Docket No, UG-06____
Exhibit ____(DWS-1T)
Witness: David W. Stevens

BEFORE THE

WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

UG-06_____

GENERAL RATE APPLICATION

OF

CASCADE NATURAL GAS CORPORATION®
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February 14, 2006

Prepared Direct Testimony of
David W. Stevens

(Policy)

PREPARED TESTIMONY OF DAVID W. STEVENS
(POLICY)

I. INTRODUCTION

Q. Please state your name, employer and business address for the record.

A. My name is David W. Stevens and I am employed as the President and Chief Executive Officer of Cascade Natural Gas Corporation at 222 Fairview Avenue North, Seattle, Washington.

Q. Would you briefly describe your education and professional experience?

A. I graduated from the University of Texas at Austin in 1982 with a Bachelor of Science degree in Chemical Engineering. From 1982 to 1984, I was employed by Getty Oil Company as a Production Engineer. From 1984 to 2004, I was employed by Southern Union Company in various operational and executive capacities, including President and CEO of Panhandle Energy, a subsidiary of Southern Union Company; President and CEO of Energy Worx; Executive Vice President – Utility Operations for Southern Union Company and President of Southern Union Gas. I became President and CEO of Cascade Natural Gas Corporation on April 1, 2005.

I served on the board of directors for the Southern Gas Association, Intrastate Natural Gas Association of America and was on the president's counsel of the American Gas Association. I am also active in a number of community service associations.

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

A. I am testifying as the policy witness for the Company. I provide an overview of the Company and the primary factors driving the Company's need for general rate relief, and also briefly address some of the current and future challenges that are being faced by the Company, such as the need to expand and reinforce distribution system infrastructure to support Cascade's strong customer growth in Washington. I will also discuss the Company's Conservation Alliance Plan, which includes a decoupling mechanism and is part of the filing. Finally, I will describe the other witnesses testifying for the Company and the issues on which they will be testifying.

Q. Have you previously testified or sponsored testimony before utility commissions?

A. Yes. I have testified before regulatory bodies in the states of Alabama, Arkansas, New Mexico and Texas.

II. OVERVIEW OF CASCADE NATURAL GAS CORPORATION

Q. Please briefly describe Cascade Natural Gas Corporation.

A. Cascade provides natural gas service to approximately 235,000 customers in 93 communities in Washington and Oregon. Our diverse service territory covers more than 32,000 square miles. Cascade's Washington customers are served from three of our four operational regions: Western, which includes the Kitsap Peninsula, the Grays Harbor area, and Kelso/Longview; Northwest, which includes Bellingham, Mt. Vernon, and Oak Harbor/Anacortes; and Central, which includes the communities of Sunnyside, Wenatchee/Moses Lake, Tri-Cities, Walla Walla, and Yakima.

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Cascade is one of the fastest growing natural gas utilities in the nation. In the last five years, Cascade's customer base grew at a pace of 3 to 5%, which is significantly more than the national average. This high level of growth was made possible by the overall population growth in the Company's service area, and the low level of market saturation for natural gas in the Northwest.

Q. Please describe Cascade's current business focus.

A. Cascade's primary focus is providing safe and reliable natural gas distribution and related services to our customers throughout our service territories. We have worked hard to continuously improve these services and operate as efficiently as possible while diligently controlling expenses. We also focus on providing the highest value to all of our stakeholders, including customers, employees, and shareholders.

With the onset of new executive management in the past year, the Company implemented changes in our corporate culture, emphasizing the feasibility and profitability of our strong growth. Cascade has enacted measures to manage this strong growth while recognizing the decline in gas usage per customer due to conservation and more energy-efficient homes. We improved our analysis of economic feasibility to ensure we are accurately calculating the impact of adding customers. We also shifted our sales and marketing orientation to spend dollars only where we can measure results.

We have dedicated employees that continue to deliver high customer satisfaction. We continue to look for ways to realign tasks to make us even more responsive to customers. With the increase in natural gas prices over the past few years, we believe it is vital to focus on working with customers to encourage conservation while recognizing our responsibility to all stakeholders.

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Q. When did the Company last file for a general rate increase in Washington?

A. Cascade has not requested a general rate case increase in Washington since 1995. That rate case, Docket No. UG-951415, was based upon the twelve months ended December 31, 1994 as the test period. Cascade has been able to avoid seeking rate relief due to an internal culture of pursuing operating efficiencies prior to seeking regulatory assistance, and encouraging and facilitating strong customer growth during a period of relatively low interest rates. In addition, Cascade has implemented several operating efficiencies since the last rate increase that have helped control costs. Through these cost control efforts, we are able to serve more customers with fewer employees. Since the 1994 test period in the last rate case, Cascade's residential customer count has increased 60% and commercial customers have increased 32%. The number of employees, however, has decreased by 17% during this same period.

Q. Please describe these cost control efforts.

A. In 2002 the Company began converting from handheld meter reading to automated meter reading (AMR). The $16 million dollar investment allowed the Company to reduce its meter reading staff from 25 positions down to 5, which represents approximately $1.3 million per year in annual savings over the 2002 meter reading expense levels (approximately $1 million in Washington). Additionally, the technology allows the Company to grow without incurring additional meter reading expenses, which was estimated at an increase of 1 full-term equivalent (FTE) per year to keep up with the Company's growth. This increased FTE level would substantially increase meter reading costs from the 2002 level if the AMR equipment were not installed.

In 2003, the Company made significant changes in benefit plans for non-bargaining unit employees, which included the following:

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- Freezing accruals for salaried employees to the retirement plan (pension);
- Freezing accruals to the Executive Supplemental Retirement Income Plan (SERP);
- Increasing contributions to the 401(k) for salaried employees;
- Reducing benefits provided to salaried employees under the medical plan;
- Implementing market-level monthly contributions to the medical plan for salaried employees;
- Reducing medical benefits provided to retirees; and
- Implementing monthly contributions to the medical plan for retirees.

These changes resulted in the 2004 benefit expenses being approximately $5 million less than the 2003 level, thereby reducing the cost of Washington operations by about $3.9 million.

In January 2005, the Company began centralizing its customer service functions by removing these functions from its district offices to a centralized call center located in Bellingham. The consolidation, which was completed by the end of March 2005, is estimated to produce annual savings of approximately $800,000 (or approximately $600,000 for Washington operations).

III. COMPONENTS OF THE RATE REQUEST

Q. Why is it necessary for the Company to seek rate relief in Washington?

A. Rate relief is necessary because we have exhausted the readily available internal cost control remedies. We are currently facing financial pressures from three directions: revenue loss due to declines in gas usage per customer; costs arising from additional facilities required to continue to provide reliable and safe service in Washington; and cost increases in other areas beyond the Company's control. In addition, we are proposing to implement a number

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of other initiatives in this proceeding, including a "Safety and Reliability Infrastructure Adjustment Mechanism," a redesign of our industrial non-core rates, and a decoupling mechanism, which we call a Conservation Alliance Plan. A general rate filing is necessary in order to achieve a decoupling mechanism that will be best developed with input from all stakeholders.

Q. What increase is the Company seeking in this filing?

A. The Company's testimony and exhibits support the need for an $11.7 million annual revenue increase. This increase is based on a test year ended September 30, 2005; an average rate base of about $239 million; and an overall rate of return on rate base of 9.37 percent. The Company's request in this filing is for a 4.47 percent increase in overall revenue. By comparison, the Consumer Price Index has increased by 24.4 percent in the last ten years since the Company's previous Washington rate case.

Q. What are the additional investments in facilities that the Company is making in Washington in order to continue to provide reliable and safe service?

A. Cascade has experienced strong growth in our Washington service areas over the last twenty years. The result of this growth has created a need to expand the backbone in several of our service area distribution systems. The Company is projecting that it will need to invest more than $19 million in system reinforcement projects in Washington over the next five years.

Also, due to the age and condition of some of the pipe in Longview and Anacortes, Washington, Cascade will have to replace significant portions of these systems to ensure continued safe and reliable operations. Together with the replacement of some creek

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crossings, odorizing facilities and ground beds for cathodic protection, Cascade will need to invest over $15 million in replacement projects in Washington.

In addition, based upon the various municipal projects that are planned in our service areas, Cascade anticipates that we will be required to relocate our infrastructure at a cost of more than $1.8 million in Washington.

Q. How does the Company propose to recover these investments in rates?

A. Given this additional investment of approximately $37 million in non-revenue producing safety & reliability projects in Washington over the next five years, the Company would be compelled to continually file rate cases to keep up with these expenditures. Since rate cases have an expense which is amortized over some time frame, the ultimate cost to the consumer would likely be greater utilizing a conventional rate case methodology of recovery. These system upgrades are installed in the interests of safety and reliability. We believe a preferable approach for recovering the costs associated with these investments is our Safety and Reliability Infrastructure Adjustment Mechanism, or SRIAM, which we are proposing to implement in this proceeding. This mechanism will adjust rates annually to reflect the known and measurable investment in these non-revenue producing projects. The SRIAM will align Cascade's interests with its customers and the public. The testimony of Mr. F. Jay Cummings describes this proposed mechanism in much more detail.

Q. What are the Company's anticipated costs for new distribution mains and services?

A. In addition to the $37 million in Safety & Reliability projects in Washington, Cascade's obligation to serve creates the need to invest approximately $85 million over the next five years in new distribution mains and services (approximately $58 million in Washington). These investments in mains and services by themselves will strain the Company's ability to

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raise capital at reasonable costs, thus exposing customers to even higher rates. The Company must maintain its financial integrity to ensure that the necessary capital for these new systems can be raised at a reasonable cost. Given the Company's capital requirements over the next five years, it is essential that the Company be provided a reasonable opportunity to earn a fair rate of return to enable these investments to be financed on favorable terms which results in lower rates for customers over the long term.

Q. Please describe the Company's Conservation Alliance Plan and decoupling initiative.

A. Under current regulation, Cascade's ability to recover our fixed cost has been tied to the volume of gas sales. Expected gas sales are set in the general rate proceeding based on consumption per customer during a test period and then adjusted for "normal" weather. The time lag between the rate case being fully processed and the use-per-customer information is almost two years. Any conservation measures installed by customers in the intervening period and any weather that is warmer than the "normal" applied in the rate case causes Cascade to under-recover our fixed cost.

To remedy the under-recovery of the Company's costs and better align ourselves with our customers in their efforts to conserve, Cascade has developed a rate stabilization mechanism that will decouple fixed-cost recovery from volume. We will be able to promote conservation without fear of being unable to provide a fair return to shareholders. Mr. Jon Stoltz will further explain our proposal, which has been evaluated both during the Commission's rulemaking on decoupling and Cascade's previous filing of its Conservation Alliance Plan.

Q. Please describe the other issues addressed in the Company's filing.

A. Our filing also includes proposals for addressing weather normalization, as well as new initiatives for low-income assistance and in the calculation of service charges.

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Q. Please briefly describe the Company's proposed approach for calculating the weather normalization adjustment.

A. The selection of "normal" in a weather normalization methodology should create a situation where the utility will have an equal opportunity to gain or to lose from the methodology. The currently accepted selection of "normal" relies on the 30-year arithmetic mean or average to define "normal" for Heating Degree Days (HDDs), using data provided by the National Oceanographic and Atmospheric Administration (NOAA). This creates a situation where the utility is much more likely to lose than to gain.

Cascade has retained State Climatologist Dr. Philip Mote to help the parties in the general rate case understand and decide on an improved selection of the appropriate HDDs to be used as "normal" in the weather normalization adjustment. In his testimony, Dr. Mote discusses observed warming in the Pacific Northwest climate, indicating that the currently used NOAA 30-year average is not a plausible expectation for HDDs for the next few years.

Q. Please describe the Company's proposed customer assistance program.

A. As part of our case, Cascade is proposing to provide $800,000 to the community service agencies in our service area for low-income bill payment and weatherization programs, as described in the testimony of Ms. Barnard. In connection with this additional assistance, however, we propose to implement new measures to ensure that low-income assistance is provided primarily for the benefit of customers who simply do not have the means to pay. In our experience, some customers who are able to pay choose instead to invoke their rights under the Commission's "prior obligation" rule. Under this rule, the Company cannot refuse service to a customer due to an outstanding ("prior") obligation. When the Company disconnects service for non-payment, the balance owing is considered a prior obligation and

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the Company can no longer withhold service because the applicant's balance remains unpaid. The Company is obligated to reinstate service with the payment of a deposit (limited to 2/12 of estimated annual billings) regardless of the customer's financial status and ability to pay. That deposit may not be applied to the outstanding debt and can only be applied to future outstanding bills. During the winter months, when combined with the turn-off notice requirements, the deposit is seldom enough to cover the customer's outstanding balance.

In connection with our additional funding for low-income programs in this case, we are seeking a waiver of the "prior obligation" rule to ensure that Cascade's proposed low-income programs provide benefits to those in need.

Q. Please briefly describe Cascade's proposed changes to service charges.

A. Cascade will propose to modernize rates on a variety of service charges to recognize current business practices, align fees to expenses incurred, and make the practice fairer to those customers not needing the services. Some examples are the Company's connect fee, returned check fee, late fee, seasonal turn-on, etc. Cascade has evaluated both internal expenses to provide the service as well as other Washington utility fees for these sorts of services. Mr. Jon Stoltz will explain these fee adjustments in his testimony.

IV. THE COMPANY'S DIRECT CASE

Q. Please identify the witnesses testifying for the Company in its direct case.

A. <u>Dr. Roger A. Morin</u>, Professor of Finance at the College of Business, Georgia State University and Professor of Finance for Regulated Industry at the Center for the Study of Regulated Industry at Georgia State University, has provided Cost of Capital testimony and exhibits supporting his recommendations for a reasonable ROE and for a proposed equity ratio.

Mr. Philip W. Mote, Washington State Climatologist, has provided testimony and exhibits supporting his recommendations concerning the establishment of reasonable "normal" Heating Degree Days (HDDs) for use in the Company's Weather Normalization restatement.

Mr. Lamar Maxwell Dickey of the consulting firm Threshold Associates, Inc., has provided testimony and exhibits supporting his Cost of Service allocation study.

Mr. F. Jay Cummings of the consulting firm Ruhter & Reynolds has provided testimony and exhibits supporting his recommendation for the establishment of a Safety and Reliability Infrastructure Adjustment Mechanism.

In addition to myself, Cascade employees Mr. Jon T. Stoltz, Senior Vice President, Regulatory and Gas Supply has provided testimony and exhibits including a summary schedule of all adjustments contained in this application; testimony and exhibits supporting several restating and proforma adjustments, removal of non-core competitive services revenues and cost, a weather normalization adjustment, estimated rate case expense, revenue under proposed rates, change in rate spread and rate design, and changes in rates for other services and fees;

Ms. Katherine J. Barnard, Senior Director, Regulatory Affairs has provided testimony and exhibits supporting several restating and proforma adjustments.

Mr. James Haug, Controller has provided testimony and exhibits supporting changes in Income Tax on Proforma Capitalization; and

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Mr. Matthew D. McArthur, Treasurer has provided testimony and exhibits supporting the Company's Cost of Debt.

Q. Does this conclude your testimony?

A. Yes.

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