BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. CASCADE NATURAL GAS CORPORATION, Respondent.	DOCKET UG-200568

POST-HEARING BRIEF OF PUBLIC COUNSEL

March 22, 2021

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I. INTRODUCTION

1. Cascade Natural Gas Corporation ("Cascade" or "the Company") requests a substantial rate increase for its natural gas service. In its in initial filing dated June 19, 2020, Cascade requests that the Utilities and Transportation Commission ("Commission") grant a rate increase of $13.8 million, or 5.3 percent.[1] Cascade revised its request on July 24, 2020, resulting in an increased request of $14.3 million.[2] On rebuttal, Cascade's request declined significantly to $7.4 million.[3]

2. Cascade's rate request comes during a deadly, global pandemic, which has been economically devastating for Washingtonians. Businesses were ordered to close, causing millions of people to lose their jobs as a result of the COVID-19 pandemic. Utilities are operating under a disconnection moratorium, put in place first by the Governor and then augmented by the Commission. The moratorium prevents Cascade from disconnecting customers for nonpayment. Under these circumstances, customers are over-burdened and cannot absorb a rate increase. Now more than ever, the Commission must carefully weigh Cascade's request and consider the impact that any rate increase will have on customers.

3. The Public Counsel Unit of the Attorney General's Office ("Public Counsel") has analyzed Cascade's rate request, and we have offered testimony from two notable witnesses on revenue requirement and cost of capital and capital structure. Public Counsel recommends that the Commission reduce Cascade's current rates by $2.4 million.

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[1] Direct Testimony of Nicole A. Kivisto, Exh. NAK-1T at 3:16–17.

[2] Supplemental Direct Testimony of Maryalice C. Peters, Exh. MCP-8 (column 4, line 4); Rebuttal Testimony of Maryalice C. Gresham, Exh. MCG-11T at 2:15–3:2. Ms. Gresham previously filed testimony in this docket as 'Maryalice C. Peters.'

[3] Kivisto, Exh. NAK-2T at 2:5–6, Table 1; Gresham, Exh. MCG-11T at 3:3–9.

II. THE COMMISSION SHOULD USE A CAPITAL STRUCTURE THAT REFLECTS CASCADE'S ACTUAL CAPITALIZATION AND SHOULD REJECT CASCADE'S OVERLY-GENEROUS COST OF CAPITAL CALCULATION

A. Cascade Requests an Unreasonable Capital Structure.

4. In setting rates, the Commission determines a capital structure for ratemaking purposes. The Commission has discretion to use a capital structure that reflects the utility's actual capitalization or that is "hypothetical."[4] Whether the Commission chooses a hypothetical or actual capital structure for ratemaking purposes, it should present an optimal mix of equity and debt to balance capital costs with financial risk.[5] A capital structure weighted too heavily towards equity can result in unreasonably high costs for customers, while a capital structure weighted too heavily towards debt can jeopardize a utility's access to capital markets and financial viability.[6]

5. The Commission has recognized that the capital structure used for ratemaking purposes materially impacts customer rates and requires a capital structure that fairly balances "safety" and "economy."[7] "Safety" refers to the idea that a capital structure with more equity and less debt may result in higher overall costs and rates for customers, but has enhanced financial integrity. "Economy" refers to the idea that a capital structure with more debt and less equity may result in lower overall costs and rates for customers, but may have enhanced financial risk.

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[4] *PacifiCorp v. Wash. Utils. & Transp. Comm'n*, 194 Wn. App. 571, 608, 611-612, 376 P.2d 389, 407, 409 (2016).

[5] *In re: Zia Nat. Gas Co.,* 128 N.M. 728, 731, 998 P.2d 564, 567 (2000).

[6] *Pioneer Nat. Res. USA, Inc. v. Pub. Util. Comm'n of Texas*, 303 S.W.3d 363, 373 (Tex. App. 2009).

[7] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-111048 & UG-111049 (*Consol.*), Order 08, (May 7, 2012).

6. Public Counsel's proposed capital structure for Cascade adequately balances safety and economy. Cascade proposes a more generous hypothetical capital structure with 50.4 percent equity and 49.6 percent debt that is excessively tilted towards safety. Public Counsel recommends that the Commission set rates using a capital structure with 49.1 percent equity and 50.9 percent debt, which reflects Cascade's capitalization in recent years.[8] Cascade has maintained a capital structure with equity less than 50 percent of its capitalization.[9] The only party advocating for a capital structure with more than 50 percent equity is Cascade; all of the other parties addressing capital structure recommend an equity ratio below 50 percent.

7. Public Counsel's proposed capital structure is consistent with the capital structure approved in Cascade's last rate case, and is also consistent with the capital structures the Commission used in several recent general rate cases.[10]

B. Cascade's Requested Return on Equity Is Inflated.

8. Return on equity (ROE) is a regulated company's rate of profit. While the regulator does not guarantee a certain level of profit, the return on equity is the amount of profit deemed by the regulator to be reasonable for ratemaking purposes. The utility has the opportunity to earn that return through efficient management.

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[8] Response Testimony of Dr. J. Randall Woolridge, Exh. JRW-1Tr at 3:16–4:1.

[9] Woolridge. Exh. JRW-4.

[10] *See, Wash. Utils. & Transp. Comm'n v. Cascade Nat. Gas Corp.,* Docket UG-190210, Order 5: Final Order, ¶ 10 (Feb. 3, 2020) (Capital structure with 49.1 percent equity approved); *Wash. Utils. & Transp. Comm'n v. NW Nat. Gas Co.,* Docket UG-181053, Order 06, ¶¶ 51, 53 (Oct. 21, 2019) (Capital structure with 49 percent equity approved); *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-152253, Order 12 (Oct. 21, 2019) (Capital structure with 49 percent equity approved); *Wash. Utils. & Transp. Comm'n v. Avista Corp.,* Dockets UE-170485 & UG-170486 (*Consol.*), Order 07, ¶ 111 (Apr. 26, 2018) (Capital structure with 48.5 percent equity approved); *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-170033 & UG-170034 (*Consol.*), Order 08, ¶ 83 (Dec. 5, 2017) (Capital structure with 48.5 percent equity approved).

9. Indeed, regulators are tasked with providing regulated utilities with the opportunity to earn a fair return within the guiding principles established in two seminal United States Supreme Court cases, *Hope*[11] and *Bluefield*.[12] Through *Hope* and *Bluefield*, the United States Supreme Court recognized that rates for regulated monopoly utilities must incorporate a fair rate of return on equity that is comparable to returns investors would expect to receive on other investments of similar risk, sufficient to assure confidence in the utility's financial integrity, and adequate to maintain and support the company's credit and to attract capital at reasonable costs.[13] Because utilities, such as Cascade, operate as monopolies, there is a lack of competition for the essential services they provide.[14] Regulation serves as a substitute for competition and seeks to set rates that are fair to consumers and also provides an adequate return to investors.[15]

10. The Commission must determine the market-based cost of capital to set a utility's return on equity.[16] Cost of capital experts use economic models that seek to use market-based information to set an appropriate return on equity for regulated utilities. Examples of such models are the Discounted Cash Flow (DCF) Model and Capital Asset Pricing Model (CAPM), both of which are used by the cost of capital experts appearing for parties in this case, including Public Counsel's witness Dr. J. Randall Woolridge. Dr. Woolridge's studies resulted in an equity

[11] *Fed. Power Comm'n v. Hope Nat. Gas Co.,* 320 U.S. 591, 64 S. Ct. 281 (1944).
[12] *Bluefield Waterworks & Imp. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 43 S. Ct. 675 (1923).
[13] Woolridge, Exh. JRW-1Tr at 2:9–3:3.
[14] Woolridge, Exh. JRW-1Tr at 23:1–12.
[15] *Id*.
[16] Woolridge, Exh. JRW-1Tr at 3:4–10.

cost range of 7.3 percent to 9.0 percent.[17] This range accurately reflects current capital market data.[18]

11. Cascade initially requested a return on equity of 10.3 percent. The Company reduced its request to 9.8 percent on rebuttal. Cascade's reduction does not go far enough to adequately reflect a market-based return on equity. Public Counsel recommends the cost of equity for Cascade to be set at 9.0 percent.[19] Using Cascade's proposed cost of debt and a capital structure with an equity ratio of 49.1 percent, Public Counsel's weighted cost of capital, or overall rate of return, is 6.83 percent.[20]

1. Interest rates and capital markets are historically low.

12. The total cost of a utility's operations includes the cost of capital.[21] As explained by Dr. Woolridge, "The cost of common equity capital is the expected return on a firm's common stock that the marginal investor would deem sufficient to compensate for risk and the time value of money."[22] When a company's profits exceed what is required by investors, equity is valued in excess of its book value.[23] This means that more profitable companies have a market-to-book ratio greater than one.[24] Dr. Woolridge conducted a regression study between the estimated return on equity and the market-to-book ratios for natural gas and electric companies.[25]

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[17] Woolridge, Exh. JRW-1Tr at 4:1–5.
[18] Woolridge, Exh. JRW-1Tr at 4:8.
[19] Woolridge, Exh. JRW-1Tr at 4:8–10; Exh. JRW-2.
[20] Woolridge, Exh. JRW-14T at 4:10–14 (including Table 1); Exh. JRW-2.
[21] Woolridge, Exh. JRW-1Tr at 23:15.
[22] Woolridge, Exh. JRW-1Tr at 23:15–19.
[23] Woolridge, Exh. JRW-1Tr at 24:14–16.
[24] Woolridge, Exh. JRW-1Tr at 25:15–28.
[25] Woolridge, Exh. JRW-1Tr at 25:15–26:9; Exh. JRW-5.

Dr. Woolridge's results demonstrate a strong positive relationship between return on equity and the market-to-book ratios for utilities.[26]

13. Significantly, Dr. Woolridge's results also demonstrate that the utilities have been assigned costs of equity that exceed their real equity costs for many years.[27] This is true even though actual earned returns on equity have declined from approximately 12 percent to approximately nine percent and dividend yields declined over the last decade.[28] Over this same time period, the average market-to-book ratio has been well over 1.00X; and for the last three years, the average market-to-book ratio has been over 2.00X.[29] Dr. Woolridge testifies regarding the impact of the large market-to-book ratios:

> This means that, for at least the last decade, returns on common equity have been greater than the cost of capital, or more than necessary to meet investors' required returns. **This also means that customers have been paying more than necessary to support an appropriate profit level for regulated utilities.**[30]

14. Interest rates and capital markets have been at historically low levels.[31] In turn, authorized returns on equity for electric and natural gas utilities have slowly declined to reflect the low capital costs in the market.[32] This trend is reflected in the Commission's decisions as

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[26] Woolridge, Exh. JRW-1Tr at 26:5–7.
[27] Woolridge, Exh. JRW-1Tr at 26:7–9.
[28] Woolridge, Exh. JRW-1Tr at 27:5–7; Exh. JRW-6 at 2–3.
[29] Woolridge, Exh. JRW-6 at 3.
[30] Woolridge, Exh. JRW-1Tr at 27:9–12 (emphasis added).
[31] *See,* Woolridge, TR. 115:2–9. Utilities are raising record levels of capital due to favorable rates. This is the case even as authorized and earned returns on equity have come down. Rebuttal Testimony of Ann E. Bulkley, Exh. AEB-4T at 12:1–2, Figure 2 (After March 2020, the range of authorized returns on equity has tightened, with the highest levels not represented. This is indicative of downward trending returns on equity). Bulkley, Exh. AEB-7X at 3 (For 2020, authorized returns on equity are most commonly between 9.25 and 9.49 percent); Bulkley, TR. 53:21–54:3. Earned returns on equity in recent years range from 8.0 percent to 9.0 percent. Woolridge, Exh. JRW-1Tr at 57:14–15.
[32] Woolridge, Exh. JRW-1Tr at 17:12–18:4, incl. Figure 4.

well. For example, the Commission authorized an ROE of 9.8 percent for Puget Sound Energy on remand for joint proceedings in Dockets UE-121697 / UG-121705 and UE-130137 / UG-130138,[33] and authorized an ROE of 9.5 percent two years later in Dockets UE-170033 and UG-170034.[34] The Commission authorized ROE of 9.4 percent for Avista Corp., Cascade, NW Natural Gas Company, and Puget Sound Energy in 2020.[35]

15. To prevent customers from paying more than necessary to support an appropriate profit level for regulated utilities, it is critical for the Commission to continue to closely evaluate market data and adjust Cascade's return on equity accordingly. Continued downward adjustment is necessary. Public Counsel's recommendation appropriately reflects the downward trend in utility authorized and earned returns on equity.

2. Cascade's return on equity analysis is flawed.

16. Cascade witness Ms. Ann E. Bulkley, provides analysis that she asserts supports a return on equity for Cascade of 10.3 percent. Even though Cascade seeks a rate lower than what Ms. Bulkley provides,[36] some of the deficiencies in her analysis warrant discussion. In particular, errors in her modeling cause her results to be unreasonably inflated. Additionally, Ms. Bulkley

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[33] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-121697 & UG-121705 (*Consol.*), Order 15, ¶ 163 (June 29, 2015); *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-130137 & UG-130138 (*Consol.*), Order 14, ¶ 163 (June 29, 2015).

[34] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-170033 & UG-170034 (*Consol.*), Order 08, ¶ 94 (Dec. 5, 2017).

[35] *See Wash. Utils. & Transp. Comm'n v. Avista Corp.,* Dockets UE-190334, UG-190335, and UE-190222 (*Consol.*), Final Order 09 (Mar. 25, 2020), approving settlement that set Avista's ROE at 9.4 percent; *Wash. Utils. & Transp. Comm'n v. Cascade Nat. Gas Corp.,* Docket UG-190210, Final Order 05 (Feb. 3, 2020), approving settlement that set Cascade's ROE at 9.4 percent; *Wash. Utils. & Transp. Comm'n v. NW Nat. Gas Co.,* Docket UG-181053, Final Order 06 (Oct. 21, 2019), approving settlement that set NW Natural's ROE at 9.4 percent; and *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-190529 and UG-190530, Final Order 08, ¶ 108 (July 8, 2020).

[36] Bulkley, Exh AEB-4T at 19:7–9.

overstates the impact of fluctuating beta[37] while not studying the spread between earned returns on equity and the 30-year Treasury yield.[38] Lastly, Ms. Bulkley raises the issues of risk factors and flotation costs, but both arguments are without merit.[39]

17. Ms. Bulkley used similar modeling methodologies as Dr. Woolridge and Staff's witness, David C. Parcell. The Commission has recognized that DCF, CAPM, and Risk Premium are among modeling methodologies accepted to measure return on equity.[40] Ms. Bulkley's studies "include an inflated long-term projected interest rate and a market risk premium that is based on assumptions of future earnings growth and stock market returns that defy economic logic."[41]

18. In Ms. Bulkley's DCF model, she uses growth rate forecasts of Wall Street analysts and *Value Line*, whereas Dr. Woolridge reviewed 13 growth rate measures, including historical and projected growth rate measures and evaluated growth in dividends, book value, and earnings per share.[42] Dr. Woolridge's evaluation of growth rate is much more comprehensive and reliable than Ms. Bulkley's. With respect to her CAPM model, Ms. Bulkley's "results are based on the unrealistic assumption that, over the long-term, corporate earnings can grow at almost three times GDP."[43]

19. Ms. Bulkley argues that Dr. Woolridge failed to take into adequate consideration the fluctuation in beta during the COVID-19 pandemic.[44] To the contrary, Dr. Woolridge maintains

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[37] *See* Bulkley, Exh. AEB-4T at 87:3–20.
[38] Bulkley, TR. 62:9–17 and 63:9–14.
[39] Woolridge, Exh. JRW-1Tr at 10:3–14.
[40] *See Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-190529 and UG-190530, Final Order 08, ¶¶ 81–108 (July 8, 2020).
[41] Woolridge, Exh. JRW-1Tr at 6:18–21.
[42] Woolridge, Exh. JRW-1Tr at 7:1–13.
[43] Woolridge, Exh. JRW-1Tr at 8:7–9; *See also*, Exh. JRW-1Tr at 7:14–8:9.
[44] Bulkley, Exh. AEB-4T at 87:3–20.

an updated study of beta, which he produced in Exhibit JRW-6.[45] Beta is a measure of the systemic risk of a stock, with a beta less than one being less risky and a beta greater than one being more risky.[46] Dr. Woolridge's updated industry beta study shows electric utilities with a beta of 0.86, natural gas utilities with a beta of 0.85, and water utilities with a beta of 0.78.[47] He noted that utility stocks were more volatile than the overall market during March and April 2020, when the financial markets were particularly volatile. He also noted that the betas for most of the low-beta industries increased in his update, but that utilities were still among the lowest risk industries as measured by beta.[48]

20. In addition, Ms. Bulkley did not study the spread between earned return on equity and the 30-year Treasury yield.[49] Dr. Woolridge did study the spread between earned return on equity and the 30-year Treasury yield, which supports his overall position on the appropriate return on equity for the Company. The spread between actual return on equity and the 30-year Treasury yield is at an all-time high.[50] Between 2013 and 2018, the authorized returns on equity in Washington were 9.4 percent to 9.5 percent. During the same time, the 30-year Treasury yield averaged 3.0 percent.[51] In 2019, the Treasury yields decreased to 2.0 percent, and during 2020, Treasury yields have fluctuated as low as 1.5 percent and upward above 2.0 percent.[52] A 30-year

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[45] Woolridge, Exh. JRW-1Tr at 28:7; Exh. JRW-6 at 4; Woolridge, TR. 108:11–15.
[46] Woolridge, TR. 106:15–107:2.
[47] Woolridge, JRW-1Tr at 28:7–9.
[48] Woolridge, JRW-1Tr at 28:7–16; *See also,* Woolridge, TR. 107:11–108:20 and 111:5–21.
[49] Bulkley, TR. 62:9–17 and 63:9–14.
[50] Woolridge, Exh. JRW-1Tr at 4:14–5:9, including Figure 1; Bulkley, Exh. AEB-7X at 4.
[51] Woolridge, JRW-1Tr at 4:17–19.
[52] Woolridge, JRW-1Tr at 5:1–9; Woolridge, TR. 112:13–113:3.

Treasury yield of two percent is historically low.[53] When taken in that context, the fluctuations in the Treasury yield during the COVID-19 pandemic does not alter Dr. Woolridge's conclusions.

21. Lastly, Ms. Bulkley raises risk factors related to Cascade and flotation costs. In particular, Ms. Bulkley raises concerns associated with Cascade's small size, customer concentration, capital expenditures, and regulatory risk. Notably, the major rating agencies already consider each of these issues in the credit rating process.[54] No additional adjustment to increase Cascade's return on equity is needed. Regarding flotation costs, Cascade has not demonstrated that it has paid any flotation costs. Thus, increasing Cascade's return on equity to reflect flotation costs simply adds revenue for costs the Company did not incur.[55]

3. Commission Staff's return on equity analysis indicates a lower return on equity is appropriate.

22. While Staff witness Mr. Parcell accurately describes the economic conditions faced by utilities and that interest rates and capital costs are at historic lows, his ROE recommendation does not adequately reflect his modeling results.[56] Indeed, Mr. Parcell's four studies indicate a significantly lower ROE than he recommends.[57] The overall range of results from his studies is 6.0 percent to 10.0 percent.[58] The midpoints of Mr. Parcell's studies are as follows:

DCF Study	9.5 percent
CAPM Study	6.2 percent

[53] Woolridge, TR. 114:2–4.
[54] Woolridge, Exh. JRW-1Tr at 10:3–11.
[55] Woolridge, Exh. JRW-1Tr at 10:11–14.
[56] Woolridge, Exh. JRW-14T at 3:7–11, and 7:5–8:8.
[57] Woolridge, Exh. JRW-14T at 3:19–22.
[58] Woolridge, Exh. JRW-14T at 4:5–7 (Table 2).

Comparable Earnings (CE) Study	9.0 percent
Risk Premium Study	9.0 percent

23. Mr. Parcell's CE study is a model of his own creation that is not widely recognized as an approach to estimate the cost of equity for utilities.[59] Additionally, his interpretation of the results is subjective.[60] Moreover, FERC rejected the CE approach (called "Expected Earnings") to modeling ROE. In rejecting the CE approach, FERC highlighted why this approach does not effectively measure the cost of equity capital. FERC noted that the model is less complex as market-based approaches because it does not consider critical components in determining a utilities cost of equity, such as the market price that an investor must pay to make its investment or factors such as the projected growth rates.[61] As a result, the model is "unable to effectively estimate the rate of return that investors require to invest in the market-priced common equity capital of a utility, which is the utility's cost of equity capital."[62] FERC found "that it is not appropriate to use a model that does not accurately measure the "return to the equity owner" as required by *Hope* merely because it may be simpler to administer."[63]

24. Mr. Parcell ignores his CAPM results.[64] Of the remaining studies, only his DCF study supports Mr. Parcell's recommendation; however, if the DCF results were stated as mean or median results, the mean results are 8.8 percent and the median results are 9.0 percent.[65]

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[59] Woolridge, Exh. 14T at 13:6–12.
[60] Woolridge, Exh. 14T at 13:11–12.
[61] 169 FERC ¶ 61,129, Opinion No. 569, ¶ 204 (2019).
[62] *Id.*
[63] *Id.*
[64] Woolridge Exh. 14T at 6:16; Woolridge, TR. 91:11–17.
[65] Woolridge, Exh. 14T 13–15; Woolridge, TR. 91:1–4.

25. Mr. Parcell's recommendation takes the midpoint of the range of results for the DCF, CE, and Risk Premium models.[66] The midpoint of a range simply calculates the middle between two data points – the highest and lowest individual ROE outcomes.[67] The midpoint does not necessarily reflect all of the outcomes because only the lowest and highest go into the calculation.[68] In estimating the cost of equity, rate of return analysts typically use a proxy group and employ the means or medians for the entire group.[69]

26. Dr. Woolridge, in his testimony, illustrated the difference between taking the midpoint of the ranges and using mean and median from each of the studies. The midpoint analysis inflates the study results:

Table 3

Staff's Reported Cost of Equity Capital Position

Approach	Reported Range	Midpoint of Reported Range	Mean	Median
DCF	**9.0%-10.0%**	**9.50%**	**8.80%**	**9.00%**
CAPM	**6.0%-6.4%**	**6.20%**	**6.00%**	**6.40%**
Comparable Earnings	**8.5%-9.5%**	**9.00%**	**NA**	**NA**
Risk Premium	**8.3%-9.6%**	**9.00%**	**8.15%**	**8.15%**

27. By relying on inflated midpoints, Mr. Parcell's recommendation is unreasonably inflated. As a result, the Commission should give little weight to Mr. Parcell's recommendation.

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[66] Testimony of David C. Parcell, Exh. DCP-1T at 4:4–5.
[67] Woolridge, Exh. 14T at 5:4–8.
[68] *Id.*
[69] Woolridge, Exh. 14T at 6:3–5.

III. THE COMMISSION SHOULD ORDER A DECREASE IN REVENUE REQUIREMENT RATHER THAN AN INCREASE

28. Public Counsel recommends a reduction in Cascade's current rates of $2.4 million. The adjustments that produce that result include removing post-test year plant additions while allowing test year plant to be valued at end of period, removing wage increases for 2021 and resetting wage increases for 2020 to three percent, normalizing short-term incentive costs to target levels, and disallowing 50 percent of directors' fees.

A. The Commission Should Allow Test-Year Plant to Be Valued at End of Period, but Should Exclude Post-Test Year Plant. Alternatively, if the Commission Allows Post-Test Year Plant, It Should be Limited to Those Projects that Were Completed Before October 1, 2020.

29. Using an historical test year ending December 31, 2019, Cascade proposes adjustments to restate test year plant and related costs to the end of period (EOP) balances. Cascade then requests that plant be further adjusted through post-test year pro forma adjustments projecting the test year EOP balances to December 31, 2020, a full year after the test year.[70] In its rebuttal filing, Cascade updated the projects for which it seeks recovery, removing five projects that were postponed or completed under budget.[71] The remaining projects total approximately $57.3 million, which is approximately $8.8 million less than the amount sought in Cascade's initial filing.[72]

30. Because regulated utilities earn a return on the level of capital investment, utilities have an incentive to spend more money and build more capital projects.[73] It is important that the

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[70] Response Testimony of Mark E. Garrett, Exh. MEG-1Tr at 5:1–8; Direct Testimony of Maryalice C. Peters, Exh. MCP-1T at 7:23.
[71] Rebuttal Testimony of Patrick C. Darras, Exh. PCD-3T at 4:5–8.
[72] Darras, Exh. PCD-3T at 3:10–4:4, including Figure 1.
[73] Garrett, Exh. MEG-1Tr at 7:6–7.

Commission only allow amounts in rates when it is appropriate, considering both when the investments were made and the impact on customers. In this case, it is reasonable to allow Cascade to value its test-year rate base at the end of the period because Cascade is experiencing elevated rates of capital investment. By allowing EOP rate base for test year plant, Cascade receives a full rate base return on all of its invested capital at test year end.[74] To mitigate the impact on rates, the Commission should not allow pro forma adjustments for post-test year plant because Cascade's treatment of the post-test year updates was inconsistent.

31. Cascade included offsetting adjustments for accumulated depreciation and accumulated deferred income taxes related only to the post-test year plant additions, but failed to include post-test year updates for accumulated depreciation and accumulated deferred income taxes related to the test year end plant.[75] Cascade's inconsistency means that plant balances were not reduced for the 2019 EOP depreciation recoveries.[76] As Mr. Garrett noted, it is not appropriate to reflect costs that will increase rate base for 2020, such as plant additions, but not reflect reductions to rate base that will occur over the same period, such as depreciation recoveries.[77] Additionally, COVID-19 has introduced significant uncertainties for customers, making mitigation of rate impact critically important in this case.[78] In this regard, the Commission should limit plant additions in this case to test year additions.

[74] Garrett, Exh. MEG-1Tr at 11:6–18.
[75] Garrett, Exh MEG-1Tr at 7:2–11.
[76] Garrett, Exh. MEG-1Tr at 8:2–11.
[77] Garrett, Exh. MEG-1Tr at 8:8–11.
[78] Garrett, Exh. MEG-1Tr at 6:6–11:18.

32. In the alternative, if the Commission allows post-test year additions, they should be limited to those projects that parties were able to review. Of the post-test year projects, only four projects have in-service dates prior to October 1, 2020, and, significantly, they totaled approximately $13 million.[79] The total amount associated with the remaining projects, which have in-service dates after October 1, 2020, is approximately $44 million.[80] Only those items that went into service prior to October 1, 2020, were available for review prior to the deadline for filing response testimony in this case.[81] The Commission would need to include off-setting amounts for 2019 EOP depreciation recoveries, which total $27 million.[82]

B. The Commission Should Reject Amounts for 2021 Wage Increases and Should Set 2020 Post-Test Year Wage Increases and Related Costs Post-Test Year Wage Increases and Related Costs According to the Market.

33. Cascade made two adjustments to its payroll expenses. The first adjustment restated the test year wages to reflect pay increases granted during the test year.[83] The second adjustment increased wages for post-test year periods 2020 and 2021 for bargaining employees, non-bargaining employees, and MDU employee payroll allocated to Cascade.[84] Public Counsel's witness Mr. Mark E. Garrett, testified that 2021 pay increases should be excluded as they extend two years beyond the test year.[85] Cascade agreed, in part. On rebuttal, Cascade eliminated its 2021 union wage increase, but only lowered its 2020 and 2021 non-union wage increases.[86]

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[79] *See* Darras, Exh. PCD-3T at 4:3–4, Figure 1.
[80] *See* Darras, Exh. PCD-3T at 4:3–4, Figure 1.
[81] *See* Garrett, Exh. MEG-1Tr at 5:16–6:5.
[82] Garrett, Exh. MEG-1Tr at 8:2–11; Exh. MEG-5.
[83] *See* Peters, Exh. MCP-1T at 6:7–8.
[84] *See* Peters, Exh. MCP-1T at 6:16–7:7.
[85] Garrett, Exh. MEG-1Tr at 14:17–19.
[86] Direct Testimony of James E. Kaiser, Exh. JEK-1CT at 2:15–3:4; Kaiser, TR. 162:5–17.

34. Regarding the non-union wage increases, Cascade reduced the wage increase from four percent to 3.55 percent for 2020 and from four percent to three percent for 2021.[87] For non-union employees, Public Counsel recommends that the wage increase be set at three percent for 2020 and removed for 2021.[88]

35. Cascade negotiated a three percent wage increase for its union workers, which went into effect in April 2020.[89] This negotiated wage increase reflects the market.[90] Even though the job classifications for union and non-union workers are different, the union negotiation provides some information about what the market supports as a reasonable wage increase.[91]

36. Three percent is also reasonable in light of the wage increase guidance provided by the Company to managers. For non-union wages, salary increases are approved by a managing committee, which includes the Vice President of Human Resources and the Company President.[92] The decisions made by the managing committee are placed in a merit increase guideline that is issued by Human Resources to managers.[93] For 2019, 2020, and 2021, the guidance issued by Human Resources to managers was to keep pay within a three percent budget.[94]

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[87] Kaiser, Exh. JEK-1CT at 2:21–3:3.
[88] Garrett, Exh. MEG-1Tr at 14:11–15.
[89] Kaiser, TR. 163:4–10.
[90] Kaiser, TR. 163:11–14.
[91] Union workers include technical and craft positions that typically work in the field. Non-union workers are typically clerical, professional, and managerial. Kaiser, TR. 163:15–164:1.
[92] Kaiser, TR. 165:6–13.
[93] Kaiser, TR. 165:14–17; Exh. JEK-6X.
[94] Kaiser, TR. 165:24–170:9; Exh. JEK-6X at 2, 5, and 8. In addition to the three percent provided to managers, the Company holds an additional amount for additional wage increases that may be provided during the year.

37. In reviewing Cascade's non-union wages, Public Counsel's witness Mr. Garrett identified an issue between the four percent used to annualize its payroll costs and the 2020 pay increases that actually went into effect. Mr. Garrett observed that non-union employees' base pay increased by only 2.6 percent for exempt employees and by 2.2 percent for non-exempt employees.[95]

38. Because three percent is supported as reflecting the market, and because non-union wage increases do not equal the amount budgeted, Public Counsel believes three percent is a reasonable increase for non-union wages. Both the payroll expense and the payroll tax expenses included in Cascade's rates require adjustment.[96]

C. The Commission Should Normalized Short-Term Incentive Costs to Target Levels.

39. Cascade requests to include test year incentive compensation expenses in customer rates. Test year incentive compensation totaled $1,727,638 for the 2019 test year, which is significantly higher than target levels.[97] Cascade's stated target level for short-term incentive compensation for 2019 was $1,101,969.[98]

40. Public Counsel recommends normalizing post-test year incentive compensation by taking a five-year average.[99] Public Counsel's calculation of a five-year average (2014–2018) is $1,012,430, which is comparable to Cascade's target level.[100]

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[95] Garrett, Exh. MEG-1T at 14:2–10. The same issue did not arise for union workers, whose wage increases were set at three percent through the bargaining process. *See also* Exh. MEG-14 and Exh. MEG-15.

[96] *See*, Garrett, Exh. MEG-1Tr at 14:16–22; Exh. MEG-6.

[97] Garrett, Exh. MEG-1Tr at 19:7–9.

[98] Garrett, Exh. MEG-1Tr at 19:10–12; Exh. MEG-18.

[99] Garrett, Exh. MEG-1Tr at 19:7–13.

[100] Garrett, Exh. MEG-1Tr at 19:8–12.

41. Public Counsel's witness, Mark E. Garrett, testified that Cascade's "test year incentive compensation payout is significantly higher than its stated target level for short term incentives."[101] Mr. Garrett continues, "[w]ith incentive compensation, it is standard practice to normalize test year levels to target levels. The target level for incentives is the best estimate of the anticipated ongoing level for these costs."[102] The target level is an approximation for market price, and it is the highest level that should be included in rates.[103]

42. In this case, the 2019 test year incentive compensation awards are significantly higher than the amounts awarded in the past five years.[104] According to Cascade's witness, James E. Kaiser, year to year, the incentive compensation payout "does fluctuate based … on the goals achieved,"[105] but 2019 was "a good year"[106] for incentive payments. However, Cascade's five-year average for incentive compensation ($1,012,430) is "comparable to the Company's stated target level for short-term incentive compensation for the test year" ($1,101,969).[107] Not only is normalizing test year expenses to target levels industry standard practice, the fluctuation year to year in the amounts paid in incentive compensation highlights the importance of normalization as proposed by Public Counsel.

43. As an alternative to recovering the 2019 test year amount, Cascade offers that a three-year period would be sufficient to provide a rolling average for normalizing incentive

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[101] Garrett, Exh. MEG-1Tr at 18:15–16.
[102] Garrett, Exh. MEG-1Tr at 18:16–18.
[103] Garrett, Exh. MEG-1Tr at 18:19–19:1.
[104] Garrett, Exh. MEG-1Tr at 19:5–6, Table Comparison of Test Year Incentive Compensation to Prior Five Years.
[105] Kaiser, TR. 172:16–17.
[106] Kaiser, TR. 172:8.
[107] Garrett, Exh. MEG-1Tr at 19:8–12.

compensation, including the 2019 test year.[108] The three-year average proposed by Cascade is "around $1.4 million."[109] Cascade's alternative proposal is still significantly higher than the target level set by the Company and the five-year average proposed by Public Counsel. In addition, because Cascade's alternative uses fewer years in calculating the average, the impact of outlier levels of incentive compensation is greater than in Public Counsel's proposal of a five-year average. Thus, the Commission should adopt Public Counsel's recommendation to make an adjustment of $625,669 to reduce the short-term incentive compensation in the revenue requirement to an appropriate level.[110]

D. The Commission Should Disallow 50 Percent of Director's Fees Cost.

44. Cascade includes director's fees in its rate calculation. Although Cascade included 100 percent of Washington allocated director's fees in its initial filing,[111] it appropriately reduced its request to reflect 50 percent of the fees. Cascade witness, Maryalice C. Gresham testified that, "Cascade accepts the proposal to share Directors' fees on a 50/50 basis."[112]

45. Public Counsel recommends allocating 50 percent of the board of directors' compensation to ratepayers.[113] Our witness, Mark E. Garrett, stated, "sharing of director compensation costs would recognize the fact that the costs of director fees provide a benefit to

[108] Kaiser, TR. 173:3–7.
[109] Kaiser, TR. 173:17.
[110] Garrett, Exh. MEG-1Tr at 19:12; Exh. MEG-7.
[111] Garrett, Exh. MEG-1Tr at 21:12–13; Exh. MEG-21.
[112] Gresham, Exh. No. MCG-11T at 7:2. *See*, Exh. MCG-11T at 2:1–4.
[113] Garrett, Exh. MEG-1Tr at 21:12–16.

both shareholder and the ratepayers alike."[114] Public Counsel's proposed adjustment allocates 50 percent of directors' fees to ratepayers and 50 percent to shareholders.[115]

46. Public Counsel's proposal and Cascade's position on rebuttal are consistent with prior Commission orders. In Dockets UE-090134 and UG-090135, the Commission determined that director's fees and meeting costs "should be shared equally between shareholders and ratepayers" because the board of directors' activities benefit shareholders and ratepayers to the same extent.[116] In Dockets UE-150204 and UG-150205, the Commission noted its practice of allowing the utility to recover 50 percent of its director fees from ratepayers.[117] In this case, the Commission should continue to allocate director's fees equally between shareholders and ratepayers.

47. Cascade included $350,370 in its revenue requirement for director's fees.[118] Allocating the director's fees 50 percent to ratepayers requires an adjustment of $175,185, as shown in Public Counsel witness Mr. Garrett's Exhibit MEG-10.[119]

IV. COST OF SERVICE, RATE SPREAD, AND RATE DESIGN ARE SUBJECT TO PRIOR ORDERS ADOPTING SETTLEMENT

48. In Cascade's last three general rate cases (GRC), settlements included the requirement that Cascade conduct a load study or detailed load analysis. In Cascade's 2015 GRC, the

[114] Garrett, Exh. MEG-1Tr at 20:17–18.
[115] Garrett, Exh. MEG-1Tr at 21:12–16.
[116] *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-090134 and UG-090135 (*Consol.*), Order 10, ¶ 142 (Dec. 22, 2009).
[117] *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-150204 and UG-150205, Order 05, ¶¶ 219–220 (Jan. 6, 2016).
[118] Garrett, Exh. MEG-1Tr at 21:12–13; Exh. MEG-21.
[119] Garrett, Exh. MEG-1Tr at 21:14–16.

Commission approved a settlement that required Cascade to initiate a load study prior to filing its next rate case.[120] Cascade filed its next GRC in 2017, and the settlement in that case provided more specificity about the requirement to conduct a load study or detailed load analysis. In particular, Cascade agreed to conduct a load study or detailed load analysis. However, until such study is completed, Cascade agreed to spread any rate changes based on equal percentage of margin for customer classes other than Special Contracts and to maintain the customer charge at levels agreed to in that case.[121] The Commission held that, the settlement in the 2017 GRC imposed the "appropriate parameters and restrictions on allocation of future rate increases until such time as a load study or detailed load analysis is complete."[122]

49. Cascade filed its next rate case in 2019. The Company had not conducted a load study or detailed load analysis. As a result, Cascade proposed no change to the basic charge and spread the revenue changes on an equal percentage of margin. Cascade reiterated its commitment to conduct a load study or detailed load analysis in the settlement of that case.[123] The Commission approved the settlement, noting that maintaining the status quo was reasonable in light of the then-pending cost of service rulemaking.[124]

50. In this case, Cascade again has not completed a load study. Cascade again proposes to spread the rate change across customers, other than Special Contract, based on equal percentage

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[120] *Wash. Utils. & Transp. Comm'n v. Cascade Nat. Gas Co*., Docket UG-152286, Final Order Approving Settlement Agreement, Order 04, ¶¶ 7, 19 (July 7, 2016).

[121] *Wash. Utils. & Transp. Comm'n v. Cascade Nat. Gas Corp*., Docket UG-170929, Final Order Rejecting Tariff Sheets; Resolving Contested Issue; Approving and Adopting Settlement Agreement; and Authorizing and Requiring Compliance Filing, Order 06, ¶¶ 67, 69 (July 20, 2018).

[122] *Id.* ¶ 72.

[123] *Wash. Utils. & Transp. Comm'n v. Cascade Nat. Gas Corp*., Docket UG-190210, Final Order Approving and Adopting Settlement Agreement, Order 05, ¶¶ 18–19 (Feb. 3. 2020).

[124] *Id*. ¶ 20.

of margin and to maintain current customer charges.[125] Cascade complies with the settlements from the last two rate cases. Such compliance is appropriate because it implements the all-party settlement entered into over the course of three general rate cases. For customer classes other than Special Contract, no change should be made to the basic customer charge, and any rate change should be allocated based on equal percentage of margin.

51. At the hearing, Commissioner Rendahl pressed the Company for a written plan regarding how it plans to accomplish its load study or detailed load analysis.[126] It would be reasonable to compel the Company to create and provide a written plan regarding how it will comply with the settlement terms.

V. PUBLIC COMMENT

52. Any rate increase from Cascade has a measurable and significant impact on its customers. Particularly now, in light of the impacts of the COVID-19 pandemic and resulting economic crisis, the effect of Cascade's rate increase must play an important role in the Commission's deliberations over the result in this case. A number of customers submitted written comments in this proceeding, expressing their concerns regarding the proposed rate impact.[127]

53. Several customers living on fixed incomes expressed concerns about increasing rates. One customer stated that the "proposed increase is too high" when compared to the cost of living adjustment that she receives for her Social Security benefits.[128] Another noted that for retired persons, it might be a particularly poor time to increase rates.[129]

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[125] Direct Testimony of Isaac D. Myhrum, Exh. IDM-1T at 19:3–10.
[126] Kivisto, TR. 125:3–128:2; Parvinen, TR. 226:10–228:20.
[127] Public Counsel filed these comments in Bench Exh. No. 5, on March 3, 2021.
[128] Bench Exh. No. 5, UTC Comment Matrix Report at 2 (Comment of Dianna Torrico).
[129] *Id.*, UTC Comment Matrix Report at 1 (Comment of Doug G. Schmidt).

54. Other customers referenced the financial crisis resulting from the COVID-19 pandemic as a reason why they oppose Cascade's proposed rate increase. One customer stated, "at such a time when the general populace is in such a financial squeeze and there is much concern amongst us all about our financial futures, [Cascade's proposed rate increase] is extremely poor timing and frankly, distasteful, on the part of utility companies to raise rates."[130] Other customers note that people are suffering from higher costs on other products and services[131] and that many people are out of work and have lost their businesses this year.[132] One customer highlights the sacrifices that have been asked of the general public this year and states that, "it should only make total sense that a large utility company can also 'make a sacrifice' as the rest of us in society have been asked to do."[133]

55. These customers rightly note the important context surrounding Cascade's proposed rate increase. Many people have faced a difficult year and are in an unstable financial position. Customers are relying on the Commission to consider carefully if Cascade should be allowed to "squeez[e] more out of an already strained people."[134] Public Counsel urges the Commission to keep these customers' concerns in mind while considering this case.

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[130] *Id*., UTC Comment Matrix Report at 1–2 (Comment of Steven Nielsen).
[131] *Id*., UTC Comment Matrix Report at 1 (Comment of Dave Kimble).
[132] *Id*., UTC Comment Matrix Report at 1 (Comment of Loretta Allen).
[133] *Id*., UTC Comment Matrix Report at 2 (Comment of Steven Nielsen).
[134] *Id*., UTC Comment Matrix Report at 2 (Comment of Steven Nielsen).

VI. CONCLUSION

56. Cascade's current rates should be reduced by $2.4 million. This rate reduction is justified on the record and will benefit ratepayers as they navigate the COVID-19 pandemic. Public Counsel recommends that the Commission rule in favor of the adjustments and analysis provided by our witnesses and reduce Cascade's rates accordingly.

DATED this 22nd day of March, 2021.

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