

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Request for rate increase

Docket No. 001447-GU

by St. Joe Natural Gas Company, Inc.

DIRECT TESTIMONY

of

JEFF HOUSEHOLDER

on behalf of

ST. JOE NATURAL GAS COMPANY, INC.

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INTRODUCTION

1
2 **Q. Please state your name, occupation and business address.**

3 A. My name is Jeff Householder. I provide energy consulting,
4 regulatory affairs consulting and business development services
5 to natural gas utilities, propane gas retailers and government
6 agencies. My business address is 2333 West 33rd Street, Panama
7 City, Florida, 32405.

8
9 **QUALIFICATIONS AND BACKGROUND**

10 **Q. Please describe your professional experience and**
11 **educational background.**

12 A. Prior to beginning my consulting business in January 2000, I
13 was Vice President of Marketing and Sales for TECO Peoples
14 Gas from 1997 to 1999. I joined Peoples Gas subsequent to the
15 1997 TECO Energy acquisition of West Florida Natural Gas
16 Company. At West Florida Natural Gas, I served as Vice
17 President of Regulatory Affairs and Gas Management from 1995
18 to the TECO merger. Before that, in 1994-1995, I was Vice
19 President of Marketing and Sales at City Gas Company, a
20 division of the NUI Corporation. Prior to joining City Gas, I
21 served from 1984 to 1994 as Utility Administrative Officer for
22 the City of Tallahassee. During my ten years with the City, I
23 also held positions as Assistant Director of the Consumer
24 Services Division and managed the Energy Services
25 Department, a marketing and demand-side management unit.

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1 From 1981 to 1984, I was a Section Manager with the Florida
2 Department of Community Affairs, responsible for
3 administering the Florida Energy Code and related construction
4 industry regulatory standards. I also served from 1980 to 1981
5 as an Energy Analyst in the Governor's Energy Office. From
6 1984 to 1995, concurrent with my other positions, I provided
7 part-time consulting services to the natural gas, propane gas
8 and homebuilding industries involving a variety of building
9 code, marketing and energy regulatory matters. I am a 1978
10 graduate of Florida State University with a Bachelor of Science
11 Degree in Economics and Government.

12
13 **Q. What is the purpose of your testimony in this**
14 **proceeding?**

15 A. I will provide an overview of the current market environment in
16 which St. Joe Natural Gas Company ("SJNG" or the "Company")
17 competes for business, including a discussion of the significant
18 market risks that the Company faces. I will describe the
19 methodology used to forecast sales, customers and revenues for
20 the Historic Base Year + 1 and the Projected Test Year. I will
21 also sponsor the Company's proposed interim and permanent
22 rate design. In support of my permanent rate design testimony,
23 I have prepared a cost of service study by customer class for the
24 Projected Test Year ending December 31, 2001. In addition, I
25 have reviewed competitive energy alternatives for each customer

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1 class. I will describe how the results of both the cost of service
2 study and the competitive analysis were used in designing the
3 Company's proposed rates.

4
5 **Q. Are you sponsoring any exhibits to your testimony?**

6 **A.** Yes. Exhibit No. ___ (JMH-1) is a list of MFR Schedules I am
7 sponsoring. Exhibit No. _____ (JMH-2) is a comparison of
8 present and proposed rates by rate classification. Exhibit No.
9 _____ (JMH-3) is an analysis of competitive fuel costs in the
10 Company's service areas. The MFR Schedules and other exhibits
11 were prepared under my direction, supervision and control.

12
13 **MARKET ENVIRONMENT**

14 **Q. Over the past decade, the natural gas industry has**
15 **experienced dramatic changes in its operating practices.**
16 **Please briefly describe the changes at the federal level**
17 **that affect the environment in which the Company**
18 **competes for business.**

19 **A.** Federal initiatives, culminating in FERC Order No. 636,
20 substantially altered the long-standing market relationships
21 between natural gas producers, transporters, distributors and
22 their customers. Gas marketers became major new entrants in
23 the marketplace and interjected themselves into the traditional
24 relationships between Local Distribution Companies ("LDCs"),
25 interstate pipelines and end-use customers. Gas trading on the

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1 commodities market, the development of pricing indices, access
2 to hedging and other risk management strategies, along with
3 the emergence of an active secondary capacity market, are all
4 relatively recent products of the new gas marketplace.

5
6 **Q. How have these changes generally affected LDCs?**

7 A. This restructuring of the gas industry requires gas distributors
8 to operate in a significantly more competitive business
9 environment. The LDCs' historical role of operating the
10 distribution pipe system is now substantially more complex. As
11 interstate pipelines discontinued gas merchant functions, LDCs
12 assumed a variety of new responsibilities, including purchasing
13 gas supplies, reserving capacity on the interstate pipeline, and
14 scheduling and controlling daily gas flows. The costs of providing
15 such services were also shifted to the LDCs.

16
17 **Q. Have there been state regulatory changes in response to
18 the changes at the federal level?**

19 A. Yes. Following the federal model of unbundling, over the past
20 seven years the Florida Public Service Commission (the
21 "Commission") has approved several LDC tariff proposals to
22 provide various levels of open access transportation service.
23 Most regulated LDCs in Florida, including SJNG, offer
24 unbundled service to larger customers. Some Florida companies
25 have expanded their transportation options, establishing

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1 consumption threshold eligibility for smaller commercial
2 customers. In today's marketplace, commercial customers at all
3 consumption levels routinely express interest in unbundled
4 service options. The general publicity that has surrounded
5 telecommunication and electric industry restructuring issues
6 fuels the customer interest in natural gas unbundling. In
7 response to this growing consumer interest in transportation
8 service, the Commission recently adopted Rule 25-7.0335,
9 Florida Administrative Code, requiring LDCs to offer
10 transportation service to all non-residential accounts. As greater
11 numbers of low-volume end-use customers elect transportation
12 service, the interface between the LDC, the interstate pipeline, a
13 myriad of commodity providers and the customer grows in
14 complexity. LDCs must be prepared to seamlessly provide
15 service to customers under a dynamic set of operating
16 conditions.

17
18 **Q. How have these changes affected the local markets in**
19 **which the Company does business?**

20 A. The local marketplace is in a state of transition. The interstate
21 pipelines have transferred the merchant function to LDCs. The
22 LDCs, through their transportation tariffs, are transferring the
23 merchant role directly to end-use customers, or to gas marketers
24 providing a merchant service to customers. In many ways the
25 LDC is caught in the middle. It must provide reliable

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1 distribution service to all customers connected to its pipe
2 system. For certain types of customers, the LDC is currently
3 obligated to provide merchant services for which it must hold
4 long-term capacity contracts and reliable gas supply
5 agreements. As more customers shift to unbundled
6 transportation service, the LDC also finds itself responsible for
7 maintaining gas supply and capacity holdings to serve the
8 remaining bundled accounts. The load factors of the smaller
9 customers are generally low and exhibit a higher degree of
10 weather sensitivity. The shift of higher load factor accounts to
11 transportation often makes it more difficult for the LDC to
12 acquire reasonably priced gas supplies, and results in higher
13 allocations of capacity costs to the smaller, low load factor
14 customers.

15
16 **Q. Will the changes in the marketplace reduce the LDCs'**
17 **administrative or operational responsibilities?**

18 **A.** No. For a growing number of customers, the LDC only provides
19 transportation access for the shipment of the customers' gas. On
20 the surface, it may appear that transportation service relieves
21 the LDC of many administrative concerns. However, in the
22 FERC-approved interstate pipeline tariff, the LDC is the
23 designated "Delivery Point Operator" for the interconnection
24 between the interstate pipeline and the local distribution
25 system. As such, the LDC has substantial responsibility for the

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1 gas volumes that are scheduled for delivery into its system. The
2 actions of transportation customers on the LDC's system can
3 result in imbalance situations with the interstate pipeline. The
4 Delivery Point Operator is ultimately responsible for resolving
5 these imbalances, including payments to the pipeline for
6 overruns and penalties.

7
8 **Q. How should the LDCs adapt to these changes in the**
9 **marketplace?**

10 **A.** In the current market environment, the LDC must strive to
11 provide high quality service to several distinct groups of
12 customers that exhibit radically different load profiles and usage
13 characteristics. Some want to buy gas directly from the LDC,
14 some only want transportation service. Some transportation
15 customers want to use the LDC's interstate pipeline capacity,
16 others want to acquire their own capacity. Some customers have
17 alternate fuel capabilities, and others are close enough to the
18 interstate pipeline to bypass the LDC's system completely.
19 Effectively operating a distribution system in the present
20 business environment requires that the LDC develop a far more
21 comprehensive understanding of individual customers' gas
22 requirements. It must maintain frequent communication with
23 customers, marketers and the interstate pipeline. The LDC
24 must also have the manpower and administrative tools
25 necessary to manage the complicated contractual and

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1 operational activities necessary to meet the different
2 transportation service needs of all non-residential customers,
3 regardless of size or rate class.

4
5 **Q. How is the restructured gas market affecting the core**
6 **industrial and large commercial customer base of the**
7 **LDCs?**

8 **A.** The changing market environment is encouraging larger
9 customers, with alternate fuel or bypass options, to challenge
10 the traditional cost allocation methods that support the gas
11 industry's rate designs. The Company's 1997 rate restructuring
12 filing with the Commission (Order No. PSC-97-0526-FOF-GU)
13 illustrates this point. A large industrial customer, Florida Coast
14 Paper Company, LLC ("Florida Coast"), decreased gas usage by
15 approximately 50% and threatened to convert the remaining gas
16 load to oil unless it received a rate decrease. The rate decrease
17 ultimately approved by the Commission as part of the
18 Company's rate restructuring required a redistribution of the
19 Company's revenue requirement among the other customers.

20
21 In addition, expanding customer access to unbundled
22 transportation service leads to increased customer purchasing
23 sophistication. Open markets also attract new entrants looking
24 for profit opportunities. The combination of expanded market
25 access, more sophisticated purchasers and competitive suppliers

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1 places a downward pressure on margins in many rate classes.
2 As local distribution systems expand transportation service
3 options, margins in the larger rate classes will be difficult to
4 maintain. In traditional cost of service rate design, larger
5 customer groups frequently subsidized smaller groups.
6 Maintaining these cross-class rate subsidies has become
7 increasingly challenging.

8
9 **Q. Does the Company face specific risks from cross-class**
10 **rate subsidies?**

11 A. Yes. The Company is more exposed to the risks of potential rate
12 shifts than most Florida LDCs. The bankruptcy of Florida Coast
13 has created the significant financial difficulty the Company is
14 currently experiencing. Reallocating the Florida Coast
15 contribution to the cost of service to other customer classes
16 without evoking fuel conversions is a major challenge for the
17 Company. As further evidence of its precarious position, the
18 Company's one remaining industrial customer, Arizona
19 Chemical Company ("Arizona Chemical"), contributes almost
20 40% of the Company's total margin revenue. Reducing the
21 subsidization historically provided by large customers will
22 require that the Company work hard to control costs. It must
23 also look for opportunities to increase system throughput in an
24 economically feasible manner as a means of recovering fixed
25 operating costs and minimizing the need for future base rate

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1 increases.

2

3 **Q. It appears the market environment for LDCs is**
4 **increasingly competitive. Please elaborate on this point.**

5 A. Regulatory changes have mandated greater service options for
6 customers. Services that have traditionally been provided
7 exclusively by the LDC are being unbundled. New entrants to
8 the marketplace are competing to provide a variety of energy
9 supply, energy management, and customer information services.
10 Gas-on-gas competition at the individual customer level has
11 emerged as larger customers look for bypass and margin
12 reduction opportunities. It is not at all unusual to find a
13 marketer, or gas consultant, working to direct connect an
14 industrial customer with the interstate pipeline or leverage a
15 rate reduction from the LDC. Further, competition from
16 alternate fuel providers continually places the Company's
17 throughput and margins at risk. Many fuel providers, primarily
18 electric utilities, are offering products and services, in addition
19 to fuel, that strengthen their competitive position. For example,
20 energy audits, equipment servicing, voltage surge suppression,
21 performance contracting and appliance leases are offered by
22 various fuel providers, their unregulated affiliates or trade allies
23 as a means of retaining the core energy business. Competition
24 has always existed in the energy industry. However, it is the

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1 intensity and pervasiveness of competition among all fuel
2 providers that sets today's marketplace apart.

3

4 **Q. Please identify key risks, specific to the Company, in the**
5 **current business environment.**

6 A. I have identified five primary business risks facing the Company
7 in today's market. First, economic downturns in the primary
8 industries served by the Company can have a significant impact
9 on earnings. Second, loss of Arizona Chemical as a customer
10 could have a devastating effect on the Company's revenues.
11 Third, market competition from alternate fuel providers poses
12 an increasing risk to the Company's market share. Fourth, if the
13 Company is unable to grow its earnings base by feasibly
14 expanding service to new customers, rates will ultimately
15 become non-competitive. Fifth, to ensure earnings stability, the
16 Company's rate design must move to significantly reduce cross
17 class subsidization. The Company's earnings must become less
18 dependent on a non-captive and potentially non-existing
19 industrial account.

20

21 **Q. The first risk you identified involves economic**
22 **downturns. What is the economic outlook for the**
23 **Company's service territory?**

24 A. The prevailing view among local officials and Florida Coast is
25 that the pulp and paper mill will never restart operations. In

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1 fact, the mill is currently being dismantled. It is unclear
2 whether an attempt will be made to redevelop the site. The
3 outlook for Arizona Chemical is also uncertain as discussed later
4 in this testimony.

5
6 With the exception of the paper and, potentially, the chemical
7 industries, the economic outlook for the area is reasonably
8 positive. Population growth, as forecast by the University of
9 Florida's Bureau of Economic and Business Research ("BEBR")
10 is expected to continue at reasonable levels over the next
11 decade with approximately 3,000 new residents added by 2010.
12 To the extent that Arvida/St. Joe Company ("Arvida") escalates
13 development in Gulf County, the BEBR population and housing
14 start estimates could prove to be conservative.

15
16 The Company's forecast of customer growth in the residential
17 and small commercial markets was based on assessments of
18 individual development projects and known conversion
19 opportunities. The projections developed from these
20 assessments, and used in the preparation of the MFRs, appear
21 consistent with the building activity forecasts of the BEBR. The
22 BEBR projections include an annual housing start estimate in
23 Gulf County of approximately 75 units per year through the end
24 of this decade. No independent forecast exists for the City of
25 Mexico Beach. However, based upon my evaluation and

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1 analysis, local officials and builders project a steady increase in
2 construction over the next several years. The BEBR also
3 forecasts an increasing volume of non-residential building
4 activity in Gulf County through 2010. While the recent increase
5 in home mortgage rates may have an impact on future housing
6 starts, no significant reductions in starts for 2001 are currently
7 projected by any of the local builders or developers contacted by
8 the Company. Obviously, if interest rates continue to climb, one
9 could expect that housing starts will slow. It should be noted
10 however, that a substantial portion of the Company's projected
11 2001 customer additions result from conversions of existing
12 residences. These conversions are not sensitive to the economics
13 of the new construction market. It is reasonable to conclude that
14 residential growth in the Projected Test Year will be achieved as
15 projected.

16
17 **Q. The second market risk you identified concerns the**
18 **potential loss of Arizona Chemical as a customer. Please**
19 **elaborate.**

20 **A.** Arizona Chemical is the Company's largest customer. Annual
21 transportation sales to Arizona Chemical are forecast at
22 9,698,150 therms in the test year, approximately 87% of the
23 total system throughput. Revenues at current rates from
24 Arizona Chemical comprise around 40% of the Company's total
25 revenues. The loss of Arizona Chemical as a customer would

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1 drastically reduce the Company's revenues and force further
2 reallocation of costs among the Company's other customers.

3
4 **Q. Have there been recent developments that increase the**
5 **risk of the Company losing Arizona Chemical as a**
6 **customer?**

7 **A. Yes. International Paper, Arizona Chemical's parent company,**
8 announced on November 30, 2000 that it plans to sell Arizona
9 Chemical as part of a divestment program to eliminate non-core
10 assets. The reported intent is to sell all eight of Arizona
11 Chemical's plants, including the Port St. Joe plant. What effect
12 the sale will have on the continued operations of the plant is
13 unknown. What is known is that the closure of the Florida Coast
14 pulp and paper mill has had some impact on the profitability
15 and operational efficiency of the Arizona Chemical plant.
16 Apparently, certain raw materials that at one point were
17 provided by Florida Coast are now shipped to Arizona Chemical
18 at greater cost. Arizona Chemical's operating costs, of which fuel
19 costs are a substantial portion, undoubtedly will be a significant
20 factor in determining whether the plant will continue to operate.

21
22 At this point, Arizona Chemical's Port St. Joe plant is operating
23 on a business as usual basis. Accordingly, the forecast of
24 volumes for the Projected Test Year includes Arizona Chemical
25 as a SJNG customer at historic volume levels.

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1 **Q. The third risk you identified is competition from**
2 **alternate fuel providers. Please describe this risk.**

3 **A. Natural gas is not a monopoly fuel. All natural gas customers**
4 **have fuel alternatives. Even the territorial protection from gas-**
5 **on-gas competition offered by the traditional regulatory compact**
6 **does not hold up for individual large volume accounts targeted**
7 **by unregulated marketers willing to install pipe. In today's**
8 **market, many large customers have viable access to fuel oil,**
9 **propane or, in some instances, coal. Smaller customers,**
10 **including residential customers, may elect propane service. All**
11 **customers have access to electric service. I have already noted**
12 **the significant increase in competitive focus by alternate fuel**
13 **providers. In many cases the regulated LDC has difficulty**
14 **meeting not only the alternate fuel price, but also the package of**
15 **additional services that accompany the fuel. For example, the**
16 **propane retailers often package a free equipment service offer in**
17 **their price per gallon. They may also provide free interior piping**
18 **or free appliances. These offers are difficult to counter in a**
19 **regulated world in which a LDC is limited to the customer**
20 **incentives approved by the Commission in its conservation**
21 **programs.**

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1 **Q. How should the market risks posed by alternate fuel**
2 **competition be evaluated?**

3 **A. The market risks posed by alternate fuel competition should be**
4 **evaluated by asking three basic questions. First, can the LDC**
5 **react to the price signals of the market in a manner that keeps**
6 **customers burning natural gas? Second, can the LDC provide**
7 **sufficient additional services to compete with alternate fuel**
8 **providers where fuel cost differences are marginal? Third, will**
9 **the LDC have sufficient staff and customer education resources**
10 **to actively compete for business?**

11
12 **Q. What market risks from alternate fuel competition are**
13 **faced by SJNG?**

14 **A. The alternate fuel competition faced by the Company today is**
15 **primarily limited to propane and electricity, although Arizona**
16 **Chemical does have some capacity to burn fuel oil and**
17 **byproduct. The residential and commercial customers in the**
18 **cities of Port St. Joe and Mexico Beach receive electric service**
19 **from Florida Power Corporation. Customers in Wewahitchka**
20 **and White City receive electric service from Gulf Coast Electric**
21 **Cooperative. AmeriGas is the principal propane supplier in**
22 **SJNG's service territory. Given that a significant portion of the**
23 **Company's customer additions in the test year are residences**
24 **converting from propane or electric to natural gas, the relative**
25 **price of fuel is a critical concern.**

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1 **Q. The fourth market risk you identified relates to the**
2 **Company's need to grow its current customer base.**
3 **Please explain.**

4 **A. Companies that fail to grow find themselves spreading the fixed**
5 **costs of the system over a stable, or more likely, a declining**
6 **customer base. Rates increase, costs are cut, service is reduced,**
7 **customers look for alternatives, and the Company begins to**
8 **decline. Added to the competitive threat is a downward pressure**
9 **on margins from large volume customers further exacerbating**
10 **the Company's decline. As noted above, the Company is already**
11 **experiencing competition in its traditional markets. Fortunately,**
12 **there are growth opportunities in the Company's service areas**
13 **that allow for the feasible expansion of the system to serve**
14 **incremental loads. The Company is actively pursuing such**
15 **opportunities. Over time, prudently adding these customers will**
16 **increase the diversification of the revenue base and help protect**
17 **the Company and its ratepayers from the heavy reliance on**
18 **industrial revenue. The results of this focus on growth are**
19 **included in the Company's forecast of customers and revenue.**

20
21 **Q. You state that the Company faces a fifth market risk from**
22 **cross-class subsidization in its current rate design.**
23 **Please explain.**

24 **A. Currently, revenues from one industrial account provide close to**
25 **40% of the Company's margins. Prior to the Company's 1997**

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1 rate restructuring, and when Florida Coast was still operating
2 its pulp and paper mill, revenues from the industrial sector
3 provided over 90% of the Company's revenue. Rates for other
4 customer classes were established at levels far below parity. In
5 recent years, the industrial margin erosions resulting from rate
6 restructuring and the loss of the paper mill highlight the need to
7 ensure that the Company can appropriately recover its cost to
8 serve each customer class. The price signals historically sent to
9 the residential and commercial customer groups are inaccurate.
10 Working to eliminate the subsidies strengthens the Company's
11 opportunity to retain Arizona Chemical or attract other
12 industrial accounts, to the benefit of all ratepayers. Moving the
13 rates for each customer class toward parity sends a more
14 appropriate price signal to customers and mitigates future rate
15 shock in the event Arizona Chemical is no longer a customer.

16
17 **Q. You have focused on a number of risks in the**
18 **marketplace. Does the new market also provide**
19 **opportunities for SJNG?**

20 **A.** Yes. The Company is actively seeking feasible system expansion
21 opportunities to both grow and continue to diversify its revenue
22 base. The cities of Wewahitchka and Mexico Beach are expected
23 to be the primary growth areas in the next several years. There
24 are a number of projects that are scheduled to receive service in

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1 the near future. Opportunities the Company will pursue in the
2 future are as follows:

- 3 • The City of Wewahitchka was targeted to receive
4 natural gas service as part of the 8" pipeline
5 construction project detailed in Mr. Shoaf's
6 testimony. To date, the Company has added over
7 three hundred accounts in Wewahitchka, 90% of
8 which were converted from propane. The City of
9 Wewahitchka operates a wastewater system that
10 serves approximately 800 customers. The Company
11 originally used these wastewater accounts to target
12 gas service opportunities. The Company's recent
13 financial difficulties have made it difficult to
14 continue the Wewahitchka customer connections.
15 However, several hundred potential customers
16 exist and should be scheduled for conversion.
- 17 • The Point Subdivision is an Arvida development on
18 Highway 98 between Port St. Joe and Mexico
19 Beach. Arvida plans a waterfront, gated community
20 of 112 residential lots, a clubhouse, a pool and a
21 welcome center. Permitting is underway and
22 infrastructure construction is scheduled to begin in
23 2001. Arvida has requested natural gas service for
24 the development.

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- Arvida has sold a parcel of land in Port St. Joe to a local developer for the development of 11 low-income housing units (the Woodmere Subdivision). The Company plans to extend gas service to these units in 2001.
- The Company has surveyed 23 homeowners living in close proximity to the Gulf Correctional Institution ("GCI"). These homeowners have expressed an interest in receiving natural gas service from the Company. Serving these potential residences would require the extension of approximately 2000 feet of 2' plastic main.
- The City of Mexico Beach has been engaged in a sewer system expansion project, that, for the past two years, has limited development in several areas of that community. However, the sewer system has recently been completed and it is anticipated by City officials that development activity will increase. One relatively large tract of land, the Cory Family property, would open development of over 100 residential lots.

SALES, CUSTOMER AND REVENUE FORECAST

1
2 **Q. Has the company prepared a forecast of sales, customers**
3 **and revenues for the Base Year + 1 and Projected Test**
4 **Year?**

5 A. Yes. I prepared, on the Company's behalf, a forecast of sales,
6 customers and revenue by customer classification, for the Base
7 Year +1 and the Projected Test Year. The results of this forecast
8 are displayed on MFR Schedule G-2, pp. 6-9. The forecasts of
9 revenues for both the Base Year + 1 and the Projected Test Year
10 were computed using net customer and sales growth (loss) and
11 the Company's existing rates. As detailed on page 9 of MFR
12 Schedule G-2, the total Projected Test Year revenues from the
13 sale and transportation of natural gas, at current rates, are
14 projected to be \$1,061,132. Other income for the same period is
15 projected, at current rates, to total \$21,023. The revenue
16 requirement deficiency addressed in this case was established
17 based on the above forecast.

18
19 **Q. Please describe the forecasting process used in this**
20 **filing.**

21 A. SJNG is a company with close ties to the small communities it
22 serves. Company representatives, through their social and civic
23 activities, are well informed about opportunities to expand the
24 system, as well as potential customer loss situations. The
25 Company President is a member of the local Economic

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1 Development Council, and routinely attends City Commission
2 meetings. Proposed development projects are known well in
3 advance of construction. Due to its active community
4 involvement, the Company is continually assessing the
5 opportunities and risks of the local market. The Company's
6 expansive local knowledge of existing customers and potential
7 new customers form the fundamental basis for the forecast in
8 this case.

9

10 **Q. Please describe the Company's process for assessing the**
11 **local market.**

12 **A. The Company's assessment of the local market involves several**
13 **on-going activities: customer interviews; discussions with**
14 **residential and commercial developers; discussions with local**
15 **building industry contractors; direct involvement in local**
16 **Economic Development Councils and Chambers of Commerce;**
17 **and a variety of contacts with Building Officials, Planning**
18 **Boards and other agencies with knowledge of future**
19 **development. Information on new residential developments,**
20 **and the physical addresses of homes scheduled for conversion to**
21 **natural gas is compiled in a series of informal work papers.**

22

23

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1 **Q. What information was used to prepare the Company's**
2 **forecast in this case?**

3 **A. Data from the Company's local market assessment, along with**
4 **several years of historical information on customer additions**
5 **and therm sales, were used to prepare the forecast for this case.**
6 **A forecast of customer growth and loss has been prepared for**
7 **each customer class. Sales and transportation volumes were**
8 **projected by class for both existing and new customer additions.**
9 **Average sales volumes for the residential and small commercial**
10 **classes were calculated from historical patterns and used in the**
11 **forecasts to trend existing accounts. Consumption for new**
12 **customer additions for these classes was also projected based on**
13 **historical averages, unless adjusted to account for specific**
14 **knowledge of individual customer additions. Weather effects for**
15 **residential and small commercial customers were considered in**
16 **the volume forecasts through the averaging of consumption over**
17 **a six-year period. Added load by existing customers and**
18 **conversions of existing residences or businesses from electricity**
19 **or propane have also been also projected. The Arizona Chemical**
20 **and GCI accounts were forecasted individually, based on**
21 **conversations with these customers. The net customer and sales**
22 **forecasts were used to derive projected revenues from sales for**
23 **each customer class.**

24

25

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1 **Q. Please describe how you developed the number of**
2 **customers billed in each class for the Base Year + 1 and**
3 **the Projected Test Year.**

4 A. The first step in developing the customer growth forecast was a
5 determination of the actual number of customers in the
6 Company's existing customer classes billed in December 1999. I
7 then evaluated the net customer additions that had occurred
8 during 2000. The Company's Customer Information System
9 ("CIS") produced reports of actual customers by class which were
10 annualized for the year 2000. These customers formed the base
11 upon which customer growth was added.

12
13 I next interviewed several Company employees, local officials,
14 builders and others knowledgeable of local market conditions.
15 The information gathered from these discussions was used in
16 compiling the customer additions forecast for the remainder of
17 the Base Year +1 and the Projected Test Year. The number of
18 customers lost by class was also projected based on historical
19 data to derive net customer growth.

20
21 The Company has maintained historical records of customers by
22 class and by month for several years. I used the 1995 through
23 October 2000 customer data to develop an average of active
24 customers per month. These customer averages reflected a
25 pattern for residential customers that account for seasonal

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1 customers. This pattern was continued in the forecast for
2 November and December 2000 and the Projected Test Year.
3 There has been insignificant net customer growth in the
4 residential class over the past three years. The Company, as
5 part of a dedicated effort to prudently grow its customer base, is
6 forecasting to add 204 new services in 2001 and to lose 24
7 existing accounts for a net of 180 residential account additions.
8 Given the lack of recent historical growth in this class, it is
9 reasonable to adjust the monthly customer totals for 2000 to
10 reflect the projected customer growth.

11
12 The number of customers in the two commercial sales gas
13 classes that have active accounts in the Projected Test Year has
14 not significantly changed over the past few years, other than a
15 reclassification of accounts in 1999 discussed below. There is no
16 discernable, consistent seasonal pattern represented in the
17 commercial customer data. Based on discussions with the
18 Company's customer service representatives, and a review of
19 CIS records, the commercial additions and losses over the past
20 several years have been essentially equal. The Company is not
21 forecasting a net customer increase for the commercial sales
22 classes in the Projected Test Year. The number of active
23 commercial customers in October 2000 was continued
24 throughout 2001. No customer additions are expected in the
25 large volume or transportation service classes.

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1 **Q. Does the Company's forecast consider any**
2 **reclassification of customers based on changes in their**
3 **annual consumption?**

4 A. Yes. The Company conducts an annual review of customer usage
5 for the purpose of assigning appropriate customer
6 classifications. In July 1999, nineteen Large Commercial
7 accounts were reclassified as Commercial accounts (<2000
8 annual therms). Two Commercial accounts were reclassified as
9 Large Commercial accounts at the same time. No accounts have
10 been reclassified in 2000. At this time, the Company does not
11 project any reclassifications in 2001, other than the shift of GCI
12 into the proposed Firm Transportation Service class, discussed
13 later in this testimony.

14
15 **Q. How was the migration of customers to transportation**
16 **service addressed in the customer forecast?**

17 A. In accordance with Rule No. 25-7.0335, Florida Administrative
18 Code, the Company filed on July 1, 2000 proposed
19 transportation tariffs providing unbundled service choices to all
20 nonresidential customers. The Commission has not yet acted on
21 the filing and the proposed unbundling is not anticipated to take
22 effect before January 1, 2002. Therefore, no existing customer
23 migration to transportation service was included in the forecast.
24 It should be noted that the Company currently has several
25 transportation service options available to customers in its

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1 existing tariff. Should customers wish to take advantage of these
2 existing tariffs, the Company is prepared to provide such
3 service.

4
5 **Q. How were the therm sales projections developed?**

6 **A.** Historical consumption data for the Company's traditional
7 homogeneous customer classes (residential, commercial, large
8 commercial) were used to develop monthly consumption
9 estimates for each class. An average monthly consumption
10 amount by class was developed using the actual monthly
11 consumption totals for the period 1995 through October 2000.
12 The monthly consumption averages by class were divided by
13 actual monthly active customers over the same period, resulting
14 in average monthly therms per customer. This computational
15 method accounts for weather variability and seasonal customer
16 fluctuations.

17
18 The customer forecast described above provided the number of
19 customers billed each month during the Base Year + 1 and the
20 Projected Test Year. Annual therm sales for the respective
21 proposed homogeneous customer classes were estimated by
22 multiplying the projected number of customers billed each
23 month by the historic average usage per customer for the month,
24 totaled for the year.

25

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1 The remaining customers, Arizona Chemical and GCI were
2 forecast individually based on conversations with these
3 customers. In both cases, no volume increase is expected from
4 current levels.

5

6 **Q. How did the company estimate revenues for the Base**
7 **Year + 1 and the Projected Test Year?**

8 A. Revenue projections displayed on MFR Schedule G-2 were
9 prepared by applying the forecasts of customers and sales
10 volumes described above for the respective periods using the
11 Company's existing rates and rate structure.

12

INTERIM RATE RELIEF

13
14 **Q. Please describe the method used to propose interim rate**
15 **relief.**

16 A. For purposes of interim rates, the Company followed the
17 methodology provided in MFR Schedule F for calculating and
18 allocating appropriate interim rates.

19

20 **Q. What is the revenue increase the company is requesting**
21 **from interim rates?**

22 A. The Company requests that annual revenues be increased by
23 \$459,185.

24

25

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1 **Q. Please describe how you calculated this amount?**

2 A. The Revenue Deficiency for the interim rate increase is
3 calculated on MFR Schedule F-7. It was derived based on an
4 Adjusted Rate Base of \$4,353,279, and a Requested Rate of
5 Return of 5.66%, yielding an NOI requirement of \$246,806. The
6 Adjusted Rate Base is calculated on MFR Schedule F-1, and the
7 Requested Rate of Return is calculated on MFR Schedule F-8.
8 As required by Section 366.071(5)(b)3, Florida Statutes, the
9 Company used the bottom of the range of its most recent
10 authorized return on equity (10%) to determine the weighted
11 cost of capital. The Company's Adjusted NOI for 1999 is
12 negative \$31,410, which has been calculated on MFR Schedule
13 F-4. An NOI Deficiency of \$277,806 was determined by
14 subtracting the Company's Adjusted NOI from the NOI
15 Requirement. The requested interim rate increase of \$459,185
16 equals the NOI Deficiency grossed up by the Revenue Expansion
17 Factor (1.6529) calculated on MFR Schedule F-6.

18
19 **Q. Has the Company appropriately reflected all adjustments**
20 **required by the Commission in its last rate case?**

21 A. Typically, the determination of Rate Base, Rate of Return and
22 NOI for interim rate purposes reflect adjustments made by the
23 Commission in the Company's most recent full requirements
24 rate case. The Company's only full requirements rate case dates
25 back to 1967, when rates for SJNG were initially established by

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1 the Commission. For the purposes of this filing, the calculations
2 of Rate Base, Requested Rate of Return and Adjusted NOI
3 reflect all adjustments made by the Commission during the
4 Company's rate restructuring proceeding (Order No. PSC-97-
5 0526-FOF-GU). During this proceeding, the Commission relied
6 on the Company's 1995 capital structure as identified in the
7 Commission's overearnings investigation (Order No. PSC-96-
8 1188-FOF-GU). SJNG has petitioned the Commission for
9 waiver of portions of its MFR requirements to allow the
10 Company to refer back to the Commission's order in the rate
11 restructuring instead of the 1967 rate case.

12
13 **Q. In its request for interim rate relief, has the Company**
14 **adjusted revenues to reflect the final step rate increase**
15 **approved during the rate restructuring?**

16 **A.** No. The final step adjustment of the rate shift approved by the
17 Commission in the Company's rate restructuring was
18 implemented for meters read on or after May 21, 1999. The
19 Company has not annualized the operating revenues included
20 on MFR Schedule F-4. Clearly, the annualized effect of such an
21 adjustment would increase Adjusted NOI and reduce the
22 Company's request for interim relief. The Company has
23 appropriately annualized revenues on MFR Schedule F-10 by
24 applying the current rates to the billing determinants. In a
25 discussion with Commission staff, it was agreed that a revenue

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1 adjustment to correct NOI would be made subsequent to the
2 filing to account for the annualized effect of the authorized rate
3 increase.

4

5 **Q. How was the interim rate increase designed and**
6 **allocated among customer classes?**

7 A. The revenue deficiency was divided by the total calculated
8 revenue based on December 31, 1999 billing determinants. The
9 resulting percentage increase was applied to all customer
10 classes, except the Contract Transportation Service class.
11 Arizona Chemical is the sole customer in this class. The
12 Company, for competitive reasons outlined earlier in this
13 testimony, is proposing to reduce Arizona Chemical's current
14 rate. Therefore, no interim increase was allocated.

15

16 **COST OF SERVICE AND PERMANENT RATE DESIGN**

17 **Q. Have you prepared a rate design for the Company's**
18 **proposed rates?**

19 A. Yes.

20

21 **Q. Please describe the process used to design the Company's**
22 **proposed rates.**

23 A. I performed a fully embedded cost of service study to determine
24 the appropriate assignment of expense and investment costs to
25 each of the Company's homogeneous classes of service. The cost

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1 study utilized information from all areas of the Company's
2 operations, including customer billing and consumption records,
3 engineering studies, forecasts of growth, and cost data from the
4 accounting records. The total cost of service was assigned or
5 allocated to determine the revenue requirements of each class of
6 customers. The results of my analysis were used to identify the
7 Company's proposed rate design, which is detailed on MFR
8 schedule H-1, and is summarized in Exhibit No. _____ (JMH-
9 2).

10
11 **Q. Was a particular methodology or model used to conduct**
12 **the cost of service study?**

13 A. The standard methodology traditionally used by Commission
14 staff formed the fundamental base of the cost of service study.
15 The Company's study also follows the presentation format
16 contained in the H Schedules of the prescribed MFR forms.

17
18 **Q. How is a cost of service study performed?**

19 A. Traditional cost studies are typically segmented into three
20 individual activities: functionalization, classification and
21 allocation. Functionalization refers to the process of relating
22 plant investments and associated operating expenses to four
23 basic functional categories: production, storage, transmission
24 and distribution. Plant investments and related operation,
25 maintenance, depreciation and tax expenses are assigned to the

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1 functional categories. The functional assignment of costs is a
2 relatively straight-forward process. The Company maintains its
3 accounting records in accordance with the FERC Uniform
4 System of Accounts. FERC accounting assigns plant facilities
5 and investments to cost of service functions. Related expenses
6 follow the same functionalization. MFR Schedule H-3, pages 2
7 and 3 functionalize the overall cost of service, and pages 4 and 5
8 functionalize rate base.

9
10 Classification refers to the process of dividing the functional
11 costs into categories based on cost causation. Each local
12 distribution system is designed and operated based on the
13 individual and collective service requirements of its customers.
14 The cost of providing such service is categorized in order to
15 assign costs to the customer classes that are principally
16 responsible for those costs. Typically, there are four categories
17 used to classify costs: capacity or demand costs, commodity
18 costs, customer costs and revenue costs.

19 1. Capacity or demand costs are those costs incurred by
20 the utility to meet the on-demand service requirements of the
21 total customer base. Capacity costs are related to the peak or
22 maximum demand requirements placed on the system by its
23 customers. Capacity costs are incurred to ensure that the system
24 is ready to serve customers at peak requirements levels. These

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1 costs are generally considered to be “fixed”, and are incurred
2 whether or not a customer uses any gas.

3 2. Commodity costs are variable and relate to the
4 quantitative units of product consumed. Costs which can be
5 linked to the volume of gas sold or transported fit into this
6 category.

7 3. Customer costs are those costs incurred to connect a
8 customer to the distribution system, meter their usage and
9 maintain their account. In addition, other costs such as meter
10 reading, which are a function of the number of customers served,
11 should be included in this category.

12 4. Revenue costs are related to those costs items which
13 can be assigned based on the percentage of total revenue
14 received from each class of customer. These costs vary with the
15 amount of sales revenue collected by the Company. Gross
16 receipts taxes and regulatory assessment fees fall into this
17 category.

18
19 I have utilized the cost classification methodology contained in
20 the MFR model. The “classifiers” identified in the model were
21 not altered. The classification of each functionalized cost
22 component is contained in MFR schedule H-3, pages 2-5.

23
24 Allocation involves the distribution or assignment of the
25 classified costs to the Company’s customer classes. Those costs

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1 which can be directly attributable to a specific customer class
2 are assigned to that class. The remaining costs are assigned by
3 applying a series of allocation factors. The allocation factors
4 attempt to distribute costs based on the causal relationships
5 between the respective customer classes and the classified costs.
6 The development and application of the allocation factors and
7 direct assignment of costs is the final step in a cost of service
8 study. MFR Schedule H-2, page 5, details the development of
9 allocation factors by customer class.

10
11 **Q. You indicated that costs were allocated by customer**
12 **class. Please describe how the customer classes were**
13 **determined.**

14 **A. Customers of a utility are grouped into relatively homogeneous**
15 **classes according to their service characteristics. Consumption**
16 **levels, pressure requirements, load factors, conditions under**
17 **which service is provided (curtailment status, for example), and**
18 **end-use application of the fuel can be considered when**
19 **establishing customer classes. Typically, the utility incurs**
20 **different costs to provide service to each discrete customer class.**
21 **Rate schedules are established by class to recover these costs.**

22
23 The Company's current tariff includes eight rate schedules.
24 They are as follows:

- 25 1. Residential Service

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- 1 2. Commercial Service (0-2,000 annual therms)
- 2 3. Large Commercial Service (>2,000<50,000 annual
- 3 therms)
- 4 4. Interruptible Service (>50,000<150,000 annual
- 5 therms)
- 6 5. Large Interruptible Service (>150,000 annual
- 7 therms)
- 8 6. Contract Interruptible Service (>150,000 annual
- 9 therms / flex rate)
- 10 7. Interruptible Transportation Service (>150,000
- 11 annual therms)
- 12 8. Contract Transportation Service (>150,000 annual
- 13 therms / flex rate)

14

15 At present, no customers are served under the Interruptible
16 Service, Large Interruptible Service, Contract Interruptible
17 Service and Interruptible Transportation Service customer
18 classes. According to the Company, it is not likely that
19 customers will elect any of these classes in the foreseeable
20 future, and certainly not during the projected test year.
21 Therefore, these service classes are not specifically addressed in
22 the cost of service study.

23

24 The Company has reviewed the cost of providing service to
25 customers of varying sizes and usage characteristics. Several

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1 cost breakpoints were identified which could generally be linked
2 to annual volumetric requirements. Meter and regulator type
3 and size, service line size and on-going maintenance costs are
4 among the items that distinguish one service class from another.
5 The Company could not identify substantive cost differences
6 between its Residential class and its Small Commercial Service
7 class (0-2,000 annual therms). Discernable cost differences were
8 identified for a commercial customer class with annual volumes
9 of 2,000-25,000 therms. The Company evaluated service costs for
10 its two largest customers, both of which are currently served in
11 the Contract Transportation Service class, and identified
12 significant cost differences between these customers. Thus, the
13 Company is proposing to shift one of these customers into a new
14 service classification. The Company's analysis of the facility
15 costs by customer classification is included on MFR Schedule E-
16 7.

17
18 **Q. Please describe any proposed changes to the Company's**
19 **existing customer classifications.**

20 A. The cost of service study generally utilized the Company's
21 existing customer classifications. However, the Company is
22 proposing several adjustments to its service classes, along with
23 certain new classifications. The proposed changes are outlined
24 as follows:

25

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- 1 • The existing Commercial Service class (0 up to
2 2,000 annual therms) is renamed “Small
3 Commercial Service” with no change in
4 applicability.
- 5 • The Large Commercial Service class (currently
6 greater than 2,000 and less than 50,000 annual
7 therms) is renamed “Commercial Service”. The
8 Company proposes to revise the applicability of this
9 class to an annual therm range greater than 2,000
10 and less than 25,000.
- 11 • A new Large Commercial Service class for
12 customers using greater than 25,000 annual
13 therms and less than 500,000 annual therms is
14 proposed. The creation of this class provides a sales
15 gas option that parallels the proposed Firm
16 Transportation Service class. No customers are
17 forecast for this class in the test year.
- 18 • A new Firm Transportation Service (“FTS”) class
19 with annual therm applicability provisions
20 identical to the Large Commercial Service class is
21 proposed. One customer, GCI, is forecast for this
22 class in the test year. At present, GCI is served
23 under the Contract Transportation Service class,
24 along with Arizona Chemical. There are significant
25 differences in the character and cost of service

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between these two accounts. GCI consumes well under 400,000 annual therms while Arizona Chemical uses almost 10,000,000. GCI is a firm account, but Arizona Chemical is interruptible. As identified on MFR Schedule F-7, there is a substantial cost difference in the facilities required to serve the respective customers. I believe that these accounts should be served under separate rate schedules. The Company recognizes that the creation of the FTS customer class expands the Company's current transportation service options to customers below 150,000 annual therms (the current eligibility level in the Contract Transportation Service class). The Company does not anticipate a request for service in this class other than GCI during the test year. If such a request is made, the Company stands ready to provide transportation service under the terms of the proposed FTS rate schedule.

- The current applicability provision for the Interruptible Service class (greater than 50,000 and less than 150,000 annual therms) has been revised to the applicability levels proposed for the firm service Large Commercial class (greater than

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25,000 up to 500,000 annual therms). There are no current or projected customers in this class.

- The current Large Interruptible Service class is open to customers using over 150,000 annual therms. The Company proposes to change the applicability provisions to customers using greater than 500,000 annual therms. There are no current or projected customers in this class.

- The Contract Interruptible Service class is also currently open to customers using over 150,000 annual therms. The Company proposes to change the applicability provisions to customers using greater than 500,000 annual therms, consistent with the Large Interruptible Service class. There are no current or projected customers in this class.

- The current Contract Transportation Service class is open to customers using over 150,000 annual therms. The Company proposes to change the applicability provisions to customers using greater than 500,000 annual therms. Arizona Chemical will remain a customer in this class, while GCI will shift to the proposed FTS class.

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1 **Q. Is the company proposing to remove investment and**
2 **O&M costs directly related to Arizona Chemical from the**
3 **costs allocated to other ratepayers?**

4 A. Yes. The Company has removed net plant and O&M costs
5 attributable to Arizona Chemical from the costs allocated to
6 other customer classes, either directly or through allocation
7 factors.

8
9 **Q. Does your cost of service study account for this**
10 **adjustment?**

11 A. Yes. A separate cost analysis was conducted for Arizona
12 Chemical. The individual rate base and O&M cost elements in
13 MFR Schedule H-2, were directly input rather than allocated.
14 The Arizona costs were subtracted from the total cost to serve
15 for each cost category. The remaining costs were then allocated
16 among the remaining customer classes.

17
18 **Q. Please describe how you allocated capacity costs in the**
19 **cost of service study.**

20 A. Capacity costs were allocated on the basis of peak and average
21 monthly sales volume. An additional allocator was developed for
22 assigning the cost of mains.

23
24
25

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1 **Q. How were commodity costs allocated?**

2 A. Commodity related costs were allocated on the basis of annual
3 sales volumes.

4
5 **Q. Please describe how you allocated customer costs.**

6 A. Customer costs were allocated based on the relative number of
7 customers served in each customer class. The “weighted number
8 of customers” allocator was used to distribute costs based on the
9 recognition that larger customers exhibit higher customer costs.
10 Meters, regulators and service lines are generally more
11 expensive for larger customers. The weightings used were
12 derived from the relative investment in meters, regulators and
13 service lines required to serve representative customers in each
14 class. The weightings can be found on MFR Schedule E-7.

15
16 **Q. How were revenue costs allocated?**

17 A. Revenue costs were allocated on the basis of gross revenues by
18 customer class.

19
20 **Q. Please briefly describe the results of the cost allocation
21 process.**

22 A. The allocation of cost of service by customer class is presented
23 on MFR Schedule H-2, pages 2 and 3. The allocation of rate base
24 to each customer class is included in MFR Schedule H-2, page 4.

25

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1 **Q. It would appear that a cost of service study is primarily a**
2 **mechanical accounting of costs. Are there opportunities**
3 **to apply judgement, consider market conditions or other**
4 **unique factors in the study?**

5 A. Yes. Cost studies are not simply formula based accountings of
6 costs by rate classification. They require a substantial amount of
7 judgement by the analyst to appropriately allocate and assign
8 costs. An understanding of the utility's business strategy,
9 market area and competitive position is necessary to complete
10 an appropriate rate design. Within the cost of service study, the
11 selection and application of allocation factors requires not only a
12 mechanical understanding of the Company's costs, but also a
13 common sense understanding of a variety of economic, social,
14 regulatory and competitive considerations.

15
16 **Q. Should a cost of service study be exclusively relied upon**
17 **to establish utility rates?**

18 A. No. As noted above, there are a number of factors that must be
19 considered when designing rates. One of the most critical is the
20 competitive position of the Company in the marketplace.
21 Customers in all rate categories have fuel alternatives.
22 Increasingly, customers are demonstrating greater
23 sophistication in their consideration of energy options. The
24 relative competitive position of the Company to several fuel

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1 alternatives by customer class was discussed earlier, and is
2 displayed in Exhibit No. _____ (JMH-3).

3
4 Given the magnitude of the rate increase necessary in this case
5 it is critical that competitive concerns be addressed in setting
6 permanent rates. The historical cross class subsidization of the
7 residential and commercial classes by the Company's industrial
8 customers has resulted in artificially low rates for most
9 customers. The reduction of the subsidies, through customer loss
10 or rate decreases due to competition, will send a markedly
11 different price signal to small volume customers. We must
12 ensure that the ultimate rates consider a variety of factors other
13 than a strict adherence to cost allocation.

14
15 Price elasticity, proximity to the interstate pipeline and specific
16 fuel alternatives vary greatly among customer classes. In the
17 residential service class, energy decisions for new homes are
18 typically made by the homebuilder, not the homeowner. Fuel
19 price is only one factor homebuilders consider in evaluating
20 appliance types. There are numerous non-price issues in all
21 customer classes that effect fuel selections. Maintenance
22 concerns, fuel storage, emissions levels, appliance efficiency,
23 comfort and aesthetics all play a part in fuel decisions. The
24 bottom line is that customers have choices. The Company's
25 proposed rate design utilizes a cost of service study as a starting

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1 point, but the final rate recommendations consider the above
2 issues and make appropriate adjustments.

3

4 **Q. How are these adjustments reflected in the Company's**
5 **MFR filing?**

6 A. The initial cost of service analysis did not separate Arizona
7 Chemical from the total cost to serve. The use of the typical peak
8 and average allocation factor to assign capacity costs produced
9 an allocation of cost that resulted in a doubling of the Arizona
10 Chemical non-fuel rate. It reflects the reallocation of the cost
11 historically borne by Florida Coast. While the reallocation of
12 these costs is a principal factor in this case, an inappropriate
13 cost allocation could further erode the Company's customer base.
14 When an allocation method doubles the cost a customer would
15 incur if it were the only customer on the system, it is necessary
16 to reassess the allocation method. As noted above, an individual
17 cost of service analysis was produced for Arizona Chemical
18 which results in a proposed decrease in Arizona Chemical's rate.
19 Obviously, the loss of Arizona Chemical would require the
20 reallocation of significant costs to the remaining customers.

21

22 In addition, the Company considered its competitive position
23 with respect to bypass, electricity and propane, as well as the
24 anticipated customer acceptance of the permanent rate design,
25 in the ultimate allocation of cost to each customer class. Several

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1 reallocations of cost were undertaken to produce the final
2 proposed rates. Costs were reallocated in the MFR Schedule H-
3 2, page 4 of 6, Direct and Special Assignment of O&M costs.

4
5 **Q. Did you consider the Company's current rate design in**
6 **your analysis?**

7 **A.** Yes. In preparing my final rate proposals I reviewed the results
8 of the Commission-approved rate design in the Company's 1997
9 rate restructuring proceeding (Order No. PSC-97-1014-FOF-
10 GU). In the 1997 rate restructuring case, the rate of return for
11 all customer classes was set at 11.92%. At that time, substantial
12 rate of return disparities among classes had developed.
13 Residential returns were negative 25.21%. Commercial and
14 Large Volume Commercial returns were at negative 30.65% and
15 negative 11.24%, respectively. On the other hand, returns from
16 the Company's two Interruptible customers were at 24.70%. The
17 overall return was 11.92%.

18
19 The 1997 rate restructuring was revenue-neutral to the
20 Company. Rates were established that redistributed existing
21 costs from the industrial class to the residential and commercial
22 classes. The rates established under the restructuring moved
23 the returns to parity, at 11.92%. Of course, at the time of the
24 restructuring, the Company continued to receive substantial
25 revenues from Florida Coast. The fact that these revenues are

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1 no longer available has a major impact on the Company's cost
2 allocation and rate design proposals.

3
4 **Q. Please describe your proposed rate design.**

5 A. The loss of Florida Coast as a customer significantly impacts the
6 Company's rates of return under present rates in the Projected
7 Test Year. Absent rate relief, the overall return is negative
8 4.42%. All customer classes exhibit negative returns except the
9 Contract Transportation Service class (Arizona Chemical). The
10 Arizona Chemical return under present rates is more than
11 double the projected overall cost of capital in the test year. The
12 Company's proposed rate design results in each customer
13 moving toward a more uniform contribution to costs compared to
14 present rates. The rate design I am proposing establishes rates
15 of return for each customer class that removes much of the
16 inequity created with the loss of the Florida Coast. While
17 competitive concerns preclude me from establishing rate of
18 return parity for all classes, the final rate design moves all
19 customer classes closer to the Company's projected weighted cost
20 of capital of 6.32%. The proposed returns for the residential
21 class moves from negative 17.22% at present rates to 6.46%. The
22 Small Commercial class improves from negative 4.63% to 5.88%.
23 The return for the Commercial class increases from negative
24 8.30% to 6.62%. The new Firm Transportation Service class
25 exhibited a negative 3.19%, but is proposed at 8.45%. The

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1 Arizona Chemical Contract Transportation Service return is
2 anticipated to decrease from 15.45% to 6.96%, which is close to
3 the proposed overall return.
4

5 **Q. Please summarize the conclusions you have reached**
6 **based on your cost analysis and rate design.**

7 A. The cost of service analysis provided a reasonable basis upon
8 which to begin the design of rates by customer class. I compared
9 the initial results of the cost study to the Company's historic
10 rates, the competitive cost analysis and the Company's objective
11 of reducing rate subsidization and retaining Arizona Chemical
12 as a customer. My final rate design brings the rates of return for
13 all customer classes close to the Company's cost of capital. The
14 proposed rates substantially reduce the subsidy the industrial
15 class has been required to contribute to the overall rate of
16 return. The proposed rate design produces rates which are in
17 line with customer alternatives, and positions the Company to
18 achieve its business objectives. I believe the proposed rate
19 design is just and reasonable, producing fair and equitable rates
20 for each customer class.
21

22 **Q. How much revenue will the proposed rates produce?**

23 A. The rates and charges are designed to produce additional
24 revenues of \$551,923. Target revenues under the proposed rates
25 total \$1,634,078.

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1 **Q. Please compare the proposed rates to the present rates.**

2 A. A comparison of present and proposed base rates and customer
3 charges by customer class is presented in MFR Schedule H-1, p.
4 6 of 6, and is summarized in Exhibit _____ (JMH-2).

5
6 **Q. Is the company proposing changes to its other operating
7 revenue charges?**

8 A. Yes. Connection Charges for residential customers are proposed
9 to increase from \$10.00 to \$30.00. Commercial Connection
10 Charges are proposed to increase from \$10.00 to \$60.00.
11 Reconnection Charges are proposed at the same respective rates.
12 A new Collection in Lieu of Disconnection charge is proposed at
13 \$15.00. The Return Check Charge is proposed to increase from
14 \$10.00 to \$25.00 or 5% of the face value of the check whichever
15 is greater, corresponding to the maximum charge allowed under
16 Florida law. The Late Fee Charge is proposed to remain at its
17 existing level of \$3.00. A Change of Account Charge is proposed
18 at \$20.00. The proposed other revenue charges are projected to
19 generate \$45,553 in the Proposed Test Year, compared to
20 revenues from present rates of \$21,023. These proposed charges
21 are based on the Company's cost analysis displayed on MFR
22 Schedule E-3.

23
24 **Q. Does this conclude your direct testimony?**

25 A. Yes.

Exhibit No. (JMH-1)
St. Joe Gas, Inc.
Docket No. 001447-GU

LIST OF MFR SCHEDULES SPONSORED BY JEFF HOUSEHOLDER

<u>Schedule</u>		<u>Title</u>
E-1	PP. 1-3	COST OF SERVICE
E-2	PP. 1-4	COST OF SERVICE
E-3	PP. 1-6	COST OF SERVICE
E-4	PP. 1-2	COST OF SERVICE
E-5	PP. 1-27	COST OF SERVICE
E-6	PP. 1-5	COST OF SERVICE
E-7	PP. 1-3	COST OF SERVICE
E-8	P. 1	COST OF SERVICE
F-1	P. 1	CALCULATION OF INTERIM RATE RELIEF - RATE OF RETURN
F-2	PP. 1-2	CALCULATION OF INTERIM RATE RELIEF - WORKING CAPITAL
F-3	PP. 1-3	CALCULATION OF INTERIM RATE RELIEF - ADJUSTMENTS TO RATE BASE
F-4	P. 1	CALCULATION OF INTERIM RATE RELIEF - NET OPERATING INCOME
F-5	PP. 1-2	CALCULATION OF INTERIM RATE RELIEF - NET OPERATING INCOME ADJUSTMENTS
F-6	P. 1	CALCULATION OF INTERIM RATE RELIEF - REVENUE EXPANSION FACTOR
F-7	P. 1	CALCULATION OF INTERIM RATE RELIEF - REVENUE DEFICIENCY
F-8	P. 1	CALCULATION OF INTERIM RATE RELIEF - COST OF CAPITAL
F-9	P. 1	RECONCILIATION OF AVERAGE CAPITAL STRUCTURE TO AVERAGE JURISDICTIONAL RATE BASE (INTERIM)

<u>Schedule</u>	<u>Title</u>
F-10 P.1	CALCULATION OF INTERIM RATE RELIEF - DEFICIENCY ALLOCATION
G-2 PP. 6-7	CALCULATION OF THE HISTORIC BASE YEAR+1 - REVENUES AND COST OF GAS
G-2 PP. 8-9	CALCULATION OF THE PROJECTED TEST YEAR - REVENUES AND COST OF GAS
H-1 P. 1	COST OF SERVICE - SUMMARY
H-1 P. 2	COST OF SERVICE - DERIVATION OF REVENUE DEFICIENCY
H-1 PP. 3-4	COST OF SERVICE - RATE OF RETURN BY CLASS
H-1 P. 5	COST OF SERVICE – PROPOSED RATE DESIGN
H-1 P. 6	COST OF SERVICE - PROPOSED RATES
H-2 P. 1	COST OF SERVICE - SUMMARY
H-2 PP. 2-5	ALLOCATION OF COST OF SERVICE TO CUSTOMER CLASS
H-2 P. 6	COST OF SERVICE - SUMMARY
H-3 PP. 1-4	COST OF SERVICE - FULLY ALLOCATED EMBEDDED COST OF SERVICE
H-3 P. 5	COST OF SERVICE - SUMMARY

Exhibit No. (JMH-2)
 St. Joe Gas, Inc.
 Docket No. 001447-GU

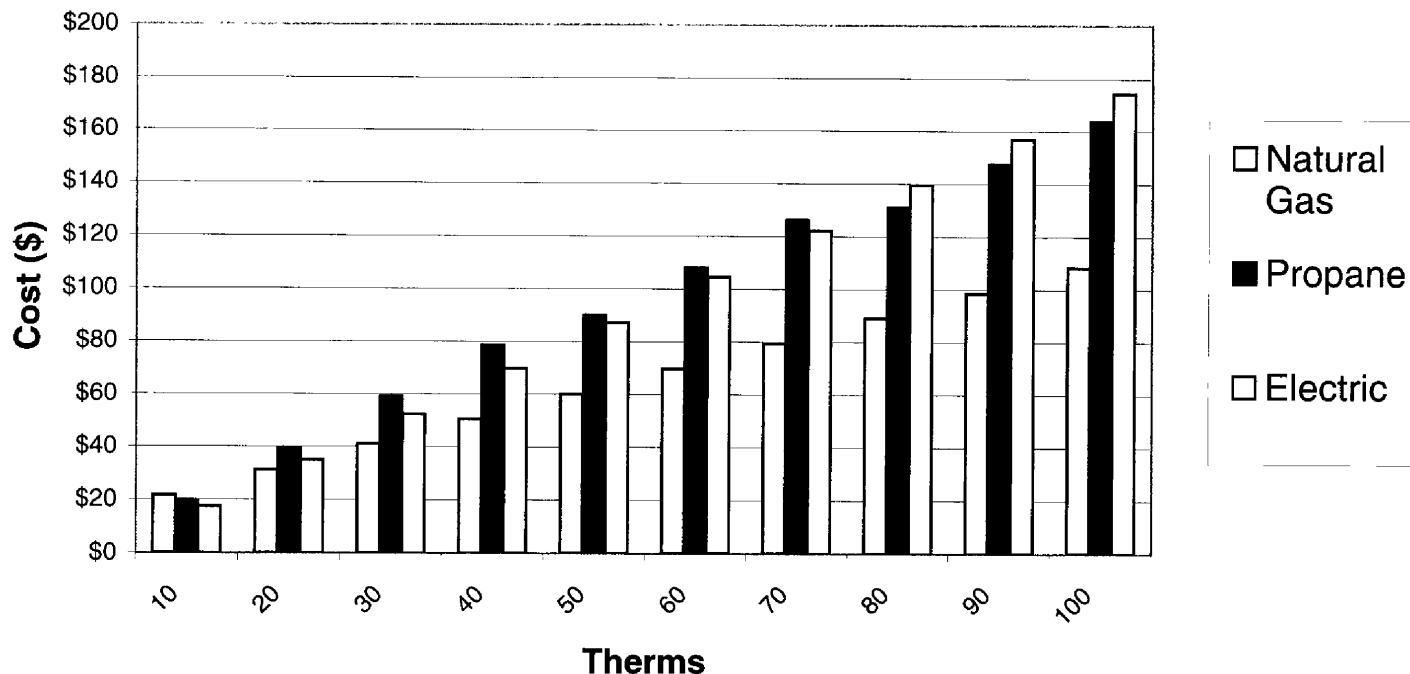
Comparison Of Present Rates To Proposed Rates

<u>Proposed Rate Schedule</u>	<u>Present Rates</u>	<u>Proposed Rates</u>
Residential Service		
Customer charge per month	\$6.00	\$12.00
Energy charge per therm	\$0.24146	\$0.51271
Small Commercial Service		
Customer charge per month	\$12.00	\$12.00
Energy charge per therm	\$0.22146	\$0.51271
Commercial Service		
Customer charge per month	\$35.00	\$40.00
Transportation charge per therm	\$0.10064	\$0.29752
Large Commercial Service		
Customer charge per month	N/A	\$1000.00
Energy charge per therm	N/A	\$0.11843
Interruptible Service		
Customer charge per month	\$360.00	\$360.00
Energy charge per therm	\$0.04210	\$0.04210
Large Interruptible Service		
Customer charge per month	\$1000.00	\$1000.00
Transportation charge per therm	\$0.04070	\$0.04070
Contract Interruptible Service		
Customer charge per month	\$7.00	\$32.50
Energy charge per therm	\$0.46905	\$0.29273
Firm Transportation Service		
Customer charge per month	N/A	\$1000.00
Energy charge per therm	N/A	\$0.11843
Interruptible Transportation Service		
Customer charge per month	\$360.00	\$360.00
Transportation charge per therm	\$0.04070	\$0.04070
Contract Transportation Service		
Customer charge per month	\$1000.00	\$1000.00
Transportation charge per therm	\$0.04070	\$0.29520

Exhibit No. (JMH-3)
St. Joe Gas, Inc.
Docket No. 001447-GU

Analysis of Competitive Fuel Costs

Competitive Rate Analysis for Residential Customers by Class Proposed Rates vs Alternate Fuel

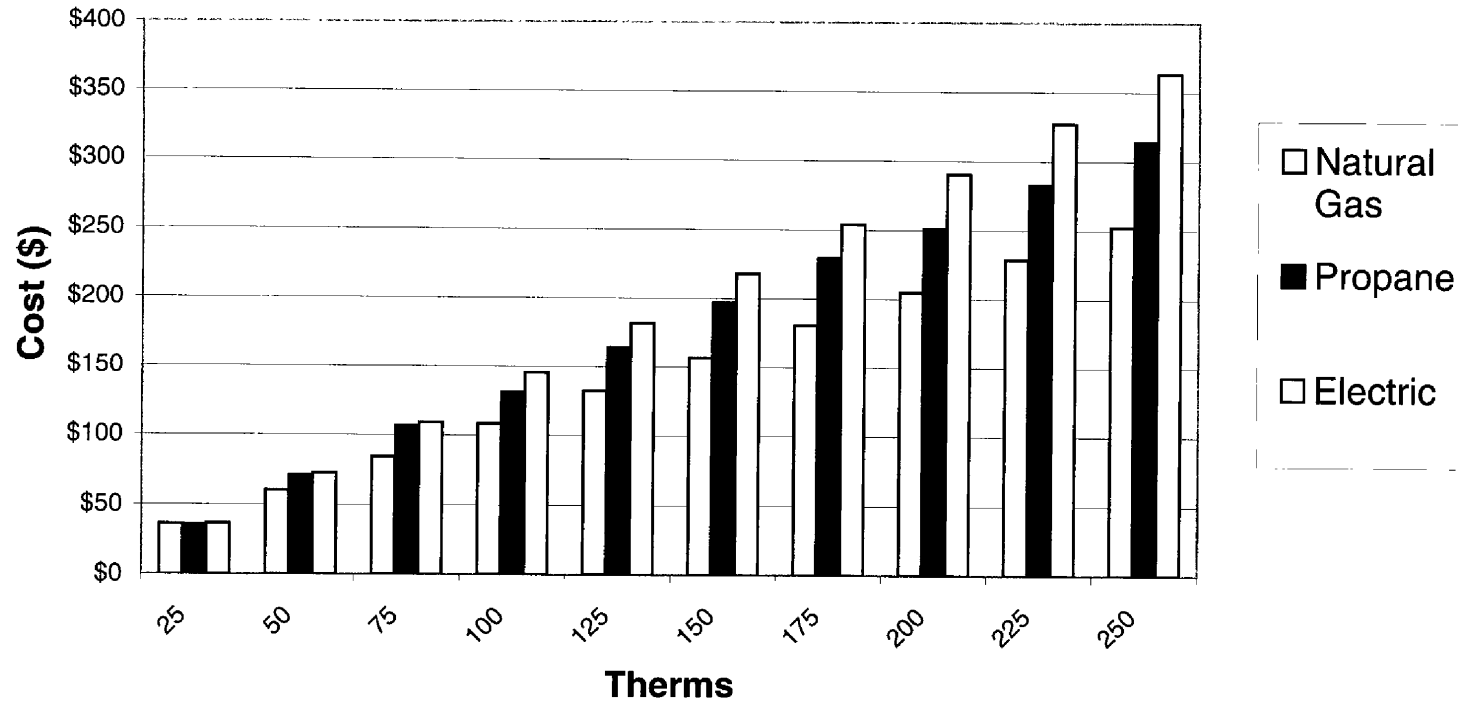


Therm Usage	10	20	30	40	50	60	70	80	90	100
Natural Gas	\$21.63	\$31.25	\$40.88	\$50.51	\$60.14	\$69.76	\$79.39	\$89.02	\$98.64	\$108.27
Propane	\$19.66	\$39.31	\$58.97	\$78.62	\$90.09	\$108.11	\$126.13	\$131.04	\$147.42	\$163.80
Electric	\$17.43	\$34.87	\$52.30	\$69.73	\$87.17	\$104.60	\$122.03	\$139.47	\$156.90	\$174.34

Percent comparison : Natural Gas to Alternate Fuel

Propane	-10.0%	20.5%	30.7%	35.8%	33.2%	35.5%	37.1%	32.1%	33.1%	33.9%
Electric	-24.1%	10.4%	21.8%	27.6%	31.0%	33.3%	34.9%	36.2%	37.1%	37.9%

Competitive Rate Analysis for Small Commercial Customers by Class Proposed Rates vs Alternate Fuel

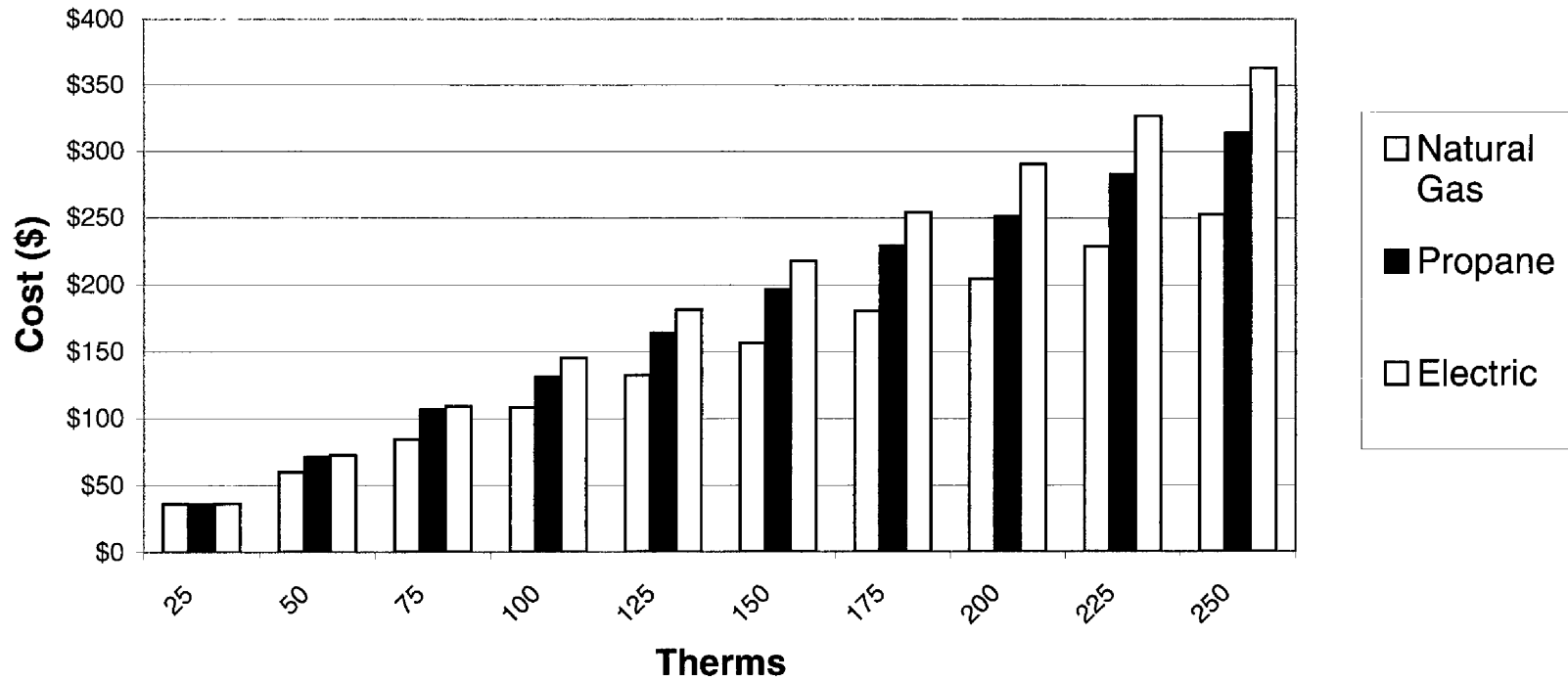


Therm Usage	25	50	75	100	125	150	175	200	225	250
Natural Gas	\$36	\$60	\$84	\$108	\$132	\$156	\$180	\$205	\$229	\$253
Propane	\$35	\$71	\$106	\$131	\$164	\$197	\$229	\$251	\$283	\$314
Electric	\$36	\$73	\$109	\$145	\$182	\$218	\$254	\$290	\$327	\$363

Percent comparison : Natural Gas to Alternate Fuel

Propane	-1.6%	15.3%	20.9%	17.4%	19.2%	20.4%	21.3%	18.6%	19.1%	19.5%
Electric	0.6%	17.2%	22.7%	25.4%	27.1%	28.2%	29.0%	29.6%	30.0%	30.4%

Competitive Rate Analysis for Commercial Customers by Class Proposed Rates vs Alternate Fuel



Therm Usage	250	500	750	1000	1250	1500	1750	2000	2250	2500
Natural Gas	\$227	\$414	\$601	\$788	\$974	\$1,161	\$1,348	\$1,535	\$1,722	\$1,909
Propane	\$314	\$628	\$942	\$1,147	\$1,433	\$1,720	\$2,007	\$2,075	\$2,334	\$2,594
Electric	\$363	\$726	\$1,089	\$1,452	\$1,815	\$2,178	\$2,541	\$2,904	\$3,267	\$3,630

Percent comparison : Natural Gas to Alternate Fuel

Propane	27.7%	34.1%	36.2%	31.3%	32.0%	32.5%	32.8%	26.0%	26.2%	26.4%
Electric	37.5%	43.0%	44.8%	45.8%	46.3%	46.7%	46.9%	47.1%	47.3%	47.4%