**Exhibit No. __ (MPP-1T)**
**Docket No. UG-19____**
**Witness: Michael P. Parvinen**

**BEFORE THE**
**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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| WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,<br>Complainant,<br><br>v.<br><br>CASCADE NATURAL GAS CORPORATION,<br><br>Respondent. | DOCKET UG-19______ |

**CASCADE NATURAL GAS CORPORATION**

**DIRECT TESTIMONY OF MICHAEL P. PARVINEN**

**March 29, 2019**

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## I. INTRODUCTION

**Q. Please state your name and business address.**

A. My name is Michael P. Parvinen. My business address is 8113 W. Grandridge Blvd., Kennewick, Washington 99336-7166. My e-mail address is michael.parvinen@cngc.com.

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

A. I am employed by Cascade Natural Gas Corporation ("Cascade" or "Company") as the Director of Regulatory Affairs. In this capacity, I am responsible for the management of all economic regulatory functions at the Company.

**Q. How long have you been employed by Cascade?**

A. I have been employed by Cascade since September 2011. Prior to joining Cascade, I was employed by the Washington Utilities and Transportation Commission ("WUTC" or "Commission") for nearly 25 years. I was employed as a Regulatory Analyst, later as a Deputy Assistant Director, and lastly as the Assistant Director of the Energy Section.

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

A. I graduated from Montana College of Mineral Science and Technology in May of 1986, with a Bachelor of Science degree in Business Administration with an emphasis in accounting.

I have testified numerous times before both the WUTC and the Public Utility Commission of Oregon ("OPUC"). I have also analyzed or assisted in the analyses of numerous other utility rate filings and participated in many utility rulemaking proceedings before the WUTC. Finally, I attended the Seventh Annual Western Utility

Rate Seminar in 1987 and the 1988 Annual Regulatory Studies Program, sponsored by the National Association of Regulatory Utility Commissioners.

## II. SCOPE AND SUMMARY OF TESTIMONY

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

A. My testimony will cover several areas. First, I will address the impact of regulatory lag on the Company and describe the Company's proposals in this case to mitigate the impact of regulatory lag. Second, I will also address the calculation of working capital that the Company has proposed for inclusion in its revenue requirement in this case. Third, I will address the conservation targets included in the settlement approved by the Commission in Docket UG-152286 and describe why the targets are no longer necessary nor appropriate.

**Q. Are you sponsoring any exhibits in this proceeding?**

A. Yes. I am sponsoring the following exhibits, which are described later in my testimony:

Exhibit No. __ (MPP-2)

Exhibit No. __ (MPP-3)

Exhibit No. __ (MPP-4)

## III. REGULATORY LAG AND COMPANY PROPOSAL

**Q. Please describe what is meant by the term regulatory lag.**

A. Regulatory lag refers to financial impact on the utility caused by the timing difference between when investments and costs are incurred and when they are recognized in rates. For example, if the Company replaces a distribution facility in March 2018, but does not file a rate case until March 2019, and rates from the case are not effective for another eleven months, the Company will bear the full cost of the investment for a 23-

month period. Even if the Company files annual rate cases, there can be a substantial lag between the timing of an investment and its inclusion in rates, after accounting for the use of a historical test period with limited pro forma capital additions and the suspension period. Because of these effects, regulatory lag typically erodes a utility's earning, particularly when rates are set using historical test periods.

In addition, regulatory lag can warp the price signal sent to customers because the delay in cost recovery means that customers make conservation and investment decisions based on historic and inaccurate costs and perhaps delay or suspend acquisition of more efficient equipment. This can be harmful to customers who should understand the full cost of the services provided to them.

**Q. How can utilities reduce the impact of regulatory lag?**

A. From a utility perspective, a company can file frequent rate cases. But, as noted above, even that approach does not fully mitigate the impact of regulatory lag. A company can also try to reduce expenses to offset the impact of regulatory lag and reduce investment on non-revenue producing investments.[1] However, cost management strategies to combat regulatory lag are largely insufficient during periods when the utility continues to make capital investments because the cost savings are overwhelmed by the unrealized returns associated with in-period capital investment. A utility can also try to reduce the costs associated with adding new customers so that the revenue generated by the new customers offset the increased costs that are not yet in rates. Unfortunately, this strategy relies on a utility's ability to find savings in the cost of line

[1] Typically, if an investment generates revenues, those revenues are also subject to regulatory lag and can offset the impact of regulatory lag on the investment.

extensions to new customers that are not passed on to customers.

**Q. Has Cascade taken actions to mitigate the impact of regulatory lag?**

A. Yes—although these actions have not been sufficient to address the continued regulatory lag experience. As Company witness Ms. Nicole Kivisto describes in her testimony, the Company works diligently to reduce expenses to the extent it can and has been successful in many ways. However, as Ms. Kivisto also points out, Cascade continues to make substantial investments to maintain a safe and reliable distribution to serve customers. These investments far exceed cost savings and, with delayed cost recovery because of regulatory lag, the investments make current revenues insufficient to provide an opportunity to earn an adequate return.

Cascade also modified its line extension policy in Docket UG-160967 to essentially allow a longer payback of initial investment by new customers. The line extension modification was intended to help expand natural gas into unserved and underserved areas, based on the recognition that the direct use of natural gas is a more efficient alternative to building natural-gas-fired electric generation to meet increased electric loads. As a result, adding customers creates a revenue shortfall in the early years as recovery of the investment is deferred, thereby compounding the negative impact of regulatory lag.

**Q. Can the Company prudently avoid making ongoing capital investments in its distribution system, in order to reduce the impact of regulatory lag?**

A. No. Cascade believes that its ongoing investments in its distribution system are required to prudently manage its system. Cascade takes its obligation to provide a safe and reliable system very seriously and that obligation requires the Company to continually monitor its seventy-year-old system and proactively replace facilities that have reached the end of their useful life and make necessary upgrades to ensure the continued provision of safe and reliable service. And the need to continually invest in these improvements inevitably results in regulatory lag.

**Q. But doesn't the Company already have a Cost Recovery Mechanism for Pipeline Replacement (CRM) that allows Cascade annual recovery of certain system investments, to reduce regulatory lag?**

A. Yes. The Company does have a CRM that allows for annual recovery of certain capital investments. However, the CRM is limited to investments that have been identified through the current Distribution Integrity Management Plan ("DIMP") which focusses on the highest priority system integrity projects. As evidenced by the significant pro forma capital additions included in this case, much of the Company's investment is directed to upgrading the system to ensure continued reliability and those investments are not recovered through the CRM.

**Q. What is Cascade's proposal in this case to address regulatory lag?**

A. Cascade requests approval to use an end-of-year or end-of-period ("EOP") calculation of all rate base items—except for working capital—depreciation expense and number of customers.

**Q. Why is the Company *not* proposing to use EOP for working capital?**

A. The Company is not proposing to use an EOP approach to working capital because this approach would not lead to a representative level of working capital for the expected rate year. I will provide a more detailed explanation later in my testimony.

**Q. Why does the Company request using EOP balances for rate base, depreciation expense, and revenue based on the end-of-year customer count?**

A We make this request to better match the rate base, depreciation expense, and revenue with the year in which new rates (rate year) will be in effect.

**Q. How does the Company's proposal more closely match the rate year?**

A. Using balances at the end of the test period better reflects conditions that will exist during the rate year. For example, the number of customers at the end of the test period is more likely to match the number of customers during the rate year, as compared to the number of customers at the beginning of the test period. The same is true for rate base balances—because the end of the test year is closer in time to the rate year, it better reflects the actual conditions and plant balances that will exist when rates are in effect.

If, instead of using EOP for these items the Company were to use the average of monthly averages ("AMA") calculation, then, for example, a customer added in December of the test year, the test period would include only one month's worth of revenue from that customer. Similarly, if a plant investment came into service in December, the test period rate base balance would include only one month's worth of costs for that new plant investment. But in both cases, the new customer would be served for the entire rate year and the new plant would be in-service for the entire rate year.

**Q. Given that EOP rate base assumes that the investments made in the test year are in service the entire year, does the Company's proposal treat the corresponding revenues in the same fashion?**

A. Yes. Because the investment is treated as if it were in service for the entire year, the Company's proposal assumes that the revenues generated by that investment were received by the Company for the entire year. In this way, the Company's proposal appropriately matches rate base and revenues.

**Q. Why is the depreciation expense adjusted based on EOP plant?**

A. Again, this is done in order to properly match the depreciation expense with the investment and the revenues. A potential problem with using EOP rate base is that it can distort the test period relationships when only one element is based on EOP balances. The Company's approach here reasonably addresses that concern by using EOP balances for rate base, depreciation expense and customer-count-dependent revenue.

**Q. Could the same argument be made for all expenses?**

A. Theoretically yes. However, Cascade has used traditional pro forma adjustments for major known and measurable changes and even though one could argue that most expenses are subject to consumer price index ("CPI") increases, Cascade is willing to accept the regulatory lag associated with these cost pressures.

**Q. Has the Commission accepted the use of EOP rate base in other proceedings?**

A. Yes. The Commission has recognized that using EOP rate base is one effective tool for reducing regulatory lag and has accepted EOP rate base in many recent rate cases filed by Puget Sound Energy, Avista, and PacifiCorp. In this way, the use of EOP rate base has been regularly used to help alleviate regulatory lag. In fact, in Cascade's last rate case the Commission specifically suggested using EOP rate base to mitigate regulatory lag.[2] In this way, Cascade is responding directly to the Commission's suggestion.

**Q. What is the impact of the Company's EOP adjustment?**

A. As can be seen in Exhibit ____(MCP-5), column R-4, entitled "Restate End of Year", the company is proposing additional revenues of $678,910. These revenues are calculated and described in the testimony of Isaac D. Myhrum Exhibit (IDM-1T). The depreciation expense adjustment is calculated by annualizing the depreciation expense applied to the end of period plant and appears in witness Maryalice Peters Exhibit ____(MCP-5), column R-4, entitled "Restate End of Year". The rate base adjustment is found in Ms. Peter's rate base work papers. The net impact of the "Restate End of Year" adjustment is a revenue requirement increase of $4,392,576.

**Q. Earlier, you said that you did not propose an EOP adjustment for working capital because this approach would not lead to an amount representative of the rate year. Please explain why.**

A. Working capital represents the amount of funds provided by shareholders to run the day-to-day operations of the business. The amount of working capital over the course of a year can include many increases and decreases and is typically a more volatile figure than, for example, rate base or customer count. Because working capital balances are more volatile it makes sense to use a yearly average, instead of a single point in time, which is unlikely to reflect the actual working capital balance during the rate year.

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[2] *Wash. Utils. & Transp. Comm'n v. Cascade Nat. Gas Corp.*, Docket UG-170929, Order 06, ¶ 37 (July 20, 2018).

**Q. Have you prepared an exhibit demonstrating the volatility associated with trying to use a point in time calculation for working capital?**

A. Yes. Exhibit ____ (MPP-2) shows a summary of each month of total working capital (prior to allocation to states). The AMA calculation is shown at the top. This exhibit shows that using a single point in time is problematic and not representative of the rate year.

**Q. You mentioned earlier in your testimony that the Enbridge explosion had an impact on the monthly working capital calculation. Can you explain this further?**

A. Yes. Because of the Enbridge explosion, Cascade's gas costs incurred in December 2018 were approximately $25 million more than the amount included in customers' rates—meaning that the accounts payable for gas costs were $25 million higher than they otherwise would have been. Also, deferred gas costs were $25 million more than they otherwise would have been. The impact was to reduce working capital on a standalone basis by $25 million.

**Q. How did Cascade pay for the increased gas costs and how would that impact the working capital calculation?**

A. In January 2019, Cascade acquired $30 million of short-term debt to pay for the gas costs accrued in December 2018 and expected gas costs incurred in January. The impact of the transaction would be an increase in debt and a reduction to the gas costs accounts payable. The standalone impact would be an increase in working capital of $30 million. These two events, the $25 million in accounts payable in 2018 and the $30 million of acquired debt to cover the December gas costs, illustrate why a one-month point in time look does not present an accurate picture of working capital. To make the working capital adjustment representative of the Company's actual circumstances, the working capital calculation should consider the whole cycle of transactions during the test year. Therefore, the AMA-based result presented in my Exhibit ____ (MPP-2), portrays the most appropriate picture of Cascade's working capital.

**Q. If the Commission were to require all components of rate base to match and thus require EOP working capital, would an adjustment to reflect the impact of the Enbridge explosion be appropriate?**

A. Yes. As demonstrated earlier regarding the timing of the event on increased gas costs and the payment of such gas costs an adjustment would be required.

**Q. Is there Commission precedent accepting an adjustment to the balance sheet for purposes of calculating working capital?**

A. Yes. In Docket UG-920840, the Commission accepted a company proposal to adjust the balance sheet for a known and measurable event.

**Q. Is Cascade proposing any other adjustments impacting revenue requirement to address regulatory lag?**

A. Yes. Cascade is proposing a return on equity that incorporates factors such as regulatory lag. Ms. Bulkley testifies that a reasonable return on equity for Cascade is 10.30 percent and that the 10.3 percent recommendation is based on regulatory risk including regulatory lag.

**Q. Has Cascade quantified the impacts of regulatory lag on the Company?**

A. Yes. Cascade has attempted two separate calculations to identify the amount of regulatory lag it has experienced and will experience.

**Q. Please describe the quantification of the lag that Cascade has experienced.**

A. Exhibit ____ (MPP-3) provides such quantification,

**Q. Can you please describe Exhibit ____ (MPP-3)?**

A. This exhibit shows the results of operations since 2015 based on the Commission Basis Reports (CBRs) filed with the Commission along with the 2018 per books results included in this filing. I then compared the results to the Company's most recent authorized rate of return to determine the annual deficiency. I then calculated the average annual deficiency over the last four years to be $3,326,927.

**Q. Can you now describe how Cascade will experience regulatory lag as a result of this rate case?**

A. Yes. Even with the acceptance of the Company's proposed Pro Forma Plant Additions adjustment there is additional 2019 investment that will not be included in rates until some future rate case. Cascade, in Exhibit ___(MPP-4), provides a calculation of the revenue requirement on projected 2019 investments not addressed elsewhere.

**Q. Can you elaborate on what you mean by investment not already addressed elsewhere?**

A. Yes. I start with the capital additions forecast to be completed in 2019 and in service prior to rates going into effect. I then reduce the total investment by those projects included in Cascade's proposed pro forma capital addition adjustment sponsored by Ms. Peters. I further reduce the 2019 investment by those projects that will be included in the annual Pipeline Cost Recovery Mechanism. Finally, and in order to recognize added new customers, I further reduce the adjusted total by recognizing growth related projects as the additional revenues these projects are expected to produce will at least partially offset the return on the added investment.

**Q. What is the result of this analysis?**

A. The calculation shows that the revenue requirement associated with proposed 2019 investment that will not be recovered by the time rates go into effect is $1,830,212.

**Q. If the Commission doesn't accept the Company's full pro forma plant adjustment is the regulatory lag further compounded?**

A. Absolutely. The total 2019 investment doesn't change, so any change to the allowed recovery of projects increases the category of costs not recovered when rates go into effect.

**Q. Based on the amount of regulatory lag identified in the exhibit, how much of an equity increase would be needed to provide recovery of the investment?**

A. Approximately 70 basis points.

## IV. REMOVAL OF CONSERVATION TARGET COMMITMENT FROM DOCKET UG-152286

**Q. What is Cascade's recommendation regarding the conservation target commitment approved by the Commission in Docket UG-152286?**

A. Cascade recommends that it be relieved of its commitment. The Company has worked hard to develop a comprehensive conservation program and the commitment to meeting the identified target approved years ago is no longer necessary.

**Q. Please describe the Cascade conservation targets commitment that was approved as part of the settlement in Docket UG-152286.**

A. In the Stipulation approved in UG-152286, Cascade agreed to take a number of actions relevant to its conservation efforts. Cascade agreed to file an annual plan, submit an annual report, hold quarterly advisory group meetings, provide advance notice of all filings to the Conservation Advisory Group (CAG), and develop a framework for analyzing Cascade's conservation program, and in addition, the Company agreed to meet 100 percent of its annual conservation target.

**Q. What is the status of Cascade's commitment to all these components?**

A. Cascade and the members of the CAG have worked hard to address and meet all the identified commitments. The relationship among the CAG members is solid, discussions are open and frank, information is openly shared, and plans are vetted and agreed upon. At the end of the process, the Company's conservation programs are designed with the CAG's full input and evaluation. However, despite diligent efforts, Cascade has been unable to meet 100 percent of its conservation targets.

**Q. Why has the Company not been able to meet its conservation targets?**

A. Cascade believes that this is true for two reasons. The first is that the conservation targets—up until very recently—have not been realistic. These targets were identified based on a study that was performed in 2014and the methods used to get to the actual target were out of date and not consistent with the CAG's preference. The second reason the Company has not been able to meet its conservation targets is that achievement of these targets is largely a function of customer decision-making that we cannot control. Therefore, regardless of how the Company may work to achieve a target, customer behavior will always have a significant impact.

**Q. Has the Company recently adopted new targets?**

A. Yes. Just this year, the Company hired a third-party consultant to develop a Conservation Potential Assessment to provide more realistic targets. Specifically, the assessment evaluates our service territory, current and historical conservation programs, economics, avoided costs, saturation of programs, new technologies, etc. to determine how much conservation is available in any given year. Based on this work, the Company now has updated targets for 2019.

**Q. Given the updated targets, does Cascade believe that it may be appropriate to require the Company to meet them?**

A. No, I do not. While the targets are more realistic, the bottom line is that a utility can do everything reasonably possible to support achievement of the targets, but the utility cannot control customer behavior, and targets may be missed nonetheless. Moreover, Cascade believes that the condition requiring Cascade to meet 100 percent of its targets has had the intended effect of focusing Cascade's efforts on working with the parties to improve its conservation programs and processes. However, that goal has been achieved, and it is no longer appropriate to maintain a requirement that Cascade meet the targets.

**Q. Are any of the other LDCs in Washington required to meet their conservation targets?**

A. No.

**Q. Does this conclude your testimony?**

A. Yes, it does.