WNA, which resulted in his recommendation that Mountain Fuel's allowed ROE be reduced by .5% if the WNA was adopted. For purposes of calculating the company's cost-of-capital, he used the company's proposed capital structure.

In response to the Division and Committee witnesses, the Company filed rebuttal testimony from Dr. Moyer, Richard T. Pratt, R. Dyke Benjamin, and John E. Olson. Dr. Moyer argued that the analyses of both Ms. Johnson and Dr. Legler were inconsistent with the Commission's April 10, 1995, Order in this case which directed that "Mountain Fuel prosecute this case based on a 1994 historical test year" and that "MFS exclude post-test-year adjustments from this case." Dr. Moyer recomputed Ms. Johnson's constant-growth DCF estimate, relying only on test-year data. Overall, he concluded that this modification of her analysis suggests a cost-of-equity capital of at least 30 basis points higher than the 11.0% she recommended. Dr. Moyer also contended that Ms. Johnson's estimates which used one-half the growth rate to estimate the D1 factor in her DCF model resulted in a downward bias of approximately 10 basis points. He further stated that the use of quarterly compounding in the DCF model would result in a higher estimate. He further testified that Ms. Johnson's two-stage DCF model was incomplete and based on unrealistic assumptions, which resulted in a substantially downward-biased cost-of-equity estimate.

Dr. Moyer contended that Dr. Legler's DCF analysis is flawed because of the use of improper and biased growth rate estimates, including historical earnings growth rates which, in Dr. Moyer's view, are essentially unrelated to future realized rates of growth. He argued that Dr. Legler applied unrealistic criteria for excluding certain estimates from his final DCF computations. He removed estimates he deemed to be "too high" but did not apply similar risk/return criteria for low estimates. He contended that Dr. Legler's application of the CAPM model was inconsistent with his earlier comparable risk analysis. He testified that Dr. Legler uses Value Line Beta estimates to screen sample firms for comparable risk, but then was unwilling to use these same Beta estimates in the CAPM model itself.

Dr. Moyer also performed a computation of Dr. Legler's calculations, excluding post-test-year data. Dr. Moyer's computations suggested a cost-of-equity capital of approximately 85 basis points greater than the 11.0% Dr. Legler originally recommended.

Dr. Richard T. Pratt testified that theoretical financial models are an attempt to quantify and simplify complex real processes. He concluded that Ms. Johnson and Dr. Legler had not appropriately indicated that theoretical models are gross simplifications of complex real processes and that estimation of inputs of these theoretical models are subject to analysts' discretion. He suggested that the Commission recognize that the theoretical models depend heavily upon the witnesses' assumptions and choice of data and therefore provide only a rough guide to the real cost-of-equity capital. Dr. Pratt then presented a detailed critique of the assumptions used by Ms. Johnson and Dr. Legler in calculating the cost-of-equity. He testified that these assumptions resulted in estimates of ROE ranging from 8.43% to 13.7%. He concluded that, as a former investment banker, he would be hesitant to raise capital for Mountain Fuel with an allowed ROE below 12.0%, but saw no need for a return above 13.0%. He recommended that the Commission adopt the midpoint of this range, which is 12.5%.

Company rebuttal witness, R. Dyke Benjamin, stated that he was responding to Ms. Johnson's contention that investors rely on some form of DCF analysis to value securities and make investment decisions. Mr. Benjamin stated that DCF and capital-asset pricing models actually play a very small role in an investment analysis of which companies are worthwhile investments. Mr. Benjamin described how his investment firm of Lazard Freres Asset Management analyzes various factors such as political context, regulation, service territory, expense control, demonstrated earnings, dividend and cash-flow growth. He testified that while he uses elements of DCF and CAPM models in the decision-making process, his firm does not rely on them as heavily as

Ms. Johnson's testimony seemed to suggest. He testified that Mountain Fuel has positive potential and would likely be considered an attractive stock when management and service territory performance alone are considered. However, he testified that the Company has reported a flat level of distribution income during the past five years, which is troubling because earnings growth is the key to future total return. He stated that there are a number of alternative investments in firms of comparable risk that, as an investor, he would view as superior to Mountain Fuel if an 11.0% return on equity is continued. He suggested that Dr. Moyer's recommendation of 12.5% return is more constructive.

Company rebuttal witness, John E. Olson, also took issue with Ms. Johnson's testimony regarding methods used by investors in evaluating different investments. He testified that returns currently allowed by state regulatory commissions will not adequately permit gas utilities to continue to attract capital on reasonable terms and that equity investors were increasingly dissatisfied with allowed returns-on-equity resulting from models such as those applied by Ms. Johnson and Dr. Legler. He testified that models such as the DCF have been applied incorrectly and that allowed returns are set too low. He testified that investors perceive that there are other investments of similar risk to Mountain Fuel offering a higher return than that recommended by witnesses in this case. He recommended that the Commission should approve a return-on-equity of 13.7%, at the upper end of Dr. Moyer's range.

In her surrebuttal testimony, Ms. Johnson responded to Dr. Moyer's position on the use of the data after the end of the 1994 test year. She maintained that establishing an adequate return level can only be done by using forward-looking data and that Dr. Moyer's estimate using 1994 data projected expected returns for the future, not returns expected for 1994. Further, she stated that even using Dr. Moyer's restatement of her methodology, the midpoint of the range is 11.0%. She pointed out that Dr. Moyer did not use the quarterly compounding version in his DCF analysis and that the assumptions required for the two-stage DCF model were similar to those required for the constant growth DCF model which all witnesses used.

She responded to criticisms relating to the adequacy of an 11.0% ROE by opining that such a return was adequate because of the lower investor-perceived risk with natural gas utilities compared to the market as a whole.

Ms. Johnson responded to criticism of her statement that DCF analysis is used by investment professionals. The intent of her statement was that some form of discounted cash flow analysis is used in evaluating securities, not that these analyses used the same DCF models used by her and other witnesses in this case.

In Ms. Johnson's response to Dr. Pratt's testimony, she pointed out that Mountain Fuel's witness, Dr. Moyer, also relied on the same models and assumptions to make his estimates as did the Committee and the Division witnesses. She said that Dr. Pratt was incorrect in his statement that she relied on dividend growth rates to estimate the cost-of-equity capital. She illustrated that she used earnings growth estimates equally with dividend growth estimates in her models.

In Ms. Johnson's response to R. Dyke Benjamin, she noted his criticism of reliance on the DCF models but testified that she could find little insight in how he would recommend that the models be adjusted and that his testimony was ultimately one ana-lyst's opinion that her recommended return-on-equity was too low.

In Ms. Johnson's response to Mr. Olson, she testified that setting allowed natural gas returns based on a rolling average of S&P 500 historical equity returns as recommended by Mr. Olson ignores risk and reward relationships. She also testified that Mr. Olson offered no evidence to support his contention that investors perceive that they can achieve higher returns from investments of similar risk.

Ms. Johnson's final conclusion was that 10.6% to 11.3% was a reasonable range for Mountain Fuel and that she recommended 11.0% as a point estimate.

In his surrebuttal testimony, Dr. Legler stated that he disagreed with Dr. Moyer's position on the use of data after the end of the 1994 test year to establish the reasonable rate-of-return. He stated that it is common to use financial data up to the time of the hearing to determine the appropriate return levels. He also stated that use of such data does not result in a mismatch of revenue, expenses, and rate base. Dr. Legler also commented on the testimony of Mr. Rose, Dr. Pratt, Mr. Benjamin, and Mr. Olson. Dr. Legler pointed out inconsistencies in their positions and challenged their contentions about the alleged insufficiency of his ROE recommendations. Dr. Legler did not change his recommendation on rate-of-return.

B. RATE BASE ISSUES

The test-year-rate base used by all parties in this case was an average of the monthly averages of utility plant, material and supplies, and cash working capital for the 1994 test year. Cash working capital for the 1994 test year was derived by means of a lead-lag study. The majority of the Company's proposed adjustments to rate base were unopposed by the other parties. These unopposed adjustments include: the correction of some accounting errors, the reduction of plant accounts related to the production area by 6.3% as specified under the Wexpro Agreement[1], the inclusion of average working storage gas costs in pass-through cases, the impacts on rate base of unbilled revenue and banked vacations, the annualization of Mountain Fuel's general office building transfer to an affiliate, and the completion of its new operations center.

The only rate-base issues of significance related to the lead-lag study used to calculate cash working capital and deferred taxes associated with IRS section 29 tax credits, which were discovered after the Company had filed its rebuttal testimony.

1. Lead-Lag Study

With respect to the lead-lag study, the Division and Committee witnesses proposed a change in the calculation of the lead time relating to payroll expenses. Committee witness, Hugh Larkin, and Division witness, Chester G. Sullivant, proposed modifications of the methodology used to calculate lead days associated with labor. The results of the two methodologies varied only slightly.

[1] Wexpro Stipulation and Agreement, *In re Mountain Fuel Supply Co.*, PSCU Case No. 76-057-14 (approved October 28, 1981).

Company witness, Gary L. Robinson, testified that the method proposed by Mr. Larkin was an acceptable calculation. He further testified that during June of each year, the Company pays gross receipts tax to the State of Utah, which covers costs of regulation. In prior years, the assumption used in the lead-lag study was that this tax payment applied to regulation provided in the previous year. However, Mr. Robinson argued that the gross receipts tax statute indicates that the payment is more properly applied to services received during the current year, even though prior-year revenues are used to determine the amount of the tax.[2] Mountain Fuel's rebuttal position with regard to this issue was that no lag days be assigned to this amount of expense.

2. Deferred Taxes Associated with Section 29 Tax Credit

In revised rebuttal testimony, Mr. Gary Robinson corrected an error that was discovered by consultants hired by the Division to review income tax issues in this case. The deferred taxes associated with Section 29 income tax credits, in the amount of $4,085,467, were inadvertently excluded from the case. Mr. Gary Robinson corrected this error and provided a calculation of the Company's revised rebuttal position on rate base.

The Division's surrebuttal position agreed with this correction. The Committee also indicated that it did not oppose the Company's correction of this error.

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[2] *See* Utah Code Ann. § 54-5-1.5(2)(c) (1994).

C. DISTRIBUTION NON-GAS REVENUES

1. Weather Normalized Revenues

Mountain Fuel based its normal weather calculation on the average heating degree days observed during the 30-year period ended December 31, 1990, as previously approved by this Commission, to adjust sales volumes to reflect normal weather[3].

Division witness, Thomas F. Peel, testified that Mountain Fuel's determination of 1994 test-year volumes and revenues was reasonable. Mr. Peel also proposed an adjustment to the IT test-year volumes and revenues, which was agreed to by the Company.

Committee witness, Mary H. Cleveland, proposed three minor adjustments to test-year revenues. These included an adjustment to annualize new F-4 revenues, an adjustment to annualize the increased revenues resulting from customers switching all or part of their usage to the FT rate schedule during the test year, and an adjustment to annualize the loss in revenues resulting from customers switching all or part of their usage to the I-4 rate schedule during the test year. In her rebuttal testimony, Ms. Cleveland agreed that the adjustment relating to FT service should be eliminated

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[3] This method was approved by the Commission in Docket Nos. 89-057-15 and 93-057-01.

because it was already included in the IT adjustment made by Mr. Peel and agreed to by the Company.

2. Contributions in Aid of Construction

The only material exception to test-year revenues raised by the Division was its opposition to the proposal by the Company to alter the treatment of contributions in aid of construction (contributions) to reflect a liability for future refunds. When a customer's service initiation request requires an investment in main or service line above the footage allowed in the tariff, a contribution is required from that customer. This contribution is treated as revenue for financial, income tax and ratemaking purposes. As additional customers connect to the main, the Company may be obligated to pay the original contributing customer a partial refund.

In 1987, Mountain Fuel requested Commission permission to report refundable and non-refundable contributions as revenues. The Commission approved this methodology in Docket No. 87-057-13. In Mountain Fuel's two subsequent rate cases, contributions have been recognized as revenues by the Commission. In this proceeding, Company witness, Gary L. Robinson, requested that a portion of the refundable contributions not be treated as revenues, but rather be recorded as a liability. Mr. Robinson explained that the Company's external auditors had pointed out that the current procedure of recording contributions, which included the refundable portion as revenues, arguably overstates income and ignores the refund liability.

Division witness Sullivant testified that the Company should continue reporting contributions in the same way it has since 1987. Mr. Sullivant testified that the current method makes consistent the Company's accounting, ratemaking, and income tax reporting methods for contributions in aid of construction. He testified that the current system is the most beneficial accounting treatment for customers.

In his rebuttal testimony, Mountain Fuel witness Furness further explained that the Company's proposal for contributions is to set up an accrued liability account for the portion of contributions expected to be refunded. He testified that current accounting standards dictate that contingencies that are probable and measurable should be recorded as liabilities.

In surrebuttal testimony, Division witness Sullivant maintained his opposition to this proposal. The Committee did not oppose the Company's proposal.

D. OPERATING EXPENSES ISSUES

The major operating expenses issues are summarized as follows:

1. Annualization of Labor Expenses

To calculate labor expense, Company witness, Gary L. Robinson, testified that the Company utilized the annualization method approved by the Commission in Mountain Fuel's last rate case. Mr. Robinson based his calculations on the average number of employees during the 1994 test year.

Committee witness, Laura Steinke, testified that the Company's payroll annualization failed to give effect to a decrease of 26 full-time employees during 1994. She testified that this decline is expected to continue in the future, particularly given the early retirement program that took place in the spring of 1995. Because of this trend, Ms. Steinke annualized full-time employees based on December 1994 employee levels.

In rebuttal testimony, Mr. Robinson stated that using an average number of employees during a test-year is in accordance with Commission orders in both the previous Mountain Fuel general rate case and in U. S. West rate cases over the past few years.

2. Bad Debt Expense

Both the Division and Committee proposed to reduce expenses associated with test-year bad debts. Division witness Sullivant proposed to use a three-year average of net writeoffs to calculate a bad debt expense of $936,000. Committee witness Larkin proposed to use a two-year average of net writeoffs of uncollectible accounts, or

$812,000. Mr. Larkin also proposed to reduce the reserve for collectible accounts by $1,086,000 and amortize the reduction in over three years. This would result in a reduced annual expense of $363,000.

In rebuttal testimony, Mr. Furness testified in support of the Company's proposal to use the actual test year expense of $1,142,000. He also stated that Mr. Larkin and Mr. Sullivant's recommendations do not reflect proper accounting treatment for unbilled revenues, adopted in 1994 pursuant to the Commission's order in Mountain Fuel's last rate case. He questioned the fairness of using either a two- or three-year average and contended that the amortization proposed by Mr. Larkin would violate the prohibition against retroactive ratemaking. In surrebuttal testimony, Mr. Sullivant and Mr. Larkin maintained their original positions.

3. Advertising and Promotional Activities

Mountain Fuel witness, Susan Glasmann, testified in support of test-year advertising expenses of $1,058,033. These expenses included amounts for financial, informational, public interest and promotional advertising. Ms. Glasmann testified that the Commission's advertising rule, Utah Admin. Code R746-406, does not necessarily prohibit coverage for promotional advertising if it is in the public interest. She also advocated that the Commission should change its practice of frequently disallowing advertising expenses. When the Commission's advertising rules were implemented, it was during the energy shortages of the 1970s. Ms. Glasmann testified that currently, natural gas supplies are abundant and therefore the concerns of the 1970's about energy shortages no longer apply.

Ms. Glasmann also testified about an advertising survey conducted for Mountain Fuel by Kagel Research. She stated that the survey indicated that a significant majority of respondents expressed a willingness to pay for advertising information in their natural gas charges, and 80% of these customers stated that they would willingly pay $2 to $3 per year for advertising in rates, an amount greater than the Company's total advertising budget.

Ms. Glasmann also testified that the limited costs of Mountain Fuel's advertising are more than made up in increased revenues from secondary natural gas usage, which is of benefit to all natural gas customers.

Committee witness, Mary H. Cleveland, proposed to disallow various portions of the Company's advertising expenses. She referenced the Commission rules on advertising and promotional programs (Rules 746-404 & -405), as well as the Commission Order in Mountain Fuel's last case, Docket No. 93-057-01. She further disagreed with Ms. Glasmann's classification of promotional advertising as being in the public interest and, therefore, proposed to disallow it. She further criticized the co-op advertising program because it is connected to load building by increasing natural gas appliance saturation.

Division witness, Darrell S. Hanson, testified that the Commission should not change its policy on advertising. He stated that Ms. Glasmann's testimony -that some advertising categories should receive rate coverage because they will create a revenue stream greater than the advertising costs- contained computational errors. He also disputed the Kagel survey and the claim that customers want certain advertising and are willing to pay for it.

Company witness, Ronald R. Durtschi, testified that over time the value of the increased revenue stream will exceed the one-time cost of promotional advertising, contrary to Mr. Hanson's conclusion. He explained that, while no party has suggested that these additional revenues be removed from this and future test years, the Company currently is precluded from collecting promotional advertising costs in its rates, which results in an inequitable situation. In surrebuttal, Mr. Hanson went into a more detailed explanation of his disagreement with Ms. Glasmmann and Mr. Durtschi over the treatment of promotional advertising costs.

4. <u>Dues and Donations</u>

Committee witness Cleveland and Division witness Sullivant recommended that certain economic development expenses and dues should be disallowed from Mountain Fuel's test-year expenses. These include economic expenses paid to the Economic Development Corporation of Utah, the Committee to Save Hill Air Force Base, and various home builder, hotel and restaurant associations, among others. Ms. Cleveland argued for the disallowance of these expenses because of her belief that some of these organizations engage in lobbying efforts or are charitable organizations. She also argued that any contributions to third-party organizations which engage in economic development should be disallowed. She testified that it is inappropriate for ratepayers to fund these organizations through their utility bills.

Mr. Sullivant testified that these same costs should be disallowed based on standards set by the Commission in Mountain Fuel's last general rate case. He stated that Mountain Fuel must show with convincing evidence that such expenditures are directly beneficial to ratepayers and that it is not up to intervening parties to disprove the Company's position. He testified that Mountain Fuel must also show that expenditures promote the efficient use of natural gas in lieu of other forms of energy.

Mountain Fuel witnesses, Dr. Thayne Robson and D. N. Rose, testified that economic development expenditures help retain and bring jobs, increase tax revenues, and increase natural gas sales from businesses attracted to the state. Mr. Rose criticized the one-sided nature of these adjustments where Division and Committee witnesses proposed to remove costs while making no effort to remove any revenues they generated or caused to be retained. He also criticized efforts to remove dues and memberships to associations that are vital to Mountain Fuel's efforts to serve customers and meet the demands of growth. The Company disagreed with Ms. Cleveland's characterization of the organizations in question as being charitable or as engaging in lobbying activities.

5. Incentive Compensation

Mountain Fuel witness, Glenn H. Robinson, testified that the Company's Performance Incentives for Employees (PIE) program has been redesigned to comply with the Division's and Committee's recommendations and the Commission's final order in Mountain Fuel's last general rate case. He also presented testimony regarding Mountain Fuel's other employee incentive programs, including Mountain Fuel's Annual Management Incentive Program (AMIP) program, Questar AMIP, discretionary bonuses and incentive overheads.

Division witness, Paul F. Mecham, recommended allowance of 47% of Mountain Fuel's AMIP program and 90% of Mountain Fuel's PIE program. He testified that, compared to their predecessor plans, the current incentive plans have improved with the PIE program improving significantly.

Committee witness, Hugh Larkin, stated that changing the net income trigger in the 1993 PIE plan to the O&M expense trigger in the 1994 PIE plan was an improvement because the O&M expenses are not readily influenced by weather. He testified that because shareholders and ratepayers benefit from Mountain Fuel meeting its PIE goals, that rate recovery should be shared equally between the two groups. As to Mountain Fuel's AMIP, Mr. Larkin testified that only the portion of compensation expense predicated upon customer service and employee productivity goals should be recovered from ratepayers.

In rebuttal testimony, Mr. Glenn Robinson recalculated Mr. Mecham's Exhibit 4.2 using a computational methodology that he believed was more consistent with principles Mr. Mecham espoused and argued that Mr. Mecham should have allowed 62% of Mountain Fuel's AMIP rather than 47%, and 100% of the PIE expenses rather than 90%. He explained why he believed all of the incentive compensation payments of the Company should be allowed. Mr. Mecham believed that Mr. Robinson's recalculation was not an accurate reflection of the Division position.

6. Aircraft

Following the Commission's directive on Mountain Fuel's 1993 general rate case, the Company established new guidelines for using the corporate aircraft based on Questar Pipeline's accounting treatment. Questar Pipeline charges a monthly fixed fee based on each affiliate's previous year's percentage of the aircraft's total flight hours plus a variable charge per flight hour. The fixed cost accounted for 19.50% of the total $675,603 corporate aircraft costs during the test period. Committee witness Cleveland believed that the amount of fixed charges assigned to Mountain Fuel in the 1994 test year were higher than they would have been had the new guidelines been in effect in 1993. Ms. Cleveland proposed an adjustment of a portion of the fixed fee charged to Mountain Fuel which reduced tax-year expenses by $176,741. Mr. Huntsman made a similar adjustment of $173,374, stating that the demand charges to

Mountain Fuel in 1994 were out of proportion to the hours of usage. He recommended allowing a portion of fixed costs based upon the hours of usage.

Company witness, Gary Robinson, argued that the Company's revised travel policy was prudent and consistent with the Commission's order in the prior case and that the Company properly followed the policy during the test year.

7. Property Tax Refund

During 1994, the Company recorded a refund of property taxes that had been paid in prior years. These refunds resulted from Mountain Fuel's appeals to the Utah State Tax Commission, which decisions related to the years 1989, 1990 and 1992. Committee witness Larkin recommended that test-year expenses be reduced by one-third of the property tax refund. He stated that property taxes are funded through base rates and, therefore, paid by ratepayers. He contended that the refunds will be used to offset future property tax expense and, to the extent that Mountain Fuel recognized a refund in 1994, that refund should likewise be recognized for ratemaking purposes.

Division witness Sullivant testified that these refunds relate to other periods and cause the test-year level of property tax expense to be understated. He did not contest the Company's decision to remove these prior period amounts from the test-year expenses.

Company witness, David M. Curtis, testified that the property tax refunds clearly relate to prior years and the refunds received in 1994 were not representative of the test period. He criticized Mr. Larkin for retroactive ratemaking and for suggesting that decreases in expenses should be given back to customers while increases in these and other costs do not receive similar treatment. In surrebuttal testimony, Mr. Larkin referred to Mountain Fuel's response to a data request in which the Company stated that the refund would be used to offset future property tax expenses. Mr. Larkin thus disagrees with the assertion that the refunds were not reflective of going-forward conditions, and he did not alter his adjustment in his surrebuttal testimony.

8. Prior Year Section 29 Tax Credits

Mountain Fuel receives Section 29 income tax credits yearly on production of natural gas from qualifying tight sands formation wells. In 1994, Mountain Fuel also recognized tax credits related to gas production from the five previous years.

Committee witness Larkin amortized these tax credits over a five-year period, suggesting that decreases in expenses from the level included in previous test periods should be given back to customers. He believed that these credits were not retroactive because they became available in the test year and this is the only period they affected federal income tax expense.

Company witness Curtis again criticized this as an instance where Mr. Larkin proposed retroactive ratemaking when expenses have decreased, while ignoring the same type of adjustments when costs increase. He also argued that Mr. Larkin's proposed level of Section 29 income tax credits was not representative of 1994 test-year conditions. Mr. Larkin, in his surrebuttal, testified that Section 29 tax credits were analogous to investment tax credits for which ratepayers receive the benefit of the entire credit. Consequently, Mr. Larkin did not revise his adjustment.

9. Parent Company Costs

Questar Corporation assigns costs to its affiliates. Administrative costs that are not directly assignable to the affiliates who caused them are allocated by use of the Distrigas allocation.

Division witness Huntsman recommended that approximately $710,000 of corporate administrative costs which had been allocated to Mountain Fuel under the Distrigas formula should be disallowed. Mr. Huntsman disallowed varying proportions of costs allocated with respect to executive management, human resources, legislative relations, public relations and advertising, tax services, corporate financing, cash management, legal services, internal audit, strategic planning, and treasury services, based on his judgment of the amount of time and resources of each department allocated to Mountain Fuel as a proportion of total time expended in each department. He argued that some of the corporate department's duties would not be performed in a stand-alone utility environment and that others would cost less on a stand-alone basis.

Company witness, Glenn Robinson, testified that Mr. Huntsman failed to take into account the substantial cost savings which come to Mountain Fuel through the administrative efficiencies of being part of a large corporate organization. He showed that in the corporate financing and cash management areas alone, Mountain Fuel saved at least $550,000 through sharing the costs of these functions with other Questar affiliates. In addition, he pointed out that savings in administrative costs have been achieved in various utility mergers, including the Utah Power & Light and PacificCorp merger. He argued that this showed further support for the concept that sharing administrative costs reduces costs to Mountain Fuel. He also stated that Mr. Huntsman's recommended disallowance was based solely on judgment and subjective allocations. Mr. Robinson also argued that an adjustment of the type proposed by Mr. Huntsman has not been adopted by either FERC or by any of the state commissions he reviewed.

Mr. Huntsman testified in reply that there is no evidence in this case that the cost per customer for the executive and administrative functions performed by a holding company is any less than the same cost for stand-alone utilities.

10. Distrigas Allocation Annualization

At the beginning of each year, Mountain Fuel calculates the Distrigas allocation percentage using the previous years' actuals rather than estimating what assets, revenues, and sales will be during a given year. The Distrigas allocation percentage is used through the year to allocate Questar Corporation's general expenses to the various subsidiaries. In the 1994 test year, the factor used to calculate the 1994 costs was calculated with 1993 data.

Both Division witness Huntsman and Committee witness Cleveland proposed to calculate the Distrigas allocation percentage for the test-year by using 1994 data. Company witness, Gary Robinson, stated that, in keeping with the Company's understanding of the Commission's Order for an historical test-year with no post-test-year adjustments, that there should be no adjustment made. Mr. Gary Robinson maintained that to match test-year investment, revenues, and expenses, the actual expenses allocated to Mountain Fuel from Questar during the test-year should be used.

11. Miscellaneous Employee Benefits

Committee witnesses Larkin, Steinke, and Cleveland proposed to disallow various employee benefits such as employee stock plans, Christmas gifts, the Company picnic, and service banquet awards. They contended that some companies are moving away from paying for these types of benefits and question whether it is proper for ratepayers to finance these benefits, especially in light of their contention that utilities provide a level of employee benefits that exceeds those offered by non-regulated companies. Mr. Rose criticized these adjustments as disallowing costs that are normally incurred by most companies for appropriate employee recognition and appreciation. He stated that without the productivity improvements of employees, that O&M costs in this case would be $20 million higher than they were during the test year. He testified that this was achieved at the same time customer satisfaction was appreciably increased over the past three years. Company witness, Gary L. Robinson, explained that rather than focusing on the overall level of compensation and benefits, the Division's and Committee's focus was on speci-fic and sometimes immaterial components of the compensation package. Mr. Rose stated that disallowing these minor expenses would send the wrong message to employees and would result in lower employee morale and productivity.

12. SFAS 112 Transition Costs

Mountain Fuel pays long-term disability benefits and medical costs to qualified terminated employees under a long-term disability plan. In 1994, the Company was required to change the accounting method used for the expense of this plan. Prior to 1994, Mountain Fuel expensed the costs of payments to these employees on a pay-as-you-go basis. Beginning in 1994, SFAS 112 required that these payments be recognized in financial statements based on an accrual method. Mountain Fuel included $1,039,000 of the costs in its test year. Both Mr. Sullivant and Mr. Larkin opposed this expense and argued that it was non-recurring and not representative on a going-forward basis. Both parties took the position that if the Commission were to allow the costs, they should be amortized over 15 years. Company witness Curtis argued for a five-year amortization. Both Mr. Larkin and Mr. Sullivant opposed the five-year amortization.

13. State Income Tax Allocation

Division witness Huntsman and Committee witness Cleveland proposed to disallow the amount of state income taxes allocated to Mountain Fuel from Questar Corporation through the Distrigas allocation. The allocation is required because Questar Corporation files federal and state income tax returns on a consolidated basis. A significant portion of the consolidated net income is earned by unregulated Mountain Fuel affiliates in states with no or lower state income taxes than Utah's. The corporation's net income is apportioned to the various states in which it does business based upon a widely accepted three-factor formula. When the Utah-apportioned net income is taxed at the higher Utah rate, additional taxes are required.

The problem occurs because Mountain Fuel's portion of the three-factor apportionment factor is disproportionately large when compared to Mountain Fuel's portion of the corporation's net income. Mr. Huntsman argued that state income taxes are higher under this arrangement than if Mountain Fuel were a stand-alone entity and that the allocation of the extra taxes was excessive and improper. Ms. Cleveland argued that ratepayers should not pay additional taxes arising as a result of affiliated earnings.

Company witness Curtis argued that the Company must file a combined Utah income tax return and, therefore, the only way to avoid these additional taxes would be to separate the ownership of the various Questar affiliates or by changing the Utah tax laws. He further argued, as did Glenn Robinson in his rebuttal testimony, that Mountain Fuel receives benefits from its affiliation with Questar Corporation that exceed the Utah state income taxes allocated from Questar.

14. Summary of Issues

Company witness Gary Robinson's Exhibit 8.6S provides a summary of the issues in this case and the final positions of the parties on each issue. The exhibit also calculates the final proposed revenue deficiencies as advocated in the prefiled testimony. These equated to $10,284,936 by Mountain Fuel, $1,087,768 by the Division, and $14,680 by the Committee.

E. REVENUE ALLOCATION AND RATE DESIGN

1. Supplier Non-Gas Cost Assignment

Mountain Fuel witness, Alan Allred, proposed that any rate change resulting from this rate case be implemented through a uniform percentage change for all classes. He demonstrated that the results of this approach closely approximates the class cost of service results. The Division agreed with the proposal. The Committee agreed as well, but advocated increasing the cost allocation to interruptible classes if the Commission decided to eliminate the SNG cost assignment.

Mr. Kevin Higgins, testifying on behalf of various transportation customers, called for an end to the rate differential to transportation customers through the assignment of SNG costs of upstream pipeline transportation to these customers. He testified that the requirement that transportation customers utilize Mountain Fuel released capacity to avoid the cost assignment precluded any opportunity for competition in the market and amounted to inappropriate price discrimination. He stated that the tariff is equal to the cost-of-service base price, plus a penalty equal to the maximum price of Mountain Fuel's release capacity on Questar Pipeline's system. In other words, if a customer chose not to purchase Mountain Fuel's released capacity, the customer must still pay Mountain Fuel for this capacity via the penalty in Mountain Fuel's distribution non-gas cost tariff. Mr. Higgins' position was opposed by the Division, Committee, and the Company but supported by Kern River. This issue is addressed in more detail later in this opinion as it is discussed in relation to Stipulation No. 2.

2. Weather Normalization Adjustment

In its application, Mountain Fuel requested a Weather Normalization Adjustment (WNA) as a mechanism to allow Mountain Fuel to collect the distribution non-gas (DNG) portion of its rates based on normal temperatures established in a general rate case. The WNA reduces the amount of the DNG portion of a customer's bill when weather is colder than normal and increases it when temperatures are warmer than normal. The Company maintained that a WNA has the potential to result in more acceptable bills to customers and reduce customer complaints during high-bill cold weather months.

Mountain Fuel witness, Glenn Robinson, explained that the DNG portion of Mountain Fuel's rates is set on the basis of normal weather and is designed to collect enough revenue to cover Commission-approved expenses exclusive of gas costs. He explained, however, that most of these expenses do not vary as sales volumes fluctuate. During a general rate case, test year sales are adjusted to normal levels to reflect the volume of gas that would be billed if temperatures throughout the year were exactly normal. Since actual temperatures nearly always vary from normal, Mr. Robinson testified that the actual volume of gas billed in the year will be higher or lower than the volume included in the test-year.

Mr. Robinson explained how the WNA reduces the DNG portion of a customer's gas bill when weather is colder than normal and increases this portion when temperatures are warmer than normal. He recommended that the WNA be adopted by the Commission as a benefit to both the Company and its customers. He characterized WNA as a positive factor for attracting investors and making the utility a better debt market credit risk. As for customers, he concluded that bills would show smaller variations depending on colder and warmer weather. He stated that this would result in more acceptable bills to customers and allow them to more closely budget for their natural gas bills.

Five witnesses filed rebuttal testimony on the WNA. They included Thomas F. Peel, S. Kent Evans and Darrell S. Hanson of the Division, Hugh Larkin, Jr., for the Committee, and Kent C. Higgins for the transportation customers. The Division witnesses generally supported the concept of a WNA. The Division focused on ways to refine the WNA to make it more effective. The Division's witnesses were concerned with the difficulty of not using an average base load amount for all customers and, for that reason, proposed not to apply weather normalization to commercial customers. Mr. Hanson explained that the Division had two concerns regarding WNA. First, that adoption of a WNA would shift the risk of weather variability from the Company to customers, and second, that customers should have a choice on whether or not a WNA would apply to them. Committee witness Larkin also opposed the WNA and suggested that it would shift the risk of weather from the Company to customers, send improper pricing signals, and was too aggressive because: (1) it made adjustments in all months and for all weather variations; (2) it did not include a deadband within, which rates would not be adjusted for weather variations; and (3) it did not place a limit on positive weather normalization adjustments.

Company witness Glenn Robinson testified that the WNA does not shift the risk of weather but, rather, eliminates it on a symmetrical basis for both customers and the Company. He also suggested mechanisms to allow customers to opt out of the WNA after they have sufficient information to make a knowledgeable decision.

3. Service Initiation Fee

Mountain Fuel charges $30 for a service initiation fee, which is meant to cover various administrative costs, as well as the costs of turning on and reading the meter. Currently about 75% of new service initiation calls require only that the meter be read.

In recognition of this cost savings, Mountain Fuel proposed two service initiation fees. The current $30.00 fee will be charged to customers in situations where gas has been turned off and the customer is requesting that service be initiated. In these instances, the Company normally turns on the meter and may inspect the customer's natural gas appliances. In situations where customers request service where the gas is still on, and the Company simply reads the meters, an $8.00 connection fee will be charged. Neither the Division nor the Committee opposed this change.

4. Return-Check Charge

Mr. Allred testified that the Company's $5.00 return-check charge does not cover the costs of handling and processing returned checks, and therefore, the charge should be increased to $15.00. He testified that administrative costs per returned check exceed $15.00 and do not include the fees charged by Mountain Fuel's banks for returned checks. The Division did not oppose the Company's proposal to increase the returned-check fee to $15.00.

Committee witness, Margo Hovingh, stated that a customer who issues an insufficient-funds check is already charged upwards of $25.00 by its bank, in addition to Mountain Fuel's $30.00 reconnection fee. She stated that the current $5.00 charge is sufficient to cover the $4.00 charge imposed on Mountain Fuel by its bank for depositing a bad check twice and allows $1.00 to offset administrative costs.

5. Released Capacity Credits

As a result of FERC Order 636, Mountain Fuel is able to release capacity it holds on upstream pipelines during periods when it cannot fully utilize it. The treatment of revenues realized by Mountain Fuel through capacity release was an issue in Mountain Fuel's last general rate case and was resolved by a stipulation approved by Commission Order. The stipulation in that case adopted a mechanism that identified revenue targets, made Mountain Fuel responsible for under-recovering, and provided Mountain Fuel with an incentive if it earned credits above target levels.

Mountain Fuel proposed to eliminate the target mechanism in this case. This would have resulted in pass-through treatment of capacity release revenues in the 191 account without any risk or reward mechanism. There was considerable testimony by the Company, Division, and Committee about the difficulties associated with setting targets and classifying the credits. The Committee favored a fixed percentage method allowing the Company to keep 15% of capacity release credits above a target level. The resolution of this issue was provided in Stipulation No. 2, as more fully discussed below.

6. Other Tariff Changes

Mountain Fuel proposed numerous other tariff changes, as shown in MFS Exhibit 9.10 and 9.1R. Other than the imbalance period makeup, geographic interruptions, operational balancing and the proposed increase in the return check charge, these changes were unopposed.

III.

STIPULATION AND SETTLEMENT

Stipulation No. 1 provides for an increased annual revenue requirement of $3.7 million, the amount agreed upon by the parties in settlement negotiations. The stipulation reaches an agreement on an overall return on rate base in the range of 10.22% - 10.34%. This is an increase from Mountain Fuel's presently authorized return-on-rate base of 10.08%.

A. REVENUE REQUIREMENT / RATE OF RETURN

Testimony was presented by Company witness Allred, Division witness Hanson, and Committee witness Mooy supporting the stipulation's return-on-rate base. All testified that the agreed-upon return-on-rate base accommodated the parties' various positions reflected at length in the prefiled testimony. Committee witness Mooy and Division witness Hanson each testified that one of the reasons for supporting the increase in the total return-on-rate base is that each would increase the ROE by 30 basis points as a one-time recognition of Mountain Fuel's performance in its gas procurement function.

Mr. Allred testified that the increased rate-of-return was supported by the Company's witnesses and was within the range of the ROE and total return estimates presented by all parties. He emphasized the Company's need to demonstrate to the financial community that it had achieved an acceptable improvement in its allowed return in this case, especially in light of its increasing investment to serve customers.

Mr. Mooy testified that since 1989, when the Commission criticized Mountain Fuel's gas procurement efforts in a general rate case, the Company's performance had improved substantially. He further testified that with implementation of Order 636, the cost allocation to Mountain Fuel of Questar Pipeline's transportation charges represented a potential increase of $14 million for core customers and presented a substantial challenge to Mountain Fuel's gas supply personnel. He explained that Mountain Fuel has been successful in reducing this potential impact by approximately $9 million per year through its capacity release performance. He also commended the Company's efforts in correcting imbalances in various producing fields. Overall, he lauded the Company's progress in gas procurement.

Division witness Hanson generally agreed with Mr. Mooy's evaluation of the Company's gas procurement efforts. All witnesses support the settlement of the rate-of-return issue as being just, reasonable, and in the public interest.

The Commission is charged with protecting the public interest and must make necessary inquiries to insure that a settlement is just and reasonable. The Commission understands that the parties are unwilling to specify a point estimate on ROE because they are not in agreement on all of the underlying elements. Mountain

Fuel seeks to assure the investment community that it has achieved an improvement in its allowed ROE. According to the Company, this would increase the attractiveness of its stock and its ability to raise the necessary funds to support the rapid growth the Company is experiencing in its Utah service territory. The Division and Committee argued that a return-on-equity of 11.0% is consistent with the methodology approved by the Commission in past Mountain Fuel and other fixed utility rate case dockets. However, both the Committee and Division have agreed to an equity return settlement 30 basic points higher than these parties would otherwise have recommended, in recognition of Mountain Fuel's gas procurement success. The Company's position is that a return-on-rate base in the range of 10.22% to 10.34% is justified regardless of any addition for gas supply performance.

We are aware of our statutory duty to encourage settlements and our concomitant duty to insure that we have good information and a thorough understanding of their terms and underlying rationale to insure that they are truly just and reasonable. We do not find it necessary to have an agreement on the ROE component of the overall return. We note that it is within a range of reasonableness consistent with the methodology we have used in previous rate orders, and we further note that the parties were able to settle on a very narrow range for the total return. We are convinced from all of the underlying evidence and from our extensive inquiry during the hearings on the stipulations that the rate-of-return on rate base of 10.22% to 10.34% as provided in Stipulation No. 1 is just, reasonable, and in the public interest.

B. REVENUE COLLECTION

1. New Premises Fee

In recognition of the increased capital and operating costs caused by new customer growth in Mountain Fuel's service area, the parties agreed in Stipulation No. 1 to the implementation of a $12.00 per month new premises fee to be assessed on new GS-1 and GSS residential premises for one year after service initiation. The parties have calculated that approximately $2 million of the agreed-upon revenue increase in this case can be collected from that fee.

Mr. Allred testified that one of the primary drivers of the increased revenue requirement of $3.7 million is the cost of additional customers that are hooked up to the system creating an increase in rate base and depreciation expense. Mr. Allred estimated that the average cost for hooking up new customers is between $800 to $1100 per year. This is significantly higher than the average investment per customer, which is about $700. He testified that the new premises fee will only recover a portion of these costs but that it will help offset expansion costs. He testified that the new premises fee is a proper cost allocation mechanism because it assigns over one-half of the rate increase in this case to customers who are causing the increase in investment and operating costs.

The new premises fee was explored by the Division in its prefiled testimony. All parties to this stipulation subsequently agreed that it was a just and reasonable mechanism to offset the costs of increased customer growth.

The Commission carefully examined witnesses about the new premises fee and the Commission agrees to implement the fee as a means to partially recognize the increasing costs of providing natural gas service to new customers. As Mr. Mooy noted during our inquiry, the rationale is consistent with a recent decision of this Commission involving Utah Power & Light Company. The $12 per month fee only partially assigns cost responsibility to new customers and does not entail a large shift in costs to new customers all at once.

2. Capacity Release Credits

The stipulation provides for the collection of the remainder of the increase in revenue requirement through a change in the way capacity release revenues are accounted for. The parties have agreed that effective September 1, 1995, 80% of capacity release credits should continue to be accounted for in Mountain Fuel's annual gas-cost pass-through proceeding, and 20% of all capacity release credits will be recorded as DNG revenues.[4] The parties agree that this will provide a direct incentive for Mountain Fuel to continue to aggressively market released capacity for the benefit of its sales customers.

The parties stipulated that in calculating the capacity release credits the following exceptions would apply:

a. During periods of recall of released capacity, 20% of capacity release credits, that would have been collected but for the recall of capacity, will be credited to DNG revenues.

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[4] These credits also include credits Mountain Fuel receives from upstream pipelines from the sale of interruptible transportation.

b. Twenty percent of SNG cost assignments collected under the IT, ITS and FT rate schedules will be credited to DNG revenues.

c. Twenty percent of SNG revenues received from customers who switched test-year transportation volumes to sales services will be credited to DNG revenues.

d. Capacity release credits from gas purchase contracts where Mountain Fuel directly reimburses the seller for transportation costs to transport the gas to Mountain Fuel's system will not be subject to the 80%/20% sharing.

Witnesses Allred, Hanson and Mooy all testified that the capacity release sharing mechanism provides a proper incentive for Mountain Fuel to continue to aggressively market its released capacity for the benefit of its firm sales customers. Both Mr. Hanson and Mr. Mooy commended the Company on its efforts in marketing released capacity. Mr. Allred testified that the capacity release sharing mechanism affords the Company a reasonable opportunity to earn $1.7 million without increasing firm sales customers' DNG rates.

The Commission accepts the capacity release sharing mechanism as provided in Stipulation No. 1. The sharing mechanism should provide the Company a direct incentive to market properly its released capacity to transportation customers. Mr. Allred testified that this change in the treatment of capacity release credits will not create an incentive to the Company to increase its upstream pipeline capacity. The Commission has determined that it will be able to review the Company's progress in future rate cases and IRP proceedings. The Commission desires that the Company maintain its successful capacity release marketing program, which has provided positive benefits to both the Company and its firm sales customers.

3. Connection Fee

The connection fee change and the returned check fee change discussed below require minor revisions to block rates for GS-1 and GSS customers. The parties have agreed with the Company's proposal to implement a reduction in the service initiation or connection fee from \$30 to \$8 in most cases.[5] Mr. Allred testified that revenue derived from service initiation fees will decrease by about \$1.7 million as a result of the implementation of the \$8.00 fee. He testified that, although costs assigned to the GS class will not change as a result of the settlement, there will be a slight increase in the block rates for GS-1 and GSS customers because of the decrease in service initiation fee revenues and increases in returned check fees that must be reallocated to block rates. Mr. Allred testified that this will result in an approximate .6% increase to the typical customer, or an increase in the annual residential bill of \$2.89, or an average of about 25¢ per month.

The Commission agrees that the \$8.00 service initiation fee properly recognizes the costs of reading a meter as opposed to providing a full appliance inspection in response to service initiation requests. The Commission also agrees that the revenue shift should be spread to the GS-1 customer class as provided in Stipulation No. 1 and

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[5] The connection fee is separate from and should not be confused with the new-premises fee.

as described by Mr. Allred, which will result in a slight increase in block rates for GS-1 and GSS customers. Rates for all other classes will be unchanged.

4. Returned Check Fee

The parties have agreed that the current $5.00 returned check charge is insufficient to cover the administrative costs incurred by handling bad checks. As such, the parties have agreed to increase the returned check fee to $15.00. The commission agrees that this charge is in the public interest and is a reasonable assignment of cost.

C. WEATHER NORMALIZATION ADJUSTMENT

The parties have agreed that the Company should be allowed to implement its proposed WNA on a phase-in basis. Stipulation No. 1 provides that the WNA as described in the Company's direct testimony will apply to GS-1 and GSS residential customers who participate in Mountain Fuel's equal payment plan and non-residential GS-1 and GSS customers beginning September 1, 1995, or as soon thereafter as the Company can implement the change. After the 1995-96 winter heating season, but prior to the 1999-2000 winter heating season, the Company, at its option, may apply the WNA to the remainder of the GS-1 and GSS residential customers commencing in the summer. At this time, the Company will notify the remaining GS-1 and GSS residential customers and provide them with two-months' notice to opt out of participation in the WNA program for the coming year. Mountain Fuel will provide this option yearly for non-budget-billed residential customers. The Company will provide a copy of the first such customer notice to the Division and Committee for review prior to distribution, and subsequent notice if there are any significant modifications in the notice.

Company witness Allred testified that the Company's DNG costs of operation are for the most part, fixed costs, while the Company's DNG rates are collected on a volumetric rate. Gas sales volumes for most GS-1 and GSS customers directly relate to weather variances. He stated that this causes a weather-related under- or over-collection of the Commission's approved level of costs. Mr. Allred testified that a WNA aligns the revenue collection mechanism with the rate design methodology. Mr. Allred explained that the phased implementation agreed upon in Stipulation No. 1 will allow the Company time to test and prove the concept and gain customer acceptance.

Division witness Hanson supported the WNA compromise. He testified that the customer choice provisions satisfactorily resolved the main concerns of the Division. Likewise, Mr. Mooy testified that the Committee was satisfied with the compromise that gives customers an option to opt out from participation in the WNA.

The Commission believes that it is just and reasonable to adopt the WNA in the form stipulated to by the parties in this case. It is reasonable that the program be phased in starting with customers who participate in the Company's equal payment plan and non-residential customers. The Commission also accepts the opt-out provision of the stipulation as a reasonable compromise.

D. CONTRIBUTIONS IN AID OF CONSTRUCTION

Stipulation No. 1 resolves the parties' dispute on how to account for contributions in aid of construction. The parties agreed to continue the current accounting method which records all revenues without recognizing a refund liability for regulatory purposes.

The Commission agrees that the current accounting method is preferable to the change requested by the Company. The Company's present accounting method for contributions has been and continues to be as directed by this Commission for regulatory purposes.

E. SFAS 112

Stipulation No. 1 also resolves a contested issue relating to accrual accounting for disability and medical benefits for qualified terminated employees. The agreement allows the Company to include the costs in rates over a ten-year period. In the context of the give and take entailed in a stipulated settlement, the Commission accepts this as a reasonable settlement of this issue. The Commission understands that neither the Division nor the Committee have agreed to this treatment for other fixed utilities and presumes that in agreeing to this treatment, other ratepayer benefits were obtained in the stipulations which reasonably compensate for the original positions of the state agencies.

F. THE 16.7 CENT COST ASSIGNMENT

In Mountain Fuel's last general rate case, Docket No. 93-057-01, the Commission accepted a settlement that assigns approximately 16.7 cents per decatherm of Mountain Fuel's SNG costs incurred from upstream pipelines to the transportation classes. This cost assignment is also found in the firm transportation (FT) rates which were first implemented in Docket No. 94-057-02. The rate differential for customers who utilize Mountain Fuel's released capacity was implemented in response to FERC Order 636 as a way to mitigate the rate effects on sales customers. This cost assignment is offset by tariff provisions which provide credits to transportation customers if Mountain Fuel receives credits against its SNG costs from upstream pipeline suppliers resulting from the transporting customer's choice of upstream capacity. This cost assignment has been controversial because, although beneficial to Mountain Fuel's sales customers, it has been negatively perceived by transportation customers whose rates are affected. All parties except ESI and Kern River originally proposed to retain the present cost assignment.

In Stipulation No. 2, the parties agreed to a scheduled phase-out of the rate differentials now existing between IT, IT-S and their IT-2 and IT-S2 counterparts. In addition, the parties agreed that the supplier non-gas cost assignment to FT rates would be phased out on the same basis. In essence, the parties have agreed that the IT, IT-S, and FT rates should remain at current levels until September 1, 1996, when these rates would decline by 4.7 cents for the first three blocks. On September 1, 1997, the IT and IT-S rates will be eliminated and the remaining portion of the 16.7 cent cost assignment of the FT rates will also be eliminated.

In addition, the parties have agreed that the current IT-2 requirement that customers must purchase Mountain Fuel's released capacity to be eligible for the IT-2 rate schedule will be eliminated on September 1, 1997. The parties agreed that the tariff changes would be implemented by compliance filings, which the Company would submit at least 30 days before the September 1 effective dates in 1996 and 1997. The parties concluded that these provisions of Stipulation No. 2 were intended to provide a mechanism to phase out the current rate design which differentiates between customers who use Mountain Fuel's released capacity and those who do not.

The Commission agrees to allow for a phase-out of the supplier non-gas cost assignment originally included in Mountain Fuel's rates pursuant to Stipulation No. 1 in Docket No. 93-057-01. The Commission believes that phasing out the rate differential over the stipulated time frame appears to provide a reasonable transition. We intend, however, to review this issue in Mountain Fuel's next rate case to insure that the subsequent steps in the phase-out are in the public interest.

G. FIVE-CENT WAIVER

With the implementation of interruptible transportation service in 1987, Mountain Fuel also implemented a program for the prearranged purchase of transportation customers' gas during periods of interruption. This program called for transportation customers to complete an application by July 1 of each year to qualify their gas for the "nickel waiver" program for the following heating season. The availability of this peaking-gas source has allowed the Company to avoid contracting for other peaking sources as it plans for its gas supply needs for each winter season. During the 1990-91 winter season, Mountain Fuel interrupted transportation customers and the five-cent waiver gas proved to be a valuable peaking source.

ESI witness Higgins had proposed to eliminate the current five-cent waiver provisions found in Mountain Fuel's current tariff in sections 3.17(k), -(l), & -(m). He proposed a strictly voluntary program based on individual contracts. Pursuant to Stipulation No. 2, the parties have agreed to eliminate two of the options provided in section 3.17 of the tariff and to amend the remaining option to ease the contracting and application burdens of transportation customers. However, transportation customers must still make their gas supply available during periods of interruption.

The Commission accepts the stipulated tariff provisions which simplify the current program.

H. Imbalance Makeup

The Company proposed to shorten the makeup period for transportation imbalances from the current 28 days to 15 days after the end of the month. In support of this recommendation, Mr. Allred testified that the Company is eliminating the 10-day period it now has to post imbalances on the Electronic Bulletin Board (EBB). This information is now available to telemetered customers each day during the month, and final information will be available on the EBB at the end of the month. The Company proposed that, instead of limiting the imbalance trading period to three days, it be extended to encompass the entire 15-day makeup period. The parties have agreed in Stipulation No. 2 that the imbalance makeup period should be 15 days. The parties also agreed to provide an additional day of makeup period for each day after the beginning of the month that the final reported imbalance data on the EBB is not available.

We agree that the 15-day period is reasonable.

I. OPERATIONAL BALANCING AND GEOGRAPHICAL INTERRUPTION

In Stipulation No. 2, the parties agreed that the proposed operational balancing and geographic changes agreed to in Stipulation No. 1 would be eliminated.

IV.

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND COMMISSION ORDER

The Commission acknowledges the efforts of all parties to this proceeding to develop the issues and ultimately resolve them by way of the stipulations filed in this case. Attached to this Order are both stipulations.

The Commission has thoroughly reviewed the stipulations. We have the benefit of an extensive record of prefiled testimony and exhibits, as well as the testimony presented at the hearings held on August 2, 10, and 11, 1995, concerning the stipulations.

We are aware of the Utah Supreme Court's language in the *MCI*[6] and *Stewart*[7] decisions, which criticize the Commission's disposition of settlements in previous U.S. West general rate proceedings. We are also aware of Utah Code Ann. §§ 54-7-1(1) (1994) & 63-46(b)-1(4) (1993), as well as the Commission's rules on settlements. After careful and extensive review of the record relating to each and every disputed issue before us, we approve the stipulations and proposed tariff modifications. Accordingly, we make the following:

FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. Mountain Fuel is a public utility subject to our regulation pursuant to Utah Code Ann. § 54-4-1, *et seq.*

2. The stipulations have been negotiated in good faith and are the product of serious bargaining by capable and knowledgeable parties.

3. The stipulations and resulting settlement are in all respects just and reasonable and in the public interest.

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[6] MCI Telecommunications v. Utah Public Service Comm'n, 840 P.2d 764 (Utah 1992).

[7] *Stewart v. Utah Public Service Comm'n,* 885 P.2d 759 (Utah 1994).

4. The Commission has examined the underlying basis of the stipulations and resulting settlement with an adequate record containing the Company's application, and extensive direct, rebuttal, surrebuttal, and live testimony.

5. Pursuant to notice published in the *Salt Lake Tribune*, the *Deseret News*, and in the Mountain Fuel billing insert, *The Gaslight News*, the public was afforded an opportunity to comment and provide testimony on the Company's application and the settlement. One public witness appeared and testified generally against the granting of any rate increase.

6. The parties' testimony concerning Mountain Fuel's capital structure demonstrated agreement on the use of the Company's actual capital structure.

7. While the parties' testimony demonstrated some differences concerning the proper rate base, as shown in stipulation exhibit 8.6S the range of disagreement was narrow. Similarly, the parties differed as to the proper level of test-year revenues, as shown in exhibit 8.6S. Again, however, the final positions were narrow. The parties' final testimony positions differed primarily with regard to return and operating expenses. 8. After reviewing the evidence on the record, the Commission finds increased revenue requirement, as stipulated, of \$3.7 million, is supported by the underlying record summarized above. The \$3.7 million resolution is within what we find to be the reasonable range of the parties' positions. Specifically, the Commission finds that granting Mountain Fuel a \$3.7 million increase in its rates and charges is just and reasonable based on the underlying record in this case and is in the public interest.

9. The provision of Stipulation No. 1, which provides for a return-on-rate base in the range of 10.22% to 10.34%, is just and reasonable in the public interest.

10. The Division and Committee have attributed a 30-basis-point value to the Company's gas procurement performance, for purposes of this case only, in evaluating and agreeing to the reasonableness of the stipulated rate of return, specifically mentioning Mountain Fuel's performance in marketing released capacity and correcting imbalances in various producing fields. The Commission agrees that the Company's gas procurement performance merits recognition and is a factor contributing to the stipulated return-on-rate base.

11. The Commission has made its findings based not only on the parties' stipulations and settlement, but also upon its own inquiry of the record and of the terms and basis of the settlement.

12. The parties testified that a substantial portion (2 million dollars) of the increased revenue requirement calculated in this case arises from an increase in rate base and depreciation expense occasioned by new customers. The Commission finds that the new premises fee is a reasonable mechanism to collect a portion of these increased costs from the new customers causing these costs and as such is just, reasonable and in the public interest. The Commission also finds that a larger shift of costs to new customers should not be undertaken at this time because of a possible negative public response and resulting harm to economic growth in the State of Utah.

13. The parties agreed that a direct incentive should be implemented to encourage Mountain Fuel to aggressively market released capacity for the benefit of

sales customers. The Commission agrees and finds that the stipulated 80%/20% sharing of released capacity revenues is in the public interest at this time and provides the Company a reasonable opportunity to earn $1.7 million of the revenue deficiency found in this case.

14. The Commission finds that it is in the public interest that Mountain Fuel maintain its successful capacity release marketing program, which has benefitted both the Company and its customers.

15. The Commission finds that in certain instances service initiation can be accomplished by simply reading a meter. In such instances, it is just and reasonable for the service initiation fee imposed to be reduced from $30.00 to $8.00. The parties testified that this rate design adjustment will result in a decrease in such fees of $1.7 million. The Commission finds that an adjustment in GS rates to recoup this shortfall is just and reasonable and in the public interest.

16. The parties' stipulated returned check charge of $15.00 is an increase from the previously authorized $5.00 and is a more reasonable cost assignment to cover the administrative costs of collecting returned checks. The Commission finds the $15.00 charge to be in the public interest as a closer representation of the costs incurred to collect on bad checks.

17. The Commission finds that the collection mechanisms, including the new-premises fee, the capacity release sharing mechanism, the reduced-service initiation fee, the increased returned check charge, and the corresponding increase in GS-1 rates are all just and reasonable and in the public interest.

18. The Commission finds that the majority of Mountain Fuel's DNG costs of operation are fixed in nature while the Company's DNG rates are collected on a volumetric basis. The WNA will provide for a more effective collection of a Commission-approved level of costs by mitigating against weather related over- and under-collection of these costs. The Commission finds it just and reasonable to implement this revenue collection mechanism.

19. The phased-in implementation of WNA, together with the provisions allowing customer choice, will allow the Commission, the Company, and all interested parties to gauge customer acceptance.

20. The Commission finds the WNA, with its provision allowing non-budget-billing customers to opt out, to be just, reasonable, and in the public interest as stipulated by the parties.

21. The Commission continues to find that the Company's current method of accounting for contributions in aid of construction is reasonable.

22. The Commission finds that in the context of a settlement of all issues, the 10-year amortization of SFAS 112 is a just and reasonable resolution of accrual accounting for disability and medical benefits for qualified terminated employees, and in the public interest.

23. The parties have agreed that the scheduled phase-out of the 16.7 cent cost assignment provides a mechanism to terminate current rate designs which differentiate between customers who use Mountain Fuel's released capacity and those who do not. While the Commission considered the cost assignment to be an effective

transitional mechanism to protect captive sales customers during implementation of FERC Order 636, the Commission finds that a phased elimination of this rate design is in the public interest.

24. The scheduled phase-out of the 16.7 cent cost assignment is a fair mechanism to achieve a transitional elimination of this controversial issue and is just and reasonable.

25. The Commission finds that shortening the imbalance make up period to account for rapid electronic notification of imbalances should be implemented in recognition of transportation customers' balancing responsibilities. However, the make-up period should be held in abeyance for each day Mountain Fuel notification is not provided. The imbalance make-up provisions as agreed to in Stipulation No. 1, and as modified in Stipulation No. 2, are just, reasonable, and in the public interest.

26. The Commission finds that requiring transportation customers to provide their gas during peak interruption seasons has provided a relatively low-cost source of peaking supplies and should be continued as a just and reasonable gas supply option. The Commission finds that the revisions to the tariff regarding this will simplify the current provisions, will make the program less expensive to transportation customers and are just, reasonable, and in the public interest.

27. The stipulations and resulting settlement have been agreed to or are unopposed by all parties to this proceeding.

Based on our Findings of Fact and Conclusions of Law, the Commission makes the following:

ORDER

1. The Company shall continue to account for contributions in aid of construction as it has in the past, without accruing for refunds.

2. The Company shall, by compliance filings, at least 30 days in advance of September 1, 1996, and September 1, 1997, respectively, implement the tariff revisions necessary to terminate the current rate designs which differentiate between customers who use Mountain Fuel's released capacity and those who do not.

3. The stipulations and resulting settlement are accepted and the tariff changes shown in the stipulation exhibits are approved, effective September 1, 1995.

4. The Company shall, prior to distribution, provide the Division and Committee with a copy of the customer notice, and any modification thereof.

5. The Findings and Conclusions are for purposes of the Order in this case. The Commission will not consider this Order, or any Order, based on settlement, as a precedent in future cases because all issues have not been fully litigated.

DATED at Salt Lake City, Utah, this 17th day of October, 1995.

Stephen F. Mecham, Chairman

Constance B. White, Commissioner

Clark D. Jones, Commissioner

Attest:

Julie Orchard
Commission Secretary