

**PUBLIC UTILITY COMMISSION OF OREGON
INTEROFFICE CORRESPONDENCE**

DATE: July 19, 2011

TO: Marc Hellman through Michael Dougherty

FROM: Linnea Wittekind

SUBJECT: **Staff's Review of MDU/Cascade Natural Gas Merger Stipulation Commitments.**

The Program Manager of the Corporate Analysis and Water Regulation Division within the Oregon Public Utility Commission (Commission) and Northwest Industrial Gas Users (NWIGU), requested Commission Audit Staff to examine the commitments that resulted from the merger stipulation between MDU Resources Group, Inc. (MDU) and Cascade Natural Gas (Cascade or Company). In performing the audit, Staff sent seven data requests to Cascade Natural Gas.

Audit Objective

- To ensure that the Commitments with an ongoing status were in compliance.

Scope

- Using a sample method, Staff reviewed seven of the ongoing Commitments.

Background

On June 5, 2007, the Commission entered into Order No. 07-221 (Order) in UM 1283. In that Order, the Commission approved an application filed by MDU for authorization to acquire Cascade. The Order approved the Stipulation entered into among MDU, Cascade, Commission Staff, the Citizens Utility Board, NWIGU, Community Action Directors of Oregon, Oregon Energy Coordinators Association and the NW Energy Coalition.

Exhibit 1 of the Stipulation consisted of a list of 35 commitments (Commitments) that were agreed to by MDU and Cascade. The Washington Utilities and Transportation Commission also provided feedback of the Commitments and their revisions are part of the final set of Commitments as approved in Commission Order No. 07-320.

Commitment No. 23 requires MDU/Cascade to file a report with the Commission regarding the implementation of the conditions within twelve months of the closing transaction, which occurred on July 2, 2007, and annually thereafter through 2012. Cascade has been in full compliance with this commitment.

Review of Commitments

Staff reviewed Commitment Nos. 10, 11, 22, 25, 27, 32, and 35 all of which are ongoing Commitments. The following is a summary of each Commitment reviewed and Staff's assessment regarding Cascade's compliance of each of the Commitment's reviewed.

Commitment No.10

Cascade commits that during the period of this condition (through December 2012), Cascade’s administrative and general (A&G) costs, excluding Account 904 costs, for rate making, revenue sharing, and regulatory reporting purposes shall be the lesser of its actual 900 Account costs (excluding 904) or the benchmark for the applicable year. MDU/Cascade is in compliance with this Commitment.

Table 1 – A&G Comparison

Year	A & G Benchmark	A & G Actual
2008	\$7,619,691	\$6,409,884
2009	\$7,592,780	\$6,489,321
2010	\$7,717,305	\$7,380,047

Staff reviewed the actual expenses in accounts 901-935 for 2008 through 2010 and did not note any unusual expenditures. Cascade was unable to provide budgeted expenses for the same accounts as they do not budget by FERC account number. When comparing the yearly actual total of accounts 901-935 to the A&G actual as shown in Table 1, Cascade’s actual A&G is consistently below the A&G benchmark and the FERC accounts 901-935.

Commitment No. 11

Beginning at the same time as the fall PGA rate adjustment and continuing through December 2012, Cascade will provide annual rate credits of \$200,000 to Oregon customers distributed on an equal margin basis unless otherwise ordered by the Commission. MDU/Cascade is in compliance with this Commitment.

Cascade provided copies of the section of the 2008 through 2010 PGA filings showing the annual rate credit of \$200,000.

Commitment No. 22

MDU and Cascade commit that Cascade will maintain adequate staffing and presence in each state in which it operates, consistent with the provision of safe and reliable service and cost-effective operations. The following table highlights Cascade’s Oregon staffing.

Table 2 – Oregon Staffing Level

Year	Cascade	MDU
2007	76	0
2008	74	0
2009	61	0
2010	63	0

Cascade explained that at they are able to ensure safe, reliable and cost-effective service at this staffing level in Oregon by utilizing technology that has been implemented in recent years. Cascade has introduced automated meter reading (AMR), Sharepoint,¹ and a leak survey program into its service territory which according to Cascade will improve service, safety and reliability.

Staff agrees with Cascade that with current technology and the introduction of Cascade’s programs they are taking steps to ensure safe, reliable, and cost-effective service. Staffing levels are reviewed by Cascade as part of the business planning process cycle. During the current economic downturn Cascade has not increased its Oregon workforce, instead the staffing levels have decreased since 2007.

Commitment No. 25

Cascade/MDU will maintain at least Cascade’s current level of charitable contributions in Oregon and Washington. In addition, qualified tax-exempt 501(c)(3) entities will be eligible to apply for grants from MDU Resources Foundation. Cascade and MDU are in compliance with this Commitment.

Table 3 – Charitable Contributions

Year	Oregon	Washington
Pre – Merger	\$5,677	\$19,800
2007	\$7,947	\$27,721
2008	\$29,796	\$43,805
2009	\$67,213	\$127,457
2010	\$58,118	\$129,619

As shown in the above table, Cascade has increased its charitable contributions since the merger and has been increasing contributions each year. According to Cascade, all expenditures are tracked throughout the year to ensure that the Company is making equitable allocations. MDU has been awarding grant money to qualified entities since 2008. Staff has confirmed that charitable contributions are properly booked into Account 426.1 *Donations*, a non-utility account. See Table 4 for the total Oregon and Washington amounts awarded for 2008 through 2010.

Table 4 – MDU Grants

Year	Oregon	Washington
2008	\$12,500	\$2,374
2009	\$32,805	\$14,250
2010	\$17,500	\$5,500

¹ According to the Microsoft SharePoint website: “Microsoft SharePoint 2010 makes it easier for people to work together. Using SharePoint 2010, your people can set up Web sites to share information with others, manage documents from start to finish, and publish reports to help everyone make better decisions.”

Some of the qualifying 501(c)(3) entities that MDU has awarded grants to include: Community Connection of Northeast Oregon, Community Action Program of East Central Oregon, and the Juvenile Diabetes Research Foundation Northwest Chapter based in Seattle, WA. In 2009 MDU awarded two \$10,000 grants, one to the Pendleton Round-Up Foundation and the other to the Sunnyside Community Hospital Foundation in Sunnyside, WA.

Commitment No. 27

Cascade will not declare or make any dividend to MDU or any other person that owns or holds any equity interest in Cascade, unless, on the date of such dividend, either Cascade's Interest Coverage Ratio is equal to or greater than 3:1 or Cascade's unsecured debt rating is at least investment grade (BBB- or its then equivalent with Standard & Poor's Ratings Group and Baa3 or its then equivalent with Moody's Investors Service, Inc). Cascade is in compliance with this Commitment.

Cascade's Interest Coverage Ratio (Earnings Before Interest, Taxes, Depreciation, and Amortization/Interest Expense) has been greater than 4:1 since the Company's merger with MDU Resources. Cascade provided Staff with a Company prepared matrix showing the ratio calculations.

Cascade's unsecured debt is currently rated BBB+ by Standard & Poor's (S&P) and was previously rated Baa1 by Moody's until Cascade shifted from Moody's to S&P earlier this year. The Baa1 rating remained constant since before the Company's merger with MDU. Cascade provided Staff with current credit rating reports. While reviewing the credit rating reports Staff was able to verify that Cascade is maintaining its own corporate credit ratings with both S&P (BBB+) and Fitch(A- for Long-term Issuer Default Rating), which is one of the requirements of Commitment No. 13. Both credit ratings are investment grade.

Commitment No. 32

MDU/Cascade affirm that they understand the commitments made by Cascade in Docket UG 167 regarding Service Quality Measures backed by revenue requirement reductions and the agreement to contribute certain revenues for public purposes, including conservation and assistance to low-income customers for bill-paying and weatherization as established in that Docket.

In part b. of Commitment No. 32 Cascade further agrees to continue public purpose funding though September 2012, and such funds shall continue to be distributed to the Energy Trust of Oregon (ETO) and community service agencies as prescribed in Section 10 of the UG 167 Stipulation. Cascade is in compliance with this Commitment.

Table 5 – Public Purpose Funding

Year	ETO	Weatherization	Community Agencies
2007	\$934,266	\$15,728	\$9,592
2008	\$967,082	\$54,245	\$7,347
2009	\$1,000,175	\$53,866	\$15,903
2010	\$1,442,280	\$153,671	\$8,191

In Section 10 of the UG 167 Stipulation, Cascade shall provide 0.75 percent of current Oregon revenues generated by Cascade rate schedules 101, *Residential Service Rate*, and 104, *Commercial Service Rate*, including customer service charges, but no less than \$500,000 per year, as public purposes funds to be distributed to ETO and community service agencies for the pursuit of demand side management (DSM) programs for residential, commercial and firm industrial sales customers.

As shown in Table 5, Cascade has been complying with UG 167 as well as Commitment No. 32 of the MDU/Cascade Merger Stipulation.

Commitment No. 35

Cascade agrees to join the Intervenor Funding Program that was established in Commission Order No. 03-388, beginning in calendar year 2007, under the same terms and conditions as other utilities participating in the program, with the exception that Cascade will make available \$30,000 in each of the three accounts specified in that Order. Cascade also agrees to support an extension of the Intervenor Funding Program beyond 2007. Cascade is in compliance with this Commitment.

The three accounts specified in Order No. 03-388 were; Citizens' Utility Board of Oregon (CUB), Preauthorized Matching Fund (ICNU and NWIGU), and an Issue Fund. The Issue Funds may be used by any pre-certified or case-certified intervenor. The table below shows the totals contributed to CUB and NWIGU as well as the yearly total distributed. According to Cascade there has been no money distributed from the Issue Fund during 2007 through 2010 because there have been no applications to these funds.

Table 6 – Distributed Intervenor Funds

Year	CUB	NWIGU	Total
2007	\$30,000	\$500	\$30,500
2008	\$30,000	\$6,716	\$36,716
2009	\$30,000	\$1,787	\$31,787
2010	\$30,000	\$133	\$30,133

Staff Recommendation

Staff recommends that Cascade Natural Gas continue to comply with Commitment No. 23 of the MDU/Cascade Natural Gas Merger Stipulation and continue to file an annual report through 2012 with the Commission regarding the implementation of the conditions.

Cascade Merger Commitment Audit
July 19, 2011
Page 6

Staff appreciates Cascade's cooperation with this audit.

CC to: Bob Jenks, Citizens' Utility Board
Tommy Brooks, o/b/o Northwest Industrial Gas Users