

Exhibit No. __ (MAC-1T)
Docket No. UG-15____
Witness: Mark A. Chiles

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,
Complainant,

v.

CASCADE NATURAL GAS
CORPORATION,
Respondent.

DOCKET UG-15____

**CASCADE NATURAL GAS CORPORATION
DIRECT TESTIMONY OF MARK A. CHILES**

December 1, 2015

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I. OVERVIEW

1 **Q. Would you please state your name, business address and position?**

2 A. Yes. My name is Mark A. Chiles and my business address is 8113 W. Grandridge Blvd.,
3 Kennewick, WA 99336. I am the Vice President and Controller for Cascade Natural Gas
4 Corporation (“Cascade” or “Company”), a wholly-owned subsidiary company of
5 Montana Dakota Utilities Resources Group, Inc. (“MDU Resources”).

6 **Q. Would you please describe your duties?**

7 A. As Vice President and Controller, I am responsible for providing leadership and
8 management of the accounting, treasury, and planning functions, including the
9 preparation of financial reports and compliance with Sarbanes-Oxley for Cascade.

10 **Q. Would you please outline your educational and professional background?**

11 A. I graduated from Boise State University with a Bachelor of Business Administration
12 degree in Accounting. I am a certified public accountant and a member of the American
13 Institute of Certified Public Accountants and the Idaho Society of Certified Public
14 Accountants. I have over 20 years of experience in the energy industry including time
15 spent in the utility, gas marketing, and exploration and production industries. During my
16 utility career, I have held the positions of Financial Reporting Accountant, Director of
17 Accounting and Finance, and Vice President and Controller.

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

19 A. The purpose of my testimony is threefold: First, I explain and support the cost of debt,
20 capital structure and rate of return requested in this proceeding; second, I summarize and
21 support the reasonableness of Cascade’s administrative and general (“A&G”) expenses;
22 and third, I explain and support the allocation of intercompany charges between Cascade
23 and related entities.

24 In brief, I provide information that shows:

- 1 • Cascade’s proposed rate of return (“ROR”) of 7.647 percent provides a
2 reasonable return for Cascade’s investors at a fair cost to Cascade’s
3 customers. The ROR is based on a 50.0 percent common equity ratio with a
4 Return on Equity of 10.0 percent and a debt cost of 5.295 percent.
- 5 • Cascade’s proposal is consistent with the commitment made in UG-061721,
6 the docket authorizing its merger with MDU Resources, that “the allocated
7 shared corporate costs, as well as its allocated and assigned utility division
8 costs, will not exceed the costs the Cascade customers would otherwise have
9 paid absent the acquisition, as adjusted for changes in the Consumer Price
10 Index (“CPI”).”¹ Cascade’s A&G expense levels are well within reason when
11 compared to other regulated companies.
- 12 • The intercompany allocations between Cascade and affiliated companies
13 account for necessary services provided to Cascade customers at costs equal
14 to or lower than those that would be incurred if Cascade either performed the
15 services for its self or contracted for the services with non-affiliated
16 companies. These services include, but are not limited to, executive oversight,
17 customer billing, payment collection and processing, accounts payable
18 processing, information technology support, and customer service support.

II. COST OF DEBT, CAPITAL STRUCTURE, AND RATE OF RETURN

19 **Q. How much debt is currently held at Cascade and what are the maturity dates of the**
20 **existing debt?**

21 A. Confidential Exhibit No. __ (MAC-2C) details Cascade’s currently outstanding debt and
22 the associated maturity dates. Total outstanding debt as of June 30, 2015, was valued at
23 \$214,650,000 with maturity dates beginning in 2020. All the debt is unsecured term notes

¹ See *In the Matter of the Joint Application of MDU Resources Group, Inc. and Cascade Natural Gas Corp. Inc. For an Order Authorizing Proposed Transaction*, Docket No. UG 061721, Order No. 6, Stipulation, App. A at 4 (commitment 10).

1 with tenors ranging from twelve years to forty years. Each issuance of debt requires
2 either semi-annual or quarterly interest payments.

3 **Q. What is the average annualized interest rate of Cascade's debt and how is this**
4 **calculated?**

5 A. The average annualized cost of debt of 5.295 percent is calculated based on the weighted
6 average outstanding debt at June 30, 2015, inclusive of the annual amortization of the
7 costs associated with the financing of the debt. The associated amortization has been
8 computed on a straight-line basis over the remaining life of the issues. Cascade uses the
9 same methodology for book accounting purposes. Since 2006, the Company has been
10 able to reduce its average annualized cost of debt from approximately 7.58 percent to
11 5.295 percent.

12 **Q. What has the Company done in recent years to reduce the cost of long-term debt?**

13 A. The Company has taken advantage of current low market interest rates by securing new
14 long-term debt corresponding with the anticipated life of the new plant currently being
15 constructed throughout Cascade's service territory. The interest rate spreads between the
16 recently retired debt and newly acquired debt has allowed Cascade to lower average
17 interest rate costs by over 200 basis points.

18 **Q. Will any of the debt included in this filing come due within the next five years?**

19 A. Yes. As shown in the attached confidential Exhibit No. __ (MAC-2C), one long-term
20 note will mature in September 2020 in the amount of \$15,000,000. The Company
21 anticipates this amount will be replaced through a new long-term debt offering.

22 **Q. Does Cascade plan to issue any other debt in the next five years?**

23 A. Any long-term debt issuances planned for the next five years are provided in confidential
24 Exhibit No. __ (MAC-3C). In addition, Cascade has a revolving line-of-credit that
25 matures in July 2018 that the Company anticipates will be replaced with a similar
26 revolving credit agreement.

1 **Q. What is the rate of return and capital structure that Cascade is requesting in this**
2 **case?**

3 A. The Company is requesting a rate of return of 7.647 percent with a capital structure of 50
4 percent equity and 50 percent debt. The components and calculation of the proposed rate
5 of return are shown in the following table:

6 **Table 1. Proposed Rate of Return**

Proposed Rate of Return			
	<u>Capital</u>		
	<u>Structure</u>	<u>Cost</u>	<u>Component</u>
Common Equity	50%	10.00%	5.00%
Total Debt	<u>50%</u>	5.295%	<u>2.647%</u>
	<u>100%</u>		<u>7.647%</u>

7 **Q. The Company is proposing a capital structure of 50 percent equity and 50 percent**
8 **debt. Why does the Company feel this is the appropriate capital structure?**

9 A. The requested capital structure is based upon Cascade's actual average capital structure
10 for the last four years and at June 30, 2015. As a regulated public utility, Cascade has the
11 responsibility to provide safe and reliable service to customers across its service territory.
12 This requires on-going investment in new plant for mains, services, meters, and other
13 support facilities. As part of the planning process, Cascade determines the amount of new
14 financing needed to support the capital expenditure program with a target of 50 percent
15 debt and 50 percent equity. The Company is committed to maintaining a healthy capital
16 ratio, which Cascade believes is in the best interests of its shareholders and customers,

1 and reduces financial risk for Cascade’s debt obligations. Following is a summary of
2 Cascade’s actual capital structure supporting the requested capital structure of 50 percent
3 equity and 50 percent debt.

4 **Table 2. Cascade’s Actual Capital Structure**

5

Capital Structure						
	<u>12/31/2011</u>	<u>12/31/2012</u>	<u>12/31/2013</u>	<u>12/31/2014</u>	<u>6/30/2015</u>	<u>Average</u>
Total Debt	48.9%	45.9%	51.7%	49.3%	52.7%	49.9%
Common Equity	51.1%	54.1%	48.3%	50.7%	47.3%	50.1%

8

9 **Why is the Company proposing a 10.00 percent return on equity?**

10 The basis for the requested 10.00 percent return on equity contained within the overall
11 requested rate of return is supported by the testimony of Dr. J. Stephen Gaske. The
12 Company agrees with the information presented and conclusion reached by Dr. Gaske
13 that a 10.00 percent ROE represents a fair return for both

14 **III. A&G COSTS**

14 **Q. In Docket UG-061721, Cascade committed that “for Washington regulatory**
15 **purposes . . . the allocated shared corporate costs, as well as its allocated and**
16 **assigned utility division costs, will not exceed the costs the Cascade customers would**
17 **otherwise have paid absent the acquisition, as adjusted for changes in the Consumer**
18 **Price Index.”² Has the Company complied with this commitment?**

19 **A.** Yes. The Company has stayed well under the threshold for A&G costs as adjusted for
20 changes in the CPI. Cascade files an annual Statement of Operations Report with the
21 Washington Utilities and Transportation Commission (WUTC or Commission) showing
22 the calculation of actual A&G expense compared to the 2006 benchmark as adjusted for

² *Id.*

1 the CPI. In 2014 the report shows that Cascade's A&G costs were not only below the
2 2014 A&G benchmark but were below the pro forma adjusted 2006 Benchmark of
3 \$21,642,845. Cascade's direct, assigned, and allocated A&G costs have remained well
4 below the agreed to A&G threshold for every year since the acquisition of Cascade by
5 MDU Resources.

6 **Q. Part of the commitment Cascade made in the acquisition agreement is that no A&G**
7 **costs would be shifted to operational or maintenance accounts. Are you aware of**
8 **any shifting of A&G costs to O&M accounts?**

9 A. No. No A&G costs have been reclassified to O&M accounts.

10 **Q. How do Cascade's A&G costs compare to the other natural gas utilities in the**
11 **United States?**

12 A. Cascade had a study prepared, the results of which are included as Exhibit No. __ (MAC-
13 4). According to the study, Cascade's A&G costs compare very favorably to those
14 incurred by other natural gas utilities. When compared to U.S. natural gas utilities with
15 fewer than 400,000 customers within a state, Cascade has an average annual A&G
16 expense of \$75.60 per customer versus the U.S. average of \$151.50 per year, and the
17 median of \$114.20 for calendar year 2013.

18 Exhibit No. __ (MAC-5), shows A&G expense per customer for all U.S. gas
19 companies, regardless of number of customers served, separated by jurisdiction for 2013.
20 Cascade's A&G expense in Washington is \$75.60 per customer on an annual basis,
21 which is below the median A&G expense by \$28.44 and below the mean A&G expense
22 by \$61.74.

23 **Q. How do Cascade's A&G costs compare to those of other natural gas utilities in the**
24 **West?**

25 A. Very favorably. Exhibit No. __ (MAC-6) shows in Cascade's Washington service
26 territory, Cascade's average A&G cost per customer of \$75.60 is below both the West

1 Coast mean by \$33.42 (44 percent lower) and the median A&G by \$3.40 (4.5 percent
2 lower)..

3 **Q. What has been the recent history of Cascade's A&G costs?**

4 A. Exhibit No. __ (MAC-7) shows the Company's A&G cost per customer from 2009 to
5 2014 and corresponding customer growth. In 2010, the A&G cost per customer rose
6 significantly due to moving the corporate office from Seattle, which is outside its service
7 territory, to Kennewick-, which is the community it serves. After 2010, in general, A&G
8 went down due to cost efficiencies while its customer base increased year over year.

9 Exhibit No. __ (MAC-8) shows the Washington-specific A&G cost per customer
10 which is even lower than the cost-per customer for the Company's entire service territory.
11 Again, the low A&G cost per customer is due to the implementing cost controls during an
12 era of 5.5 percent customer growth over a five-year period.

13 **Q. What specific actions has the Company taken to control A&G costs since the
14 acquisition?**

15 A. As part of the MDU Resources acquisition of Cascade and of Intermountain Gas
16 Company by, the Montana Dakota Utilities (MDU) Utility Group worked to identify
17 where it could gain efficiencies and, thereby, save costs. As a part of that process, the
18 MDU Utility Group determined to integrate the customer service and information
19 technology (IT) functions at the individual companies, thereby gaining efficiencies and
20 saving costs. Prior to the acquisition Cascade had multiple sites for its customer service
21 personnel. The MDU Utility Group now has two customer service sites that provide
22 service for its four utilities. In addition, the IT group was integrated into one company to
23 reduce duplication and promote efficiencies in the companies.

24 **Q. Now that the customer service and IT employees have been integrated into single
25 groups, who do they work for and how are their costs allocated?**

1 A. All customer service and IT employees are now employed by MDU. The allocation of
2 expenses between the companies is explained in the following section covering
3 intercompany allocations.

IV. INTERCOMPANY ALLOCATIONS

4 **Q. Please provide an overview of Cascade’s intercompany allocations.**

5 A. Cascade receives intercompany allocations from its parent company, MDU Resources,
6 which includes the utility company referred to as MDU. Cascade also receives
7 intercompany allocations from Intermountain Gas Company (“Intermountain”), another
8 wholly-owned subsidiary of MDU Resources. The intercompany allocations include, but
9 are not limited to, charges for board and executive oversight, legal and accounting
10 services, the use of office facilities and equipment, processing of payroll, accounts
11 payable, customer billing and payment collection, IT support, and customer service
12 support.

13 **Q. Do the related parties have agreements in place that describe the services to be
14 provided and how the charges will be allocated between them?**

15 A. Yes, when MDU Resources purchased Cascade, MDU Resources and Cascade agreed to
16 comply with all Commission statutes, rules, and ordering conditions concerning affiliated
17 interest filings. This included an Inter-company Administrative Services Agreement
18 (“IASA”). The IASA was filed with the WUTC with an effective date of July 2, 2007
19 and, with the purchase of Intermountain, an amended IASA was filed with the WUTC
20 with an effective date of March 18, 2009.

21 **Q. What is the basis for the allocation of expenses charged to and from Cascade?**

22 A. Per the IASA, expenses may be charged using one of three methodologies: (1) direct
23 assignment; (2) service charge; or (3) allocations. As an example, a directly assigned
24 charge would be made for a legal expense incurred by the corporate legal group for work
25 specifically performed for Cascade. A service charge would be assessed for work

1 performed by the corporate legal group on an issue specific to the utility group—but not
2 just Cascade. An allocation would be made for work performed by the corporate legal
3 group for the benefit of *all of the business units* within MDU Resources.

4 **Q. How often is the corporate allocation methodology reviewed?**

5 A. The methodology for the allocation of charges for certain corporate functions such as
6 payroll and accounts payable processing, procurement, IT services, and finance and
7 administration is updated periodically. Exhibit No. __ (MAC-9C) provides the cost
8 allocation basis for charges in calendar year 2014.

9 **Q. What is the process for billing intercompany charges?**

10 A. Each month, the four utilities compile allocable costs as part of the accounting close
11 process. An invoice is prepared detailing the charges so the receiving company has
12 adequate information to appropriately code the charges. The invoices are due for payment
13 upon receipt. When Cascade receives intercompany invoices, accounting personnel
14 analyze the charges for appropriateness. Any questions are reconciled with the issuing
15 company.

16 **Q. Who is responsible for keeping a record of the charges?**

17 A. Per the IASA, the issuing party is responsible for maintaining the support for the charges.
18 All parties are responsible for providing access to the records and for maintaining such
19 records in accordance with good record management practices.

V. CONCLUSION

20 **Q. Does this conclude your testimony?**

21 A. Yes, it does.