

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

WUTC V. CASCADE NATURAL GAS CORPORATION

DOCKET NO. UG-060256

DIRECT TESTIMONY OF MICHAEL L. BROSCH (MLB-1T)

ON BEHALF OF

PUBLIC COUNSEL

ADDRESSING CASCADE NATURAL GAS

PROPOSED PLANT IN SERVICE AND DECOUPLING TRACKERS

DATED AUGUST 15, 2006

DIRECT TESTIMONY OF MICHAEL L. BROSCH (MLB-1T)

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**I. INTRODUCTION / SUMMARY**

**Q. Please state your name, occupation and address.**

A. My name is Michael L. Brosch. My business address is 740 North Blue Parkway, Suite 204, Lee's Summit, Missouri 64086.

**Q. By whom are you employed?**

A. I am a principal in the firm Utilitech, Inc., a consulting firm engaged primarily in utility rate and regulation work. The firm's business and my responsibilities are related to special services work for utility regulatory clients. These services include rate case reviews, cost of service analyses, jurisdictional and class cost allocations, financial studies, rate design analyses and focused investigations related to utility operations and ratemaking issues.

**Q. On whose behalf are you appearing in this proceeding?**

A. I am appearing on behalf of the Washington Attorney General – Public Counsel Section (Public Counsel). Utilitech entered into a contract with Public Counsel to review and respond to certain non-traditional rate tracking proposals raised by Cascade Natural Gas Corporation (Cascade, CNG or Company) as part of its recommendations within its filing for an increase in its gas rates and revenues.

**Q. Will you summarize your educational background and professional experience in the field of utility regulation?**

A. Exhibit No. \_\_\_\_ (MLB-2) is a summary of my education and professional qualifications. I have testified before utility regulatory agencies in Arizona, Arkansas, California, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Michigan, Missouri, New Mexico, Ohio, Oklahoma, Utah, Washington, and Wisconsin in

1 regulatory proceedings involving electric, gas, telephone, water, sewer, transit, and  
2 steam utilities. In Washington I have testified in several major proceedings before  
3 the Commission, including Sprint’s spinoff of its local telecommunications division  
4 (UT-051291), U S West rate cases (UT-950200, UT-970766), the U S West/Qwest  
5 merger (UT-991358), the most recent Verizon rate case (UT-040788) and the  
6 regulatory accounting for, and later sale of Qwest’s directory publishing business  
7 (UT-98048 and UT-021120).

8 **Q. Have you previously participated in energy utility regulatory proceedings?**

9 A. Yes. I have participated in many electric and gas regulatory proceedings, as listed  
10 and described in Exhibit No. \_\_\_\_ (MLB-3). While much of my experience involves  
11 traditional rate increase or rate reduction cases, I have also addressed rate  
12 adjustment tracking tariffs as well as deferral accounting proposals on many prior  
13 occasions.

14 **Q. What is the purpose of your testimony in this docket?**

15 A. My testimony is intended to respond, on behalf of Public Counsel, to certain  
16 regulatory policy concerns raised by two proposed rate adjustment tracking  
17 mechanisms being advocated by Cascade. The first proposed new tracking  
18 mechanism would increase electric and gas utility service rates between future CNG  
19 rate cases on a single-issue basis using what the Company has labeled its “Safety  
20 and Reliability Infrastructure Adjustment Mechanism” or “SRIAM” to account for  
21 increases in certain Plant in Service investments that are anticipated by the

1 Company.<sup>1</sup> The second new rate tracking mechanism would partially “decouple”  
2 gas margin recovery to account for variations in usage per customer between rate  
3 cases through a so-called “Conservation Alliance Plan” (or “CAP”) tariff.<sup>2</sup> My  
4 testimony explains several problems arising from CNG’s proposed new plant  
5 investment tracker (SRIAM) and CAP decoupling rate adjustment proposals and  
6 recommends that these mechanisms not be approved by the Commission.

7 **Q. Please summarize the recommendations that are set forth in your testimony.**

8 A. In general, I recommend that the Commission not approve piecemeal rate  
9 adjustment tracking tariffs for isolated elements of utility revenue requirements in  
10 the absence of compelling evidence that such piecemeal rate adjustments are  
11 warranted. My testimony explains how traditional test-year regulation achieves a  
12 balanced measurement of revenue requirements. I then describe how tracking  
13 tariffs and deferral accounting methods can be used as exceptions to the normal  
14 test-year approach, when warranted by extraordinary circumstances. I explain  
15 several general criteria that should be satisfied before piecemeal cost tracking tariffs  
16 should be accepted by regulators. When these criteria are applied to the specific  
17 SRIAM tracking and gas revenue CAP decoupling mechanisms Cascade has  
18 proposed, I demonstrate why the Company’s proposals should be rejected by the  
19 Commission.

20 **Q. How is the balance of your testimony organized?**

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<sup>1</sup> F. Jay Cummings Direct Testimony, Exhibit No. \_\_\_\_ (FJC-1T), pages 2-7.

<sup>2</sup> Jon T. Stoltz Direct Testimony, Exhibit No. \_\_\_\_ (JTS-1T), pages 25-31.

1 A. My testimony is arranged by major topical area. A Table of Contents appearing at  
2 the beginning of the testimony sets forth this organization.

3 **II. TEST PERIOD RATEMAKING CONCEPTS**

4 **Q. What is a test period and how is it used in utility regulation?**

5 A. Energy utilities have traditionally been regulated based upon their cost to provide  
6 service, including an opportunity to earn a reasonable return on invested capital.  
7 The process used to evaluate and measure the cost of service and resulting revenue  
8 requirement is the rate case, in which a balanced review of jurisdictional expenses,  
9 rate base investment, the cost of capital and revenues at present rates can be  
10 undertaken at a common point in time, referred to as a “test period.” *See, e.g.,*  
11 *WUTC v. Avista Corporation*, Docket Nos. UE-991606, UG-991607, Third  
12 Supplemental Order, ¶¶ 14-16 (September 29, 2000). In Washington, the test  
13 period is usually a recent actual 12-month period of time within which revenues at  
14 present rate levels are compared to operating expenses and the required return on  
15 average rate base, to determine whether an overall increase or reduction in revenue  
16 levels is needed. *Id.*; *WUTC v. Puget Sound Power & Light Co.*, UE-920433,  
17 920499, 921262, Eleventh Supplemental Order, pp. 4-5 (September 21, 1993).

18 It is essential for this synchronized review of both revenue levels and cost  
19 levels to occur within a carefully structured test period, because both revenues and  
20 costs tend to change with the passage of time as customers are added, inflation and  
21 productivity changes impact costs, capital market conditions change and sales  
22 volumes fluctuate. The dynamic nature of utility costs and revenues does not

1 necessarily imply frequent rate cases. As long as revenues and costs remain in  
2 approximate balance, causing the utility's earnings to stay within acceptable  
3 proximity to authorized return levels, an electric or gas utility may be able go many  
4 years between rate cases.

5 An important element of traditional test period regulation is the incentive  
6 created for management to control and reduce costs, so as to maximize the  
7 opportunity to actually earn at or above the authorized return level between rate case  
8 test periods.

9 Another beneficial characteristic of traditional test year regulation is the  
10 intensive focus upon utility operations and costs within a formal proceeding in  
11 which Commission Staff and other interested parties can carefully examine or audit  
12 the components making up the revenue requirement. In contrast, piecemeal rate  
13 tracking tariff adjustments often receive little scrutiny or input from regulators and  
14 consumer representatives, even though significant customer impacts can result from  
15 such tariffs. These mechanisms place an added burden on Commission Staff and  
16 intervenors, and ultimately regulatory bodies are likely to give less scrutiny to these  
17 costs.

18 **Q. Under traditional test period rate case regulation, what normally happens**  
19 **when a specific utility expense increases between test periods?**

20 A. Increases in specific individual expenses between test periods, if nothing else  
21 changes, would directly impact the utility's pre-tax earnings and the achieved rate of  
22 return. However, all of the utility's costs and revenues tend to change over time.  
23 Customer and revenue growth or reductions in other costs often serve to offset or



1 mitigate isolated cost changes, such that a utility company may be able to avoid rate  
2 increases for extended periods of time.

3 Sustained cost increases that were not offset by reductions in other costs or by  
4 increases in customer and sales levels may contribute to declines in achieved returns  
5 sufficient to justify the filing of a petition to increase rates. However, whenever a  
6 rate case occurs, all of the elements of revenue requirement are again measured and  
7 adjusted, in a balanced overall review that should account for cost increases in some  
8 areas being offset by cost savings in other areas. For example, here, Cascade is  
9 forced to account for its higher customer count and sales volumes and its current  
10 capital market conditions and cost of capital in this docket, at the same time it has  
11 proposed to recognize a larger rate base and increased depreciation expenses. This  
12 balanced review of all elements of revenue requirement is a key characteristic of  
13 traditional regulation.

14 **Q. You mentioned an “incentive” effect that results from traditional test period**  
15 **regulation. What is the incentive that is created?**

16 A. Once revenues and costs are measured within the rate case test period, all changes  
17 such as cost reductions or sales margin growth cause improvements in the achieved  
18 actual return level, relative to Commission-authorized returns, and are “favorable”  
19 from the shareholder perspective. Shareholders are rewarded with higher earnings  
20 between test years when management is able to successfully minimize cost  
21 increases, maximize productivity gains, or add profitable new customers to the  
22 system. Conversely, unfavorable changes between test years, such as cost increases  
23 or sales revenue declines, can contribute to earnings below authorized levels.

1 Punishment in the form of reduced earnings occurs when expense increases or sales  
2 and margin losses between rate case test periods are not fully offset by revenue  
3 gains. In this way, regulatory lag provides a symmetrical incentive for management  
4 that can either reward cost containment and the profitable growth in sales or  
5 temporarily punish excessive cost increases until the time when a new rate case can  
6 be litigated.

7 **Q. Does the use of a projected or “future” test period approach, as compared to**  
8 **the actual or “historical” test period approach that is used in Washington,**  
9 **change the balance that is achieved among test period ratemaking elements?**

10 A. No. A balanced and matched measurement of the revenue requirement elements is  
11 still pursued. Several state regulatory commissions employ projected (aka future)  
12 test period ratemaking using budgeted information, rather than actual recorded  
13 accounting data from a historical year. Use of such projected test period financial  
14 data introduces management, staff and intervenor judgment and debate regarding  
15 how sales volumes, employment levels, non-labor expenses and rate base  
16 investments may change in the future rate-setting period. However, the desired end-  
17 result is still a matched comparison of revenues to costs within an internally  
18 consistent test period. The test year approach used, projected versus historical, does  
19 not change the need for a balanced comparison of revenues at present rates to the  
20 overall cost of service in order to determine rate changes that are needed.  
21 Unfortunately, while presumed to be desirable at reducing regulatory lag, projected  
22 test year analyses are inherently more complex in practice because of difficulties  
23 associated with accurately predicting future events, documenting assumed future

1 events in the absence of factual data and the challenges involved in defending such  
2 predictions upon critical review in a litigation setting.

3 **Q. What are the most common types of exceptions to the standard approaches to**  
4 **test period rate case regulation of energy utilities that you have described?**

5 A. Exceptions to the synchronized test period review of revenues and costs have been  
6 allowed in limited instances by regulators for certain large and volatile cost  
7 elements that are predominately beyond the control of utility management and that  
8 might produce unacceptable financial outcomes if not allowed special treatment.

9 The most common exception to traditional test period regulation is the widespread  
10 utilization of purchased energy adjustment clauses to periodically adjust rates, so as  
11 to track changes in the costs of purchased gas for local gas distribution utilities or to  
12 track changes in the costs of generation fuel and/or purchased power incurred by  
13 electric utilities. Power Cost Adjustment (PCA) and Purchased Gas Adjustment  
14 (PGA) mechanisms are employed by many state regulators because fuel and  
15 purchased energy commodity costs are recognized to be:

- 16
- 17 • Large in relation to the total cost to provide electric service;
  - 18 • Subject to market forces (rather than management control);
  - 19 • Volatile and difficult to reasonably quantify in rate cases; and
  - 20 • Substantial enough to cause potential earnings volatility if not tracked.

21 Another exception to traditional test period regulation that occurs with some  
22 regularity is the concept of deferral accounting, which is sometimes referred to as  
an accounting authority order. For designated transactions or types of costs, the

1 utility may be allowed to deviate from the accounting otherwise required under  
2 Generally Accepted Accounting Principles (GAAP) or the Federal Energy  
3 Regulatory Commission (FERC) accounting principles set forth in the Uniform  
4 System of Accounts (USOA). Examples of accounting deferral orders might  
5 include extraordinary storm recovery costs or deferral of costs associated with  
6 merger transaction and transition costs, in an effort to mitigate the financial impact  
7 of extraordinary events or to better match cost recognition to the periods thought to  
8 benefit from a merger of utility entities.

9 **Q. Has the Commission noted any of these considerations in allowing Power Cost**  
10 **Adjustment mechanisms in Washington?**

11 A. Yes. In its recent decision in the PacifiCorp rate case, the Commission reaffirmed  
12 certain principles that should be incorporated in a properly designed PCA, stating  
13 the following:

- 14 • The purpose is to recognize variability in the cost of operating  
15 *existing* power supply resources as a result of abnormal weather  
16 conditions that are out of a utility's control. Ratepayers understand  
17 the connection between weather and rates;  
18
- 19 • Power cost adjustment mechanisms are *short-run* accounting  
20 procedures to address *short-run* cost changes resulting from unusual  
21 weather;  
22
- 23 • It is not appropriate to include new resources in a power cost  
24 adjustment mechanism. New resources must be considered in  
25 general rate cases or power cost only rate cases;  
26
- 27 • Ratepayers should receive the benefit of a reduction in cost of  
28 capital, as a power cost adjustment introduces rate instability for  
29 ratepayers and earnings stability for stockholders, and;

- 1                   • Power cost adjustment mechanisms should not interfere with least  
2                   cost planning, conservation, or other regulatory goals.<sup>3</sup>  
3

4     **Q.     Why is a discussion of traditional test period regulation, versus rate tracking**  
5     **and deferral accounting, relevant to this CNG rate case proceeding?**

6     A.     Cascade is requesting Commission approval of two new piecemeal rate tracking  
7           devices to change rate levels between rate cases for increased return and  
8           depreciation on certain new Plant in Service investments and for post-test year  
9           changes in gas usage per customer. Public Counsel, on the other hand, seeks to  
10          restrict the use of this exceptional regulatory treatment only to instances where  
11          there is compelling evidence that piecemeal ratemaking is in the public interest. It  
12          is my belief that parties to regulatory proceedings should not be allowed to tinker  
13          with the balance inherent in traditional test period ratemaking processes by isolating  
14          certain revenue or cost elements for rate tracking or deferral accounting treatment in  
15          the absence of compelling evidence that traditional regulation is not working  
16          effectively. The testimony that follows explains certain generalized criteria that the  
17          Commission should consider in evaluating requests by energy utilities to selectively  
18          depart from balanced test period regulation in changing rates and revenues. The  
19          testimony then applies such criteria to Cascade's specific new rate tracking  
20          proposals in this Docket.

21     **Q.     What general problems are created by the use of rate trackers, accounting**  
22     **deferrals and rate case true-up devices?**

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<sup>3</sup> *WUTC v. PacifiCorp*, Docket No. UE-050684, Order No. 4 at ¶ 91 (April 17, 2006) (2006 PacifiCorp GRC Order). Citations omitted, emphasis in original.

1 A. The general problem associated with use of these regulatory tools is the potentially  
2 serious distortion of the “matching” that is desirable in a rate case test year. This is  
3 often referred to as the “matching principle” in ratemaking. It recognizes the  
4 importance of matching all revenues and costs (expenses, rate base, rate of return)  
5 at a consistent period of time to determine needed changes in utility pricing. I  
6 understand that the Commission has recognized this principle in a recent Avista  
7 case in its findings regarding an adjustment for the Coyote Springs II generating  
8 plant. The Commission’s Order states in part: “The matching principle requires that  
9 all cost-of-service components – revenue, investment, expenses and cost of capital –  
10 must be considered and evaluated at a similar point in time.” *WUTC v. Avista*  
11 *Corporation*, UE-050482, UT-050483, Order No. 5, ¶¶ 111-113 (December 21,  
12 2005).

13 As I mentioned in prior testimony, all elements of the revenue requirement  
14 calculation are dynamic through time and changes that are favorable tend to offset  
15 other changes that are unfavorable. For example, adding customers and the related  
16 revenue growth can help “pay for” increases in operating expenses, while growth in  
17 the depreciation reserve tends to offset to some degree the construction activity that  
18 adds new Plant in Service.<sup>4</sup> If a party is allowed to select certain items for special  
19 treatment with a rate tracker or through deferral accounting, one can reasonably  
20 expect that the selected items will be “cherry picked” by that advocate so as to

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<sup>4</sup> New customers increase utility sales volumes, yielding margin revenues (revenues less fuel costs) that contribute toward recovery of the fixed costs of the business. Some incremental non-fuel costs may also be caused by adding new customers, if facilities extensions are required that exceed advances or contributions pursuant to tariff or rule.

1 influence the regulatory process to the sole advantage of that party. Other specific  
2 concerns with these regulatory exceptions to balanced test year analysis include:

- 3 • Reduction of management incentives (by eliminating regulatory lag);
- 4 • Shifting of cost responsibility and risk to customers who are least able  
5 to influence cost levels or sales levels;
- 6 • Increases in tariff and bill complexity that may be difficult to explain  
7 to customers or that may complicate customers' ability to control their  
8 costs;
- 9 • Administrative complexity and costs associated with audit verification,  
10 and administration of complex accounting entries, cost allocations  
11 and/or tariff calculations, often on an accelerated procedural schedule;  
12 and
- 13 • Potential for inadequate regulatory oversight and auditing of tariff  
14 application.

15 With these concerns in mind, as discussed above the exceptions to normal test  
16 year ratemaking using rate trackers and/or deferral accounting should only be  
17 allowed when extraordinary circumstances exist that preclude the setting of just and  
18 reasonable rates through traditional test year procedures.

19 **Q. Under what circumstances should regulators consider adoption of tracking**  
20 **tariffs and/or regulatory deferral accounting for specific changes that occur**  
21 **between rate case test years?**

1 A. Rate trackers and cost deferrals should be approved only in instances where  
2 compelling circumstances justify departure from traditional test period review of all  
3 costs and revenues within rate case proceedings in which the overall revenue  
4 requirement can be audited and considered in a balanced and synchronized manner.  
5 Costs or revenue changes to be deferred or rate tracked should generally have all of  
6 the following attributes to merit such exceptional and preferential rate recovery  
7 treatment:

- 8 1. Substantial enough to have a material impact upon revenue  
9 requirements and the financial performance of the business between  
10 rate cases.
- 11 2. Beyond the control of management, where utility management has  
12 little influence over experienced revenue or cost levels.
- 13 3. Volatile in amount, causing significant swings in income and cash  
14 flows if not tracked.
- 15 4. Straightforward and simple to administer, readily audited and  
16 verified through expedited regulatory reviews.
- 17 5. Balanced and not distortive of test period relationships –reflective of  
18 factors that mitigate impacts in a manner that preserves test year  
19 matching principles.

20 In the testimony that follows, I will apply these general criteria to the two  
21 proposed rate trackers being advocated by CNG, so as to illustrate why these  
22 Company proposals should be rejected.



1 **Q. Do regulated utilities in Washington, if they experience significant attrition**  
2 **between rate cases that compromises their financial strength, have any options**  
3 **for regulatory relief other than piecemeal ratemaking trackers or deferrals?**

4 A. Yes. In general, past Commission orders show that Washington utilities have been  
5 allowed interim or emergency rate relief when facing very serious financial  
6 circumstances, if required factors are present.<sup>5</sup> In the event Cascade actually  
7 experiences serious attrition problems under traditional regulation in the future, the  
8 Company may be able to qualify for interim emergency rate relief as a remedy for  
9 such problems.

10 **Q. Does the historical financial performance of Cascade in Washington indicate**  
11 **any apparent problems with traditional regulation, such that extraordinary**  
12 **rate tracking treatment is warranted?**

13 A. No. The Company has not requested a general rate case increase in Washington  
14 since 1995, which is a strong indication that traditional regulation is working well  
15 and that the Company's non-gas costs to provide utility service have not been  
16 growing any faster than utility margin revenues (revenues less gas costs). Cascade's  
17 actual earned return on rate base has been consistently positive and has remained  
18 within a narrow range from 9.4 percent to 10.6 percent from 2000 through 2004,  
19 when measured and reported on a Washington Commission normalized basis in its  
20 WAC 480-90-031 monitoring reports. Only recently, in the rate of return reported

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<sup>5</sup> The Commission has broad powers to award interim relief "when it deems it justified." *WUTC v. Verizon Northwest, Inc.*, Docket No. UT-040788, Order No. 11, ¶21 (footnote omitted). The *Verizon* order lists the 20 orders over the last three-plus decades in which the Commission has responded to such requests. *Id.*, n. 10.

1 by CNG to the Commission for the 12 months ended September 2005, CNG earned  
2 7.65 percent on rate base. These financial results in 2005 serve as the unadjusted  
3 starting point for the traditional rate increase filing now being reviewed by the  
4 Commission.<sup>6</sup>

5 **III. REGULATORY LAG IS SYMMETRICAL AND PROMOTES EFFICIENCY**

6  
7 **Q. In previous testimony, you described how the balanced measurement of all**  
8 **elements of the revenue requirement within a test period is important. What is**  
9 **“regulatory lag” and how does it impact utility regulation?**

10 A. Regardless of whether we use actual historical test period data or projected future  
11 test period financial estimates to determine public utility revenue requirements, there  
12 will always be a “lag” between the timing of available financial data that is  
13 incorporated into evidence relied upon by the regulator and the subsequent period of  
14 time during which new utility rates are effective. Historical test periods necessarily  
15 rely upon actual, recorded financial data that is at least several months old at the time  
16 of rate hearings and may include data at the beginning of the period that is up to two  
17 years old by the time a final order is issued. Advocates of the projected test period  
18 approach claim that a significant benefit associated with the use of budgeted future  
19 financial data is the ability to reduce regulatory lag by relying upon data that is more

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<sup>6</sup> Cascade’s response to Public Counsel’s Data Request No. 28 contains WUTC Commission Basis earnings reports. Mr. Stoltz’ Exhibit No. \_\_\_\_ (JTS-2), Schedule 1 at Page 1 shows “Per Books” return on “Rate Base” at 6.6% before “Restating” and “Proforma” adjustments and at 6.3% after such adjustments, but before reflecting the proposed rate increase. The proposed 4.5 percent base rate increase (Exhibit No. \_\_\_\_ (JTS-2), Schedule 1 Revenue Increase \$11.7 million is 4.5% of Proforma Total Revenues of \$259.3 million) after 10 years at present rates is a strong indication that traditional regulation has achieved reasonable financial results for CNG historically. See the chart denominated as Table No. 3 where these ROR data are displayed along with trends in gas gross margin amounts.

1 representative of the cost and revenue environment expected while the new rates  
2 would be effective. However, even the recent actual and estimated data used in  
3 assembling projected test period revenue requirement calculations must be fixed at a  
4 point in time for presentation before the Commission. The data is therefore subject  
5 to regulatory lag and the financial circumstances faced by the utility continue to  
6 change.

7 Regulatory lag is therefore an unavoidable characteristic of test period  
8 regulation that can work to the advantage or disadvantage of the utility depending  
9 upon how future actual revenue and cost trends compare to amounts used to  
10 determine the revenue requirement. Symmetrical risks and opportunities arise for  
11 utility ratepayers and shareholders as a result of regulatory lag because favorable and  
12 unfavorable changes in revenue requirement can produce over or under-earning  
13 outcomes until either the utility or some other party initiates a new rate case  
14 proceeding.

15 **Q. Are any regulatory incentives created by the existence of regulatory lag?**

16 A. Yes. As discussed above, one obvious and desirable incentive created by regulatory  
17 lag is that management is encouraged to control and minimize operating expenses  
18 and capital expenditures at economically efficient levels so as to optimize achieved  
19 earnings between rate cases. Additionally, management faces an incentive to  
20 attempt revisions to the traditional regulatory framework, either through legislative  
21 initiatives or regulatory proceedings, in an effort to change the methods and  
22 procedures through which cost of service changes can be translated into increased  
23 revenues. The new tracking tariffs for infrastructure cost increases and for gas

1 usage per customer that are proposed by Cascade are examples of efforts to  
2 “sweeten” the regulatory framework with preferential ratemaking treatment for  
3 isolated elements of the overall revenue requirement calculation.

4 **Q. How does the creation of rate tracking tariffs, such as Cascade’s proposed new**  
5 **plant investment SRIAM tracker and CAP customer usage tracker, impact**  
6 **regulatory lag and the incentive to utility management that is created by**  
7 **regulatory lag?**

8 A. Tracking tariffs can virtually eliminate the regulatory lag incentive. CNG’s plant  
9 investment SRIAM tracker, if approved, would reduce the incentive faced by  
10 management to carefully manage capital expenditure levels between rate case test  
11 years, because any increases in plant investment caused by eligible capital spending  
12 can be translated into rate increases outside of a formal rate case proceeding. On  
13 the other hand, CNG has little influence over gas usage per customer volumes  
14 because most of such fluctuation between rate cases is caused by weather variation  
15 and by customer usage impacts caused by appliance efficiency improvements, price  
16 elasticity and other external causes. I discuss gas usage incentive concerns in a later  
17 section of my testimony.

18 **IV. EXPANDED RATE TRACKING SHIFTS RISKS AND COSTS TO**  
19 **RATEPAYERS**

20 **Q. How would Commission approval of Cascade’s proposed plant investment**  
21 **SRIAM tracking tariff impact customers?**

22 A. Cascade’s proposal represents higher prices for consumers with no corresponding  
23 demonstrated benefits. In its proposed form and using projected “eligible” plant

1 investment data, CNG’s proposed SRIAM Tracker is expected to increase gas rates  
2 by \$0.5 million starting in year one, increasing to \$1.2 million in year two, \$2.3  
3 million in year three, \$3.0 million in year four and \$4.3 million in year five.<sup>7</sup> These  
4 rate increases would occur outside of a rate case in which CNG would need to also  
5 account for customer growth and other changes in cost levels.

6 Mr. Cummings’ testimony implies that SRIAM will help avoid future rate  
7 cases. He states, “The SRIAM provides for annual recognition in rates of the cost  
8 of service associated with eligible investments without the need for time consuming  
9 and costly general rate cases” and “Absent the SRIAM, Cascade’s only choice will  
10 be to file frequent and costly general rate cases to recover the cost of service related  
11 to these investments.”<sup>8</sup> However, there is no guarantee that Cascade will delay  
12 filings for traditional rate increases in the future, even if the proposed tracker is  
13 approved. In fact, the SRIAM Rule 21 tariff would require Cascade to file another  
14 general rate case at some point within five years after the effective date of the first  
15 SRIAM rate change.<sup>9</sup>

16 **Q. How would Commission approval of Cascade’s proposed CAP decoupling**  
17 **tracking tariff impact customers?**

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<sup>7</sup> See Cascade’s response to NWIGU Data Request No. 14. SRIAM filings would be made on December 1 of each year, based upon increases in “eligible investment” as defined in CNG’s proposed new Rule 21, with surcharge rates effective the following February.

<sup>8</sup> Exhibit No. \_\_\_\_ (FJC-1T), page 2, lines 18-19, and page 3, lines 7-9, respectively.

<sup>9</sup> Proposed Tariff Original Sheet No. 25, Rule 21-Safety & Reliability Infrastructure Adjustment Mechanism states, “The company shall file a general rate case within five years after the effective date of the first SRIAM rate change implemented pursuant to this Rule.” Exhibit No. \_\_\_\_ (JTS-9), schedule 7 of 7.

1 A. Again the Company’s proposal promises higher prices paid by consumers, with no  
2 demonstrated benefits in the form of enforceable commitments to not seek  
3 traditional rate increases in the future or to accept a lower rate of return so as to  
4 recognize the shifting of sales volume risks to customers. I will discuss in greater  
5 detail how the proposed CAP would impact customers in a later section of this  
6 testimony.

7 **Q. What do these two alternative ratemaking proposals have in common?**

8 A. Both of CNG’s proposed new rate trackers represent management’s selection of  
9 isolated elements of the revenue requirement calculation, where future changes are  
10 expected to have negative profit consequences, for piecemeal rate changes that  
11 would shift costs and risks to ratepayers. These regulatory “sweeteners” would  
12 distort the Washington regulatory framework and would systematically  
13 disadvantage ratepayers who are entitled to a more balanced assessment of the  
14 overall cost of service when utility rates are changed.

15 **Q. Has Cascade made any showing that it will need the additional future revenues**  
16 **that would be created through CAP and SRIAM tracker piecemeal rate**  
17 **increases in order to have a reasonable opportunity to earn the allowed rate of**  
18 **return?**

19 A. No showing has been made that any known and measurable changes in future CNG  
20 revenues or expenses would contribute to significant earnings deficiencies that  
21 could not be sufficiently addressed under traditional regulation. Even though  
22 traditional Washington regulation has clearly served the Company well financially,

1 Cascade does not offer any evidence indicating any known and measurable changes  
2 that merit changing the regulatory framework prospectively. Other than  
3 speculation regarding possible higher future CNG capital spending levels within  
4 Mr. Cummings' testimony, no evidence of known and measurable financial changes  
5 has been presented.<sup>10</sup>

6 **Q. If the Commission approves the CAP and plant investment SRIAM tracker,**  
7 **will operating risks normally borne by shareholders be shifted to ratepayers?**

8 A. Yes. The two new trackers, if approved, would substantially sweeten the  
9 regulatory framework within which CNG conducts its business. Any future  
10 increases in plant investment that would normally be borne by shareholders  
11 between rate case test years, to be funded from reductions in other utility costs or  
12 from customer sales gains, would instead be tracked through rate changes to be  
13 funded on a piecemeal basis by ratepayers. Similarly, if weather normalized gas  
14 usage per customer declines between test years, Cascade would increase rates to  
15 shift such risk to its customers on a piecemeal basis.

16 **Q. Has the Commission previously authorized rate tracking mechanisms that**  
17 **benefit CNG shareholders, by shifting the risks arising from large and volatile**  
18 **cost changes to ratepayers?**

19 A. Yes. Cascade is already insulated from significant risks associated with changes in  
20 volatile purchased gas costs through its Commission-approved PGA mechanism.

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<sup>10</sup> Exhibit No. \_\_\_\_ (FJC-1T), page 4.

1 Cascade is over-reaching in this case, by seeking two new rate tracking mechanisms  
2 to further transfer its operational risks onto ratepayers.

3 **Q. Would it be appropriate for the Commission to make a downward adjustment**  
4 **to the authorized return on equity if revenue decoupling or the proposed**  
5 **SRIAM tracking tariff is approved in this Docket?**

6 A. Yes. The return on common equity that is allowed by the Commission is intended  
7 to compensate for the financial and business risks that are borne by equity investors  
8 in Cascade Natural Gas Corporation stock. Commission approval of the SRIAM  
9 tracker and CAP tariffs would directly and favorably impact CNG's future revenues  
10 and income levels while reducing existing levels of operating risk arising from  
11 regulatory lag. The allowed return on equity should therefore be commensurately  
12 lower with the SRIAM tracking and CAP tariffs in place than is required without  
13 such regulatory mechanisms.

14 **V. COMPLEXITY AND ADMINISTRATIVE BURDENS ARE**  
15 **INCREASED BY TRACKING TARIFFS**

16  
17 **Q. How do tracking tariffs impact regulatory complexity and administrative**  
18 **costs?**

19 A. The addition of tracking tariffs adds complexity to regulatory processes in several  
20 ways. First, each new tracking tariff creates new regulatory reporting in support of  
21 periodic price changes that must be created by utility company staff and then  
22 reviewed by Commission personnel. Then, it may be necessary for Commission  
23 Staff to organize and conduct audits of the underlying financial data beneath the  
24 filings, since customer prices are directly impacted by such data. If any disputes



1 arise from either informal review procedures or more comprehensive audits, it may  
2 be necessary to develop formal discovery and dispute resolution procedures. When  
3 applicable review procedures are completed, the utility must implement the rate  
4 change along with any customer disclosures that may be required and then be ready  
5 to respond to customer inquiries arising from rate changes. Unfortunately, because  
6 tracking tariffs are designed to facilitate expedited rate changes, the process just  
7 described must often occur within a compressed timeline that can frustrate efforts  
8 for thorough review and/or contribute to increased costs to the utility, the regulatory  
9 agency, and intervenors.

10 **Q. Is it reasonable to expect that Cascade employees and WUTC Staff personnel**  
11 **would be burdened with significant additional work if the CAP decoupling**  
12 **tariff were adopted?**

13 A. Yes. In its response to Public Counsel Data Request No. 35, Cascade was asked to  
14 provide specimen copies of the form of all documents proposed to be submitted to  
15 the Commission each year to administer the CAP tracker. In its response, the  
16 Company indicates the need for an updated “Weather Normalization Adjustment”  
17 and then the creation of an entire series of complex accounting schedules, as set  
18 forth in Exhibit No. \_\_\_\_(MLB-4) attached to my testimony. Given the importance of  
19 the calculations to customers’ rates, WUTC Staff personnel would need to be tasked  
20 to review and audit such calculations.

21 In Public Counsel Data Request No. 38, the Company was asked for its  
22 “best estimate of annual administrative and regulatory costs to be incurred if the  
23 CAP decoupling mechanism is approved by the Commission and implemented by

1 Cascade” and the Company responded that it, “...expects to use its existing  
2 Regulatory Staff in explaining and implementing CAP filings” and that “CAP filing  
3 exhibits and tariffs are expected to take approximately 8 man-hours to  
4 prepare...less than 8 man-hours to explain.. [and] “...no more than ½ man-hour to  
5 reflect the new rate in the billing system.” The Company also stated its belief that  
6 “...its CAP filings will be simple and easy to follow....We anticipate that Staff will  
7 be able to review the CAP filing in approximately 8 man-hours.” A complete copy  
8 of this response is attached to my testimony as Exhibit No. \_\_\_\_ (MLB-5).

9 I do not agree with Cascade’s optimistic view that minimal incremental  
10 administrative costs would result from implementation of the proposed CAP tariff.  
11 Even if the CAP proved to be as simple and non-controversial to administer as  
12 expected by Cascade, any regulatory complexity and burden added by the CAP  
13 would be additive to the regulatory administration burden and costs already arising  
14 from the Company’s PGA and would only be “simple and easy”, as suggested by  
15 Cascade in its PC-38 response if no significant disputes arise over implementation  
16 details. While in isolation, CNG may not anticipate the CAP to add any significant  
17 time commitment for WUTC Staff, it would be entirely reasonable for the  
18 Commission to consider any added burden as cumulative to all other Cascade  
19 trackers as well as trackers that now exist or may be proposed by other regulated  
20 utilities if customer usage or plant investment tracking becomes accepted WUTC  
21 policy.

1 **Q. Would Cascade’s proposed plant investment SRIAM tracker, if approved, also**  
2 **add to the cumulative administrative burden upon the utility and the WUTC**  
3 **Staff?**

4 A. Yes, for the same reasons discussed above with respect to the CAP tracker  
5 mechanism. The administrative complexity of Cascade’s proposed Rule 21 SRIAM  
6 tracker is evident from the multiple tariff components and calculations set forth in  
7 paragraphs 3 through 6 of the tariff as well as the inherent challenges associated  
8 with isolating what are believed to be “Eligible Investments” for application of the  
9 tariff. Exhibit No. \_\_\_\_ (JTS-9), schedule 7 of 7. Later in this testimony I discuss in  
10 greater detail the definitional problems associated with isolating eligible types of  
11 investment to administer the SRIAM.<sup>11</sup>

12 **VI. REBUTTAL TO CNG’S PLANT INVESTMENT SRIAM**  
13 **TRACKER WITNESS**

14  
15 **Q. At page 3 of his testimony, Mr. Cummings states that he recommends that the**  
16 **proposed new SRIAM device be implemented at this time because, “Cascade’s**  
17 **projected expenditures on investments covered by the SRIAM over the next**  
18 **five years are significant and substantially larger than amounts spent in past**  
19 **years.” Are predictions of larger future capital investments a reasonable basis**  
20 **to redefine Washington regulation of such rate base investments?**

21 A. No. Capital investment levels by gas distribution utilities tend to vary from year to

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<sup>11</sup> Eligible Investments are vaguely defined in tariff 25 / rule 21 and in Mr. Cummings’ testimony. See also Cascade’s responses to WUTC Staff Data Request Nos. 143, 144, 145 and 149 in Exhibit Nos. \_\_\_\_ (MLB-8, 9, 10, and 12 ) as illustrations of difficulties arising from any attempt to categorize capital expenditures in the manner required by the tariff.

1 year and can be addressed through traditional test year ratemaking procedures, if  
2 increased capital investment causes any permanent decline in earnings levels.  
3 Speculation about the level of future utility plant investment, in isolation, provides  
4 no useful information about whether Cascade will have a reasonable opportunity to  
5 earn its authorized return, because other revenue requirement determinants such as  
6 labor costs, non-labor expenses, changes in the cost of capital and future revenue  
7 margin trends will also significantly impact achieved returns. Cascade has not  
8 explained why the productivity gains it has achieved historically, that have allowed  
9 it to continuously invest in new utility plant while also earning reasonable returns  
10 and avoiding a rate case for more than 10 years, will suddenly terminate in the  
11 future, such that radical new investment tracking tariffs like SRIAM are now  
12 needed to provide piecemeal ratemaking for capital investments.

13 **Q. Has Cascade been successful historically in offsetting the costs of newly added**  
14 **plant investment as well as inflationary increases in operating expense levels by**  
15 **employing new technologies and improved business practices?**

16 A. Yes. In its Direct Testimony<sup>12</sup> and in response to Public Counsel Data Request  
17 No. 30, Cascade explains how it has employed various new technologies, revised  
18 employee benefits, centralization of business functions and other operational  
19 efficiency measures to offset rising costs. I have attached a copy of this response as  
20 Exhibit No.\_\_\_\_(MLB-6). While the economic costs and benefits created by these  
21 historical productivity efforts should be captured within the test period, so as to

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<sup>12</sup> Direct Testimony of David Stevens, Exhibit \_\_\_\_ (DWS-1T), page 4, lines 17-28, and page 5, lines 1-18.

1 accurately quantify net revenue requirements at this time, it is reasonable to expect  
2 that management will continue to work toward achievement of future productivity  
3 gains. Under traditional regulatory practices, any newly achieved productivity  
4 gains that are achieved subsequent to the test year will be retained for the sole  
5 benefit of shareholders and will be available to offset cost increases that may occur  
6 during the period new rates set in this docket are in effect. The achieved margin  
7 income and rate of return table set forth in my Table 3 (below) illustrates how  
8 productivity gains and customer growth have apparently contributed to earnings  
9 stability and reasonable returns for CNG historically.

10 **Q. Has the Company made any showing that it may experience attrition in the**  
11 **future because of higher expected capital expenditures or for any other**  
12 **reason?**

13 A. No. In fact, it appears questionable that Cascade will actually experience capital  
14 spending at significantly higher levels in the future.

15 **Q. At page 4, lines 17-23, of his testimony, Mr. Cummings provides a table of**  
16 **“Annual Washington Expenditures” stating, “While the 2006 budget for these**  
17 **types of investments is lower than recent levels of spending, projections for the**  
18 **next five years show required expenditures in each of these years are expected**  
19 **to be well above those amounts spent in any prior year, averaging more than**  
20 **\$7,400 thousand [sic] per year. With these sizable investment requirements,**  
21 **the Company will be unlikely able to defer the need for frequent rate cases to**  
22 **enable the cost of these financial commitments to be included in rates unless**  
23 **the SRIAM is implemented.” How do you respond?**

1 A. First, to state the obvious, estimated future expenditure levels are not sufficiently  
2 known and measurable to be useful for ratemaking purposes. In fact, as part of its  
3 voluminous response to Public Counsel Data Request No. 41(h) that requested  
4 more data supporting this table, the Company acknowledged, “The trend of  
5 expenditures is the company’s best estimate of future needs based on our  
6 knowledge of past expenditures, the expected load growth rates of various systems  
7 and the aging of the systems. The actual expenditures are likely to vary from the  
8 plan in response to actual service requests, actual operations results and changes in  
9 future regulation and enforcement.”

10 Second, information provided in the aforementioned response indicates that in  
11 several recent years, actual net expenditures were millions of dollars lower than  
12 budgeted expenditures.<sup>13</sup> Gas capital expenditures in any particular year are, to  
13 some extent, discretionary because some program/project activities can be deferred  
14 in the short term. It is impossible to know whether Cascade’s historical ability to  
15 reduce or defer budgeted capital expenditure has been fully reflected in forecasted  
16 spending levels for future years.

17 Third, some of the largest spending amounts projected in the  
18 “Reinforcements” column of Mr. Cummings’ table are to provide additional  
19 capacity within the distribution system for new customers. Customer additions will  
20 produce new sales and yield margin revenues for the Company that will serve to

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<sup>13</sup> Attachment to Response to Public Counsel Data Request 41, Capital Expenditure Reports, indicate actual spending in fiscal 1999, fiscal 2000 and the year ended July 2001 was under “budget” by \$6 million, \$7.5 million and \$5.6 million, respectively. Data for other years was not provided.

1 offset capital expenditures made to expand distribution system capacity. It is  
2 patently unfair to allow special rate tracker treatment for distribution system  
3 reinforcement expenditures to provide capacity for new customers when the  
4 proposed SRIAM tracker does not fully account for the added margin revenues  
5 earned from serving such new customers.

6 Fourth, a portion of Cascade’s future distribution system capital expenditures  
7 will be to replace existing gas plant in service, which will create plant retirement  
8 entries on the books. If traditional test period regulation were used to account for  
9 such capital expenditures, the per books Plant in Service balances includable in rate  
10 base would be increased by completed construction work order balances, but would  
11 be reduced by the retirements of existing plant assets that are replaced. Cascade’s  
12 proposed Rule 21 Tariff does not provide for any reduction in gross plant for  
13 retirements that should produce depreciation expense savings if properly  
14 recognized.<sup>14</sup>

15 Finally, even capital investments that are not associated with “revenue  
16 producing” new customer connections or expanded distribution system capacity to  
17 serve increasing demand may produce operational efficiencies and cost savings that  
18 are not accounted for in the structure of the proposed SRIAM tracker.

19 **Q. How is it possible for new future investment in gas distribution plant to create**  
20 **operational efficiencies that reduce expenses?**

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<sup>14</sup> The DR14 Supporting Schedule attached to Cascade’s response to NWIGU Data Request No. 14 also illustrates adding “Annual Capital Expenditures” to the “SRIAM Investments” balance upon which depreciation is calculated, with no accounting recognition given retirements of plant that will occur in future years.

1 A. Many types of operations and maintenance expenses are influenced by the age and  
2 condition of utility plant. For example, service calls for gas leaks and gas leak  
3 repair expenses are impacted by the condition of mains and service lines and the  
4 systematic replacement of problem areas in the gas distribution system can produce  
5 profound improvement (i.e., reductions) in these costs. Automation opportunities  
6 also exist through modernization of distribution facilities, with examples such as  
7 automated meter reading that create staffing and O&M expense reduction  
8 opportunities through new capital investments. Therefore, capital investments in  
9 gas distribution plant should not be subject to single issue rate tracking unless all of  
10 the corresponding operational impacts created by such investments are also  
11 recognized within the tracker. As a practical matter, it would likely be impossible  
12 to design a comprehensive tracking mechanism to capture all financial impacts  
13 arising from new capital investment, because of the capital intensity of the utility  
14 business and the complex ways in which changes in utility plant assets impact  
15 business operations.

16 **Q. Referring again to the table of “Annual Washington Expenditures” at page 4**  
17 **of Mr. Cummings’ testimony, are these amounts inclusive of all capital**  
18 **investment that Cascade has made or expects to make in each of the historical**  
19 **and projected years shown?**

20 A. No. The amounts shown are for selected subset of “types of investments” that Mr.  
21 Cummings has elected to focus upon, in categories he has chosen that include  
22 “reinforcements”, “relocations” and “replacements”. Total CNG capital  
23 expenditures are much larger in each year, when expanded to also include



1 investments made to increase the capacity and scope of the distribution system to  
2 serve load growth and for investments in general plant. According to information  
3 provided by Cascade in response to WUTC Staff Data Request Nos. 146 and 147,  
4 Total Capital Expenditures inclusive of the data in Mr. Cummings' table would  
5 appear as follows:

<b>Table 1</b>	
Fiscal Year	Total Capital Expenditures \$000
2000	\$15,937
2001	21,649
2002	20,733
2003	27,693
2004	39,020
2005	28,011
2006 Estimated	17,200
2007 Estimated	24,200
2008 Estimated	26,100
2009 Estimated	30,700
2010 Estimated	28,500
2011 Estimated	35,400

6  
7 The SRIAM plant investment tracker proposal would improperly attempt  
8 to isolate only certain vaguely defined types of capital investment for prospective  
9 rate tracking that are expected by Mr. Cummings to grow in the future, even though  
10 the overall trend in CNG total capital spending is not moving significantly higher  
11 than historical levels.

1 **Q. One of the criteria you mentioned for piecemeal rate tracking in earlier**  
2 **testimony is that tracked costs should be substantial enough to have a material**  
3 **impact upon revenue requirements and the financial performance of the**  
4 **business between rate cases. Would the financial impact of tracking changes in**  
5 **gas distribution plant investment be substantial enough to have a material**  
6 **impact upon revenue requirements and the financial performance of the**  
7 **business between rate cases?**

8 A. No. In the back-casting analysis performed by Cascade in response to Public  
9 Counsel Data Request No. 43, the annual financial impacts of the proposed SRIAM  
10 tracker, if it had been in effect continuously in the years 2001 through 2005, would  
11 have started at only \$72,987 in 2001 and would produce a cumulative margin  
12 revenue impact of \$1.0 million per year by 2005. Comparing these annual amounts  
13 to the requested annual operating income for CNG's Washington business of \$22.4  
14 million<sup>15</sup>, the highest accumulated annual amount after five full years of tracker  
15 growth represents less than five percent<sup>16</sup> of Cascade Natural Gas Corporation's  
16 proposed annual operating income in Washington. Under traditional test year  
17 regulation, rate cases can occur frequently enough that any under-recoveries of  
18 plant investment costs need not accumulate for five years to reach even this \$1.0  
19 million pretax level.

20 **Q. Should capital spending on gas distribution system plant be viewed as beyond**  
21 **the control of management?**

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<sup>15</sup> Exhibit No. \_\_\_\_ (JTS-9), Schedule 1 of 7, line 3 Total Net Operating Income is \$22,413,493.

<sup>16</sup> One million divided by \$22.4 million = 4.5%.

1 A. No. While it is true that significant capital expenditures are continuously required  
2 by utilities to replace, extend and modernize gas distribution facilities, management  
3 does have some control over expenditure levels and should be actively involved in  
4 facilities planning and design, construction workforce management, materials  
5 procurement, contractor bidding and administration and other elements of capital  
6 expenditure optimization.

7 **Q. Can the input values and computations involved in administering the**  
8 **Company’s proposed SRIAM plant investment tracker tariff be readily**  
9 **audited and verified through expedited regulatory reviews?**

10 A. No. A fair amount of complexity is involved in the numerous calculations  
11 associated with the annual SRIAM tracker. First, there is a fundamental problem  
12 with the proposed SRIAM in defining which capital investments should be  
13 recovered on a piecemeal basis through the tracker. The primary input values under  
14 the proposed SRIAM would be the “eligible investments” made in new plant  
15 between rate case test years. Mr. Cummings defines such “eligible investment” at  
16 page 2, line 20, through page 3, line 2, of his Direct Testimony.<sup>17</sup>

17 In Public Counsel Data Request No. 42, the Company was asked to “provide  
18 examples of the types of investments that would be included and excluded under  
19 this definition and to state with specificity which types of new investment would  
20 not be “eligible” for SRIAM inclusion. I have included a copy of this response as  
21 Exhibit No. \_\_\_\_ (MLB-7) and note that only two types of new gas plant capital

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<sup>17</sup> A similar definition of “eligible investment” appears in the proposed Tariff Sheet No. 25 / Rule 21.

1 investment are not eligible:

- 2 • Projects directly initiated as a result of a customer’s request for new  
3 service.
- 4 • System wide computer investments, office buildings/warehouses and  
5 other non-distribution system investments.

6 These definitional criteria are apparently intended to address two of the  
7 consistency problems described earlier in my testimony that arise from tracking of  
8 plant investments to serve new revenue-producing customers or new technology  
9 investments that may produce significant expense savings. However, the  
10 application of these eligibility criteria is inherently problematic for several reasons:

- 11 1. Eligible distribution plant investment that is required to expand the capacity  
12 of the distribution system, but that is not “directly initiated as a result of a  
13 customer’s request for new service,” may be needed primarily because of  
14 demand growth associated with serving general peak load growth caused by  
15 new customers generally;<sup>18</sup>
- 16 2. Eligible distribution plant investment to improve the reliability of the  
17 distribution system may create O&M savings by reducing maintenance and  
18 outage response costs, but such O&M savings would not be consistently  
19 tracked through the SRIAM as an offset to the investment; and
- 20 3. Ineligible investments in system wide computer technology may produce

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<sup>18</sup> This is particularly true given Cascade’s concern that weather normalized demands of existing customers is trending downward, rather than contributing to additional demand that requires distribution system capacity expansion.

1 productivity benefits sufficiently large to offset more than the direct costs  
2 incurred, but such investments and the related productivity gains are not  
3 accounted for in the proposed SRIAM.

4 Exhibit No. \_\_\_\_(MLB-8) through Exhibit No. \_\_\_\_ (MLB-12) also contain  
5 copies of Cascade’s responses to WUTC Staff Data Request Nos. 143, 144, 145,  
6 148, and 149 respectively, as illustrations of difficulties arising from any attempt  
7 to categorize capital expenditures in the manner required by the tariff. These  
8 responses illustrate some of the challenges in determining SRIAM eligibility for  
9 a specific capital project that replaces existing plant that may be responsive to  
10 multiple needs, including customer growth (Exhibit No. \_\_\_\_ (MLB-8)), expanded  
11 peak demand capacity (Exhibit No. \_\_\_\_ (MLB-9)), or physical deterioration,  
12 regulatory requirements and/or relocations (Exhibit No. \_\_\_\_ (MLB-12)). In  
13 response to WUTC Staff Data Request No.145 (Exhibit No. \_\_\_\_ (MLB-10)),  
14 Cascade states its intent to rely upon “the most immediate reason for engaging in  
15 the project” to determine eligibility, because of these difficulties.

16 **Q. Even if the definitions of “eligible” investments could be refined so that the**  
17 **problems you describe are reasonably addressed, do you believe that the**  
18 **proposed SRIAM plant investment tracker tariff can be readily audited and**  
19 **verified through expedited regulatory reviews?**

20 A. No. Mr. Cummings is proposing a 60-day period between the filing and effective  
21 date of SRIAM rate changes.<sup>19</sup> It would be virtually impossible for Staff and other

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<sup>19</sup> Direct Testimony of F. Jay Cummings, Exhibit No. \_\_\_\_ (FJC-1T), page 6, line 26, to page 7, line 11.

1 concerned parties to investigate the entire population of capital addition projects  
2 included in Cascade’s annual SRIAM filing to determine or verify compliance with  
3 any refined eligibility criteria. Then, given the complexities of downstream  
4 calculations for depreciation, return on investment, property taxes, income tax  
5 depreciation and deferred income taxes, as well as the allocation and translation of  
6 revenue requirements into rates, I expect that only cursory review of SRIAM filings  
7 would be possible within the proposed 60-day filing process.

8 **VII. REBUTTAL TO CASCADE’S CAP DECOUPLING WITNESS**  
9

10 **Q. At pages 26 through 31 of his testimony, Mr. Stoltz describes Cascade’s**  
11 **proposed decoupling mechanism, which has been labeled a “Conservation**  
12 **Alliance Plan”. In your opinion, is it necessary to introduce revenue**  
13 **requirement tracking of changes in usage per customer and related margins in**  
14 **order to promote conservation?**

15 **A.** No. Usage per customer for gas distribution utilities in Washington and other states  
16 has for many years been subject to the effects of conservation, as well as many  
17 other variables impacting natural gas demand, including:

- 18 • changes in consumer preferences (cooking, lighting, laundry, etc.),
- 19 • replacement of older, less efficient gas appliances and furnaces,
- 20 • tighter and more efficient residential and commercial building designs,
- 21 • overall economic conditions,
- 22 • changes in industrial customer activity levels, and
- 23 • consumer responses to changes in gas prices (elasticity).

1           Moreover, usage per customer is only one of the two main variables impacting total  
2           margin revenues – the other input being the number of customers being served.  
3           Cascade serves a rapidly growing service area that has experienced overall demand  
4           growth, with the addition demand volumes of new customers offsetting the effects  
5           of declining usage among existing customers. Cascade says it has increased its  
6           gross margin by adding new customers, but the declining consumption from  
7           existing customers has virtually eliminated the increase in residential margin from  
8           adding new customers.<sup>20</sup>

9                         With many variables impacting overall gas demand and margin income levels,  
10           it is unreasonable in my view to isolate only usage per customer changes that are  
11           thought to represent conservation effects for piecemeal rate tracking. No  
12           dramatically changed facts or circumstances now support elimination of normal test  
13           year ratemaking that sets gas delivery rates based upon test year normal weather  
14           sales volumes, allowing productivity gains elsewhere in the business to offset the  
15           gradual effects of changing sales volumes.

16   **Q.     Does the regulatory lag create a problem, by encouraging gas utilities to grow**  
17   **demand while discouraging utility management from actively promoting**  
18   **conservation of energy?**

19   **A.**     Not significantly. Utility shareholders will generally benefit when sales volumes  
20           increase between test periods and are harmed when sales decline. Sales volumes  
21           are influenced by the addition of new customers and by changes in usage levels of

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<sup>20</sup> Cascade Response to Public Counsel Data Request No. 47a.

1 existing customers, suggesting that utility promotion of energy conservation by  
2 existing customers might be actively discouraged by management. However, in this  
3 era of higher-priced natural gas, conservation measures are necessary to attract new  
4 customers and to retain existing gas utility customers that may otherwise elect  
5 alternative energy sources such as electricity when appliances are being installed or  
6 replaced. Cascade has little choice but to promote the efficient use of natural gas.  
7 The Commission should, in my opinion, expect Cascade to provide energy  
8 conservation programs for its customers as a necessary element of its public service  
9 obligation under the least cost planning requirement. *See, e.g.,* WAC 480-90-238.

10 **Q. If the Commission is concerned about the potential disincentive to utility**  
11 **management to promote reduced gas consumption between rate cases, are**  
12 **there alternatives to the CAP decoupling approach that can be employed?**

13 A. Yes. First, it should be noted that the Commission's least cost planning rules  
14 mandate that balanced consideration be given in natural gas utility least cost plan  
15 filings to "the mix of natural gas supply and conservation designated to meet  
16 current and future needs at the lowest reasonable cost to the utility and its  
17 ratepayers." WAC 480-90-238(1)

18 Beyond mandating conservation measures, some regulators have responded to  
19 the "disincentive" concern in the design of utility demand side management  
20 ("DSM") programs by approving shareholder incentives or compensation for DSM-  
21 caused lost margins within such programs. By carefully targeting such incentives,  
22 it is possible to match the additional compensation to shareholders to actual



1 achievements under DSM measures that are deployed, rather than globally shifting  
2 all risks associated with sales declines from shareholders to customers.

3 **Q. Does Cascade's usage per customer CAP tracking proposal properly balance**  
4 **the interests of shareholders and customers?**

5 A. No. Gas utility delivery revenues (revenues less gas costs) are subject to fluctuation  
6 for many reasons as previously listed, including sales volume variation due to  
7 weather, replacement of inefficient older appliances, improved building codes,  
8 variation due to conservation and price elasticity effects as well as growth in  
9 revenue from adding new customers. Cascade's CAP proposal would adjust rates  
10 to eliminate gas usage and revenue fluctuations due to weather, replacement of  
11 appliances, price elasticity or conservation effects, effectively guaranteeing  
12 collection by the utility of the gas margin revenue per customer that was used to set  
13 rates. At the same time, CNG would be allowed to collect and retain for its  
14 shareholders (not track through rates) steadily increasing margin revenues  
15 associated with adding new customers. The combined effect of rate tracking for  
16 anticipated declines in usage per customer, while not tracking favorable revenue  
17 impacts from adding customers, will assure the utility and its shareholders of stable  
18 and increasing future revenue levels while shifting all risks associated with usage  
19 per customer declines due to weather and conservation onto customers. Customers  
20 would pay higher rates as a result of their collective success in conserving energy  
21 and would pay higher rates when weather is mild, while paying lower rates only  
22 when sales growth due to severe winter weather is normalized through the CAP.

1 All of this would occur while Cascade’s gas margin revenues continue to grow as  
2 customers are added to the system.

3 **Q. Does Cascade expect to implement CAP in a manner that produces stable and**  
4 **steadily increasing future margin revenues?**

5 A. Yes. Mr. Stoltz describes how deferral accounting will be used to insure that  
6 authorized levels of margin “per customer” for Rate Schedule 503 and 504  
7 customers in each year remain stable. This would occur in spite of usage variations  
8 caused by weather or other influences upon per customer usage, and would be  
9 achieved by an annual recalculation of a new per therm rate to recover the  
10 authorized margin “per customer” amounts prospectively, along with any deferral  
11 balance amortizations.<sup>21</sup> However, total sales volumes and margin revenues are the  
12 product of the total number of customers being served as well as the usage “per  
13 customer” in any given year. Mr. Stoltz’s testimony is silent with regard to total  
14 delivery volume trends or the number of customers being served, instead focusing  
15 upon stabilizing the margin “per customer”, the only variable where Cascade  
16 expects to suffer margin income reductions.

17 **Q. According to Mr. Stevens’ testimony at page 3, lines 1-3, “Cascade is one of the**  
18 **fastest growing natural gas utilities in the nation. In the last five years,**  
19 **Cascade’s customer base grew at a pace of 3 to 5%, which is significantly more**  
20 **than the national average”. How would continued customer growth in the**  
21 **future work with Cascade’s proposed CAP tracker?**

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<sup>21</sup> Exhibit No. \_\_\_\_ (JTS-1T), pages 27-29.

1 A. The new CAP device would serve to lock in a stable commodity margin dollar  
 2 amount per customer that would grow in linear fashion as new customers are added.  
 3 According to projected information contained in the Company’s response to Public  
 4 Counsel Data Request No. 35, Exhibit No. \_\_\_\_ (MLB-4), based upon anticipated  
 5 future Residential and Commercial customer counts, the CAP would produce  
 6 growing future margin revenues from both Residential Rate Schedule 503 and  
 7 Commercial Rate Schedule 504 customers as follows:

8 **Table 2**

9 **Projected Margin Revenues Under Cascade’s CAP Proposal**

	FY2006	FY2007	FY2008	FY2009	FY2010
<b>Residential Customers - 503</b>	153,107	157,684	162,415	167,287	172,306
Avg Commodity Margin Per Cust	\$ 184.48	\$ 184.48	\$ 184.48	\$ 184.48	\$ 184.48
Projected Commodity Margin	\$ 28,245,179	\$29,089,544	\$29,962,319	\$30,861,106	\$31,787,011
Basic Service Charge	\$ 12,860,988	\$13,245,456	\$13,642,860	\$14,052,108	\$14,473,704
<b>Total Residential Margin</b>	<b>\$ 41,106,167</b>	<b>\$42,335,000</b>	<b>\$43,605,179</b>	<b>\$44,913,214</b>	<b>\$46,260,715</b>
<b>Commercial Customers - 504</b>	22,351	22,567	22,793	23,021	23,251
Avg Commodity Margin Per Cust	\$ 721.91	\$ 721.91	\$ 721.91	\$ 721.91	\$ 721.91
Projected Commodity Margin	\$ 16,135,410	\$16,291,343	\$16,454,495	\$16,619,090	\$16,785,129
Basic Service Charge	\$ 3,754,968	\$ 3,791,256	\$ 3,829,224	\$ 3,867,528	\$ 3,906,168
<b>Total Rate 504 Margin</b>	<b>\$ 19,890,378</b>	<b>\$20,082,599</b>	<b>\$20,283,719</b>	<b>\$20,486,618</b>	<b>\$20,691,297</b>

10  
 11 Source: Response to Public Counsel Data Request No. 35, part f, Exhibit No. \_\_\_\_ (MLB-4).  
 12

13 These projections illustrate, at the Rows captioned “Total Residential Margin” and  
 14 “Total Rate 504 Margin”, how the CAP would serve to lock in stable and  
 15 increasing future margin revenues for Cascade, shifting all risks of changes in  
 16 commodity usage per customer to ratepayers while retaining the full benefit of  
 17 customer growth for shareholders.

1 **Q. Has Cascade demonstrated that it will need CAP-stabilized commodity**  
2 **revenues per customer and the resulting overall higher projected revenues**  
3 **from customer growth in future years?**

4 A. No. The Commission is asked to assume that stabilized increasing revenues will be  
5 needed by Cascade, but no showing of past attrition or future projected attrition  
6 problems has been made. Such an assumption is inconsistent with a decade of  
7 experience by Cascade, where the overall impact of experienced historical changes  
8 in usage per customer, increasing numbers of customers, productivity  
9 improvements , and all other changes within the business have allowed the  
10 Company to earn reasonable returns without filing a rate case. Cascade has not  
11 demonstrated any problem with traditional, test period regulation that will provide a  
12 continuing future opportunity for comprehensive quantification of all elements of  
13 the revenue requirement in a balanced and matched manner, if its costs to serve  
14 begin to grow more rapidly than its revenues.

15 **Q. Does traditional ratemaking involve the measurement of overall gas delivery**  
16 **volumes, in a manner that recognizes both the number of customers being**  
17 **served, as well as the recently declining usage “per customer” that Mr. Stoltz**  
18 **has chosen to focus upon?**

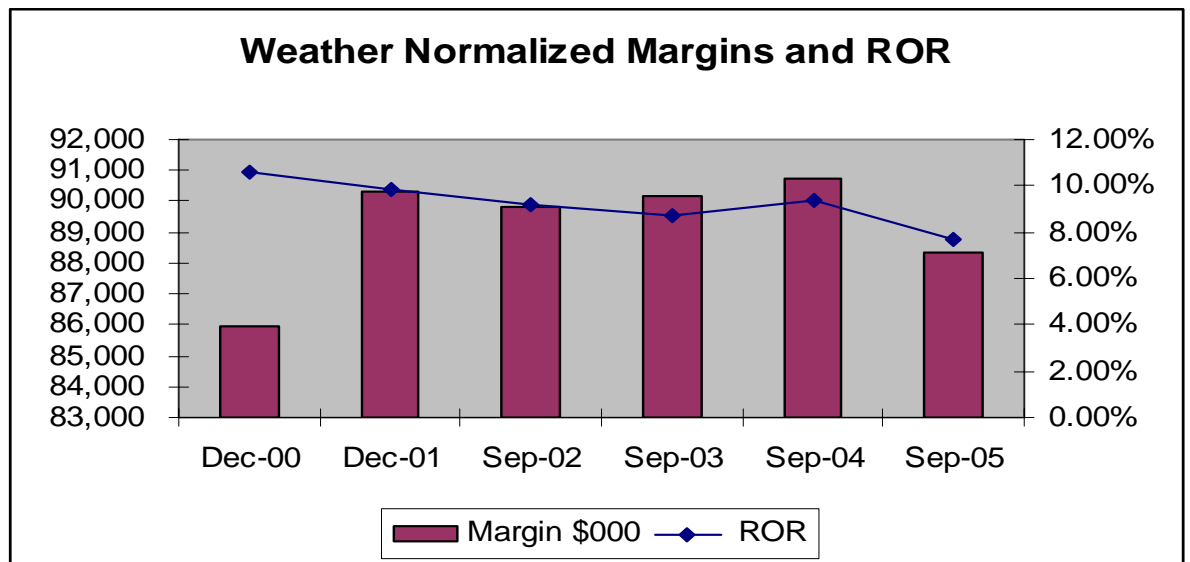
19 A. Yes. This holistic test year approach under traditional regulation is critically  
20 important to the establishment of just and reasonable utility rates, because it  
21 accounts for all of the elements of the revenue requirement, including the number of  
22 customers being served in the test year, their usage levels, and all of the investment  
23 and expenses incurred to provide gas delivery services to such customers within the

1 test year. The reasonableness of resulting utility rates is heavily dependent upon a  
2 balance review of all ratemaking elements at a common point in time. Departures  
3 from the traditionally balanced test year approach should only be implemented  
4 when compelling facts justify upsetting this balance by establishing special cost  
5 trackers or accounting deferrals subject to strictly applied regulatory criteria.

6 **Q. Have the historical gas margin revenues that Cascade has earned in**  
7 **Washington been declining on a weather normalized basis?**

8 A. Actual weather-normalized gas margin revenues have been fluctuating within a  
9 fairly narrow range, according to data filed by the Company in its reporting  
10 pursuant to WAC 480-90-208:

11  
12 **Table 3**



13  
14 Source: Derived from Cascade Response to Data Request No. 28  
15

1 As noted in prior testimony, the rates of return (“ROR”) on rate base have also been  
2 relatively stable, with a decline in the test year that is contributing to the Company’s  
3 asserted need for rate relief. Obviously, rate relief that may be granted by the  
4 Commission would directly increase weather normalized gas margin amounts.

5 **Q. Cascade may argue that the Commission should consider only margin losses**  
6 **caused by declining usage per customer, while ignoring offsetting margin**  
7 **growth caused by adding new customers, because the Company incurs**  
8 **additional investment and expenses when it connects and serves new**  
9 **customers. Would this be reasonable?**

10 A. No. As noted throughout my testimony, traditional regulation involves an intensive  
11 review of all of the elements of the revenue requirement within the established test  
12 year, including all costs associated with adding and serving new customers. It  
13 would be inappropriate to assume that Cascade realizes no financial benefit from  
14 customer growth between rate cases that can help to mitigate conservation effects.  
15 It would also be inappropriate, in my view, to assume that Cascade is unable to  
16 deploy new technology or improved methods of operation to exploit productivity  
17 gains useful in mitigating cost increases or ratepayer conservation effects.<sup>22</sup> I  
18 would encourage the Commission to not accept any unproven assumptions  
19 regarding whether or not customers added to Cascade’s gas delivery system  
20 between rate cases are financially harmful or beneficial to the Company, when the  
21 only certainty is that new customers create new margin revenues.

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<sup>22</sup> See pages 4 and 5 of Cascade witness Stevens Direct Testimony, Exhibit No. \_\_\_\_ (DWS-1T) for a discussion of numerous “cost control efforts” the Company has successfully implemented in recent years.

1 **Q. At page 28 of his testimony, Mr. Stoltz describes how the proposed CAP**  
2 **tracker will create deferral entries to two separate regulatory asset/liability**  
3 **accounts, one called a “Conservation Variance” deferral account and the other**  
4 **called a “Weather Variance” deferral account. Does the creation of these two**  
5 **separate deferral accounts reveal anything about the purpose of the CAP?**

6 A. Yes. The proposed CAP would operate as a weather normalization tariff, while also  
7 tracking changes in usage per customer after weather effects have been normalized.  
8 By tracking changes in both weather fluctuations and in usage per customer after  
9 weather is normalized (which Cascade has deemed to be entirely “conservation”),  
10 the CAP would work to virtually guarantee future realization by the Company of  
11 the test year average usage per customer commodity margin revenues.

12 **Q. Does Cascade’s proposed CAP deferred accounting and tracking of all**  
13 **experienced changes in usage and commodity revenues per customer, before**  
14 **and after weather normalization, cause the CAP to be much more than a**  
15 **weather/conservation tracker?**

16 A. Yes. As noted in prior testimony, usage per customer (and margin revenue per  
17 customer) is affected by weather and conservation effects, but also by changes in  
18 consumer preferences (cooking, lighting, laundry, etc.), changes in building  
19 designs, replacement of older less efficient appliances, price elasticity and overall  
20 economic conditions. Cascade’s proposed CAP tracker would track variations in  
21 usage per customer caused by all of these factors, while labeling all such changes  
22 “conservation” effects. Unfortunately, the CAP tracker is designed to not track the

1 single most important cause of favorable margin revenue trends, the continued  
2 above-average growth in the number of customers served by Cascade.

3 **Q. In prior testimony, you discussed how the CAP tariff is expected to generate**  
4 **additional future margin revenue for shareholders. If we now look backward,**  
5 **instead of forward, how much additional revenue would Cascade have**  
6 **collected since its last Washington rate case if the Company's proposed CAP**  
7 **decoupling rates had been effective for gas utility operations?**

8 A. According to the Company's response to Public Counsel Data Request No. 63, a  
9 back-casting analysis of the CAP tariff indicates that the Company would have  
10 accumulated a conservation deferral recoverable through higher rates of \$5.7  
11 million as of September 30, 2005. As would be expected, the cumulative weather  
12 deferral balance after multi-year back-casting is much smaller (less than \$500,000)  
13 because of offsetting weather conditions (warm and cold winters) across multiple  
14 years. The large cumulative conservation variance deferral balance amount  
15 indicates how the proposed CAP tracker would favor shareholders, by charging  
16 customers higher rates to make up for declining normalized gas usage per customer,  
17 while ignoring the fact that margin revenues in total are growing due to customer  
18 growth as illustrated in Table 2.

19 **Q. What does the large cumulative conservation deferral tell us about the need for**  
20 **a CAP tariff to maintain the financial performance of the business between**  
21 **rate cases?**

22 A. Cascade has historically earned adequate returns on its rate base investment in  
23 Washington and has not filed a rate increases request in many years, indicating that



1 traditional regulation with no CAP tracking tariff has served the Company and its  
2 ratepayers well. The fact that back-casting the proposed tariff would create millions  
3 of dollars in additional cumulative revenue for Cascade during prior periods when  
4 the Company was already earning a reasonable return is evidence that the proposal  
5 is excessively favorable to shareholders and would upset the balance existent within  
6 traditional regulation.

7 **Q. Can the input values and computations involved in administering the**  
8 **Company's proposed CAP tariff be readily audited and verified through**  
9 **expedited regulatory reviews?**

10 A. No. The Company's proposed tariff (Rule 22 – Conservation Alliance Plan  
11 Mechanism) adds considerable complexity to the Company's existing tariffs, by  
12 requiring monthly weather normalization calculations, monthly regulatory asset  
13 deferral entries for weather and all other usage variances (deemed conservation),  
14 annual filings to compute new commodity rates, the application of imputed interest  
15 to deferral balances, and temporary rate adjustments for amortization of previously  
16 deferred amounts. For these calculations to be readily audited on an expedited  
17 basis, Staff and other concerned parties would need to dedicate significant resources  
18 to the analysis of cumulative deferrals, the annual re-determination of this rate and  
19 the required true-up or prior year over or under-recoveries

20 **Q. Please summarize your specific recommendations regarding Cascade's**  
21 **proposed plant investment SRIAM tracker and the CAP mechanism.**

1 A. For all of the reasons explained in my testimony, I recommend the Commission  
2 reject CNG's proposed SRIAM plant investment tracker and its proposed CAP  
3 decoupling mechanism.

4 **Q. Does this conclude your testimony at this time?**

5 A. Yes.