

Exhibit No. ___T (DWS-2T)
Docket No. UG-060256
Witness: David D. Stevens

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

**CASCADE NATURAL GAS
CORPORATION**

Complainant,

v.

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

Respondent.

DOCKET NO. UG-060256

REBUTTAL TESTIMONY OF

David W. Stevens

**STAFF OF
Cascade Natural Gas Corporation**

(POLICY)

September 12, 2006

1 temperature normalization approach that actually takes into account the undeniable warming
2 trend of recent years, and the Company's proposal for timely recovery of system
3 infrastructure costs through our SRIAM.
4

5 At the same time, the Company was encouraged by support for some form of
6 decoupling from Staff witness Steward and the NW Energy Coalition. Our rebuttal
7 testimony addresses a number of issues raised by these witnesses, including the
8 improvements to our conservation programs discussed in Ms. Barnard's testimony. The
9 Company is also recommending modifications to its proposed SRIAM in response to
10 concerns raised by various parties, as discussed in Mr. Cummings' testimony. Mr. Stoltz
11 describes several modifications to the Company's cost of service and rate design proposals
12 which we are recommending to address issues raised in the NWIGU and Public Counsel
13 testimony. Ms. Barnard also provides more detail regarding the proposed \$800,000 in low-
14 income assistance, in response to issues raised by Staff witness Parvinen. After this
15 movement, while the parties' positions are closer, there are fundamental differences with
16 respect to (1) cost of capital, (2) weather normalization, (3) decoupling, and (4) the
17 Company's proposed SRIAM. I will discuss these issues in turn below.
18

19 Q. Please explain why the parties' recommendations would result in an allowed return that fails
20 to recover the Company's cost of capital.
21

22 A. Staff witness Parcell recommends an overall rate of return of 8.43%, which includes a return
23 on equity (ROE) of 9.75%. This recommended ROE is irreconcilable with recent decisions
24 of the Commission that have all been well in excess of 10.0%. Moreover, the
25 recommendation is out of step with recent ROE decisions nationally, where the nationwide
26 average ROEs granted in the past few years ranged from 10.5% to 11.0%, as shown in Dr.
27 Morin's testimony. Over this same period, interest rates have risen as Mr. Parcell
28 acknowledged in his own testimony. Mr. Parcell's recommendation does not pass a basic

1 reasonableness test. For the reasons described more fully in Dr. Morin's rebuttal testimony,
2 Mr. Parcell's motivation seems geared toward producing an unreasonably low number
3 rather than truly measuring the return required by investors for bearing the risks associated
4 with the Company. One can only assume Mr. Parcell hopes the Commission will split the
5 difference between his extreme proposal and Dr. Morin's recommendation to arrive at a
6 number he probably truly believes is at the lower end of the ROE scale.

7
8 Mr. Parcell compounds the harm by recommending an inadequate equity ratio (41.13%)
9 which fails to reflect neither the capital structure required to maintain the Company's
10 financial integrity nor the Company's actual equity ratio. Mr. Parcell's use of December 31,
11 2005 as the time to set the capital structure simply doesn't make sense. First of all, when
12 Mr. Parcell performed his calculation, the Company had already released both March 31 and
13 June 30, 2006 financial results. Also, the Company is on a September 30th fiscal year, so
14 using a calendar year has no particular significance. It is impossible to know if Mr. Parcell
15 either overlooked our more recent financial disclosures or was intentionally seeking to use
16 the worst possible scenario. In any event, using the latest available capital structure is a
17 more logical and reasonable approach. As demonstrated in Mr. McArthur's testimony,
18 Cascade has a capital structure much closer to 50% equity/50% debt today, and is planning
19 on making another improvement with the retirement of \$8 million in debt in October.
20 Hopefully, Mr. Parcell will update his testimony and properly reflect the latest available and
21 expected capital structures for the Company. Lastly, Dr. Morin's prior testimony fully
22 explains why a 50/50 capital structure is appropriate, and the facts show that Cascade is
23 quickly approaching that capital structure.

24
25 Q. Please describe the issue associated with temperature normalization and its impact on this
26 proceeding.
27

1 A. Staff witness Mariam is proposing to use 30 years of NOAA temperature data as the basis
2 for setting "normal" weather, notwithstanding the direct testimony of Dr. Mote that such an
3 approach would fail to reflect the undeniable warming trend in recent years. Under
4 Mr. Mariam's approach, the Company likely would incur a substantial under-recovery of its
5 revenues, for the weather is more likely to be warmer than Mr. Mariam's "normal" than
6 colder. Mr. Mariam utterly failed to engage the issues raised in Dr. Mote's testimony, or
7 show how Dr. Mote's analyses were reflected in Mr. Mariam's calculations or conclusions.
8 The simple answer is no person knows what the weather will hold. However, Mr. Mariam's
9 continuous insistence on 30 year NOAA as the appropriate measure of future weather is
10 seriously flawed and is unlikely to produce reasonable results for the Company, as shown in
11 Mr. Stoltz's rebuttal testimony.

12
13 When the Company asked Mr. Mariam whether he had ever tested his method relying
14 on utilization of 30 year NOAA against actual results for various periods, he responded by
15 stating he relies solely on data provided by Cascade and does not "testify about differences
16 between year actual versus normal HDD...." (Staff Response to Cascade Data Request
17 Nos. 47-49.) Further, Mr. Mariam stated that Staff has proposed the exact same weather
18 methodology since 1999, apparently without any analyses to verify whether it would
19 produce reasonable results under actual weather conditions. (Staff Response to Cascade
20 Data Request No. 53.) As shown in Mr. Stoltz's testimony, we have evaluated Mr.
21 Mariam's historical weather recommendations and they have definitely overstated expected
22 volumes which, in turn, reduce any company's ability to earn the Commission-allowed
23 return. It is obvious that using Mr. Mariam's historical recommendation of 30 year NOAA
24 doesn't work as the basis for determining "normal" temperature for purposes of setting
25 future rates. It is also obvious that Dr. Mote has both the credentials and experience to
26 provide the best advice regarding the methodology for determining "normal" temperatures
27 in a future period.
28

1 Q. With respect to Cascade's Conservation Alliance Plan (CAP) or decoupling, what is the
2 Company's response to Staff witness Steward's proposed modifications?

3
4 A. While I appreciate the Ms. Steward's attempt to find a middle ground between the various
5 parties, I must disagree. The reason we filed the plan in the first place is to take away the
6 disincentive companies currently have to increase their promotion of conservation, given the
7 adverse impacts on their financial results under the existing regulatory methodology. As we
8 have repeatedly stated, we believe this is in the best interest of our customers. We
9 structured our filing to include both a conservation and weather decoupling component in
10 order to keep it simple and consistent with our current Conservation Alliance Plan in
11 Oregon. If we attempt to separate the weather component of the plan from the conservation
12 component, we will continue to have arguments over what is weather-driven versus what is
13 conservation-driven. This is particularly true if the Commission somehow decides to utilize
14 the weather methodology proposed by Mr. Mariam, which will likely produce weather
15 "normalized" results that completely swamp any conservation-related adjustments under
16 partial decoupling. States across this country have implemented similar plans with
17 combined conservation and weather elements, and the combined methodology is likely
18 utilized in other states in order to avoid continued disagreements. While I am aware of
19 some states having exclusive weather decoupling, I am not aware of any with exclusive
20 conservation decoupling. For these reasons, we disagree with Ms. Steward's arguments for
21 modifying our proposal.

22
23 Q. What is the Company's response to the recommendations in NW Energy Coalition witness
24 Weiss' testimony?

25
26 A. With respect to Mr. Weiss' testimony critiquing the Company's existing conservation
27 programs, the Company has repeatedly stated it would prefer to have a third party run its
28 conservation program as is being done for the Company in Oregon for its Oregon

1 Conservation Alliance Plan. The Company has held preliminary discussions with other
2 parties about running a Washington program, as discussed further in Ms. Barnard's rebuttal
3 testimony. The Company is prepared to utilize various service providers to implement an
4 aggressive conservation program in Washington. The Company has hired a consultant to
5 derive the best conservation programs for Washington as is further discussed by Ms.
6 Barnard. The Company also plans to create an Advisory Board for its Conservation
7 Alliance Plan. With these measures to address the concerns identified in Mr. Weiss'
8 testimony, the imposition of "stretch" goals or shareholder penalties do not make sense.
9

10 Mr. Weiss also makes some obstructive comments regarding the need for "stretch
11 goals" and "penalties" which I find quite disturbing coming from the NW Energy Coalition.
12 One thing I thought we could all agree upon was that it would be beneficial for both the
13 utility and its customers if we could eliminate – entirely – the disincentive for utility
14 promotion of conservation which exists under the current regulatory regime. Rather than
15 striving toward what would seem to be a common objective – elimination of the
16 disincentives – Mr. Weiss would rather point out that *any recovery at all* that the utility gets
17 under decoupling is better than the zero recovery under the existing regulatory regime, and
18 therefore the utility must "earn" its way to total elimination of the disincentives through a
19 maze of stretch goals and margin sharing percentages. As stated by Mr. Weiss:

20
21 *[A]ny* recovery due to decoupling goes directly to shareholders, and is over-and-
22 above what they would have received absent decoupling. Any percentage above
23 0% is an incentive to the Company beyond what it currently receives. . . .
24 (Exhibit No. ___ (SDW-1T) at 21.)
25

26 Under this line of reasoning, it is apparently not a "given" that disincentives to conservation
27 are, by their nature, bad and should be eliminated. Rather, the point of reference is to the
28 flawed regulatory regime currently in place and, using that point of reference, the utility
29 should be thankful for *any* relief it gets above the "0% incentive" currently provided.

1 Mr. Weiss' analysis is backward, and is counter-productive to the promotion of energy
2 conservation.

3
4 Q. How does the issue regarding the decoupling mechanism bear on the Company's required
5 return on equity?

6
7 A. As Dr. Morin has stated, if the Company were to fail and receive its Conservation Alliance
8 Plan the allowed return on equity should be higher than 11.15%. Both Dr. Morin and Mr.
9 Parcell appear to agree that the difference is around 25 basis points.

10
11 Q. How do you respond to the parties' criticisms of the Company's proposed SRIAM?

12
13 A. The Company proposed the SRIAM for two simple reasons. The first is the need for the
14 Company to expend a significant amount of capital over time on projects that are not
15 revenue producing, but are necessary to ensure safe and reliable service. The second
16 reason was to offer a streamlined procedure that would minimize the need for the Company
17 to file frequent general rate cases.

18
19 With respect to the first point, Mr. Cummings shows in his rebuttal testimony that if the
20 significant one time expenses for call center centralization and automated meter reading are
21 removed, the capital expenditures of the Company will rise on average by about 22%. In
22 addition, the expenditures are for items that help the Company to provide safe and reliable
23 service to its existing customer base, particularly now that we are proposing to narrow the
24 scope of the investment recovered through the SRIAM.

25
26 With respect to the second point, as can easily be demonstrated in this rate case, the
27 time and expense involved in a rate case is substantial. Since these costs are passed on to
28 customers either through regulatory fees or through rates, we felt it was important to

1 develop a mechanism that would remove easily justifiable and reasonable expenses from
2 this process to defer the need for future rate cases, which would allow the Company to
3 continue to operate with a very small regulatory staff. We think the proposed SRIAM, as
4 modified in our rebuttal testimony, is in the best interests of both the Company and its
5 customers.

6
7 Lastly, the Company has proposed significant disclosure requirements in order to
8 alleviate the Staff's concerns about the Company not prudently managing capital expenses.
9 The simple answer is that companies have existing incentives in place to ensure that capital
10 expenditures are managed prudently, including the negative impact on capital structure
11 associated with over-spending which, in turn, can lead to a lower debt rating. The
12 Company will still have a significant delay in recovering the cash associated with these
13 expenditures so imprudent management could place the Company in a cash flow crunch as
14 well. In addition, the Staff has numerous places along the time line to challenge any
15 expenses it deems not to meet the SRIAM criterion or to be imprudent.

16
17 Q. What is your opinion on the various comments relating to rate structure as well as the
18 various fees proposed by the Company?

19
20 A. As is demonstrated in our testimony, the Company's goal was to attempt to appropriately
21 assign costs to those customers who are responsible for the Company incurring the expense.
22 For example, it is totally unrealistic to believe the Company can provide a reconnection
23 service for \$16 when our cost estimate is approximately \$32. The Commission can, of
24 course, take considerations other than cost causation into account in setting rates, and can
25 allocate the Company's revenue deficiency in a different manner. The Company obviously
26 will accept that outcome. The Company's goal and methodology, however, should not be
27 misconstrued as attempting to gouge customers when the fact is that the objective was to
28 reflect cost causation, which we believe is in the best interests of the vast majority of our

1 customers. Mr. Stoltz's rebuttal testimony describes some of the modifications the
2 Company is making to its rate spread and rate design recommendations.

3
4 Q. What is the Company's position on the relationship between the "prior obligation" rule and
5 its proposal to provide \$800,000 in funding for low-income programs?

6
7 A. We have been persuaded that the best forum for pursuing the current abuses under the "prior
8 obligation" rule is a Commission rulemaking proceeding, and we will investigate pursuing
9 that option. We remain convinced that the rule is being abused by those who have the
10 ability to pay, and our proposal to provide \$800,000 in low-income funding was to address
11 the needs of low-income customers while making the "prior obligation" rule unavailable to
12 those who didn't need assistance. We do not agree that there has to be "abuse of sufficient
13 nature that is causing significant damage" (as stated in the response of The Energy Project
14 to Cascade Data Request No. 6) before a rulemaking is warranted. Any abuse is significant,
15 in our view. Our employees are concerned about having the expenses associated with the
16 "prior obligation rule" charged to them (as customers) when they personally know certain
17 customers have abused the rule. We continue to support our proposal for providing funding
18 in the amount of \$800,000 and, as discussed in Ms. Barnard's rebuttal testimony, we will be
19 working with the various Community Action Agencies in the administration of that program
20 to ensure that it is in the best interests of all customers. The measures identified in Ms.
21 Barnard's testimony should address the issues in Staff witness Parvinen's testimony that
22 caused Staff to oppose this proposal.

23
24 Q. Do you have any summarizing thoughts about the various testimony?

25
26 A. Yes. My concern when I see the various testimony and, in particular, the testimony of Mr.
27 Parcell and Mr. Mariam, is the goal of staff is to ensure the Company never earns a fair, just
28 reasonable and sufficient return. As discussed in my testimony above, the combination of

1 (1) the extremely low ROE and equity-thin capital structure of Mr. Parcell with (2) the
2 unsupported and inaccurate weather estimates from Mr. Mariam would produce results that
3 would be catastrophic for the Company. We simply do not see how that could ever be
4 construed as reasonable end result for this ratemaking process.

5
6
7 Q. Please identify the witnesses testifying for the Company in its rebuttal presentation.

8
9 A. Dr. Roger Morin, Professor of Finance at the College of Business, Georgia State University
10 and Professor of Finance for Regulated Industry at the Center for the Study of Regulated
11 Industry at Georgia State University, addresses the ROE and cost of capital testimony of
12 Staff witness Parcell, and continues to support his recommendation for an ROE of 11.15%
13 and a 50% equity ratio.

14
15 Mr. F. Jay Cummings of the consulting firm Ruhter & Reynolds has provided testimony and
16 exhibits supporting his recommended modifications to the Safety and Reliability
17 Infrastructure Adjustment Mechanism (SRIAM) proposed in his direct testimony.

18
19 In addition to myself, Cascade employees Mr. Jon T. Stoltz, Senior Vice President,
20 Regulatory and Gas Supply has provided testimony and exhibits regarding the removal of
21 non-core competitive services revenues and costs, the weather normalization adjustment,
22 estimated rate case expense, change in rate spread and rate design, and changes in rates for
23 other services and fees;

24
25 Ms. Katherine Barnard, Senior Director, Regulatory Affairs has provided testimony and
26 exhibits regarding the Company's proposed conservation initiatives, the low income bill
27 assistance proposal and the various ratebase proforma adjustments.

1 Mr. Matt McArthur, Treasurer has provided testimony and exhibits supporting the
2 Company's Cost of Debt and addresses the capital structure issue.

3

4 Q. Does this conclude your rebuttal testimony?

5

6 A. Yes.

7