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## BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

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| **IN THE MATTER OF INTERMOUNTAIN GAS COMPANY'S APPLICATION FOR AUTHORITY TO REVISE ITS GENERAL SERVICE PROVISIONS RELATED TO THE INSTALLATION AND EXTENSION OF NATURAL GAS MAINS AND SERVICES** | **CASE NO. INT-G-20-01**<br><br>**COMMENTS OF THE COMMISSION STAFF** |

**COMES NOW** the Staff of the Idaho Public Utilities Commission, by and through its attorney of record, Matt Hunter, Deputy Attorney General, and in response to the Notice of Modified Procedure issued in Order No. 34636 on April 21, 2020, in Case No. INT-G-20-01, submits the following comments.

### BACKGROUND

On January 27, 2020, Intermountain Gas Company ("Intermountain" or "Company") applied to the Commission for authority to revise the Company's General Service Provisions related to the installation and extension of natural gas mains and services ("Line Extension Policy"). This filing is in response to Commission Order No. 33757, issued in the Company's last general rate case (INT-G-16-02), which ordered the Company to update its line extension tariff to incorporate the Commission authorized rate of return ("ROR"), no later than 90 days after the conclusion of Case No. INT-G-16-02. The Commission also encouraged Intermountain to modify its Line Extension Policy as soon as possible to address changes in references, rules, and vested interest policy.

On February 25, 2020, the Commission issued a notice setting a March 11, 2020 intervention deadline. Order No. 34560. The Commission also suspended the Company's proposed April 1, 2020 effective date for the tariff for 30 days plus 5 months, pursuant to *Idaho Code* § 61-622(4).

## STAFF ANALYSIS

Staff believes that the proposed changes to the Company's Line Extension Policy will result in a simpler and more equitable policy and recommends the Commission approve the Company's proposed Line Extension Policy. Furthermore, Staff supports the Company's proposal to update its Line Extension Policy annually through a tariff advice.

Staff notes that the existing Line Extension Policy was established as part of the Company's 1985/1986 rate case proceedings (U-1034-99 and U-1034-122). Many of the assumptions underlying the existing Line Extension Policy, such as the authorized Rate of Return and relationships between consumption and weather, are outdated. In some cases, neither Staff nor the Company was able to find documentation for the rationale underlying key portions of the existing Line Extension Policy. As stated on page 4 of the Company's Application, Staff and the Company worked collaboratively to develop the updated and improved tariff.

Staff also audited the cost accounting methods that the Company used to determine the embedded costs and overhead charges used to determine the Company's Allowable Investment ("Allowance") and project cost estimates.

The primary purpose of a Line Extension Policy is to assure equity between new and existing customers. A Line Extension Policy should assure that the costs of new interconnections are not unfairly shifted to existing customers, while also assuring that the new customers do not pay more for their interconnection than is necessary. So long as consumption estimates and estimates of the embedded mains and services costs are accurate, the embedded cost methodology proposed by the Company should achieve this result.

The Company's proposal also makes the following changes to its existing policy:

1) It uses the 7.3% ROR authorized by the Commission in the Company's most recent rate case instead of the 12.5% ROR that has been in use since the Company's 1985/1986 rate cases.
2) It modifies the vested interest policy so that vested interest payments are based only on mains-related revenue that is embedded in rates.
3) The text of the Line Extension Policy has been consolidated into a single section (Section C) and re-written so that it is easier to read than the existing policy.

**Proposed Computation of the Allowable Investment**

The line extension allowance places an upper limit on the costs that can be included in rate base. Its computation is predicated on the notion that new customers should pay the entire cost of infrastructure needed to connect them with the Company's distribution system, either through an up-front Contribution in Aid of Construction ("CIAC"), or through the revenue related to mains and service drops that is embedded in base rates. Since it will take the Company many years to collect the costs of mains and service drops through base rates, the Company must make an up-front investment ("Allowable Investment" or "Allowance"). The relationship between the cost of a line extension project, the CIAC, and the Allowance may be expressed by the formula:

PROJECT COST = CIAC + ALLOWANCE

The Allowance is calculated using the present value of embedded line extension related revenue that will be collected through base rates over the depreciation life of the line extension project. This calculation depends on accurate estimates of the line extension related costs that are embedded in base rates, as well as accurate estimates of gas consumption.

Because the Company's current Class Cost of Service ("CCOS") model lacks sufficient detail to determine embedded line extension costs directly, Staff and the Company developed a proxy methodology that can be used until a more detailed CCOS model can be developed and presented in a future rate case. Details of the proxy methodology are discussed below.

As stated on page 5 of the Company's Application, residential gas consumption is estimated by adding consumption estimates for natural gas appliances to an estimate of space heating consumption determined using a factor of 0.234 therms per square foot per year. Derivation of this factor is discussed more fully below.

Commercial establishments vary widely in size and the uses to which they put natural gas; as a result, the Company estimates consumption on a case-by-case basis. Estimates for commercial customers are based on factors such as climate zone, heated square footage, commercial property type, and applicable gas appliances. Application at 5. Although not specifically stated in the Company's Application, Staff found that the Company uses the consumption of similarly situated customers as a guide. For example, the Company might use actual gas consumption from an existing fast food restaurant as a guide for estimating gas consumption for a similar, new fast food restaurant. Staff reviewed the Company's methodology for estimating commercial gas consumption and believes it to be appropriate.

Staff notes that for service line extensions, the primary cost driver is the number of linear feet between the Company's main and the customer's meter, and the Company expresses the service line Allowance in terms of the number of linear feet that the Company will install without charge to the customer. There are other possible cost drivers for mains extensions, so the Company expresses this allowance in terms of dollars.

**Class Cost of Service Proxy**

Ideally, embedded costs used to estimate the Allowance would be obtained directly from the Company's most recent CCOS model. Unfortunately, neither the CCOS model presented by the Company in its last rate case (INT-G-16-02), nor the Class Revenue Allocation ordered by the Commission (Order No. 33757), provides a breakdown, by class, of the accounts in which line extension costs are embedded. Staff and the Company worked together to develop a methodology that can serve as a proxy for the needed CCOS information. The proxy allocates each account using each class's share of the Commission-ordered Class Base Revenue Requirement and the fraction of plant-in-service in each account. A gross-up, to account for the effects of taxes, is then added.

For the Mains Extension policy, proxies were developed for FERC Accounts 374 (Distribution Land & Land Rights), 375 (Distribution Structures and Improvements), 376 (Distribution Mains), and 378 (Distribution Measuring and Regulation Station Equipment). For the Service Line Extension policy, proxies were developed for Accounts 380 (Services) and 385 (Individual Regulator Stations). Because the Company installs meters and regulators for all customers, and because these costs are not driven by conditions that are unique for each customer, Accounts 381 (meters), 382 (Meter Installations), 383 (House Regulators), and 384 (House Regulator Installation) were excluded from both the project cost estimate and the computation of the Allowance.

**Estimating Residential Gas Consumption**

The Company's proposed method for estimating residential gas consumption is both simpler and more accurate than the existing method. The current method has been in use since the Company's 1986 rate case (U-1034-122), and uses seven different space heating factors to adjust the model for weather conditions in Nampa, Boise, Twin Falls, Pocatello, Idaho Falls, Sun Valley, and Montpelier. Given the time elapsed since that case, Staff was unable to determine how these seven factors were calculated. However, using actual consumption data from homes constructed during calendar years 2015 and 2016, Staff determined that use of these space heating factors decreases the accuracy of the Company's estimates of residential gas consumption.

On page 5 of its Application, the Company states that it commissioned Musgrove Engineering ("Musgrove") to perform a study of gas consumption for space heating on a square foot basis. Application at Exhibit 3. Staff, the Company, and Musgrove worked together to verify Musgrove's modeling assumptions and inputs. The Musgrove model was then calibrated and validated using actual consumption data from homes constructed during the 2015 and 2016 calendar years.

The International Energy Conservation Code ("IECC"), which is the basis for Idaho residential energy efficiency standards, recognizes two climate zones in the Company's service territory: the Company's western service territories are in the relatively warm Zone 5B, and its eastern and northern service territories are in the relatively cool Zone 6B. Although winter temperatures are generally cooler in Zone 6B than they are in Zone 5B, more stringent Zone 6B IECC building standards result in consumption that is similar in both zones.

Using the Musgrove model to analyze the heating requirements of several representative floor plans, it can be shown that a single consumption factor of 0.243 therms per square foot per year can be applied to both regions. Application, Exhibit 3 at 5. This simplifies calculations and provides a more accurate estimate than is obtained using the current methodology.

The proposed methodology also includes updated consumption estimates for residential gas appliances such as hot water heaters and gas ranges. Staff checked the updated consumption estimates using publicly available information and believes them to be reasonable.

**Vested Interest Policy**

Staff supports implementation of the Company's proposed vested interest policy, and believes it is more equitable than the current policy. Staff explains that without a vested interest policy, it is possible for the first customer in a newly served area to bear a substantial portion of the cost of a new main that may subsequently be used by new customers who pay no contribution toward the cost of that main. Under the current vested interest policy, customers with a vested interest receive 1.5 times the total annual revenue that the Company would receive from the new customer(s). Staff believes that by using total revenue instead of only the embedded revenue associated with mains, it is possible for the current policy to unfairly shift costs to the general body of customers.

Under the Company's proposal, the vested interest holder will receive the main line allowance amount as a vested interest payment for each new customer that connects to the main within a 5-year period. The total amount of vested interest payments is limited by the initial main extension CIAC paid by the vested interest holder. This limit ensures that the total allowance amount plus the remaining CIAC amount never exceeds the total cost of the main. Staff believes the proposed method provides the vested interest holder the opportunity to be fairly reimbursed for each additional customer's share of the CIAC initially paid by the vested interest holder, and ensures that the project cost is only recovered from the customers who benefit from the main extension. The Company proposes that it review its records annually to determine which customers would be eligible for refunds.

The proposed five-year limit on vested interest payments limits the administrative burden on the Company, and it is consistent with the time limits used by other regulated Idaho companies with vested interested policies. Likewise, the Company's proposal to review vested interests annually is intended to limit administrative costs. Although Staff would prefer vested interest payments be paid immediately after a new customer hooks up, Staff also believes the increased administrative costs of doing so is not warranted by the relatively small number of customers with vested interests.

**Policy Revised for Clarity**

Staff appreciates the Company's efforts to reorganize and rewrite its Line Extension Policy. The proposed text is succinct and easier to read than the existing text. The Company consolidated its Line Extension Policy by moving information that had been in Section A to Section C. Staff believes this revision will reduce misunderstandings and customer complaints about the policy.

**Proposed Annual Tariff Advice Filing**

Staff supports implementing an annual filing requirement. The Company proposes to update the tariff annually, via a tariff advice, to reflect changes to construction overhead charges and service line cost per square foot. After each general rate case, the annual filing will also need to include a change in the allowable investment since the embedded cost of line extensions should change as a result.

**Refunds**

Commission Order No. 33757 dated April 28, 2017 required the Company to update its Line Extension Policy for the new ROR within 90 days of the Commission order and encouraged modification of other components. However, as noted earlier, calculations and workpapers from the 1985/1986 cases were unavailable, and it was not possible to perform a simple update using the Commission authorized ROR.

The Company continued to operate using the latest approved Line Extension Policy authorized in the 1985/1986 case while the Company worked with Staff for more than two years to develop the concepts of the proposed policy. Over time, interpretations and application of the 1985/1986 Line Extension Policy by the Company varied. As the work between Staff and the Company progressed, it became apparent that the proposed Line Extension Policy would result in lower CIAC payments going forward than some customers paid under the existing Line Extension Policy.

According to the Company in its response to Staff's Production Request No. 5, between May 1, 2017 and November 18, 2019, there were 277 different Mains extension projects which could qualify for refunds under the Company's proposal. The total potential refunds for these projects is $529,846. Staff notes that the Company has stated that it has made no representations to its Residential and Commercial customers that they might receive refunds based on proposed changes to the Company's Line Extension Policy. Company Response to Staff's Production Request No. 8.

It could be argued that the Company was following its existing Line Extension Policy and no refunds should be required to be paid based on a proposal that has not been approved yet. Because the Company was required to update its Line Extension Policy to reflect the new lower authorized ROR and encouraged to work with Staff and file other changes to its Line Extension Policy, it could also be argued that changes to the existing Line Extension Policy took too long to update and refunds should be made to customers who have paid a higher line extension CIAC since the conclusion of the Company's last rate case (INT-G-16-02). Any refunds could be the difference between the higher CIAC under the existing Line Extension Policy and what would have been paid under the proposed Line Extension Policy if approved by the Commission.

The Company offered to make refunds. Unless the Commission requires the refunds to be booked below the line as a penalty, it is important to note that rate base will increase in the same amount as the refunds due to a lower CIAC offset. The result will be all customers paying increased rates for depreciation and a return on the higher rate base.

## STAFF AUDIT

Staff audited the Company's treatment of costs used to determine the Allowable Investment and project costs, including construction overhead charges. Staff agrees with the methods used by the Company and agrees with the proposed 11.92% overhead charge rate.

### Construction Overhead Charges and Project Costs

Construction overhead charges compensate the Company for costs incurred managing, supervising, and administering line extension projects. These costs include construction and labor related costs of engineering and supervision of staff; other general and administrative costs, including the day-to-day costs of project operations; and expenses such as rent, utilities, insurance, certain salaries, legal fees, meals, and travel. These charges are capitalized and included in the Company's rate base.

During its audit, Staff found that the charges are recorded properly, and that overhead costs for specific projects are recorded in the appropriate accounts.

In its response to Production Request Nos. 1-3, the Company provided a detailed description and work papers that outline the trial balance and the calculations of these charges.

Staff has reviewed these workpapers and agrees with the accounting treatment methodology used, as well as the calculations employed. The proposed overhead charge rate of 11.92% has been accurately calculated.

**Determination of Allowable Investment**

The Company proposes an embedded cost methodology for computing its Allowable Investment in new gas facilities. This method will ensure that any project costs exceeding the Allowable Investment will be paid by the customer as a customer advance and treated as a CIAC.

Central to the embedded cost methodology are the Allowable Investment factors, which are derived using the present values of the embedded cost of Mains and Services in the Company's approved tariff.

Using the Commission approved 7.30% ROR as the discount rate, the Allowable Investment factors for service line extensions are $0.593 and $0.445, respectively, for residential and commercial customers. The Allowable Investment factors for Main line extensions are $0.660 and $0.495, respectively, for residential and commercial customers. Staff has verified and agrees with the derivation of Allowable Investment factors shown in Company Exhibits 4 and 5.

## EFFECTIVE DATE

The Company will need time to develop a computer system that will ensure consistent application of the new tariff across the Company's service territory. Application at 9. Staff recommends an effective date of August 1, 2020.

## CUSTOMER NOTICE

The Company's Notice of Application was sent to the customers, builders, developers, and HVAC contractors that the Company believes would be affected by the proposed changes.

As of June 10, 2020, the Commission received two public comments. One from a builder/developer who indicated that the proposed service line extension allowance is too low. The other comment was from the Rocky Mountain Propane Association stating that Intermountain's Line Extension Policy should require line extension customers to pay proper CIAC so that the connections are not subsidized by other customers.

**STAFF RECOMMENDATIONS**

Staff believes that the proposed changes to the Company's Line Extension Policy will result in a simpler and more equitable policy. Staff makes the following recommendations:

1) That the Commission accept the Company's proposed General Service Provisions, and Sections A and C be accepted as filed.
2) That the tariff changes be effective August 1, 2020.
3) That the Commission order the Company to file an annual tariff update each August 1st.
4) That the Commission determine if the Company should calculate and, when appropriate, issue refunds to customers who have paid advances between May 1, 2017 and August 1, 2020, as proposed in the Company's Application.

Respectfully submitted this day of June 2020.

Matthew Hunter

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Deputy Attorney General

Technical Staff: Mike Morrison
Kevin Keyt
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# CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 11TH DAY OF JUNE 2020, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. INT-G-20-01, BY E-MAILING A COPY THEREOF, TO THE FOLLOWING:

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