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**Charles A. Costin**

Cecil G. Costin, Jr.  
(1923 - 1990)

December 21, 2007

Mailing Address:  
Post Office Box 98  
Port St. Joe, FL 32457-0098

Ms. Ann Cole  
Commission Clerk  
Florida Public Service Commission  
2540 Shumard Oak Blvd.  
Tallahassee, Florida 32399-0850

RECEIVED-FPSC  
07 DEC 21 PM 3:36  
COMMISSION  
CLERK

**Re: Docket No. 070592: Application by St. Joe Natural Gas Company, Inc., for an increase in permanent base rates.**

Dear Ms. Cole:

Enclosed for filing on behalf of St. Joe Natural Gas Company, Inc. are an original and twenty copies of the St Joe Natural Gas Company's Petition, Testimony and Minimum Filing Requirements in the above referenced docket. A copy of the Petition, Testimony and Minimum Filing requirements have been provided to the Office of Public Counsel. Additionally, a copy of the Petition has been served on the Executive Officer of counties and municipalities within the service area of the Company. Attached is a certificate of service listing the officials to whom the Petition has been provided.

Please acknowledge your receipt of the enclosures and the date of their filing on the enclosed copy of this letter and returning same to me in the enclosed preaddressed envelop.

CMP \_\_\_\_\_  
COM 5 \_\_\_\_\_  
CTR 1 \_\_\_\_\_  
ECR 1 \_\_\_\_\_  
GCL 1 \_\_\_\_\_  
DPC \_\_\_\_\_  
RCA 1 \_\_\_\_\_  
SCR \_\_\_\_\_  
SGA \_\_\_\_\_  
SEC \_\_\_\_\_  
JTH \_\_\_\_\_

Thank you for your assistance.

Sincerely,

Charles Costin

Attorney for St. Joe Natural Gas Company, Inc.

DOCUMENT NUMBER-DATE

11180 DEC 21 07

FPSC-COMMISSION CLERK

**BEFORE THE FL PUBLIC SERVICE COMMISSION**

**PETITION FOR RATE INCREASE BY  
ST JOE NATURAL GAS COMPANY, INC.**

**DOCKET NO. 070592-GU**

**PETITION - TESTIMONIES**

**SECTION A - COVER LETTER**

**SECTION B - PETITION FOR A RATE INCREASE**

**SECTION C - TESTIMONY - STUART SHOAF**

**SECTION D - TESTIMONY - ANDY SHOAF**

**SECTION E - TESTIMONY - STEPHEN SHOAF**

**SECTION F - TESTIMONY - DEBBIE STITT**

**SECTION G - TESTIMONY - JEFF HOUSEHOLDER**

DOCUMENT NUMBER-DATE

11180 DEC 21 5

FPSC-COMMISSION CLERK

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Dear Ms. Cole:

Enclosed for filing on behalf of St. Joe Natural Gas Company, Inc. are an original and twenty copies of the St Joe Natural Gas Company's Petition, Testimony and Minimum Filing Requirements in the above referenced docket. A copy of the Petition, Testimony and Minimum Filing requirements have been provided to the Office of Public Counsel. Additionally, a copy of the Petition has been served on the Executive Officer of counties and municipalities within the service area of the Company. Attached is a certificate of service listing the officials to whom the Petition has been provided.

Please acknowledge your receipt of the enclosures and the date of their filing on the enclosed copy of this letter and returning same to me in the enclosed preaddressed envelop.

Thank you for your assistance.

Sincerely,



Charles Costin

Attorney for St. Joe Natural Gas Company, Inc.

DOCUMENT NUMBER-DATE  
11180 DEC 21 07

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

In re: Petition of St. Joe Natural Gas )  
Company for an increase in permanent )  
Rates and charges )  
\_\_\_\_\_ )

Docket No. 070592  
Date Filed: December 21, 2007

**PETITION FOR PERMANENT AND INTERIM RATE INCREASE**

St. Joe Natural Gas Company, Inc. ("SJNG" or the "Company"), by and through its undersigned counsel and pursuant to Sections 366.06 and Section 366.071, Florida Statutes and Rules 25-7.039, 25-7.040 and 25-22.038 Florida Administrative Code ("F.A.C.") hereby respectfully requests approval for a permanent increase in the Company's rates and charges as set forth in this Petition and the accompanying Minimum Filing Requirements ("MFR's"), testimony and exhibits.

In support of its Petition the Company states the following:

**PROCEDURAL BACKGROUND AND INFORMATION**

1. The name and address of the principal business office of the Petitioner is as follows:

St. Joe Natural Gas Company, Inc.  
Post Office Box 549  
Port St, Joe, Florida 32456

2. All pleadings and correspondence in this proceeding should be directed to:

Charles Costin  
Costin and Costin Attorneys at Law  
413 Williams Avenue  
Post Office Box 98  
Port St. Joe, Florida 32457

Telephone: 850-227-1159  
Facsimile: 850-229-6597  
e-mail: ccostin@costinlaw.com

with a copy to:

Stuart Shoaf  
President  
St. Joe Natural Gas Company, Inc.  
Post Office Box 549  
Port St. Joe, Florida 32456

Telephone: 850-229-8216  
Facsimile: 850-229-8392  
Email: sshaoaf@stjoenatural gas.com

3. By this Petition, the Company seeks approval from the Commission of its interim rate request, the determination of a fair, just and reasonable cost of equity capital, a fair, just and reasonable overall rate of return on investment, the approval of new and revised rate schedules, the approval of Original Volume No. 4 of the Company's tariff and a permanent increase in the Company's rates and charges.
4. The Company is a corporation organized and existing under the laws of the State of Florida. The Company was incorporated on April 1, 1959.
5. The Company is engaged in business as a natural gas utility company providing gas sales and transportation service as defined in Section 366.02, Florida Statutes, and is subject to the jurisdiction of the Florida Public Service Commission.
6. The Company provides service to approximately 3,000 residential, commercial and industrial customers in Port St. Joe, Mexico Beach, Wewahitchka, and unincorporated areas of Gulf County, Florida.
7. The Company's currently approved base rates have been in effect without increase since June 8, 2001. The Company petitioned the Commission on

December 15, 2000 for an increase in rates. The Commission opened Docket No. 001447-GU for the proceeding. By Order No. PSC-01- 0465-PCO-GU, issued February 26, 2001 the Commission approved an interim increase in rates for the Company. By Order No. PSC-01-1274-PAA-GU, issued June 8, 2001, the Commission approved a permanent increase in rates for the Company. In setting the Company's permanent rates, the Commission authorized a mid-point return on common equity of 11.5%, plus or minus 100 basis points as is the Commission's convention, and an overall rate of return of 5.96%. The Projected Test Year for the proceeding was the period ended December 31, 2001.

8. On October 4, 2001 the Company requested, in a letter to the Commission's then active Bureau of Gas Regulation, administrative authorization to, i) re-name its current rate classes, ii) provide optional transportation service rate classes for all non-residential customers iii) eliminate two rate classes (Contract Interruptible Service (CIS) and Contract Transportation Service (CTS) and, iv) modify the Company's tariff rate schedules accordingly. The primary purpose for this action was to comply with Commission Rule 25-7.0335 which required regulated gas utilities to provide a transportation service option to all non-residential customers.. The Company's rate schedule modifications made no adjustments to the Commission approved rates in place at the time. No customers were receiving service under the CIS or CTS rate schedules. The Company received a letter, dated December 3, 2001, from the Commission approving its tariff modifications.

9. On September 7, 2007, the Company notified the Commission by U.S. mail, pursuant to Rule 25-7.140, F.A.C., that it planned to file for a permanent rate increase no later than December 31, 2007, and had selected the 12-month period ending December 31, 2008 as the Projected Test Year for this rate proceeding. The test period for the requested interim rate increase is the historical 12-month period ended December 31, 2006.
10. By letter dated September 14, 2007, Commission Chairman Lisa Polak Edgar acknowledged receipt of the Company's test year notification letter and the opening of Docket No. 070592 for this proceeding.

#### **REQUEST FOR PROPOSED AGENCY ACTION PROCEURES**

11. Section 366.06(4), Florida Statutes, authorizes natural gas utilities to request that the Commission process a petition for rate relief using the Commission's Proposed Agency Action ("PAA") procedures. As initially indicated in its test year notification letter, SJNG elects to proceed in this Docket under the Commission's PAA procedures. In accordance with Rule 25-039, F.A.C, the Company is filing with its Petition its complete MFR's, and the testimony and exhibits of Company witnesses Stuart L. Shoaf, Stephen W. Shoaf, Andy Shoaf, Debbie K. Stitt and rate case consultant Jeff M. Householder. By submitting its testimony the Company does not imply that it believes a protest and hearing will be required in this case. Moreover, the Company specifically reserves its right to submit additional testimony and exhibits following the issuance of the Commission's PAA Order, addressing any or all issues that may be raised in a protest of the PAA, including a protest filed by the Company.

## **SUMMARY OF PETITION**

12. The Company is entitled by law to receive a fair and reasonable return on its property used and useful in public service. The Company's rates should be sufficient to yield reasonable compensation for the services rendered.
13. The Company's existing rates and charges are inadequate and insufficient to allow it to realize fair and reasonable compensation for the services provided to the public.
14. By this Petition, SJNG is seeking the Commission's approval of a permanent rate increase of \$624,166 on an annual basis, based on the 12-month projected test year ended December 31, 2008 test year. The Company is also seeking interim rate relief in the amount of \$274,981 on an annual basis, based on the 12-month historical test year ended December 31, 2006. The Company is not seeking an increase in its authorized return on common equity, but is seeking Commission approval of its permanent rates based on the Company's currently approved rate of 11.5%. The Company's filing proposes changes to its existing rate structure that have the effect of dividing the existing single residential service rate class into three distinct classes. Further, in its proposed rate design the Company proposes changes that will move toward collecting a greater percentage of its fixed operating costs from fixed charges, a practice that has become increasingly common in gas utility rate designs.

## **REQUEST FOR GENERAL RATE INCREASE**

15. The Company's current authorized rate of return, as established in the most recent Surveillance Reporting Period ended June, 2007, is between 5.81% and



6.85%. During the Surveillance Reporting Period ended June 2007, the Company's actual earned rate of return was 0.58%. Although the Company files its earnings surveillance reports as required by the Commission on a six-month cycle, it tracks earnings results each month. The Company's internal computation of its earned rate of return for October 2007 is -2.29%. As is demonstrated in the Company's filing, the reduction in rate of return is not a case of imprudent spending, rather it principally reflects the loss of customers, terms and revenue compared to the forecast expectations, upon which the current base rates were established, in the Company's 2001 rate proceeding. The forecast rate of return at present rates in the Projected Test Year plummets to -14.41% (negative). The Company's current returns do not provide a reasonable return to shareholders and will ultimately affect the Company's ability to attract new capital at reasonable rates. The earnings deficiency reflected in the reduced returns has begun to create difficulties for the Company that could ultimately impede its ability to provide quality service to existing customers and extend service to new customers. The negative and declining rate of return evidences significant financial concerns for the Company which could threaten its economic viability if not remedied through this proceeding.

16. There are five primary reasons the Company needs rate relief. First, the customer growth forecast in the Company's 2001 rate proceeding has not materialized. The Company's 2001 rate proceeding ended three months prior to the September 11, 2001 terrorist attacks that slowed market growth below expectations. Although the Company's housing construction market area

rebounded in 2002 and 2003, many of the units were all electric condominiums. The hurricane seasons of 2004 and 2005 started a serious decline in growth and the recent sub-prime mortgage problems have continued the market slow down. The Company has continued to add new customers, just not at the rate expected in the 2001 proceeding. Second, the Company's existing customer totals are declining. Over the past five years the Company has recorded an actual net loss of well over 400, primarily residential, customers. A significant portion of the customer loss is due to redevelopment activities where natural gas homes have been demolished and all electric condominiums have been constructed. Third, the average therm consumption per residential customer is declining. Part of this reduction in usage per customer is due to warmer than normal weather over the past several years. In addition, due primarily to escalating energy prices and aggressive electric utility advertising, customers appear to be both conserving and replacing gas appliances with electric. Fourth, the Company's largest (both volume and margin) account, Arizona Chemical, has reduced annual therm consumption by almost 4,500,000 therms comparing 2002 usage to 2007 usage, and is expected to further reduce volumes in 2008. The Company expects that margins in 2007 from Arizona will be down approximately \$165,000 compared to 2002 margins. Fifth, the Company has experienced a general increase in expenses over the seven years since its last base rate proceeding.

17. The Company has made every reasonable effort to avoid seeking a rate increase. SJNG has implemented extraordinary cost savings measures including the following:

- Curtailing discretionary operating costs (travel, training, materials, etc.)
  - Limiting the Company's contribution percentage in its health insurance plan.
  - Limiting or delaying staff salary increases.
  - Deferring the replacement of staff, or replacing retiring positions with lower cost employees.
  - Deferring replacement of worn out office furniture and obsolete computers.
  - Deferring the roof replacement on the 301 Long Avenue building.
  - Ceasing the payment of dividends to shareholders.
  - Reducing the contribution levels to the Company's retirement plan.
18. An increase in rates is needed to position the Company to take advantage of legitimate opportunities to grow its business. As noted above, the Company has continued to extend service to new customers. There are several opportunities for prudent growth in 2008 and beyond that could help strengthen the Company financial situation. It appears that the significant customer loss experienced over the past several years is waning. Implementation of the Company's revised energy conservation incentives, approved by the Commission in Order No. PSC-07-0495-PAA-EG, issued June 11, 2007, is having a positive effect on customer retention and appliance conversions to gas. The proposed rate increase will enable the Company to continue to grow and spread its fixed operating costs across a greater customer base to the benefit of all customers.
19. The Company requests approval of a permanent rate increase in the amount of \$624,166, an annual increase of 57.7%.

## **REQUEST FOR INTERIM RATE RELIEF**

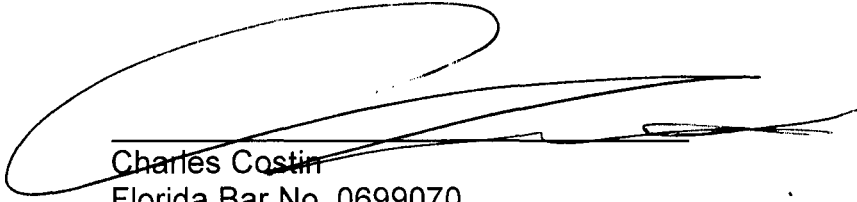
20. Coincident with the request for permanent rate relief, the Company also requests that the Commission approve an increase in annual revenues of \$274,981 on an interim basis in accordance with Section 366.071, Florida Statutes. Interim relief is necessary to avoid further deterioration of the Company's earnings which is certain unless the Commission grants interim relief. Interim relief will also provide the Company with an opportunity to earn the fair rate of return authorized by the Commission in Docket No. 001447-GU. The request amount of interim rate relief has been calculated pursuant to Section 366.071(5), Florida Statutes, and is reflected in MFR Schedule F as filed by the Company, based on a historical test year ended December 31, 2006. The Company will allocate the interim rate increase applicable to all of its filed gas rate schedules in accordance with Rule 25-7.040(2)(a), F.A.C.
21. As required by Section 366.071, Florida Statutes, and Rule 25-7.040(3), F.A.C., the Company agrees that the interim rate relief collected is under bond or corporate undertaking and is subject to refund with interest at a rate determined in accordance with said Rule. For purposes of this interim rate request, the Company proposes that the interim relief would be secured by a corporate undertaking.

WHEREFORE, the Company respectfully requests that the Commission:

- a) authorize the Company to increase its rates on an interim basis by \$274,981, subject to corporate undertaking and refund, and recover the interim amount in accordance with Rule 25-7.040, F.A.C.;

- b) consent to placing in effect the new rate schedules filed with this Petition which increase the rates and charges for Gas Delivery Service and other related services offered by the Company to produce additional revenue of \$627,026;
- c) find the Company's proposed capital structure to be appropriate and that a fair and reasonable rate of return is a weighted cost of capital of 6.17%, using a return on common equity of 11.5%;
- d) approve the proposed rates, charges, restructuring of rate classes, redesign of rates and other proposed changes to the Company's tariff;
- e) conduct its review of this request pursuant to the Proposed Agency Action process authorized by Section 366.06(4), Florida Statutes, should the Commission elect to withhold consent to the placing in effect of the proposed new rate schedules; and
- f) grant the Company such further relief as the Commission may find reasonable and proper.

Respectfully submitted this 21<sup>st</sup> day of December, 2007.



Charles Costin  
Florida Bar No. 0699070  
Costin and Costin Attorneys at Law  
413 Williams Avenue  
Post Office Box 98  
Port St. Joe, Florida 32457

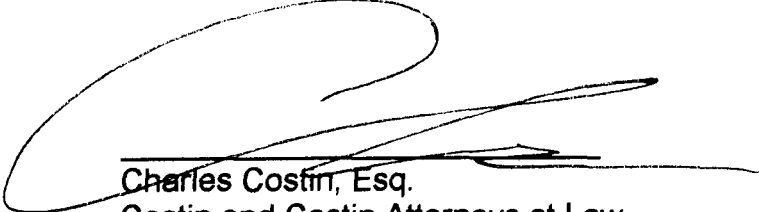
Attorney for St. Joe Natural Gas Company, Inc.

## CERTIFICATE OF SERVICE

I HEREBY CERTIFY that true and correct copies of the Petition in Docket No. 070592 have been served upon the following parties by U.S. Mail this 21<sup>st</sup> day of December, 2007.

Martha Brown, Esq.  
Office of General Counsel  
Florida Public Service Commission  
2540 Shumard Oak Blvd.  
Tallahassee, Florida 32399-0850

Office of Public Counsel \*  
111 Madison Street, Room 812  
Tallahassee, Florida 32399-1400



Charles Costin, Esq.  
Costin and Costin Attorneys at Law  
413 Williams Avenue  
Post Office Box 98  
Port St. Joe, Florida 32457  
850-227-1159

Attorney for St. Joe Natural Gas Company, Inc.

\*Includes Minimum Filing Requirements and Testimony

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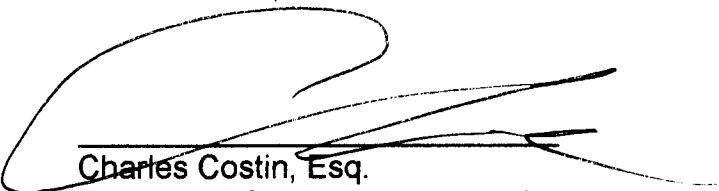
Chairman  
Gulf County Board of County Commissioners  
1000 Cecil G. Costin, Sr. Blvd.  
Port St. Joe, Florida 32456

Chairman  
Bay County Board of County Commissioners  
810 West 11<sup>th</sup> Street  
Panama City, Florida 32401

Chief Executive Officer  
City of Port St. Joe  
305 Cecil G. Costin, Sr., Blvd.  
Port St. Joe, Florida 32456

Chief Executive Officer  
City of Mexico Beach  
118 N. 14<sup>th</sup> Street  
Mexico Beach, Florida 32410

Chief Executive Officer  
City of Wewahitchka  
109 S. 2<sup>nd</sup> Street  
Wewahitchka, Florida 32465



Charles Costin, Esq.  
Costin and Costin Attorneys at Law  
413 Williams Avenue  
Post Office Box 98  
Port St. Joe, Florida 32457  
850-227-1159

Attorney for St. Joe Natural Gas Company, Inc.

1                                   **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2   **DIRECT TESTIMONY**

3   **OF STUART L. SHOAF**

4   **ON BEHALF OF**

5   **ST. JOE NATURAL GAS COMPANY, INC**

6   **DOCKET NO. 070592-GU**

7   **December 2007**

8

9   **Q.    PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

10 A.    My name is Stuart L. Shoaf. My business address is St. Joe Natural Gas  
11        Company, Inc., 301 Long Avenue, Port St. Joe, Florida 32456-0549.

12 **Q.    BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

13 A.    I am the President of St. Joe Natural Gas Company, Inc. ("SJNG" or the  
14        "Company").

15 **Q.    PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

16 A.    I received a Bachelor of Science Degree in Business Administration from the  
17        University of Tennessee in 1975.

18 **Q.    PLEASE DESCRIBE YOUR WORK EXPERIENCE PRIOR TO BECOMING**  
19 **PRESIDENT OF SJNG.**

20 A.    Upon graduation from the University of Tennessee, I was employed by MK  
21        Ranches in Howard Creek in the position of cattle foreman. I was first  
22        employed by SJNG in February 1979 as a construction foreman. I later worked

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1 for the Company in various capacities prior to becoming President including:  
2 new construction, marketing, customer service, and operations and  
3 maintenance.

4 **Q. WHAT ARE YOUR CURRENT DUTIES AS PRESIDENT OF SJNG?**

5 A. My duties as President include managing all facets of the Company's regulated  
6 utility operations including: strategic planning; financial management; natural  
7 gas operations; engineering; sales and marketing; customer service;  
8 accounting functions and regulatory activities.

9 **Q. ARE YOU RESPONSIBLE FOR THE SJNG UNREGULATED APPLIANCE**  
10 **SALES BUSINESS?**

11 A. The Company's unregulated appliance sales business operates as a division of  
12 SJNG, not as a separate corporate entity. As President of SJNG, I have certain  
13 legal, administrative and control responsibilities (execution of agreements,  
14 check signing, etc.). However, my day-to-day involvement in the unregulated  
15 part of Company's business is minimal. My brother, Stephen Shoaf, is General  
16 Manager of our unregulated appliance sales business (marketed under the  
17 name "The Appliance Solution"). A more detailed description of the Company's  
18 unregulated business activities is provided in Stephen Shoaf's testimony.

19 **Purpose of Testimony and Organization of Case**

20 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

21 A. My testimony will generally describe the Company, its operations, and its  
22 customer base. I will explain the need for immediate rate relief, both on an

1 interim and permanent basis, primarily due to attrition and the significant  
2 reduction in gas consumption on the part of the Company's largest, and only  
3 remaining industrial customer, Arizona Chemical. I will describe the Company's  
4 basis for selecting its proposed Projected Test Year. My testimony will also  
5 describe several actions taken by the Company to forestall the filing of this  
6 request for rate relief. I will address the current status of several issues raised  
7 during the Company's 2001 rate case proceeding including the Company's  
8 extraordinary income tax liability associated with the bankruptcy and  
9 unanticipated loss of its then largest customer, Florida Coast Paper Company,  
10 L.L.C. ("Florida Coast"), as well as the overearnings refund required by Order  
11 No. PSC-96-1188-FOF-GU. Finally, I will address the proposed retention of the  
12 Company's current rate of return on common equity.

13 **Q. IN ADDITION TO YOUR TESTIMONY, WHAT INFORMATION IS SJNG**  
14 **FILING IN SUPPORT OF ITS RATE REQUEST?**

15 A. The Company is filing the Commission Form PSC/ECR 10-G, Investor Owned  
16 Natural Gas Utilities Minimum Filing Requirements ("MFRs") required by  
17 Commission Rule No. 25-7.039. The Company is also filing the testimony and  
18 exhibits of Debbie Stitt, the Company's accounting witness; Andy Shoaf, the  
19 Company's operations and market environment witness, and Jeff Householder  
20 (rate consultant) the Company's interim rate, cost of service and rate design  
21 witness.

22 **Q. ARE YOU SPONSORING ANY OF THE MFR SCHEDULES?**

1 A. No, I am not directly sponsoring any of the Company's MFR schedules.  
2 However, as President, all of the MFR schedules were prepared under my  
3 direction, supervision and control.

4 **Q. ARE YOU SPONSORING ANY EXHIBITS TO YOUR TESTIMONY?**

5 A. Yes. Exhibit SLS-1 provides an historical overview of the Company's actual  
6 customers, terms and margins by rate class for the period 2001-2006. The  
7 exhibit also compares the actual historic customer and term data to the  
8 forecast projections used to calculate Commission approved rates in the  
9 Company's 2001 base rate proceeding.

10 **General Overview Of Company**

11 **Q. PLEASE DESCRIBE SJNG'S LEGAL ORGANIZATION.**

12 A. SJNG is a Florida corporation that was incorporated on April 1, 1959. The  
13 Company operates a natural gas distribution business that is subject to the  
14 Commission's regulation under Chapter 366, Florida Statutes, and an  
15 unregulated appliance sales and service business.

16 **Q. WHAT TERRITORY DOES SJNG SERVE?**

17 A. SJNG's regulated natural gas service territory includes the Florida cities of Port  
18 St. Joe, Mexico Beach and Wewahitchka. The Company's service territory also  
19 includes unincorporated areas of Gulf County, Florida.

20 **Q. PLEASE PROVIDE A BREIF OVERVIEW OF THE SJNG REGULATED**  
21 **DISTRIBUTION OPERATIONS.**

1 A. At the end of December 2006, (the proposed Historic Base Year in this filing)  
2 SJNG provided service to approximately 3,118 total customers, including one  
3 Company meter. At that time, SJNG's customer base consisted of:  
4 approximately 2,862 residential customers; 213 commercial customers; 38  
5 large commercial customers; 4 firm transportation customers (the Gulf  
6 Correctional Institution (GCI) and three accounts at Arizona Chemical and 1  
7 company meter. In 2006, the Company's total gas throughput equaled  
8 8,200,693 therms. Approximately 87% of the total throughput was scheduled  
9 for delivery to the Company's two large volume transportation service  
10 customers: Gulf Correctional Institute (423,503 therms) and Arizona Chemical  
11 (6,740,311 therms). Residential customer usage contributed approximately 9%  
12 of total throughput, with the Company's commercial customers accounting for  
13 the remaining 4%.

14 **Q. PLEASE OUTLINE THE COMPANY'S NON-FUEL REVENUES (MARGIN)**  
15 **FROM GAS DELIVERIES.**

16 A. The Company's non-fuel revenues from gas delivery charges in 2006 totaled  
17 \$982,410. Residential margins totaled approximately \$593,000; small  
18 commercial margins were approximately \$58,000; large commercial margins  
19 approximately \$62,000, GCI margins were approximately \$47,000 and Arizona  
20 chemical margins were approximately \$280,000.

21 **Q. WHAT IS THE CURRENT STATUS OF UNBUNDLING ON THE COMPANY'S**  
22 **DISTRIBUTION SYSTEM?**

1 A, In accordance with Commission Rule No. 25-7.0335, the Company offers  
2 transportation service to all non-residential customers. The Company's tariff  
3 includes rules and regulations for transportation service and provides separate  
4 transportation service rate schedules that mirror each non-residential general  
5 sales service rate schedule. At present, GCI and Arizona are the only  
6 customers receiving transportation customers. In this proceeding, the Company  
7 is proposing minor adjustments to its current transportation service  
8 administrative procedures. No expansion of transportation service to residential  
9 service classes is proposed. Jeff Householder's testimony provides a detailed  
10 description of the proposed transportation related tariff revisions.

11 **Q. HAS THE COMPANY MODIFIED ITS RATE CLASSES SINCE ITS LAST**  
12 **BASE RATE PROCEEDING?**

13 A. Yes. In an October 4, 2001 letter to the Commission's Bureau of Gas  
14 Regulation, the Company requested administrative authorization to, i) re-name  
15 its current rate classes, ii) provide optional transportation service rate classes  
16 for all non-residential customers iii) eliminate two rate classes (Contract  
17 Interruptible Service (CIS) and Contract Transportation Service (CTS) and, iv)  
18 modify the Company's tariff rate schedules accordingly. The primary purpose  
19 for this action was to comply with Commission Rule 25-7.0335, which required  
20 regulated gas utilities to provide a transportation service option to all non-  
21 residential customers. The Company's rate schedule modifications made no  
22 adjustments to the Commission approved rates in place at the time. No

1 customers were receiving service under the CIS or CTS rate schedules. The  
2 Company received a letter, dated December 3, 2001, from the Commission  
3 approving its tariff modifications.

4 **Q. DOES THE COMPANY SERVE CUSTOMERS IN EACH OF ITS APPROVED**  
5 **RATE CLASSES?**

6 A. No. At present, no customers qualify for service in the GS-4, TS-2, TS-3 or TS-  
7 4 rate classes. The Company is proposing several adjustments to its current  
8 rate schedules. The proposed rate schedules are described in detail in  
9 Company witness Householder's testimony.

10 **Need For Rate Relief**

11 **Q. ARE THE COMPANY'S CURRENT RATES PRODUCING REVENUES**  
12 **SUFFICIENT TO YIELD AN ADEQUATE RETURN ON THE COMPANY'S**  
13 **INVESTMENT?**

14 A. No. The Company's current authorized mid-point rate of return is 6.33%, as  
15 indicated in its June 2007 Earnings Surveillance Reporting. The Company's  
16 actual earned rate of return for the same period is -0.58%. The Company's  
17 most recent internal calculation of its overall return (October), using the same  
18 methodology as the Earnings Surveillance Report, indicated that at the end of  
19 September 2007 the achieved rate of return had fallen to negative -2.29%.

20 **Q. WHEN DID SJNG LAST IMPLEMENT AN INCREASE IN BASE RATES?**

21 A. The Company last petitioned the Commission for rate relief on December 15,  
22 2000 in Docket No. 0014447-GU. The Commission authorized the Company to

1 collect increased revenues of \$327,149 in Order No. PSC-01-1274-PAA-GU,  
2 issued June 8, 2001, (the "2001 Rate Order").

3 **Q. WHY IS IT NECESSARY FOR SJNG TO SEEK RATE RELIEF AT THIS**  
4 **TIME?**

5 A. The forecast rate of return at present rates in the Projected Test Year  
6 plummets to negative -14.38%. The earnings deficiency reflected in the  
7 reduced returns has begun to create difficulties for the Company that could  
8 ultimately impede its ability to provide quality service to existing customers and  
9 extend service to new customers. There are five primary reasons the  
10 Company's overall return is negative. First, the customer growth forecast in the  
11 Company's 2001 rate proceeding has not materialized. Second, the Company's  
12 existing customer totals are declining. Over the past five years the Company  
13 has recorded an actual net loss of well over 200, primarily residential,  
14 customers. Third, the average therm consumption per residential customer is  
15 declining. Fourth, the Company's largest (both volume and margin) account,  
16 Arizona Chemical, has reduced annual usage by approximately 4,500,000  
17 therms since 2002, and is expected to further reduce volumes in 2008.  
18 Arizona's current margins are down over \$165,000 compared to 2002 margins.  
19 It should be noted that Arizona's 2002 volumes were approximately 2,000,000  
20 therms lower than Arizona's historic peak usage from the 1990's. Fifth, the  
21 Company has experienced a general increase in expenses over the seven  
22 years since its last base rate proceeding.

1 **Q. PLEASE COMPARE THE CUSTOMER AND THERM FORECAST IN THE**  
2 **2001 RATE CASE WITH THE COMPANY'S ACTUAL RESULTS**  
3 **FOLLOWING THE RATE CASE.**

4 A. Attachment SLS-1 charts actual average annual customers and total delivered  
5 therms by rate class for the period 2002-2006. The chart also provides the  
6 projected customers and therms used to derive total target revenues in the  
7 2001 Rate Order.

8 **Q. WHY HAVE THE RESIDENTIAL CUSTOMERS FORECAST IN THE 2001**  
9 **RATE PROCEEDING FAILED TO MATERIALIZE?**

10 A. As displayed in Attachment SLS-1, the Company's 2001 Projected Test Year  
11 residential customer forecast from its most recent base rate case totaled 3,250  
12 accounts. Included in the 2001 Projected Test Year total were 204 new  
13 residential accounts and 24 lost accounts (net 180 customer additions). At the  
14 time the 2001 rate case was filed there was an expectation that the St. Joe  
15 Company developments (, et. al.) and opportunities to convert residences in  
16 Wewahitchka to natural gas would provide the growth anticipated in the rate  
17 filing. St. Joe completed the infrastructure installation in Phase I and the  
18 Beachside and Creekview sections of Phase II and sold the majority of the  
19 lots. However, most of the lot owners have held the property as an investment.  
20 Only 12 homes have been constructed to date in the 110 lot Phase I  
21 subdivision; all 12 have gas service. The Phase II Beachside development has  
22 75 lots with 6 constructed homes, all 6 have gas service. The Creekview



1 development has 39 lots with no constructed homes to date. The Village  
2 Center complex currently has six commercial buildings under construction four  
3 of which are installing gas equipment.

4 The level of residential new construction projected in the 2001 rate case  
5 never materialized. The Company's rate proceeding was completed in June  
6 2001. Three months later the terrorist attacks of September 11, 2001 resulted  
7 in a general downturn of markets across the country, including the SJNG  
8 service areas. New construction rebounded relatively quickly, and although the  
9 2002- 2004 period reflected a strong growth in Florida, it never reached the  
10 forecast totals. The market downturn that began in Gulf County in late 2004  
11 and accelerated following the hurricanes of 2005 has continued with the recent  
12 and much publicized concerns in the sub-prime mortgage market. In addition,  
13 the Company began to lose market share to electricity. As described in greater  
14 detail in Andy Shoaf's testimony, the building industry slow-down, has limited  
15 the Company's ability to add new construction customers at the 2001 forecast  
16 levels. However, even before the recent market slowdown, much of the  
17 residential development in the Company's service areas over the past four  
18 years has been multifamily condominiums that did not include natural gas.  
19 While the permit activity in Gulf and eastern Bay Counties were at record levels  
20 in 2002, 2003 and 2004, most of the units actually constructed were all electric.  
21 In addition to the new construction issues, the expected conversion of  
22 customers to natural gas in Wewahitchka has not occurred. The high level of

1 national media attention focused on the elevated gas commodity prices  
2 following the hurricanes, in the Company's view, contributed to the difficulty in  
3 achieving the expected number of conversions.

4 **Q. PLEASE QUANTIFY THE COMPANY'S ACTUAL AS OPPOSED TO**  
5 **FORECAST RESIDENTIAL CUSTOMER LOSS.**

6 A. The Company's 2002 actual average annual residential customers equaled  
7 3,076. Actual average annual residential customers served in the 2006 Historic  
8 Base Year equaled 2,885, a net reduction of 191 residential customers over the  
9 five year period 2002-2006. Average residential customer totals for the ten-  
10 month period January through October, 2007 indicates a further reduction to a  
11 total of 2,851 (total net reduction of 225 customers). As noted above, the 2001  
12 Projected Test Year forecast (upon which the Company's revenue requirement  
13 was determined) included 3,250 residential accounts, almost 400 more average  
14 residential accounts than were served by the Company in 2006.

15 **Q. WHAT HAS CAUSED THE COMPANY'S ACTUAL CUSTOMER LOSS?**

16 A. Much of the actual customer loss has resulted from redevelopment activities in  
17 the Mexico Beach area. On several occasions developers have acquired single  
18 family residences, including mobile home parks, demolished the homes, and  
19 constructed mid-rise condominiums. The single family residences were natural  
20 gas customers, the condominiums are all electric. As an example, in 2004 the  
21 Big Gator Mobile Home Park was purchased by a developer who removed the  
22 mobile homes and constructed a condominium. The Company lost 17 gas

1 accounts as a result. The Company has also lost numerous individual  
2 customers to electric conversions. Based on conversations with disconnecting  
3 customers, it appears that the anti-gas advertising that Gulf Power runs in the  
4 Panama City market is having a spill-over effect in the Company's service area.  
5 The Company has not had the resources necessary to conduct a sustained  
6 advertising campaign to counter any negative effects of the pro-electric  
7 advertising. The non-residential customer totals have remained relatively  
8 constant, both compared to the 2001 Projected Test Year forecast and the  
9 actual average customer totals for the period since the rate case was  
10 completed.

11 **Q. PLEASE DESCRIBE THE DECLINE IN AVERAGE RESIDENTIAL THERM**  
12 **CONSUMPTION.**

13 A. Over the past twenty-five years, the natural gas industry in the United States  
14 has experienced a significant reduction in gas consumed per customer,  
15 especially in the residential market. According to an American Gas Association  
16 (AGA) study, today's average American home uses 25% less natural gas than  
17 in 1980. The Company's experience is similar to the national trend. The  
18 Company is recording steady declines in usage per consumer, especially  
19 among its residential consumers. These reductions in usage are the result of  
20 several factors. Increases in the efficiency of appliances and improvements in  
21 building construction standards have been key contributors. In addition, the  
22 general increase and volatility in fuel prices in this decade has given

1 consumers incentive to reduce their energy use. Information compiled by AGA  
2 indicates that homeowner conservation efforts have accelerated. Over the past  
3 five years, homeowners have reduced gas consumption even more than the  
4 1% per year trend experienced over the previous twenty years. Similar trends  
5 have been seen in non-residential markets.

6 The average therm consumption for a residential customer used to  
7 derive target revenues in the 2001 Rate Order (Attachment 6, page 15) was  
8 347 therms per year. The Company's residential forecast for the 2001 rate  
9 proceeding was based on the actual average per customer monthly  
10 consumption recorded during the period 1995 through October 2000. The  
11 forecast accounted for the impact of weather and conservation over the five-  
12 year period. During the period 1996-2000 Heating Degree Days (HDD)  
13 recorded at Panama City (40 miles from Port St. Joe) totaled 1,232.

14 The Company's actual average residential consumption for the five-year  
15 period 2002-2006 totaled 288 therms per customer. Average annual residential  
16 consumption is approximately 59 therms per customer lower compared to the  
17 2001 Rate Order therm forecast. During the five-year period 2003-2007, HDD  
18 totaled 1,154. The Company's Projected Test Year forecast is based on the  
19 assumption of ten year normalized weather, where total HDD equal 1,166.  
20 Actual HDD, reflected in customer usage, for the five year forecast period  
21 immediately preceding the 2001 rate filing were almost 80 degree days colder  
22 (1,232 HDD) than the most recent five-year historic period and 66 degree days

1 higher than the ten year normal.

2 **Q. PLEASE PROVIDE A GENERAL OVERVIEW OF ARIZONA CHEMICAL'S**  
3 **OPERATIONS.**

4 A. Arizona Chemical (Arizona) was formed in 1930 by International Paper and  
5 American Cyanamid. Arizona's principal business involves the fractionation  
6 (separation) of crude pine or tall oil into fatty acids, rosin esthers and turpenes.  
7 Tall oil is a by-product of the paper industry. The chemicals produced by  
8 Arizona are used to manufacture a variety of products, such as adhesives,  
9 cleaners, paint, ink, oleochemicals, cosmetics and plastics. Arizona operates  
10 six manufacturing facilities in the United States and five additional facilities in  
11 Europe. Three of the U.S. manufacturing facilities are located in Florida  
12 (Pensacola, Panama City and Port St. Joe). Arizona was acquired in 2007 by  
13 Rhone Capital, a private equity group.

14 The Port St. Joe plant originally obtained a significant portion of its raw  
15 material (pine oil) from the Florida Coast Paper Company mill located across  
16 the street from Arizona's site. A pine oil pipeline interconnected the facilities.  
17 Florida Coast ceased operations in 1998. The Florida Coast mill has been  
18 dismantled and the mill site completely cleared. Subsequent to the closing of  
19 the paper mill, Arizona has trucked all of its raw materials to Port St. Joe.  
20 Arizona has made several efficiency improvements, modernizing burners,  
21 recovering more by-products and instituting better fuel management practices.  
22 In communications with Arizona, they have indicated an interest to continue

1 moving production to their more economic facilities with capacity, such as the  
2 plant in Savannah, Georgia. Arizona competes in a global market. They are  
3 experiencing an increase in competition from imported adhesives and  
4 packaging which is also contributing to reduced gas volumes.

5 **Q. PLEASE QUANTIFY THE REDUCED GAS CONSUMPTION AT ARIZONA.**

6 A. Attachment SLS-1 provides annual therm use at Arizona for the period 2002  
7 through 2006, including the forecast consumption used to derive the  
8 Company's revenue requirement in its 2001 base rate proceeding. Peak usage  
9 at Arizona in the mid-1990's exceeded 11,000,000 annual therms. However, at  
10 the time of the 2001 rate proceeding, less than three years following the close  
11 of the Florida Coast mill, consumption had already begun to decline. Forecast  
12 transportation sales to Arizona in the 2001 Projected Test Year totaled  
13 9,698,160 therms. Gas consumption at Arizona moved slightly higher in 2002  
14 at 9,935,950 therms, but 2003 consumption levels were down almost 500,000  
15 therms from 2002 (9,446,300 total therms). In 2004, Arizona's consumption  
16 was dramatically reduced to 6,608,650, a decrease of over 33% from the peak  
17 2002 levels. Consumption in 2005 and 2006 remained relatively constant at  
18 6,617,950 and 6,652,680 therms, respectively. To date, however, through mid-  
19 December 2007, the Company has delivered 5,200,000 therms to Arizona, and  
20 is not expecting significant usage over the last two weeks of 2007. Based on  
21 conversations with Arizona management and historic volumes for 2007, the  
22 Company is forecasting 2008 volumes at 4,980,000 therms.

1 **Q. IS THE COMPANY LOSING CUSTOMERS, TERMS AND MARGINS IN ITS**  
2 **OTHER RATE CLASSES?**

3 A. Not to any significant degree. The Company's general service commercial (GS-  
4 2, GS-3 rate classes) have exhibited relatively stable performance compared to  
5 the 2001 rate case forecast. The TS-5 rate class serves one customer – the  
6 Gulf Correctional Institution (GCI). The TS-5 class has experienced an annual  
7 term increase of over 20% comparing actual 2007 results to the 2001 rate  
8 case projections.

9 **Q. HAVE THE COMPANY'S EXPENSES INCREASED SINCE ITS 2001 RATE**  
10 **PROCEEDING?**

11 A. Yes. In the 2001 rate proceeding, the Commission authorized rates designed to  
12 recover \$781,832 in annual non-fuel Operating Expenses from base rates,  
13 exclusive of Other Operating revenue (Attachment 6 to the 2001 Rate Order).  
14 Actual non-fuel operating expenses for the 2008 Projected Test Year from the  
15 Company's cost of service study total \$913,680, an increase of 14% over 6  
16 years compared to the 2001 Rate Order expense levels. The Company makes  
17 a diligent effort to control operating expenses. The above operating expense  
18 increase represents less than a 2% increase per year since the 2001 rate  
19 proceeding. Over the past six years, the company has experienced a steady  
20 rise in the costs of insurance, gasoline, property taxes and other expenses  
21 required to deliver an appropriate level of service to our customers.

22 **Q. WHAT EFFECT HAVE THE ABOVE ISSUES HAD ON THE COMPANY'S**

1           **ABILITY TO ACHIEVE THE TARGET REVENUE AND RETURN ON**  
2           **INVESTMENT AUTHORIZED IN THE 2001 RATE PROCEEDING?**

3    A.    The 2001 Rate Order (Attachment 6, page 15) approved a revenue  
4           requirement from base rates of \$1,338,595 on delivered annual therms of  
5           11,483,243. Total target revenues including Other Operating Revenue were  
6           approved in 2001 at \$1,443,005. The Company's actual total non-fuel revenue,  
7           including Other Operating Revenue, in 2006 was \$1,081,687. As indicated  
8           above, there are two customer classes (GS-1, residential and TS-6, Arizona  
9           Chemical) for which the Company has significantly under-recovered its revenue  
10          requirement. The 2001 Rate Order target revenues for the residential customer  
11          class equaled \$780,034 from the delivery of 1,126,382 annual therms. Over the  
12          five annual periods following the 2001 rate case (2002-2006) the Company's  
13          residential sales margins have never reached the target revenue level. Actual  
14          residential margins in 2006 totaled \$592,988. Target revenue from sales to  
15          Arizona in the 2001 Rate Order totaled \$392,548, equal to almost 30% of the  
16          Company's total target margins from base rates. By the end of 2006 margins  
17          had declined to \$280,284. The Company estimates that 2007 margins from  
18          transportation sales to Arizona will be further reduced to approximately  
19          \$203,152.

20   **Q.    HAS THE COMPANY TAKEN STEPS TO AVOID A RATE INCREASE?**

21    A.    Yes.    The Company has made every reasonable effort to avoid seeking a rate  
22          increase. SJNG has implemented extraordinary cost savings measures



1 including the following:

- 2 • Curtailing discretionary operating costs (travel, training, materials, etc.)
- 3 • Limiting the Company's contribution percentage in its health insurance plan.
- 4 • Limiting or delaying staff salary increases.
- 5 • Deferring the replacement of staff, or replacing retiring positions with lower
- 6 cost employees.
- 7 • Deferring replacement of worn out office furniture and obsolete computers.
- 8 • Deferring the roof replacement on the 301 Long Avenue building.
- 9 • Ceasing the payment of dividends to shareholders.
- 10 • Reducing the contribution levels to the Company's retirement plan.
- 11 • Negotiating the payment of CIAC for distribution system extensions.

12 **Requested Rate Relief**

13 **Q. WHAT IS THE AMOUNT OF THE PERMANENT RATE INCREASE SJNG**  
14 **SEEKS IN THIS CASE?**

15 A. To restore a reasonable rate of return on its investment, the Company is  
16 seeking a permanent annual rate increase of \$627,026, representing an overall  
17 increase of 57.97%. The calculation of SJNG's permanent revenue requirement  
18 is addressed in Mr. Householder's prefiled direct testimony.

19 **Q. ON WHAT PROJECTED TEST PERIOD IS SJNG BASING ITS REQUEST**  
20 **FOR A PERMANENT CHANGE IN BASE RATES?**

21 A. The year ending December 31, 2008 will best reflect the Company's on-going  
22 operations with respect to customer base, investment requirements, throughput

1 levels and overall cost of service at the time that the rates set in this proceeding  
2 will be in effect. The use of a 2008 Projected Test Year would enable the  
3 Company to account for investments in needed system improvements and  
4 extensions of gas facilities to serve new customers. Additionally, the 2008  
5 Projected Test Year would provide an opportunity to reasonably forecast sales  
6 volumes and margin revenues in a manner that accounts for both load growth  
7 opportunities and the load attrition experienced by the Company over the past  
8 several years. The Company's fiscal year corresponds to the calendar year.  
9 The selection of calendar year 2008 as the Projected Test Year allows the  
10 Company to use audited, readily available financial and statistical data from its  
11 2006 fiscal year to represent the Historic Base Year.

12 **Q. IS SJNG ALSO SEEKING INTERIM RATE RELIEF?**

13 A. Yes. Using the Commission's methodology, the Company requests interim rate  
14 relief in the amount of \$274,981 based on an historical base year ending  
15 December 31, 2006. The calculation of the Company's interim revenue  
16 requirement is addressed in Mr. Householder's prefiled direct testimony.

17 **1994 and 1995 Overearnings Refund**

18 **Q. HAS THE COMPANY COMPLIED WITH THE REQUIREMENTS OF**  
19 **COMMISSION ORDER NO. PSC-96-1188-FOF-GU.**

20 A. Yes. In Order No. PSC-96-1188-FOF-GU, issued on September 23, 1996, the  
21 Commission found that for 1994 and 1995 the Company had overearnings of  
22 \$261,318. The Commission however, did not require that the excess earnings

1 be refunded at that time. Rather, the Company was allowed to dispose of the  
2 excess earnings by amortizing, off the books, the \$261,318 over a 25 year  
3 period. However, the Order required the Company to refund overearnings over  
4 a 60 month period if, in the future, the Company requested a rate increase that  
5 "has the effect of increasing revenues." The Company's 2001 rate proceeding  
6 resulted in such a revenue increase. The 2001 Rate Order (page 23-24)  
7 established an unamortized balance of \$215,152 at the end of May 2001. In the  
8 2001 Rate Order, the Company was directed to initiate an annual refund of  
9 \$43,030 to customers through a series of bill credits. The bill credits were to be  
10 provided over a sixty month period. The Company completed the full refund of  
11 overearnings in July 2007.

#### 12 Gross Receipts Tax

13 **Q. HAS THE COMPANY COMPLIED WITH COMMISSION ORDER PSC-01-**  
14 **1274-PAA-GU WITH RESPECT TO GROSS RECEIPTS TAX BILLINGS?**

15 A. Yes. The Commission's 2001 Rate Order required the Company to, "redesign  
16 its billing statements and separately state the 2.5% Florida Gross Receipts  
17 Tax." The Company began separately stating Gross receipts Taxes in 2001.

#### 18 Florida Coast Paper Company

19 **Q. PLEASE DESCRIBE ANY ISSUES WITH RESPECT TO THE FLORIDA**  
20 **COAST PAPER MILL BANKRUPTCY THAT WILL IMPACT THIS RATE**  
21 **PROCEEDING.**

22 A. As described on page 20 of the Commission's 2001 Rate Order, the Company

1 entered into an agreement in 1991 with the St. Joe Forest Products Company  
2 to build a \$2.3 million gas pipeline to increase gas delivery capability to Port St.  
3 Joe. In 1996, the mill was acquired by a partnership operating as Florida Coast  
4 Paper Company. The Company borrowed the money to construct the pipeline,  
5 however, the loan was collateralized by the assignment of revenues from  
6 Florida Coast, and guaranteed by Florida Coast. The Company's service  
7 agreement with Florida Coast included a take or pay condition for  
8 approximately 800,000 decatherms annually. Florida Coast also agreed to pay,  
9 directly to the bank, the monthly payments on the loan. The loan payments  
10 made by Florida Coast would offset any gas payments to the Company. Any  
11 payments made by Florida Coast that exceeded the cost of gas actually  
12 consumed by Florida Coast would be recorded in the Company's Deferred  
13 Credit Account as pre-paid revenues. Ultimately such pre-paid amounts would  
14 be offset by future sales subsequent to the pay-off of the loan. The loan was  
15 paid-off in December 1998.

16 Florida Coast ceased operations in 1998, and declared bankruptcy in  
17 April 1999. The Company's balance sheet included a deferred credit for pre-  
18 paid gas. At the end of December 1999, the balance of Florida Coast pre-paid  
19 gas was \$1,578,595. As a result of the bankruptcy and mill closure, the pre-  
20 paid amount would never be credited to Florida Coast. This situation raised  
21 three principal issues that were addressed in the Company's 2001 rate  
22 proceeding.

1           1.     Extraordinary Income Tax Liability: The closure of the mill and  
2 Florida Coast's bankruptcy raised the issue of when the deferred credit should  
3 be recognized as taxable income for both Federal and state tax purposes. In  
4 addition, the Company had also received \$27,402 in prepaid revenue related to  
5 the Gulf Correctional Institute that was subject to tax. The Company filed an  
6 *Application for Change in Accounting Method*, Internal Revenue Service ("IRS")  
7 Form 3115, with the IRS in 2000. The application was granted. The Company  
8 was authorized by the IRS to allocate its tax liability associated with the  
9 deferred credit over a period of four years, beginning with the 2000 tax year.  
10 The Company completed its Federal tax payments relative to this issue in  
11 2004.

12           2.     Amortization of Deferred Credit: The pipeline constructed to  
13 enhance service deliveries to Florida Coast remained in service as the  
14 Company's primary interconnection to Florida Gas Transmission following the  
15 closure of the paper mill. The pipeline also facilitated gas service to  
16 Wewahitchka and the GCI. The Commission's 2001 Rate Order required the  
17 Company to amortize the amount of the deferred credit (\$1,578,595) over the  
18 remaining life of the pipeline (31 years at the time of the Order). For rate setting  
19 purposes, this amortization was accomplished through an imputation of annual  
20 revenue in the amount of \$50,992.

21           3.     Capital Structure: In its 2000 petition for rate increase, the  
22 Company included the prepaid revenue amounts for both Florida Coast and

1 GCI in its capital structure as Other Deferred Credits at zero cost. The  
2 Commission agreed with this treatment (2001 Rate Order, page 20). The  
3 Company has continued this practice in the MFR's filed in this rate proceeding.

4 **Rate of Return**

5 **Q. HAS THE COMPANY RETAINED AN EXPERT COST OF CAPITAL**  
6 **WITNESS FOR THIS RATE PROCEEDING?**

7 A. No. The Company has elected not to retain the services of a cost of capital  
8 consultant. In the Company's view, the substantial expense of such retaining  
9 an expert for this case is not warranted. The typical analytical evaluations  
10 undertaken to establish a natural gas utility's overall capital costs, especially its  
11 cost of common equity, are problematic for very small companies, such as  
12 SJNG. The Company is not publicly traded. All of the Company's stock is  
13 privately held by four members of the founding family. The Company has no  
14 bond or debt rating from a nationally recognized rating organization. There is  
15 no proxy group or similarly situated utility group represented in the Value Line  
16 Investment Survey. The gas utilities represented in the S&P Public Utilities  
17 Index bear little relation to the Company's operations. The Company would  
18 generally have difficulty obtaining credit at interest rates represented by  
19 national market forecasts, such as the Blue Chip Financial Forecast. The  
20 earnings growth rate projections (earnings per share) from Value Line, Zacks,  
21 IBES/First Call or Reuters/Market Guide, for example, are useless. Finally, the  
22 standard quantitative measurements used to determine a reasonable equity

1 cost, (Discounted Cash Flow model, Risk Premium analysis, Comparable  
2 Earnings approach, or Capital Asset Pricing Model) require data inputs that,  
3 when applied to the Company, either do not exist or are of limited value.

4 **Q. IN THE ABSENCE OF A COST OF CAPITAL EXPERT WITNESS, WHAT**  
5 **FACTORS SHOULD THE COMMISSION CONSIDER IN SETTING THE**  
6 **COMPANY'S RATE OF RETURN.**

7 A. A regulated utility's overall cost of capital is determined by weighting the cost of  
8 each source of capital (equity, short and long-term debt, deposits, etc) by the  
9 proportion of each respective source of capital compared to total capital. The  
10 overall cost of capital should set a rate of return that compensates the  
11 Company for the use of its capital and enables the Company to attract  
12 additional capital at reasonable terms. The Commission should set rates in this  
13 proceeding that permit the Company to earn a return on its investment  
14 consistent with the long- standing capital attraction and comparable risk  
15 principles established by the U.S. Supreme Court. The Court in two landmark  
16 decisions provided several standards to demonstrate fairness and  
17 reasonableness when establishing a regulated company rate of return  
18 (*Bluefield Water Works & Improvement Company v. Public Service*  
19 *Commission of West Virginia, et.al, 262 U.S. 679 (1923)* and *Federal Power*  
20 *Commission v. Hope Natural Gas Company, 320 U.S. 501 (1944)*). The tests to  
21 satisfy the fair and reasonable standard in the Bluefield and Hope cases are  
22 summarized as follows: i) the rate of return for a public utility should be similar

1 to the returns of other financially sound businesses with comparable risk  
2 profiles, ii) the rate of return should be adequate to assure confidence in the  
3 financial integrity of the utility, and iii) the rate of return should be sufficient to  
4 support the credit requirements of the utility and enable it to attract the capital,  
5 at reasonable costs, needed to provide adequate and reliable service to  
6 consumers. As noted in the Commission's 2001 Rate Order (page 8), "The  
7 required rate of return depends on investor's expectations and the total  
8 financial risk reflected in the company's capital structure".

9 Establishing the Company's current and Projected Test Year debt costs  
10 and other non-equity capital costs should be relatively straightforward. The  
11 Company's MFR Schedule C-4 outlines its minimal current debt obligations. As  
12 described in Andy Shoaf's testimony, the Company's 2008 capital budget  
13 includes system expansion projects and various pieces of equipment required  
14 to add customers and maintain reliable service. The Company's MFR Schedule  
15 C-4, indicates the Company's expectation that it will fund the majority of the  
16 capital program through new long-term debt. The Company has projected the  
17 cost of such debt based on conversations with local lending institutions.  
18 Establishing an appropriate Return on Equity (ROE) is less straight-forward. As  
19 noted above, the usual quantitative models used to assess a company's cost of  
20 common equity are of limited applicability to SJNG. As noted in the  
21 Commission's 2001 Rate Order (page 8), "deciding the appropriate cost rate for  
22 common equity is, ultimately, a subjective process." The Company would



1 propose to establish an ROE in this proceeding based on, i) a general  
2 assessment of business risk, ii) comparability with other similarly situated  
3 utilities and, iii) an assessment of financial risk as reflected by the debt/equity  
4 ratios in the Company's capital structure.

5 **Q. IS SJNG SEEKING AN INCREASE IN ITS AUTHORIZED RETURN ON**  
6 **EQUITY?**

7 A. No. The Company is requesting the retention of its currently authorized return  
8 on common equity of 11.5% in this proceeding. In keeping with the  
9 Commission's past practices, the recommended return of 11.5% would  
10 establish the mid-point for an authorized range of plus or minus 100 basis  
11 points.

12 **Q. PLEASE PROVIDE AN ASSESSMENT OF THE COMPANY'S BUSINESS**  
13 **RISK.**

14 A. There are several key factors that help define the Company's business risk.

- 15 • SJNG is an extremely small company compared to the majority of other  
16 regulated natural gas utilities. In general, a smaller company is riskier than a  
17 larger company, all other things being equal, since a change in revenue  
18 and/or expenses has a proportionately greater impact on a small company.
- 19 • The Company is heavily dependent on one large volume industrial  
20 transportation customer, Arizona Chemical. As indicated in Attachment  
21 SLS-1, Arizona contributed over 25% of the Company's total revenues in  
22 2006. Earlier in my testimony, I described several concerns about the future

1 of Arizona as a SJNG customer. The paper mill that originally provided raw  
2 material for Arizona has ceased operations. Arizona's annual volumes were  
3 down approximately 33% in 2006 compared to 2002, and revenues were  
4 down approximately \$100,000 over the same period. Usage in 2007 has  
5 been reduced by an additional approximately 1,500,000 therms. Arizona's  
6 plant site is less than 1000 feet from a Florida Gas Transmission (FGT)  
7 pipeline lateral. FGT already provides direct connect service to an industrial  
8 customer less than one mile from the Arizona Chemical plant. International  
9 Paper (Arizona's parent at the time) put the company up for sale in 2000.  
10 Arizona was acquired by a private equity firm in 2007. It is unclear what  
11 their future plans are for the Port St. Joe facility.

- 12 • Natural gas is not a monopoly fuel. All natural gas customers have fuel  
13 alternatives. In today's market, many large customers have viable access to  
14 fuel oil, propane or, in some instances, coal. Smaller customers, including  
15 residential customers, may elect propane service. All customers have  
16 access to electric service. In many cases a regulated LDC has difficulty  
17 meeting not only the alternate fuel price, but also the package of additional  
18 services that accompany the fuel. For example, the propane retailers often  
19 package a free equipment service offer in their price per gallon. They may  
20 also provide free interior piping or free appliances. These offers are difficult  
21 to counter in a regulated world, in which a LDC is limited to the customer  
22 incentives approved by the Commission in its conservation programs. The

1           alternate fuel competition faced by the Company today is primarily limited to  
2           fuel oil, propane and electricity. Arizona Chemical has a viable #6 fuel oil  
3           fuel alternative, although as discussed above they do have a by-pass  
4           option. The residential and commercial customers in Port St. Joe and  
5           Mexico Beach are served by Florida Power Corporation. Customers in  
6           Wewahitchka and White City are served by the Gulf Coast Electric  
7           Cooperative. There are multiple propane retailers with Amerigas as the  
8           principal propane supplier. As described earlier in my testimony, the  
9           Company is losing customers to alternate fuel, primarily electricity, during  
10          the redevelopment of Mexico Beach.

- 11          • The Company is sensitive to downturns in the economy and the national  
12          media sensationalizing “high” gas prices in the media. As described in Andy  
13          Shoaf’s testimony, the recent slowdown in the residential housing market  
14          has delayed the construction of numerous homes the Company would likely  
15          have served with gas. Production at Arizona and the use of gas by various  
16          commercial customers is also heavily dependent on the economy.
- 17          • Notwithstanding the economic concerns addressed above, the Company  
18          must grow its customer base to diversify revenues and more appropriately  
19          spread fixed operating costs. Unfortunately, the very nature of expanding  
20          the distribution system for a small company exposes it to significant risk.  
21          Recovery of a system expansion investment can be significantly delayed if  
22          an economic slowdown delays home construction.

- 1           • The Company's existing rate structure exposes it to risk related to weather  
2           and conservation. Under current rates, the Company recovers  
3           approximately 40% of its total gas delivery revenues from fixed charges and  
4           60% from variable charges.

5   **Q.   HOW DOES THE COMPANY'S PROPOSED ROE COMPARED TO THE**  
6   **COMMISSION AUTHORIZED ROE'S FOR OTHER FLORIDA GAS**  
7   **UTILITIES.**

8   A.   In Florida, no regulated gas utility has an authorized ROE less than 11.25%.  
9       The two largest gas utilities (Peoples Gas System and Florida City Gas) are  
10      approved at 11.25%. All other gas utilities, including the three small utilities that  
11      are most similarly situated to SJNG (Indiantown Gas Company, Sebring Gas  
12      System and Chesapeake Utilities Corporation Florida Division) have authorized  
13      ROE's of 11.5%. Indiantown's ROE was approved by Order No. 04-0565-PAA-  
14      GU, issued June 2, 2004; Sebring's ROE was approved by Order No. PSC-04-  
15      1260-PAA-GU, issued December 20, 2004 and Chesapeake's ROE was  
16      approved by Order No. PSC-01-00-2263-FOF-GU, issued on November 28,  
17      2000.

18   **Q.   DOES THIS CONCLUDE YOUR TESTIMONY?**

19   A.   Yes.

**Exhibit SLS-1  
 SJNG 2008 Rate Case Proceeding  
 Comparison of 2001 Rate Case Forecast to Actual Results 2002-2007**

		Average Annual Customers							
Current Rate Classes	2001 Rate Case Forecast	2002	2003	Actual			2007	2008 Rate Case Forecast	2001 Rate Case vs. 2007 Actuals
				2004	2005	2006			
RS	3250	3,076	3,057	3,018	2,950	2,885	2,840	2,820	-410
GS-2	215	213	221	216	210	213	218	218	3
GS-3	37	41	40	39	40	38	36	36	-1
TS-5	1	1	1	1	1	1	1	1	0
TS-6	3	3	3	3	3	3	3	3	0
Total	3506	3,334	3,321	3,277	3,203	3,139	3,098	3,078	-409
Delta		-172	-13	-44	-74	-64	-42	-20	

		Annual Therms							
Current Rate Classes	2001 Rate Case Forecast	2002	2003	Actual			2007	2008 Rate Case Forecast	2001 Rate Case vs. 2007 Actuals
				2004	2005	2006			
RS	1,126,382	934,776	938,096	883,681	818,266	738,671	720,466	761,701	-405,916
GS-2	99,690	86,864	101,476	100,919	94,487	94,021	97,149	97,610	-2,541
GS-3	220,733	223,466	237,426	227,413	208,398	212,307	222,295	221,568	1,562
TS-5	338,278	417,944	407,592	367,198	415,873	414,896	434,931	408,098	96,653
TS-6	9,698,160	9,965,533	9,474,845	6,703,545	6,747,714	6,740,311	5,200,000	3,000,000	-4,498,160
Total	11,483,243	11,628,583	11,159,435	8,282,756	8,284,738	8,200,206	6,674,841	4,488,977	-4,808,402
Delta		145,340	-469,148	-2,876,679	1,982	-84,532	-1,525,365	-2,185,864	

2007Therms - Actual through November; December 2007 estimated at November volumes for all classes except Arizona Chemical.

1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **DIRECT TESTIMONY**

3 **OF ANDY SHOAF**

4 **ON BEHALF OF**

5 **ST. JOE NATURAL GAS COMPANY, INC**

6 **DOCKET NO. 070592-GU**

7 **December 2007**

8

9 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

10 A. My name is Andy Shoaf. My business address is St. Joe Natural Gas  
11 Company, Inc., 301 Long Avenue, Port St. Joe, Florida 32456-0549.

12 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

13 A. I am employed by St. Joe Natural Gas Company, Inc. ("SJNG" or the  
14 "Company") in the position of Manager Corporate Services.

15 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

16 A. I received a Bachelor of Science Degree in Information Studies from Florida  
17 State University in 2006.

18 **Q. PLEASE DESCRIBE YOUR WORK EXPERIENCE.**

19 A. SJNG is a family owned business. Before graduating college, I had an  
20 opportunity, over several years, to begin learning the business by working  
21 part-time in different capacities within the Company. During this period I  
22 worked in operations, service, sales, office administration/customer service  
23 and the Company's unregulated appliance business. I became a full-time

DOCUMENT NUMBER-DATE

1 employee in May 2006. In my current position I am responsible for the  
2 regulated business unit's customer service, rates and regulatory affairs,  
3 marketing and sales, and gas supply functions. I am also responsible for  
4 information technology services for both the regulated and non-regulated  
5 business units.

6 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

7 A. I will provide an overview of the current market environment in which the  
8 Company competes for business. I will describe the opportunities to expand  
9 the Company's distribution system to serve new customers, as well as a  
10 system improvement project required to support both existing customers and  
11 potential new accounts. I will outline the Company's 2008 capital and  
12 expense budgets and provide information on several specific budget items.

13 **Q. ARE YOU SPONSORING ANY EXHIBITS TO YOUR TESTIMONY?**

14 A. Yes. Exhibit AS-1 is a list of the MFR Schedules I am sponsoring. These MFR  
15 Schedules were prepared under my direction, supervision and control. Exhibit  
16 AS-2 is a composite exhibit with several charts depicting an analysis of the  
17 competitive position of the Company's proposed rates compared to various  
18 alternative fuels available in the Company's service areas.

19 **Market Environment**

20 **Q. PLEASE GENERALLY CHARACTERIZE THE SERVICE AREAS IN WHICH**  
21 **THE COMPANY COMPETES FOR BUSINESS.**

22 A. The Company's customers are generally located in three distinct service  
23 areas: the small town of Port St. Joe, and the inland community of

1 Wewahitchka in Gulf County and the beach resort community of Mexico  
2 Beach, in eastern Bay County. As noted in Stuart Shoaf's testimony, the  
3 majority of the Company's approximately 3,000 customers are residential  
4 services. Over 55% of the customer base is located in Port St. Joe where the  
5 Company's original distribution system was established in 1959.  
6 Approximately 32% of total customers are located in the beach communities  
7 of Mexico Beach, S. Joe Beach, and Beacon Hill. The population of Gulf  
8 County in 2005 was 14,560 with approximately 67% of the residents living in  
9 areas designated as rural. Mexico Beach's population was 1,017 and  
10 Wewahitchka's 1,722, according to 2005 Census data.

11 **Q. HAVE THE BUSINESS AND ECONOMIC CLIMATES IN THE COMPANY'S**  
12 **SERVICE AREAS CHANGED SINCE ITS LAST RATE CASE?**

13 A. Yes. Over the past few years the natural gas industry has experienced  
14 significant changes in its operating practices, the volatility of fuel prices and  
15 the level of competition for business. At the time of the Company's last rate  
16 proceeding (early 2001), the national economy was booming. Locally, it  
17 appeared that Port St. Joe and the surrounding area was on the verge of  
18 significant redevelopment and growth. The permanent closure of the Florida  
19 Coast Paper Company mill in 1999 forever changed Port St. Joe's economy  
20 and forced the Company to file for rate relief. However, the community and  
21 the Company were optimistic about the potential for non-industrial growth.  
22 The St. Joe Company had announced plans to begin a series of development



1 projects in the area that, in the Company's view at that time, would lead to the  
2 addition of numerous residential and commercial gas customers.

3 A concerted effort by local business and community leaders was  
4 underway to encourage and support the revitalization of Port St. Joe in an era  
5 without the paper mill. The mill was demolished and the site cleared. The St.  
6 Joe Company and other developers targeted the region for residential second  
7 home and retirement communities. Their intent was to take advantage of the  
8 beach location and the well publicized "baby boomer" disposable income to  
9 attract customers. The Company's 2001 rate case included a customer  
10 forecast that projected gas customer additions. The Company's 2001 rate  
11 order was issued in June 2001. The September 11, 2001 terrorist attacks  
12 shifted the national economy from the boom period of the late 1990's and  
13 early 2000's into recession. Although the local housing market paused briefly  
14 following the attacks, it quickly rebounded. The real estate market continued  
15 at a brisk pace, with closings and housing starts at record levels.  
16 Unfortunately, a significant amount of the residential development was  
17 devoted to mid-rise condominiums in the Mexico Beach area that did not use  
18 gas, and residences on Cape San Blas where there is no gas service. The  
19 following chart indicates recent historic residential permit levels for Gulf  
20 County (U.S, Census data base).

21 **Gulf County Single Family Residential Permits**

22 Year No. Permits

23

1	1999	114
2	2000	188
3	2001	141
4	2002	244
5	2003	181
6	2004	183
7	2005	38
8	2006	235
9	2007	70 (through September)

10 The 2006 permits include 132 permits for the Barefoot Cottages subdivision  
 11 which decided to install all electric appliances and several permits for units  
 12 that were not constructed.

13 The market changed again in late 2004 with the advent of the current  
 14 housing slow down and credit crunch. According to the Fishkind and  
 15 Associates, Inc. Econocast 2007 forecast, Florida housing starts declined  
 16 from an actual 262,685 in 2005 to a projected approximately 165,000 starts in  
 17 2007 and approximately 100,000 starts in 2008. Fishkind's forecast indicates  
 18 that the residential market bottoms in 2007 and gradually improves through  
 19 2010. Residential construction in Gulf and eastern Bay (Mexico Beach)  
 20 counties followed a similar pattern. For example, after several high volume  
 21 years, 2007 single family residential home permits in Gulf County are down  
 22 72% compared to the peak year of 2002. As noted above, the new  
 23 construction market is slow; only 70 residential permits have been issued in  
 24 Gulf County through September 2007 compared to over 244 in 2002. Of  
 25 these 70 permits only 20 are located on the Company's existing distribution

1 system. The 2005 hurricane season appeared to accelerate the slowdown. As  
2 reported in the October issue of Florida Trend, many Florida builders have  
3 moved all or part of their operations to the Carolinas where they encounter no  
4 hurricanes and fewer regulations. In a September 29, 2007 article in the Wall  
5 Street Journal, Connor Dougherty also reported on declining retirement  
6 migration to Florida, with South and North Carolina and Tennessee actively  
7 competing for retirees. The principal issues cited for this shift were  
8 overcrowding, severe weather, insurance and property taxes. As one  
9 apparent example of this phenomenon, the St. Joe Company recently  
10 announced a major restructuring of operations. They are exiting the  
11 homebuilding business and will concentrate on marketing existing land  
12 holdings and developing infrastructure for coastal communities. It remains to  
13 be seen how this action will impact actual home construction in the St. Joe  
14 area developments.

15 **Q. YOU HAVE OUTLINED A NUMBER OF CHALLENGES FACING THE**  
16 **COMPANY IN TODAY'S MARKETPLACE. DO THESE MARKETS ALSO**  
17 **PROVIDE OPPORTUNITIES TO COMPETE FOR NEW BUSINESS?**

18 A. Yes. The Company recognizes that its traditional markets are changing. As  
19 noted in Stuart Shoaf's testimony, the large industrial customers that have  
20 historically been the cornerstone of the Company's sales are either gone or  
21 have substantially reduced their gas use. It is not clear whether the remaining  
22 industrial customer will continue its Port St. Joe operation in the future.  
23 Ultimately, the key to the Company's long-term success will be its ability to

1            profitably grow its customer base. As noted above, the Company believes  
2            that population growth will continue in its service areas. The question is  
3            whether the Company can position itself to take advantage of the  
4            opportunities growth brings.

5    **Q.    WHAT ARE THE PROSPECTS FOR A TURN AROUND IN THE**  
6    **RESIDENTIAL MARKETS SERVED BY THE COMPANY?**

7    A.    Several economic forecasts project that both the national and Florida housing  
8           slump will bottom-out in 2008 and begin to recover in 2009. To cite one such  
9           forecast; an October 18, 2007 presentation by Hank Fishkind (Fishkind and  
10           Associates, Inc.) to the Southwest Florida Chamber of Commerce indicates a  
11           “slow recovery in 2008” but in the 2009-2010 period the “recovery builds  
12           momentum”. Discussions with the St. Joe Company and other area  
13           developers have also indicated their expectation that 2009 will begin the  
14           recovery. It should be noted that no one seems to expect a return to  
15           construction levels approaching the peak years.

16   **Q.    WHAT ARE THE PROSPECTS FOR GROWTH IN THE NON-RESIDENTIAL**  
17   **MARKET?**

18   A.    The Company expects that commercial growth will be slow, at best, until the  
19           residential markets turn around. The City of Port St. Joe has proposed  
20           development plans for the marina area and the old Florida Coast mill site that  
21           would include significant commercial properties, many of which would be  
22           likely gas users. The Company’s expectations are that these plans will  
23           materialize slowly over the next several years. The company does not

1 anticipate significant commercial growth through 2010. Given the apparent  
2 intent by local government and developers to proceed with a long-term plan to  
3 promote the Port St. Joe area as an upscale beach and retirement  
4 community, it is unlikely that significant industrial development will occur.

5 **Q. IN YOUR OPINION IS THERE A FUTURE OPPORTUNITY TO ADD**  
6 **CUSTOMERS IN THE SJNG SERVICE AREA?**

7 A. Yes. The Company has continued to add customers over the past several  
8 years. However, the increase in lost customers, as described above, has  
9 resulted in a net total loss of customers since the 2001 rate proceeding. The  
10 Company believes it can increase its customer additions and slow the loss of  
11 customers (primarily through its new conservation programs) and that there  
12 will be continued population growth in its service areas. It appears that over  
13 the next decade Florida's population growth rate, while slowing, is still  
14 expected to increase significantly. The Fishkind Econcast 2007 forecast  
15 indicates sustained, although lower than usual, population growth over the  
16 next several years. The retiring baby boomer generation is expected to  
17 dramatically increase the number of people migrating to new locations within  
18 the U.S. over the next twenty years. Although Fishkind projects that Florida's  
19 total share of these individuals will drop from approximately 10.5% in 1995-  
20 2000 to around 8% in the 2020-2030 time period, the sheer number of  
21 migrants will keep Florida's population growing.

22 Stan Smith, Director of the Bureau of Economic and Business  
23 Research (BEBR) at the University of Florida, recently was quoted in the

1 Sarasota Herald Tribune (September 30, 2007), "In 2006-2007 there has  
2 been somewhat of a slowdown in growth, but the growth is still pretty  
3 substantial. By comparison to previous years it is smaller, but it is important to  
4 keep in mind that 2003 to 2006 were some of the highest growth rates in  
5 Florida's history." Population growth, as forecast by the BEBR in its "Florida  
6 Long-term Economic Forecast 2006", is projected to continue in the  
7 Company's service areas at over 1% per year through 2030. It is important to  
8 note that the BEBR, and other population studies, track permanent residents.  
9 It is likely that the Company's service areas will continue to experience  
10 construction of a substantial number of second homes. The population growth  
11 statistics may under estimate the potential for customer growth. The projected  
12 growth will provide opportunities for the Company to serve residential  
13 development and the commercial businesses that naturally follow.

14 Over the past two years the St. Joe Company has invested several  
15 million dollars in expanding the existing infrastructure in its Windmark  
16 development. Windmark began as a 112 lot high-end residential development  
17 along the gulf-side of Highway 98 between Mexico Beach and Port St. Joe.  
18 Last year approximately four miles of U.S. Highway 98 along the coast next to  
19 the Windmark development has moved inland. St. Joe has been installing  
20 new roads and other infrastructure as well as constructing a "town center" for  
21 the development. The Company has a distribution system in the original  
22 Windmark subdivision. Two of the Company's capital projects planned for  
23 2008 will extend gas service to additional areas in Windmark. At build-out in

1 approximately ten- years Windmark is projected to contain 1,500 residences  
2 and numerous commercial businesses.

3 **Q. WHAT MUST THE COMPANY DO TO TAKE ADVANTAGE OF THESE**  
4 **GROWTH OPPORTUNITIES?**

5 A. To effectively compete for customers the Company must first return to a  
6 sound financial position so that it may attract the capital necessary to fund  
7 system expansions to developing areas and provide reliable service to new  
8 and existing customers. Beyond the financial considerations, the Company  
9 must enhance its ability to anticipate and influence the markets it serves. The  
10 Company must develop and implement marketing programs that successfully  
11 add and retain customers. The Company must find ways to encourage its  
12 customers to use gas efficiently, promoting conservation actions that are in  
13 the best interest of the consumer. The Company must be competitive with  
14 alternate fuels, although not necessarily the lowest cost provider. There are  
15 many advantages of natural gas that are not reflected solely by price. Stable  
16 flame characteristics, safe and reliable delivery, no on-site storage, quick heat  
17 recovery (virtually instantaneous with tankless water heaters), infinite cooking  
18 temperatures, and superior temperature performance compared to heat  
19 pumps are a few of the important non-price features of natural gas.  
20 Increasingly, consumers see natural gas as an environmentally friendly fuel,  
21 producing significantly total cycle lower carbon emissions than most  
22 competitive fuels.

1           In addition to competitive rates, the Company's must also implement  
2 rates that limit the subsidization of one rate class by another. Historically, the  
3 Company's industrial customers contributed to the recovery of the cost to  
4 serve smaller volume, especially residential customers. Finally, the  
5 Company's ability to meet and exceed the service expectations of its  
6 customers must be strengthened. Many of the challenges described above,  
7 especially those related to meeting customer needs and alternate fuel  
8 competition, can be effectively managed. The Company's business strategies  
9 and marketing approach are already in transition, adapting, as best it can, to  
10 the uncertain market and more competitive environment. The Company is  
11 actively seeking feasible system expansion opportunities to grow and  
12 diversify its revenue base, further reducing dependence on the current  
13 industrial revenues. A return to financial stability is the first of many steps the  
14 Company must take to ensure that it can meet the challenges of the  
15 marketplace. The proposed rates, rate structure and system expansion  
16 initiatives included in this filing represent a significant step toward meeting the  
17 business and economic challenges facing the Company in today's gas  
18 market.

19 **Q. IN 2007, THE COMMISSION AUTHORIZED SJNG TO MODIFY ITS**  
20 **ENERGY CONSERVATION PROGRAMS. ARE THE PROGRAM**  
21 **MODIFICATIONS CONTRIBUTING TO THE COMPANY'S ABILITY TO ADD**  
22 **AND RETAIN CUSTOMERS?**

23 A. Yes. Implementation of the Company's revised energy conservation



1 incentives, approved by the Commission in Order No. PSC-07-0495-PAA-EG,  
2 issued June 11, 2007, is having a positive effect on customer retention and  
3 appliance conversions to gas. The Company received authorization to  
4 increase the allowance incentive payments for its residential new construction  
5 and appliance replacement programs and add cooking and clothes drying  
6 allowances to the existing water heater and furnace allowances. The  
7 Commission also approved a new residential appliance retention program. In  
8 the five months since the new incentives were adopted, the Company has  
9 experienced a dramatic increase in the number of allowances for gas to gas  
10 appliance replacements and electric to gas appliance conversions. In the first  
11 six-months of 2007 (the new allowances were approved in June 2007) the  
12 Company issued payments for 7 appliance replacement/retention allowances.  
13 In the five months (through November 2007) following approval of the new  
14 allowances the Company has issued payments for 59 appliance  
15 replacement/retention allowances. The new construction allowances have  
16 also increased from 10 during the first six-months to 20 over the next five  
17 months. It remains to be seen whether this level of activity is sustainable, but  
18 at present there are positive signs that the conservation program allowances  
19 may be helping to reverse the Company's recent lost appliance and lost  
20 customer trend.

21 **Q. WHY IS IT IMPORTANT THAT THE COMPANY CONTINUE TO GROW ITS**  
22 **CURRENT CUSTOMER BASE?**

1 A. Companies that fail to grow find themselves spreading the fixed costs of the  
2 system over a stable, or more likely, a declining customer base. Rates  
3 increase, costs are cut, service is reduced, customers look for alternatives  
4 and the Company begins to decline. As noted above, the Company is already  
5 experiencing competition and substantial customer attrition in many of its  
6 traditional markets. Added to these threats is a downward pressure on margin  
7 from the Company's large volume customers. Fortunately, we believe there  
8 are growth opportunities in the Company's service areas that allow for the  
9 feasible expansion of the system to serve incremental loads. The Company is  
10 actively pursuing such opportunities. Over time, prudently adding high value  
11 customers in all classifications will help protect the Company and its  
12 ratepayers from the current heavy reliance on industrial and low usage  
13 residential customers, and stabilize the revenue base.

14 **Q. EARLIER YOU MENTIONED PRICE COMPETITION WITH ALTERNATE**  
15 **FUELS. PLEASE DESCRIBE THE CHALLENGES FACED BY THE**  
16 **COMPANY AS IT COMPETES FOR BUSINESS WITH ALTERNATE FUEL**  
17 **PROVIDERS.**

18 A. Natural gas is not a monopoly fuel. All natural gas customers have fuel  
19 alternatives. In today's market, many large customers have viable access to  
20 fuel oil, propane or, in some instances, coal. Smaller customers, including  
21 residential customers, may elect propane service. All customers, with the  
22 possible exception of large industrial process loads, have electric service  
23 alternatives. Alternate fuel competition is pervasive throughout the

1 Company's customer classes, non-residential and residential. While  
2 competition from alternate fuel providers is not new, it is at an unusually  
3 intensive level especially among electric utilities and propane retailers.

4 In many cases a regulated LDC has difficulty meeting not only the  
5 alternate fuel price, but also the package of additional services that  
6 accompany the fuel. Electric utilities and propane retailers are offering  
7 products and services, in addition to fuel, which strengthen their competitive  
8 position. For example, energy audits, equipment servicing, voltage surge  
9 suppression, performance contracting and appliance leases are offered by  
10 various electric providers, their unregulated affiliates or trade allies, as  
11 incentives for customers to use electricity. Propane retailers often package a  
12 free equipment service offer in their price per gallon. They may also provide  
13 free interior piping or free appliances. These offers are difficult to counter in a  
14 regulated world, in which the Company is limited to the customer incentives  
15 approved by the Commission in its conservation programs.

16 The market risks posed by alternate fuel competition can be distilled to  
17 four basic challenges. First can the Company react to the price signals of the  
18 market in a manner that keeps customers burning natural gas? Second, can  
19 the Company design rates that reduce cross-class subsidization and more  
20 readily align with competing fuel rates? Third, can the Company provide,  
21 directly or through trade allies, sufficient additional services to compete with  
22 alternate fuel providers where fuel cost differences are marginal? Fourth, will  
23 the Company have sufficient staff and customer education resources to

1 actively compete for business? Positioning the Company to effectively  
2 respond to alternate fuel competition is a central objective of this filing.

3 **Q. DOES THE COMPANY REGULARLY COMPARE ALTERNATE FUEL**  
4 **PRICES TO NATURAL GAS?**

5 A. Yes. The Company regularly analyzes competing fuel costs. This process  
6 involves a number of activities including: surveys of customers, contacts with  
7 competitors, the review of various energy price indices, an analysis of various  
8 tariff base rates and fuel recovery charges and the calculation of physical by-  
9 pass costs.

10 My testimony includes an exhibit that describes the results of the  
11 Company's most recent cost comparisons. Exhibit No. CAS-2 provides the  
12 results of the cost comparisons between natural gas and propane, fuel oil and  
13 electricity for several customer classes. The exhibit provides a comparison of  
14 the proposed SJNG rates by class with the respective alternate fuel. For  
15 classes generally represented by residential and small commercial  
16 customers, the energy alternatives reviewed are electricity and propane. For  
17 the larger commercial and industrial customers the alternate energy sources  
18 include various grades of oil and propane. Exhibit CAS-2 was completed with  
19 energy pricing obtained in December 2007. Prior to this analysis, the  
20 Company most recent previous analysis of competitive pricing comparing gas  
21 to electric for residential customers was performed in the Participants Tests  
22 included in its Energy Conservation Program filing (Docket No. 070237-EG).

1 **Q. DOES THE COMPANY EXPERIENCE SEASONAL CHANGES IN ITS**  
2 **CUSTOMER BASE?**

3 A. Although the Company serves a beach community, it currently has relatively  
4 little seasonal variation in customers. Over the past five years average  
5 residential customers during the summer months May through October  
6 equals 2,934. The same five year average for the winter months November  
7 through April produces a total of 2,966 customers. Commercial seasonal  
8 customer totals remain virtually unchanged. The Company does experience a  
9 seasonal swing in gas consumption due principally to the operation of  
10 residential heating systems during the winter. The Company's Projected Test  
11 Year forecast included in Jeff Householder's testimony provides specific  
12 information on monthly consumption by rate class.

13 **Q. DOES THE COMPANY COLLECT CIAC FROM POTENTIAL CUSTOMERS**  
14 **TO MINIMIZE THE COMPANY'S CAPITAL OBLIGATIONS FOR SYSTEM**  
15 **EXPANSIONS?**

16 A. Over the past several years the Company has collected Contributions in Aid  
17 to Construction from a number of new construction single family residential  
18 customers where the estimated annual revenue from sales would not meet  
19 the Company's Maximum Allowable Construction Cost (MACC). In most  
20 cases these residences wanted gas service for a single appliance (cooking,  
21 generator, etc.). The Company has also negotiated a CIAC, grossed up for  
22 taxes, with the St. Joe Company that compensates the Company for certain  
23 gas facility installations in the WindMark development. The Company

1 received several CIAC payments from the St. Joe Company over the past two  
2 years and has charged several facility installations against the CIAC  
3 collections. The Company maintains separate accounting records for all CIAC  
4 payments, including the St. Joe payment. The current balance in the St. Joe  
5 Company CIAC account is a credit of \$135,000 and is recorded in the  
6 Customer Advances for Construction, Account 166.1 on the Company's  
7 books. In accordance with Commission rules, the Company excludes all CIAC  
8 amounts, including the St. Joe Company payments, from rate base.

9 **2008 Capital Budget**

10 **Q. PLEASE PROVIDE AN OVERVIEW OF THE COMPANY'S ACTUAL**  
11 **CAPITAL EXPENDITURES FOR THE 2006 HISTORIC BASE YEAR.**

12 A. The Company's capital expenditures in 2006 totaled \$144,939.

13 **Q. WHAT ARE THE COMPANY'S ESTMIATED CAPITAL EXPENDITURES**  
14 **FOR 2007?**

15 A. The Company has included capital expenditures for the year 2007 in  
16 Schedule G-1 of the MFRs. The Company anticipates investing approximately  
17 \$148,676 in capital through the end of 2007. Virtually all of the Company's  
18 minimal capital expenses over the past two years have been for the extension  
19 of gas facilities. As noted in Stuart Shoaf's testimony, the Company has  
20 deferred replacement of certain utility vehicles, equipment and office  
21 machines due to its financial condition.

22 **Q. WHAT ARE THE COMPANY'S ESTIMATED CAPITAL EXPENDITURES**  
23 **FOR THE 2008 PROJECTED TEST YEAR?**

1 A. The Company has projected total capital expenditures for the year 2008 of  
2 \$700,264. The capital budget is reflected in Schedule G-1 of the MFRs. The  
3 Company is estimating that \$567,386 of the total budget will be for system  
4 expansion and improvement projects. In addition, the budget includes  
5 \$132,878 for other capital items (vehicle and equipment replacement, office  
6 machines).

7 **Q. PLEASE DESCRIBE ANY MAIN ADDITIONS OR SYSTEM**  
8 **IMPROVEMENTS INCLUDED IN THE 2008 CAPITAL SPENDING PLAN.**

9 A. The Company's 2008 capital plan includes the following projects:

- 10 • High Pressure Loop - \$352,000: A system improvement loop is planned  
11 that will stabilize pressure fluctuations on the south side of the Company's  
12 distribution system. The looping project will operate at high distribution  
13 pressure (300 psig). Construction involves the installation of approximately  
14 4 miles (23,000 feet) of 4-inch steel gas main from the Company's existing  
15 Florida Gas Transmission gate station around the west side of Port St. Joe  
16 to intersect the existing distribution system in close proximity to the Sacred  
17 Heart Hospital construction site. In addition to resolving current seasonal  
18 low pressure problems, the loop will also enable the Company to serve the  
19 hospital and expand to new development south of U.S. Highway 98.
- 20 • Sacred Heart Hospital – \$28,049: Sacred Heart Health System is  
21 currently constructing a full-service 49,000 square-foot hospital on the  
22 south side of Port St. Joe close to the existing Gulf Coast Community  
23 College Gulf County campus. The facility will include gas equipment in the

1 kitchen and a boiler system for domestic water and space heating. Annual  
2 usage is estimated at approximately 160,000 therms per year. Sacred  
3 Heart has requested gas service and estimates completion of the hospital  
4 in the first quarter of 2009. Funding is for the installation of 2,400 feet of  
5 four-inch plastic gas main, a two-inch service line, meter and regulator.  
6 The installation of the four-inch main will also tie-in the hospital main to the  
7 high pressure loop discussed above. The project is planned for the  
8 second quarter of 2008.

- 9 • Long Avenue System Improvement - \$60,676: The Company plans a  
10 four-inch 7,575 foot plastic main looping project that will physically tie and  
11 effectively extend the four-inch high pressure loop discussed above. Upon  
12 completion the Long Avenue project will enable the Company to back-feed  
13 the entire distribution system. The Long Avenue Loop will provide  
14 redundant service reliability (two feeds) to the hospital and will support  
15 growth on the south side of Port St. Joe. The project is planned for the  
16 fourth quarter of 2008.

- 17 • Villages at Bayview and Jones Homestead Primary Feed - \$41,652: The  
18 Company plans to extend approximately 5,200 of four-inch plastic main  
19 supported by the High Pressure Loop and Long Avenue System  
20 Improvements, to serve a new St. Joe Company development (Villages at  
21 Bayview) and an existing subdivision (Jones Homestead). The project is  
22 scheduled for the forth quarter 2008.



- 1           • Villages at Bayview Plastic Distribution System - \$38,596: The project  
2 involves the installation of 7,000 feet of two-inch plastic. Villages at  
3 Bayview is a new St. Joe Company residential and light commercial  
4 development project on the south side of Port St. Joe in close proximity to  
5 the new Sacred Heart Hospital. The St. Joe Company has committed to  
6 gas service for the project. Phase One of the project includes 65 town  
7 home residences and eight commercial building lots. Based on  
8 discussions with the developer, the Company anticipates completing the  
9 distribution expansion and providing service to ten model homes in late  
10 2008. The potential build-out of this development could total 308 units. At  
11 present, however, 120 of these units are planned as apartments with no  
12 current commitment to gas service.
- 13           • Jones Homestead Phase One Distribution System - \$20,691: The project  
14 involves the installation of 2,700 feet of two-inch plastic. The Jones  
15 Homestead is an existing subdivision in close proximity to the Myers park  
16 development described above. There are approximately 30 total existing  
17 homes with 20 homes that could be converted from propane to natural gas  
18 in Phase One of the expansion. Phase Two could extend the distribution  
19 system to an area scheduled for new residential development adjacent to  
20 the St. Joe Country Club. There would be approximately 30 lots in the new  
21 section. Installation of the Phase One distribution system and connection  
22 of the existing homes is planned for the forth quarter of 2008.

- 1 • Miscellaneous Services, Meters and M&R Equipment - \$17,022: The  
2 Company plans to continue promoting the enhanced allowances recently  
3 approved for its Energy Conservation Programs. In addition to any new  
4 customers related to the above projects, the Company estimates that it will  
5 install service to approximately 40 residences in 2008, in addition to those  
6 services described above.
- 7 • PT Unit Replacement - \$8,700: The Company plans to replace PT Units  
8 on four transportation service customer meter facilities, the city gate and  
9 retain one spare in inventory.

10 **Q. PLEASE DESCRIBE ANY OTHER ITEMS INCLUDED IN THE COMPANY'S**  
11 **PROJECTED 2008 CAPITAL PROGRAM.**

12 A. The following vehicle, equipment and office machine costs are included in the  
13 capital budget for 2008.

- 14 • Truck - \$30,000 (Account 392.00 Transportation Equipment):  
15 Replacement of an existing 2003 Chevrolet 2500 truck used for utility  
16 construction and system maintenance. The existing truck currently has  
17 over 120,000 miles on the odometer.
- 18 • Backhoe - \$82,628 (Account 396.00 Power Operated Equipment):  
19 Replacement of an existing 14 year old backhoe (depreciation life of 15  
20 years).
- 21 • PC Workstations and Software - \$20,250 (Account 391): Replacement of  
22 four existing computers. Existing units are approximately 5-6 years old  
23 and are exhibiting significant operating problems.

1 **Q. PLEASE DESCRIBE ANY SIGNIFICANT NEW O&M EXPENDITURES**  
2 **PROJECTED FOR 2008 THAT ARE NOT SUBJECT TO THE EXPENSE**  
3 **TRENDING INCLUDED IN MFR SCHEDULE G-2.**

4 A. The Company's operations and maintenance expenses have always been  
5 strictly controlled. The Company is planning no new staff positions or other  
6 initiatives that would significantly increase expenses. There are however,  
7 several expense items that may be not be adequately recovered through the  
8 Commissions traditional expense trending methodology. The Company has  
9 adjusted its 2008 Projected Test Year expenses in MFR Schedule G-2 to  
10 reflect its projections of the following extraordinary expenses.

- 11 • Retirement Plan – The Company's standardized profit sharing retirement  
12 plan provides for an annual contribution of 0-15% of aggregate employee  
13 annual compensation. Prior to Florida Coast ceasing operations in 1998,  
14 the Company consistently made annual contributions to its pension plan.  
15 As noted in Commission Order No. PSC- 01-1274-PAA-GU (the 2001 rate  
16 proceeding) the Company's average annual contribution was \$51,000 for  
17 the years 1992-1998. The 2001 rate case provided for a \$50,000 plan  
18 contribution. However, given the Company's financial condition,  
19 contributions to the plan have been sporadic. For example, the Company  
20 contributed \$0 in 2004; \$0 in 2005; \$10,000 2006. The Company has  
21 accrued \$45,000 in 2007 (the contribution is made in March of each  
22 following year), but will likely be required to borrow the money to make the  
23 contribution. The Company is concerned that its inability to offer a

1 fundamental employee benefit will make it difficult to retain qualified  
2 employees. At current compensation levels the maximum annual  
3 contribution at 15% of total salaries could reach approximately \$100,000  
4 for 2007. The Company has included a \$41,000 retirement plan expense  
5 in its 2008 Projected Test Year which reflects contributions based solely  
6 on the Company's regulated utility compensation.

- 7 • Rate Case Expense Amortization – Total projected rate case expense  
8 equals \$78,000. The Company is proposing a four year amortization of  
9 rate case expenses consistent with the Commission's disposition of  
10 several natural rate proceedings over the past several years. Rate case  
11 expense included in the Projected Test Year is \$19,500.

- 12 • The Company acquired access rights, in late 2004, to property owned by a  
13 shareholder adjacent to its current operations facility. The Company uses  
14 the property as a storage area for regulated utility vehicles and material.  
15 The Company made certain minor improvements to the property (fencing,  
16 gravel drive, etc.) and uses the area for regulated utility vehicle parking  
17 and equipment storage. The Company has negotiated the construction of  
18 a metal warehouse by the shareholder to be used by the utility to store  
19 equipment, fittings, plastic pipe and other regulated utility items. The utility  
20 is in the process of entering into a long term lease for use of the building  
21 and property at a fair market rate. The expense for building and property  
22 lease included in the Projected Test Year is \$2,000 per month.

1 Q. STUART SHOAF'S TESTIMONY DESCRIBES SIGNIFICANT CUSTOMER  
2 LOSS OVER THE PAST FEW YEARS. IS THE COMPANY IN  
3 COMPLIANCE WITH COMMISSION RULE 25-12.045 WITH RESPECT TO  
4 METER AND SERVICE REMOVALS?

5 A. Yes.

6 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

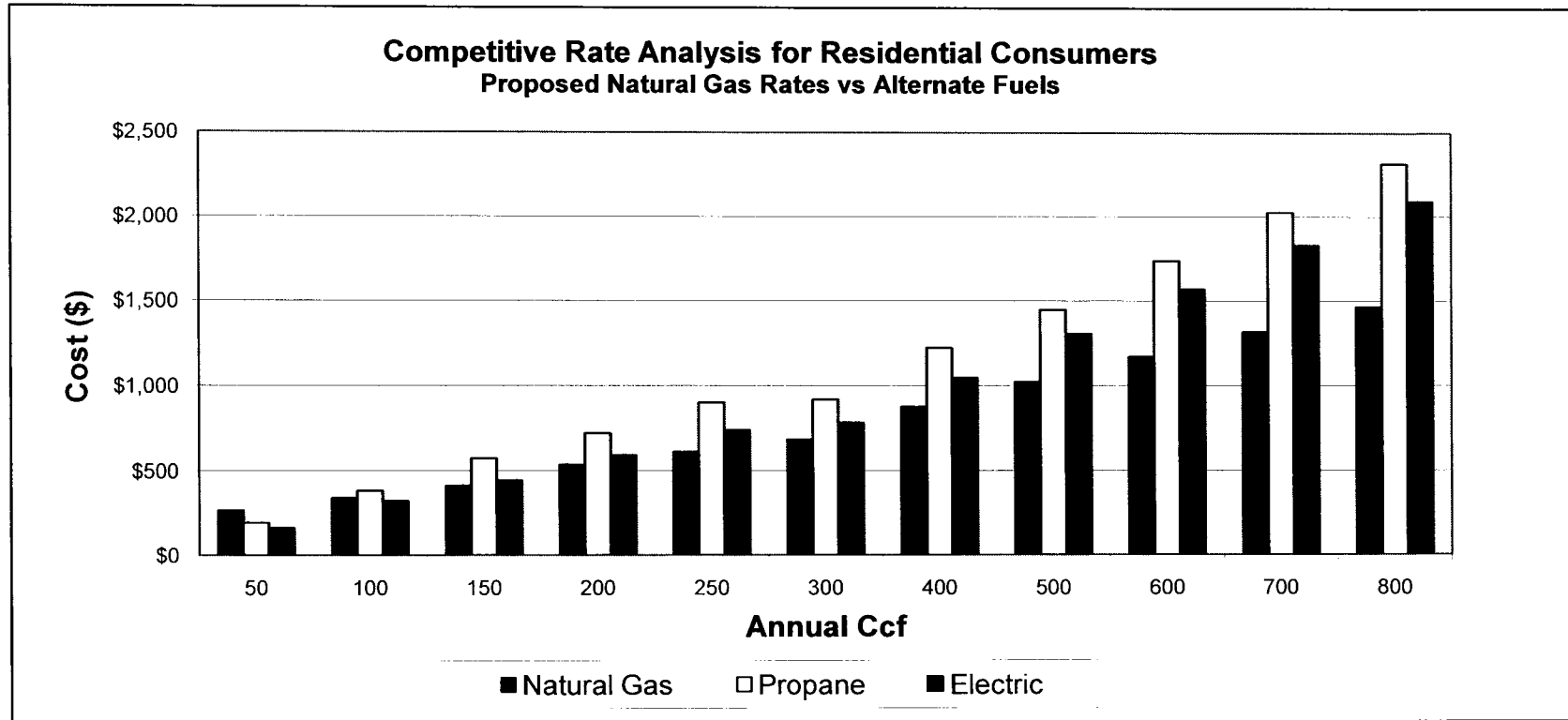
7 A. Yes.

Exhibit No. (AS-1)  
St. Joe Natural Gas Company, Inc.  
Docket No. 070592-GU

**LIST OF MFR SCHEDULES SPONSORED BY ANDY SHOAF**

<u>Schedule</u>	<u>Title</u>
G-1 P. 23	Historic Base Year +1 – Detailed Construction Budget
G-1 P. 24	Historic Base Year +1 – Plant Additions
G-1 P. 25	Historic Base Year +1 – Plant Retirements
G-1 P. 26	Projected Test Year – Detailed Construction Budget
G-1 P. 27	Projected Test Year – Plant Additions
G-1 P. 28	Projected Test Year – Plant Retirements

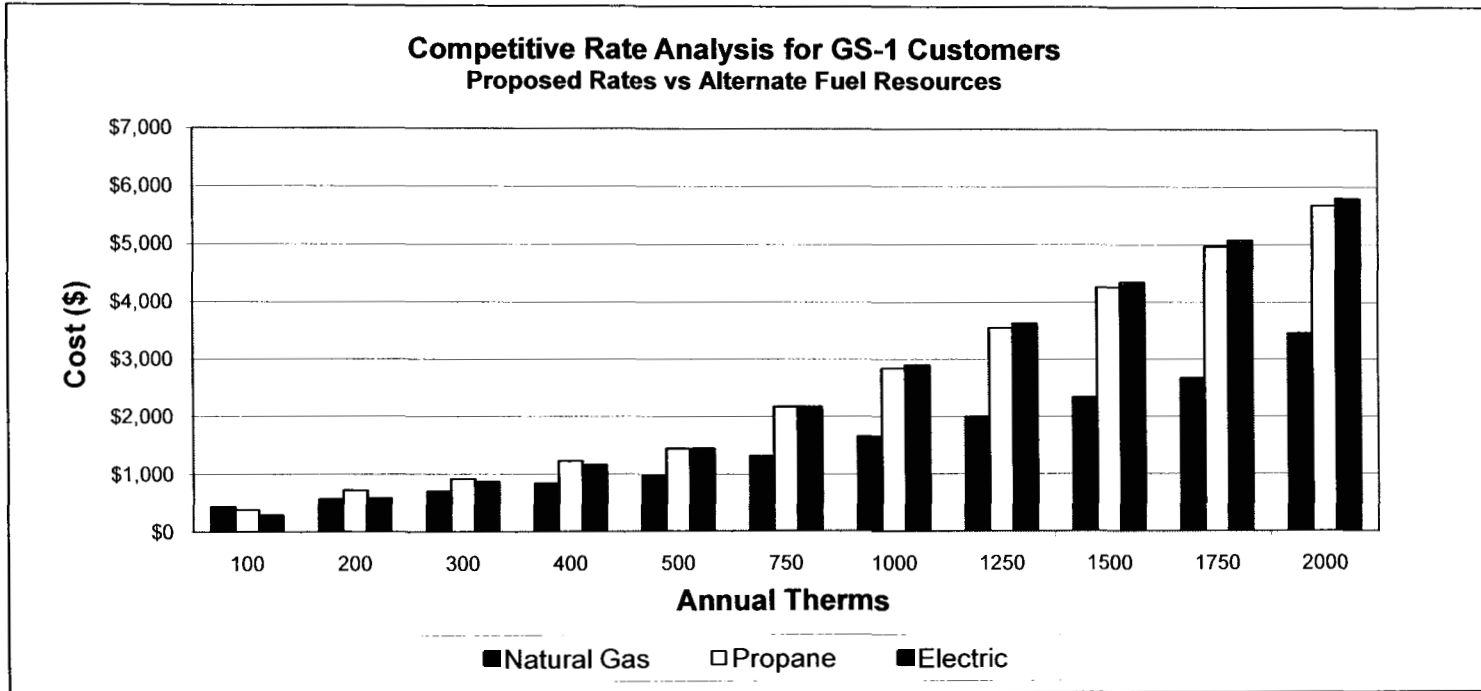
**Exhibit AS-2**  
**St. Joe Natural Gas Company, Inc.**  
**Docket No. 070592-GU**  
**Page 1 of 5**



Annual Ccf	50	100	150	200	250	300	400	500	600	700	800
<b>Natural Gas</b>	\$266	\$339	\$413	\$537	\$611	\$684	\$876	\$1,023	\$1,170	\$1,317	\$1,464
<b>Propane</b>	\$191	\$382	\$573	\$721	\$901	\$917	\$1,223	\$1,447	\$1,736	\$2,026	\$2,315
<b>Electric</b>	\$161	\$322	\$445	\$593	\$741	\$784	\$1,045	\$1,306	\$1,568	\$1,829	\$2,090

Percent comparison : Natural Gas to Alternate Fuel

<b>Propane</b>	-38.9%	11.3%	28.0%	25.5%	32.2%	25.4%	28.4%	29.3%	32.6%	35.0%	36.8%
<b>Electric</b>	-64.8%	-5.2%	7.2%	9.4%	17.6%	12.7%	16.2%	21.7%	25.4%	28.0%	30.0%

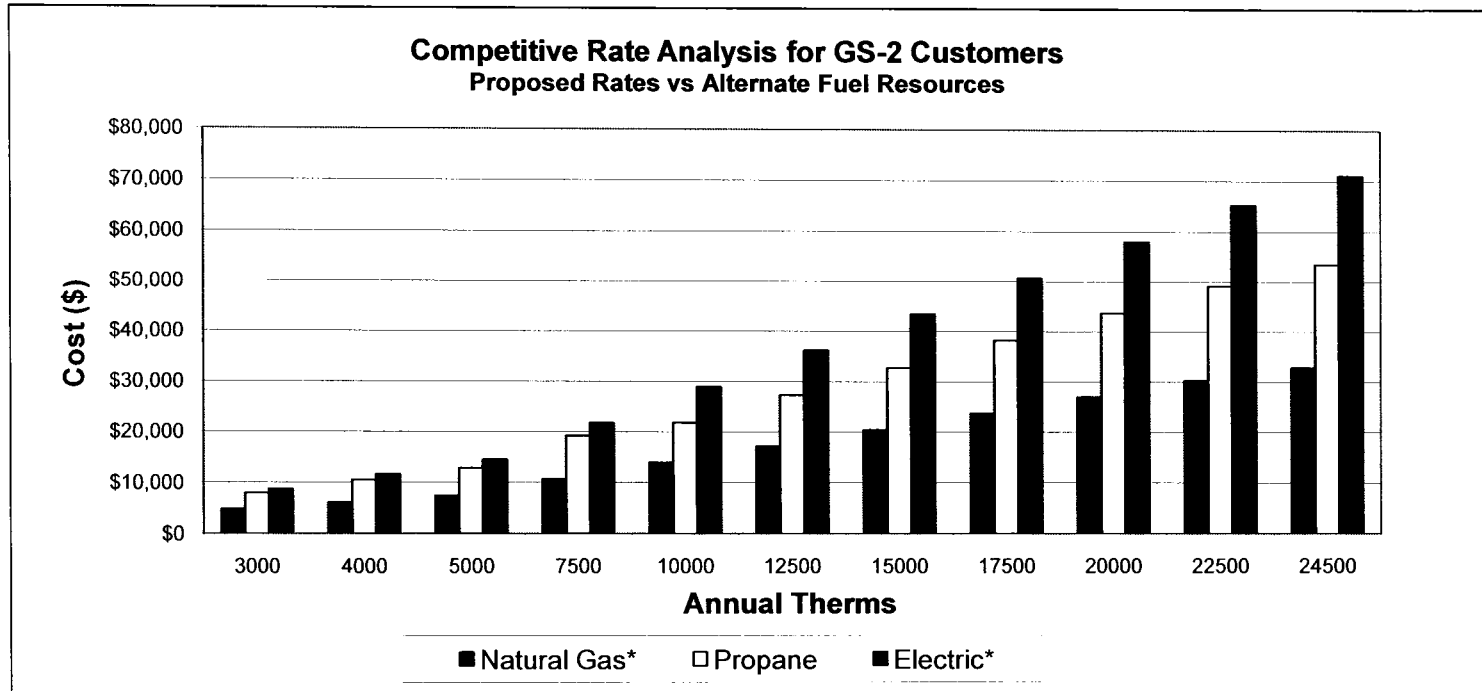


Therm Usage	100	200	300	400	500	750	1000	1250	1500	1750	2000
<b>Natural Gas</b>	\$435.49	\$570.98	\$706.46	\$841.95	\$977.44	\$1,316.16	\$1,654.88	\$1,993.60	\$2,332.32	\$2,671.04	\$3,455.80
<b>Propane</b>	\$382.20	\$720.72	\$917.28	\$1,223.04	\$1,446.90	\$2,170.35	\$2,839.20	\$3,549.00	\$4,258.80	\$4,968.60	\$5,678.40
<b>Electric</b>	\$289.84	\$579.67	\$869.51	\$1,159.34	\$1,449.18	\$2,173.77	\$2,898.36	\$3,622.95	\$4,347.53	\$5,072.12	\$5,796.71

Percent comparison : Natural Gas to Alternate Fuel

<b>Propane</b>	-13.9%	20.8%	23.0%	31.2%	32.4%	39.4%	41.7%	43.8%	45.2%	46.2%	39.1%
<b>Electric</b>	-50.3%	1.5%	18.8%	27.4%	32.6%	39.5%	42.9%	45.0%	46.4%	47.3%	40.4%



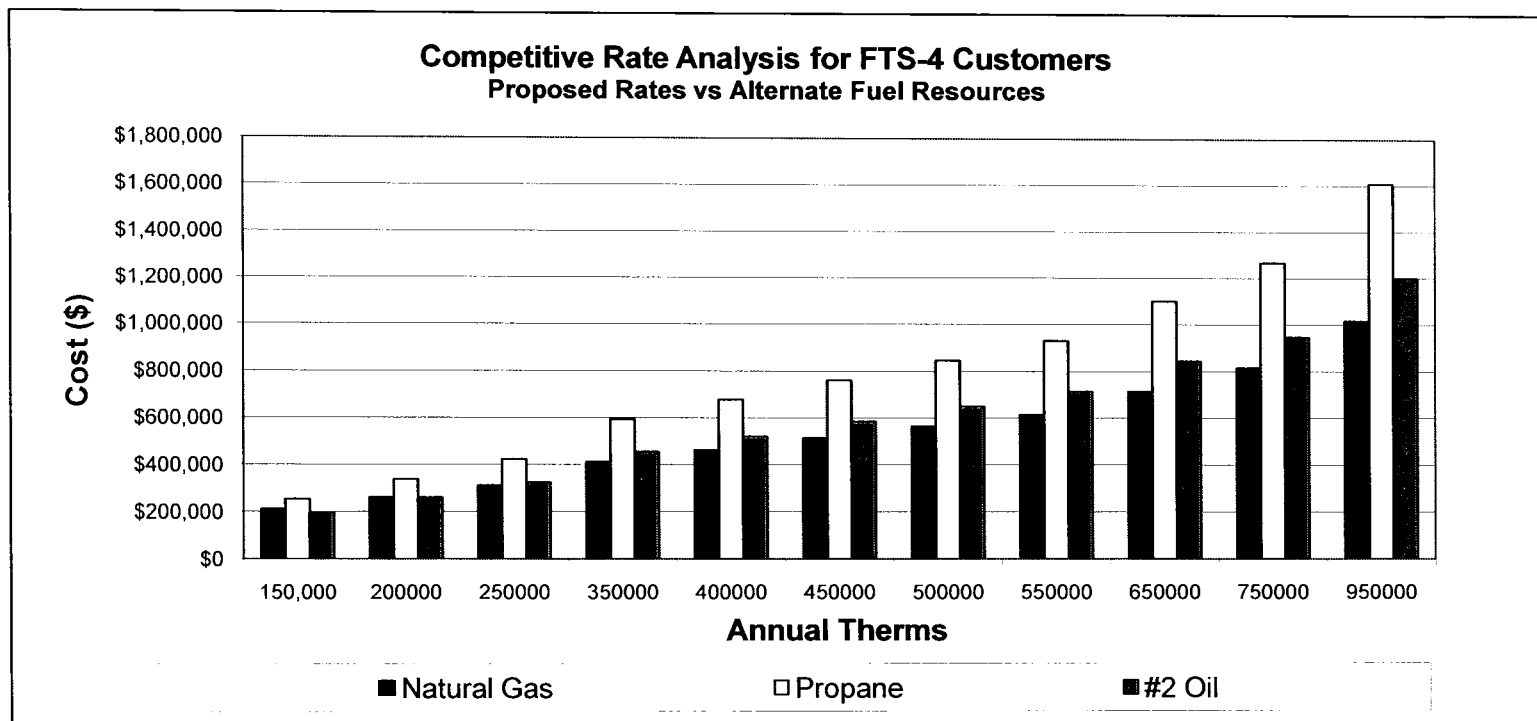


Therm Usage	3000	4000	5000	7500	10000	12500	15000	17500	20000	22500	24500
<b>Natural Gas*</b>	\$4,763.70	\$6,071.60	\$7,379.50	\$10,649.25	\$13,919.00	\$17,188.75	\$20,458.50	\$23,728.25	\$26,998.00	\$30,267.75	\$32,883.55
<b>Propane</b>	\$7,862.40	\$10,483.20	\$12,831.00	\$19,246.50	\$21,840.00	\$27,300.00	\$32,760.00	\$38,220.00	\$43,680.00	\$49,140.00	\$53,508.00
<b>Electric*</b>	\$8,695.07	\$11,593.42	\$14,491.78	\$21,737.67	\$28,983.56	\$36,229.45	\$43,475.34	\$50,721.23	\$57,967.12	\$65,213.01	\$71,009.72
<b>Electric Demand</b>	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0

\* The Amounts shown for Natrual Gas and Electric include the respective Demand Charges

Percent comparison : Natural Gas to Alternate Fuel

<b>Propane</b>	39.4%	42.1%	42.5%	44.7%	36.3%	37.0%	37.6%	37.9%	38.2%	38.4%	38.5%
<b>Electric</b>	45.2%	47.6%	49.1%	51.0%	52.0%	52.6%	52.9%	53.2%	53.4%	53.6%	53.7%

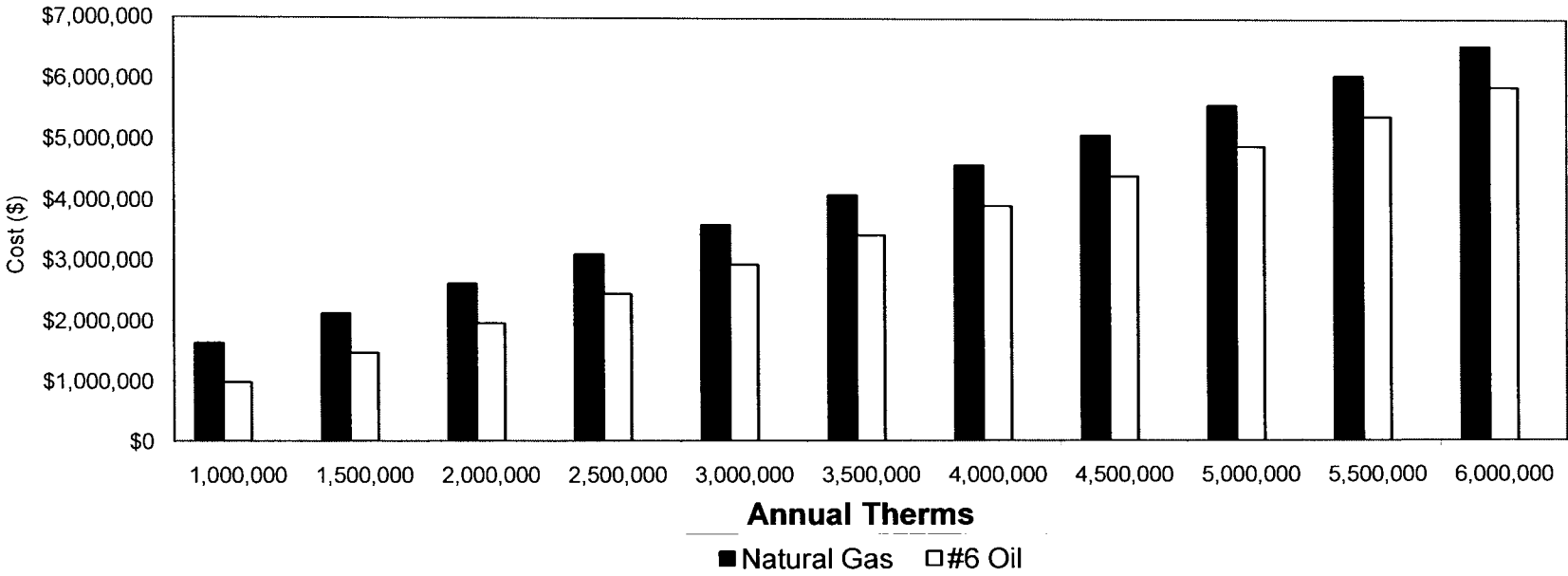


Therm Usage	150,000	200,000	250,000	350,000	400,000	450,000	500,000	550,000	650,000	750,000	950,000
<b>Natural Gas</b>	\$211,122	\$261,496	\$311,870	\$412,618	\$462,992	\$513,366	\$563,740	\$614,114	\$714,862	\$815,610	\$1,017,106
<b>Propane</b>	\$253,890	\$338,520	\$423,150	\$592,410	\$677,040	\$761,670	\$846,300	\$930,930	\$1,100,190	\$1,269,450	\$1,607,970
<b>#2 Oil</b>	\$194,946	\$259,928	\$324,910	\$454,874	\$519,856	\$584,838	\$649,819	\$714,801	\$844,765	\$947,653	\$1,200,361

Percent comparison : Natural Gas to Alternate Fuel

<b>Propane</b>	16.8%	22.8%	26.3%	30.3%	31.6%	32.6%	33.4%	34.0%	35.0%	35.8%	36.7%
<b>#2 Oil</b>	-8.3%	-0.6%	4.0%	9.3%	10.9%	12.2%	13.2%	14.1%	15.4%	13.9%	15.3%

**Competitive Rate Analysis For FTS-4 Customers by Class  
 Proposed Rates vs. Alternate Fuel Resources**



Therm Usage	1,000,000	1,500,000	2,000,000	2,500,000	3,000,000	3,500,000	4,000,000	4,500,000	5,000,000	5,500,000	6,000,000
<b>Natural Gas</b>	\$1,632,160	\$2,124,240	\$2,616,320	\$3,108,400	\$3,600,480	\$4,092,560	\$4,584,640	\$5,076,720	\$5,568,800	\$6,060,880	\$6,552,960
<b>#6 Oil</b>	\$979,112	\$1,468,668	\$1,958,225	\$2,447,781	\$2,937,337	\$3,426,893	\$3,916,449	\$4,406,005	\$4,895,561	\$5,385,117	\$5,874,674

Percent comparison : Natural Gas to Alternate Fuel

<b>#6 Oil</b>	-66.7%	-44.6%	-33.6%	-27.0%	-22.6%	-19.4%	-17.1%	-15.2%	-13.8%	-12.5%	-11.5%
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1                                   **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2   **DIRECT TESTIMONY**

3   **OF STEPHEN SHOAF**

4   **ON BEHALF OF**

5   **ST. JOE NATURAL GAS COMPANY, INC**

6   **DOCKET NO. 070592-GU**

7   **December 2007**

8

9   **Q.    PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

10 A.    My name is Stephen W. Shoaf. My business address is St. Joe Natural Gas  
11        Company, Inc., 303 Long Avenue, Port St. Joe, Florida 32456-0549.

12 **Q.    BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

13 A.    I am employed by St. Joe Natural Gas Company, Inc. ("SJNG" or the  
14        "Company") as General Manager of the Company's non-regulated appliance  
15        business. The Company's non-regulated appliance business is marketed  
16        under the name "The Appliance Solution".

17 **Q.    PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

18 A.    I received a Bachelor of Science degree from the University of Tennessee in  
19        1975.

20 **Q.    PLEASE DESCRIBE YOUR WORK EXPERIENCE PRIOR TO BECOMING**  
21 **GENERAL MANAGER OF THE APPLIANCE SOLUTION BUSINESS UNIT.**

22 A.    From 1978 to 1981, I was employed by MK Ranches of Howard Creek,  
23        Florida as Division Manager responsible for developing the rice and soybean

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1 division for the corporate farming operation. From 1981 to 1983 I was an  
2 Account Executive with Merrill Lynch in Montgomery, Alabama. In 1983, I  
3 accepted a position as Regional Director of Sales for the Advanced  
4 Telecommunications Corporation (ATC) in Atlanta, Georgia. I was responsible  
5 for ATC's sales and marketing efforts in Georgia, Alabama and Tennessee  
6 through 1989, when I joined Phillips & Brooks Gladwin, Inc., as Southwest  
7 Division Manager working with major accounts (Bell, GTE, AT&T, United  
8 Telephone and Sprint) over a five state area. From 1992 through 2003 I  
9 served as Vice President of Sales and Marketing for Davel Communications  
10 located in Cleveland Ohio. I joined SJNG as General Manager of The  
11 Appliance Solution division in 2003.

12 **Q. WHAT ARE YOUR CURRENT DUTIES AS GENERAL MANAGER OF THE**  
13 **APPLIANCE SOLUTION?**

14 A. My duties as General Manager of The Appliance Solution business unit  
15 includes managing all facets of the Company's non-regulated operations  
16 including: strategic planning, financial management, sales and marketing,  
17 customer service and appliance installation and service. I have oversight  
18 responsibilities for those non-regulated business unit functions performed by  
19 regulated utility personnel, such as accounting, billing and finance activities. I  
20 also provide sales assistance to the regulated utility, primarily related to new  
21 gas service extensions and the utility's energy conservation programs. I am  
22 the primary Company contact with the homebuilding industry for both the non-  
23 regulated appliance business and the regulated gas utility business. A

1 significant portion of the regulated Company's new residential construction  
2 sales efforts are provided through my position.

3 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

4 A. My testimony will provide a general overview of the Company's non-regulated  
5 appliance sales business, along with a discussion of the cost allocation  
6 methods currently employed by the Company to assign costs between its  
7 regulated and non-regulated functions.

8 **Q. ARE YOU SPONSORING ANY OF THE MFR SCHEDULES?**

9 A. No, I am not directly sponsoring any of the Company's MFR schedules,  
10 although I assisted in the preparation of the non-regulated business unit data  
11 included in the MFRs.

12 **Q. ARE YOU SPONSORING ANY EXHIBITS TO YOUR TESTIMONY?**

13 A. No.

14 **Q. PLEASE DESCRIBE THE COMPANY'S NON-REGULATED BUSINESS  
15 ACTIVITIES.**

16 A. The Company has historically operated a non-regulated appliance sales and  
17 service business as part of the SJNG corporate entity. There is no separate  
18 corporate identity for The Appliance Solution business unit. SJNG files a  
19 consolidated Federal income tax return for its regulated and non-regulated  
20 business units.

21 The Company originally entered the non-regulated appliance business  
22 in the 1960's to ensure that its customers would have access to gas  
23 appliances and repair service. In a small community like Port St. Joe there

1 are few appliance dealers or repair technicians. The Company's appliance  
2 business was an integral part of the overall marketing effort to add and retain  
3 natural gas distribution system customers. To support the Company's ability  
4 to add distribution customers, it also offered interior gas piping service  
5 (downstream of the meter). It should be noted, that in Order No. PSC-96-  
6 1188-FOF-GU, issued September 23, 1996, the Commission, in support of  
7 increased customer growth, allowed the Company to record house-piping  
8 expense above the line for recovery in base rates as part of its regulated  
9 operation. Most of the Company's appliance sales were to individual  
10 homeowners replacing an existing gas appliance or converting a non-gas  
11 appliance to gas. The majority of the interior piping activity supported the  
12 Company's residential new construction customer additions. The Company  
13 used a small portion of its utility office/warehouse facility to display and  
14 warehouse appliances. At the time of the Company's last base rate case in  
15 2001, the non-regulated business operation was a relatively minor part of the  
16 Company's overall business. Returns in the non-regulated business unit were  
17 marginal. As an example, in 2002 the Company's non-regulated business  
18 recorded a net loss.

19 In 2003, the Company decided to restructure and expand its appliance  
20 sales and service business to take advantage of the booming local beach  
21 home market and to generally expand consumer awareness of gas through  
22 appliance marketing activities. The appliance business also began offering  
23 electric appliances and expanded to include sales to neighboring counties.

1 The Company's principal shareholders invested in the construction of a new  
2 building on land owned by the Company, adjacent to the Company's existing  
3 office in Port St. Joe. The building was completed in late 2003 and the  
4 Company began marketing its appliance business as The Appliance Solution.  
5 On November 13, 2003 the Company received notice from the Florida  
6 Department of State that "The Appliance Solution" had been registered as a  
7 fictitious name; Registration Number: G03317700013. I was hired as General  
8 Manager. Although the new building is primarily devoted to the appliance  
9 business, the utility relocated a customer service position and handles the  
10 majority of its walk-in payment and service activities in the building.

11 **Q. DOES THE COMPANY EMPLOY A COST ALLOCATION METHOD FOR**  
12 **APPROPRIATELY ASSIGNING COSTS BETWEEN THE REGULATED**  
13 **AND NON-REGULATED UNITS?**

14 A. Yes. Wherever possible costs are directly assigned to the business unit  
15 responsible for causing the costs. If a direct assignment is not possible, the  
16 Company allocates costs between the two units based on an assessment of  
17 the percentage of total cost that should be assigned to a unit for the individual  
18 product or service cost to be allocated. The Company does not allocate costs  
19 based on one standard allocation percentage applied to all allocated items.  
20 The allocation method is based on an individual assessment of cost, and is  
21 not based on the respective comparative percentages of plant, customers,  
22 revenue or other factors. Employee allocations are based on an assessment  
23 of the annual amount of time a given employee devotes to a given business



1 unit. For non-employee allocations, the Company individually reviews each  
2 charge category (e.g. utilities, property taxes, postage) to determine a specific  
3 allocation percentage.

4 The Commission's most recent review of the Company's non-regulated  
5 cost allocations occurred during the Company's 2001 rate proceeding.  
6 Subsequent to the expansion of its non-regulated operations in 2003, the  
7 Company revised its allocation percentages to reflect the new level of activity  
8 in its non-regulated business unit. As part of the preparation for this rate filing,  
9 the Company revisited its allocations and has implemented new allocation  
10 percentages for certain employees and functions. These updated cost  
11 allocations are reflected in the Company's expenses for the 2007 Historic  
12 Base Year + 1 and the 2008 Projected Test Year, as submitted in the MFRs.

13 **Q. HOW DOES THE COMPANY CURRENTLY ALLOCATE EMPLOYEE TIME**  
14 **BETWEEN ITS REGULATED AND NON-REGULATED UNITS.**

15 A. Prior to the time The Appliance Solution business was initiated in 2003, the  
16 Company's non-utility operations were staffed by utility employees who  
17 allocated time between the regulated and non-regulated business units as  
18 required. Operations employees (service technicians) charged time to work  
19 orders based on actual tasks performed. One utility office employee allocated  
20 approximately 25% of costs to the non-utility business, and one employee  
21 was assigned 100% to the non-utility business. Subsequent to expanding the  
22 appliance business in 2003, the Company's non-utility business staffing has  
23 evolved to include a mix of employees whose time is devoted virtually 100%

1 to non-utility operations and utility employees who perform certain non-utility  
2 functions and whose time is allocated between the units.

3 In 2007, the Company reviewed all of its employee work  
4 responsibilities. The original intent was to update position descriptions for  
5 competitive salary survey purposes. The Company President assigned me  
6 and Andy Shoaf to conduct interviews with each office employee to discuss  
7 their actual job functions and the annual time required to complete each  
8 function. Updated job descriptions were prepared for each employee based  
9 on these discussions. It became apparent that the historic percentages for  
10 allocating employee time between regulated and non-regulated activities were  
11 not tracking the current job functions.

12 The Company implemented its new allocation percentages and  
13 adjusted its books in October 2007. In its MFRs the Company's regulated  
14 employee expenses for 2007 and the 2008 Projected Test Year reflect the  
15 updated allocation percentages.

16 **Q. PLEASE PROVIDE AN OVERVIEW OF THE COMPANY'S EMPLOYEES**  
17 **AND THEIR RELATIONSHIP TO THE REGULATED AND NON-**  
18 **REGULATED BUSINESS UNITS.**

19 A. The Company currently has sixteen (16) total employees. Of this total, four (4)  
20 are principally involved in The Appliance Solution, and the remaining twelve  
21 (12) are utility employees. The Company's President and CEO (Stuart Shoaf)  
22 devotes virtually all of his time to the regulated business unit. Over the past  
23 three years his involvement in the non-regulated business has been limited to

1 executing legal agreements and signing checks. As General Manager of The  
2 Appliance Solution, I run the non-regulated business unit. This is a family  
3 owned business. The shareholders have essentially divided the Company's  
4 operations into utility and non-utility functions and assigned my brother and  
5 me oversight of the respective operations. That is not to say there is no  
6 overlap between the units. With only a couple of exceptions, most of the  
7 Company's employees spend at least some time working in both business  
8 units. As an example, the Company does not employ dedicated sales people.  
9 I provide sales assistance to the utility, attend builder meetings and generally  
10 coordinate installation activities (interior piping, permitting, etc) for the utility.  
11 My time is charged 90% to The Appliance Solution unit and 10% to the utility.

12 The Company's Operations Manager and five service technicians  
13 charge time to work orders that are coded as regulated or non-regulated  
14 functions based on the actual work performed. The work order codes result in  
15 a direct assignment of costs. Of the five service technicians, four are  
16 assigned to the utility and report to the Operation Manager. These employees  
17 perform occasional non-regulated functions. The remaining service technician  
18 is assigned to The Appliance Solution and occasionally performs utility work if  
19 needed.

20 In addition to me and The Appliance Solution service technician, two  
21 other employees are assigned to The Appliance Solution. One of these  
22 individuals is responsible for office administration and outside sales functions.  
23 This employee also performs several functions for the utility, primarily related

1 to payment processing, billing and related customer service activities. The  
2 employee's time is allocated at 75% to The Appliance Solution. I also have  
3 one employee who performs design, sales and various purchasing functions  
4 for the non-regulated business and is allocated 100% to The Appliance  
5 Solution.

6 The remaining employees are assigned to the utility. As described in  
7 Andy Shoaf's testimony, his only material involvement in The Appliance  
8 Solution is to provide occasional IT support. He allocates 1% of his time to the  
9 non-regulated unit. As described in Debbie Stitt's testimony, she provides  
10 accounting support for the non-regulated unit. However, the books are  
11 maintained on Quick Books and most entries (purchasing, sales, billing) are  
12 made by The Appliance Solution staff. Ms. Stitt makes four monthly journal  
13 entries and provides some summary reports. She allocates 4% of her time to  
14 the non-regulated unit. Of the remaining three office administration staff  
15 assigned to the utility, one is allocated 100% to the utility, and the other two  
16 utility positions allocate 12% to 15.5% of their time to The Appliance Solution.

17 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

18 A. Yes.

1                   **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2                                   **DIRECT TESTIMONY**

3   **OF DEBBIE STITT**

4                   **ON BEHALF OF ST. JOE NATURAL GAS COMPANY, INC**

5                                   **DOCKET NO. 070592-GU**

6   **December 2007**

7

8   **Q.    PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

9   A.    My name is Debbie K. Stitt. My business address is St. Joe Natural Gas  
10        Company, Inc., 301 Long Avenue, Port St. Joe, Florida 32456-0549.

11 **Q.    BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

12 A.    I am employed by St. Joe Natural Gas Company ("SJNG" or "Company") as the  
13        Office Manager. In this capacity, I am responsible for all internal accounting and  
14        bookkeeping activities for the Company's regulated and non-regulated  
15        businesses, as well as the general supervision of customer service, billing, and  
16        other office administrative functions for the regulated utility.

17 **Q.    PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

18 A.    I received an Associates of Arts Degree in Accounting from Gulf Coast  
19        Community College in 1984.

20 **Q.    PLEASE DESCRIBE YOUR WORK EXPERIENCE.**

21 A.    I have been employed by SJNG for twenty-one years in the accounting  
22        department.

23 **Q.    WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

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1 A. My testimony will provide support for the Company's requested rate relief by  
2 addressing the Company's historical rate base, historical income, projected  
3 income and capital structure.

4 **Q. ARE THERE ANY EXHIBITS TO YOUR TESTIMONY?**

5 A. Yes. Exhibit No. DKS-1 is a list of MFR schedules I am sponsoring. The MFR  
6 Schedules and other exhibits were prepared under my direction, supervision  
7 and control.

8 **Historic Data**

9 **Q. HOW DID YOU DERIVE THE HISTORIC DATA PRESENTED IN THE MFR'S?**

10 A. All data related to the historic base year (2006) are taken from the books and  
11 records of the Company, located in Port St. Joe, Florida. The Company  
12 maintains its accounting records in accordance with the recognized accounting  
13 practices and provisions of the Uniform System of Accounts as prescribed by  
14 the Florida Public Service Commission (the "Commission").

15 **Rate Base**

16 **Q. PLEASE DESCRIBE HOW THE COMPANY'S HISTORIC YEAR RATE BASE**  
17 **WAS CALCULATED FOR PURPOSES OF THIS RATE FILING.**

18 A. For the historic base year, a 13-month average rate base was calculated for the  
19 period ended December 31, 2006. The historic base year corresponds to the  
20 Company's fiscal year. The Company was able to utilize year-end accounting  
21 data, without partial period adjustments, in completing the historic base year  
22 MFR requirements. MFR Schedule B-2 shows the calculation of the Company's  
23 historic base year rate base. Net plant is defined as the sum of (1) plant in

1 service, less common plant allocated; (2) acquisition adjustments; and (3)  
2 construction work in progress ("CWIP"), less accumulated depreciation, and  
3 amortization. Net plant during the historic year was \$3,062,286. An allowance  
4 for working capital, after adjustments, in the amount of \$14,894 was then added  
5 to net plant to calculate the total rate base. As shown on MFR Schedule B-2,  
6 the total 13 month average rate base for the Company, after adjustments, was  
7 \$3,077,180.

8 **Q. HAS THE COMPANY IDENTIFIED AND EXCLUDED FROM RATE BASE**  
9 **THOSE PORTIONS OF ITS COMMON PLANT THAT ARE PROPERLY**  
10 **ALLOCATED TO NON-UTILITY OPERATIONS?**

11 A. Yes. In preparation for this rate proceeding, the Company conducted a  
12 comprehensive review of non-utility cost allocations, including those related to  
13 plant assets. Adjustments were made to common plant and accumulated  
14 depreciation in rate base and depreciation expense. These adjustments are  
15 reflected on pages 15 through 22 of MFR Schedule G-1 for the historic base  
16 year +1, and for the projected test year. Common Plant allocations for all  
17 periods were based on the ratio of regulated net utility plant investment to non-  
18 regulated net plant investment in the historic base year. During the historic  
19 base year utility net plant was recorded at \$3,150,838 and non-utility net plant  
20 was \$333,341, which results in a 9.6% ratio.

21 **Q. HAS THE COMPANY EXCLUDED COMPONENTS OF WORKING CAPITAL**  
22 **APPLICABLE TO NON-UTILITY OPERATIONS FROM THE WORKING**  
23 **CAPITAL ALLOWANCE?**

1 A. Yes. Any specific assets and liabilities related to non-utility operations remaining  
2 on SJNG's books were removed from working capital by adjustment. In addition,  
3 provision has been made to exclude from working capital the appropriate portion  
4 of common current assets and liabilities apportionable to non-utility activities. The  
5 basis for the allocation was the ratio of utility plant to non-utility plant discussed  
6 above.

7 **Q. PLEASE EXPLAIN ANY ADJUSTMENTS TO THE HISTORIC YEAR RATE**  
8 **BASE.**

9 A. Adjustments to the historic year rate base as indicated in MFR Schedule G-1,  
10 include: assets were reduced by non-utility merchandise and jobbing \$267,983;  
11 plant and operating material \$24,129; and appliance inventory \$442,210;  
12 prepayments \$6,144; accounts payable for appliances \$264,723. Non-utility  
13 taxes accrued and payable was decreased by \$3,089. Capital structure was  
14 reduced by a note payable of \$150,000; customer deposits of \$46,719;  
15 accumulated deferred income taxes of \$23,311; deferred credit amounts of  
16 \$1,275,004 for Florida Coast Paper Company (FCPC) and Gulf Correctional  
17 Institute. Other adjustments include miscellaneous current liabilities \$30,856  
18 reduction.

19 **Q. WHAT ARE THE APPROPRIATE DEPRECIATION RATES FOR THE**  
20 **HISTORIC BASE YEAR AND THE PROJECTED TEST YEAR?**

21 A. The depreciation rates used by the Company for the historic base year reflect  
22 the rates approved by the Commission in Order PSC-03-1108-PAA-GU, issued  
23 October 6, 2003. Commission Rule 25-7.045, (8) (a) F.A.C., requires that all



1 gas utilities file a depreciation study at least once every five (5) years from the  
2 submission date of the previous filing. The Company's submission date for its  
3 2003 depreciation Study was January 22, 2003. Part (8) (c) of the above Rule  
4 provides that,

5 "A utility posing an effective date coinciding with the expected date of  
6 additional revenues initiated through a rate case proceeding shall submit  
7 its depreciation study no later than the filing date of its Minimum Filing  
8 Requirements."

9 The Company has prepared a Depreciation Study to update the depreciation  
10 rates authorized by the Commission in 2003. In accordance with the Rule 25-  
11 7.045 (8) (c), the Company is submitting its 2008 Depreciation Study, filed  
12 under a separate petition, concurrent with the filing of the Minimum Filing  
13 Requirements in this proceeding. In its 2008 Depreciation Study, the Company  
14 estimated its capital additions and retirements for the month of December 2007.  
15 The Company's projected test year utilizes depreciation rates from the  
16 proposed 2008 Depreciation Study, as filed.

17 **Q WHAT IS THE EFFECT OF THE COMPANY'S 2007 AND 2008 CAPITAL**  
18 **INVESTMENT PROGRAM ON RATE BASE IN THE PROJECTED TEST**  
19 **YEAR?**

20 A. Capital spending for 2007 (actual through November and projected for  
21 December) is detailed on Schedule G-1, and totals \$148,676 for the historic  
22 base year +1 (page 23) and \$700,263 (page 26) in the projected test year. The  
23 capital expenditures for the projected test year have been scheduled by month

1 in accordance with the Company's expectations as to the timing of the actual  
2 outlays. Average Rate Base is calculated reflecting the timing of the  
3 expenditures and their impact on CWIP and plant balances.

4 **Q. WHAT IS THE APPROPRIATE PROJECTED TEST YEAR UTILITY PLANT IN**  
5 **SERVICE FOR SJNG?**

6 A. The appropriate Utility Plant in Service is \$6,437,506, reflecting the adjustments  
7 described above, MFR Schedule G-1, page 1.

8 **Q. PLEASE EXPLAIN ANY ADJUSTMENTS TO THE PROJECTED TEST YEAR**  
9 **RATE BASE.**

10 A. Net Plant was reduced by \$38,651 to reflect common plant adjustments.  
11 Working Capital was reduced by \$112,681 to eliminate non-utility assets and  
12 liabilities. Total adjustments to Rate Base in the Projected Test Year are  
13 \$1,013,886, from MFR Schedule G-1, page 4.

14 **Q. WHAT IS THE APPROPRIATE WORKING CAPITAL ALLOWANCE FOR THE**  
15 **PROJECTED TEST YEAR?**

16 A. The appropriate Working Capital Allowance, calculated using the Balance Sheet  
17 Method, is (\$112,681) per Schedule G1, page 3, which reflects the adjustments  
18 described above.

19 **Q. WHAT IS THE APPROPRIATE ADJUSTED RATE BASE FOR THE**  
20 **PROJECTED TEST YEAR?**

21 A. The appropriate Adjusted Rate Base for the projected test year is \$3,069,046.  
22 MFR Schedule G-1, page 1 presents the components of the SJNG Rate Base.

23

1 **Net Operating Income (Historical)**

2 **Q. HOW DID YOU DERIVE THE DATA USED TO DETERMINE THE**  
3 **COMPANY'S INCOME FOR THE HISTORIC BASE YEAR ENDED**  
4 **DECEMBER 31, 2006?**

5 A. All data related to the Company's historical income was obtained from the  
6 Company's books and records. These books and records are kept in  
7 accordance with recognized accounting practices and the Uniform System of  
8 Accounts as prescribed by the Commission.

9 **Q. WHAT WERE THE COMPANY'S OPERATING REVENUES FOR THE**  
10 **HISTORIC BASE YEAR?**

11 A. The Company's 2006 operating revenues were \$2,064,578. This information  
12 appears on Schedule C-1 of the MFRs.

13 **Q. WHAT WERE THE COMPANY'S OPERATING EXPENSES FOR THE**  
14 **HISTORIC BASE YEAR?**

15 A. The Company's 2006 operating expenses were \$1,958,032. This information  
16 appears on Schedule C-1 of the MFRs.

17 **Q. HOW WAS THE COMPANY'S INCOME TAX EXPENSE CALCULATED?**

18 A. For MFR purposes, taxes on adjustments and projections were calculated as  
19 follows: Florida state income tax was calculated on taxable income using a rate  
20 of 5.5%. Federal income tax was calculated on taxable income at the  
21 incremental rate of 34%. Income taxes on historical base year and base year  
22 minus one were calculated using the federal corporate tax table, and the state  
23 tax rate of 5.5%.

1 **Q. PLEASE DESCRIBE HOW THE COMPANY ALLOCATED COSTS TO ITS**  
2 **UNREGULATED ACTIVITIES DURING THE HISTORIC BASE YEAR?**

3 A. Stephen Shoaf's testimony provides details on the company's non-utility  
4 expense allocation process. All non-utility labor activity performed by the  
5 Company employees is recorded on each employee's daily time sheet in  
6 account number 416 and non-utility material is inventoried in accounts 155 and  
7 156. The Company uses Work Orders for all work performed and non-utility  
8 work is booked in appropriate non-utility accounts.

9 **Q. PLEASE EXPLAIN ANY ADJUSTMENTS TO THE COMPANY'S**  
10 **HISTORICAL OPERATING REVENUES AS IDENTIFIED ON MFR**  
11 **SCHEDULE C-2.**

12 A. The Company's revenues were reduced by the following: (1) \$104,463 for non-  
13 regulated revenue that is below the line income, (2) \$751,362 for purchased  
14 gas adjustment revenue, (3) \$1,872 for franchise fees paid to the City of Mexico  
15 Beach, Florida. (4) \$ 9,768 for regulatory assessment fees. The Company will  
16 not receive revenues from FCPC in the future, and they have been eliminated  
17 from the Projected Test Year forecast - \$50,922, as directed in the Company's  
18 2001 rate order.

19 **Q. PLEASE EXPLAIN ANY ADJUSTMENTS IN THE COMPANY'S HISTORICAL**  
20 **OPERATING EXPENSES AS IDENTIFIED ON MFR SCHEDULE C-2.**

21 A. The Company's operating expenses were decreased by the following  
22 adjustments: (1)\$100 for donations; (2) \$121 for penalties; (3) \$763,864 for fuel  
23 costs; (4) \$1,369 for interest expense; and (5) \$1,872 for franchise fees paid to

1 the City of Mexico Beach Florida, which were also removed from the  
2 Company's historical operating revenues and (6) \$315 for Florida Natural Gas  
3 Association (7) \$4,108 for non-utility depreciation. In addition, the Company's  
4 operating expenses were decreased by \$50,922 for deferred revenues billed,  
5 but not collected due to the FCPC bankruptcy. As I have previously stated, this  
6 amount was also removed from the Company's historical operating revenues.

7 **Q. HOW HAS THE COMPANY RECORDED HOUSE PIPING EXPENSE?**

8 A. In accordance with Order No. PSC-96-1188-FOF-GU, issued September 23,  
9 1996, the Company has recorded house-piping expense above the line for  
10 recovery in base rates (Account 879) Such expenses in the historic base year  
11 totaled \$28,295, from MFR Schedule C-5.

12

13 **Net Operating Income (Projected)**

14 **Q. WHAT IS THE APPROPRIATE AMOUNT OF OPERATING REVENUE AT  
15 PRESENT RATES FOR THE PROJECTED TEST YEAR?**

16 A. Operating revenues for the Projected Test Year are \$1,598,810, reflecting the  
17 Company's forecast of customers and volumes and the application of the  
18 proposed rates as sponsored by Mr. Householder in his prefiled direct  
19 testimony and MFR Schedule E-2.

20 **Q. WHAT IS THE APPROPRIATE AMOUNT OF OPERATING EXPENSE AT  
21 PRESENT RATES FOR THE PROJECTED TEST YEAR?**

22 A. The Company's projected expenses for the 12 months ending December 31,  
23 2001 are \$913,680, as reflected in MFR Schedule E-6.

1 **Q. WHAT ADJUSTMENTS WERE MADE TO PROPERLY REFLECT**  
2 **OPERATING REVENUES FOR THE PROJECTED TEST YEAR?**

3 A. No adjustments were made to operating revenues for the projected test year.

4 **Q. WHAT IS THE APPROPRIATE O&M EXPENSE BENCHMARK COMPOUND**  
5 **MULTIPLIER FOR SJNG?**

6 A. The appropriate compound multiplier is 1.1659, reflecting the net increase (which  
7 in the Company's case is a decrease) in the average number of customers and  
8 the increase in the average Consumer Price Index ("CPI") from 1996 to the  
9 current case historic base year (2006). The calculation of this benchmark  
10 variance factor is presented on Schedule C-37.

11 **Q. PLEASE EXPLAIN THE SOURCE OF DATA FOR THE O & M COMPOUND**  
12 **MULTIPLIER CALCULATION ON MFR SCHEDULE C-37.**

13 A. Company records were used to determine the number of customers at year-  
14 end. The Consumer Price Index (CPI) annual average data was obtained from  
15 the Commission staff.

16 **Q. PLEASE EXPLAIN THE TRENDING FACTORS ON MFR SCHEDULE G-2,**  
17 **PAGE 10, AND DESCRIBE ANY ADJUSTMENTS YOU MADE FOR KNOWN**  
18 **CHANGES.**

19 A. The trending was done in two parts. All O&M expenses were divided between  
20 labor and other expenses. An appropriate factor was calculated or otherwise  
21 determined for each group of expenses. This factor was then compounded for a  
22 two-year period (2007 and 2008) and applied to the 2006 expenses in each  
23 functional area to derive the Projected Test Year amounts.

1 Annual increases of 2.5% and 3% were used to trend labor expenses in  
2 2007 and 2008, respectively. Non-labor expenses were trended using either: 1)  
3 the projected annual CPI increase of 3.475% for 2007 and 2.3% for 2008 or, 2)  
4 a compounded customer growth at zero times the inflation rate of 2.3%. CPI  
5 annual increase projections for 2007 were based on U.S. Bureau of Labor  
6 Statistics actual CPI through November 2007 plus estimated December 2007  
7 equal to the actual November index. The CPI projections for 2008 were based  
8 on Blue Chip Financial Forecast data.

9 **Q. COULD YOU DESCRIBE THE MAJOR EXPENSES THAT WERE**  
10 **DETERMINED BY SOME METHOD OTHER THAN TRENDING 2002**  
11 **EXPENSES?**

12 A. O&M expenses that were developed by specific examination of the expected  
13 costs in 2004 rather than by trending 2002 expenses are discussed in detail in  
14 Stuart Shoaf's testimony.

15 **Q. WHAT IS THE APPROPRIATE AMOUNT OF RATE CASE EXPENSE AND**  
16 **THE APPROPRIATE AMORTIZATION PERIOD?**

17 A. The Company's calculation of rate case expense for the current case is  
18 included on Schedule C-13. The total projected costs amount to \$78,000. It  
19 should be noted, however, that this projection will change in the event a hearing  
20 is required to resolve this case. We propose that the amount projected for this  
21 case is amortized over a four-year period. The total amount projected for rate  
22 case amortization expense in the projected test year is \$19,500.

1 Q. HAS SJNG PROPERLY IDENTIFIED AND EXCLUDED FROM O&M THOSE  
2 PORTIONS OF ITS EXPENSES THAT ARE APPLICABLE TO ITS NON-  
3 UTILITY OPERATIONS?

4 A. Yes.

5 Q. WHAT IS THE APPROPRIATE AMOUNT OF PROJECTED TEST YEAR O&M  
6 EXPENSE?

7 A. The appropriate amount of O&M for the Projected Test year is \$913,680, which  
8 is included in Operating Expenses used to calculate Net Operating Income on  
9 Schedule G-2, page 1.

10 Q. WHAT IS THE APPROPRIATE AMOUNT OF DEPRECIATION EXPENSE TO  
11 BE INCLUDED IN THE PROJECTED TEST YEAR?

12 A. The appropriate amount of depreciation expense is \$260,105, after eliminating  
13 non-utility common plant, which is included on Schedule G-2, page 25.

14 Q. WHAT IS THE APPROPRIATE AMOUNT OF TAXES OTHER THAN INCOME  
15 TAXES TO BE INCLUDED IN THE PROJECTED TEST YEAR?

16 A. The appropriate amount of taxes other than income taxes is \$63,386, which is  
17 included in Operating Expenses on Schedule G-2, page 1.

18 Q. WHAT IS THE APPROPRIATE AMOUNT OF NOI FOR THE PROJECTED  
19 TEST YEAR?

20 A. The appropriate amount of NOI for the projected test year, as adjusted for the  
21 items described above, is (\$200,835) as identified on MFR Schedule G-2, page  
22 1.

23



**Capital Structure**

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**Q. HAVE YOU PREPARED A SCHEDULE SHOWING THE COMPANY'S CAPITAL STRUCTURE FOR THE PROJECTED TEST YEAR?**

A. Yes. This information appears on MFR Schedule G-3, Page 2.

**Q. HAVE YOU PREPARED THE COMPANY'S CAPITAL STRUCTURE FOR RATEMAKING PURPOSES CONSISTENT WITH THE MANNER IN WHICH IT WAS APPROVED IN THE LAST RATE CASE?**

A. Yes.

**Q. WHAT DEBT TO EQUITY RATIO IS PROPOSED FOR THE PROJECTED TEST YEAR?**

A. The Company proposes to employ a debt to equity ratio of 52.8% debt and 47.2% equity in the projected test year. The calculation of capital structure reflects sources of capital as follows: Equity, 47.2%; Long Term Debt, 8.74%; Customer Deposits, 1.42% and Short Term Debt, 0%, Deferred Credits (Florida Coast) 39.76%, Deferred Taxes 2.88%.

**Q. HOW IS THE TOTAL AMOUNT OF EQUITY IN THE PROJECTED TEST YEAR DETERMINED?**

A. The amount of equity is based on the projected weighted average balance of common equity for the Projected Test Year, including the equity adjustments described above. It is my belief that the SJNG proposed debt/equity ratio is appropriate and reflective of the approximate actual capital structure that will exist during the period rates are in effect.

1 **Q. PLEASE DESCRIBE THE COMPANY'S FORECAST DEBT POSITION IN THE**  
2 **PROJECTED TEST YEAR.**

3 A. In December 2007 the Company paid back a \$150,000 loan originally obtained  
4 from one of its principle shareholders in 1995. The cost rate on this loan was 8%.  
5 The Company borrowed \$150,000 against its existing \$400,000 line of credit, at a  
6 7.75% cost rate, from the Bayside Savings Bank in Port St. Joe to repay the  
7 shareholder loan. The Company's 2008 capital budget anticipates expenditures of  
8 approximately \$700,000 to support the projects described in Andy Shoaf's  
9 testimony. The Company is forecasting that \$600,000 of the capital budget  
10 requirements and some operating requirments will be funded from debt. The  
11 Company's total debt for the projected test year is forecast at \$750,000; a  
12 combination of the \$150,000 loan described above and the additional \$600,000  
13 required for the 2008 capital program and operating expenses. All Company debt  
14 in the projected test year is anticipated to be long-term.

15 **Q. WHAT IS THE APPROPRIATE LEVEL OF CUSTOMER DEPOSITS TO BE**  
16 **USED IN THE DETERMINATION OF THE SGS CAPITAL STRUCTURE FOR**  
17 **THE PROJECTED TEXT YEAR?**

18 A. The appropriate level of Customer Deposits to be included in the determination  
19 of the SJNG capital structure is \$43,582, which is the average level of customer  
20 deposits for the Projected Test Year.

21 **Q. WHAT IS THE APPROPRIATE LEVEL OF DEFERRED INVESTMENT TAX**  
22 **CREDITS TO BE USED IN THE DETERMINATION OF the SGS CAPITAL**  
23 **STRUCTURE FOR THE PROJECTED TEST YEAR?**

- 1 A. The Company has no Deferred Investment Tax Credits.
- 2 **Q. WHAT IS THE APPROPRIATE LEVEL OF DEFERRED INCOME TAXES TO**  
3 **BE USED IN THE DETERMINATION OF THE SGS CAPITAL STRUCTURE**  
4 **FOR THE PROJECTED TEST YEAR?**
- 5 A. \$88,325.
- 6 **Q. DOES THE SJNG CAPITAL STRUCTURE FOR RATEMAKING PURPOSES**  
7 **FOR THE PROJECTED TEST YEAR PROPERLY EXCLUDE NON-UTILITY**  
8 **INVESTMENTS?**
- 9 A. Yes.
- 10 **Q. WHAT IS THE APPROPRIATE COST RATE FOR COMMON EQUITY?**
- 11 A. The appropriate cost rate for Common Equity is 11.5%, as addressed in Stuart  
12 Shoaf's testimony.
- 13 **Q. WHAT IS THE APPROPRIATE COST RATE FOR LONG-TERM DEBT?**
- 14 A. The appropriate cost rate for Long-Term Debt is 7.75%, based on the current  
15 cost rate for the Company's line of credit and discussions with a local financial  
16 institution.
- 17 **Q. WHAT IS THE APPROPRIATE COST RATE FOR SHORT-TERM DEBT?**
- 18 A. The Company anticipates no Short-Term Debt in the Projected Test Year.
- 19 **Q. WHAT IS THE APPROPRIATE COST RATE FOR CUSTOMER DEPOSITS?**
- 20 A. The appropriate cost rate for Customer Deposits is 6.0%.
- 21 **Q. WHAT IS THE APPROPRIATE COST RATE FOR INVESTMENT TAX**  
22 **CREDITS AND DEFERRED INCOME TAXES?**
- 23 A. As noted above, SJNG has no Deferred Investment Tax Credits.

1 **Q. WHAT IS THE APPROPRIATE WEIGHTED AVERAGE COST OF CAPITAL**  
2 **FOR SJNG FOR RATEMAKING PURPOSES FOR THE PROJECTED TEST**  
3 **YEAR?**

4 A. The appropriate weighted average overall cost of capital for the Company in the  
5 Projected Test Year is 6.14%.

6 **Q. WHAT IS THE APPROPRIATE REVENUE EXPANSION FACTOR FOR THE**  
7 **PROJECTED TEST YEAR?**

8 A. The appropriate revenue expansion factor is 1.6114, as calculated on Schedule  
9 G-4.

10 **Q. WHAT ARE THE REVENUE DEFICIENCY AND TOTAL OPERATING**  
11 **REVENUE REQUIREMENT FOR THE PROJECTED TEST YEAR?**

12 A. The revenue deficiency for SJNG in the Projected Test Year is \$624,166, as  
13 calculated on Schedule G-5 of the MFRs. This deficiency has been used as the  
14 basis for the proposed rates developed by Company witness Jeff Householder,  
15 as presented in his testimony. The requested increase is required by the  
16 Company in order to give it the opportunity to earn a fair rate of return based on  
17 conditions during the projected test year.

18 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

19 A. Yes.

**LIST OF MFR SCHEDULES SPONSORED BY DEBBIE STITT**

<u>Schedule</u>	<u>Title</u>
A-1 P. 1	Summary
A-2 P. 1	Summary
A-3 P. 1	Summary – Rate Base
A-4 P. 1	Summary – Net Operating Income
A-5 P. 1	Summary
A-6 P. 1	Summary
B-1 PP. 1-2	Rate Base – Historic Balance Sheet
B-2 P. 1	Rate Base
B-3 P. 1	Rate Base – Adjustments
B-4 P. 1	Rate Base – Plant Balances – Test Year
B-5 PP. 1-3	Rate Base – Allocation of Common Plant
B-6 P. 1	Rate Base – Acquisition Adjustment
B-7 PP. 1-2	Rate Base – Property Held for Future Use
B-8 P. 1	Rate Base – Construction Work In Progress
B-9 P. 1	Rate Base – Historic Depreciation Reserve Balances
B-10 P. 1	Rate Base – Amortization/Recovery Reserve Balances
B-11 P. 1	Rate Base – Depreciation/Amortization Reserve Common Plant

<u>Schedule</u>	<u>Title</u>
B-12 P. 1	Rate Base – Customer Advances for Deposit
B-13 PP. 1-2	Rate Base – Working Capital
B-14 P. 1	Rate Base – Miscellaneous Benefits
B-15 P. 1	Rate Base – Deferred Credits
B-16 P. 1	Rate Base – Additional Rate Base Components
B-17 PP. 1-4	Rate Base – Investment Tax Credits
C-1 P. 1	Operating Revenues
C-2 PP. 1-2	Net Income Adjustments
C-3 P. 1	Operating Revenues
C-4 P. 1	Unbilled Revenues
C-5 PP. 1-2	Operation and Maintenance Expenses
C-6 P. 1	Allocation of Expenses
C-7 P. 1	Conservation Revenues and Expenses
C-8 PP. 1-2	Uncollectible Accounts
C-9 PP. 1-2	Advertising Expense
C-10 P. 1	Civic and Charitable Contributions
C-11 P. 1	Industry Association Dues
C-12 P. 1	Lobbying and Other Political Expenses
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1                   **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2                                   **DIRECT TESTIMONY OF**

3   **JEFF HOUSEHOLDER**

4                   **ON BEHALF OF ST. JOE NATURAL GAS COMPANY, INC.**

5                                   **DOCKET NO. 070592-GU**

6   **December, 2007**

7

8   **Q.    PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.**

9   A.    My name is Jeff Householder. I am President of Jeff Householder and Company,  
10        Inc., an energy and regulatory affairs consulting firm. My business address is  
11        2333 West 33<sup>rd</sup> Street, Panama City, Florida, 32405.

12 **Q.    PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE AND**  
13 **EDUCATIONAL BACKGROUND.**

14 **A.**    Over the past seven years, I have provided energy consulting, regulatory affairs  
15        and business development services primarily to natural gas utilities, natural gas  
16        marketing companies, propane gas retailers, government agencies and  
17        industrial and commercial clients. I have participated in numerous regulatory  
18        filings before the Florida Public Service Commission, including several rate  
19        proceedings. Prior to beginning my consulting business in January 2000, I was  
20        Vice President of Marketing and Sales for TECO Peoples Gas from 1997 to  
21        2000. While with TECO, I was also responsible for the management of TECO  
22        Gas Services, an unregulated energy marketing company. I joined Peoples Gas  
23        subsequent to the 1997 TECO Energy acquisition of West Florida Natural Gas

1 Company. At West Florida Natural Gas, I served as Vice President of Regulatory  
2 Affairs and Gas Management from 1995 to the TECO merger. Before that, I was  
3 Vice President of Marketing and Sales at City Gas Company, a division of the  
4 NUI Corporation. Prior to joining City Gas, I was employed as Utility  
5 Administrative Officer for the City of Tallahassee, (an electric, gas, water and  
6 waste water utility). During my ten years with the City's utility operations, I also  
7 managed the Energy Services Department, a marketing and demand-side  
8 management unit. In each of the above listed utility positions, I had either direct  
9 responsibility for or substantive input into the rates and regulations under which  
10 the utility operated, including development of each utility's embedded cost  
11 studies and rate designs. From 1981 to 1984, I was a Section Manager with the  
12 Florida Department of Community Affairs, responsible for administering the  
13 Florida Energy Code and related construction industry regulatory standards. I  
14 also served, early in my career, as an Energy Analyst in the Governor's Energy  
15 Office in the state of Florida. From 1984 to 1995, concurrent with my other  
16 positions, I provided part-time consulting services to the natural gas, propane  
17 gas and homebuilding industries involving a variety of building code, marketing  
18 and energy regulatory matters. I received a Bachelor of Science Degree in 1978  
19 from Florida State University with an interdisciplinary major in Social Science  
20 (principally Economics and Business), and additional majors in Government and  
21 International Relations.

22 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**  
23 **PROCEEDING?**

1 A. I will describe the methodology used to forecast sales, customers and revenues  
2 for the Historic Base Year + 1 and the Projected Test Year. I will support the  
3 Company's request for interim and permanent rate relief along with the proposed  
4 permanent rate design. In support of my permanent rate design testimony, I  
5 have prepared a cost of service study by customer class for the Projected Test  
6 Year ended December 31, 2008. I will describe how the results of both the cost  
7 of service study and the competitive analysis were used in designing the  
8 Company's proposed rates.

9 **Q. ARE YOU SPONSORING ANY EXHIBITS TO YOUR TESTIMONY?**

10 A. Yes. Exhibit No. JMH-1 is a list of MFR schedules I am sponsoring. Exhibit No.  
11 JMH-2 is a comparison of present and proposed rates by rate classification. The  
12 referenced MFR Schedules and exhibits were prepared under my direction,  
13 supervision and control.

14

15 **Sales, Customer and Revenue Forecast**

16 **Q. HAS THE COMPANY PREPARED A FORECAST OF SALES, CUSTOMERS**  
17 **AND REVENUES FOR THE BASE YEAR + 1 AND PROJECTED TEST**  
18 **YEAR?**

19 A. Yes. I prepared, on the Company's behalf, a forecast of sales, customers and  
20 revenue by customer classification, for the Base Year +1 and the Projected Test  
21 Year. The results of this forecast are displayed on MFR Schedule G-2, pp. 6-9.  
22 The forecasts of revenues for both the Base Year + 1 and the Projected Test  
23 Year were computed using net customer and sales growth (loss) and the

1 Company's existing rates. As detailed on page 8 of MFR Schedule G-2, the  
2 Projected Test Year revenues at current rates including fuel and Other Revenue,  
3 totals \$2,132,307. Fuel revenues are \$1,050,619. Other Revenue, at current  
4 rates totals \$99,277. Projected Test Year revenues from sales net of fuel and  
5 Other Revenue at present rates is \$982,410, as is displayed on MFR Schedule  
6 E-2, page 2. The revenue requirement deficiency addressed in this case was  
7 established based on the above forecast results.

8 **Q. DOES THE COMPANY'S CUSTOMER, SALES AND REVENUE FORECAST**  
9 **ACCOUNT FOR PROPOSED REVISIONS TO ITS EXISTING CUSTOMER**  
10 **CLASSIFICATIONS?**

11 A. Yes. The forecasts of customers, sales and revenues presented in the MFRs  
12 filed in this rate proceeding are consistent with the Company's proposed  
13 customer classifications and rate schedules. The proposed classes are  
14 described in detail later in my testimony. The Company's historical customer,  
15 sales and revenue data was sorted based on the proposed customer  
16 classifications. This historical data formed a base-line for the Company's  
17 projections.

18 **Q. PLEASE DESCRIBE THE CUSTOMER AND SALES FORECASTING**  
19 **PROCESS USED IN THIS FILING.**

20 A. SJNG maintains close ties to the small communities it serves. Company  
21 representatives, through their social and civic activities, are well informed about  
22 opportunities to expand the distribution system or increase load, as well as  
23 potential customer or load loss situations. The Company President is an active

1 member of the Chamber of Commerce and regular attendee at County and city  
2 Commission meetings. Any proposed development project is known well in  
3 advance of construction. Through its active community involvement, the  
4 Company is continually assessing the opportunities and risks of the local market.  
5 I interviewed several Company employees, and participated in discussions of  
6 the 2008 capital budget, to obtain information on anticipated customer additions.

7 I also used several years of historical information on customer additions  
8 and therm usage to prepare the forecast for this case. A forecast of net  
9 customer additions (loss) has been prepared for each customer class based on  
10 historic annual average customers by rate class. The Company has experienced  
11 a net loss of customers, primarily in the residential service class, over the past  
12 several years. While the Company has continued to add new customers each  
13 year the loses, on average, have exceed the gains. At present, the Company  
14 serves two large volume transportation accounts; Arizona Chemical and the Gulf  
15 Correctional Institution. The Company is not forecasting additional transportation  
16 service customers during the Projected Test Year.

17 Therm usage was forecasted using three methods. For all customer  
18 classes I used Company historic billing system data to develop actual monthly  
19 sales volumes (therms). A three-year and five-year average usage by month  
20 was developed for all customer classes. For residential customer classes, I  
21 prepared a regression analysis with a ten-year normalized weather assumption.  
22 Weather effects for commercial customers were considered in the volume  
23 forecasts through the averaging of consumption over a five-year period. I



1 assessed the potential weather impacts, year over year, by examining Heating  
2 Degree Day (HDD) data over the past fifteen years. The HDD annual average in  
3 the five-year period 2003-2007 totaled 1154; the average during the period  
4 previous ten year period 1998-2007 totaled 1166, an insignificant difference. It is  
5 interesting to note that the annual average HDDs for the five year period (1996-  
6 2000) immediately prior to the Company's last rate case in 2001 (upon which  
7 therms were forecast) totaled 1,233, almost 80 HDD colder than the most recent  
8 five-year period. Given the marginal difference between the ten-year and  
9 previous five-year HDD average, I was comfortable that the five year average  
10 therm usage for commercial customers would appropriately project usage for  
11 2008. Finally, the Arizona Chemical forecast was based on actual 2007  
12 volumes. Given the dramatic reduction in Arizona's gas consumption over the  
13 past several years, as described in Stuart Shoaf's testimony, the historic usage  
14 data would appear to be of little use in predicting future load patterns.

15 **Q. HOW WERE THE NUMBER OF CUSTOMERS IN EACH CLASS FOR THE**  
16 **BASE YEAR + 1 AND THE PROJECTED TEST YEAR DEVELOPED?**

17 A. The first step in developing the customer growth forecast was a determination of  
18 the number of customers over an historic period. The Company has maintained  
19 records of customers by class and by month for several years. I used the  
20 Company's customer records for the years 2002 through 2007 to develop an  
21 average of active customers per month and the average total for each year. I  
22 compared the data year over year to assess customer gains and losses in both  
23 the residential and commercial classes.

1           The Company is proposing to stratify its current single residential service  
2 customer class into three individual classes; RS-1 (0 to >150 annual therms);  
3 RS-2 (150 to >300 therms); and RS-3 (300 therms and greater). In November  
4 2007, the Company's customer information system was able to produce historic  
5 usage data by customer/premise back to January 2006 (23 months of data). The  
6 Company prepared a report that sorted existing residential customers into the  
7 three proposed customer classes based on usage over the historic period.  
8 Based on this analysis, it was determined that approximately 38% of customers  
9 would be assigned to the RS-1 class, 33% to the RS-2 class and 29% to the RS-  
10 3 class. Given the general decline in residential customers over the past several  
11 years, I used the actual 2007 monthly residential customer totals through  
12 November (December 2007 was forecast at November 2007 levels) as a base,  
13 rather than an historic average. The 2007 customers were divided into the  
14 proposed rate classes based on the percentage distributions described above.  
15 The average number of residential customers in 2007 totaled 2840: 1,079 RS-1  
16 customers; 937 RS-2 customers; and 824 RS-3 customers.

17           To determine an appropriate lost customer factor, I evaluated the average  
18 change in residential customers over the historic period 2002-2007. The net  
19 change in customers year over year resulted in a five year average net customer  
20 reduction of 47 customers per year (the three-year average was a 59 net  
21 customer reduction per year). As described in Andy Shoaf's testimony, the  
22 Company, in June 2007, received Commission approval for enhanced  
23 residential energy conservation incentive allowances that appear to be

1 improving its ability to retain customers and add appliance load. Although it is  
2 too early to tell if the recent level of activity is sustainable, I reduced the average  
3 lost customers for 2008 from the five year average of 47 to 36. It was assumed  
4 that the customer loss would occur across each proposed class in the same  
5 percentage distribution used to create the classes.

6 Residential customer additions were forecast based on discussions with  
7 Company employees. The capital budget includes the addition of seventy (70)  
8 residential services in 2008. It is assumed that all seventy additions will become  
9 active during the year. These customer additions were added in the calendar  
10 quarter in which the service line is scheduled for installation in the capital  
11 budget. As described in greater detail later in my testimony, the Company is  
12 proposing to close the RS-1 and RS-2 classes to future customer additions. All  
13 of the new customers were forecast in the RS-3 class. A schedule was prepared  
14 that included the residential customer distribution by rate class, average lost  
15 customers and the new customer additions. The average number of customers  
16 forecast for 2008 totaled 2,820, a net reduction of twenty accounts from 2007.

17 **Q HOW WAS THE COMMERCIAL CUSTOMER FORECAST PREPARED?**

18 A. The commercial customer forecast was prepared in a similar manner to the  
19 residential forecast described above. However, since the Company is not  
20 proposing to modify its existing commercial customer classes, there was no  
21 need to adjust the actual historic data. It should be noted that the Company is  
22 proposing to re-label its commercial classes. Under its current tariff all residential  
23 customers are classified as "GS-1". As described above this class is proposed to

1 be divided into three "RS" classes. The current commercial classes are Begin  
2 with the "GS-2" designation, through GS-6. The Company has commercial  
3 transportation rate classes (TS) for each corresponding sales rate class (GS).  
4 Under the proposed tariff, the current rate classes would be re-labeled beginning  
5 with "GS-1" through "GS-5". The Company would continue to offer transportation  
6 service through rate classes that mirror its general sales rate classes. A detailed  
7 description of the proposed rate classes is presented later in this testimony.

8 I analyzed active commercial customers by month for the annual periods  
9 2002-2007 (December 2007 was based on actual November 2007). I prepared  
10 five-year and three-year average customer totals by month, as well as net  
11 annual customer gain or loss. I selected the five-year average customer total as  
12 the basis for forecasting the 2008 Projected Test Year for the proposed GS-1  
13 rate class (0 up to 2,000 therms per year) and the proposed GS-2 rate class  
14 (2,000 up to 25,000 therms per year). The Company serves no customers in its  
15 proposed GS-3, GS-4, GS-5 FTS-1, FTS-2 and FTS-3 rate classes. The five-  
16 year average customer total used to forecast the new GS-1 class was 215. The  
17 three year average was 213. Actual average GS-1 customers in 2007 totaled  
18 218 customers. The five-year average customer total used to forecast the GS-2  
19 class was 38.4. The three year average was 37.6. Actual average GS-2  
20 customers in 2007 totaled 36 customers. The current FTS-4 (GCI – one meter)  
21 and FTS-5 (Arizona Chemical – three meters) did not change.

22 The number of commercial customers has not significantly changed over  
23 the past few years. There is virtually no discernable, consistent seasonal

1 customer gain or loss pattern represented in the commercial customer data.  
2 Based on discussions with the Company representatives, and a review of CIS  
3 records, the commercial additions and losses over the past several years have  
4 been essentially equal. No commercial or large volume industrial customer  
5 additions are expected in the Projected Test Year. The Company does  
6 anticipate adding the Sacred Heart Hospital in the first quarter of 2009. The  
7 capital budget includes facility costs in 2008, but the service will not be activated  
8 during the Projected test Year.

9 **Q. HOW WAS THE RESIDENTIAL THERM SALES PROJECTION DEVELOPED?**

10 A. Historical monthly residential consumption data for the years 2002 – 2007 were  
11 obtained from Company records. December 2007 was forecast based on  
12 December 2006 volumes. The historic data was used to produce three-year and  
13 five-year consumption averages. The data was also used to evaluate seasonal  
14 differences in consumption and changes in consumption year over year. As  
15 noted above, a comparison of HDD in each year was prepared.

16 The twenty-three months of individual customer therm usage data, dating  
17 back to January 2006, available from the Company's billing system was used to  
18 apportion the total residential therms into the three proposed residential rate  
19 classes described above. I developed a ratio of therm usage for each proposed  
20 residential class to the total residential therm consumption based on the 23  
21 months of available data. Based on this analysis, it was determined that  
22 approximately 12% of total therms would be assigned to the RS-1 class, 32% to  
23 the RS-2 class and 56% to the RS-3 class. I then applied these ratios to the

1 actual total residential monthly therm consumption for the historic years 2002  
 2 through 2007 (forecasting December 2007). The result was an assignment of  
 3 historic monthly residential therms into the proposed customer classes. I used  
 4 the historic therms by proposed class to develop five-year and three-year  
 5 average monthly and annual consumption totals for each proposed class. I also  
 6 prepared a regression analysis to determine normalized consumption levels for  
 7 each residential class. The R<sup>2</sup> was 0.63. The regressions assumed normal  
 8 weather using monthly average HDD over the past ten-year period (1998-2007).

9 The three and five year average therms for each class were compared to  
 10 the weather normalized therms projected by the regression analysis. The results  
 11 are as follows:

<b>Residential Therms</b>				
		<u>3-Year Avg.</u>	<u>5-Year Avg.</u>	<u>10-Year Normalized</u>
14	RS-1	91,096	93,380	91,255
15	RS-2	242,923	227,000	243,348
16	RS-3	425,115	459,108	425,858

17  
 18 The ten-year normalized therm totals produced by the regression analysis were  
 19 selected for the Projected Test Year forecast for each residential rate class.

20 **Q. PLEASE DESCRIBE THE COMMERCIAL THERM SALES FORECAST.**

21 A. Similar to the residential forecast procedure described above, I first  
 22 obtained historical monthly commercial consumption data for the years 2002 –  
 23 2007 from Company records (December 2007 was forecast at December 2006

1 levels). I prepared five-year and three-year averages by month for commercial  
2 consumption using the above data. The five-year averages were used for  
3 proposed rate classes GS-1, GS-2 and FTS-4. As noted above the Company  
4 anticipates no customer gain or load increases in their commercial classes. The  
5 FTS-5 class (Arizona Chemical) was forecast at 4,980,000 therms, slightly lower  
6 than their 2007 actual usage (at the time of this filing it appeared that Arizona's  
7 2007 usage would total approximately 5,200,000 therms).

8 **Q. HOW DID THE COMPANY ESTIMATE REVENUES FOR THE BASE YEAR + 1**  
9 **AND THE PROJECTED TEST YEAR?**

10 A. The customer forecast described above provided the number of customers billed  
11 each month during the Base Year + 1 and the Projected Test Year for the  
12 proposed classes. Annual therm sales for these respective customer classes  
13 were estimated by multiplying the projected number of customers billed each  
14 month by the forecast usage per customer for the month, totaled for the year.  
15 Revenue projections displayed on MFR Schedule G-2 were prepared by  
16 applying the forecasts of customers and sales volumes described above for the  
17 respective periods using both the Company's current and proposed rate  
18 structures.

19  
20 **Interim Rate Increase**

21 **Q. ON WHAT HISTORICAL PERIOD IS THE SJNG REQUEST FOR AN INTERIM**  
22 **INCREASE BASED?**

23 A. The historical period is the 12-month period ended December 31, 2006.

1 **Q. WHAT IS THE AMOUNT OF THE INTERIM INCREASE SJNG IS**  
2 **REQUESTING IN THIS PROCEEDING?**

3 A. The Company requests that annual revenues be increased by \$274,981 on an  
4 interim basis. This amount represents a 26.35% increase in base rates.

5 **Q. HAS THE INTERIM REQUEST BEEN CALCULATED IN ACCORDANCE WITH**  
6 **THE COMMISSION'S REQUIREMENTS?**

7 A. Yes. In my opinion, the requested interim increase is consistent with Rule 25-  
8 7.040, Florida Administrative Code, and Section 366.071, Florida Statutes,  
9 regarding interim awards.

10 **Q. PLEASE DESCRIBE THE METHOD USED TO PROPOSE INTERIM RATE**  
11 **RELIEF.**

12 A. The Company followed the methodology provided in MFR Schedule F for  
13 calculating and allocating appropriate interim rates.

14 **Q. PLEASE DESCRIBE THE CALCULATION OF THE PROPOSED INTERIM**  
15 **RATE RELIEF?**

16 A. The Revenue Deficiency for the interim rate increase is calculated on MFR  
17 Schedule F-7. It was derived based on an Adjusted Rate Base of \$3,330,861  
18 and a Requested Rate of Return of 6.75%, yielding an NOI requirement of  
19 \$224,727. The Adjusted Rate Base is calculated on MFR Schedule F-1, and the  
20 Requested Rate of Return is calculated on MFR Schedule F-8. As required by  
21 Florida Statute 366.071 (5)(b)3, the Company used the bottom of the range  
22 (10.5%) of its most recent authorized return on equity (Order No. PSC-01-1274-  
23 PAA-GU) to determine the weighted cost of capital. The Company's Adjusted



1 NOI for 2006 is (\$54,084), which has been calculated on MFR Schedule F-4. An  
2 NOI Deficiency of \$170,643 was determined by subtracting the Company's  
3 Adjusted NOI from the NOI Requirement. The requested interim rate increase of  
4 \$274,981 equals the NOI Deficiency grossed up by the Revenue Expansion  
5 Factor (1.6114) calculated on MFR Schedule F-6.

6 **Q. HAS THE COMPANY APPROPRIATELY REFLECTED ALL ADJUSTMENTS**  
7 **REQUIRED BY THE COMMISSION IN ITS LAST RATE CASE?**

8 A. Yes.

9 **Q. HOW WAS THE INTERIM RATE INCREASE ALLOCATED AMONG**  
10 **CUSTOMER CLASSES?**

11 A. The revenue deficiency calculated on MFR Schedule F-7 was allocated on an  
12 equal percentage basis (26.35%) to each of the Company's existing customer  
13 classifications. The transportation charge for each respective class has been  
14 adjusted to achieve the proposed interim increase. Exhibit No. JMH-2, which is a  
15 summary of MFR Schedule F-10, presents the allocation of the Company's  
16 requested interim rate relief.

17

18 **Cost of Service and Rate Design**

19 **Q. PLEASE DESCRIBE THE PROCESS USED TO DESIGN THE PROPOSED**  
20 **PERMANENT RATES.**

21 A. I performed a fully embedded cost-of-service study to determine the appropriate  
22 assignment of expense and investment costs to each of the Company's classes  
23 of service. The cost study utilized information from all areas of the Company's

1 operations, including customer billing and consumption records, engineering  
2 studies, forecasts of growth, and cost data from the accounting records. The  
3 total cost of service was assigned or allocated to determine the revenue  
4 requirements of each class of customers. The results of my analysis provided  
5 the principal basis for the Company's proposed rate design, which is detailed on  
6 MFR schedule H-1, and is summarized on Exhibit No. JMH-2.

7 **Q. WAS A PARTICULAR METHODOLOGY OR MODEL USED TO PREPARE**  
8 **THE COST OF SERVICE STUDY?**

9 A. Yes. The standard methodology traditionally used by Commission Staff formed  
10 the principal basis of the cost of service study. The Company's study also  
11 follows the presentation format contained in the H Schedules of the prescribed  
12 MFR forms.

13 **Q. YOU NOTED ABOVE THAT THE COST STUDY PROVIDES "THE PRINCIPAL**  
14 **BASIS" FOR DESIGNING RATES. WERE OTHER FACTORS USED TO**  
15 **ESTABLISH THE PROPOSED RATES?**

16 A. Yes. As described in more detail later in the testimony, specific adjustments  
17 were made to the initial cost allocations produced by the Commission Staff's  
18 model. I adjusted the final rates in several of the classifications to address  
19 alternate fuel competition and other market issues. Each of the market-based  
20 rate adjustments was accomplished through a reallocation of cost in the Direct  
21 and Special Cost section of the Commission Staff's cost model, MFR Schedule  
22 H-2.

1 **Q. PLEASE DESCRIBE THE OBJECTIVES IN PERFORMING A COST OF**  
2 **SERVICE STUDY.**

3 A. There are two primary objectives in cost of service analysis. The first objective is  
4 to establish a relationship between the Company's costs to provide service and  
5 the cause of such costs. Plant investment and operating cost information  
6 associated with major operational functions (production, distribution, customer  
7 service, etc.) are classified based on utilization factors (demand, commodity,  
8 number of customers, revenue, etc.) that "cause the cost", and then allocated to  
9 the Company's customer classes to determine the cost to provide service to  
10 each class. The second objective is the determination of the rate of return for  
11 each of the Company's customer classifications based on present rates. Such  
12 information will provide guidance in equitably allocating the Company's existing  
13 costs and proposed revenue increase. The determination of cost causality  
14 developed in the cost study is the fundamental starting point in designing rates  
15 by class that recover the Company's cost to serve.

16 **Q. YOU INDICATED THAT COSTS WERE ALLOCATED BY SERVICE CLASS.**  
17 **PLEASE DESCRIBE HOW CLASSES OF SERVICE ARE ESTABLISHED.**

18 A. Customers of a utility are usually grouped into relatively homogeneous classes  
19 according to their service characteristics. Consumption levels, pressure  
20 requirements, load factors, conditions under which service is provided  
21 (curtailment status, for example), and end-use application of the fuel can be  
22 considered when establishing service classes. Traditionally, LDC's have  
23 established classes based on customer type (residential, commercial, industrial)

1 and/or annual volumetric therm consumption ranges. Other class distinctions,  
2 firm vs. interruptible and sales vs. transportation, for example, are also common.

3 Typically, the utility can identify a different level of cost to provide service  
4 to each discrete service class. Distinctions between classes established by  
5 customer type or volume have generally been based on the discernable cost  
6 differences from one class to another or the presence of market conditions that  
7 dictate the classification. Several cost breakpoints can be identified which can  
8 generally be linked to annual volumetric requirements. Meter and regulator type  
9 and size, service line size, and on-going maintenance costs are among the cost  
10 items that distinguish one service class from another. Another important factor  
11 that may be considered in classifying customers is the impact of a customer or  
12 class of customers on the Company's local distribution capacity. The facility  
13 related costs to serve are a function of peak hour load requirements not annual  
14 transportation volumes. System demand considerations are critical in assessing  
15 the overall cost of providing service to the respective service classes. However,  
16 most LDC's have elected to group customers by annual volume rather than a  
17 peak hour or other demand requirement.

18 **Q. PLEASE DESCRIBE THE SERVICE CLASSIFICATIONS IN THE COMPANY'S**  
19 **CURRENT TARIFF.**

20 **A.** The Company offers general sales service and transportation service rate  
21 classes. All residential customers and non-residential customers opting for a  
22 general service rate class, purchase gas commodity and interstate pipeline  
23 transportation service directly from the Company. Customers electing

1 transportation service arrange for gas supply services from a third party supplier  
2 (gas marketer). The company's current rate classes are as follows:

3	<u>Rate Class</u>	<u>Applicability</u>
4	General Service – 1 (GS-1)	(Residential: all volumes)
5	General Service – 2 (GS-2)	(Non-residential: 0 - 2,000 therms)
6	General Service – 3 (GS-3)	(Non-residential: 2,000 – 25,000 therms)
7	General Service – 4 (GS-4)	(Non-residential: 25,000 – 150,000 therms)
8	General Service – 5 (GS-5)	(Non-residential: 150,000–500,000 therms)
9	General Service – 6 (GS-6)	(Non-residential: >500,000 annual)
10	Transportation Service – 2 (TS-2)	(Non-residential: 0 - 2,000 therms)
11	Transportation Service – 3 (TS-3)	(Non-residential: 2,000 – 25,000 therms)
12	Transportation Service – 4 (TS-4)	(Non-residential: 25,000 – 150,000 therms)
13	Transportation Service – 5 (TS-5)	(Non-residential: 150,000 – 500,000 therms)
14	Transportation Service – 6 (TS-6)	(Non-residential: >500,000 therms)

15

16 The Company's current rate class TS-6 (original Sheet No. 5.12) and Standard  
17 Forms (Original Sheet No. 71.17) provides for a Contract Transportation Service  
18 rate adjustment to reflect a customer's competitive pricing options.

19 **Q. IS THE COMPANY PROPOSING CHANGES TO ITS EXISTING SERVICE**  
20 **CLASSIFICATIONS?**

21 A. Yes. The Company is proposing to divide its existing residential service class  
22 into three separate classes; RS-1, RS-2 and RS-3, as described earlier in my  
23 testimony. Additionally, the Company is proposing to re-name its existing non-

1 residential rate classes. The Company is proposing to delete its Interruptible  
 2 Sales Service (Original Sheet No. 71.10) and Contract Interruptible Sales  
 3 Service Agreement (Original Sheet No. 71.17). These agreements should have  
 4 been deleted during the 2001 rate case proceeding in conjunction with the  
 5 elimination of interruptible rate schedules.

6 **Q. PLEASE PROVIDE A COMPLETE LIST OF THE RATE CLASSIFICATIONS AND**  
 7 **RATE RIDERS THE COMPANY PROPOSES TO ADOPT AND/OR RETAIN AND**  
 8 **THE ANNUAL THERM VOLUMETRIC RANGES FOR EACH CLASS, IF**  
 9 **APPLICABLE.**

10 A. The proposed rate classifications are as follows:

<u>Rate Class</u>	<u>Therms Per Year</u>
• Residential Service – 1 (RS-1) closed*	0 - <150
• Residential Service – 2 (RS-2) closed*	150 - <300
• Residential Service – 3 (RS-3)	>300**
• General Sales Service – 1 (GS-1)	0 - <2,000
• Firm Transportation Service – 1 (FTS-1)	0 - <2,000
• General Sales Service – 2 (GS-2)	2,000 - <25,000
• Firm Transportation Service – 2 (FTS-2)	2,000 - <25,000
• General Sales Service – 3 (GS-3)	25,000 - <150,000
• Firm Transportation Service – 3 (GS-3)	25,000 - <150,000
• General Sales Service – 4 (GS-4)	150,000 - <1,000,000
• Firm Transportation Service – 4 (FTS-4)	150,000 - <1,000,000
• General Sales Service – 5 (GS-5)	>1,000,000

1           • Firm Transportation Service – 5 (FTS-5)                   >1,000,000

2           • Contract Firm Transportation Service Rider               >100,000

3           • Area Extension Program Rider

4           \* Closed to new entrants subsequent to the date of the rate order in this  
5 proceeding.

6           \*\* Open for all new residential customers subsequent to the date of the rate  
7 order.

8   **Q. PLEASE DESCRIBE THE COMPANY'S PROPOSAL TO CLOSE THE**  
9   **PROPOSED RS-1 AND RS-2 CLASSES TO NEW CUSTOMERS.**

10 A. The Company is proposing to close the RS-1 and RS-2 residential service rate  
11 classes to new customers following the effective date of the rate order issued in  
12 this proceeding. All new residential customers activating service after the above  
13 effective date would receive service in proposed rate class RS-3. The  
14 Company's proposal is virtually identical to the Chesapeake Utilities Corporation  
15 Florida Division tariff approved by the Commission in Order No. PSC-05-0315-  
16 CO-GU, issued on March 21, 2005. Customer premises assigned to the  
17 proposed RS-1 or RS-2 classes would be subject, as is normal practice, to  
18 reclassification as is provided in Section 5 of the proposed tariff Rules and  
19 Regulations, for any customer whose usage increases to the next higher rate  
20 class annual therm applicability level. The Company would also propose that in  
21 the event gas usage at a RS-2 rate class premise decreases that the customer  
22 would remain assigned to the RS-2 rate class. Customers assigned to rate class  
23 RS-3 would not be subject to reassignment to either of the closed classes.

1 The Company proposes that the application of the rate schedules be at the  
2 premise, not the customer, level. In the event an existing customer in rate  
3 schedule RS-1 or RS-2 terminated service, any new customer occupying that  
4 premise would be assigned to the rate class associated with that premise.

5 **Q. WHY IS THE COMPANY PROPOSING THE ABOVE DESCRIBED RATE**  
6 **CLASS CLOSURE?**

7 A. Historically, the rates of return applicable to small volume residential customers  
8 have been set at levels that do not recover the Company's cost to serve. The  
9 returns for these customers are typically subsidized by larger volume customers.  
10 The subsidization affects the Company's competitive position since rates for  
11 larger customers are higher to support the subsidy. Additionally, setting rates for  
12 small use residential customers at levels that do not recover the Company's cost  
13 to serve ultimately puts pressure on the Company's ability to grow its system to  
14 the benefit of all customers. Closing the RS-1 and RS-2 rate classes will take a  
15 step toward ensuring that all future residential customer additions provide an  
16 appropriate recovery of costs, without unduely impacting existing customers..

17 **Q. WHY IS THE COMPANY SEEKING GREATER VOLUME BASED**  
18 **STRATIFICATION IN ITS RATE CLASSES?**

19 A. The Company is proposing to restructure its existing Residential Service class to  
20 achieve greater stratification within the class. The Company proposes to  
21 restructure its residential rate class to group customers based on common  
22 usage characteristics, investment requirements to serve customers in a given  
23 group, and operational costs and market considerations. The Company has



1 reviewed the cost of providing service to residential consumers of varying sizes  
2 and usage characteristics. Several cost breakpoints were identified which could  
3 generally be linked to annual volumetric requirements. The proposed rate  
4 classes, as well as the rates to be applied, were also developed with  
5 consideration of the competitive factors that influence and affect the markets in  
6 which the Company conducts its business. Historically, many utility rate designs  
7 have resulted in larger-volume customer classes subsidizing the costs of smaller  
8 volume classes. It is typical to find a wide volumetric therm range within a  
9 company's single residential class, with the class exhibiting significant  
10 subsidization within the class. That is, the class does not homogeneously  
11 represent the customers it contains. Further stratifying the Company's existing  
12 residential customer class to collect customers into more homogeneous groups  
13 would be a significant step toward reducing subsidization.

14 To guide the development of the proposed rate classifications the  
15 Company reviewed the cost of providing service to consumers of varying sizes  
16 and usage characteristics. Several cost breakpoints were identified which could  
17 be reasonably linked to annual volumetric requirements. Meter and regulator  
18 type and size, service line size, and on-going maintenance costs are among the  
19 cost items that distinguish one service class from another. While many of the  
20 facility-related costs to serve are more a function of peak day load requirements  
21 than of annual consumption volumes, it is possible to establish annual  
22 volumetric classifications based on discernible cost differences. Rate class  
23 stratification is further warranted in order for the Company to effectively compete

1 with alternate fuels, primarily propane, fuel oil and electricity. As an example, the  
2 unregulated propane industry is free to customize rates for individual or small  
3 groups of consumers to meet competitive market conditions. The Company  
4 needs the ability to more closely match alternate fuel pricing practices. Greater  
5 volumetric stratification in the residential customer class would significantly  
6 improve the Company's ability to meet competitive pricing threats.

7 In theory, rates for all customer classes should be established at levels to  
8 achieve parity in the rate of return between classes. In practice, rates must be  
9 designed that enable the Company to compete for business. Achieving perfect  
10 return equity among classes is meaningless if it results in increased customer  
11 attrition or the inability to grow the Company. Reallocating the margin  
12 contribution from one customer class to another, and appropriately addressing  
13 both cost recovery and market pricing, is a major challenge of this case. Of  
14 course, the overall pressure on rates created by competitive and economic  
15 forces dictate that the Company continue its on-going efforts to implement  
16 efficient practices and contain costs. It must also look for opportunities to grow  
17 margins in an economically feasible manner as a means of recovering fixed  
18 operating costs and minimizing the need for future base rate increases.

19 **Q. DO THE COMPANY'S CURRENT RESIDENTIAL SERVICE CONSUMERS**  
20 **EXHIBIT CHARACTERISTICS THAT WOULD WARRANT ESTABLISHING**  
21 **MULTIPLE RESIDENTIAL CLASSES?**

22 A. Yes. Applying the same service cost and market considerations discussed  
23 above, the Company's existing residential service class can be divided into three

1 distinct groups, (i) consumers using less than 150 therms per year, (ii)  
2 consumers using between 150 and 300 therms per year, and (iii) consumers  
3 using over 300 therms per year. The small use consumers generally are not  
4 heating their homes with gas. These consumers typically have one or two gas  
5 appliances (water heater, range or dryer), or are seasonal (summer) residents.  
6 For system planning purposes the Company estimates gas water heater use at  
7 approximately 180 to 220 therms per year. A gas range or dyer would typically  
8 consume approximately 25 to 40 therms per year, each. The Projected Test  
9 Year forecast includes 1,061 residential consumers using less than 150 therms  
10 per year. In the Company's proposed rate design these consumers would be  
11 included in the RS-1 class.

12 The proposed RS-2 class (150 - 300 annual therms) in Projected Test  
13 Year forecast includes 921 residential consumers. Most consumers at this usage  
14 level have multiple gas appliances and may be using gas to heat their homes.  
15 The forecast also includes 838 residential consumers using over 300 therms per  
16 year who would be assigned to the RS-3 class (greater than 300 therms per  
17 year).

18 **Q. PLEASE EXPLAIN THE RATIONALE FOR STRATIFICATION IN THE**  
19 **RESIDENTIAL SERVICE RATE CLASSES.**

20 Historically, the rates of return for small volume consumer classes have  
21 been set well below the system average return. Other larger-volume classes  
22 subsidized the small consumers. Additionally, for companies with one all-  
23 inclusive residential class, it is not unusual to find the larger volume residential

1 consumers subsidizing the smaller volume residential consumers. There are two  
2 significant concerns raised by this situation. First, as noted above, increasing  
3 alternate fuel competition is making it more difficult to add and retain core  
4 commercial and industrial customers. That difficulty is compounded when rates  
5 for those commercial consumers are set to subsidize small consumer, especially  
6 residential classes. Second, setting rates for small, principally low use residential  
7 consumers at levels that do not produce an appropriate return affects the  
8 Company's ability to invest in facilities to add these consumers.

9 Gas distribution system expansions are generally dictated by the typical  
10 pattern of development in an area experiencing growth. Residential housing  
11 developments are constructed followed by commercial projects to provide  
12 services to the new residents. Gas utilities make feasibility assessments for  
13 facility extensions to serve the residential developments. If the residential  
14 projects are not feasible, the Company will not be able to extend its facilities,  
15 losing not only the residences, but most likely the commercial businesses as  
16 well. One of the most significant components in the Company's extension of  
17 facilities feasibility evaluations is the margin received from residential  
18 consumers. If the rates for such consumers are established at levels that do not  
19 recover costs and produce reasonable returns on investment, the Company may  
20 lose opportunities to grow its distribution system or exacerbate cross class  
21 subsidization. Investing in residential service for returns below the Company's  
22 cost of capital ultimately places additional pressure on highly competitive non-  
23 residential rates. Failure to grow the distribution system and spread the

1 Company's fixed costs over a larger consumer base would likely result in future  
2 rate increases for all ratepayers.

3 Stratifying the existing single residential service rate class would enable  
4 the Company to group the small use residential consumers into a class (RS-1)  
5 where rates can be designed to generate a marginally positive return and  
6 gradually move toward the system return over an extended period. Rates for  
7 larger volume residential consumers in the proposed RS-2 and RS-3 classes  
8 can be increased more expeditiously to levels approaching parity. I believe that  
9 there are both cost to serve and market environment reasons to split the existing  
10 residential class into two groups. Obviously, there are also substantial  
11 differences in the margin contributions of customers at various consumption  
12 levels within a given class. This situation results in clear rate inequities within  
13 the current class. Efforts to establish parity in the rates-of-return among  
14 customer classes is difficult to justify when there are major cost of service  
15 differences within a given class. Continuing the current volume ranges in the  
16 Company's customer classes would perpetuate the undue subsidization of  
17 certain customer groups. SJNG will not resolve all of the rate inequities within a  
18 given class with this rate filing, however, we propose to take an important first  
19 step.

20 **Q. DOES THE COMPANY'S CUSTOMER, SALES AND REVENUE FORECAST**  
21 **ACCOUNT FOR THE PROPOSED REVISIONS TO ITS EXISTING**  
22 **CUSTOMER CLASSIFICATIONS?**

1 A. Yes. The forecasts of customers, sales and revenues presented in the MFRs  
2 filed in this rate proceeding are consistent with the Company's proposed  
3 customer classifications and their respective rate schedules.

4 **Q. HAS THE COMPANY PROVIDED BILLING DETERMINANT INFORMATION**  
5 **THAT WILL ALLOW THE COMMISSION TO COMPARE THE EXISTING**  
6 **CLASSIFICATIONS TO THE PROPOSED CLASSIFICATIONS?**

7 A. Yes. MFR Schedules E-1 and E-5 have been prepared to enable the  
8 Commission to compare bills, terms and revenues under the existing classes to  
9 the proposed classes.

10 **Q. DOES THE COMPANY INTEND TO MAINTAIN CUSTOMER INFORMATION**  
11 **THAT WILL ENABLE IT TO CONTINUE TO PROVIDE DATA TO THE**  
12 **COMMISSION BY TRADITIONAL CUSTOMER TYPE?**

13 A. Yes. The Company's current Customer Information System is capable of  
14 maintaining account records by customer type. In addition, such information is  
15 necessary for the Company to apply the appropriate tax factors and certain  
16 billing adjustments that currently are based on the existing customer classes.

17 **Q. HOW IS A COST OF SERVICE STUDY PERFORMED?**

18 A. Traditional cost studies can be segmented into three individual activities:  
19 functionalization, classification and allocation.

20 Functionalization refers to the process of relating plant investments and  
21 associated operating expenses to four basic functional categories. The  
22 functional categories are production, storage, transmission and distribution.  
23 Plant investments and related operation, maintenance, depreciation and tax

1 expenses are assigned to the functional categories. The functional assignment  
2 of costs is a relatively straightforward process. The Company maintains its  
3 accounting records in accordance with the FERC Uniform System of Accounts.  
4 FERC accounting assigns plant facilities and investments to cost of service  
5 functions. Related expenses follow the same functionalization.

6 Classification refers to the process of dividing the functional costs into  
7 categories based on cost causation. Each local distribution system is designed  
8 and operated based on the individual and collective service requirements of its  
9 customers. The cost of providing such service is categorized in order to assign  
10 costs to the customer classes that are principally responsible for those costs.  
11 Typically, there are four categories used to group costs: capacity or demand  
12 costs, commodity costs, customer costs and revenue costs. Rate base and the  
13 overall cost of service are classified on MFR Schedule H-1.

14 1. Capacity or demand costs are those costs incurred by the utility to  
15 meet the on-demand service requirements of the total customer base. Capacity  
16 costs are related to the peak or maximum demand requirements placed on the  
17 system by its customers. Capacity costs are incurred to ensure that the system  
18 is ready to serve customers at peak requirements levels. These costs are  
19 generally considered to be “fixed”, and are incurred whether or not a customer  
20 uses any gas.

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

1           3. Customer costs are those costs incurred to connect a customer to the  
2 distribution system, meter their usage and maintain their account. In addition,  
3 other costs such as meter reading, which are a function of the number of  
4 customers served, should be included in this category. Customer costs continue  
5 to be incurred without regard to a customer's level of consumption.

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

11           I have utilized the cost classification methodology contained in the MFR  
12 model. The "classifiers" identified in the model were not altered. The  
13 classification of each functionalized cost component is contained in MFR  
14 schedule H-1, pages 2-5.

15           Allocation involves the distribution or assignment of the classified costs to  
16 the Company's service classes. Those costs which can be directly attributable to  
17 a specific customer or class of customers are assigned to that customer or  
18 class. The remaining costs are assigned by applying a series of allocation  
19 factors. The allocation factors attempt to distribute costs based on the causal  
20 relationships between the respective customer classes and the classified costs.  
21 The development and application of the allocation factors and direct assignment  
22 of costs is the final step in a cost of service study. MFR Schedule H-2, page 5,  
23 details the development of allocation factors by class of service.



1 **Q. PLEASE DESCRIBE HOW YOU ALLOCATED CAPACITY COSTS IN THE**  
2 **COST OF SERVICE STUDY.**

3 A. Capacity costs were allocated on the basis of peak and average monthly sales  
4 volume for most customer classes. The principle underlying the peak and  
5 average allocator is that fixed demand costs should be apportioned to rate  
6 classes in a manner that reflects both the basis for which the costs are incurred,  
7 as well as the actual utilization of the system by customers entitled to receive  
8 service once the system has been installed. However, for the FTS-5 class  
9 (Arizona Chemical) the peak and average allocation method resulted in  
10 uneconomical rates and a separate allocation method was employed. Arizona is  
11 price sensitive and has several alternate fuel options, including #6 fuel oil and  
12 the potential bypass of the Company's distribution system. Arizona's plant is less  
13 than 1,000 feet from an existing FGT lateral.

14 The peak and average methodology allocates certain plant and plant  
15 related expenses by assessing system-wide monthly demand by customer  
16 class. It is not sophisticated enough to account for peak hour demand, system  
17 load diversity or demand requirements on particular segments of the distribution  
18 system. Gas distribution systems are designed to meet peak hour requirements.  
19 Employing a capacity cost allocator based on peak and average monthly data  
20 typically results in poor load factor customers receiving a lower than appropriate  
21 allocation of capacity costs. Conversely, customers with higher load factors  
22 (usually the large volume customer classes) typically receive a higher allocation  
23 of costs than is reasonable. In a competitive environment, recovering costs from

1 customers who are not causing the costs may result in lost accounts. Therefore,  
2 it is reasonable to modify the capacity allocator for the FTS-1 customer class to  
3 assign a more equitable share of the fixed distribution costs.

4 **Q. WHAT METHODOLOGY DID YOU USE TO MODIFY THE PEAK AND**  
5 **AVERAGE CAPACITY COST ALLOCATOR USED IN THE STAFF'S MODEL**  
6 **FOR LARGE VOLUME CUSTOMERS?**

7 A. I utilized an allocation method used in the several Florida City Gas cost of  
8 service filings, including their 2003 rate case (Commission Order No. PSC-). The  
9 Company calculated the cost of physical bypass for Arizona Chemical. I  
10 adjusted several categories within the Direct and Special Assignments costs on  
11 MFR Schedule H-2, Page 2 of 5, for the FTS-5 rate class. The cost adjustments  
12 resulted in an aggregate target annual revenue amount approximately equal to  
13 the customers' incremental cost to bypass the distribution system. Without this  
14 adjustment the rates resulting from the larger cost allocation provide a potential  
15 incentive for Arizona to leave the system.

16 **Q. HOW WERE COMMODITY COSTS ALLOCATED?**

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

18 **Q. PLEASE DESCRIBE HOW YOU ALLOCATED CUSTOMER COSTS.**

19 A. Customer costs were allocated based on the relative number of customers  
20 served in each customer class. The "weighted number of customers" allocator  
21 was used to distribute costs based on the recognition that larger customers  
22 exhibit higher customer costs. Meters, regulators and service lines are generally  
23 more expensive for larger customers. The weightings used were derived from

1 the relative investment in meters, regulators and service lines required to serve  
2 representative customers in each class. The weightings can be found on MFR  
3 Schedule E-7.

4 **Q. HOW WERE REVENUE COSTS ALLOCATED?**

5 A. Revenue costs were allocated on the basis of gross revenues by customer  
6 class.

7 **Q. IT WOULD APPEAR THAT A COST OF SERVICE STUDY IS PRIMARILY A**  
8 **MECHANICAL ACCOUNTING OF COSTS. ARE THERE OPPORTUNITIES**  
9 **TO APPLY JUDGMENT, CONSIDER MARKET CONDITIONS OR OTHER**  
10 **MITIGATING FACTORS IN THE STUDY?**

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

19 **Q. SHOULD A COST OF SERVICE STUDY BE EXCLUSIVELY RELIED UPON**  
20 **TO ESTABLISH UTILITY RATES?**

21 A. No. As noted above, there are a number of factors that must be considered  
22 when designing rates. One of the most critical is the competitive position of the  
23 Company in the marketplace. Customers in all rate categories have fuel

1 alternatives. Price is only one factor considered when evaluating fuel types.  
2 There are numerous non-price issues in all customer classes that affect fuel  
3 selections. For example, maintenance concerns, fuel storage, emissions levels,  
4 appliance efficiency, comfort and aesthetics all play a part in a customer's fuel  
5 decisions. The bottom line is that customers have choices. The Company's  
6 proposed rate design utilizes a cost of service study as a starting point, but the  
7 final rate recommendations consider the above issues and make appropriate  
8 adjustments.

9 **Q. DOES THE COMPANY'S PROPOSED RATE DESIGN REFLECT**  
10 **ADJUSTMENTS BASED ON ALTERNATE FUEL PRICING OR OTHER**  
11 **MARKET FACTORS.**

12 A. Yes. The Company considered alternate fuel prices, customer rate impact and  
13 other market factors in designing rates. The proposed classes of service and  
14 their respective rates were selected based on the Company's primary need to  
15 retain customers. In setting rates for the low usage classes RS-1, RS-2, RS-3,  
16 GS-1 and GS-2, the Company was particularly sensitive to the Company's  
17 competitive concerns with electricity and propane. The Company's rate design  
18 for non-residential customers in the FTS-4 and FTS-5 classes also propose  
19 rates that reflect competition with electricity and propane gas. Proposed rates for  
20 these large industrial classes are designed to provide the Company its best  
21 opportunity to compete with the other alternatives available to large volume  
22 customers, yet recover an appropriate cost of service.

1 **Q. PLEASE BRIEFLY SUMMARIZE THE PROCESS EMPLOYED TO**  
2 **IMPLEMENT MARKET BASED ADJUSTMENTS TO THE COST**  
3 **ALLOCATIONS IN STAFF'S MODEL.**

4 A. An initial cost allocation was prepared using the Staff's cost of service model  
5 without modification. A second cost study was prepared that re-allocated certain  
6 costs among classes to reflect price competition, and other market concerns. As  
7 described above for the Arizona Chemical cost adjustment, this second cost  
8 allocation was accomplished through the Direct and Special Assignment section  
9 in Staff's model. All of the cost re-allocations occurred in O&M expense  
10 classification section. The initial adjustment for Arizona Chemical (FTS-5)  
11 reduced the cost allocation for Arizona from over \$800,000 to approximately  
12 \$286,000. Additional adjustments spread the Arizona cost reduction across  
13 other classes and reallocated costs between the non-Arizona classes. The  
14 adjustments had the effect of moving all rate classes toward a similar proposed  
15 rate increase percentage. The final proposed allocation of cost of service by  
16 customer class, as filed, is presented on MFR Schedule H-2 pages 3 and 4. The  
17 allocation of rate base to each customer class is included in MFR Schedule H-2,  
18 page 2.

19 **Q. IS THE COMPANY PROPOSING CHANGES TO ITS CURRENT RATE**  
20 **STRUCTURE FOR VOLUMETRIC CUSTOMER CLASSES?**

21 A. No. The rate structure proposed for all volumetric rate classes includes the  
22 continuation of a traditional fixed monthly Customer Charge and a variable Gas  
23 Delivery Charge based on the quantity of gas consumed during a billing period.

1           However, the overall proposed rate structure is intended to shift toward greater  
2           recovery of fixed costs through fixed charges.

3   **Q.   TO WHAT EXTENT IS THE COMPANY PROPOSING TO MOVE TOWARD A**  
4   **SFV OR MFV RATE STRUCTURE?**

5   A.   The Company is proposing a rate design for all customers that incorporates the  
6       primary elements of SFV of MFV rates. That is, a significant portion of the  
7       Company's proposed revenue requirement would be collected through an  
8       increase in the existing fixed monthly customer charges. The variable rate  
9       component would collect a smaller percentage of the overall revenue  
10      requirement. The revenue recovered through the Company's proposed fixed  
11      customer charges represents approximately 60% of the total proposed target  
12      revenues in the Projected Test Year compared to approximately 40% at present.

13 **Q.   WHY IS SFV OR MFV APPROPRIATE?**

14 A.   As the interstate pipelines unbundled FERC recognized that, in the absence of  
15      commodity sales by the pipelines, few variable cost components remained. The  
16      pipelines continued to have compressor and odorization costs that were  
17      dependent on gas throughput. However the revenue requirement was largely  
18      defined by fixed costs unaffected by the volume of gas transported on the  
19      pipeline. The pipeline made an investment in its facilities and incurred operating  
20      costs that did not vary with usage. The SFV rate design used by virtually all  
21      FERC regulated pipelines collects the vast majority of revenues through fixed  
22      demand or capacity reservation charges. For example, FGT's rates for reserving  
23      capacity represent approximately 95% of their total charges. These reservation

1 or demand rates are applied on a take or pay basis, further evidence of FERC's  
2 acknowledgement that fixed costs are more appropriately recovered through  
3 fixed charges. At the outset of open access, several pipelines, including FGT,  
4 adopted a modified version of SFV rate design. The MFV design split the fixed  
5 rate components into two separate fixed charge elements, similar to the  
6 Customer Charge and Demand Charge the Company is proposing for larger  
7 customers.

8 The Company has fewer variable cost elements than the interstate  
9 pipelines. Apart from a minimal annual cost for odorant, there are few expenses  
10 that can be directly linked to throughput. The Company understands that a  
11 complete shift to fixed rates for all classes is not practical at this time.  
12 Nonetheless, the Company is proposing to initiate moving toward a rate design  
13 that may ultimately recover a majority of the Company's revenue requirement  
14 from fixed charges.

15 **Q. WHAT FACTORS WERE CONSIDERED IN ESTABLISHING THE PROPOSED**  
16 **CUSTOMER CHARGES?**

17 A. Exhibit No. JMH-2 displays the difference between the existing and proposed  
18 monthly Customer Charges for each of the proposed classes. The Company's  
19 proposed Customer Charges are designed to recover a greater proportion of the  
20 revenue requirement for each customer class than under current rates. The  
21 Company's intent is to move individual rate elements closer to cost based levels.  
22 The unit cost data from the cost study was used to guide the Company's  
23 determination of appropriate Customer Charge rates.

1 **Q. WHY IS THE LEVEL OF THE CUSTOMER CHARGE IMPORTANT?**

2 A. There are three fundamental reasons why it is important to carefully consider  
3 Customer Charge rates for each customer class. First, to the extent rates are  
4 established on a SFV basis, the Customer Charge provides customers with a  
5 reasonable price signal related to the impact of receiving service from the  
6 Company's distribution system. Second, to the extent that a portion of customer-  
7 related costs are recovered through variable or usage charges, intra-class  
8 subsidies would be created as larger customers pay a disproportionate share of  
9 such costs. The Company's proposed rate design addresses this concern  
10 through the increased stratification of the existing customer classes. Third, the  
11 Customer Charge provides a greater degree of revenue stability for the  
12 Company by allowing it to recover fixed costs to serve through a fixed charge.

13 **Q. DID YOU CONSIDER THE COMPANY'S RATE OF RETURN FOR YOUR  
14 PROPOSED CUSTOMER CLASSES AT PRESENT RATES IN YOUR  
15 ANALYSIS?**

16 A. Yes. Prior to designing the Company's final proposed rates I reviewed the rate of  
17 return results for each of the new customer classes. The returns for each  
18 proposed customer class at present rates is displayed on MFR schedule H-3,  
19 page 2. At present rates, it is clear that substantial rate of return disparities exist  
20 within and between classes. It is also clear that existing rates are not producing  
21 positive returns in virtually all of the Company's proposed rate classes.

22 **Q. HOW DID YOU DEVELOP THE PROPOSED RATES?**



1 A. The cost of service analysis provided a reasonable basis upon which to begin  
2 the design of rates by customer class. I compared the results of the cost studies  
3 to the Company's historic rates and the competitive cost analysis. I considered  
4 the Company's objectives to reduce rate subsidization among and within classes  
5 and to recover a greater portion of its fixed costs from fixed charges. The  
6 Company's proposed rate design results in each customer moving toward a  
7 more uniform contribution to costs compared to present rates. The final rates  
8 were designed on the basis of cost of service by class, the competitive  
9 considerations discussed above and a review of the current structure of rates  
10 and classes. The rate design I am proposing on the Company's behalf  
11 establishes rates of return for each customer class that continue to improve the  
12 historical inequity within and between classes. The final rate design ensures that  
13 each proposed volumetric class generates a return at the Company's projected  
14 cost of capital of 6.14%. Rates of return for each proposed class under projected  
15 rates are included in MFR Schedule H-3, page 3.

16 **Q. IS THE COMPANY PROPOSING CHANGES TO ITS OTHER OPERATING**  
17 **REVENUE CHARGES?**

18 A. Yes. The Company is proposing to increase its residential Connection and  
19 Reconnection Charge from \$30 to \$40. The Company is also proposing to  
20 increase its Change of Account Charge from \$20 to \$30. Finally, The Company  
21 is proposing to increase its existing Late Payment fee from \$3.00 to \$10.00. The  
22 current Late Payment Fee provision that collects the fixed rate component  
23 (proposed at \$10) or "1.5% of the amount due which ever is greater" would not

1 change. The Company's Other Operating Revenue forecast includes \$50,922 in  
2 deferred income imputed by the Commission in the 2001 rate Order as part of  
3 the disposition of the Florida Coast Paper bankruptcy described in Stuart  
4 Shoaf's testimony. The forecast of Other Revenue in the Projected Test Year at  
5 present rates is \$99,277 and under proposed rates is \$107,047. The current  
6 other revenue charges are displayed on MFR Schedule E-1, page 3 and  
7 Schedule H-3, page 5.

8 **Q. HOW ARE MISCELLANEOUS CHARGE REVENUES HANDLED IN THE**  
9 **COST STUDIES?**

10 A. The Company forecast Miscellaneous Revenue by class based on its existing  
11 charges and proposed charges. When available, historical data was utilized to  
12 project the number of annual charges. The cost study includes the cost to  
13 provide the various Miscellaneous Charge services in the Total Revenue  
14 Requirement. The miscellaneous charge revenues were adjusted out of the  
15 proposed revenue requirement by class prior to the development of the  
16 proposed base rates.

17 **Q. DID THE COMPANY INCLUDE AN ANALYSIS OF ALL OF ITS PROPOSED**  
18 **RATE SCHEDULES IN THE COST OF SERVICE STUDY?**

19 A. No. The Company only evaluated the rate classifications with active customers  
20 in its cost study. The company does not currently serve customers in its GS-3,  
21 GS-4, GS-5, FTS-1, FTS-2 or FTS-3 rate classes. However, given that the  
22 proposed sales and transportation service rate classes mirror each other (same  
23 annual term range applicability provisions and same rates) all of the proposed

1 rate classes are represented, except the GS-3 and FTS-3 classes. These  
2 classes are intended to serve customers in the 25,000 to 150,000 annual therm  
3 range. The company's current tariff includes a GS-3, TS-3 rate class at the  
4 following rates: \$360 Customer charge and \$0.04210 Gas Delivery Charge. The  
5 Company's proposed tariff includes the following rates for this service class:  
6 Customer Charge - \$925.00 and Gas Delivery Charge - \$.06610 per therm.  
7 These rates are consistent with the structure and level of rates in neighboring  
8 classifications and reflect a 57% increase over existing rates. The Company  
9 forecasts no customers in the GS-3 or FTS-3 classes for 2008.

10 **Q. PLEASE COMPARE THE PROPOSED RATES TO THE PRESENT RATES.**

11 A. A comparison of present and proposed base rates and customer charges by  
12 customer class is presented in MFR Schedule H-3, page 5, and is summarized  
13 on Exhibit No. JMH-2.

14 **Q. HOW MUCH REVENUE WILL THE PROPOSED RATES PRODUCE?**

15 A. The rates and charges are designed to produce additional revenues of  
16 \$624,1666, as indicated on MFR Schedule H-3, page 1. Total target revenues  
17 under the proposed rates are \$1,705,854.

18 **Q. PLEASE SUMMARIZE THE CONCLUSIONS YOU HAVE REACHED BASED  
19 ON YOUR COST ANALYSIS AND RATE DESIGN.**

20 A. The cost of service analysis provided a reasonable basis upon which to begin  
21 the design of rates by customer class. I compared the initial results of the cost  
22 study to the Company's historic rates, the competitive cost analysis and the  
23 Company's objective to minimize rate subsidizations among and within classes.

1 My final rate design brought the rate of return for all customer classes to the  
2 Company's cost of capital. The rate design begins to shift toward a SFV  
3 structure for all accounts. I believe the proposed rate design is just and  
4 reasonable, producing fair and equitable rates for each customer class.

5 **Q. ARE THERE OTHER SUBSTANTIVE CHANGES TO THE RATE SCHEDULES**  
6 **PROPOSED BY THE COMPNAY?**

7 A. Yes. The Company is proposing to include a new section in the Special Terms  
8 and Conditions of Service in all Residential Service rate schedules and all  
9 General Sales Service and Firm Transportation Service rate schedules. The new  
10 special condition would enable the Company to recover, through a surcharge to  
11 the Gas Delivery Service charge, the cost of converting a potential consumer  
12 from an alternate fuel to natural gas. At the option of the consumer, and subject  
13 to the agreement of the Company, the consumer's conversion costs for interior  
14 piping, appliance conversion, etc. would be paid by the Company. The  
15 consumer would repay the Company over a reasonable time period agreed to by  
16 the parties, such repayment to include carrying costs at the Company's cost of  
17 capital. The proposed conversion surcharge expands the number of consumers,  
18 especially those at lower income levels, which would be able to receive the  
19 benefits of natural gas service.

20

21 **Proposed Adoption of the Company's 4<sup>th</sup> Revised Tariff**

22 **Q. HAS THE COMPANY REVISED ITS TARIFF CONSISTENT WITH THE RATE**  
23 **DESIGN AND PROGRAM MODIFICATIONS PROPOSED ABOVE?**

1 A. Yes. In conjunction with its base rate filing, the Company is submitting proposed  
2 revisions to its tariff. In addition, the tariff was generally updated and edited to  
3 remove redundant sections and group related rules and regulations in common  
4 sections. The Company determined that, given the extent of the proposed  
5 modifications, it was not practical to edit the existing tariff. The company is  
6 submitting with this rate filing a new 4<sup>th</sup> revised tariff.

7 **Q. HAS THE COMPANY PREPARED A LEGISLATIVE VERSION OF ITS NEW**  
8 **TARIFF INDICATING THE SPECIFIC PROPOSED REVISIONS?**

9 A. Yes. A red-line legislative copy of the current tariff has been prepared depicting  
10 sections that have been deleted, modified and/or moved to the new tariff. It  
11 should be noted that while the Company is proposing a new tariff version, much  
12 of existing language in several sections of the current tariff has been retained.  
13 The Company is prepared to work closely with the Commission to identify all  
14 substantive revisions to the tariff.

15 **Q. PLEASE BRIEFLY DESCRIBE THE SUBSTANTIVE TARIFF**  
16 **MODIFICATIONS PROPOSED IN THIS FILING.**

17 A. In addition to those tariff revisions related to customer classes and rates  
18 described previously in my testimony the following discussion summarizes the  
19 Company's substantive tariff revision proposals.

- 20 1. The entire tariff construction was reordered to comply with Commission  
21 Rule 25-9.
- 22 2. The Definitions sections has been modified to remove out-of-date and  
23 unnecessary definitions.

- 1           3.     The Company added a new Gas Delivery Service definition applicable to  
2                     both sales service and transportation service customers.
- 3           4.     A new Classification of Service section (Section 1) was added describing  
4                     the services provided by the Company.
- 5           5.     A new Classification of Customers section (Section 2) was added to  
6                     consolidate the service applicability information and specifically define  
7                     Shippers as customers.
- 8           6.     The Miscellaneous Customer Charges (Connect Fees, etc.) were  
9                     consolidated in a new Section 7. The current tariff includes thses fees in a  
10                    rate schedule on Original Sheet No. 5.23, which is proposed for deletion.
- 11          7.     An new Assignment of Customer Rate Schedule (Section 5) is proposed  
12                    along with an annual customer rate review.
- 13          8.     The Company's Extension of Facilities Policy is proposed to include an  
14                    Area Expansion Program, designed in accordance with the provisions  
15                    approved by the Commission for Chesapeake Utilities Florida Division in  
16                    Order No. PSC-07-0427-TRF-GU, issued May 15, 2007.
- 17          9.     All transportation service related rules were consolidated in a new Section  
18                    14.
- 19          10.    The Company's Curtailment Plan was removed from the proposed tariff.  
20                    The Company will administratively file its Curtailment Plan with the  
21                    Commission.

1            11.    The existing Contract Transportation Service (CTS) negotiated rate  
2                            provisions in the current TS-6 rate class were moved to a new CTS Rider.

3                            No changes to the procedures or applicability have been proposed.

4    **Q.    DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

5    **A.    Yes.**

**LIST OF MFR SCHEDULES SPONSORED BY JEFF HOUSEHOLDER**

<u>Schedule</u>	<u>Title</u>
E-1 Pp. 1-3	Cost Of Service - Therm Sales and Revenues
E-2 Pp. 1	Cost Of Service - Revenues at Present and Proposed Rates
E-3 Pp. 1-4	Cost Of Service – Miscellaneous Revenue
E-4 Pp. 1-2	Cost Of Service - Peak Monthly Sales Volumes
E-5 Pp. 1-4	Cost Of Service - Monthly Bill Comparisons
E-6 Pp. 1-5	Cost Of Service – Derivation of Overall Cost of Service
E-7 Pp. 1	Cost Of Service – Meter Set and Service
E-8 P. 1	Cost Of Service – Dedicated Facilities
E-9 P. 1	Cost Of Service - Tariff
F-10 P.1	Calculation Of Interim Rate Relief - Deficiency Allocation
H-1 P. 1	Cost Of Service – Classification of Rate Base - Plant
H-1 P. 2	Cost Of Service – Classification of Rate Base – Accum. Dep.
H-1 Pp. 3-4	Cost Of Service – Classification of Expense
H-1 P. 5	Cost Of Service – Summary
H-2 P. 1	Cost Of Service – Development of Allocation Factors
H-2 Pp. 2-5	Cost of Service - Allocation Of Rate Base To Customer Classes
H-2 P. 6	Cost Of Service - Summary
H-3 P. 1	Cost Of Service –Derivation of Revenue Deficiency



H-3	P. 2	Cost Of Service – Rate of Return Present Rates
H-3	P. 3	Cost Of Service – Rate of Return Proposed Rates
H-3	P. 4	Cost Of Service – Proposed Rate Design
H-3	P. 5	Cost Of Service – Calculation of Proposed Rates

***Non-Residential Firm Transportation Customers***

FTS-1 (0 - 2,000 therms/yr)		
Customer Charge per month	\$9.00	\$25.00
Gas Delivery Charge per therm	\$0.38086	\$0.38488
FTS-2 (2,000 - 25,000 therms/yr)		
Customer Charge per month	\$40.00	\$70.00
Gas Delivery Charge per therm	\$0.20665	\$0.33790
FTS-3 (25,000 – 150,000 therms/yr)		
Customer Charge per month	\$360.00	\$925.00
Gas Delivery Charge per therm	\$0.04210	\$0.06610
FTS-4 (150,000 – 1,000,000 therms/yr)		
Customer Charge per month	\$1,000	\$5,000.00
Gas Delivery Charge per therm	\$0.08091	\$0.03748
FTS-5 (>1,000,000 therms/yr)		
Customer Charge per month	\$1,000	\$6,000.00
Gas Delivery Charge per therm	\$0.03676	\$0.01406
CTS* (>150,000 therms/yr)		
Customer Charge per month	\$1,000	Rate Schedule for which Customer otherwise qualifies.
Gas Delivery Charge per therm	Negotiable	Negotiable

\*CTS rates are negotiable for customers with alternate fuel capabilities.

**COMPARISON OF PRESENT TO PROPOSED RATES BY CLASS**

<u>Proposed Rate Schedule</u>	<u>Present Rates</u>	<u>Proposed Rates</u>
<b><i>Residential Customers</i></b>		
RS-1 (0 - 150 therms/yr)		
Customer Charge per month	\$9.00	\$16.50
Gas Delivery Charge per therm	\$0.38086	\$0.46972
RS-2 (150 - 300 therms/yr)		
Customer Charge per month	\$9.00	\$20.25
Gas Delivery Charge per therm	\$0.38086	\$0.46880
RS-3 (<300 therms/yr, and new RS customers)		
Customer Charge per month	\$9.00	\$24.00
Gas Delivery Charge per therm	\$0.38086	\$0.46903
<b><i>Non-Residential Sales Customers</i></b>		
GS-1 (0 - 2,000 therms/yr)		
Customer Charge per month	\$9.00	\$25.00
Gas Delivery Charge per therm	\$0.38086	\$0.38488
GS-2 (2,000 - 25,000 therms/yr)		
Customer Charge per month	\$40.00	\$70.00
Gas Delivery Charge per therm	\$0.20665	\$0.33790
GS-3 (25,000 – 150,000 therms/yr)		
Customer Charge per month	\$360.00	\$925.00
Gas Delivery Charge per therm	\$0.04210	\$0.06610
GS-4 (150,000 – 1,000,000 therms/yr)		
Customer Charge per month	\$1,000	\$5,000.00
Gas Delivery Charge per therm	\$0.08091	\$0.03748
GS-5 (>1,000,000 therms/yr)		
Customer Charge per month	\$1,000	\$6,000.00
Gas Delivery Charge per therm	\$0.03676	\$0.01406