

Exhibit No. ___T (FJC-2T)
Docket No. UG-060256
Witness: F. Jay Cummings

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

F. Jay Cummings

Safety and Reliability Infrastructure Adjustment Mechanism

September 12, 2006

1 **REBUTTAL TESTIMONY OF F. JAY CUMMINGS**
2 **(Safety and Reliability Infrastructure Adjustment Mechanism)**

3
4 Q. Please state your name and business address.

5
6 A. My name is F. Jay Cummings. My business address is 3625 North Hall Street, Suite
7 750, Dallas, Texas 75219.

8
9 Q. Are you the same F. Jay Cummings who filed direct testimony in this proceeding?

10
11 A. Yes. I filed prepared testimony on behalf of Cascade Natural Gas Corporation
12 ("Cascade" or "Company") as part of its direct case.

13
14 Q. What is the purpose of your rebuttal testimony?

15
16 A. My rebuttal testimony addresses the parties' testimony pertaining to the Safety and
17 Reliability Infrastructure Adjustment Mechanism ("SRIAM") which I proposed in my
18 prepared testimony. Commission Staff ("Staff") witness Parvinen, Public Counsel
19 witness Brosch, and Northwest Industrial Gas Users ("NWIGU") witness Schoenbeck
20 provide direct testimony in which each witness recommends that the Commission not
21 approve the SRIAM as filed. In response to a number of issues raised by these parties
22 in developing their recommendations, I propose several changes in the Company's
23 original SRIAM proposal. While I do not necessarily agree that all of these revisions to
24 the SRIAM are needed, I believe that they address major concerns of the parties, and the
25

1 Company is offering them in the interest of developing a sound regulatory mechanism
2 that should be acceptable. After describing the proposed revisions to the SRIAM, my
3 testimony discusses other issues raised by the parties in their assessment of the
4 SRIAM.¹ Company witnesses Stevens also addresses issues related to the SRIAM in
5 his rebuttal testimony.

6
7 Q. Please describe the revisions that you are recommending to the Company's original
8 SRIAM proposal.

9
10 A. Attached as Exhibit No. ___ (FJC-3) are the tariff changes for the SRIAM (Rule 21,
11 Original Sheets 25 and 25A) with my proposed revisions shown in legislative style.
12 First, the scope of eligible investments has been narrowed to eliminate system
13 reinforcement investments from the coverage of the SRAIM. I do not agree with Public
14 Counsel witness Brosch's simple explanation that these investments are revenue-
15 producing projects undertaken "to provide additional capacity within the distribution
16 system for new customers."² Such investments may be required because usage patterns
17 of existing customers in a section of the distribution system have changed, operational
18 constraints with an aging system limit the capability to serve certain areas, and/or
19 cumulative addition and relocations of customers over a number of years require system
20 upgrades. However, I propose that these investments be eliminated from the SRIAM in

21
22 ¹ In addressing Public Counsel witness Brosch's testimony, I focus my attention on his SRIAM-specific
23 discussion, contained on pages 10, 14-15, 17-22 and 24-35, and will not discuss his general explanation of the
24 functioning of traditional regulation contained on pages 4-10, 11-14, and 15-17.

25 ² Public Counsel witness Brosch, p. 27, lines 18-19.

1 response to Public Counsel witness Brosch’s and Staff witness Parvinen’s perception
2 that determining which capital investments qualify for SRIAM treatment would be
3 burdensome.³ The resulting narrower coverage of the SRIAM includes only
4 replacements of deteriorating facilities, facility investments required to meet federal and
5 state safety requirements, and government-mandated facility relocations. The need to
6 make these investments should be straightforward and easily documented, a point that I
7 will discuss later in my testimony in addressing the SRIAM review and audit process.
8

9 Q. You have added “federal and state safety requirements” to the description of eligible
10 investments in the proposed SRIAM tariff sheet (Exhibit No. __ (FJC-3), page 1). Does
11 this change expand the coverage of the SRIAM as filed?
12

13 A. No. The intention of the SRIAM as filed was to include facility investments required
14 by, for example, possible future federal mandates to expand pipeline integrity
15 requirements to local distribution companies. I have added the clarifying language to
16 ensure that there is no misunderstanding regarding the coverage of the SRIAM as
17 revised. Eligible SRIAM investments are those undertaken for safety purposes and to
18 meet government mandates.
19

20 Q. Please continue with your explanation of the revisions to the SRIAM as contained in
21 your Exhibit ___ (FJC-3).
22

23
24 ³ See, for example, Public Counsel witness Brosch, page 32, lines 11-13 and Staff witness Parvinen, page 28, line
25 15 – page 29, line 3.

1 A. Both Staff witness Parvinen and Public Counsel witness Brosch discuss the fact that the
2 SRIAM as filed does not take into account depreciation expense and property tax
3 savings associated with plant that is replaced.⁴ I concur that this consideration was an
4 oversight in preparing the SRIAM as filed. Page 2 of Exhibit ___ (FJC-3) shows that
5 the property tax and depreciation expense components have been modified to recognize
6 offsets resulting from property tax and depreciation expense savings associated with
7 facilities that are retired upon placing the SRIAM investments in service.

8
9 With these changes, the proposed SRIAM is identical in coverage and calculation
10 methodology to that used by Missouri local gas distribution companies in developing
11 their infrastructure replacement surcharges. (It should be noted, however, that Missouri
12 utilities are able to achieve more timely recovery of the cost of infrastructure
13 investments through semi-annual rate adjustments compared to annual adjustments
14 under the proposed SRIAM.)

15
16 Q. Have the parties raised common concerns in addressing the SRIAM?

17
18 A. Yes. All of the parties recommend that the SRIAM not be implemented based, at least
19 in part, on the following contentions:

- 20 • The SRIAM constitutes single-issue or “piecemeal” ratemaking;⁵

21
22
23 ⁴ Staff witness Parvinen, page 29, lines 16-18 and Public Counsel witness Brosch, page 28, lines 11-14.

24 ⁵ See, for example, Public Counsel witness Brosch, page 10, lines 6-16; Staff witness Parvinen, page 29, line 20 –
25 page 30, line 12; and NWIGU witness Schoenbeck, page 5, lines 5-7.

- 1 • The cost of new plant recovered through the SRIAM is not offset by a reduction
- 2 in operations and maintenance expenses associated with replacing or relocating
- 3 older facilities;⁶ and
- 4 • The SRIAM is not needed.⁷

5 In addition, Staff witness Parvinen perceives the SRIAM to involve an unacceptable
6 administrative burden on Staff, and Public Counsel witness Brosch contends that the
7 time period for the review and verification process is inadequate.⁸ I address each of
8 these issues in turn in the remainder of my testimony.

9
10 Q. Do you have any comments regarding the parties' discussion of single-issue or
11 "piecemeal" ratemaking as it pertains to the SRIAM?

12
13 A. Yes. Whether labeled single-issue or "piecemeal" ratemaking, the parties contend that
14 it is inappropriate to isolate one component of the cost of service for cost recovery
15 without considering all aspects of the revenue requirement calculation.⁹ I do not believe
16 that rejection of a proposed regulatory mechanism for the sole reason that it would

17
18 ⁶ Public Counsel witness Brosch, page 29, lines 2-5; Staff witness Parvinen, page 29, lines 15-16; and NWIGU
19 witness Schoenbeck, page 6, lines 20-21.

20 ⁷ Public Counsel witness Brosch, page 14 line 10 – page 15, line 4 and page 31, lines 1-19; Staff witness
21 Parvinen, page 30, line 14 – page 31, line 4; and NWIGU witness Schoenbeck, page 5, lines 8-11.

22 ⁸ Staff witness Parvinen, page 28, lines 5-6; page 28, line 15 - page 29, line 3; and Public Counsel witness Brosch,
23 page 34, line 16 – page 35, line 7.

24 ⁹ While the testimony of Staff witness Parvinen and NWIGU witness Schoenbeck suggests that single-issue
25 ratemaking would preclude adoption of any rate tracker mechanism, Public Counsel witness Brosch contends
26 that piecemeal rate trackers are inappropriate "in the absence of compelling evidence that traditional ratemaking
27 is not working effectively" (Public Counsel witness Brosch, page 10, lines 14-16). In response to Cascade
28 Natural Gas Data Request No. 90, Mr. Parvinen clarifies his testimony by indicating that "There are
29 circumstances when single-issue is acceptable such as PGAs, PCAs, conservation trackers and rider, etc."

1 isolate one component of the cost of service without further analysis is sound regulatory
2 policy. In fact, numerous regulatory commissions throughout the country appear to
3 agree that single-issue ratemaking, in and of itself, is not objectionable, based on their
4 approval of weather normalization clauses, purchased gas cost adjustment mechanisms,
5 main replacement cost recovery riders, uncollectible expense trackers, and pension
6 expense riders, to name a few.

7
8 I would acknowledge that concerns about single-issue ratemaking are legitimate where
9 there is a cause-and-effect relationship between an item included in a proposed rate
10 tracker and another, offsetting item excluded from the tracker. Even in these instances,
11 however, proposed rate trackers may be considered reasonable. For example, a rate
12 adjustment provision that covers the cost of main investments to extend service to new
13 subdivisions but ignores the revenue derived from the customers added through the
14 extension is an example of the type of mechanism that may be considered problematic
15 single-issue ratemaking. Such a cause-and-effect relationship should be clear-cut,
16 material in amount, and not based on speculation in order qualify as a consideration
17 sufficient to warrant rejection of a proposed mechanism.¹⁰

18
19 Rate tracker mechanisms that do not involve clear cause-and-effect relationships
20 between included and excluded cost of service components should not be summarily
21 rejected based on the basis that they constitute single-issue ratemaking. While excluded
22

23 ¹⁰ For example, one may contend that warm weather may enable a utility to reduce overtime expenses built into
24 base rates. The vague contention should not be used to reject a weather normalization clause because it
25 constitutes cause-and-effect single issue ratemaking.

1 components may increase or decrease over time for any number of reasons, the mere
2 fact that they may change should not provide a reasonable basis for summary rejection
3 of such mechanisms. Rather the mechanisms should be evaluated based on factors such
4 as expected benefits to the utility and its customers.

5
6 Q. Does the SRIAM constitute single-issue ratemaking involving cause-and-effect
7 relationships?

8
9 A. No. Eligible investments are clearly not revenue-producing. Facilities replaced because
10 of their deteriorating condition or because of federal and state safety requirements
11 merely enable the Company to provide safe and reliable service to its existing customer
12 base. Relocations required due to highway construction or other public works projects
13 only preserve the Company's ability to provide continuing service to existing
14 customers. Earlier in my rebuttal testimony, I explained why I do not agree with the
15 contention that investments required to reinforce the distribution system are revenue
16 producing. However, reinforcement investments are removed from the revised SRIAM
17 in Exhibit ___ (FJC-3), and this issue does not require resolution.

18
19 All three parties (Staff, Public Counsel, and NWIGU) allege that the SRIAM is
20 unacceptable because it ignores an alleged cause-and-effect relationship between new
21 plant included in the SRIAM and an expected reduction in operations and maintenance
22 expenses associated with replacing or relocating older facilities with new facilities.¹¹

23
24

¹¹ See footnote 6.

1 For the reasons described below, however, I do not believe that this expectation rises to
2 the level of a material cause-and-effect relationship.

3
4 Q. Please explain why you do not agree with the parties' allegation that the SRIAM should
5 be rejected because it ignores causally-related, offsetting expense reductions associated
6 with new facilities.

7
8 A. Staff witness Parvinen and NWIGU witness Schoenbeck make passing generalized
9 assertions about this expectation with no examples, support, quantification, or
10 explanation.¹² Public Counsel witness Brosch at least offers examples of alleged
11 sources of these expense savings – service calls for gas leaks and gas leak repair
12 expenses.¹³ Upon offering these examples, Mr. Brosch proceeds to conclude that
13 “systematic replacement of problem areas in the gas distribution system can produce
14 profound improvements (*i.e.*, reductions) in these costs.”¹⁴ Public Counsel witness
15 Brosch provides no basis for his speculation regarding “profound improvements” nor
16 has he provided any quantification on how significant the impact may be.

17
18
19 ¹² Staff witness Parvinen only provides a generalized, unsubstantiated claim that “new plant costs less to maintain
20 than old plant” (page 29, line 16) and NWIGU witness Schoenbeck only states, without example or support, that
21 “When older pipe is replaced, for example, operations and maintenance expenses should decline” (page 6, lines
22 20-21).

23 ¹³ Public Counsel witness Brosch, page 29, lines 2-3. Mr. Brosch continues his discussion of expense reductions
24 discussing automation opportunities. These “opportunities” are not causally related to the SRIAM investments.
25 Furthermore, the only example that Mr. Brosch mentions is automated meter reading, technology that the
Company has already implemented.

¹⁴ *Id.*, lines 4-5.

1 It seems reasonable to assume that a brand new gas distribution system should be less
2 costly to maintain than one built 50 years ago. That comparison is not relevant to an
3 assessment of the SRAIM, however. Through the SRIAM, the Company's distribution
4 system is not replaced with a new one. The proper focus is on the possibility of
5 material, incremental expense savings associated with SRIAM replacements *in a given*
6 *year*. If a service person has a small reduction in the number of gas leak calls to work
7 each month because a major replacement project is completed, that employee may be
8 now be able to handle a couple more line locates or new service connections in that
9 month. Expenses are not reduced through elimination of the service person position;
10 rather there may be a very modest improvement in the timeliness of filling certain
11 customer service requests. In addition, the dispersed geographic nature of the
12 Company's service area further limits the potential for incremental expense savings.
13 Furthermore, not all SRIAM-related investments involve replacement of pipe that is old
14 or deteriorated. For example, a perfectly sound system may be replaced and relocated
15 to accommodate a highway construction project.

16
17 Over the course of a number of years, the culmination of numerous replacement projects
18 *may* enable the Company to realize some expense savings through manpower reductions
19 and realignments. Whether or not such savings are as "profound" in amount -- as Mr.
20 Brosch believes they will be -- over a period of time when "systematic" replacements
21 may be undertaken is not on point in a proper evaluation of the SRIAM. Rather the
22 possibility that such savings may materialize over a long period of time suggests that the
23 SRIAM should not continue indefinitely without recognizing this possibility. For this
24 reason, the Company's SRIAM proposal would require the Company to file a general
25

1 rate case within five years after the effective date of the first surcharge. Operations and
2 expenses savings, if any, and all other factors affecting the determination of the cost of
3 service would be evaluated and used to update the determination of base rates at that
4 time.

5
6 Q. How do you respond to the claim of various parties that the SRIAM is not needed?

7
8 A. I first address Public Counsel witness Brosch's basis for reaching his conclusion that the
9 SRIAM is not needed. Mr. Brosch indicates that traditional regulation is working well
10 for the Company because it has not had a rate case in 10 years and the Company's
11 returns in this period until 1995 appear acceptable.¹⁵ Without further analysis, it is
12 simply not reasonable to presume that historical financial performance is a good
13 indicator of the future performance.

14
15 Mr. Brosch contends that the Company's past operational efficiency measures will
16 continue indefinitely into the future,¹⁶ but he does not provide a single example of the
17 source of such *future* opportunities. It is unreasonable to assume that a soundly-
18 managed company will have endless opportunities to reduce costs through efficiency
19 measures. In fact, given the significant cost-cutting that the Company has already
20 implemented, as discussed in Mr. Stevens' direct testimony, we have every reason to
21 believe that there are significantly fewer opportunities for such cost savings in the
22

23
24 ¹⁵ *Id.*, p. 14, line 10 – page 16, line 4.

25 ¹⁶ *Id.*, page 25, line 16 – page 26, line 3.

1 future. The possibility that the future may very well be different is indicated by the
2 sizable SRIAM-related investments expected in the coming years, as discussed in my
3 prepared testimony.¹⁷ Public Counsel witness Brosch merely responds by indicating
4 that these future projects involve “speculation” and do not constitute “known and
5 measurable changes.”¹⁸ Of course, capital expenditures in the future are not known and
6 measurable today, and the Company does not claim that they are. If they were, their
7 costs could be included in determination of the revenue requirement in this case. And,
8 if the level of spending in any given future year happens to differ from the level
9 projected today, it has no consequence for the SRIAM surcharge calculations. These
10 calculations are based on actual investments in plant in service, not projected amounts.

11
12 Public Counsel witness Brosch’s final support for his claim that the SRIAM is not
13 needed is that SRIAM revenue calculations for the historical period of 2001 through
14

15 ¹⁷ Prepared Testimony of F. Jay Cummings, page 3, lines 21 – page 4, line 19.

16 ¹⁸ Public Counsel witness Brosch, page 20, lines 2-5. Mr. Brosch attempts to bolster his position that these future
17 SRIAM-related capital expenditures are not known and measurable by contending that the projections for any
18 year may be overstated because projects may be deferred and the Company may be able to reduce expenditures
19 below budgeted levels (page 27, lines 10-16). While the notion that future spending levels are not known and
20 measurable is not a useful point in assessing the SRIAM, I would note in response to Mr. Brosch that
21 relocations due to public works projects typically cannot be deferred, as may very well be the case with
22 government safety mandates. Furthermore, it is not a sound management practice to defer needed replacements
23 of deteriorating facilities very long. Deferrals and under budget spending levels are more typically associated
24 with discretionary, revenue-producing projects or with unusual, one-time projects than with SRIAM
25 investments. For example, a main extension may be downsized when a developer changes plans with respect to
the size or characteristics of a new development. Or the project may be readily delayed if other projects become
more pressing from the Company’s perspective. Similarly, implementing a completely new customer service
and billing system, a project undertaken very infrequently and containing many uncertainties, may be less costly
than expected if, for example, the budget was prepared assuming the potential for unknown data conversion
requirements or additional programming to link existing software to the new system, but these events ultimately
do not materialize.

Mr. Brosch’s presumption that three years’ experience involving expenditures that were less than budget
implies a future of overstated projections is not supported by the reality of recent years’ experience. For
example, in the most recent three fiscal years, the Company’s actual capital spending levels were over budget by
\$3.2 million and \$4.0 million in 2003 and 2004, respectively, and under budget by \$0.4 million in 2005.

1 2005 show that “the highest accumulated annual amount after five full years of tracker
2 growth represents less than five percent of Cascade Natural Gas Corporation’s proposed
3 annual operating income in Washington.”¹⁹ Again, past historical results are not
4 indicative of the future. In fact, projections suggest that the future will be materially
5 different. Based on the SRIAM as revised with its narrower coverage in Exhibit No. ___
6 (FJC-3), SRIAM revenues will grow to more than \$2.0 million annually during the term
7 of the tracker, or more than nine percent of the proposed annual operating income in
8 Washington. I consider such an impact to material and supportive of the need for the
9 SRIAM.

10
11 Q. What is the basis for Staff witness Parvinen’s claim that the SRIAM is unnecessary?

12
13 A. Staff witness Parvinen states that “[t]he lack of need for the mechanism can be seen
14 from a simple comparison of the company’s total capital expenditures over the past
15 several years to total expected capital expenditures in the future.”²⁰ The focus on total
16 capital expenditures is misplaced; the need for the SRIAM is driven by expected
17 expenditures on *eligible investments*, not *total capital expenditures*. Even if a focus on
18 total capital expenditures were appropriate, Mr. Parvinen’s comparison of 2000-2005
19 average expenditures to 2006-2011 average projected expenditures is skewed by his
20 failure to exclude the \$17⁺ million spent by the Company in fiscal years 2003-2005 on
21 the automated meter reading and call center consolidation projects. These projects are

22
23 ¹⁹ *Id.*, page 31, lines 14-16.

24 ²⁰ Staff witness Parvinen, page 30, lines 17-19.

1 clearly unusual, large items that will not be recurring. They should be removed from
2 the comparison. Upon removing these items, the comparison of the averages in the two
3 periods shows a growth of 22%, certainly not an inconsequential change. And, more
4 importantly, the growth is driven by SRIAM-related investments. While eligible
5 investments under the SRIAM as revised in Exhibit No. ___ (FJC-3) averaged only one
6 percent of total capital expenditures in the 2000-2005 period, they are expected to grow
7 to an average of 11 percent of total capital expenditures in the 2006-2011 period.²¹ Mr.
8 Parvinen concludes that “infrastructure investment in future years will likely be
9 approximately equal to the past.”²² He bases his conclusion on the fact that the
10 Company has indicated in discovery that certain “smaller projects” may not have been
11 captured in the 2000-2005 SRIAM-related investments. Note that the Company
12 indicated that any excluded projects are *small*. It is unreasonable to conclude that the
13 excluded items are large enough to substantially change the dramatic growth in the
14 relative portion of expected capital expenditures associated with SRIAM-related
15 investments referenced above.

16
17 Q. Why does NWIGU witness Schoenbeck believe that the SRIAM is unnecessary?

18
19 A. NWIGU witness Schoenbeck states that “Cascade had not filed a general rate case in
20 Washington in nearly 10 years. There is no evidence that Cascade has been
21 experiencing earnings attrition such that an adjustment mechanism is warranted at this
22

23
24 ²² *Id.*, page 31, line 20 – page 32, line 1.

1 time to address so-called regulatory lag.”²³ My response above to Public Counsel
2 witness Brosch is equally applicable to Mr. Schoenbeck’s argument regarding the
3 absence of a demonstrated need for the SRIAM.
4

5 Q. Do you have any comments on Staff witness Parvinen’s perception that the SRIAM
6 involves an unacceptable administrative burden on Staff and on Public Counsel witness
7 Brosch’s related contention that the time period for the review and verification process
8 is inadequate?
9

10 A. Yes. These concerns should be alleviated to a large degree by the reduced scope of the
11 SRIAM as revised in my Exhibit No. ____ (FJC-3). In addition, as I explained in my
12 prepared testimony, the Company intends to provide additional detail on SRIAM
13 projects as part of its annual budget submission process pursuant to Chapter 480-140
14 WAC.²⁴ The Company’s intention in committing to this requirement was to enable
15 Staff to review and raise any questions that Staff may have on upcoming projects well
16 in advance of their appearing as part of a SRIAM filing.
17

18 Despite this advance information provision commitment, Staff and Public Counsel
19 appear to have continuing concerns about the review process. Based on my discussions
20 with the Company, I propose to add formality to this information provision and review
21 process to address these concerns. By October 1 each year, the Company will submit its
22

23 ²³ NWIGU witness Schoenbeck, page 6, lines 7-9.

24 ²⁴ Prepared Testimony of F. Jay Cummings, page 7, lines 1-6.
25

1 capital budget for the upcoming fiscal year and provide Staff with details on SRIAM
2 projects included in the budget. The Company proposes that Staff review the nature of
3 the projects and inform the Company of whether it has any questions on or objections to
4 the inclusion of specific SRIAM-designated projects within 30 days. As the projects are
5 undertaken over the next twelve months, the Company will provide Staff with updates
6 on the status of each project, expenditures to date, explanations of budget variances, and
7 expected completion dates. During the fiscal year, the Company will also provide Staff
8 with details on any projects that must be added due to, for example, a public works
9 project initiated after the start of the fiscal year that requires timely facility relocations.
10 Through this process, Staff will not only have fourteen months advance notice of
11 projects to be included in an upcoming SRIAM but also will be able to conduct an
12 ongoing review and audit process during the fiscal year. Only a limited number of
13 projects completed toward the end of the fiscal year should have to be audited during
14 the 60-day period after a SRIAM filing.

15
16 Q. Do you have any comments on any other issues raised by the parties pertaining to the
17 SRIAM?

18
19 A. Yes. I discuss Public Counsel witness Brosch's contention that approval of the SRIAM
20 would reduce management's incentive to carefully manage capital expenditures.²⁵ I
21 also will address Mr. Brosch's dismissal of my testimony pertaining to the benefit of the
22 SRIAM in reducing the frequency of future general rate cases and his observation that

23
24 _____
25 ²⁵ Public Counsel witness Brosch, page 17, lines 9-11.

1 management has some control over the level of capital expenditures.²⁶ I also address
2 Staff witness Parvinen’s claim that the SRIAM is poorly defined because it does not
3 include recognition that a certain level of SRIAM investments is normally incurred each
4 year.²⁷

5
6 Q. Please respond to Public Counsel witness Brosch’s claim that the SRIAM will
7 discourage the Company from carefully managing its capital expenditures between rate
8 cases.

9
10 A. Yes. Company witness Stevens addresses aspects of this claim in his rebuttal
11 testimony. I would add that Public Counsel witness Brosch’s generalized assertion can
12 be invoked as the basis for opposing virtually any tracker mechanism. And, in contrast
13 to many other rate adjustments mechanisms, the prospects of “inflated” costs should be
14 relatively easy to detect with a SRIAM-type mechanism. For example, a purchased gas
15 adjustment mechanism involves expenses incurred as result of purchases that vary every
16 day and that are made through a large number of contracts with varying terms and
17 pricing structures and spot market transactions, as well as opportunities to purchase a
18 variety of financial instruments. By contrast, the cost of a SRIAM-related investment
19 project can easily be benchmarked against the cost of similar projects in the recent past
20 to assess its reasonableness, with any deviations supported by quantifiable project-
21 specific considerations, such as highway crossings or rocky terrain.

22
23 ²⁶ *Id.*, page 18, lines 11-13 and page 31, line 20 – page 32, line 6.

24 ²⁷ Staff witness Parvinen, page 29, lines 4-11.

1 Furthermore, even in the unlikely event that one dollar more than necessary is spent on
2 an eligible investment, the Company would not have it returned quickly through the
3 SRIAM. Rather, through the return and depreciation components, that dollar would be
4 returned over a number of years. Sound managers will thus retain a strong incentive to
5 manage capital expenditures wisely, an incentive strengthened by investors' concern
6 about not only earnings but also cash flow considerations. Finally, I note that the
7 SRIAM explicitly indicates that the SRIAM in no way limits the authority of the
8 Commission "to review the reasonableness of expenditure and the prudence of
9 investments included in the SRIAM in a general rate case in which the investments are
10 initially to be included in rate base."²⁸ Staff and other parties will thus retain the ability
11 to challenge the prudence of SRIAM expenditures in future proceedings. And, the
12 proposed SRIAM tariff requirement that the Company file a general rate case within
13 five years of the effective date of the first SRIAM rate change provides the proceeding
14 in which the reasonableness and prudence of SRIAM investments can be addressed.

15
16 Q. How does Public Counsel Brosch dismiss the benefit of the SRIAM in reducing future
17 rate case frequency?

18
19 A. Mr. Brosch merely states that "there is no guarantee that Cascade will delay filings for
20 traditional rate increases in the future."²⁹ The SRIAM will result in timely recognition
21 of a portion of the Company's increased cost of service, reducing the size of any future
22

23 ²⁸ Rule 21 – Safety & Reliability Infrastructure Adjustment Mechanism, paragraph (8).

24 ²⁹ Public Counsel witness Brosch, page 18, lines 11-12.

1 revenue deficiency. All other things the same, such an offset will logically enable the
2 Company to delay future general rate case filings. I find it curious that Mr. Brosch
3 contends that any number of unknown and unidentified future sources of productivity
4 gains should enable the Company to delay filings of future rate cases,³⁰ but when faced
5 with a real mechanism that will contribute to a reduced need for general rate relief, Mr.
6 Brosch suggests that it has virtually no effect.

7
8 In support of his “no guarantee” claim, Mr. Brosch complains about the SRIAM tariff
9 requirement for a general rate case filing within five years of the first rate change.
10 While the Company included this provision to provide a specific time when SRIAM
11 investments can be reviewed for rate base treatment and to permit inclusion in rates of
12 any expense changes -- such as savings that Mr. Brosch expects will occur, the
13 Company would not be opposed to its elimination if Mr. Brosch’s “no guarantee”
14 assertion is deemed important.

15
16 Q. Please provide your comments on Public Counsel witness Brosch’s observation that
17 management does have some control over the level of capital expenditures.

18
19 A. Public Counsel witness Brosch appears to suggest that this is one more reason to reject
20 the SRIAM. I disagree. Spending on SRIAM investments is required to meet
21 government mandates and/or to ensure safe delivery of natural gas to customers. Any
22 control over whether or not to engage in such projects is certainly extremely limited,
23

24 ³⁰ *Id.*, page 25, line 20 – page 26, line 3.

1 especially when compared to discretionary, revenue-producing projects. The fact that
2 the Company has “some” control the magnitude of expenditures on a given project
3 through sound management and planning, as referenced by Mr. Brosch, is no different
4 than indicating that the Company has “some” control over gas costs through its demand
5 forecasting, contract negotiations and administration, and daily dispatching decisions.
6

7 Q. Do you agree with Staff witness Parvinen that the SRIAM is poorly designed because it
8 includes all eligible investments, including those that would “normally” be expected
9 each year?
10

11 A. No. Staff witness Parvinen explains his concern by indicating that the SRIAM “does
12 not account for the reality that its capital structure, return, and capital budget assume a
13 certain level of this type of investment each year.”³¹ The determination of the
14 Company’s base rates in this proceeding does not consider in any manner the cost of
15 future eligible investments to be included in the SRIAM. Mr. Parvinen’s contention
16 would have validity only if the Company’s rate base included projected investments that
17 would be counted again in the subsequent application of the SRIAM. This is not the
18 case, as is clearly indicated in the description of eligible investments included in the
19 SRIAM in Exhibit ___ (FJC-3). Finally, the fact that the Company’s capital budget in
20 future years may contain some level of eligible investments in each year has no bearing
21 on the appropriateness of the recovery of the cost of these new investments, the costs of
22 which are not considered in the development of base rates in this rate case.
23

24 ³¹ Staff witness Parvinen, page 29, lines 7-9.
25

1 Q. Does this conclude your rebuttal testimony?
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3 A. Yes.
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CASCADE NATURAL GAS CORPORATION

(N)

RULE 21- SAFETY & RELIABILITY INFRASTRUCTURE ADJUSTMENT MECHANISM

APPLICABLE:

This Safety and Reliability Infrastructure Adjustment Mechanism (SRIAM) is applicable to all firm distribution rate schedules (Schedules 502, 503, 504, 505, 511, 512, 663, and 664).

PURPOSE:

The purpose of this provision is to define (1) the eligible investments to be included in the SRIAM, and (2) the procedures for the resulting adjustments in base rates.

ELIGIBLE INVESTMENTS:

An investment included in the SRIAM must be used and useful at the end of the applicable fiscal year and must not have been included in the Company's rate base in its most recent general rate case. Eligible investments consist of: (a) mains, service lines, and related facilities that replace existing facilities that have worn out or are in deteriorated condition or that are installed to comply with state and federal safety requirements; and (b) facility relocations required due to public works projects by or on behalf of any government agency provided that the costs related to such projects have not been completely reimbursed to the company; ~~and (c) additional mains, gate station facility expansions, compressed natural gas and liquefied natural gas equipment or any other infrastructure improvements designed to improve the reliability and/or capacity of the distribution system during peak weather events.~~

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. In this general rate case filing, the company will include all eligible investments reflected in prior SRIAM rate adjustments in rate base and currently effective SRIAM rates will be reset to zero.

REVISION TO BASE RATES DUE TO SRIAM INVESTMENTS:

- 1) On December 1 each year, the company shall file with the Commission to update all applicable rate schedules to reflect SRIAM surcharges as shown on Schedule 597 and calculated according to the procedures described below. SRIAM surcharges become effective on February 1 each year.
- 2) Eligible investments shall be used and useful and in service as of September 30, the end of the company's fiscal year, to be included in the SRIAM filing on December 1 of that year.

(continued on next page)

(N)

CNG/O06-02-01

ISSUED February 14, 2006

EFFECTIVE March 16, 2006

ISSUED BY CASCADE NATURAL GAS CORPORATION

BY Jon T. Stoltz

TITLE Senior Vice President
Regulatory & Gas Supply

CASCADE NATURAL GAS CORPORATION

RULE 21- SAFETY & RELIABILITY INFRASTRUCTURE ADJUSTMENT MECHANISM (Continued)

(N)

REVISION TO BASE RATES DUE TO SRIAM INVESTMENTS (Continued):

- 3) The SRIAM revenue to be recovered through the annual filing shall reflect the cost of service of eligible investments, as well as reconciliation of prior period SRIAM collections, if applicable, and shall consist of the following components:
 - a. Return component, or net plant, i.e. gross plant less accumulated depreciation less accumulated deferred income taxes at the end of the applicable fiscal year, multiplied by the 9.37% rate of return inclusive of income taxes
plus
 - b. Property tax component, or gross plant net of related retirements multiplied by the 1.17% effective property tax
plus
 - c. Depreciation expense component, or the sum across applicable plant accounts of each account's gross eligible investment multiplied by the account's depreciation rate used in the company's most recent general rate case less depreciation expense on any related retirements
plus
 - d. Reconciliation component, or the difference between prior period SRIAM revenues calculated pursuant to this Rule and actual SRIAM revenue collections
plus
 - e. Revenue-related tax component, or 4.535% multiplied by the sum of items 3a through 3c.

- 4) The SRIAM revenue calculated pursuant to provision 3 shall be collected through a per customer surcharge over the twelve month period beginning February 1. In order to calculate the surcharge for each applicable rate schedule, the SRIAM revenue shall be allocated to each rate schedule based on the relative proportion of base margin revenues associated with the schedule in setting rates in the most recent general rate case.

- 5) The SRIAM surcharge for each applicable rate schedule shall be the SRIAM revenue allocated to the rate schedule pursuant to provision 4 divided by the number of customers anticipated for the year beginning on February 1.

- 6) As part of each annual filing, the company shall provide all supporting documentation related to the SRIAM surcharge, including surcharge calculation details and description of major investment projects completed during the most recent fiscal year. The description shall include the cost and need for each major project.

- 7) Subsequent to any general rate case, factors referenced in provisions 3 and 4 used in SRIAM revenue and surcharge calculations shall be updated to reflect those used in setting base rates in the general rate case.

- 8) Nothing herein limits the statutory authority of the Washington Utilities and Transportation Commission to review the reasonableness of expenditures on and the prudence of investments included in the SRIAM in a general rate case in which the investments are to be initially included in rate base.

(N)

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