Exhibit No. __ (TJN-4Tr)
Docket No. UG-200568
Witness: Tammy J. Nygard

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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

CASCADE NATURAL GAS CORPORATION

REBUTTAL TESTIMONY OF TAMMY J. NYGARD

January 8, 2021

Revised February 26, 2021

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I. INTRODUCTION

Q. Are you the same Tammy J. Nygard who filed direct testimony in Exhibit TJN-1T as part of Cascade Natural Gas Corporation's ("Cascade" or the "Company") initial filing ("Initial Filing")?

A. Yes, I am.

II. SCOPE AND SUMMARY OF TESTIMONY

Q. What is the purpose of your Rebuttal Testimony?

A. My Rebuttal Testimony presents Cascade's updated and revised cost of capital in its Rebuttal Filing; responds to testimony from Staff witness Mr. David Parcell, Public Counsel witness Dr. J. Randall Woolridge and Alliance of Western Energy Consumers ("AWEC") witness Mr. Bradley Mullins challenging the Company's proposed capital structure; and responds to Mr. Mullins' testimony on Cascade's cost of debt.

Q. Please summarize your testimony.

A. My testimony:

- Supports the reasonableness of Cascade's revised and updated proposed overall rate of return ("ROR") of 7.22 percent;
- Demonstrates that Cascade's proposed equity ratio of 50.4 percent is supported by Cascade's actual, adjusted capital structure at year-end 2020 and the preceding two-year average, and is necessary to maintain its current credit ratings;
- Explains why the Commission should reject Staff and intervenor proposals for reduced equity ratios; and

- Outlines the background and savings associated with Cascade's debt issuances in 2020, and supports Cascade's updated, reduced cost of long-term debt.

Q. Are you sponsoring any exhibits to your Rebuttal Testimony?

A. Yes. I am sponsoring the following exhibits, which are described later in my testimony: Exhibit No. __ (TJN-5); Exhibit No. __ (TJN-6C); and Exhibit No. __ (TJN-7C).

III. UPDATED OVERALL COST OF CAPITAL

Q. Has Cascade updated components of its recommended cost of capital in this case?

A. Yes. I provide Cascade's year-end 2020, actual capital structure, normalized to remove the impact of an unusual, multi-year amortization of certain PGA costs, and updated to reflect an equity infusion in December 2020. I also sponsor the Company's updated cost of debt. Cascade witness Ms. Ann Bulkley has updated her analysis on the Company's cost of equity, which supports her initial recommendation. Cascade witness Ms. Nicole Kivisto explains why Cascade has nevertheless reduced its recommended return on equity ("ROE") by fifty basis points in response to the economic hardship now facing many of Cascade's customers.

Q. What is Cascade's overall cost of capital proposed in its Rebuttal Filing?

A. As shown in Table 1, Cascade proposes an updated overall ROR of 7.22 percent, a reduction from the 7.54 percent ROR proposed in the Initial Filing. The recommended ROR reflects the Company's updated cost of debt of 4.589 percent, a capital structure with a 50.4 percent equity ratio, and an ROE of 9.8 percent. This ROR provides a reasonable return for Cascade's investors at a fair cost to Cascade's customers.

Table 1: Cascade's Recommended Cost of Capital

Component	% of Capital	Cost	Weighted Cost
Long Term Debt	49.60%	4.589%	2.276%
Common Stock Equity	50.40%	9.8%	4.939%
Total	100.0%		7.215%

Q. Is Cascade's revised ROR below its current authorized ROR?

A. Yes. Cascade's proposed ROR of 7.22 percent is below its current authorized ROR of 7.24 percent.[1] To reflect its current financing costs, Cascade is proposing an increase in its ROE from 9.4 percent to 9.8 percent and an increase in its equity ratio from 49.1 percent to 50.4 percent. The significant reduction in Cascade's debt costs, however, offsets these increases and produces an overall decrease in Cascade's proposed ROR.

Q. Is Cascade's proposed ROR of 7.22 percent lower than or comparable to RORs authorized by the Commission in 2020?

A. Yes. The Commission approved a 7.39 percent ROR for Puget Sound Energy ("PSE") in July 2020,[2] and a 7.21 percent ROR for Avista Corporation ("Avista") in March 2020.[3] In addition, the Commission approved an ROR of 7.17 percent for PacifiCorp in December 2020.[4]

Q. Are the recommended RORs of other parties to this case much lower?

A. Yes. Staff recommends an ROR of 6.93 percent, and Public Counsel and AWEC recommend an ROR of 6.83 percent.

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[1] *Washington Utilities & Transportation Commission v. Cascade Natural Gas Corp*., Docket UG-190210, Final Order 05 at ¶ 10 (Feb. 3, 2020).

[2] *Washington Utilities & Transportation Commission v. Puget Sound Energy, Inc*., Dockets UE-190529 & UG-190530, Order 08 at ¶ 28 and ¶ 108 (July 8, 2020) ("PSE GRC").

[3] *Washington Utilities & Transportation Commission v. Avista Corp*., Dockets UE-190334 & UG-190335, Order 09 at ¶ 34 and ¶ 38 (March 25, 2020) ("Avista GRC").

[4] *Washington Utilities & Transportation Commission v. PacifiCorp, dba Pacific Power & Light Co.*, Dockets UE-191024, et al., Order 09/07/12 at ¶ 56 (Dec. 14, 2020) ("PacifiCorp GRC").

IV. CAPITAL STRUCTURE UPDATE

Q. What is Cascade's proposed capital structure?

A. As described in my Direct Testimony, Cascade is requesting a capital structure comprised of 50.4 percent common equity and 49.6 percent debt. Cascade's Rebuttal Update confirms that this capital structure reasonably reflects the Company's actual equity ratio and is necessary to maintain Cascade's access to low-cost debt during its major capital expenditure program.

Q. Why does Cascade believe a capital structure with this balance of debt and equity is appropriate?

A. A capital structure of approximately 50 percent equity and 50 percent debt reflects an appropriate balance of safety and economy and, contrary to Staff's witness Mr. Parcell's testimony, Cascade has financed its operations with this target capital structure for many years and will continue to do so. Maintaining the Company's actual equity ratio of 50.4 percent is necessary for Cascade to retain its current credit rating, which will ensure continued access to capital markets and low-cost debt financing, particularly during the current economic turmoil and in light of tax reform and Cascade's significant capital investment program.

Q. Please explain how Cascade's proposed equity ratio of 50.4 percent reflects its actual capital structure.

A. As explained in my Direct Testimony, Cascade's proposal is based on the Company's actual average year-end capital structure in 2018-2019. Consistent with Cascade's approach in its 2019 general rate case, Cascade adjusted its capital structure to backout the impact of the multi-year amortization of PGA balances related to the Enbridge incident, which temporarily and abnormally decreases the Company's equity ratio.[5]

Q. Has Cascade maintained approximately the same equity in its capital structure in 2020?

A. Yes, Cascade's adjusted, year-end 2020 capital structure includes an equity share of 50.1 percent. This reflects a $20 million equity infusion in December 2020. As shown in Table 2 below, updated for 2020 data, Cascade's adjusted, three-year average equity ratio is 50.3 percent, in line with the request in this case.

Table 2: Cascade's Adjusted Year-End Capital Structure

Capital Structure				
	Adjusted 12/31/2018	Adjusted 12/31/2019	Adjusted 12/31/2020	Average
Total Debt	49.2%	49.9%	49.9%	49.7%
Common Equity	50.8%	50.1%	50.1%	50.3%

Q. Why do you believe that recognition of Cascade's actual equity ratio in rates is critical to its current credit ratings?

A. There are two primary reasons. First, Cascade is in a period of significant capital spending, so a thicker equity ratio is necessary to maintain its credit metrics. Second, rating agencies have increased their scrutiny of utility balance sheets as a result of cash flow issues related to the Tax Cuts and Job Act (TCJA).

[5] *Washington Utilities & Transportation Commission v. Cascade Natural Gas Corp.,* Docket UG-190210, Direct Testimony of Tammy J. Nygard, Exh. TJN-IT at 4 (Mar. 29, 2019).

Q. In light of these factors, could a decision to reduce Cascade's actual equity share in this case result in a rating downgrade?

A. Yes. As explained in the Direct Testimony of Ms. Bulkley, Fitch Ratings ("Fitch") downgraded Cascade from A- to BBB+ in August 2018 based on weaker financial metrics resulting from the Company's elevated capital expenditures and a "less than favorable outcome in its Washington rate case."[6] Fitch's downgrade focused on the negative regulatory treatment of TCJA changes and "a below-average 9.4% authorized ROE and 49% equity ratio."

Fitch recently affirmed Cascade's credit rating, but made note of Cascade's weakened credit metrics "as a result of the negative effects of tax reform and a large capex program focused on accelerated pipe replacement." Fitch stated that, given Cascade's higher leverage, "balanced rate orders in pending and future proceedings will be key to maintaining existing ratings."[7] Fitch commented that, as a result of below-average ROEs and regulatory lag in Washington, Cascade has been underearning its authorized return for several years.[8]

Similarly, S&P changed its outlook on Cascade to negative in March 2020. S&P noted that Cascade's stand-alone metrics did not support its current rating, and its smaller than average customer base increased its risk. S&P pointed to Cascade's credit-supportive relationship with its parent MDU Resources Group Inc., as well as

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[6] FitchRatings, *Fitch Affirms MDU Resources, Centennial Energy; Downgrades Cascade; Outlook Stable* (Aug. 1, 2018).
[7] *See* Nygard, Exh. TJN-5 (FitchRatings, *Fitch Affirms Ratings of MDU, Montana-Dakota, Cascade and Centennial Energy; Outlooks Stable* (Dec. 22, 2020)).
[8] *Id.*

Cascade's ability to effectively manage regulatory risk, as the factors justifying retention of its current credit rating.[9]

Q. Do the witnesses for Staff and intervenors consider the impact of their capital structure or overall rate of return recommendations on Cascade's credit ratings?

A. No. This is a significant omission given rating agency concern about Cascade's weak credit metrics.

V. RESPONSE TO PARTIES' ALTERNATIVE CAPITAL STRUCTURES

Q. Staff witness Mr. Parcell recommends a hypothetical capital structure with a reduction in Cascade's equity ratio to 48.5 percent.[10] Does Mr. Parcell explain the source of this number?

A. Not really. Based on Mr. Parcell's argument that 48.5 percent was the equity ratio authorized for PSE and Avista in 2020, presumably he picked the number on this basis.[11] But the issue was uncontroverted in PSE's case and settled in Avista's case, so there is no record from which to determine the reasonableness of a 48.5 percent capital structure as applied to Cascade.[12] The Commission approved a higher equity ratio of 49.1 percent for PacifiCorp, which is the same as Cascade's currently authorized equity ratio, but this was also presented to the Commission as a settlement.[13]

Q. Mr. Parcell claims that Cascade's actual equity ratio in 2018 and 2019 was 49.1 percent and 46.6 percent, respectively, lower than the 50.4 percent adjusted

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[9] *See* Nygard, Exh. TJN-5 (S&P Global Ratings Research Report, Cascade Natural Gas Corp. (Mar. 31, 2020)).
[10] Direct Testimony of David C. Parcell, Exh. DCP-1T at 23.
[11] *Id.* at 24.
[12] PSE GRC at ¶ 28; Avista GRC at ¶ 34.
[13] PacifiCorp GRC at ¶ 56.

average cited in your Direct Testimony.[14] Please respond.

A. Mr. Parcell relies upon Cascade's unadjusted capital structure which includes the extraordinary costs associated with the three-year amortization of the PGA balance for the Enbridge incident. He claims there is no basis for excluding the debt costs associated with financing these costs from Cascade's capital structure. But Mr. Parcell does not respond to Cascade's position that, because gas costs are normally recovered in one year, the financing impact of the three-year recovery period should be removed so that the capital structure is normalized for the rate period.

Q. Mr. Parcell claims that Cascade is recovering a FERC interest rate on the deferred PGA balances, so there is no basis for an adjustment to the capital structure. Is this a valid argument?

A. No. The FERC interest rate corresponds to a debt rate, not an equity rate. But under Mr. Parcell's position, unless Cascade covers the cost of the deferred PGA balances with an additional equity infusion (the costs of which are not covered by the FERC interest rate), the deferred PGA balance will reduce the equity and increase the debt in Cascade's capital structure for purposes of setting rates in this case. Gas purchases are operating costs, however, and Cascade should not be forced to cover the deferred PGA balance with equity to establish its target equity ratio in the rate effective period, especially given the temporary and unusual nature of this cost.

Q. Mr. Parcell claims that Cascade has had an equity ratio less than 50 percent for the last five years.[15] Is this accurate?

[14] Parcell, Exh. DCP-1T at 21.
[15] *Id.*

A. No. As adjusted to remove the deferred PGA costs, Cascade's most recent three-year average (2018-2020) equity ratio is 50.3 percent, which is in line with the Company's request. Given Cascade's ratings downgrade in 2018 resulting from weak credit metrics, equity ratios before that time should not be relied upon for determining a safe and appropriate equity ratio for the rate period.

Q. Does Mr. Parcell provide evidence supporting the reasonableness of Cascade's proposed equity ratio?

A. Yes. First, Mr. Parcell testifies that the average equity ratio in the proxy group (which is the same as Cascade's proxy group) is 54.3 percent, 390 basis points higher than Cascade's proposed ratio and 580 basis points higher than Mr. Parcell's recommendation.[16] Second, Mr. Parcell provides the average common equity ratios awarded to natural gas companies between 2012 and 2019. For this eight-year period, the average equity ratio was 50.6 percent, which is just above Cascade's proposed ratio and 210 basis points higher than Mr. Parcell's recommendation.[17] Analyzed against comparable companies, Cascade's requested equity ratio of 50.4 percent is at or below average, confirming its reasonableness. In contrast, Staff's recommendation for a 48.5 percent equity share is well below prevailing levels.

Q. Public Counsel witness Dr. Woolridge recommends an equity ratio of 49.1 percent.[18] Please respond.

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[16] *Id.* at 22. Mr. Parcell's analysis was conducted at the holding company level. As I discuss in my response to Dr. Woolridge's testimony, the correct comparison is to the capital structures of the utility subsidiaries, which contain higher equity ratios.
[17] *Id.*
[18] Response Testimony of Dr. J. Randall Woolridge, Exh. JRW-1T at 22.

A. Dr. Woolridge first claims that Cascade's average actual equity ratio between 2018-2020 is 48.52 percent.[19] Dr. Woolridge impliedly rejects Cascade's adjustment to normalize the impact of the deferred PGA balance, which is incorrect for the reasons I have explained. Second, Dr. Woolridge claims that the holding companies in his proxy group (which includes six of the eight companies in Cascade's proxy group) had an average common equity ratio of 46.1 percent in December 2019.[20] As explained by Ms. Bulkley in her Rebuttal Testimony, however, the appropriate comparison is to the equity at the utility operating company level, which reflects an average common equity ratio of 56.67 percent for the companies in Cascade's proxy group.

Q. AWEC witness Mr. Mullins recommends an equity ratio of 47.1 percent.[21] Please explain the basis of this recommendation.

A. Mr. Mullins claims that Cascade is highly leveraged because its debt issuances represent approximately 66 percent of Cascade's rate base.[22] For this reason, he proposes a reduction of 200 basis points from Cascade's current authorized equity ratio of 49.1 percent to 47.1 percent.[23]

Q. Is there any theoretical or practical basis for measuring leverage using rate base as Mr. Mullins suggests?

A. No. Mr. Mullins does not cite any support for his novel theory and his reduction to Cascade's proposed equity ratio appears to be arbitrary. Financial institutions, credit

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[19] *Id.*
[20] *Id.* at 21.
[21] Response Testimony of Bradley G. Mullins, Exh. BGM-1T at 16.
[22] *Id.* at 15.
[23] *Id*. at 16.

rating agencies and regulators gauge leverage based on a utility's total balance sheet, not solely its rate base. Cascade, like other utilities, finances items other than rate base, so there is no rational basis to develop a capital structure by comparing debt to rate base.

VI. COST OF DEBT UPDATE

Q. Please explain the update to Cascade's cost of debt.

A. After the June 2020 debt issuance discussed in my Direct Testimony, Cascade went through a review process to evaluate all long-term debt to determine if any could be redeemed without a make-whole payment, so that the Company could take advantage of the current low interest rates. With this review, Cascade determined that there was a $25 million long-term debt that was callable at par. Based on this, the Company evaluated potential savings and moved forward with a new debt issuance to replace this long-term debt. By refinancing this debt, Cascade will be saving its customers $6 million over the 15 years of the debt. Exhibit No. __ (TJN-6C) includes support for the savings over the 15 years.

Q. Does the Company's Rebuttal Filing reflect the new 4.589 percent cost of debt and associated cost savings?

A. Yes.

Q. Have any parties raised concerns about the proposed cost of debt in this case?

A. AWEC raises two issues. First, AWEC claims that Cascade was likely aware of the new debt issuance before it filed this case and should have included the impact in its

Initial Filing.[24] AWEC has no evidence for this claim and it is not true. As I explained above, Cascade decided to refinance debt in response to economic conditions this summer, a decision that occurred after the Initial Filing.

Second, AWEC calculates the updated cost of debt including this new issuance as 4.540 percent, lower than Cascade's 4.589 percent.[25] Cascade's figure uses actual amortization of the debt, as illustrated in Exhibit No. __ (TJN-7C), and is more complete and accurate than AWEC's calculation.

Q. Does this conclude your Rebuttal Testimony?

A. Yes.

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[24] *Id.* at 13.
[25] *Id.*