BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION Complainant, v. CASCADE NATURAL GAS CORPORATION Respondent.	DOCKET UG-170929

RESPONSE TESTIMONY OF BRADLEY G. MULLINS

ON BEHALF OF

THE NORTHWEST INDUSTRIAL GAS USERS

February 15, 2018

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I. INTRODUCTION AND SUMMARY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Bradley G. Mullins, and my business address is 333 SW Taylor Street, Suite 400, Portland, Oregon 97204.

Q. PLEASE STATE YOUR OCCUPATION AND ON WHOSE BEHALF YOU ARE TESTIFYING.

A. I am an independent energy and utilities consultant representing large energy consumers before state regulatory commissions, primarily in the Western United States. I am appearing in this matter on behalf of the Northwest Industrial Gas Users ("NWIGU"). NWIGU is a non-profit trade association whose members are sales and transportation customers of local distribution companies located throughout the Pacific Northwest, including gas customers of Cascade Natural Gas Corporation ("Cascade" or "Company").

Q. PLEASE SUMMARIZE YOUR EDUCATION AND WORK EXPERIENCE.

A. I have a Master of Accounting degree from the University of Utah. After obtaining my master's degree, I worked at Deloitte in San Jose, California, where I specialized in performing research and development tax credit studies. I later worked at PacifiCorp as an analyst involved in power cost forecasting. I began performing independent energy and utility consulting in September 2013 and currently provide services to utility customers on matters such as revenue requirement, power cost forecasting, and rate spread and design. I have sponsored testimony in several regulatory jurisdictions around the United States, including before the Washington Utilities and Transportation Commission (the "Commission"). A list of cases where I have submitted testimony can be found in Exh. BGM-2.

1 **Q. WHAT IS THE PURPOSE OF YOUR RESPONSE TESTIMONY?**

2 A. I discuss my review of Cascade's request for authority to increase charges and rates for
3 natural gas service by approximately $5.9 million, or 2.71% in base rates, effective
4 August 1, 2017.[1]

5 **Q. WHAT WAS THE SCOPE OF YOUR REVIEW?**

6 A. I reviewed the Direct Testimony of Cascade, including the workpapers that it submitted
7 with its filing. I also reviewed Cascade's responses to discovery requests submitted by
8 NWIGU and other parties to this proceeding. Finally, I performed an independent
9 analysis of Cascade's revenue requirement, which may be found at Exh. BGM-3.

10 **Q. BASED UPON YOUR REVIEW, WHAT ARE YOUR RECOMMENDATIONS**
11 **AND CONCLUSIONS?**

12 A. In contrast to Cascade's request for increased revenues, I show that it would be
13 appropriate for the Commission to require Cascades to reduce its rates for natural gas
14 services, particularly after taking the Tax Cuts and Jobs Act into consideration. My
15 revenue requirement analysis shows Cascade is in a position of revenue *sufficiency* in the
16 amount of $5,888,124. Based on my analysis, I recommend the Commission require
17 Cascade to reduce its rates by 2.7% beginning August 1, 2018. In Table 1, below, I detail
18 a step-study between the revenue requirement included in the Company's initial filing
19 and the revenue requirement calculated in my analysis. Brief issue summaries follow the
20 table.

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[1] Order 1, Complaint and Order Suspending Tariff Revisions ¶1 (Sep. 14, 2017).

TABLE 1

Washington Revenue Requirement Impacts of Recommendations ($000)
Based on a 9.4% Return on Equity

Ln	Adj. No.	Description	----- $000 -----	
1		**Cascade Initial Filing**		**5,885**
2		**Recommended Adjustments**		
3	*n/a*	Apply 9.4% ROE	(1,211)	
4	*PF-3*	Pro Forma Plant Additions	(2,076)	
5	*M-1*	Supplemental Executive Retirement Plan	(572)	
6	*M-2*	Affiliate Bonus Payments	(1,190)	
7	*M-3*	Employee Arbitration Contingency	(221)	
8	*P-4*	Rate Case Costs	(214)	
9	*P-1*	Interest Coordination	189	
10	*TCJA-1*	Restate Tax Expense	(3,731)	
11	*TCJA-2*	EDFIT Amortization	(1,071)	
12	*TCJA-3*	Tax Deferral 1/1/18 - 7/31/18	(1,573)	
13	*TCJA-4*	Update Conversion Factor	(105)	
14		**Total Adjustments**		**(11,773)**
15		**Initial Recommendation**		**(5,888)**

1 Revenue Requirement Adjustments:

2 • *Pro Forma Plant Additions.* I recommend including only one post-test period
3 plant addition in revenue requirement.

4 • *Supplemental Executive Retirement Plan.* I recommend removing all test-period
5 accruals associated with Cascade's Supplemental Executive Retirement Plan.

6 • *Affiliate Bonuses Payments.* I recommend removing the cost of incentive awards
7 allocated from affiliates, since Cascade has been unable to demonstrate that
8 those amounts benefit ratepayers.

9 • *Employee Arbitration Contingency.* I recommend removing a contingent
10 liability related to a legal matter between the Company and one of its former
11 employees.

12 • *Rate Case Costs.* I recommend calculating the pro forma adjustment for rate
13 case costs using an annual average value, in contrast to Cascade's method, which
14 compresses two years' worth of rate case costs into a single test year.

Tax Cuts and Jobs Act Adjustments:

- *TCJA 1 – Restated Tax Expense.* I recommend restating tax expense using the 21% Federal income tax rate, rather than the 35% rate assumed in Cascade's filing.
- *TCJA 2 – Excess Deferred Federal Income Taxes.* I recommend including amortization of Excess Deferred Federal Income Taxes in revenue requirement, pursuant to new tax normalization requirements.
- *TCJA 3 – TCJA Deferral Jan 1, 2018 – July 31, 2018.* I recommend creating a deferred account for excess income tax collected in rates prior to the rate effective date of this docket. I also recommend amortizing that account over the two year period beginning August 1, 2018.
- *TCJA 4 - Conversion Factor.* I recommend using a revenue conversion factor that is based upon the 21% Federal income tax rate, rather than the 35% rate assumed in Cascade's filing.

II. REVENUE REQUIREMENT ADJUSTMENTS

a. Post Test Year, Pro Forma Plant Additions

Q. WHAT PRO FORMA PLANT ADDITIONS HAS CASCADE INCLUDED IN ITS FILING?

A. Through pro forma adjustment P-2, Cascade proposes to include 52 capital projects in results on a post-test period basis. The list of projects Cascade proposes for inclusion on a post-test period basis may be found at Company Exh. MPP-6. In that exhibit, Cascade provides a list of budgeted capital expenditures. The budget consists of a range of projects with projected in service dates as early as 9/30/2016 and as distant as 12/31/2025. Cascade then performed a screening analysis, where it removed any project meeting one of the following criteria: 1) blanket projects (i.e. routine capital projects, not associated with any discrete addition); 2) projects recoverable through the Cost Recovery Mechanism ("CRM"); 3) growth, or revenue producing projects; 4) projects beyond 2017; and 5) projects with no support. The resultant list of capital projects that Cascade

1 requests for inclusion in revenue requirement on a post-test period include projects
2 forecast to be placed into service over the period 9/30/2016 through 12/31/2017. In
3 addition, the list of capital projects range in size from just $222 to $4,929,287. Exh.
4 MPP-6 also contains brief narrative descriptions for the respective projects.

5 **Q. WHAT IS YOUR UNDERSTANDING OF THE COMMISSION'S PAST**
6 **PRACTICE WITH RESPECT TO POST-TEST PERIOD CAPITAL ADDITIONS?**

7 A. The Commission's policy on pro forma capital additions has been established over a long
8 series of contested proceedings, extending back several decades. In the Pacific Power
9 2014 general rate case, the Commission reaffirmed its policy on pro forma capital
10 additions, stating that its "long-standing practice is to consider post-test-year capital
11 additions on a case-by-case basis following the used and useful and known and
12 measurable standards while exercising the considerable discretion these standards allow
13 in the context of individual cases."[2] According to the Commission, "[t]his approach
14 provides the Commission with flexibility when evaluating relevant factors without being
15 confined by 'too rigid an approach' through a consistent, bright-line standard."[3]

16 In addition, only *major* pro forma plant additions have been allowed on a post-
17 test-year basis. The projects that the Commission has approved in the past have
18 represented major additions of discrete pieces of property, such as a fish passage along
19 the Lewis River and construction of a new cooling tower at the Jim Bridger Power plant.

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2 *WUTC v. Pacific Power*, Dockets UE-140762 *et al.*, Order 08 at ¶165 (*citing WUTC v. PacifiCorp*, Docket UE-130043, Order 05 at ¶ 198 (Dec. 4, 2013)).

3 *Id.* (*citing* Docket UE-130043, Order 05 at ¶¶ 198-199).

1 **Q. WHY IS IT APPROPRIATE TO CONSIDER ONLY *MAJOR* PLANT**
2 **ADDITIONS ON A POST-TEST PERIOD BASIS?**

3 A. Rate base is established in the context of a long-term depreciation study, not in the
4 context of individual retirements and additions. Over time, gross plant might grow as
5 new facilities are built and old ones replaced. Depreciation reserves, however, also grow,
6 in a manner taking into consideration the way property is expected to retire over time.
7 Accordingly, when performing rate base valuation, there is an inherent *matching*
8 *principle* requiring gross plant balances and depreciation reserve balances to be
9 calculated at the same point in time.

10 Consideration of a post-test period plant addition, however, is a departure from a
11 ridged application of that matching principle. Since the Commission's policy on post-test
12 period capital additions represents a loosening of the matching principle, it is necessary to
13 limit the types of plant additions that are considered on a post-test period basis to avoid
14 using patently mis-matched gross plant and depreciation reserve balances.

15 **Q. CAN YOU PROVIDE AN EXAMPLE TO ILLUSTRATE YOUR POINT?**

16 A. Yes. One could adopt an expansive view of post-test period plant additions, and include
17 each and every plant addition placed in service on a post-test period basis. Doing so,
18 however, would produce a plain mis-match between gross plant and depreciation reserve
19 balances in the rate base valuations. If this expansive view were adopted in this case, and
20 each and every capital addition identified in Exh. MPP-6 in gross plant were included in
21 gross plant, the gross plant balance would be effectively stated on an end-of-period,
22 December 31, 2017 basis. The corresponding depreciation reserve, however, would

1 continue to be stated on an average-of-monthly-averages basis for the twelve months
2 ending December 31, 2016. This sort of plain mis-match between the gross plant and
3 depreciation reserve balances should be avoided, however, as it creates a potential
4 windfall to the Company at the expense of ratepayers. If an end-of period, December 31,
5 2017 balance were to be used for rate base, then it would also be necessary to roll-
6 forward the entirety of the depreciation reserve balance to be based on a December 31,
7 2017 balance, as well.

8 If the analysis is focused instead on discrete, abnormally large projects, the gross
9 plant balance can still reasonably be considered a December 31, 2016 balance, albeit
10 adjusted for the discrete, major project. Thus, by limiting the analysis to major projects,
11 it is possible to adhere to the matching principle, while still addressing regulatory lag that
12 might result when a large project goes into service immediately after the test period used
13 in a rate case.

14 **Q. ARE THE BRIEF NARRATIVE DESCRIPTIONS INCLUDED IN COMPANY**
15 **EXH. MPP-6 SUFFICIENT TO INCLUDE THOSE ASSETS IN RATE BASE?**

16 A. No. The brief narrative descriptions found in Exh. MPP-6 are not sufficient to be able to
17 consider the projects on a post-test period basis. In the past, the Commission has
18 explicitly rejected projects that were only supported by brief narrative descriptions,
19 stating in the Pacific Power 2014 general rate case that "[t]he brief descriptions of these
20 25 projects, supported by another two pages of data showing anticipated in-service dates

1 and cost estimates, simply do nothing to establish that the projects should be added to rate

2 base."[4]

3 **Q. ARE ANY OF THE PROJECTS CASCADE IDENTIFIED APPROPRIATELY**
4 **CONSIDERED *MAJOR* PLANT ADDITIONS?**

5 A. Of the projects identified in Exh. MPP-6, only one appears to be even close to the level
6 that has historically been reviewed by the Commission on a post-test period basis. The
7 project titled: "6" Steel HP Main, Kennewick/Rick" (the "Richland Project") was for
8 capital in the amount of $4,929,287.

9 **Q. WHAT HAVE YOU CONCLUDED BASED ON YOUR REVIEW OF THE**
10 **RICHLAND PROJECT?**

11 A. Not much. In Exh. MPP-6, the description stated "The reinforcement addresses the lack
12 of adequate distribution capacity to serve core customers in downtown Richland as the
13 company experienced very low pressure conditions in Richland during extreme cold
14 weather in early January 2017. This reinforcement will also accommodate additional
15 load requested by Lamb Weston." When requested to provide a more detailed
16 explanation of this, and other, projects in Staff Data Request 64, however, Cascade made
17 no attempt to further justify or explain the project.[5]

18 **Q. HAS THE RICHLAND PROJECT BEEN PLACED INTO SERVICE?**

19 A. Yes. In response to Public Counsel Data Request 45, the Company indicated that the
20 majority of the project was placed into service on October 5, 2017.[6] The total amount of

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4 *WUTC v. Pacific Power*, Dockets UE-140762 *et al.*, Order 08 at ¶165 (*citing WUTC v. PacifiCorp*, Docket UE-130043, Order 05 at ¶171 (Dec. 4, 2013)).

5 Exh. BGM-4 at 6 (see Row 118).

6 Exh. BGM-4 at 17 (see Row 118).

1 capital expended was $4,795,619. The total capital was $133,668 less than the Company
2 had budgeted.

3 **Q. SHOULD THE RICHLAND PROJECT BE INCLUDED ON A POST TEST**
4 **PERIOD BASIS?**

5 A. A major concern is the degree to which the project is revenue producing, and thus not
6 necessarily a contributor to regulatory lag. In addition, the brief descriptions provided by
7 Cascade are not sufficient to consider the project on a post-test period basis.
8 Notwithstanding, the project is a large project, in relation to the other capital projects
9 detailed in Exh. MPP-6. Given these considerations, I have not removed the Richland
10 Project from adjustment P-3, with the understanding that, in Rebuttal Testimony, Cascade
11 will provide further information about the Richland Project and also demonstrate that it
12 has appropriately considered all incremental revenues associated with the Richland
13 Project.

14 **Q. WHY DID CASCADE INCLUDE PROJECTS PLACED INTO SERVICE PRIOR**
15 **TO THE END OF THE TEST PERIOD IN ITS ADJUSTMENT?**

16 A. Based on the filtering criteria Cascade used, some of the projects included in Exh. MPP-6
17 with an in service date prior to January 1, 2017 were included in the pro forma
18 adjustment. Those projects however, were placed into service in the test period, and are
19 already included in revenue requirement results. Accordingly, Cascades' pro forma
20 adjustment double counts those particular capital projects.

21 **Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?**

22 A. Page 13 of Exh. BGM-3 compares my calculation of adjustment P-3 to the adjustment
23 Cascade has proposed. When performing this adjustment, I retained the incremental

1 revenues of $199,944 that the Company had forecast to receive as a result of the Richland
2 Project. Accordingly, the adjustment produced a $48,826 increase to net operating
3 income and a $4,744,665 increase to rate base. The revenue requirement impact is an
4 increase of approximately $482,636, an amount which is $2,076,140 less than the pro
5 forma capital adjustment Cascade has proposed in this matter.

6 **b. Supplemental Executive Retirement Plan**

7 **Q. WHAT COSTS RELATED TO CASCADE'S SUPPLEMENTAL EXECUTIVE**
8 **RETIREMENT PLAN HAVE BEEN INCLUDED IN RESULTS?**

9 A. In response to NWIGU Data Request 08, Cascade identified $726,254 of Total System
10 expense, and $546,651 Washington-Allocated expense, attributable to Cascade's
11 Supplemental Executive Retirement Plan ("SERP").[7]

12 **Q. WHAT TYPE OF RETIREMENT PLAN IS A SERP?**

13 A. A SERP is a form of deferred compensation that is provided to a select group of
14 management or highly compensated employees. The thing that makes a SERP distinct
15 from other forms of deferred compensation agreements—such as a 401K or qualified
16 pension plan—is that a SERP does not satisfy the non-discrimination requirements
17 established by the Internal Revenue Service. To be considered a qualified plan, all
18 employees must be eligible for the same benefits, regardless of position. While an entity
19 may offer discriminatory plans, there are different tax consequences for doing so.

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7 Exh. BGM-4 at 20.

1 **Q. ARE SERP EXPENSES CASH FLOW TO THE UTILITY?**

2 A. No. The SERP expenses identified above are accrual for a future cash flow, which might
3 be made to particular executives in retirement. While the Company has incurred an
4 obligation to make payments to those executives, it has not actually expended any funds
5 in connection with the obligations.

6 **Q. ARE SERP COSTS APPROPRIATELY INCLUDED IN REVENUE**
7 **REQUIREMENT?**

8 A. No. Other utilities, such as Avista Corporation and Puget Sound Energy have been
9 required to exclude SERP expenses from revenue requirement. In the Final Order in
10 Puget Sound Energy's 2009 general rate case, for example, the Commission stated:

11 > [W]e find persuasive the arguments recommending removal of [SERP]
12 > costs. PSE has failed to provide an adequate justification for continuing to
13 > require ratepayers to fund supplemental retirement benefits for a small
14 > number of executives who already are highly compensated and entitled to
15 > the same levels of qualified retirement plan benefits as other employees,
16 > within the limits of what the IRS allows.[8]
17

18 This general policy extends back at least to the 1985 general rate case of
19 Washington Water Power Co, when the Commission removed *supplemental pensions* for
20 retired employees, finding that those costs "should be contributed by shareholders rather
21 than ratepayers."[9]

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8 *WUTC v. Puget Sound Energy, Inc.,* Docket Nos. UE-090704 and UG-090705, Order No. 11 ¶¶74-81 (Apr. 2, 2010).

9 *WUTC v. Washington Water Power Co.,* Docket No. U-85-36, Third Suppl. Order, pp. 26-27 (Apr. 4, 1986).

1 **Q. ARE THERE OTHER REASONS TO REMOVE SERP EXPENSES FROM**
2 **REVENUE REQUIREMENT?**

3 A. Yes. As noted above, the SERP expenses are just an accrual required for book
4 accounting, not a cash expenditure. While those obligations may be appropriately
5 recognized as a cost for book accounting, that does not mean it is necessary to consider it
6 a cost in the context of cost of service ratemaking.

7 **Q. WHAT IS THE IMPACT OF REMOVING SERP COSTS FROM REVENUE**
8 **REQUIREMENT?**

9 A. The impact of removing SERP costs is an approximate $571,998 reduction to revenue
10 requirement.

11 **<u>c. Affiliate Bonus Payments</u>**

12 **Q. WHAT AMOUNT OF INCENTIVE PAY HAS CASCADE INCLUDED IN THE**
13 **TEST PERIOD?**

14 A. Cascade has included employee incentive payments in the amount of $1,765,931 in test
15 year labor costs. Cascade clarified this amount in response to Public Counsel Data
16 Request 110.[10]

17 **Q. WHAT ISSUE HAVE YOU IDENTIFIED WITH RESPECT TO THOSE**
18 **INCENTIVE PAYMENTS?**

19 A. In response to Public Counsel Data Request 34, Cascade provided detail underlying those
20 incentive payments.[11] Of the total amount of incentives, $1,136,795 or, approximately
21 64.6%, were in the form of cross-charges from affiliates.

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[10] Exh. BGM-4 at 23.
[11] Exh. BGM-4 24.

1 In addition, Cascade was also asked, in Staff Data Request 109, to provide further
2 detail regarding these expenses, to determine the degree to which the incentive payments
3 were designed to benefit ratepayers through reduced expense or improved customer
4 service.[12] In response, Cascade indicated that a portion of the incentive payments paid by
5 Cascade to its own employees was tied to improved customer service or reduced expense.
6 Cascade also indicated that the incentive payments cross charged from affiliates were not
7 tied to any of the ratepayer benefit categories detailed in the response.

8 **Q. BASED ON THIS RESPONSE, WHAT DO YOU PROPOSE?**

9 A. I recommend removing the incentive amounts charged from affiliates, in the amount of
10 $1,136,795. I am also concerned about the incentive payments paid directly to Cascade
11 employees because Cascade has not done a very good job in explaining how those
12 incentive programs are designed to benefit rate payers. Notwithstanding, I propose
13 allowing Cascade to include those amounts in revenue requirement.

14 **Q. WHAT IS THE IMPACT OF YOUR ADJUSTMENT?**

15 A. After considering revenue sensitive costs, removal of the affiliate bonuses results in a
16 revenue requirement reduction of $1,189,505.

17 **d. Employee Arbitration Contingency**

18 **Q. WHAT DID CASCADE DISCLOSE IN DISCOVERY RELATED TO**
19 **EMPLOYEE ARBITRATION COSTS?**

20 A. In response to WUTC Data Request 98, Cascade identified accrual of approximately
21 $280,000 Total System, or $210,756 Washington Allocated, in FERC Account 925,

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12 Exh. BGM-4 25-26.

1 Injuries and Damages, related to an employee litigation claim.[13] The amount represented
2 a contingent liability. Similar to SERP costs, no cash has been expended with respect to
3 these amounts. Rather, Cascade is required to book those amounts because Cascade
4 believes it is probable that it will be required to pay the amounts in litigation, and thus,
5 has recorded its estimate of the obligation as a contingent liability.

6 **Q. ARE CONTINGENT LIABILITY COSTS APPROPRIATELY INCLUDED IN**
7 **NORMALIZED REVENUE REQUIREMENT?**

8 A. No. Contingent liabilities such as this are typically not eligible for recovery in revenue
9 requirement. A contingent liability represents costs associated with a potential outcome
10 in litigation, not an actual cash flow to the utility. Under Generally Accepted Accounting
11 Principles, a contingent liability is recognized based on the application conservatism
12 principle, the basis for which is to prevent a business entity from overstating its earnings
13 in any given period. The conservatism principle, however, does not apply to ratemaking.
14 Revenue requirement used for ratemaking is concerned with establishing a normalized
15 view of the utility's results, not a conservative view of results. Accordingly, contingent
16 liability costs should be excluded from revenue requirement on the basis that they are not
17 normal, recurring costs to the utility.

18 **Q. ARE THE PARTICULAR EMPLOYEE ARBITRATION COSTS PRUDENTLY**
19 **INCURRED?**

20 A. If the employee arbitration is ultimately made in favor of the employee—as Cascade
21 believes is probable—that would be evidence that the Company might have acted

[13] Exh. BGM-4 27-29.

1 imprudently with respect to the employee's claim. In response to Public Counsel Data
2 Request 97, Cascade provided further information surrounding the arbitration claim.[14] In
3 that response, Cascade indicated that it withheld, and is in the process of appealing,
4 certain back payments to an employee who was found to be wrongfully terminated by a
5 labor arbitrator. Given the information identified in that request, it would also be
6 appropriate to remove the employee arbitration costs from revenue requirement on the
7 basis of prudence. If it is ultimately found that it was proper for Cascade to have
8 withheld the employee's back pay, then Cascade will not actually incur any actual costs
9 associated with the employee claim. If Cascade is ultimately held liable for those costs,
10 however, that means that Cascade acted improperly by withholding the employee's back
11 pay, suggesting that costs are not appropriately allocated to ratepayers.

12 **Q. WHAT IS THE REVENUE REQUIREMENT IMPACT OF REMOVING THE**
13 **EMPLOYEE ARBITRATION COSTS?**

14 A. Removing the above describe employee arbitration costs results in an $220,528 reduction
15 to revenue requirement.

16 **<u>e. Rate Case Costs</u>**

17 **Q. HAVE YOU REVIEWED ADJUSTMENT P4, RELATED TO RATE CASE**
18 **COSTS?**

19 A. Yes. In Exh. MPP-5, Cascade identifies proforma adjustment P-4, related to rate case
20 costs. The calculation for adjustment P-4 may be found in Mr. Parvinen's revenue
21 requirement workpapers "UG-170929 CNG Exh MPP 2-6 and WP-1 8-31-17" in the tab

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14 Exh. BGM-4 at 30-32.

1 titled "Rate Case Costs." The pro forma adjustment is applied by taking the actual rate
2 case costs incurred over the two year period 2016 to 2017. The workpaper then subtracts
3 the amount incurred in the 2016 test period to arrive at the pro forma adjustment amount.
4 The effect of the pro forma adjustment is to include the full amount of rate case costs
5 incurred over the two year period 2016 to 2017 in revenue requirement results.

6 **Q. DO YOU AGREE WITH CASCADE'S APPROACH?**

7 A. No. It is not reasonable for Cascade to seek recovery of two years' worth of rate case
8 costs within a single year in its revenue requirement model. Approval of Cascade's
9 approach would effectively result in double-recovery of its rate case costs.

10 **Q. WHAT APPROACH DO YOU RECOMMEND?**

11 A. Instead of including two years' worth of rate case costs in a single year, I propose to take
12 the average amount incurred over the period 2016 through 2017. It might be appropriate
13 to simply use the costs incurred in the 2016 test period. The costs incurred in 2017,
14 however, were materially higher than the 2016 values. Thus, using the average over the
15 two year period provides the Company with recovery of the higher level of rate case costs
16 it experienced subsequent to the rate period in 2017.

17 **Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?**

18 A. Use of an average results in a pro forma adjustment of $94,439 to pre-tax operating
19 income, which equates to a revenue requirement increase of $98,818. Relative to
20 Cascade's adjustment, this recommendation results in a $213,535 reduction to revenue
21 requirement.

1 **III. TAX CUTS AND JOBS ACT ADJUSTMENTS**

2 **Q. HOW SHOULD THE COMMISSION CONSIDER THE TAX CUTS AND JOBS**
3 **ACT WHEN ESTABLISHING CASCADE'S REVENUES?**

4 A. The Tax Cuts and Jobs Act ("TCJA"), HR 1 of the 115th Congress, was signed into law
5 on December 22, 2017, and became effective on January 1, 2018. Among other things,
6 the TCJA resulted in a reduction to the Federal corporate income tax rate from 35% to
7 21%. For the most part, considering the impacts TCJA is a relatively straight-forward
8 exercise, and for that reason, it is appropriate to incorporate all known impacts associated
9 with the TCJA into the base rates under review in this matter.

10 **Q. WHY IS IT IMPORTANT FOR THE BASE RATES TO INCORPORATE THE**
11 **IMPACTS OF THE TCJA?**

12 A. Returning the tax benefits associated with the TCJA to ratepayers in an expedient manner
13 will avoid creating large accruals, which may cause rate instability over time. For
14 example, rates might decline in the period that the deferral account is being amortized,
15 only to increase again once the amortization has been completed. Said another way, as
16 the deferrals grow larger, the risk of rate instability grows commensurately.

17 In addition, one view is that it might be inconsistent with the normalization
18 requirements in IRC § 168(i)(9) for the Commission to approve cost of service rates that
19 do not take into consideration the changes resulting from the TCJA. The normalization
20 requirements have changed, and the Commission may not approve rates that are
21 inconsistent with the normalization requirements.

1 **Q. HOW HAVE YOU INCORPORATED THE TCJA INTO YOUR REVENUE**
2 **REQUIREMENT RECOMMENDATION?**

3 A. I performed four adjustments to incorporate the TCJA into revenue requirement. In
4 Adjustment TCJA-1, I restate the tax expenses included in revenue requirement based on
5 the lower 21% corporate tax rate. In TCJA-2, the effects of the Excess Deferred Federal
6 Income Taxes have been incorporated into results. In TCJA-3, I have incorporated the
7 effects of a deferral in rates for taxes over-collected for the period December 1, 2018
8 through July 31, 2018. Finally, in TCJA-4, the impacts of updating the revenue
9 conversion factor have also been isolated. Note that when calculating these adjustments,
10 the impacts of TCJA-1 through TCJA-3 have been calculated using the updated revenue
11 conversion factor.

12 **a. TCJA-1: Restate Tax Expense**

13 **Q. PLEASE PROVIDE AN OVERVIEW OF ADJUSTMENT TCJA-1.**

14 A. TCJA-1 simply details the impact of restating income tax expense at the 21% tax rate
15 required under the TCJA. This amount was calculated by taking the current and deferred
16 income taxes identified in Cascade's results, divided by the old 35% tax rate and
17 multiplied by the new 21% tax rate.

18 **Q. HOW HAVE YOU APPLIED THIS ADJUSTMENT?**

19 A. The calculation of this adjustment can be found on Page 15 of Exh. BGM-3. As seen in
20 that exhibit, the restating impact of the TCJA tax rate on income tax expense is
21 determined by simply recalculating the tax provision (both current and deferred taxes)
22 based on the new 21% tax rate. Current tax expense is re-calculated by multiplying net
23 taxable income for the test period by the 21% tax rate, rather than the 35% tax rate

1 previously included in results. Deferred tax expense is also recalculated by multiplying
2 the book-tax differences in the test period by the 21% tax rate, rather than the 35% tax
3 rate that is currently being used to calculate deferred income tax expense in results.
4 As noted in the exhibit, this calculation was performed first for the income tax
5 expense reflected in the Company's per book results, and then for the income tax expense
6 attributable to each of the other restating and pro forma adjustments. Alternatively, this
7 aspect of the adjustment could be applied to each of the restating and pro forma
8 adjustment independently, as Cascade has done in its Supplemental Response to Bench
9 Request 01.
10 In addition, prior to filing Response Testimony, NWIGU submitted a data request
11 asking for further detail regarding the make up of the current and deferred income tax
12 expenses reflected in Cascades results. To the extent that Cascade's response influences
13 my recommendation, I might update my analysis prior to the hearing in this matter.

14 **Q. WHAT IS THE IMPACT OF YOUR ADJUSTMENT?**

15 A. In my model, applying the reduced tax rate results in $2,817,129 reduction to income tax
16 expense. On a pre-tax, revenue requirement basis, the impact of this restating adjustment
17 is $3,713,333.

18 **Q. IS THIS THE SAME GENERAL METHODOLOGY THAT CASCADE USED IN**
19 **ITS FIRST SUPPLEMENTAL RESPONSE TO BENCH REQUEST 01?**

20 A. Yes. While Cascade did not isolate the impact of the tax change as a single adjustment,
21 as I have done, it estimated the impact of the tax change to be a reduction of

1 approximately $4,209,376, including the impact of updating the conversion factor.[15]
2 Cascade's adjustment produced a slightly larger impact because the pro forma
3 adjustments in its revenue requirement model were different than the pro forma
4 adjustments included in my revenue requirement model, based on the recommendations
5 discussed above.

6 **b. TCJA-2: Excess Deferred Federal Income Taxes**

7 **Q. WHAT ARE EXCESS DEFERRED FEDERAL INCOME TAXES?**

8 A. The TCJA contains new normalization provisions surrounding Excess Deferred Federal
9 Income Taxes ("EDFIT"), which simplifies the treatment of the balance sheet impacts of
10 the tax law change for public utilities. Effectively, EDFIT represent a financial gain to
11 the utility, and absent the TCJA normalization provisions surrounding EDFIT, a utility
12 might have claimed that it was entitled to retain those benefits. Or, perhaps ratepayers
13 might have claimed that they should receive those gains through a single lump-sum
14 payment. The TCJA, however, simplifies the ratemaking treatment surrounding the tax
15 changes by prescribing the specific methods that must be used by regulators to account
16 for the EDFIT benefits, avoiding controversy over the way that those amounts get retuned
17 to ratepayers.

18 Under Generally Accepted Accounting Principles, the general rule is that when a
19 change in the tax rate is enacted into law, the effects of the change must be reported in

15 See Cascade's First Supplemental Response to Bench Request 01, Sub-request E ($4.2 million represents the difference between the $5.9 million in Cascade's initial filing and increase of $1.7 million increase calculated in the response).

1 the period that includes the "enactment date."[16] The normalization requirements for
2 EDFIT in IRC § 168(i)(9), however, provide an exception to that general rule for public
3 utilities.

4 For business enterprises other than a public utility, the change in tax rate will
5 result in material balance sheet impacts. For a non-utility business enterprise, deferred
6 tax liabilities—funds that the entity is effectively holding in reserve to pay for future
7 taxes—must be revalued at the new tax rate. If the tax rate declines, the tax liability
8 balance declines, resulting in the recognition of a gain, similar to the gain that occurs
9 when the principal balance of a loan is forgiven. For non-utilities, this gain flows
10 through the income statement in the current period, in one lump-sum.

11 For public utilities, however, the treatment is different. Under the normalization
12 requirements of IRC § 168(i)(9), the balance sheet gains associated with the change in tax
13 rate must remain on the public utility's balance sheet, and instead of recognizing the
14 gains in one lump sum, the gains are amortized to results over an extended period of time.
15 A few methods are available to amortize the gains, but amortization period is generally
16 intended to correspond to the period over which the underlying book-tax differences are
17 expected to reverse.

18 **Q. HOW HAVE YOU CALCULATED THE ADJUSTMENT RELATED TO EDFIT?**

19 A. The restating adjustment was calculated, first, by reclassifying the EDFIT balance out of
20 Accumulated Deferred Federal Income Taxes ("ADFIT") and assigning it a separate line

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[16] See Financial Accounting Standards Board ("FASB"), Statement of Financial Accounting Standards No. ("SFAS") 109, Accounting for Income Taxes ¶ 27; See also FASB Accounting Standards Codification ("ACS") 740-25-47.

1 in the revenue requirement table. Second, an amortization amount was calculated and
2 included in operating results. Finally, the EDFIT rate base balance was further reduced
3 by one-half of the annual amortization amount.

4 **Q. HOW DID YOU DETERMINE THE EDFIT AMORTIZATION AMOUNT?**

5 A. Under IRC § 168(i)(9) two general methods are described to account for EDFIT: 1) the
6 average rate assumption method; and 2) the alternative method. The general rule is that a
7 utility may not "reduce[] the excess tax reserve more rapidly or to a greater extent than
8 such reserve would be reduced under the average rate assumption method," and thus the
9 average rate assumption method generally must be used. As an exception to the general
10 rule, however, a utility may use the alternative method, if it does not track ADFIT by
11 asset vintage. Since, as a practical matter, most utilities do not calculate the ADFIT
12 reserves by asset vintage most will likely resort to using some form the alternative
13 method. Under the alternative method, EDFIT amortization may occur using composite
14 depreciation rates, which is the method I used in deriving the impacts of Adjustment
15 TCJA-2.

16 **Q. WHERE HAVE YOU PERFORMED THESE CALCULATIONS?**

17 A. Page 16 of Exh. BGM-3 details the calculation of EDFIT and EDFIT amortization based
18 on rate period balances for ADFIT. As can be seen in that exhibit, I calculate an EDFIT
19 balance of $29,477,684, and corresponding amortization of $839,215 per year. When
20 performing this calculation, the test period balances were used, rather than the balances
21 as of December 31, 2017. The test period balances were used for consistency purposes.
22 As can be noted, ADFIT in test period results was very limited and only included two

book-tax differences. First, ADFIT included a book-tax difference related to accelerated tax depreciation, and second, ADFIT include a book-tax difference related to debt refinancing costs. In addition, ADIT balances were not available by functional plant, so I relied on a single composite depreciation rate of 2.83%, calculated by taking depreciation expenses over rate period plant in service.

Q. HOW DO THE AMOUNTS YOU CALCULATED CORRESPOND TO THE AMOUNTS CASCADE CALCULATED?

A. Cascade calculated a materially higher EDFIT balance of $49,503,717. In its supporting workpapers, that value was based on hard-coded numbers, so its not clear how cascade calculated it. The driver for the difference between my calculation and Cascade's calculation appears to be related to the fact that that Cascade has included a number of book tax differences in its calculation of EDFIT, which it did not consider in ADFIT included in the test period results. Another difference relates to the fact that my calculation relies on test period balances, rather than balances as of the December 31, 2017.

Q. DO YOU HAVE ANY OTHER CONCERNS WITH CASCADE'S SUPPLEMENTAL RESPONSE TO BENCH REQUEST 01?

A. Yes. Cascade appears to misrepresent the way the EDFIT benefits get returned to ratepayers. Cascade is correct that EDFIT has only minimal impacts on rate base, as it represents a reclassification of reserves that were formerly attributable to ADFIT into a separate rate base category. Notwithstanding, as the EDFIT amount is amortized, the amortization must flow through to results as a post-tax gain. Otherwise, the reversal of

EDFIT would represent a windfall to the Cascade. Cascade does not appear to recognize the gain that results when EDFIT is amortized.

Q. WHAT ARE THE REVENUE REQUIREMENT IMPACTS OF EDFIT?

A. The amortization of EDFIT represents post-tax gain, and thus, the pre-tax revenue requirement impacts of that amortization must further grossed up for taxes, at the new 21% rate. Based on my calculations, the impact of incorporating EDFIT into results is a revenue reduction of $1,070,716.

c. TCJA-3: Deferral (Jan 1, 2018 – July 31, 2018)

Q. PLEASE PROVIDE AN OVERVIEW OF YOUR ADJUSTMENT TCJA-3

A. This adjustment represents a deferral for excess taxes collected over the period January 1, 2018 through July 31, 2018 (the "Deferral Period"). It relies on a simplified formula relying solely on rate base, and authorized return on equity, and can be performed without considering the utility's results. Thus, the formula is agnostic to the operating results in the test period.

Q. HOW HAVE YOU CALCULATED THE DEFERRAL?

A. As can be seen on Page 17 of Exh. BGM-3, the TCJA deferral consists of two components. First, I determine the impact of restating the tax expense in results over the Deferral Period. Second, I determine the impact of amortizing the EDFIT gain over the deferral period, using the same amortization amount detailed for TCJA-2 above.

Q. HOW DID YOU DETERMINE THE IMPACT OF RESTATING TAX EXPENSE IN THE DEFERRAL PERIOD?

A. A higher-level approach was used for determining the over collection of tax expense in the deferral period. My approach estimates the tax impact on current rates based on the

1 Cascade's level of rate base and cost of capital. Under this method the "pre-tax" return
2 on equity is used to determine the portion of revenues dedicated to paying federal income
3 taxes, as show in the following formula:

4 RB * ROE / (1-T) * E% = Revenues for Taxes
5 Where: RB = Rate Base; ROE = Return on Equity;
6 T = Marginal Tax Rate, and; E% = Equity %.

7 The above calculation is performed based on the old 35% tax rate, and then again
8 based on the new 21% tax rate. The difference represents the estimate the revenue
9 requirement savings associated with the lower rate.

10 **Q. WHAT AMORTIZATION PERIOD DO YOU PROPOSE?**

11 A. I propose a two year amortization period for the TCJA deferral. In addition, I
12 recommend that the amortization occur in base rates, rather than through a separate
13 surcharge.

14 **Q. SHOULD THE DEFERRAL BE INCLUDED IN RATE BASE?**

15 A. No. I recommend that the balance should accrue interest at Cascade's pre-tax cost of
16 capital, but that the interest accrues within the deferred account, similar to the way that
17 interest is typically included in a power cost adjustment mechanism deferral.

18 **Q. WHAT IS THE REVENUE REQUIREMENT IMPACT OF THIS**
19 **RECOMMENDATION?**

20 A. The deferral calculation detailed in Exh. BGM-3 suggests that Cascade will over collect
21 tax expenses by $2,713,094. Based on the amortization schedule detailed on Page 18 of
22 Exh. BGM-3, I calculate annual amortization of $1,502,892, producing a revenue
23 requirement impact of $1,572,578 after considering revenue sensitive costs.

1 **Q. HOW DOES YOUR ADJUSTMENT COMPARE TO THE AMOUNTS CASCADE**
2 **CALCULATED IN RESPONSE TO BENCH REQUEST 01?**

3 A. Cascade identified $1,871,625 in revenues for taxes in the deferral period. Its calculation
4 is slightly lower than my calculation because it only considered the impact of the TCJA
5 on tax expense and did not consider EDFIT. My calculation includes $619,674 of pre-tax
6 EDFIT benefits. Excluding EDFIT, my calculation of over collected taxes is
7 approximately $2,093,421, which close to what Cascade had calculated.

8 **<u>d. TCJA-4: Conversion Factor</u>**

9 **Q. PLEASE PROVIDE AN OVERVIEW OF THE FINAL ADJUSTMENT YOU**
10 **PERFORMED WITH RESPECT TO THE TCJA-4?**

11 A. This adjustment details the impact of the conversion factor. Application of this aspect of
12 the TCJA change is relatively mechanical, with an impact of $104,785 on revenue
13 requirement.

14 **IV. RATE SPREAD**

15 **Q. DO YOU HAVE CONCERNS WITH CASCADE'S COST OF SERVICE STUDY?**

16 A. Yes. I have several concerns and believe that Cascade's Cost of Service Study is flawed
17 and should be rejected. First, Cascade failed to provide a load study to help determine
18 class core responsibilities of daily therms at city gates. Second, even ignoring the fact
19 that Cascade failed to provide a load study, I fundamentally disagree with the use of the
20 Peak and Average methodology, especially in light of the December 2016 Order in
21 Docket Nos. UE-160228 and UG-160229 (consolidated), where the Commission initiated
22 a collaborative effort with stakeholders in an effort to establish greater clarity and
23 uniformity in future cost of service studies.

1 **Q. DID CASCADE AGREE TO INTIATE A LOAD STUDY PRIOR TO THIS RATE**
2 **CASE?**

3 A. Yes. In Docket UG-152286, Cascade agreed to initiate a load study prior to filing this
4 case. To demonstrate compliance with this condition, Cascade argues "The Company has
5 taken the first steps in the load study by initiating what is internally referred to as a
6 'citygate study.' The data collected from the citygate study will serve as the foundation
7 for the load study."

8 **Q. WHY DIDN'T CASCADE COMPLETE A LOAD STUDY BEFORE FILING THIS**
9 **CASE?**

10 A. It is not entirely clear, especially since Cascade controls the timing of its rate case filing.
11 Cascade appears to argue that "implementing meter/loggers would be expensive to do."
12 Instead, Cascade offers a forecast model to forecast at the daily citygate level by each
13 customer class which will then be used to determine the class core responsibilities of
14 daily therms at the citygates.

15 **Q. DO YOU THINK THE PROPOSED FORECAST IS AN ADEQUATE**
16 **REPLACEMENT FOR THE LOAD STUDY?**

17 A. No, the proposed forecast is not an adequate replacement for the load study. Until
18 Cascade completes a load study to determine actual class core responsibilities of daily
19 therms at the citygates, it is inappropriate to spread rates based on the results of a Cost of
20 Service Study, because the underlying data is flawed, outdated and unreliable. As a
21 result, the increase or decrease in this docket should be spread on an equal percent of
22 margin basis to each schedule, except for Special Contracts.

1 **Q. WHAT IS TYPICALLY THE LARGEST COST ITEM IN A NATURAL GAS**
2 **CLASS COST OF SERVICE STUDY?**

3 A. The classification and allocation of distribution main fixed costs is usually the largest
4 cost item in a natural gas class cost of service study and important factors in determining
5 class cost of service.

6 **Q. PLEASE SUMMARIZE YOUR CONCERNS WITH THE COMPANY'S PEAK &**
7 **AVERAGE COST OF SERVICE STUDY.**

8 A. The Company's proposal to allocate distribution main fixed costs using the Peak and
9 Average methodology double counts the average demand component and is inconsistent
10 with principles of cost causation. The Peak and Average methodology ignores how
11 capacity related costs associated with distribution mains, including both rate base and
12 expenses, are incurred by the Company, and therefore produces skewed results.

13 The Company's distribution mains are designed to meet customers' contribution
14 to the system peak day demand rather than annual use or average demand. Distribution
15 mains are also placed in service in locations to ensure that all customers on the system
16 receive adequate service. In other words, the distribution system is designed to ensure
17 that there is adequate capacity to provide customers service every day of the year,
18 including the day of coincident peak day demand.

19 Because distribution main and related costs are incurred to meet the system peak
20 day demand, capacity related costs should be allocated to customers based on their
21 coincident contribution to the system peak day demand. This is consistent with the
22 principle of cost causation and properly allocates costs to customers. Coincident demand

1 allocation is also consistent with the Company's Integrated Resource Planning, which
2 develops a plan for meeting design day peak demand.

3 **Q. WHAT IS CASCADE'S PROPOSAL ON RATE SPREAD?**

4 A. Based on its Cost of Service Study, Cascade's proposal is to allocate all of the increase in
5 this proceeding to Cascade's Residential Service class (Tariff Schedules 502 and 503),
6 the Interruptible Service class (Tariff Schedules 570 and 577) and the Distribution
7 System Transportation Service (Tariff Schedule 663). The result is a 6.7 percent increase
8 for transportation customers, a 4.4 percent increase for residential customers, and no rate
9 change for other customer classes.

10 **Q. DO YOU HAVE AN ALTERNATIVE PROPOSAL FOR RATE SPREAD?**

11 A. Yes. I recommend the allocation of any margin revenue increase or decrease to the rate
12 classes on an equal percent of margin basis, except for special contracts. This is a
13 reasonable approach, and does not favor any one cost of service methodology
14 recommended by any particular party upon which rate spread is based.

15 **Q. WHY DIDN'T NWIGU PROVIDE ITS OWN COST OF SERVICE STUDY?**

16 A. The lack of a load study undermines the results of Cascade's Cost of Service Study.
17 Rather than having all parties presenting the Commission with competing cost of service
18 studies without the benefit of a load study, with a wide and predicable range of results,
19 NWIGU believes the rate increase or decrease in this proceeding should be spread on an
20 equal percent of margin basis. This will preserve the status quo and allow the parties to
21 participate in the collaborative which is intended to grapple with the differing views on
22 cost of service which are more easily explored in a collaborative compared to litigation.

1 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

2 A. Yes.

3