Exh. KMH-1T
Docket UG-200568
Witness: Kristen M. Hillstead

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. CASCADE NATURAL GAS CORPORATION, Respondent.	DOCKET UG-200568

TESTIMONY OF

Kristen M. Hillstead

STAFF OF WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Revenue Requirement
Test Year Per-Books Audit Adjustment UTC-1
Interest Coordination Adjustment

November 19, 2020

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Kristen M. Hillstead, and my business address is 621 Woodland Square Loop SE, Lacey, Washington, 98503. My business mailing address is P.O. Box 47250, Olympia, Washington, 98504-7250. My business e-mail address is kristen.hillstead@wutc.wa.gov.

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

A. I am employed by the Washington Utilities and Transportation Commission (Commission) as a Regulatory Analyst in the Energy Regulation Section of the Regulatory Services Division.

Q. What are your educational and professional qualifications?

A. I received a Bachelor of Arts degree, with an emphasis in accounting, from The Evergreen State College in 1994. I have been employed by the Commission since September of 1990. I have worked as a Regulatory Analyst since 1999, first in the Telecommunications Section and transferring to the Energy Regulation section in July of 2013.

Q. Please state your qualifications to provide testimony in this proceeding.

A. During my tenure in Regulatory Services, I have been responsible for auditing the books and records of regulated companies, examining affiliated interest transactions, monthly service quality reports, eligible telecommunications company filings, purchased gas adjustment filings, and cost recovery mechanism filings, and developing and presenting Staff recommendations concerning such filings at Commission open public meetings and adjudications.

Q. Have you previously filed testimony before this Commission?

A. Yes. I filed testimony in the following cases: Docket UT-040788, Verizon Northwest Inc.'s general rate case, Docket UT-061625, Qwest Corporation's petition for an alternative form of regulation, Docket UT-090842, Verizon/Frontier transfer of control, and Docket UT-100820, Qwest Communications International Inc., and CenturyTel, Inc.'s joint application for approval of indirect transfer of control, and Docket UG-170929, Cascade Natural Gas Corporation's general rate case proceeding. Recently, I was the lead analyst in Northwest Natural Gas Company's general rate case, UG-181053. I have written testimony in several general rate cases that were ultimately sponsored by other Commission witnesses: Docket UE-140762, Pacific Power & Light Company (PacifiCorp), and Dockets UE-150204 and UG-150205 (*consolidated)*, Avista Corporation. Most recently I drafted testimony in PacifiCorp's 2019 general rate case, Docket UE-191024, though that case was settled before testimony was filed.

II. SCOPE AND SUMMARY OF TESTIMONY

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

A. The purpose of my testimony is to present Staff's calculation of Cascade Natural Gas Corporation's (Cascade or Company) revenue requirement. My revenue requirement calculation aggregates the adjustments sponsored by Staff witnesses Huang, Panco, and White. I also address the results of Staff's per-books audit and the interest coordination adjustment.

Q. Please summarize Staff's recommended revenue requirement for Cascade.

A. Staff recommends a revenue requirement *decrease* of $508,968 as shown in Exh. KMH-2.[1] Staff's revenue requirement is based on a 9.25 percent return on equity and in a 6.93 percent overall rate of return.[2]

III. REVENUE REQUIREMENT

Q. Please describe Staff's revenue requirement model exhibit.

A. Exh. KMH-2 incorporates all the moving pieces that generate Cascade's Revenue Requirement. This exhibit starts with Column 1: Results per Company Filing (Results of Operations) for the year ending December 31, 2019. Column 2: Summary of Adjustments includes the totals from the Summary of Adjustments exhibit (Exh.

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[1] Hillstead, Exh. KMH-2 at 1, col. 4, ln. 4.
[2] Parcell, Exh. DCP-1T at 2.

KMH-3). Column 3: Test Year Adjusted Total is the total of Column 1 and Column 2. The revenue requirement "need" is identified in Column 4 as Requested Revenue Increase. With Staff's recommended adjustments, I calculate a revenue *surplus* of $508,968.[3] This revenue surplus is the basis for Staff's recommendation that the Commission order a $508,968 revenue decrease for Cascade.

Q. Please discuss how Staff developed its revenue requirement recommendation.

A. Staff uses the Company's updated revenue requirement model in response to UTC Staff Data Request (DR) No. 127 as its starting point for analyzing the adjustments and making its recommendation.[4] As I discuss in further detail below, this is the appropriate starting point as it incorporates necessary revisions and corrections to Cascade's as-filed revenue requirement model.

Staff's revenue requirement is based on a modified historical test year approach, with adjustments for known and measurable changes to the test year 2019 results of operations.

Q. Please explain how the revenue requirement is calculated.

A. The revenue requirement is calculated by first taking the Company's adjusted rate base and multiplying it by the proposed rate of return to equal the *required* return. Second, the adjusted net income is subtracted from the *required* return to calculate the required net income. The final step is to convert the Company's required net

[3] Hillstead, Exh. KMH-2 at 1, col. 4, ln. 4.
[4] Hillstead, Exh. KMH-8.

income into its revenue requirement by dividing the required net income by the Company's conversion factor.[5]

Q. Did Staff prepare an exhibit that shows this calculation?

A. Yes. The derivation of Staff's revenue requirement is provided in Exh. KMH-4. Staff accepts the Company's methodology for calculating its conversion factor and has provided this calculation in Exh. KMH-5.

Q. Briefly describe Cascade's request for additional revenue.

A. In its initial filing, filed June 24, 2020, Cascade requested a revenue increase of $13.8 million. On July 27, 2020, the Company revised its initial filing, increasing its request for additional revenue to $14.1 million.[6] On September 17, 2020, in response to UTC Staff DR No. 127, Cascade provided a further revised revenue requirement model that updated the Company's depreciation rates[7] and corrected a calculation error within the revenue requirement model itself. With these changes, the Company's revised revenue requirement request is $12.0 million.

I provide Cascade's response to UTC Staff DR No. 127 as Exh. KMH-8.

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[5] For utility rate making purposes, the conversion factor, when applied to the net income, produces the necessary revenue requirement. The conversion factor takes into account factors such as uncollectible accounts, Commission regulatory fees, federal income tax, and the public utility tax (Cascade refers to this tax as B&O Tax in its exhibit). The conversion factor is unique to each company and is different in each general rate case. Cascade's conversion factor for this case is 0.75481. *See* Peters, Exh. MCP-4.

[6] Cascade's July 27, 2020, filing updates the status of certain customers that changed service schedules after Cascade's initial filing (this would have had implications to the decoupling mechanism had the filing not been updated). The Company also included detail for its AMA to EOP adjustment. Myhrum, Exh. IDM-6T at 1:7-14.

[7] Cascade filed an accounting petition requesting to update depreciation rates with the Commission in Docket UG-200278. In response to UTC Staff DR No. 127, the Company used revised depreciation rates that have been settled between parties and are awaiting approval from the Oregon PUC. *See* Hillstead, Exh. KMH-8.

Q. Did the Company propose any adjustments in support of its revenue requirement request?

A. Yes. Cascade provided testimony, exhibits, and workpapers identifying its proposed adjustments that derive the $12.0 million revenue requirement request. The Company provides the following 10 adjustments to arrive at its revenue requirement request of $12.0 million.

Adjustment Number	Adjustment Description
R-1	Annualize CRM Adjustment
R-2	Promotional Advertising Adjustment
R-3	Restate Revenue Adjustment
R-4	Restate End of Period (EOP) Adjustment
R-5	Restate Wages
R-6	Executive Incentives
P-1	Interest Coordination Adjustment
P-2	Pro Forma Wage Adjustment
P-3	Pro Forma Plant Additions
P-4	MAOP Deferral Amortization

Q. Does Staff agree with Cascade's $12.0 million revenue requirement request?

A. No. Staff's analysis of the Company's filing results in a *negative* required net operating income of $384,176, in other words, a revenue *surplus.* When the Company's conversion factor is applied to this revenue surplus, the result is a *negative* revenue requirement of $508,968. Staff's revenue requirement calculation is shown in Exh. KMH-4.

Q. Please briefly identify the Company's revenue requirement adjustments and the Staff witnesses who analyzed the adjustments.

A. Staff analyzed the following:

- The Cost Recovery Mechanism (CRM) Adjustment (R-1), Promotional Advertising Adjustment (R-2), the Restatement of Revenue Adjustment (R-3), the Investor Supplied Working Capital calculation, and test year plant additions.
- Staff witness Amy White analyzed the Company's per books results of operations, the End of Period (EOP) Adjustment (R-4), and the MAOP Deferral Amortization Adjustment (P-4). Staff witness White will discuss these adjustments in her testimony.
- Staff witness Joanna Huang analyzed the Company's per books results of operations, the Restatement of Wages Adjustment (R-5), the Restatement of Executive Incentives Adjustment (R-6), the Pro Forma Wage Adjustment (P-2), and the Company's allocation factors. Staff witness Huang will discuss these adjustments in her testimony.
- Staff witness David Panco provides testimony regarding the Pro Forma Plant Additions (P-3).
- Staff witness David Parcell provides testimony regarding the Company's cost of capital.

Q. Please provide a comparison between the Company's adjustments, as provided by Cascade in response to UTC Staff DR No. 127, and Staff's proposed adjustments. Please include the resulting revenue requirement calculation.

A. Table 1 compares the Company's adjustments with Staff's proposed adjustments, and the impact of the adjustments on net operating income. This table also illustrates the revenue requirement request calculated by Cascade to the revenue requirement recommendation proposed by Staff.

Table 1 – Comparison of Adjustments

	Cascade	Staff	Difference
Per Books Net Op Rev (ROO Col. 1 Row 18)	$20,804,385	$20,804,385	0
Annualize CRM Adjustment R-1	($2,192,117)	($2,198,971)	($6,853)
Promotional Advertising Adj. R-2	21,876	21,876	$0
Restate Revenue Adjustment R-3	11,263,913	11,263,913	$0
Restate End of Period Adjustment R-4	(812,389)	(812,389)	$0
Restate Wages Adjustment R-5	(68,514)	(68,514)	$0
Restate Executive Incentives R-6	972,281	972,281	$0
Interest Coordination Adjustment P-1	(92,149)	(302,312)	(210,162)
Pro Forma Wage Adjustment P-2	(1,596,423)	(649,310)	947,113
Pro Forma Plant Additions P-3	(1,883,538)	(150,895)	1,732,643
MAOP Deferral Amortization P-4	(731,342)	(632,320)	99,023
Test Year Audit Expenses UTC-1		36,202	36,202
Net Effect of Adjustments	$4,881,596	$7,479,561	$2,597,965
Net Operating Income w/Adjustments (ROO, Col 3, Line 18)	$25,685,981	$28,283,946	$2,597,965
Total Pro Forma Rate Base (ROO Col 3, line 24)	$460,585,036	$402,652,193	($57,932,843)
Return on Rate Base	7.54%	6.93%	
Target Revenue Requirement	$34,746,535	$27,899,770,	($6,846,765)
Revenue Requirement Deficiency/(surplus)	$9,060,554	($384,176)	
Conversion Factor	0.75481	0.75481	
Overall Rev Req Deficiency/(surplus)	$12,003,699	($508,968)	($12,512,667)

IV. ADJUSTMENTS

Q. Please identify the adjustments proposed by Cascade and specify Staff's position regarding each adjustment.

A. Table 2 identifies the adjustments that are contested by Staff, and Table 3 identifies the adjustments that are uncontested by Staff.

Table 2 – Contested Adjustments

Adjustment Number	Adjustment Description
R-1	Annualize CRM Adjustment
P-2	Pro Forma Wage Adjustment
P-3	Pro Forma Plant Additions
P-4	MAOP Deferral Amortization

Table 3 – Uncontested Adjustments

Adjustment Number	Adjustment Description
R-2	Promotional Advertising Adjustment
R-3	Restate Revenue Adjustment
R-4	Restate End of Period (EOP) Adjustment
R-5	Restate Wages
R-6	Executive Incentives
P-1	Interest Coordination Adjustment

Q. Did Staff audit the Company's per-books balances?

A. Yes, Staff performed an audit of the Company's 2019 test year results of operations. As part of its review Staff submitted several DRs related to various per book balances in multiple expense accounts and thoroughly analyzed the Company's responses to these data requests.

Q. What did Staff discover?

A. Through its analysis of the Company's 2019 test year results of operations, Staff discovered a few items that it believes should not have been included in the Company's per book balances. Staff recommends that the following items be removed from the revenue requirement:

- A portion of the expenses the Company booked to FERC 908 were inadvertently allocated to Washington instead of directly assigned to Oregon;
- FERC 908 also included an employee benefit "sponsorship" expense; and
- FERC 930.2 included items inappropriate to recover from ratepayers, including expenses for birthday and retirement parties, cards, flowers, balloons, and appliances.

Staff removes these items from the revenue requirement through Adjustment UTC-1. This adjustment decreases net operating income by approximately $36,000.

Q. Did Staff prepare an exhibit of Staff's adjustment?

A. Yes. Please see Exh. KMH-6.

Q. What is the impact of Staff's proposed adjustments on Cascade's net operating income, also include the adjustments' impact on revenue requirement?

A. Staff's proposed adjustments increase the Company's net operating income by $2,597,965, thus reducing the revenue requirement by $3,441,863, as shown in Table 4.

Table 4 – Impact of Adjustments on NOI and Revenue Requirement

Adjustment Number	Company	Staff	Change to Net Operating Income	Revenue Requirement
Contested Adjustments				
R-1[8]	($2,192,117)	($2,198,971)	($6,853)	$9,080
P-2	(1,596,423)	(649,310)	947,113	(1,254,765)
P-3	(1,883,538)	(150,895)	1,732,643	(2,295,458)
P-4	(731,342)	(632,320)	99,022	(131,189)
UTC-1	$0.00	36,202	36,202	(47,961)
Uncontested Adjustments				
R-4	($812,389)	($812,389)	$0	$0
P-1	(92,149)	(302,312)	(210,162)	(278,429)
Total Impact of Adjustments			$2,597,965	($3,441,863)

As mentioned earlier in my testimony, Staff witness Panco reviewed Cascade's pro forma plant additions adjustment (P-3). Staff witness Panco's adjustment is two-fold, it not only increases net operating income by $1,732,643, as shown in Table 4, it also reduces the Company's rate base by $57,932,843[9], as shown in Table 5.

Table 5 – Rate Base Adjustments

Adjustment Number	Company	Staff	Change to Rate Base
Contested Adjustment			
P-3	$64,722,531	$6,789,688	($57,932,843)
Uncontested Adjustment			
R-4[10]	21,636,113	21,636,113	0
Total Impact of Adjustments			($57,932,843)

[8] Adjustment R-1 is identified as contested, although it is being adjusted by Staff to remove growth therms consistent with the removal of growth plant and revenue (*See* Panco, Exh. DJP-1T at 13). In this case, Staff is using 2019 EOP therms, the impact of this adjustment decreases net operating income as shown in Table 3. (Exh. KMH-7 is an illustration of the CRM adjustment, R-1). In addition, Staff is not contesting the methodology of the Company's decoupling mechanism; however, for consistency purposes, the 2019 therms need to be used. *See* Higby, Exh. ANH-5.

[9] This calculation is *after* the inclusion of accumulated depreciation and accumulated deferred income taxes.

[10] Staff witness White's adjustment, R-4 Restate EOP is uncontested and does not alter rate base itself. However, the adjustment does have an impact on Staff's revenue requirement calculation as a result of Staff's capital structure recommendation, as shown in Table 6.

Q. What is the impact of the rate base adjustments on Cascade's return on rate base and revenue requirement?

A. Table 6 shows the difference between the Company's and Staff's return on rate base calculation based on Cascade's and Staff's proposed plant additions and capital structure recommendations, respectively. The impact of each of these adjustments on revenue requirement is also shown.

Table 6 – Impact of Rate Base Adjustments on Revenue Requirement

Contested Adjustment				
Adjustment Number	Return on Rate Base Company	Return on Rate Base Staff	Difference	Revenue Requirement
P-3	$4,882,668	$470,457	($4,412,210)	($5,845,431)
Uncontested Adjustment				
R-4	1,632,228	1,499,166	(133,062)	(176,285)
		Total Impact of Adjustments	($4,545,272)	($6,021,716)

Q. Please describe the interest coordination adjustment.

A. The interest coordination adjustment, Adjustment P-1, (sometimes referred to as interest synchronization or the pro forma interest adjustment), revises the booked interest expense by multiplying the weighted cost of debt by the pro forma rate base to determine the pro forma interest expense. The purpose of this adjustment is to synchronize the effect of interest expense for the computation of income taxes associated with plant in service to the utility operations. The derived amount captures the proper federal income tax for ratemaking purposes.

Q. Please describe Staff's proposed changes to the pro forma interest coordination adjustment.

A. Staff does not contest the Company's calculation methodology. This adjustment is a pass-through and is adjusted or revised according to changes to rate base, capital structure, and weighted cost of debt. This adjustment calculates the tax effect on interest using Staff witness Parcell's recommended cost of capital of 6.93 percent, applied to Staff's recommended level of rate base.[11] The Company's adjustment reduces net operating income by $92,149, whereas Staff's adjustment reduces net operating income by $302,312. The difference between the Company's proposal and Staff's recommendation results from the change in the weighted average cost of debt and the level of rate base used in the calculation. Staff's interest coordination adjustment further decreases the Company's net operating income by $210,162, as shown in Table 4.

Q. Did Staff prepare an exhibit that illustrates the interest coordination adjustment?

A. Yes. Staff provides its interest coordination adjustment in Exh. KMH-9.

Q. You have referred to several adjustments in your testimony, did Staff prepare an exhibit summarizing these adjustments?

A. Yes. All adjustments proposed by Cascade and Staff are included in Exh. KMH-3. Exh. KMH-3 displays the proposed adjustments in columnar format identifying the specific adjustment, the revenues, the expenses, the net operating income, and the

[11] Staff witness Panco provides Staff's recommendation on pro forma rate base. Panco, Exh. DJP-1T at 12-20.

revenue requirement effect. All adjustments in Exh. KMH-3 and their impact on the revenue requirement flow through to the ROO Summary Sheet, Exh. KMH-2.

Q. Does this conclude your testimony?

A. Yes.