

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

Gas Transmission Northwest Corporation ) Docket Nos. RP06- -000

**Prepared Direct Testimony of John A. Roscher**

1 **Q: What is your name and business address?**

2 A: My name is John A. Roscher. My business address is Gas Transmission Northwest  
3 Corporation, 1400 Fifth Avenue, Suite 900, Portland, Oregon 97201.

4 **Q: What is your occupation?**

5 A: I am presently employed by Gas Transmission Northwest Corporation ("GTN") as  
6 Director, Rates and Regulatory Affairs.

7 **Q: Please describe your educational background and your occupational experiences as**  
8 **they are related to your testimony in this proceeding.**

9 A: I graduated from Pennsylvania State University in December, 1985, with a Bachelor of  
10 Science degree in Mineral Economics. In December of 1999, I received my MBA from  
11 Portland State University.

12 From January 1986 through December 1991, I was employed by the Federal  
13 Energy Regulatory Commission ("FERC" or "Commission") as an Industry Economist.  
14 From August 1986 until my departure from the FERC, I was a member of the Allocation  
15 and Rate Design Branch of the Division of Gas Pipeline Rates. From January of 1992  
16 through December of 1992, I was employed by Western Gas Resources, Inc. in Denver,  
17 CO as a Regulatory Specialist. From January of 1993 through June of 1995, I was  
18 employed by Consolidated Natural Gas Company in Pittsburgh, PA as a Rate Engineer.

1           Since August of 1995, I have been employed by GTN (formerly Pacific Gas  
2           Transmission Company), holding various regulatory-related positions until May of 1999,  
3           when I was promoted to Director, Rates and Regulatory Affairs, my current position. As  
4           Director of Rates and Regulatory Affairs, I am responsible, in part, for ensuring that  
5           GTN's business practices are conducted within the guidelines of current Commission  
6           regulations and policy.

7   **Q:   Have you ever testified before the Federal Energy Regulatory Commission or any**  
8   **other energy regulatory commission?**

9   A:   Yes. I filed testimony and testified before this Commission in Docket Nos. RP87-33-  
10       000, Williams Natural Gas Company; RP88-44-000, El Paso Natural Gas Company;  
11       RP88-227-000, Paiute Pipeline Company; and RP89-86-000, Chandeleur Pipe Line  
12       Company. In addition, I filed testimony in Docket Nos. RP90-139-000, *et al.*, Southern  
13       Natural Gas Company; RP88-115-000, *et al.*, Texas Gas Transmission Corporation; and  
14       RP91-140-000, Questar Pipeline Company. I have submitted written comments and  
15       testified before a Staff Panel in Docket No. PR00-9-000, PG&E Texas Pipeline, L.P.  
16       Most recently, I filed testimony before this Commission in Docket Nos. RP99-518-019,  
17       *et al.*, PG&E Gas Transmission, Northwest Corporation.

18   **Q:   What is the purpose of your testimony in this proceeding?**

19   A:   I am presenting cost classification, allocation, and rate design recommendations for  
20       GTN's mainline system and laterals. In addition, I am proposing a number of tariff  
21       changes that will serve to provide rate certainty to GTN's shippers and to minimize future  
22       turnback risk for GTN and its long-term firm shippers.

23               Specifically, my rate design testimony will address, consistent with prior  
24       Commission directives, roll-in analyses for two separate expansion projects that were

1 placed into service subsequent to GTN's last general section 4 rate filing in Docket No.  
2 RP94-149-000. I will additionally discuss the roll down of an existing incremental fuel  
3 rate that is associated with one of the expansions. My rate design testimony further  
4 addresses the issue of turnback capacity, which is the primary driver of this rate case, and  
5 my recommendations associated with cost recovery and risk sharing associated with  
6 unsubscribed long-term capacity. In order to enhance GTN's opportunity to recover  
7 costs associated with turnback capacity and to mitigate the impact of unsubscribed  
8 capacity costs on both the pipeline and its shippers, I am additionally recommending a  
9 flexible pricing proposal designed to maximize the revenue contributions of short-term,  
10 seasonal, and interruptible shippers. In this regard, I will address, in part, GTN's  
11 proposal to implement market-based interruptible transportation rates. My testimony  
12 additionally recommends converting GTN's firm reservation rates from monthly to daily  
13 charges.

14 Last, I propose in my testimony to add reservation of capacity tariff language to  
15 GTN's General Terms and Conditions, and to modify GTN's right-of-first-refusal  
16 ("ROFR") tariff provisions to allow GTN to subject ROFR capacity to open-season  
17 bidding for expansion capacity. These changes are designed to promote capacity  
18 rationalization when the pipeline expands in order to minimize future turnback risk.

19 **Q: What Statements and Schedules are you sponsoring?**

20 **A:** I am sponsoring the following Statements and Schedules:

21 Schedule I-2, Classification of Cost-of-service

22 Schedule I-3, Allocation of Cost-of-service

1 Statement J, Comparison and Reconciliation of Estimated Operating Revenues with  
2 Cost-of-service

3 Schedule J-1, Summary of Billing Determinants

4 Schedule J-2, Derivation of Rates

5 **Roll in of Pipeline Expansions**

6 **Q: Has GTN expanded its system since its last section 4 rate case?**

7 A: Yes, since GTN's last rate case, GTN has expanded its system on two separate occasions.  
8 GTN's 1998 Pipeline Expansion Project ("1998 Expansion"), a compression-only  
9 expansion that added approximately 56,000 Dth per day of annual capacity to the north  
10 end of GTN's system along with 20,000 Dth per day of winter-only, full-haul capacity,  
11 was placed into service on November 1, 1998. GTN's 2002 Pipeline Expansion Project  
12 ("2002 Expansion"), a limited expansion that utilized a combination of compression and  
13 looping to add 210,800 Dth per day of annual capacity and 20,380 Dth per day of winter-  
14 only capacity, was placed into service in two separate stages. Stage one was placed into  
15 service on November 13, 2001, while stage two was placed into service on November 1,  
16 2002.

17 **Q: Please summarize your conclusions as to the proper pricing of these expansions.**

18 A: The 1998 Expansion meets the applicable standard for roll in set forth in the 1995 Policy  
19 Statement. The 2002 Expansion satisfies the 1999 Policy Statement's test for roll in.

20 **Q: What were the rate determinations made by the Commission in the certificate**  
21 **orders approving these projects?**

22 A: By order issued August 31, 1998, in Docket Nos. CP98-167-000, *et al.* ("1998 Certificate  
23 Order"), GTN received certificate authorization to construct its 1998 Expansion [84  
24 FERC ¶ 61,204 (1998)]. The 1998 Certificate Order indicated that the Commission

1 would apply a presumption in favor of rolling in the costs attributed to the installation  
2 and construction of the proposed facilities in GTN's next rate proceeding when the rate  
3 increase to existing customers from rolling in the proposed facilities is 5% or less, unless  
4 there has been a significant change from the facts and circumstances underlying the  
5 order.

6 By order issued August 6, 2001, in Docket No. CP01-141-000 ("2001 Certificate  
7 Order"), the Commission certificated GTN's 2002 Pipeline Expansion [96 FERC ¶  
8 61,194 (2001)]. The Commission approved GTN's request for pre-approval of rolled-in  
9 rate treatment for the project in GTN's next rate proceeding, assuming no material  
10 change in circumstances. With respect to changed circumstances, the Commission noted  
11 that parties would be free to raise cost overrun concerns in a future rate proceeding.

12 This section 4 filing is the first general rate filing since the Commission approved  
13 the two expansion projects and thus it is in this filing that GTN is for the first time  
14 establishing the pricing of all of the subject expansion capacity.

15 **Q: Did the Commission find incremental rates to be appropriate for any aspect of the**  
16 **2002 Expansion?**

17 A: Yes. As discussed in greater detail below, the Commission did find in the 2001  
18 Certificate Order that GTN's expansion shippers should bear the cost of any increased  
19 fuel costs, directing GTN to design a surcharge to ensure that expansion shippers would  
20 be subject to an incremental fuel charge.

21 **Q: Can you provide your understanding of the Commission's roll-in policy that is**  
22 **relevant to these two expansions?**

23 A: Yes. In 1995 the Commission issued a Policy Statement ("1995 Policy Statement") that  
24 established that the Commission will apply a presumption in favor of rolled-in rates when

1 the rate increase to existing customers from rolling in new facilities is 5% or less and the  
2 pipeline makes a showing of system benefits. In 1999 the Commission issued a  
3 subsequent Policy Statement ("1999 Policy Statement") that modified the Commission's  
4 roll-in policy by eliminating the 5% rate increase allowance included in the 1995 Policy  
5 Statement. The Commission stated in the 1999 Policy Statement that the threshold  
6 requirement in establishing the public convenience and necessity for existing pipelines  
7 proposing an expansion project is that the pipeline must be prepared to financially  
8 support the project without relying on subsidization from its existing customers.  
9 However, the Commission further clarified that changes regarding the roll-in-vs.-  
10 incremental standards contained in the 1999 Policy Statement would not be applied  
11 retroactively to cases where the certificate has already been issued and the investment  
12 decisions have already been made. Moreover, the 1999 Policy Statement references by  
13 footnote the Commission's Order on Rehearing in GTN's last section 4 rate case. 82  
14 FERC ¶ 61,289 (1998). In the Order on Rehearing, the Commission determined that  
15 when a pipeline constructs an expansion with an incremental rate, shippers acquiring  
16 long-term firm capacity after the expansion, whether from the pipeline or through  
17 permanent capacity release, must pay the same rate as the expansion shippers or it would  
18 otherwise be considered unduly discriminatory. To avoid any overrecovery of the  
19 expansion costs, the incremental rate is rolled down over time and, if there are enough  
20 post-expansion capacity sales or releases, the expansion is ultimately rolled in.

21 **Q: Which of the Commission's Policy Statements apply to the 1998 and 2002 Expansion**  
22 **projects?**

23 A: With respect to the 1998 Expansion, GTN filed its application for a certificate of public  
24 convenience and necessity on December 20, 1997, in Docket No. CP98-167-000. The

1 1998 Certificate Order was issued on August 31, 1998. As noted in the 1998 Certificate  
2 Order, the 1995 Policy Statement applies to GTN's 1998 Expansion.

3 With regard to the 2002 Expansion, GTN filed its application for a certificate of  
4 public convenience and necessity on April 2, 2001, and the Commission issued its 2001  
5 Certificate Order on August 6, 2001. Because the 2002 Expansion certificate application  
6 was filed, and the certificate order issued, subsequent to the issuance of the 1999 Policy  
7 Statement, the 1999 Policy Statement applies to GTN's 2002 Expansion.

8 **Q: What methodology did you use to determine the appropriate pricing of the 1998**  
9 **Expansion?**

10 A: In order to determine whether roll in of the 1998 Expansion was warranted, I calculated  
11 and compared the per-unit costs of 1) the GTN mainline rate excluding the 1998  
12 Expansion and 2002 Expansion, and 2) the 1998 Expansion. Exhibit No. GTN-7, page 1  
13 of 2, details the calculated stand-alone cost-of-service for the GTN mainline system,  
14 excluding both 1998 Expansion and 2002 Expansion costs. Line number 9 identifies the  
15 mainline system full-path rate as \$0.431838 per Dth. This rate is the current threshold for  
16 roll in of the 1998 Expansion under the 1995 Policy Statement.

17 **Q: Has there been any change in circumstances associated with the 1998 Expansion**  
18 **since the FERC's pre-determination of roll in?**

19 A: Yes. As noted in the Commission's 1998 Certificate Order, a contract with El Paso  
20 Energy Marketing Canada, Inc. ("El Paso Energy") for firm transportation service in the  
21 amount of 17,702 Dth/d between Kingsgate and Malin over a three-year period was  
22 submitted as part of GTN's original certificate application. El Paso Energy had an  
23 express condition in its agreement that permitted it to withdraw its acceptance of the  
24 agreement, which El Paso exercised. As a result, GTN filed an amendment to its

1 application on February 4, 1998, revising Exhibit I to reflect the elimination of the El  
2 Paso Energy contract and revising Exhibit N to show associated adjustments to revenues.

3 **Q: Was the El Paso Energy capacity subsequently resold?**

4 A: Yes. Following the in-service date of the 1998 Expansion and prior to the in-service date  
5 of GTN's 2002 Expansion, GTN effectuated a number of maximum rate, long-term firm,  
6 full-haul capacity sales that more than accounted for the 17,702 Dth/d of full-haul  
7 capacity that El Paso Energy declined to accept. These contracts are still in effect today  
8 and will remain in effect beyond the end of the test period. Therefore, prior to the in-  
9 service date of GTN's 2002 Expansion, the 1998 Expansion was fully subscribed.

10 **Q: Is the 1998 Expansion capacity fully subscribed today?**

11 A: No. Following a two year ROFR extension, on October 31, 2003, a Duke Energy  
12 Trading and Marketing, LLC ("Duke Energy") contract for 10,000 Dth/d of annual  
13 capacity from Kingsgate to Stanfield terminated. On October 31, 2005, Poco Marketing  
14 Ltd's contract for 13,392 Dth/d of annual capacity from Kingsgate to Stanfield was  
15 terminated at the end of its contract term. In addition, Duke Energy and EnCana Energy  
16 Marketing USA ("EnCana") (original expansion shipper was Montana Power Trading  
17 and Marketing Company) recently elected not to renew their Kingsgate to Malin  
18 contracts through GTN's ROFR process. Combined, these two contracts account for  
19 15,000 Dth/d of annual full-haul capacity that will expire during the test period on  
20 October 31, 2006.

21 **Q: Does the 1998 Expansion satisfy the roll-in test?**



1 A: Yes. The 1998 Expansion, which benefits from *de minimis* capital costs of only \$6  
2 million, easily meets the roll-in threshold of the 1995 Policy Statement even after taking  
3 into account all changed circumstances.

4 Exhibit No. GTN-7, page 1 of 2, provides the stand-alone cost-of-service for the  
5 1998 Expansion with its associated incremental rate. Line number 16 identifies the 1998  
6 Expansion stand-alone full-path rate as \$0.134945 per Dth. Since the stand-alone rate for  
7 the 1998 Expansion is lower than that of the mainline system as set forth above, roll in of  
8 the 1998 Expansion costs and associated billing determinants is warranted.

9 The rate impact of rolled-in treatment for the proposed expansion is below the 5%  
10 threshold required by the Commission. With respect to system benefits, the 1998  
11 Certificate Order recognized that one of the benefits that the Commission considers in  
12 applying the Policy Statement is reduced customer costs. GTN's roll-in analysis  
13 demonstrates that rate reductions associated with the 1998 Expansion continue to provide  
14 such a benefit. In addition, the Commission found in the 1998 Certificate Order that the  
15 1998 Expansion facilities provide additional system reliability and service flexibility.

16 **Q: What methodology did you use to determine the appropriate pricing of the 2002**  
17 **Expansion?**

18 A: As with the 1998 Expansion, I began by calculating and comparing the per-unit costs of  
19 1) the 2002 Expansion, and 2) the GTN mainline system excluding the 2002 Expansion.  
20 Exhibit No. GTN-7, page 2 of 2, details the calculated stand-alone cost-of-service for the  
21 GTN mainline system, excluding the 2002 Expansion costs. Line number 9 identifies the  
22 mainline system full-path rate as \$0.427080 per Dth. This rate is the current threshold for  
23 roll in of the 2002 Expansion under the 1999 Policy Statement.

1 **Q: Has there been any change in circumstances associated with the 2002 Expansion**  
2 **since the FERC's pre-determination of roll in?**

3 A: Yes. First of all, total project costs for the 2002 Expansion exceeded GTN's original cost  
4 estimates by approximately \$7,643,000, as reported in GTN's May 15, 2003 Statement of  
5 Final Cost filing in Docket No. CP01-141-000. Second, contracted capacity associated  
6 with the 2002 Expansion has changed as well. On October 23, 2002, Gas Path South, an  
7 affiliate of Newport Northwest ("Newport"), which had contracted for 175,000 Dth/d of  
8 annual expansion capacity for a term of 52 years, defaulted.

9 **Q: Was the Newport capacity subsequently resold?**

10 A: Subsequent to Newport's default, new capacity sales on GTN have exceeded the amount  
11 of capacity previously held by Newport.

12 **Q: Are there any test period adjustments to contracted capacity levels that might affect**  
13 **the 2002 Expansion roll-in analysis?**

14 A: Yes. As reflected in Schedule G-2, GTN anticipates that Calpine Energy Services LP  
15 ("Calpine") will reject 35,800 Dth/d of annual capacity that it originally contracted for as  
16 part of the 2002 Expansion open-season. In addition, GTN anticipates the termination or  
17 rejection during the test period of a number of long-term firm contracts that were entered  
18 into following Newport's default, which might otherwise have been relied upon to  
19 support rolling in the 2002 Expansion. Specifically, two one-year contracts totaling  
20 45,000 Dth/d are set to expire on October 31, 2006. In addition, GTN anticipates that  
21 Calpine will reject at least two additional long-term firm contracts, representing 40,000  
22 Dth/d of full-haul capacity, that commenced following Newport's default. If all of the  
23 above-referenced volumes were removed from the roll-in analysis, the 2002 Expansion  
24 would not satisfy the roll-in test.

1 **Q: What other considerations are relevant to the roll-in analysis?**

2 A: An important consideration that is relevant to this roll-in analysis is the Commission's  
3 policy that requires that all shippers who purchase existing or permanently-released  
4 capacity after an expansion goes into service pay the highest incremental rate applicable  
5 to expansion facilities, and that the effect of applying the incremental rate to additional  
6 volumes would be a rolling down of the incremental rate.

7 That policy is based on the principle that it would be unduly discriminatory to  
8 permit post-expansion shippers taking turn-back capacity, permanent capacity release, or  
9 even new expansion capacity to qualify for a lower maximum rate than that paid by the  
10 pipeline's expansion shippers. I understand that this is based on the fact that any shipper  
11 taking capacity after the expansion goes into service is similarly situated to the expansion  
12 shippers themselves and thus a rate found just and reasonable for expansion customers is  
13 just and reasonable for all subsequent customers receiving the same service. As  
14 discussed below, subsequent to the 2002 Expansion going into service, total maximum  
15 rate long-term firm capacity sales and maximum rate permanent releases of capacity have  
16 greatly exceeded the capacity of the 2002 Expansion. Thus, any incremental rate that  
17 might be established in this proceeding would also be applied to these volumes, with a  
18 resulting roll down to reflect the new volumes.

19 **Q: Does this policy require that an incremental rate be in effect before the pipeline may**  
20 **roll down that incremental rate using post-expansion capacity sales?**

21 A: No. GTN could have elected to establish an incremental rate for the 2002 Expansion  
22 after it was placed into service, after the cost overruns were incurred, and after Newport  
23 defaulted on its agreement, but it did not do so. As noted, the roll-down policy is based  
24 on the fact that any shippers acquiring capacity after the expansion goes into service are

1 similarly situated to the expansion shippers and thus must pay the same rate as the  
2 expansion shippers. GTN is using this section 4 proceeding – the first such proceeding  
3 since service commenced on the 2002 Expansion – to establish the appropriate pricing of  
4 the 2002 Expansion.

5 **Q: To what extent have new capacity sales and permanent capacity releases occurred at**  
6 **the maximum rate subsequent to the in-service date of the 2002 Expansion?**

7 A: Exhibit No. GTN-8 shows that a significant amount of maximum rate capacity has been  
8 sold and permanently released subsequent to Phase I of the 2002 Expansion going into  
9 service on November 13, 2001. Specifically, GTN has sold an additional 147,333 Dth/d  
10 of long-term firm capacity, while 496,258 Dth/d of long-term firm capacity has been  
11 released on a permanent basis since November 13, 2001.

12 **Q: How are these post-expansion capacity sales and permanent capacity releases**  
13 **factored into the roll-in analysis?**

14 A: I utilized all maximum rate post-expansion long-term firm capacity sales and permanent  
15 capacity releases, with the exception of those expected to terminate or default during the  
16 test period, to calculate a rolled-down, stand-alone rate for the 2002 Expansion. Exhibit  
17 No. GTN-7, page 2 of 2, details the 2002 Expansion costs along with the post-expansion  
18 capacity sales and permanent releases that I used to determine a rolled-down 2002  
19 Expansion rate. Line number 18 details the resulting rolled-down rate of \$0.186586. I  
20 then compared this resulting rate to the filed-for mainline system rate without the 2002  
21 Expansion to determine if roll in would cause the existing customers to subsidize the  
22 expansion shippers. As noted above, Exhibit No. GTN-7, page 2 of 2, identifies the  
23 mainline full-path rate, without the 2002 Expansion, as \$0.427080 per Dth. The  
24 resulting rolled-down 2002 Expansion rate is lower than the filed-for mainline system

1 rate without the 2002 Expansion costs and volumes. As such, the 2002 Expansion  
2 facilities qualify for rolled-in treatment under the 1999 Policy Statement because, with  
3 roll in, existing shippers will not subsidize the expansion.

4  
5 **Fuel Cost Roll in**

6 **Q: In addition to rolling in the costs and associated billing determinants of the 2002**  
7 **Expansion, are you proposing to roll in associated fuel costs as well?**

8 A: Yes. I am proposing a full roll in of the incremental fuel surcharge that was established  
9 as part of the 2002 Expansion.

10 **Q: Will you briefly provide a history of the origin of the incremental fuel surcharge?**

11 A: Yes. In the 2001 Certificate Order, the Commission required GTN to "design a surcharge  
12 to ensure that expansion shippers are subject to an incremental fuel charge for fuel costs  
13 above the costs attributable to fuel absent the proposed addition of 97,500 horsepower of  
14 compression." 96 FERC at 61,840. On May 1, 2002, GTN submitted tariff sheets in  
15 Docket Nos. RP02-331-000, *et al.* ("Compliance Filing"), that: 1) established an  
16 incremental fuel surcharge for shippers utilizing GTN's 2002 Expansion, and 2) proposed  
17 a mechanism that would allow GTN to roll down the incremental fuel surcharge over  
18 time.

19 **Q: Was GTN required to implement a roll-down mechanism?**

20 A: No. Instead of proposing a roll-down mechanism, GTN could have assessed the  
21 incremental fuel rate to new capacity sales and permanent capacity releases without  
22 actually rolling down the fuel rate until its next section 4 rate proceeding. As discussed  
23 above, my understanding of FERC policy is that new shippers receiving capacity through

1 pipeline capacity sales or permanent capacity releases should pay the highest incremental  
2 rate following an expansion being placed into service.

3 **Q: Did the Commission approve GTN's proposed roll-down mechanism?**

4 A: The Commission initially rejected GTN's roll-down mechanism as proposed in its  
5 Compliance Filing because it went "beyond the scope" of the 2001 Certificate Order.  
6 However, the Commission's rejection of GTN's roll-down proposal was without prejudice  
7 to GTN submitting a future, limited section 4 filing showing the reasonableness of a roll-  
8 down mechanism. 101 FERC ¶ 61,116 (2002).

9 **Q: Did GTN resubmit a proposal to roll down the incremental fuel surcharge?**

10 A: Yes. On August 15, 2003, in Docket No. RP03-573-000, GTN submitted revised tariff  
11 sheets to clarify that all new long-term shippers would be subject to the highest  
12 incremental fuel rate and to implement a tariff mechanism that would roll down the  
13 incremental fuel rate as new shippers became subject to the incremental fuel rate. Unlike  
14 GTN's original proposal, however, GTN did not propose to subject existing shippers to  
15 the pipeline's incremental fuel rate through the ROFR process. This revised mechanism  
16 was approved by Letter Order dated September 11, 2003, with an effective date of  
17 September 15, 2003.

18 **Q: Since the incremental fuel roll-down mechanism became effective, can you describe**  
19 **the impact that it has had on the incremental fuel rate thus far?**

20 A: Exhibit No. GTN-8 details the capacity sales and permanent releases that were/are  
21 subject to roll down since the mechanism became effective and the resulting impact on  
22 the incremental fuel rate. As shown on line numbers 3 and 150 of Exhibit No. GTN-9,  
23 the incremental fuel rate will have decreased from an initial 0.000854% per Dth-mile to

1 0.000328% per Dth-mile by the end of the test period. This reduction represents an  
2 approximate 62% decrease in the incremental fuel rate since September 15, 2003.

3 **Q: What is the basis for calculating the original incremental fuel rate?**

4 A: In the 2001 Certificate Order, the Commission directed GTN to design a surcharge that  
5 reflected the proposed addition of 97,500 horsepower of compression, taking into account  
6 the average of the latest twelve months of actual data. When GTN filed to establish its  
7 incremental fuel rate in Docket No. RP02-331-000 on May 1, 2002, it relied on a twelve-  
8 month rolling average fuel percentage per Dth-mile as of December 2001 equal to  
9 0.0040% per Dth-mile, or 2.45% per Dth on a full-haul equivalent basis. (A full haul on  
10 the GTN system is 612.46 miles.)

11 **Q: How was the incremental surcharge designed?**

12 A: The surcharge, in simple terms, compared incremental horsepower to existing  
13 horsepower (weighted by heat rate) to develop a ratio of 21.35%. This ratio represented  
14 the potential for incremental fuel consumption above pre-existing levels. This ratio was  
15 multiplied by the actual average fuel percentage of 0.0040%, as previously described, to  
16 derive an incremental fuel rate of 0.000854%. This “incremental fuel surcharge” was  
17 designed to be added, on a prospective basis, to the fuel rate that would apply to existing  
18 shippers.

19 GTN’s initial incremental fuel rate of 0.000854% per Dth-mile was calculated in  
20 Docket No. RP02-331-002, which was filed November 15, 2002. This initial incremental  
21 fuel rate is equal to 0.52% per Dth on a full-haul basis.

22 **Q: Since the initial incremental fuel rate was less than the pre-existing average fuel**  
23 **rate, why was an incremental fuel rate established in the first place?**

1 A: As noted above, the incremental fuel rate was designed as a surcharge to the fuel rate that  
2 otherwise applied to existing shippers. Therefore, the total fuel rate that applies to  
3 incremental shippers is the generally applicable fuel rate plus the incremental fuel  
4 surcharge. For comparative purposes, based upon the above data, the initial post-  
5 expansion fuel rate that applied to an existing full-haul shipper was 2.45% per Dth, while  
6 the fuel rate that initially applied to a full-haul expansion shipper was 2.97% per Dth  
7 (2.45% + 0.52%).

8 **Q: Is it appropriate that GTN's fuel roll-down mechanism only applies to the**  
9 **incremental surcharge?**

10 A: In hindsight, no. The threshold for roll in of fuel rates should be comparable to the  
11 threshold for roll in of transmission rates. In other words, the threshold for roll in of an  
12 incremental transmission rate is the mainline system rate that existing shippers pay.  
13 Likewise, the threshold for roll in of an incremental fuel rate should be the mainline  
14 system fuel rate that existing shippers pay.

15 Because GTN's roll-down mechanism only considers the incremental surcharge,  
16 which is already lower than the rate that existing shippers pay, the only way the  
17 incremental rate could be fully rolled down is if it were reduced to zero. It would have  
18 been more appropriate to roll down the overall fuel rate that applies to expansion shippers  
19 rather than just the incremental surcharge because it is the overall initial incremental fuel  
20 rate of 2.97% that compares to the existing service fuel rate of 2.45%, which is the  
21 appropriate roll-in threshold.

22 **Q: Have you prepared an exhibit which illustrates a roll down of the initial overall**  
23 **incremental fuel rate of 2.97%?**



1 A: Yes, Exhibit No. GTN-10 applies GTN's FERC-approved roll-down methodology to the  
2 overall incremental fuel rate of 2.97%. This illustrative roll down of the incremental fuel  
3 rate matches the roll down illustrated in Exhibit No. GTN-9, the only exception being the  
4 starting point, which is the overall incremental fuel rate rather than just the surcharge.  
5 Exhibit No. GTN-10 demonstrates that enough pipeline capacity sales and permanent  
6 releases have occurred since the inception of the roll-down mechanism to warrant rolling  
7 in the 2002 Expansion fuel costs. As shown on line 152 of Exhibit No. GTN-10, rolling  
8 down of the overall incremental fuel rate yields a current rate, expressed on a full-haul  
9 basis, of 1.14%, well below the roll-in threshold originally established by the  
10 Commission at 2.45%.

11 **Q: Does GTN's use of the newer 2002 Expansion compressor units benefit existing**  
12 **shippers from a fuel use perspective?**

13 A: Yes. Exhibit No. GTN-11 illustrates the average annual utilization (from 2003 through  
14 2005) of GTN compressor units at the five compressor stations where compressor units  
15 were added as part of GTN's 2002 Expansion. In general, this exhibit shows that at each  
16 location, the newer, more efficient 2002 Expansion compressors are predominantly being  
17 used. With relatively lower flow conditions on the pipeline currently, the compressors  
18 that are run are used to move both expansion and existing shipper supplies. Existing  
19 shippers benefit when GTN utilizes its newer compressor stations for several reasons.  
20 First, the newer units are more efficient and therefore consume less fuel, thereby  
21 lowering existing shipper fuel costs. Second, running the higher horsepower newer units  
22 allows GTN, at times, to avoid running two smaller units, resulting in additional  
23 efficiencies and lower fuel consumption. Last, the newer units are generally more

1 reliable than the older units, and therefore reliance on the newer units reduces overall  
2 maintenance costs.

3 **Q: What additional benefits would result from a rolling in of the incremental fuel rate?**

4 A: Eliminating the incremental fuel surcharge will facilitate new capacity sales to the benefit  
5 of long-term firm ("LTF") uniform rate shippers because it will reduce the level of  
6 discounting necessary to sell additional capacity because of the relatively lower fuel rate.

7  
8 **Turnback Capacity and Risk Sharing Mechanism**  
9

10 **Q: What is GTN's unsubscribed capacity situation?**

11 A: As indicated in the testimony of GTN Witness Leslie Ferron-Jones, GTN currently has on  
12 its system approximately 450,000 Dth/d of unsubscribed long-term firm capacity, the vast  
13 majority of which came about as a result of long-term firm shippers turning back capacity  
14 to the pipeline when their transportation agreements expired.

15 **Q: Is GTN proposing to recover all the costs of its unsubscribed capacity from its**  
16 **remaining customers?**

17 A: No. GTN is proposing a mechanism that will require GTN and its customers to share the  
18 cost recovery risk associated with unsubscribed mainline capacity.

19 **Q: What is your proposed risk sharing mechanism?**

20 A: I am proposing a mechanism that appropriately apportions the risk of unsubscribed  
21 mainline capacity between GTN and its remaining maximum rate, mainline shippers and  
22 that requires customers to pay their fair share of the pipeline's costs in proportion to the  
23 use of unsubscribed capacity.

24 I propose that GTN and its maximum-rate shippers share the risk associated with  
25 unsubscribed mainline capacity on a 10%/90% basis ("Risk Sharing Percentage"),  
26 respectively. As described in greater detail below, to the extent that new or existing

1 shippers make use of GTN's unsubscribed capacity, GTN proposes to share revenue  
2 generated from unsubscribed mainline capacity sales with its recourse rate, long-term  
3 firm mainline shippers on a 25%/75% basis ("Revenue Sharing Percentage"),  
4 respectively. Therefore, maximum rate long-term firm shippers' ultimate cost  
5 responsibility will be in proportion to the use of GTN's unsubscribed capacity.

6 **Q: Why do you propose to assign 90% of the costs of unsubscribed capacity to recourse**  
7 **rate, long-term firm shippers while only crediting back 75% of the revenues**  
8 **associated with incremental sales of unsubscribed capacity?**

9 A: The Risk Sharing Percentage that I am proposing meets the Commission's articulated  
10 policy guidelines of assigning less than 100% of the unsubscribed capacity costs to a  
11 pipeline's remaining shippers while providing the pipeline with a reasonable opportunity  
12 to recover its costs and earn its requested return. While a reciprocal revenue sharing  
13 proposal might seem appropriate, I am mindful of the Commission's policy guideline  
14 regarding a pipeline's incentive to sell unused capacity. I believe that by allowing the  
15 pipeline to retain 25% of unsubscribed capacity sales, the pipeline will have an ongoing  
16 incentive to sell its unsubscribed capacity.

17 **Q: When would GTN's proposed Revenue Sharing Percentage apply?**

18 A: I propose that each year, prior to sharing revenues associated with unsubscribed mainline  
19 capacity sales, GTN first be permitted to recover all costs allocated to subscription  
20 services. In other words, GTN should be entitled to recover costs allocated to long-term  
21 firm, short-term firm, seasonal, and interruptible services prior to sharing revenues from  
22 unsubscribed mainline capacity sales. Once GTN recovers all costs allocated to  
23 subscription services, GTN will then share all incremental reservation revenues,

1 including the reservation components of GTN's interruptible transportation rates, from  
2 the sale of unsubscribed mainline capacity with its long-term firm recourse rate shippers.

3 **Q: Is it your proposal that GTN credit revenues from sales of unsubscribed mainline**  
4 **capacity regardless of how the capacity is sold?**

5 A: Yes. Once GTN collects all of the costs allocated to subscription services, GTN will  
6 share revenues associated with mainline capacity sales regardless of their source, be it  
7 from long-term firm, short-term firm, seasonal, or interruptible capacity sales.

8 **Q: Will GTN's Risk Sharing and Revenue Sharing Percentages result in an**  
9 **overcollection of costs by GTN?**

10 A: No. As illustrated on line 13 of Schedule I-3, Workpaper 1, GTN's Risk Sharing  
11 Percentage places the pipeline at risk for approximately \$5.6 million in unsubscribed  
12 capacity costs above and beyond the costs allocated to subscription services. Over the  
13 next five years, as described in the testimony of GTN Witness Ferron-Jones, GTN  
14 anticipates that revenues will generally remain flat relative to test period levels, as the  
15 revenue impact of terminating contracts is generally offset by certain incremental, mostly  
16 discounted, capacity sales. Therefore, GTN's Revenue Sharing Percentage of 25 percent  
17 will only contribute to the recovery of GTN's unsubscribed capacity costs if GTN is  
18 successful in generating revenues in excess of test period projections, which GTN does  
19 not expect will happen.

20 **Q: Given GTN's test period and forward-looking market view, how will GTN have a**  
21 **reasonable opportunity to recover its costs and earn its FERC-authorized return?**

22 A: While GTN's current and forward-looking value may indicate that GTN will not be able  
23 to earn its FERC-authorized return or recover the unsubscribed mainline capacity costs  
24 for which it was placed at risk, over the longer term GTN may succeed in finding new  
25 markets for its unsubscribed capacity as described in the testimony of GTN Witness

1 Ferron-Jones. Therefore, while full recovery of GTN's share of unsubscribed capacity  
2 costs is not currently known or measurable, GTN, over the longer term, has a reasonable  
3 opportunity to recover its unsubscribed capacity costs if it is successful in finding new  
4 markets for its unsubscribed capacity.

5 **Q: In addition to sharing 75% of revenues generated from unsubscribed capacity sales,**  
6 **what other steps is GTN taking to mitigate the impact of turnback capacity on**  
7 **recourse rate, long-term firm shippers?**

8 A: GTN proposes to implement rate design changes that will prospectively apply to  
9 seasonal, short-term, and interruptible transportation services. The rate design changes  
10 are designed to enable GTN to charge more for these services, when opportunities present  
11 themselves, in order to maximize the recovery of unsubscribed capacity costs, thereby  
12 mitigating the impact of turnback capacity on GTN and its recourse rate, long-term firm  
13 shippers. Specifically, GTN is proposing to implement 1) market-based rates for full-  
14 haul interruptible transportation service; 2) flexible service rates (as defined below) for  
15 seasonal firm, short-term firm, and interruptible transportation other than full-haul; and 3)  
16 postage stamp hub service rates for parking and lending services that are similar to 100%  
17 load factor IT rates. I will address GTN's proposals regarding market-based and flexible  
18 service rates below. GTN Witness Benjamin K. Johnson provides specific  
19 recommendations regarding GTN's hub service rates in his testimony.

20  
21 **Market-Based IT Rates**

22 **Q: Please describe GTN's market-based IT rate proposal.**

23 A: GTN Witness Paul Carpenter's testimony sets forth the analysis that shows that GTN  
24 meets the criteria for establishing market-based rates for full-haul IT service. GTN

1       Witness Barry Sullivan provides testimony that demonstrates that GTN's market-based  
2       rate proposal conforms with Commission policy objectives.

3               In general, GTN is proposing to have the ability to charge higher rates for services  
4       that provide flexibility in terms of shippers' contractual commitments to the pipeline, *i.e.*,  
5       services that allow shippers to pick and choose when service is taken and, therefore,  
6       when capacity is paid for. Market-based IT rates for full-haul service will provide the  
7       pipeline with the greatest pricing flexibility in this regard. For full-haul shippers deciding  
8       among various pipeline services, market-based IT service will eliminate shippers' current  
9       option of receiving a usage-based service that is oftentimes comparable to firm and is  
10      capped on a cost-of-service basis. With market-based IT rates, full-haul shippers seeking  
11      capacity will have to weigh their potential exposure to high transportation costs and  
12      consider the trade-offs between this exposure and the certainty provided by entering into  
13      either short-term firm or long-term firm transportation agreements.

14             As noted above, the open-ended pricing flexibility provided by market-based,  
15      full-haul IT rates will provide GTN the greatest opportunity to capture value, when  
16      opportunities arise, in order to maximize the recovery of unsubscribed capacity costs and  
17      mitigate the impact of turnback capacity on GTN and its recourse rate, long-term firm  
18      shippers.

19   **Q:    Would market-based IT sales be subject to your proposed Revenue Sharing**  
20   **Percentage?**

21   **A:**    Yes, as noted above, once GTN collects all of the costs allocated to subscription services,  
22            GTN will share revenues associated with mainline capacity sales regardless of their  
23            source, including full-haul market-based IT sales.

1 **Q: If the Commission does not approve GTN's market-based rate proposal for full-**  
2 **haul IT service, what rate would apply to full-haul IT service?**

3 A: To the extent that the Commission ultimately does not approve market-based rates for  
4 full-haul IT service on GTN, flexible service rates, as discussed below, would apply to  
5 full-haul IT service.

6  
7 **Flexible Service Rates**  
8

9 **Q: What is your flexible service rate proposal for short-term and seasonal services?**

10 A: GTN proposes to facilitate the recovery of unsubscribed capacity costs by allowing GTN  
11 to apply higher rates to contracts under which capacity is not subscribed on an annual,  
12 uniform MDQ basis. Such services would include seasonal long-term firm, variable  
13 MDQ long-term firm, short-term firm, and interruptible transportation other than full-  
14 haul. In short, GTN should be permitted to charge higher rates for services that are  
15 designed to meet shippers' short-term or seasonal capacity needs at any time during the  
16 year. These services are referred to collectively as "flexible services."

17 The maximum rate for flexible services will be equal to 2.5 times the maximum  
18 reservation component of the recourse rate that applies to long-term firm, uniform MDQ  
19 shippers, plus the delivery component applicable to long-term firm, uniform MDQ  
20 shippers. As discussed below, GTN will assess flexible service rates at any time during  
21 the year, and revenues from flexible services will be shared on an annual basis to the  
22 extent that overall pipeline revenues for mainline service exceed what would have been  
23 collected had the maximum recourse rates for long-term, uniform MDQ shippers applied  
24 to all mainline volumes transported during the annual period. Revenues above this  
25 threshold will be shared between GTN and its shippers on a 25%/75% basis, consistent

1 with the Revenue Sharing Percentage proposed for unsubscribed capacity sales. As noted  
2 above, revenue sharing will provide an added incentive for the pipeline to maximize  
3 revenues to the benefit of firm shippers once its annual revenue requirement (based upon  
4 application of the maximum recourse rates to all volumes transported) is met.

5 **Q: What revenue sharing applies to the provision of flexible services?**

6 A: There are two instances where GTN will share revenues. First, as discussed earlier in my  
7 testimony, once GTN recovers all costs allocated to subscription services, GTN will share  
8 all reservation revenues attributable to mainline service with its recourse rate, long-term  
9 firm shippers on a 25%/75% basis, including revenues associated with flexible services.  
10 Second, to the extent that GTN collects more on an annual basis under its flexible service  
11 rate proposal than it would have had maximum recourse rates for long-term, uniform  
12 MDQ shippers applied to all mainline volumes transported during the annual period,  
13 GTN will share revenues above this threshold on a 25%/75% basis as well.

14 **Q: Why is the use of flexible service rates particularly important for GTN and its long-**  
15 **term shippers?**

16 A: Implementation of flexible service rates will enable GTN to take advantage of pricing  
17 opportunities when selling its unused capacity. GTN generally experiences two peak  
18 periods (both in terms of throughput and relative value) -- summer and winter -- although  
19 market conditions may cause the value of GTN's capacity to swing at any time  
20 throughout the year. As such, it would not make sense to design traditional seasonal rates  
21 that would confine GTN's ability to capture upward swings in capacity value to a limited  
22 period of time during the year. GTN's flexible service rate design proposal will allow the  
23 pipeline to capture swings in pipeline capacity value whenever they occur. Flexible  
24 service rates will allow GTN to charge more for flexible services, when the opportunity



1 presents itself, thereby maximizing the pipeline's revenues and reducing the risk-sharing  
2 burden of both the pipeline and its shippers. In other words, flexible service rates will  
3 help to mitigate the impact of capacity turnback for both GTN and its long-term firm  
4 shippers.

5 **Q: Are there any drawbacks with respect to reliance solely on uniform maximum**  
6 **rates?**

7 A: Yes. The application of uniform maximum rates to short-term services can create  
8 situations where short-term customers are able to purchase peak capacity at a price that  
9 may be lower than its market value (uniform MDQ rates undervalue short-term service  
10 during peak periods) while the pipeline sells off-peak capacity at discounted rates,  
11 resulting in short-term customers receiving annual service at a lower cost than long-term  
12 shippers. Similarly, short-term shippers seeking winter-only or summer-only capacity  
13 may obtain peak-period capacity for a fraction of the annual cost of providing capacity,  
14 leaving the long-term shippers responsible for the remainder. Unlike my proposed  
15 flexible service rate proposal, which shifts the recovery of a portion of a pipeline's fixed  
16 costs to shorter time periods, uniform maximum rates recover fixed costs in 12 monthly  
17 installments.

18 **Q: What types of seasonal long-term firm service does GTN provide?**

19 A: GTN sells certain long-term capacity that is only available during the winter months due  
20 to ambient conditions. In addition, GTN is able to sell long-term capacity that is  
21 available year-round on a variable MDQ basis.

22 **Q: Is GTN authorized to sell firm capacity on a variable MDQ basis?**

23 A: By letter order issued February 14, 2006, in Docket No. RP06-180-000, the Commission  
24 accepted a January 20, 2006 tariff filing by GTN that explicitly permits GTN to offer

1 firm transportation service with differing MDQ levels over the course of a shipper's  
2 contract term. By offering flexible MDQs over a firm shipper's contract term, GTN is  
3 better positioned to satisfy shipper needs that vary on a seasonal or monthly basis.  
4 Importantly, while GTN currently has the ability to offer variable MDQ service that takes  
5 into account seasonal usage or seasonal capacity values, GTN does not currently have the  
6 ability to price its recourse seasonal services on a seasonal basis.

7 **Q: Why is GTN proposing to share incremental revenues above an annual revenue**  
8 **threshold rather than credit all incremental revenues back to long-term, uniform**  
9 **rate shippers?**

10 A: Revenue sharing will ensure that an incentive remains for the pipeline to sell capacity  
11 once its annual revenue requirement, based upon application of maximum uniform  
12 recourse rates, is met. In addition, revenue sharing reflects the fact that both the pipeline  
13 and its long-term firm shippers stand to benefit from an application of flexible service  
14 rates to flexible service contracts.

15 **Q: Does GTN propose to apply flexible service rates to existing flexible service**  
16 **contracts?**

17 A: No. To the extent that market conditions allow GTN to assess flexible service rates that  
18 are higher than the maximum uniform MDQ recourse rate, GTN will assess the higher  
19 rates on a prospective basis only.

20 **Q: How would expansion capacity be affected by your risk-sharing and flexible service**  
21 **rate proposals?**

22 A: Revenues for expansion capacity would be treated separate and apart from these revenue-  
23 sharing mechanisms. If, however, GTN were to expand its system and make use of  
24 turnback capacity, shippers will receive credit for the reservation charges that otherwise  
25 would apply to that capacity had it been sold outside of the expansion.

1 **Q: Are the flexible service rates you are proposing consistent with the Commission's**  
2 **policy and rate design objectives?**

3 A: Yes. My flexible service rate proposal is wholly consistent with the pricing mechanisms  
4 contemplated by the Commission in its Rate Design Policy Statement, Order No. 637,  
5 and its December 22, 2005 Notice of Proposed Rulemaking in Docket Nos. RM05-23-  
6 000, *et al.*, ("Storage NOPR"), as discussed below. In particular, Order No. 637 and the  
7 Storage NOPR address the shortcomings of uniform cost-of-service rates and the cost  
8 recovery issues faced by pipelines such as GTN that are confronted with both  
9 decontracting and an increasing reliance by shippers on short-term and seasonal services.  
10 Order No. 637 provides that pipelines may institute value-based peak/off-peak  
11 ("seasonal") rates for all short-term services as one possible method of promoting  
12 allocative efficiency that is consistent with the goal of protecting customers from  
13 monopoly power. (Allocative efficiency means that those who value the product or  
14 service most should be the ones to have it.) Short-term services are defined to include  
15 short-term firm service, interruptible service, and multi-year seasonal contracts.

16 The Commission supported pipeline implementation of seasonal rates in Order  
17 No. 637 on the basis that such rates promote several important policy goals. The  
18 Commission recognized that the use of such rates could (1) remove one of the biases  
19 favoring short-term contracts; (2) reduce the need for discounts and reliance on discount  
20 adjustments because short-term shippers will share more of the pipeline's costs; and (3)  
21 increase efficiency in short-term markets by allowing prices to better reflect demand  
22 during peak periods. The flexible service rate proposal accomplishes these same policy  
23 objectives. In addition, the flexible service rates that I am proposing are consistent with  
24 the stated objectives found in Part 284.10(b) of the Commission's regulations. Part

1 284.10(b) distinguishes peak and off-peak rates stating that rates for peak periods should  
2 be designed to ration capacity and rates for off-peak periods should be designed to  
3 maximize throughput. Flexible service rates meet this objective by allowing the pipeline  
4 to charge more for flexible services during peak periods while allowing the pipeline to  
5 continue to discount rates during off-peak periods.

6 In the Storage NOPR, the Commission articulated its perspective on uniform  
7 maximum rates with respect to storage service. The Commission's conclusions apply  
8 equally to pipeline capacity. Noting again that uniform maximum rates are based on  
9 projections of annual revenue requirements and relatively constant levels of demand, the  
10 Commission recognized that service used on a short-term or spot basis often does not  
11 exhibit the level of demand assumed by cost-of-service rate design, and that permitting a  
12 service provider to earn higher revenues from short-term services during peak demand  
13 periods or through other pricing mechanisms may allow cost-of-service recovery.

14 **Q: The Commission has noted that the use of seasonal rates could reduce the need for**  
15 **discounts and reliance on discount adjustments because short-term shippers will**  
16 **share more of the pipeline's costs. Does this hold true for flexible service rates as**  
17 **well?**

18 **A:** Yes. In the absence of a flexible service pricing mechanism, rates for seasonal and short-  
19 term services would be capped at uniform MDQ rates. While prices could rise to the  
20 traditional maximum recourse level during peak periods, during off-peak periods the rates  
21 collected by the pipeline would reflect off-peak capacity values. Therefore, on average  
22 there would be a need to discount-adjust seasonal and short-term services which were  
23 priced to meet the market during the off-peak periods.

24 On the other hand, if rates for seasonal and short-term services were permitted to  
25 follow the market by exceeding the traditional maximum recourse level during peak

1 periods, then the average rates charged for these services would be higher, and the  
2 difference between the average rate charged and the traditional maximum recourse rate  
3 would be reduced, thereby reducing the pipeline's need to discount-adjust.

4 **Q: Does a flexible service pricing mechanism reduce the level of discount adjustments**  
5 **necessary for all of the flexible services you have described, including interruptible**  
6 **transportation?**

7 A: Yes, because, on average, the rates charged for these services will be higher, assuming  
8 the pipeline is successful at selling flexible service capacity when differentials exceed the  
9 pipeline's traditional maximum recourse rates. Discount adjustments will still be based  
10 upon the traditional maximum recourse rates.

11 **Q: What market changes have created the need for flexible service rates?**

12 A: Flexible service rates are particularly important given the changes that have occurred  
13 since GTN's rates were last set. When GTN's rates were set in Docket No. RP94-149-  
14 000, GTN was fully subscribed on a long-term basis with the exception of 57,875 Dth/d  
15 of Stanfield to Malin capacity for which GTN was placed at risk. Subsequent to that rate  
16 case, GTN had essentially remained at or near full subscription through 2002. As  
17 described in the testimony of GTN Witness Ferron-Jones, it was subsequent to 2002 that  
18 market conditions deteriorated and GTN faced significant levels of decontracting. In  
19 other words, GTN is in a much different situation now than it was when its rates were last  
20 set in 1996.

21 As stated above, implementation of flexible service rates will enable GTN to take  
22 advantage of pricing opportunities when selling its unused capacity. Flexible service  
23 rates will allow GTN to charge more for seasonal and short-term services, when the  
24 opportunity presents itself, thereby maximizing the pipeline's revenues and reducing the

1 risk-sharing burden of both the pipeline and its shippers. In other words, flexible service  
2 rates will help to mitigate the impact of capacity turnback for both GTN and its long-term  
3 firm shippers.

4 **Q: Does your flexible pricing proposal apply to authorized overrun service?**

5 A: Yes. The flexible service rate proposals for IT services will apply equally to authorized  
6 overrun services.

7  
8  
9 **Rate Design**

10 **Q: Are you proposing to retain GTN's current mileage-based rate design structure and**  
11 **the use of the straight fixed-variable ("SFV") rate design methodology?**

12 A: Yes. I am proposing to retain GTN's current mileage-based rate structure, which is  
13 consistent with the requirement in Section 284.10(c)(3) of the Commission's regulations  
14 that transportation rates reasonably reflect any material variation in the cost of providing  
15 service due to the distance over which transportation is provided. In addition, I am  
16 proposing to design rates utilizing the SFV rate design methodology, consistent with  
17 current Commission policy.

18 **Q: Are you sponsoring Statements related to cost allocation and rate design?**

19 A: Yes, I am sponsoring Schedules I-2, classification of cost-of-service, and I-3, allocation  
20 of cost-of-service. In addition, I am sponsoring Statement J, comparison and  
21 reconciliation of estimated operating revenues with cost-of-service; Schedule J-1,  
22 summary of billing determinants; and Schedule J-2, derivation of rates.

23 **Q: Please describe the classification of costs set forth in Statement I-2.**

24 A: In Schedule I-2, GTN's functionalized cost-of-service is classified between fixed and  
25 variable, and between mileage and non-mileage. Consistent with the classification of the

1 cost-of-service upon which GTN's current rates are based, I classified the non-labor  
2 compressor station operation and maintenance ("O&M") expenses included in Account  
3 Nos. 853 and 864, and odorant costs included in Account No. 859, as variable. In  
4 addition, compressor use taxes that are assessed in the State of Washington and reflected  
5 in Taxes Other Than Income were classified as variable. All other costs are classified as  
6 fixed.

7 Fixed costs are further classified between mileage and non-mileage. Consistent  
8 with the classification of costs underlying GTN's current rates, all administrative and  
9 general expenses ("A&G"), in addition to the supervision and engineering expenses  
10 included in Account Nos. 850 and 861, were classified as non-mileage. All other fixed  
11 costs vary with miles of haul and are therefore classified as mileage-based.

12 The last consideration is the classification of costs between reservation and  
13 delivery. Consistent with the SFV methodology, I classified all fixed costs as either  
14 mileage or non-mileage reservation costs, and classified all variable costs as delivery  
15 costs.

16 **Q: Please describe the allocation of costs set forth on Schedule I-3.**

17 A: Schedule I-3 illustrates the allocation of unsubscribed, long-term firm capacity costs  
18 between GTN and its maximum recourse rate shippers, consistent with the risk sharing  
19 mechanism described earlier in my testimony. As illustrated on Schedule I-3, Workpaper  
20 1, mileage and non-mileage reservation quantities were utilized to determine a ratio of  
21 unsubscribed capacity to recourse rate capacity. Total recourse rate capacity includes all  
22 capacity projected to be sold at maximum recourse rates in addition to GTN's  
23 unsubscribed, long-term firm capacity. The ratio of unsubscribed capacity is then

1 multiplied by 10%, which represents GTN's Risk Sharing Percentage. GTN's share of  
2 the mileage and non-mileage reservation costs associated with unsubscribed capacity was  
3 determined by multiplying GTN's risk sharing mileage and non-mileage percentages by  
4 total mileage and non-mileage costs, and these risk sharing costs were then subtracted  
5 from GTN's overall cost-of-service, thereby ensuring that GTN will be placed at risk for  
6 its share of the unsubscribed capacity costs at the rate derivation stage.

7 **Q: Are any other cost-of-service adjustments shown on Schedule I-3?**

8 A: Yes. In addition to illustrating the allocation of unsubscribed capacity costs to GTN,  
9 Schedule I-3 includes a credit to the cost-of-service equal to the amount of revenue GTN  
10 anticipates receiving from discounted short-term services during the test year. Short-term  
11 services referred to here include short-term firm transportation and interruptible hub  
12 services that include parking and lending. A cost-of-service credit associated with short-  
13 term firm and hub services equal to \$1,393,988 is shown on line 7 of Schedule I-3.

14 It is worth noting here that GTN does not project any maximum rate short-term  
15 firm volumes during the test period, and that the crediting of discounted short-term  
16 service revenues simplifies the iterative discount adjustment process by excluding these  
17 volumes from the iterative process. GTN relies on its discounted long-term firm and  
18 interruptible service contracts to conduct an iterative discount adjustment process, as  
19 discussed later in this testimony.

20 **Q: Is the cost-of-service arrived at on Schedule I-3 the basis of GTN's derivation of**  
21 **rates?**

22 A: Yes. The net cost-of-service illustrated on Schedule I-3, which reflects adjustments to  
23 account for the allocation of risk sharing costs to GTN and the crediting of discounted



1 short-term service revenues, is the basis of GTN's derivation of rates illustrated in  
2 Schedule J-2.

3 **Q: Please describe Schedule J-1, Summary of Billing Determinants.**

4 A: Schedule J-1 illustrates, by rate schedule and rate component, adjustments to test period  
5 volumes shown in Schedule G-2 to arrive at the Schedule J-2 billing determinants used  
6 for rate design. On Schedule J-1, Workpaper 1, the iterative discount adjustment process  
7 is illustrated. Billing determinants for GTN's stand-alone laterals are shown on Schedule  
8 J-1 as well.

9 **Q: Please describe the iterative discount adjustment process.**

10 A: An iterative process was run to discount-adjust all discounted long-term firm and  
11 interruptible mainline contracts reflected in the test period. The first iteration compares  
12 the discounted rates applicable to each contract to the maximum rates generated using  
13 GTN's net cost-of-service from Schedule I-3 and GTN's net billing determinants,  
14 unadjusted for discounts, from Schedule I-3, Workpaper 1, line 21. This ratio of  
15 discounted rate to maximum rate represents the percentage of capacity that would have  
16 been sold at the maximum rate. The remaining capacity is removed from the billing  
17 determinants associated with each discounted contract, and rates are recalculated using  
18 the adjusted billing determinants resulting from the first iteration.

19 This iterative process continues until an equilibrium is reached where additional  
20 iterations produce no change in the level of the maximum rate. This equilibrium was  
21 reached after four iterations.

22 **Q: Briefly describe the derivation of rates shown on Schedule J-2.**

1 A: As illustrated in Schedule J-2, the net mainline cost-of-service from Schedule I-3 is  
2 divided by the discount-adjusted billing determinants from Schedule J-1. The billing  
3 determinants include imputed mileage and non-mileage reservation quantities for  
4 interruptible transportation service. Reservation quantities for interruptible transportation  
5 service were imputed on a 100 percent load factor basis. The resulting cost-based  
6 maximum recourse rates for mainline service are shown on Schedule J-2, page 1 of 3.

7 The derivation of rates for the Medford and Coyote Springs Laterals are shown on  
8 Schedules J-2, pages 2 and 3, respectively.

9 **Q: Did you consider whether the costs and volumes associated with the Medford and**  
10 **Coyote Springs Laterals should be rolled in with GTN's mainline costs and**  
11 **volumes?**

12 A: Yes; however, on a unit basis the rates associated with the Medford and Coyote Springs  
13 Laterals still exceed the rates for service on GTN's mainline. Therefore, I am not  
14 recommending at this time that the Medford and Coyote Springs Laterals be rolled in  
15 with GTN's mainline.

#### 16 17 **Conversion to Daily Rates**

18 **Q: Through the design of rates, are you proposing to change the way in which GTN**  
19 **collects firm transportation revenues?**

20 A: Yes. Reservation charges currently in effect for firm transportation service on GTN were  
21 designed as monthly charges in GTN's last general section 4 rate proceeding. In the  
22 instant proceeding, GTN is proposing to design reservation charges for firm  
23 transportation service on a daily basis.

24 **Q: Why are you proposing to design daily reservation charges as opposed to monthly?**

1 A: There are several reasons. First and foremost is that shippers, when doing business on  
2 GTN, value GTN capacity on a per-unit basis relative to the differentials that exist across  
3 the system. For example, when GTN negotiates discounted rate agreements, the  
4 negotiations center around a daily price per Dth of capacity.

5 Second is ease of use. Converting to a daily rate structure will make it easier for  
6 GTN to administer billing and will facilitate development of GTN's next generation  
7 business systems. For example, GTN's current billing system is required to be capable of  
8 converting firm service rates from daily to monthly, due to the fact that capacity sales and  
9 capacity release transactions are often negotiated on a daily basis but are billed on a two-  
10 part monthly reservation charge basis. Rate conversions such as these may create  
11 confusion when customers review their bills. Converting to daily rates will eliminate this  
12 unnecessary complexity and confusion. Further, as GTN is undergoing efforts to replace  
13 its existing billing system, converting to daily rates at this juncture would simplify the  
14 design of the new system by eliminating the requirement to convert from daily to  
15 monthly pricing and vice versa.

16 **Q: With daily rates, will GTN need to adjust its rates to take into account leap years?**

17 A: Yes. Under GTN's proposed daily rates, non-mileage and mileage reservation billing  
18 determinants are multiplied by 365 days (rather than 12 months) in the rate design  
19 process. GTN proposes to prospectively submit revised tariff sheets that utilize a factor  
20 of 366 days in the design of daily rates that will be in effect during leap years.

21  
22 **Proposed Tariff Changes**

23  
24 **Q: Are you proposing changes to the General Terms and Conditions of Service**  
25 **("GT&C") in GTN's FERC Gas Tariff?**

1 A: Yes, I am proposing a number of changes that are designed to position GTN to be able to  
2 maximize the utilization of its capacity on a long-term basis, thereby improving GTN's  
3 contract profile to the benefit of GTN and its long-term firm shippers.

4 The overriding issue in this rate case is turnback capacity. Until a few years ago,  
5 GTN was effectively fully contracted on a long-term basis. However, persistent poor  
6 market conditions, in combination with certain FERC policies and precedents that have  
7 subsequently changed, have resulted in GTN now facing significant and ongoing  
8 turnback risk. As explained below, more timely modifications of FERC policy would  
9 have rendered a completely different set of results, which would have benefited both the  
10 pipeline and its long-term firm shippers.

11 **Q: What changes could have rendered a more favorable situation today?**

12 A: There are three specific areas where timely changes to FERC policy would have made a  
13 significant difference to GTN and its shippers. First, the Commission approved higher  
14 collateral requirements for non-creditworthy shippers bidding on expansion capacity, but  
15 not until after GTN's 2002 Pipeline Expansion went into service. Second, in various  
16 creditworthiness proceedings and in the Commission's Policy Statement on  
17 Creditworthiness Issues in Docket Nos. PL05-8-000, *et al.*, the Commission indicated its  
18 willingness to consider creditworthiness as part of a pipeline's not unduly discriminatory  
19 process for determining net present value when considering bids for new capacity. Last,  
20 changes to the Commission's ROFR policy could have significantly reduced GTN's  
21 capacity turnback exposure by facilitating the recontracting of long-term firm capacity  
22 subject to a ROFR.

23 **Q: How has Commission policy changed subsequent to the construction of GTN's 2002**  
24 **Expansion?**

1 A: At the time of GTN's 2002 Expansion, the Commission allowed pipelines to allocate  
2 available capacity based on the highest valued bid for the capacity, without distinction as  
3 to customer class. GTN's tariff, at the time of the 2002 Expansion (and currently),  
4 applied this bid evaluation methodology, which is a function merely of price and term.  
5 Other than requiring that expansion bidders qualify for bidding by meeting the  
6 creditworthiness requirements of GTN's tariff, the relative creditworthiness of individual  
7 bidders was not taken into consideration when evaluating bids or awarding capacity. As  
8 a result, GTN's 2002 Expansion capacity was awarded to two qualified bidders that  
9 submitted bids with terms of 52 and 40 years. Specifically, capacity was awarded to  
10 Newport and Calpine, two non-creditworthy shippers whose combined requests for  
11 capacity exceeded the amount of capacity being offered in the expansion open-season.

12 **Q: What was GTN's collateral requirement for the 2002 Expansion?**

13 A: At the time the expansion open-season was run, GTN set its collateral requirement for  
14 non-creditworthy bidders equal to 12 months of reservation charges, an amount equal to  
15 what its lenders had required as collateral for its previous 1993 Pipeline Expansion and  
16 consistent with what other pipelines had required before committing funds to other  
17 construction projects.

18 A number of subsequent changes in Commission policy would have protected  
19 GTN and its shippers from the risk associated with conducting an open-season for  
20 expansion capacity for which excess demand existed.

21 **Q: How do you define excess demand?**

22 A: The 2002 Expansion was designed to deliver an additional 210,800 Dth/d of annual firm  
23 service and an additional 20,380 Dth/d of winter-only service. When GTN conducted its

1 expansion open-season, GTN received binding bids totaling 2,137,900 Dth/d. Clearly, at  
2 the time there was excess demand for the limited expansion capacity. The 2002  
3 Expansion capacity was fully placed into service by the end of 2002; yet by November 1,  
4 2006, only four years later, GTN anticipates that approximately 450,000 Dth/d of annual  
5 firm capacity will have been turned back to the pipeline either as a result of default or due  
6 to contract non-renewals.

7 **Q: How could stronger collateral requirements have protected GTN and its existing**  
8 **long-term firm shippers from expansion shipper default?**

9 A: After GTN's 2002 Pipeline Expansion was placed into service, the Commission  
10 implemented policy changes that would have limited GTN and its shippers' exposure to  
11 default risk and, ultimately, unsubscribed expansion capacity. The Commission has since  
12 determined that pipelines can require collateral for new facilities up to the shipper's  
13 proportionate share of the cost of the proposed facilities.

14 Assuming GTN would have requested non-creditworthy bidders' pro-rata share of  
15 the cost of 2002 Expansion facilities, either those shippers would have withdrawn from  
16 the bidding process, or GTN would have been fully collateralized for the expansion  
17 capacity. In any event, GTN and its existing long-term firm shippers would have been  
18 protected from expansion shipper default.

19 **Q: How could the addition of creditworthiness considerations to the bid evaluation**  
20 **process have protected GTN and its existing long-term firm shippers from**  
21 **expansion shipper default?**

22 A: Had GTN been able to incorporate creditworthiness considerations into the bid evaluation  
23 process for 2002 Expansion capacity, it is likely that the expansion capacity would have  
24 been awarded to creditworthy shippers that would still be on the system today. As  
25 discussed in the testimony of GTN Witness Ken Nichols, GTN is proposing in the instant

filing to add creditworthiness considerations to bid evaluation procedures for both expansion and existing capacity.

**Q: How could a more timely change in the Commission's ROFR policy have limited GTN and its existing long-term firm shippers' exposure to capacity turnback?**

A: GTN's open-season for the 2002 Expansion ran from January 2, 2001, through February 15, 2001. Due to the overwhelming demand for 2002 Expansion capacity, GTN ran an additional open-season in June of 2001 for capacity that could be placed into service in 2003. In the 2002 Expansion open-season, GTN received 45 total bids, 22 of which were maximum rate bids of 20 years or longer, representing 1,169,000 Dth/d of capacity. In the 2003 Expansion open-season, GTN received 11 total bids, eight of which were maximum rate bids of 20 years or longer representing approximately 205,000 Dth/d of capacity.

During this same time period, a number of long-term firm contracts came up for renewal and were subjected to the ROFR process. The table below illustrates these contracts:

| Shipper                               | Expiration Date | Path                   | MDQ    | ROFR Results            |
|---------------------------------------|-----------------|------------------------|--------|-------------------------|
| PanCanadian Energy Svcs Inc. (EnCana) | 10/31/2001      | Kingsgate to Malin     | 10,000 | 5-year match to 2006    |
| Duke Energy Trading & Marketing, LLC  | 10/31/2001      | Kingsgate to Stanfield | 10,000 | 2-year match to 2003    |
| Duke Energy Trading & Marketing, LLC  | 10/31/2001      | Kingsgate to Malin     | 5,000  | 5-year match to 2006    |
| Coast Energy Group                    | 10/31/2002      | Kingsgate to Malin     | 20,000 | No bids, 1-year renewal |

**Q: What was the ultimate disposition of these ROFR contracts?**

A: Both EnCana and Duke Energy elected not to renew their contracts through GTN's ROFR process and, therefore, the contracts will expire during the test period. The Duke Energy contract that was extended to 2003 was not renewed again. Similarly, the Coast Energy contract was not renewed either.

1   **Q:     During the ROFR processes, what level of bidding occurred?**

2   A:     The PanCanadian capacity received four bids, only one of which exceeded 20 years.  
3           Duke Energy's Kingsgate to Malin capacity received three bids, only one of which  
4           exceeded 20 years. Duke Energy's Kingsgate to Stanfield capacity received only one  
5           two-year bid. Finally, the Coast Energy contract received no bids.

6   **Q:     Based upon GTN's experience, what is the significance of the differences between**  
7           **the ROFR and open-season processes?**

8   A:     Ultimately, through the ROFR processes, 45,000 Dth/d of existing long-term firm  
9           capacity received very little interest and did not renew for any significant period of time.  
10          During the same period, however, GTN ran two expansion open-seasons that generated  
11          substantially more bids for substantially more capacity than was offered through the  
12          ROFR processes.

13   **Q:     What, in your opinion, drove the lack of interest in the ROFR capacity?**

14   A:     I would attribute some lack of interest to the five-year term matching cap that was in  
15          place at the time. It was not until October 31, 2002, that the Commission removed the  
16          term matching cap from the ROFR process. GTN filed on November 8, 2002, to remove  
17          the cap from its tariff. In addition, I would attribute some lack of interest to the fact that  
18          ROFR capacity is encumbered by the original shipper's option to match acceptable bids  
19          in order to retain its capacity. In general terms, I believe that a buyer would be more  
20          interested in bidding on an unencumbered product or service rather than one that is  
21          encumbered by a free option that might prevent the buyer from ultimately receiving the  
22          sought-after product or service. In other words, submitting an acceptable bid in a ROFR  
23          process does not guarantee the bidding party capacity, while submitting a winning bid in



1 an open-season process generally does guarantee capacity, assuming that the new  
2 capacity is ultimately constructed.

3 **Q: What is the significance of GTN's experience with respect to the Commission's**  
4 **allocative efficiency objective?**

5 A: Allocative efficiency means that those who value the product or service most should be  
6 the ones to have it. It is clear from the above example that allocative efficiency was not  
7 realized through the ROFR process. Based upon GTN's experience, most parties that had  
8 a significant interest in GTN capacity were not motivated to bid on capacity that was  
9 encumbered by ROFR rights. Because of this, a pipeline such as GTN that expands its  
10 system when a significant amount of capacity is coming up for renewal is placed at  
11 considerable risk of post-expansion capacity turnback should potential shippers not bid  
12 on the ROFR capacity. Shippers that hold capacity that is coming up for renewal, on the  
13 other hand, are more than happy to hold on to valuable capacity with the knowledge that  
14 they can walk away from it should the capacity become devalued in the future.

15 **Q: What underscored GTN's decision to proceed with the 2002 Expansion?**

16 A: When GTN initiated the open-season for the 2002 Expansion on January 2, 2001,  
17 differentials across GTN's system were strong, GTN was essentially fully subscribed on  
18 a long-term firm basis, GTN received binding bids in excess of 2.1 Bcf/d for an  
19 expansion of approximately 220,000 Dth/d, and no existing long-term firm shippers  
20 participated in the associated capacity rationalization process. GTN awarded capacity to  
21 two shippers who submitted bids for 52 and 40 years, and GTN ended up rejecting a  
22 significant number of bids with terms between 10 and 40 years. Given these favorable  
23 conditions, GTN should have been able to expand its system and reduce its post-  
24 expansion turnback exposure.

1 **Q: Why would a pipeline with existing long-term firm contracts coming up for renewal**  
2 **face considerable recontracting risk after an expansion goes into service?**

3 A: Expansions are oftentimes driven by sustained market fundamentals that indicate,  
4 through basis differentials, that the per-unit market value of existing pipeline capacity  
5 exceeds the current cost-based rates that a pipeline charges to transport natural gas.  
6 When a pipeline expansion relieves a capacity bottleneck (or when several pipelines  
7 expand as happened following the California energy crisis), however, the differentials  
8 that supported an expansion typically decline in response, to levels that are below a  
9 pipeline's cost-based rates. It is at this time, following major pipeline expansions, that an  
10 individual pipeline is most vulnerable to capacity turnback. This is because shippers with  
11 contracts that expire following the in-service date of an expansion are less likely to renew  
12 their contracts at the maximum recourse rate, or at all, subject to the magnitude of the  
13 downward impact on basis differentials caused by the expansion(s). To the extent  
14 expanding pipelines could mitigate the risk of post-expansion capacity turnback, both  
15 pipelines and shippers would benefit.

16 **Q: How could the ROFR/capacity expansion processes be modified to limit the risk of**  
17 **prospective capacity turnback?**

18 A: As noted below, the Commission has already approved longer notice periods for ROFR  
19 capacity when a pipeline expansion is planned. However, an extension of the ROFR  
20 process when an expansion is planned does nothing to facilitate the rationalizing of  
21 capacity unless potential expansion shippers are motivated to submit bids during a ROFR  
22 bid process. Therefore, in order to promote allocative efficiency, rationalize capacity,  
23 and limit post-expansion turnback risk, the Commission should expose ROFR capacity to  
24 the bidding process for expansion capacity.

1 **Q: What would have happened if this had been in place for the 2002 Expansion?**

2 A: As noted earlier, 45,000 Dth/d of firm capacity was subject to the ROFR during the time  
3 when GTN was running open-seasons for expansion capacity. The 45,000 Dth/d of  
4 ROFR capacity was either turned back to the pipeline or is expected to be turned back by  
5 the end of the test period, a mere five years after the 2002 Expansion was placed into  
6 service. To the extent that this ROFR capacity was subject to the 2002 Expansion open-  
7 season bids, the amount of turnback capacity on GTN at the present time would  
8 potentially be 45,000 Dth/d less than what it is today.

9 **Q: Are you proposing tariff changes that will allow ROFR capacity to be subject to**  
10 **expansion open-season bidding?**

11 A: Yes. I am proposing substantive modifications on Sheet Nos. 210, 210A, 211, and 214.

12 **Q: Please describe your proposed tariff changes.**

13 A: I am proposing to implement a tariff change that the Commission has previously found to  
14 be just and reasonable. Consistent with reservation of capacity tariff provisions  
15 previously approved by the Commission, I am proposing, in revised Paragraph 32 of  
16 GTN's GT&C, to allow GTN to reserve any existing or potential unsubscribed capacity  
17 for future expansion projects. Currently, once available capacity on GTN is made  
18 available through an open-season process, unsold capacity is subsequently made  
19 available on a first-come, first-served basis. By adding reservation of capacity language  
20 to its tariff, GTN will be able to ensure that when its system is expanded, all available  
21 capacity will be subject to the expansion open-season bidding process, thereby making  
22 existing and expansion capacity available under consistent terms.

23 In addition, consistent with ROFR tariff provisions previously approved by the  
24 Commission, I am proposing to modify Paragraph 33 of GTN's GT&C to provide GTN

1 the flexibility to initiate the ROFR process up to 36 months in advance of a shipper's  
2 contract expiration in the event that GTN has proposed to expand its system, when the  
3 sizing of the expansion may be affected by a shipper's plans regarding the continuation of  
4 service. In order to address any reluctance on the part of expansion bidders to submit  
5 bids for capacity that is encumbered with a ROFR, I am additionally proposing to subject  
6 all ROFR capacity that will become available within this 36-month period to the  
7 expansion open-season bidding process. In other words, when expansion bidders submit  
8 binding bids for expansion capacity, GTN may apply these bids to the capacity that is  
9 subject to a ROFR.

10 **Q: Is it your proposal that this 36-month notice period only affect capacity that will**  
11 **become subject to the ROFR prior to a proposed expansion?**

12 A: No. I propose that the 36-month notice period apply at the time GTN runs a binding-bid  
13 open-season for expansion capacity. Therefore, the 36-month period could cover the 36  
14 months prior to the proposed expansion in-service date, or it could cover a 36-month  
15 period of time that straddles the proposed expansion in-service date.

16 **Q: Is it your proposal that GTN will continue to rationalize capacity in the traditional**  
17 **sense as well?**

18 A: Yes, GTN will continue to conduct a capacity rationalization process, consistent with  
19 current Commission policy, in addition to subjecting ROFR capacity to open-season  
20 bidding. However, capacity needs should first be met with ROFR capacity (to the extent  
21 that shippers choose not to match acceptable expansion bids), followed by acceptable  
22 offers to rationalize capacity, and last by a physical expansion of the system.

23 **Q: Why would ROFR capacity be used first to meet the needs of expansion shippers?**

1 A: It makes sense to first rationalize capacity that is set to expire in the near term because it  
2 is this capacity that is most likely to decontract immediately following an expansion  
3 should market conditions change post-expansion.

4 **Q: How would an existing shipper use its ROFR if its capacity were subjected to**  
5 **expansion bids?**

6 A: Once binding bids have been received for expansion capacity, the pipeline will decide  
7 which bids are acceptable based upon rate, term, and creditworthiness considerations. An  
8 existing shipper who holds a ROFR would then be required to match the acceptable  
9 bid(s) with the lowest credit-adjusted NPV that the pipeline is willing to accept to expand  
10 its system. For example, assuming all things being equal except length of bid term, if the  
11 pipeline receives expansion bids from three to 40 years, and the pipeline chooses to  
12 expand its system to meet all maximum rate expansion bids with terms greater than 20  
13 years, then the existing shipper could exercise its ROFR by extending its contract for 20  
14 years at the maximum recourse rate. If the shipper chooses not to match, then the  
15 existing shipper's capacity would be used to meet the needs of the expansion shippers,  
16 thereby reducing the size of the expansion project.

17 **Q: In the event a shipper with ROFR rights chooses not to match the minimum**  
18 **acceptable expansion term, what becomes of the existing shipper's capacity when**  
19 **the existing contract expires prior to the expansion in-service date?**

20 A: In the event that ROFR capacity becomes available in advance of expansion capacity  
21 being placed into service, then the pipeline could either solicit expansion shipper interest  
22 in an early start date for a portion of their capacity needs, or the pipeline could go at-risk  
23 for the capacity during the interim period, selling the capacity on a short-term basis.  
24 During this interim period, the capacity would not carry ROFR rights.

1 **Q: In the event a shipper with ROFR rights chooses not to match the minimum**  
2 **acceptable expansion term, how are the needs of expansion shippers met when the**  
3 **existing contract expires after the expansion in-service date?**

4 A: The pipeline would only subject ROFR capacity set to expire after the proposed  
5 expansion in-service date to acceptable bids from expansion bidders that were willing to  
6 take service at a later start date. In such a situation, if an existing shipper chose to match  
7 an acceptable expansion bid with a later start date, then the pipeline could give the  
8 expansion bidder(s) the option of taking capacity early, build to meet the expansion  
9 shipper needs and go at-risk during the interim period, phase the expansion, or choose not  
10 to build to meet the later start date(s).

11 **Q: In summary, what are the benefits of your proposals to change GTN's ROFR tariff**  
12 **provisions?**

13 A: My proposals are aimed at ensuring that when an expansion is planned, all available or  
14 potentially-available capacity is subject to the same bidding process, and that parties who  
15 desire capacity actively participate in the pipeline's ROFR process. The risk that a  
16 ROFR shipper faces under my proposal is in some ways diminished by the fact that the  
17 shipper would only have to match the lowest term that the pipeline finds acceptable to  
18 expand its system, while on the other hand the ROFR shipper's risk increases somewhat  
19 because shippers that otherwise would not bid on encumbered capacity will now be  
20 bidding, by default, on capacity encumbered by ROFR rights. The real benefit is to the  
21 pipeline and its existing long-term shippers. The benefit to the pipeline of terming up  
22 expiring contracts is enhanced financial certainty and reduced turnback risk. Likewise,  
23 the benefits to the existing long-term shippers are essentially the same and may be  
24 demonstrated by the enhanced rate certainty and lower rates that result from reduced  
25 capacity turnback.

1    **Q:**    **Does this conclude your testimony?**

2    **A:**    Yes, it does.