Exhibit No. ___ T(MPP-1T)
Docket No. UG-060256
Witness: Michael P. Parvinen

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. CASCADE NATURAL GAS CORPORATION, Respondent.	DOCKET NO. UG-060256

TESTIMONY OF

MICHAEL P. PARVINEN

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

August 15, 2006

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1 **I. INTRODUCTION**

2 Q. **Would you state your name and business address?**

3 A. My name is Michael P. Parvinen. My business address is 1300 S. Evergreen Park Dr.

4 S.W., P.O. Box 47250, Olympia, Washington 98504-7250. My e-mail address is

5 mparvine@wutc.wa.gov.

6

7 Q. **By whom are you employed and in what capacity?**

8 A. I am employed by the Washington Utilities and Transportation Commission as a

9 Regulatory Analyst.

10

11 Q. **How long have you been with this agency?**

12 A. I have been with the Commission since January 1987.

13

14 Q. **What are your educational and professional qualifications?**

15 A. I graduated from Montana College of Mineral Science and Technology in May 1986, and

16 received a Bachelor of Science degree in business administration with a major in

17 accounting. I have appeared before the Commission in: Docket UE-050482/UG-050483

18 – Avista Corporation; Docket UG-040640/UE-040641 – Puget Sound Energy; Docket

19 UG-021584 – Avista Corporation; Docket UE-011570/UG-011571 – Puget Sound

20 Energy, Inc.; Docket UE-010395 – Avista Corporation; Docket No. UE-991606/UG-

21 991607 – Avista Corporation; Docket No. UG-931405 - Washington Natural Gas

22 Company; Docket No. UG-920840 - Washington Natural Gas Company; Docket No.

UG-911246 - Cascade Natural Gas Corporation; Docket No. UE-900093 - The Washington Water Power Company; Docket No. U-89-2688 - Puget Sound Power & Light Company; Docket No. D-2576 - Bremerton-Kitsap Airporter, Inc.; and Docket No. U-88-2294-T - Richardson Water Companies. I have also analyzed or assisted in the analyses of numerous transportation and utility rate filings. I attended the Seventh Annual Western Utility Rate Seminar in 1987 and the 1988 Annual Regulatory Studies Program, sponsored by the National Association of Regulatory Utility Commissioners (NARUC).

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. Please describe the scope of your testimony and list the corresponding witnesses of Cascade Natural Gas Corporation (Cascade, or company) that you address.

A. I present Commission Staff's (staff) recommendation regarding Cascade's revenue requirement, its "Prior Obligation" Washington Administrative Code (WAC) waiver request, and its proposed Safety and Reliability Infrastructure Adjustment Mechanism (SRIAM). I address issues covered in the testimony of company witnesses Stevens, Stoltz, Barnard, Haug, and Cummings.

Q. Please list the other staff witnesses and their general area of responsibility in this proceeding.

A. There are three other staff witnesses presenting testimony in this proceeding. Dr.

1 Yohannes Mariam addresses the company's proposed weather normalization adjustment
2 and underlying methodology. He recommends rejecting the company's proposed
3 weather normalization proposal, and continuation of the methodology adopted by this
4 Commission in all of the most recent rate cases. Dr. Mariam also addresses the
5 company's proposed cost of service model.

6 Mr. David C. Parcell presents staff's recommendation regarding the appropriate
7 capital structure and cost of capital. He recommends that rates be set using a return on
8 common equity of 9.5 percent (9.75 percent without decoupling) on a capital structure
9 that contains 41.13 percent common equity. He recommends an overall rate of return of
10 8.33 percent (with decoupling, 8.43 percent without decoupling).

11 Ms. Joelle Steward addresses the company's proposed Conservation Alliance
12 Plan (CAP), rate spread and rate design. She recommends rejecting the company's
13 proposed CAP and adopting a decoupling mechanism to capture the effects of
14 conservation and exclude weather changes. She also proposes the mechanism be in place
15 for a three-year trial period. Ms. Steward recommends that the staff proposed net
16 revenue requirement decrease (revenue requirement less amount of revenue to be
17 recovered from miscellaneous charges) not be reflected in rate changes based on the
18 diminutive size of the decrease.

19

20 **Q. Please summarize staff's recommendation in this docket.**

21 A. Staff recommends that the Commission:

22 1) Increase Cascade's retail gas service revenues by $1,629,422 based on an

overall rate of return of 8.33 percent. This results in a net $256,298 decrease to adjust retail rates after recognizing miscellaneous service charge revenue increases;

2) Accept the miscellaneous service charge changes and new items as proposed by the company and as modified by staff;

3) Reject Cascade's request for a waiver of the "Prior Obligation" rule on the basis that a waiver is an inappropriate response to a few abusers;

4) Reject Cascade's request for its proposed Safety and Reliability Infrastructure Adjustment Mechanism (SRIAM) as approval would set bad precedent regarding single-issue ratemaking. Furthermore, the mechanism is not needed because there is no extraordinary amount of total investment being incurred during the proposed length of the mechanism;

5) Accept staff's proposed partial decoupling mechanism for a three-year trial period to eliminate the disincentive to pursue conservation. Reject the component tied to recovery of margins associated with weather changes as this component does not coincide with staff's objective on decoupling and, as structured, the proposed mechanism increases bill volatility for customers;

6) Accept staff's consistently applied and Commission-accepted weather normalization calculation based on 30-year NOAA data, as opposed to the company's simple linear statistical model approach based on 55 years of estimated data to trend weather changes reflecting global warming.

Q. Are you sponsoring any exhibits in this proceeding?

A. Yes, I sponsor the following exhibits:

Exhibit No. ___ (MPP-2) Calculation of Revenue Requirements
Exhibit No. ___ (MPP-3) Results of Operation
Exhibit No. ___ (MPP-4) Working Capital Calculation
Exhibit No. ___ (MPP-5) Miscellaneous Service Charges
Exhibit No. ___ (MPP-6) Optional Gas Management Service LSN Order and Staff Memo
Exhibit No. ___ (MPP-7) Company Responses to Staff Data Requests Nos. 87, 123, 124, 132, 146, 147, 148, and 213

III. REVENUE REQUIREMENT

Q. Please begin by briefly describing Exhibit No. ___ (MPP-2), Calculation of Revenue Requirements.

A. This exhibit shows the calculation of the required revenue increase to earn an 8.33 percent rate of return and is shown on Line 7, entitled "Increase Revenue Requirement" in the amount of $1,629,422. This number is reduced by the amount of revenues that will be collected by the increases or assignment of miscellaneous charges and fees in the amount of $1,885,720. Line 9, entitled "Increase Revenue Requirement Assigned to Rate Schedules," is negative $256,298. This represents the amount of revenues to be passed back to rate payers in the form of decreases to the retail rate schedules.

Q. Turning to Exhibit No. ___ (MPP-3), would you please describe this exhibit?

A. Page 1 of Exhibit No. ___ (MPP-3), first column (b), entitled "Statement of Operations Per Books," reflects the test year (October 2004 to September 2005) amounts and indicates that Cascade earned a rate of return of 6.81 percent. The 6.81 percent rate of return is different than the 6.60 percent, as reflected as the per books rate of return on Exhibit No. ___ (JTS-2), Schedule 1 of 1, Page 1 of 4, due to a difference in the calculation of the test year allowance for working capital to be discussed later in my testimony. The second column (c), entitled "Total Restating Adjustments," summarizes the adjustments included on page 2 of this exhibit. The third column (d), entitled "Total Restated Adjustments," is a subtotal prior to pro forma adjustments. The fourth column (e), entitled "Total Pro Forma Adjustments," is a sum of the adjustments shown on pages

3 and 4 of this exhibit. The fifth column (f), entitled "Total Pro Forma Results," shows the total adjusted results prior to applying the recommended revenue increase. The next column (g), entitled "Revenue Increase Required" shows the overall revenue increase required to allow the company the opportunity to earn the recommended rate of return. The last column (h), entitled "Twelve Month Ended 9/30/05 Pro Forma," shows the results of operations after the recommended revenue increase to produce an overall rate of return of 8.33 percent.

Pages 5 through 25 provide a detailed calculation for each of the restating and pro forma adjustments as well as the calculation of the conversion factor.

Q. Would you please describe the difference in the per books calculation of the allowance for working capital that accounts for the difference in column (b)?

A. Yes. First, I'll start with a description of the allowance for working capital. The allowance for working capital provides a return to shareholders for the funds made available to run the day-to-day operations of the company. The calculation, as accepted by this Commission, starts with average invested capital (mostly comprised of equity and long-term debt) and then deducts operating investment (mostly rate base) and non-operating investment (investments that earn a return but that are not associated directly with utility service). The result is the total working capital, which is then allocated proportionately between operating investment and non-operating investment.

The analysis of working capital requires an extensive review of all balance sheet accounts and sub-accounts to determine the proper placement in the calculation.

1 Essentially, the first key question to answer when reviewing each account is: does the
2 account earn a return? If the answer is "no," then the question is: should the account earn
3 a return? If the answer to either question is "yes," then the account is included in the
4 calculation as invested capital, utility investment, or non-utility investment.
5
6 **Q. Please continue with your explanation of the difference.**
7 A. Exhibit No. ___ (MPP-4) shows my calculation of the test year allowance for working
8 capital. There are three differences in the calculation, and they are identified on lines 4, 5
9 and 6. When reviewing the company's balance sheet and calculation of the investor
10 supplied working capital, staff discovered three accounts or amounts that should be
11 treated differently than proposed by the company.
12
13 **Q. What are the accounts in question?**
14 A. They are amounts actually recorded in short term asset and liability accounts. As I stated
15 earlier, each account has to be evaluated to determine if it earns its own return, either
16 directly or indirectly. Since the amounts do earn a return but are not directly involved
17 with providing utility service, they should be included in the non-operating investment
18 portion of the calculation.
19 The first account in the amount of $30,263 relates to appliance loans to
20 employees, clearly an interest-bearing account. The second account, entitled "Prepaid
21 ESRIP Deferred Compensation," is listed as a prepaid expense; however, the amount is
22 actually a deferred debit (normally included as a non-operating investment) and is based

on an actuarial determination of the account balance, taking into account many variables and market factors including interest. The net result of the actuarial determination is the balance shown in this account. Interest earned is the key element in this determination.

The third item, Pension Contribution, is listed as an account payable when it would be more appropriate to be recorded as a deferred debit (normally included as a non-operating investment). Again, this item is the pension asset as determined by an actuarial determination including the effects of interest incurred on the asset.

Q. Turning to the restating and pro forma adjustments, please indicate which adjustments are uncontested by staff.

A. The following adjustments are uncontested; however, staff is contesting the federal income tax (FIT) rate applied to each adjustment so the net operating income level appears to be different from that represented in the company's Exhibit No. ___ (JTS-2), Schedule 1 of 1, Pages 2 through 4 of 4. I discuss the FIT in the description of the Income Tax on Pre 1981 Assets adjustment:

Restatement of Test Period at Current Rates
Reclassify Gas Transportation into Rate Schedules
Removal of Severance Expenses
Restated Property Tax Expense
Restated Franchise Fees Expense
Adjustment to Remove Promotional Expense
Pro forma Industrial Contract Changes
Insurance Expense Adjustment
Postage Expense
Pro Forma Property Tax Adjustment
Pro Forma Membership/Dues Adjustment
Pro Forma Amortization of Gain on Propane Plant

1 **Q. Please indicate which adjustments are contested by staff, either as to their amount**

2 **or because of other related issues.**

3 A. The following adjustments are contested:

4 Removal of Gas Management Services
5 Restate Gas Costs For Lost & Unaccounted For Gas
6 Restated Wages and Related Costs
7 Restate Test Period for Normal Weather
8 Restate Per Books to Actual Uncollectibles
9 Pro Forma Wages & Related Costs
10 Estimated Rate Case Expense
11 Income Tax on Pre 1981 Assets
12 Income Tax on Pro Forma Capitalization
13 Pro Forma Gas Management & Risk Management Software
14 Pro Forma Adjustment for Integrated Resource Planning Costs
15 Pro Forma CIS Hardware Upgrade
16 Conservation Promotional Advertising
17 Low Income Assistance
18 Pro Forma Special Contracts

19

20 **Q. Are there other revenue requirements areas that staff is contesting?**

21 A. Yes. Staff is contesting the calculation of test period working capital, described earlier in

22 my testimony, the proposed changes in miscellaneous service charges and fees, and the

23 calculation of the conversion factor.

24

25 **Q. Please summarize the differences between the staff and the company with respect to**

26 **the miscellaneous service charges and fees.**

27 A. Staff has a revised level of revenue from the services and does not recommend endorsing

28 two of the proposed charges. These items will be discussed later in my testimony.

29

1 **Q. Please describe the difference in the conversion factor calculation.**

2 A. Staff's calculation of the conversion factor is shown in Exhibit No. ___ (MPP-3), page
3 25. The only difference in my calculation and that of the company is, I used a 34 percent
4 federal income tax rate, and the company used a 35 percent rate. An explanation
5 supporting the 34 percent is given later in my testimony.

6

7 **Q. Please describe the reason for the difference in amounts and/or theory for each of**
8 **the contested adjustments beginning with the Removal of Gas Management Services**
9 **adjustment.**

10 A. **<u>Removal of Gas Management Services</u>**

11 Cascade proposes to remove the revenues and expenses associated with providing
12 certain services to its non-core customers that it claims are competitive under FERC
13 Order No. 547 and should not be part of the regulated results of operation given that it is
14 allegedly the shareholders that bear the risk associated with these transactions.

15 Staff disagrees with the proposed adjustment for the following reasons. First,
16 even though this Commission deemed this service under rate schedule 687 as
17 competitive, the service is provided under a Commission-approved tariff. The staff
18 memo in Docket UG-000597 expressly states that the service must maximize revenues
19 for the benefit of core customers. A copy of the staff memo and Commission order are
20 included as Exhibit No. ___ (MPP-6). The company has been operating under this
21 premise by including all revenues and expense above the line. In other words, the
22 revenues and expenses have been included in the regulated operating accounts as they

should be.

Second, assuming the Commission deemed the service should be booked below the line as a stand alone operation, a proper allocation of all associated costs needs to be performed. However, the company proposed an allocation of only those costs assigned to the Gas Management Services department and did not perform a complete allocation of all appropriate costs consistent with past Commission decisions, in particular the merchandising and jobbing allocation methodology from Docket UG-920840.

Staff has eliminated the company's proposed adjustment.

Restate Gas Costs For Lost & Unaccounted For Gas

Cascade proposed an adjustment to the test period levels of lost and unaccounted for gas to a level based on a five-year average. The purpose of the adjustment is to recognize and account for the impact of charging non-core customers for the portion of the lost and unaccounted for gas attributable to their service.

Staff agrees that the charge to the non-core customers is appropriate but no adjustment to base rates is necessary because the costs associated with lost and unaccounted for gas flow through the purchased gas adjustment (PGA) mechanism.

Staff has eliminated the company's proposed adjustment.

Restated Wages and Related Costs

Staff takes issue with three components of the wage adjustment, all dealing with officer salaries. The company proposed an adjustment to officer salaries based on the new CEO and CFO, who started service approximately halfway through the test year. This involved removing the test year salaries of the retired CEO and CFO. However,

based on the company's response to Staff Data Request No. 87 (included in Exhibit No. ___ (MPP-7), the company erred in identifying the proper amount booked in the test period.

The second component relates to the new CEO and CFO. The company's proposed adjustment included a full year's effect of the salaries for the new officers; however, the company neglected to remove the test period salaries actually paid to the new officers. This resulted in a double-counting of salaries. Staff removed the partial-year salaries.

The third component relates to staff removing from the level of salaries certain items that should not be borne by the ratepayers. These items include a monthly allowance for lease or purchase of a car, and payment of club dues and other expenses.

Staff's proposed wage adjustment is an increase in expense of $188,561, as compared to the company's $517,034.

Restate Test Period for Normal Weather

Dr. Mariam addresses the calculation and methodology for this adjustment. Staff's proposed adjustment increases test period revenues by $2,192,757, as compared to the company's $730,779.

Restate Per Books to Actual Uncollectibles

Staff has adjusted the company's per books accrual for uncollectibles to the actual incurred write-offs for the test period. This is a standard ratemaking adjustment and in this case results in an expense decrease of $191,006.

Pro Forma Wages & Related Costs

1 The only difference in this adjustment from that proposed by the company is the
2 impact of applying wage increases to different test year wage amounts. The test year
3 wage amounts are different as described in the Restated Wages and Related Costs
4 adjustment covered earlier in my testimony.

5 The staff expense increase is $832,522 (Exhibit No. ___ (MPP-3), page 4 of 25,
6 Column (c), line 12) as compared to the company's expense level of $852,527 (Exhibit
7 No. ___ (JTS-2), Schedule 1 of 1, page 3 of 4, column (c), line 12).

8 **Estimated Rate Case Expense**

9 The company proposes an adjustment to reflect a normal level of rate case costs
10 based on a three-year period between rate cases and total costs equaling $490,000. The
11 only difference between the staff adjustment and that as proposed by the company is that
12 staff has included an additional cost associated with providing staff with a working copy
13 of the cost of service model. The difference in expense level is $20,000 normalized over
14 three years ($6,667 adjustment difference). The company is expected to firm up its initial
15 estimate on its rebuttal case.

16 Staff notes that on rebuttal, when the company firms up its estimated rate case
17 costs, that it also must fully support the levels of each of the consulting fees incurred.

18

19 **Q. Does staff have concerns with the level of rate case expense proposed?**

20 A. Yes, staff is particularly concerned with the amount identified for Mr. Cummings, who
21 testifies in support of the Safety and Reliability Infrastructure Adjustment Mechanism
22 (SRIAM). Given the nature of the testimony, it appears that any of the company

1 witnesses could have provided the same testimony. There appears to be no particular
2 expertise that this witness brings to the docket at hand to warrant the amount of fees
3 identified for this witness ($80,000).
4
5 **Q. Please continue with your description of the contested adjustments.**
6 A. **Income Tax on Pre 1981 Assets**
7 The difference between the staff adjustment and that of the company relates to the
8 use of a 34 percent federal income tax (FIT) rate, as compared to 35 percent used by the
9 company. The company is basing the 35 percent on an expected level of earnings in
10 2007 of over $10 million. Ten million dollars in taxable income is the threshold where
11 income is taxed at 35 percent.
12
13 **Q. What was the corporation's taxable income for the test year?**
14 A. A review of the corporate tax return for the test year shows a taxable income of $3.6
15 million. Even if one were to add the company's proposed increase in revenue
16 requirement, the taxable income would still be substantially below the $10 million
17 threshold. Another check of reasonableness is to start with the net operating income after
18 staff's proposed revenue requirement of $19,278,812 (Exhibit No. ___ (MPP-3), page 1,
19 column (h)), plus the FIT of $5,140,220, in the same column, which creates a taxable
20 income associated with Washington operations of $24,419,032. Dividing the taxable
21 income by 77.06 percent to represent the total corporate taxable income, before deducting
22 interest and the tax depreciation in excess of book, increases this amount to $31,688,336.

1 The interest and excess tax depreciation over book are $13,276,083 ($10,230,550 (from
2 Exhibit No. ___ (MPP-3), page 18, line 3) divided by 77.06 percent) and $10 million
3 (from the company's tax return), respectively. The net taxable income would be
4 approximately $8.4 million ($31.7 million less $13.3 million less $10 million). Since
5 $8.4 million is less than the $10 million threshold, it is reasonable to use a 34 percent tax
6 rate.
7
8 **Q. If the company were granted its full request, would it change your second analysis?**
9 A. The result would then be over the $10 million threshold, but the amount over $10 million
10 times the one-percent difference between 34 percent and 35 percent would produce only
11 approximately $45,000, hardly enough to warrant applying 35 percent to all adjustments
12 plus the conversion factor.
13
14 **Q. Continue with your description of the contested adjustments.**
15 A. **<u>Income Tax on Pro Forma Capitalization</u>**
16 This adjustment is quite often referred to as the interest synchronization
17 adjustment or pro forma debt adjustment. The difference between the staff and company
18 adjustments is related to three factors: first, rate base is different due to the per books
19 allowance for working capital difference described earlier in my testimony. The second
20 difference is the use of the weighted cost of debt from Mr. Parcell's rate of return
21 calculation. The third difference is then the FIT rate. Staff's calculation can be found in
22 Exhibit No. ___ (MPP-3), page 18 of 25.

1 **Pro Forma Gas Management & Risk Management Software**

2 The company proposed an adjustment to incorporate the expected costs associated
3 with upgrading its gas management and risk management software. Staff disagrees with
4 the inclusion of this proposed adjustment for two reasons. First, it is not a proper pro
5 forma adjustment. A pro forma adjustment is for known and measurable changes that are
6 not offset by other factors. Offsetting factors would be the benefits derived from the
7 acquisition of the asset. Logically, there is a reason the company is acquiring the asset.
8 Company responses to Staff Data Requests Nos. 123 and 124 identify the many benefits
9 (i.e. offsetting factors) to be gained from this purchase. These data responses are
10 included in Exhibit No. ___ (MPP-7).

11 Second, this Commission does not typically include a pro forma addition for the
12 reason stated in the previous paragraph. However, on occasion a pro forma rate base
13 addition has been included, if the addition is material enough in nature to warrant a
14 general rate case filing by itself. Such additional items that have been included in past
15 cases are new power plants or major transmission investments, but even in those
16 situations the benefits of the newly acquired power and capacity are calculated into the
17 pro forma power supply expense. This proposed pro forma adjustment, by contrast, is
18 not a material item. Even without measuring offsetting factors the revenue requirements
19 effects of the addition is approximately 0.05 percent on gross revenues or 0.04 percent on
20 rate base. By way of comparison, WAC 480-07-505 identifies a general rate proceeding
21 as a three-percent increase in gross revenues.

22 Staff has removed the company's proposed adjustment.

Pro Forma Adjustment for Integrated Resource Planning Costs

The company proposed an adjustment to reflect costs associated with Vector Gas Software, a program designed to improve analysis for the company's integrated resource planning process, and to embed on an ongoing basis a level of expenses associated with identifying potential conservation investment. Staff disagrees with the inclusion of this software related costs portion of this adjustment for the same reasons as stated in the Pro Forma Gas Management & Risk Management Software adjustment described above. This adjustment is even less material than the Pro Forma Gas Management & Risk Management Software adjustment.

There are two important differences between this adjustment and the previous adjustment: First, the company made this purchase in response to Commission recommendations on the company's last two Integrated Resource Plans (IRPs). However, since the purchase was outside the test period, the logic staff has applied to the previous adjustment, in regards to pro forma rate base, still hold true. Second, the company, as part of this adjustment, is also proposing to include a pro forma adjustment to expenses, for a study that is being performed to identify conservation potential, in the amount of $45,000. Staff disagrees with the inclusion of this item as a pro forma adjustment because the company has not provided any evidence that this item is an incremental outside services cost in comparison to the total outside service costs included in the test year. The company incurred $2,133,588 in outside services during the test period. There is no evidence that the proposed $45,000 is over and above the test period level.

If the company on rebuttal can demonstrate that the $45,000 is truly an incremental expense item, staff would entertain including the cost of the study normalized over a three year period.

Staff has removed the company's proposed adjustment.

Pro Forma CIS Hardware Upgrade

The company proposed another pro forma rate base adjustment to reflect the costs associated with replacing its billing and Customer Information System (CIS) software. This is another proposed pro forma rate base adjustment that staff does not agree with for essentially the same reasons as the previous adjustments: namely, the asset is an immaterial addition, and there is no measurement of offsetting factors.

This asset is a somewhat different than the previous two assets. This proposed asset resembles more of a replacement of an existing asset and as such could be put into rates if the costs associated with the old system are removed. However, the company did not propose the removal of the cost of the old systems. Also, the benefits of the new system go much farther than a simple replacement of an asset. Efficiencies will be gained that are not measured and, therefore, don't meet the definition of a proper pro forma adjustment. These efficiencies are identified in the response to Staff Data Request No. 132, included in Exhibit No. ___ (MPP-7).

Staff has removed the company's proposed adjustment.

Conservation Promotional Advertising

The company proposes to spend an additional $150,000 on conservation advertising and is including the amount as a pro forma adjustment. Staff does not agree

with the inclusion of this adjustment as proposed by the company. This is not a proper pro forma adjustment as no offsetting benefits have been identified or measured.

When money is spent on conservation advertising it is anticipated that conservation will take place, thus freeing up capacity, reducing or delaying capital investment, or increasing capacity available for release or use by the system. These types of benefits have not been included. Therefore, staff has removed the company's proposed adjustment.

Staff recommends that when the company develops future conservation programs, the additional advertising associated with the programs be included as a cost of the new program and included in the Commission-approved recovery mechanism for those programs.

<u>Low Income Assistance</u>

The company is proposing to include an adjustment to make funds available to Community Action Agencies in order to provide low-income assistance in the amount of $800,000 (Exhibit No. ___ (JTS-2), Schedule 1 of 1, page 4 of 4, column (q)). Staff is, at this time, not inclined to support this adjustment. The company has not substantiated fully where the funds will be spent. Questions such as, whether these funds will be solely for low income bill assistance or conservation measures, whether they will also be available for agency administrative expenses, or whether they will be available to reduce Cascade's uncollectibles, need to be answered by the company before staff is willing to include this proposed adjustment.

1 Staff has removed the proposed adjustment.

2 **Pro Forma Special Contracts**

3 Staff is proposing an adjustment to reflect escalation clauses built into Cascade's
4 special contracts with various customers. Cascade has entered into a number of special
5 contracts with customers who have the ability to bypass Cascade's distribution system
6 and connect directly to the pipelines serving Cascade. These special contracts have all
7 been approved by the Commission. Staff has pro formed the test year special contract
8 revenue to rate year levels based on the actual escalation rate implemented in late 2005.
9 Staff has assumed the 2006 escalator will be the same as 2005 for purposes of this
10 calculation. The escalation rates are based on inflation rates, and staff has seen no
11 evidence that the 2006 inflation rate will be substantially different than the inflation rate
12 in 2005. This is a proper pro forma adjustment because it takes test period volumes or
13 service and applies new rates.

14 This adjustment pro forms or adds an additional $162,748 of revenue for the
15 company as can be seen in Exhibit No. ___ (MPP-3), page 4 of 26, column (r), line 1.

16

17 **Q. You mentioned an additional revenue requirement item that is not included in**
18 **Exhibit No. ___ (MPP-3). Will you elaborate?**

19 A. Exhibit No. ___ (MPP-2), line 8, contains an item entitled "Increase from Miscellaneous
20 Service Charges and Fees." The company proposed to reflect these increases in revenues
21 as a reduction to the overall revenue requirement calculation, as opposed to having
22 another rate-making adjustment. Staff is neutral on the presentation and is maintaining

consistency with the company for comparison purposes. Either approach produces the same results.

Q. Have you prepared an exhibit detailing your calculation of the revenues from the company's proposed miscellaneous service charges and fees?

A. Yes. Please see Exhibit No. ___ (MPP-5).

Q. Please describe the difference between the revenues shown on Exhibit No. ___ (MPP-5) and the company's portrayal of revenues in Exhibit No. ___ (JTS-9), Schedule 2 of 7, page 1 of 3.

A. For lines 1 to 4 and 6 and 7 on Exhibit No. ___ (MPP-5), I used the actual occurrences during the test year, shown in column (b), times the new or proposed rates. This method constitutes a proper pro forma adjustment. The company in its proposed calculation assumed that rate year occurrences will go down because the proposed rate is significantly going up, thus causing customers to not utilize the services. This may very well be an accurate statement; however, since the new proposed rates are based on actual costs associated with actual test period occurrences, logic would dictate that if the occurrences do go down so would the costs. The company's proposal is only a one sided calculation. A proper pro forma adjustment uses test period units times the new rate, which staff has done.

The revenue derived from the late fees, as shown on line 10, column (e), is an estimate provided by the company in response to Staff Data Request 213, included in

1 Exhibit No. ___ (MPP-7).

2

3 **Q. Are there other differences in the calculation?**

4 A. Yes, there are two more. The first difference is that I propose a different rate for several

5 of the services. The second difference is staff not endorsing two of the company

6 proposed charges.

7

8 **Q. In regards to the first difference, would you identify each of the services where you**

9 **modified the rate, and explain why you proposed the modification?**

10 A. The first adjustment is to the Reconnect Charge (off-hours). The company proposed

11 $100, and staff is proposing $75. All the other regulated utilities in Washington have

12 similar reconnection charges, and the off-hours component is simply twice the rate for

13 the 8am to 5pm component. By going to $75, staff is setting the rate at the highest of all

14 the regulated utilities and above the twice the 8am to 5pm rate proposed by Cascade.

15 The second adjustment is to the Disconnection Visit Charge. Staff proposes to set

16 the rate at $15, as opposed to the company's proposed $25. Staff's proposed rate is based

17 on the high end of the other regulated utilities in Washington.

18 Staff also proposes to set the late pay fee at one percent as opposed to 1.5%, and

19 the rate should be applied to all unpaid balances, not just those over $100. All the other

20 regulated utilities in Washington that have a late payment charge set it at one percent on

21 unpaid balances. Staff also proposes to eliminate the $4 minimum charge proposed by

22 Cascade as excessive and unwarranted. Only Northwest Natural Gas has a minimum

charge and it is $1.

Staff also proposes to modify the language regarding the tampered meter charge. Staff proposes a charge based on the incident at hand, as opposed to the "one-size-fits-all" approach proposed by the company. Staff supports language such as that of Northwest Natural Gas which assesses a tampered meter charge for:

> Actual costs of damages, repairs and any additional or unusual costs or services directly related to the meter interference, plus the amount of unbilled gas determined to have been lost, plus applicable reconnect charges.

This approach gives the company greater latitude based on individual situations and also allows for the recovery of gas costs that would otherwise be passed on to the rest of the customers.

Q. As a second item you mentioned the company proposed charges that you are not endorsing. Could you please elaborate?

A. Yes. The company has proposed Equipment Service Call and Short Notice Locate Service fees. Staff does not support charges for these services because this raises significant safety concerns. Staff believes it is better to spread any costs associated with these services among all customers rather than risk someone endangering themselves, others, or the distribution system by trying to perform these services themselves or avoiding the services entirely, simply in order to avoid paying either of these charges.

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IV. "PRIOR OBLIGATION" WASHINGTON ADMINISTRATIVE CODE (WAC) WAIVER REQUEST

1
2 **Q. Please summarize staff's response to the company's request for a waiver of the**
3 **"Prior Obligation" rule.**
4 A. A waiver request is not warranted in this situation.
5
6 **Q. Can you elaborate on why a waiver is not warranted?**
7 A. There are many reasons. First, the company requested a waiver but does not actually
8 state which WAC rule it is requesting to be waived. Also, there is no mention of what
9 the expected outcome is if the waiver is granted. Through data responses to discovery
10 requests it appears that the company is requesting a waiver from paragraphs (2) and (3)
11 of WAC 480-90-123 "Refusal of Service." The company would like the ability, at least
12 for the abusers of the system, to require the customer to pay its prior obligation or half
13 the obligation, and to put in place payment arrangements for the other half prior to
14 reconnection.
15
16 **Q. Based on staff's understanding of what the company is proposing do you still**
17 **recommend that the Commission not grant the waiver request?**
18 A. Yes. The Commission adopted the current version of the rule at the September 12, 2001,
19 open meeting. At that time, the Commission ordered the utilities to track how many
20 times the "prior obligation" rule was used and the amount of uncollectibles related to
21 prior obligations. This study took place over an 18-month period. The results of the
22 study showed that Cascade's residential uncollectibles rate was 0.44 percent. Of those

uncollectibles, the unpaid prior obligation portion was only 0.03 percent of residential revenues. Staff concluded that the prior obligation amount was insignificant to the utilities, and that any change to the WAC would result in only minor monetary benefits, and therefore, no change to the WAC was warranted.

Cascade does not specifically track the amount of dollars lost through the prior obligation rule. It has merely identified three instances of abuse where the same customers claimed prior obligations four, five and 11 times, totaling approximately $6,000. Clearly, these totals are not material and staff believes they do not justify granting a waiver of the rule.

The company has the option to request, at any time outside of a rate case in the form of a rulemaking proceeding, a rule change where all the utilities and other stake holders could participate and develop language maintaining the intent of the rule as well as eliminating the ability to abuse the system.

V. SAFETY AND RELIABILITY INFRASTRUCTURE ADJUSTMENT MECHANISM (SRIAM)

Q. Please briefly describe the company's proposed SRIAM.

A. The company is proposing a mechanism to recover on a year-by-year basis investment associated with the replacement, relocation, and reinforcement of existing facilities. The mechanism will provide for return on the investment and also recovery of all associated costs. The annual adjustment to customers will be calculated on a per customer basis. A

more detailed explanation of the mechanism can be found in the testimony of company witness Cummings.

Q. What is Staff's recommendation with respect to the company's proposed SRIAM?

A. The proposed SRIAM should be rejected for three basic reasons. First, the proposed SRIAM is poorly designed. Second, the mechanism constitutes inappropriate single-issue ratemaking. Third, the mechanism is not necessary given Cascade's historical and budgeted total capital expenditures.

Q. Please elaborate on why the mechanism is poorly designed.

A. There are a number of components that lead to the conclusion that the proposed mechanism is poorly designed. They include the following:

- The burden is on Staff to determine which projects should or should not be included in the mechanism;
- The proposed mechanism fails to include recognition that a certain level of normal year-to-year investment is for what the company has defined as, replacement, reinforcement, and relocation;
- There is no recognition that as plant is replaced certain offsets would be expected such as depreciation expense, property taxes, maintenance, etc. on the replaced facilities.

Q. Please elaborate on each of these points.

1 A. The first point goes to the burden of proof. The company states that the immediate
2 reason for engaging in the project determines how the project is classified. As an
3 example: if a section of the system needed replacing and also needed to be sized larger
4 for future or even current growth, the project would be classified as a reinforcement
5 project to be included in the SRIAM. This leaves the discretion of classification on the
6 company and the burden falls on staff to review each and every project to determine if it
7 is appropriately categorized as an SRIAM investment or not. The company has every
8 incentive to place as much investment as possible into the mechanism and let staff try to
9 discover which projects are inappropriate. The Commission does not have the manpower
10 to audit a mechanism of this type.

11 The second point is based on the simple reality that a certain portion of the
12 company's ongoing investment every year is for the types of investments described in the
13 mechanism. Every business, in order to continue to operate, replaces assets as part of its
14 normal ongoing investment. The proposed mechanism does not account for the reality
15 that its capital structure, return, and capital budget assume a certain level of this type of
16 investment every year. The proposed mechanism treats all of its replacement, relocation,
17 and reinforcement investments as incremental, over-and-above what would normally be
18 expected in any given year.

19 The third item pertains to the fact that the mechanism is designed to adjust rates
20 in order to recover the costs associated with replacements, relocations, and
21 reinforcements, yet it has no component to recognize decreased costs associated with the
22 new and replaced investment. Certain costs would be expected to decrease such as

1 maintenance expense (new plant costs less to maintain than old plant) and depreciation
2 expense, and property taxes on the old plant would be zero instead of what is embedded
3 in rates. The mechanism does not reflect any changes to these types of expenses.
4
5 **Q. Please expand on your contention that the SRIAM constitutes single-issue rate**
6 **making.**
7 A. The ratemaking treatment of an asset in the form of a return on the asset, and recovery of
8 associated expenses, is only a single area or component within the cost of service. The
9 guaranteed recovery of this group of items ignores that other cost of service elements
10 may be creating downward pressures on rates. For instance, as plant depreciates in the
11 future, the return requirement declines. Also, a prudent utility continually seeks
12 opportunities for cost savings as Cascade has been able to do in order to avoid rate filings
13 since 1995. The proposed SRIAM reduces the incentive to pursue those opportunities.
14 All efficiencies realized by the utility will be kept for shareholders, while a single
15 issue is tracked and passed directly onto customers through the proposed mechanism. A
16 general rate case is the appropriate arena to address whether new capital investments and
17 the related costs, as well as the net effects of all other revenues and costs, warrant
18 changes in customers' rates.
19
20 **Q. You also mention, as the third reason for recommending rejection of the proposal,**
21 **that the proposed mechanism is not needed. Please elaborate on how you draw that**
22 **conclusion.**

1 A. The lack of need for the mechanism can be seen from a simple comparison of the
2 company's total capital expenditures over the past several years to total expected capital
3 investments in the future. The average total capital investment for the years 2000
4 through 2005 was $25.5 million (derived from response to Staff Data Request No. 146,
5 included in Exhibit No. ___ (MPP-7)). The average total expected capital investment for
6 the years 2006 through 2011 is $27 million (derived from response to Staff Data Request
7 No. 147, included in Exhibit No. ___ (MPP-7)). Since customers are being added at a
8 rate of approximately three percent per year, this more than accounts for the observed
9 change in average total capital investment.
10
11 **Q. What about the company's plan to significantly invest in infrastructure-type**
12 **investments in future years?**
13 A. Looking at the data on total capital investment in the past compared to the forward
14 looking capital expenditures, which includes the infrastructure investment, I conclude
15 that there is a mismatch in identifying future infrastructure investment with past
16 infrastructure investment.
17
18 **Q. Can you be more specific?**
19 A. The company's response to Staff Data Request No. 148 (included in Exhibit No. ___
20 (MPP-7)) states that only certain large projects were identified as reinforcement,
21 replacement, or relocation to calculate the past investment. Smaller projects were likely
22 included in general mains and service lines on the capital expenditure reports. No study

1 was produced to support the analysis. However, one may conclude that since total
2 investments from the last six years are not substantially different from future budgets and
3 that growth in customers is expected to continue, infrastructure investment in future years
4 will likely be approximately equal to the past, since the calculation of the past
5 infrastructure investments did not include all cases.
6
7 **Q. Does this conclude your testimony?**
8 A. Yes. It does.
9