

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

IN THE MATTER OF THE PETITION OF AVISTA CORPORATION, D/B/A AVISTA
UTILITIES FOR AN ORDER AUTHORIZING IMPLEMENTATION OF NATURAL GAS
DECOUPLING MECHANISM AND TO RECORD ACCOUNTING ENTRIES ASSOCIATED
WITH THE MECHANISM

DOCKET NO. UG-060518

DIRECT TESTIMONY OF STEVEN G. JOHNSON (SGJ-1T)

ON BEHALF OF
PUBLIC COUNSEL

November 13, 2006

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STEVEN G. JOHNSON EXHIBIT LIST

- | | |
|---------------------------|--|
| Exhibit No. ____ (SGJ-2) | Estimated Company Sponsored Therms Achieved in 2005 by Rate Schedule |
| Exhibit No. ____ (SGJ -3) | Schedule 101 Lost Margin and Deferral from 2004 - 2005 |
| Exhibit No. ____ (SGJ-4) | Schedule 101 Lost Margin, Total Margin and Deferral from July 2005 – June 2006 |
| Exhibit No. ____ (SGJ-5) | Schedule 101 Lost Margin and Deferral from January 2007 – June 2007 |
| Exhibit No. ____ (SGJ-6) | Schedule 101 Lost Margin and Deferral from July 2007 – June 2008 |
| Exhibit No. ____ (SGJ-7) | Gas Efficiency Incentive/Penalty Mechanism |

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I. INTRODUCTION

Q. Please state your name, employer, and business address.

A. My name is Steven G. Johnson. I am employed as a Regulatory Analyst for the Public Counsel Section, Washington State Attorney General’s Office. My business address is 800 5th Avenue, Suite 2000, Seattle, Washington 98104-3188.

Q. Please briefly describe your educational background and professional experience.

A. I have a Bachelor of Science Degree from The Evergreen State College and a Master of Public Administration from The Evans School at the University of Washington. I have been employed as a Regulatory Analyst with Public Counsel Section of the Washington State Attorney General’s Office for 2 years. Prior to my employment with Public Counsel, I was employed at Puget Sound Energy as a Transmission Resource Analyst (merchant transmission planning) for approximately two and a half years including an internship. I have appeared before the Commission for Public Counsel in several Open Meetings and as a witness in the settlement panel for the PacifiCorp/MidAmerican merger. *In the Matter of the Joint Application of MidAmerican Energy Holdings Company and PacifiCorp, d/b/a Pacific Power & Light Company For an Order Authorizing Proposed Transaction*, Docket No. UE-051090. I have also provided written testimony on behalf of Public Counsel in the Avista ERM case, *In the Matter of Avista Corporation, d/b/a Avista Utilities, for Continuation of the Company’s Energy Recovery Mechanism*, Docket No. UE-060181.

Q. For whom are you testifying?

A. I am testifying on behalf of the Public Counsel Section of the Office of the Attorney General of the State of Washington (Public Counsel).

Q. What is the purpose of your testimony?

1 A. My testimony responds to the settlement and supporting testimony filed in this docket
2 requesting approval of a natural gas decoupling mechanism. Because the proposal is
3 largely based on, and similar to Avista's originally filed proposal, I also respond to the
4 Company's pre-filed direct testimony and earlier discovery responses where
5 appropriate. As an alternative to the settlement, I conditionally propose a pilot program
6 based on an incentive/penalty conservation mechanism which is more cautious and
7 conservative with ratepayer dollars.

8 **Q. Can you summarize your recommendations and provide an overview of your**
9 **testimony?**

10 A. The Commission should reject the settlement proposal. Instead, if the Commission
11 finds that Avista meets the standard set out in the *Washington Utilities and*
12 *Transportation Commission v. PacifiCorp d/b/a/ Pacific Power & Light Company*,
13 Docket UE-050684, Order 04, (PacifiCorp Order), ¶ 109 to be met with regard to
14 incremental conservation and effects on low-income ratepayers, I recommend the
15 Commission approve a pilot gas energy efficiency incentive mechanism. My proposal
16 for inducing Avista to achieve company sponsored conservation imposes a far smaller
17 financial burden on ratepayers and takes into account the existing regulatory
18 environment.

19 My testimony begins in Section II with a review of the stated goals of the
20 settlement and the joint testimony in support of the settlement's decoupling proposal.
21 Section III describes the reasons the Commission should reject the settlement. Finally,
22 Section IV provides details of my direct conservation incentive mechanism proposal.

1 **II. THE GOAL OF THE SETTLEMENT PROPOSAL**

2 **Q. What is the stated goal of the settlement decoupling proposal?**

3 A. The settlement states it will “serve the broader interest of removing disincentives to
4 engage in additional conservation.”¹ However, the parties neither identify what these
5 additional conservation measures would be nor require the DSM target in their
6 mechanism to be increased over the current level. The settlement testimony state that
7 the decoupling mechanism would “further promote energy efficiency and
8 conservation.”² There seems to be some confusion between these two claimed goals as
9 to whether decoupling simply will make Avista *indifferent* to conservation or whether
10 decoupling will induce Avista to pursue conservation. In my review of the settlement
11 proposal, I discuss the actual effect of the proposal that is before the Commission.

12 **Q. Does the Company claim that the rate setting procedures available to them
13 including a general rate case proceeding are not adequate for setting rates?**

14 A. No. The Company has made no claim that Avista’s current rates are not fair, just, and
15 reasonable, that general rate cases do not provide a means to set reasonable rates, or
16 that this decoupling proposal is necessary to generate a revenue increase that Avista
17 needs in order to earn a reasonable rate of return. Avista claims the rate increases in the
18 last two general rate cases were due to the decline in customer use, but provides no
19 supporting documentation.³ In fact, it is important to recall that Avista entered
20 settlement agreements in its two most recent cases stipulating that the agreements set
21 rates at fair, just, and reasonable levels. *WUTC v. Avista Corporation*, Fifth
22 Supplemental Order, Docket No. UE-011595, ¶¶ 34-40. *WUTC v. Avista Corporation*,

¹ Settlement Agreement, p. 2, ¶ 5.
² Exhibit No. __T(Joint-1T), p. 7, ll. 11-12
³ Exhibit No. ____ (BJH-1T), p. 4, ll. 8-9.

1 UE-050482, UG-050483, Order No. 05, Appendix A (Settlement Agreement), ¶ 21,
2 (Avista 2005 GRC Settlement Order). Also, Avista has not made a claim in this case
3 that it faces the type of dire financial situation that could warrant a request for interim
4 or emergency rate relief.

5
6 **III. THE SETTLEMENT DECOUPLING PROPOSAL SHOULD**
7 **BE REJECTED AS NOT IN THE PUBLIC INTEREST**

8
9 **A. The Settlement’s Focus on Declining Use Among a Select Group of**
10 **Customers is Misleading.**

11
12 **Q. By isolating lost sales due to declining use, is the monthly deferral decoupling**
13 **calculation in the settlement a departure from test year ratemaking principles?**

14 A. Yes. The calculation of the monthly deferral amount is a deferral mechanism that adds
15 to company revenue between rate cases. As such, it constitutes single issue ratemaking.
16 The deferral mechanism compares the total therm use of Schedule 101 (residential and
17 small commercial) customers during the 2004 calendar year to their use in certain
18 future periods. The difference in use, which is usually a decline, is multiplied by the
19 Schedule 101 margin. Ninety percent of the total is available to place in rates if certain
20 other conditions are met.⁴ The deferral amount can be placed into rates even when the
21 total amount of Avista’s Schedule 101 sales increase. This allows Avista to collect
22 additional revenue for declining use among a cohort of 2004 customers between rate
23 cases while also getting additional revenue sales from new customers. This abandons

⁴ Avista Response to Public Counsel Data Request No. 34, column “Total Usage” under Washington Schedule 101 Natural Gas Service shows frequency of decline/increase.

1 the matching principle fundamental to ratemaking and recently reaffirmed by the
2 Commission in the Avista 2005 GRC Settlement Order, ¶¶ 108-117. The monthly
3 deferral calculation is in fact a revenue stabilizing mechanism attached to a DSM test
4 and an over-earnings test. As I discuss later in detail, this is why there is a disconnect
5 between removal of “disincentives” for Company-sponsored conservation, as claimed
6 in the settlement, and the large amounts deferred for collections in rates.

7 **Q. Are there factors other than Avista-sponsored conservation that contribute to the**
8 **decline in use that is tracked and deferred under the settlement proposal?**

9 A. Yes. Avista acknowledges that the monthly deferral calculation includes “conservation
10 and price elasticity.”⁵ Elasticity, which is the customer’s response to price changes, is
11 especially pertinent because the last several years, high gas prices have caused
12 customers to curtail gas use. There are other causes for decline as well, including:

- 13 • Replacement of older, less efficient gas appliances and furnaces,
- 14 • Tighter and more efficient residential and commercial buildings codes and
15 designs,
- 16 • Overall economic conditions, and
- 17 • Changes in commercial/industrial customer activity levels.

18 **Q. What is the proportion of decline in use due to Company-sponsored conservation**
19 **versus decline due other influences?**

20 A. Avista has not performed any specific analysis to quantify the contribution of the non-
21 company sponsored conservation items above.⁶ It is possible to derive an estimate of
22 the other influences by comparing Avista-sponsored conservation achievements to the

⁵ Settlement Agreement, p. 5, ¶ 3.

⁶ Avista Response to Public Counsel Data Request No. 32.

1 overall decline of the cohort of 2004 customers. In Exhibit No. __ (SGJ-2), I estimate
2 Avista-sponsored therm savings in year 2005 for Schedule 101 to be approximately
3 273,000 therms. The decline in therm use of the cohort of 2004 customers between
4 2004 to 2005 is over 1.13 million therms.⁷ This is 4 times the decline caused by
5 Company-sponsored conservation.

6 **Q. Is the decline in customer use a new phenomenon?**

7
8 A. No. Avista states that from 1999 to 2005 Schedule 101 customers have reduced their
9 average use by 13.5 percent.⁸ Avista's Response to Public Counsel Data Request No.
10 34 shows a decline in per customer therm use in most years from 1994 to 2005.⁹

11 **Q. If per-customer use has been declining, what has overall consumption done?**

12 A. Schedule 101 total therm use increased by 18 percent between 1994 and 2005 and the
13 total number of customers has increased 41 percent adding additional revenues from
14 fixed charges per customer.¹⁰ Though there is a decline in per customer use over time,
15 additional customers provide overall revenue growth for the company. Avista retains
16 for shareholders the margin revenues gained by new customer use that occurs between
17 rate cases.

⁷ Avista Response to Public Counsel Data Request No. 1; Revised WA Decoupling Calc – Joelle.xls/2005.

⁸ Exhibit No. ____ (BJH-1T), p. 4, ll. 5-7.

⁹ The Company claim of average use per customer includes new customers whose use is believed to be, on average, lower than the use of existing customers. Thus, the addition of new customers drags down the average use of all customers, which are shown in Avista Response to Public Counsel Data Request No. 34. In the prior question I discussed only the decline in therm use of existing year 2004 customers in year 2005.

¹⁰ Avista Response to Public Counsel Data Request No. 34. My calculation: $(2005 \text{ total usage} - 1994 \text{ total usage}) / 1994 \text{ total usage} \times 100 = 18.1 \text{ percent}$ and $(2005 \text{ customers} - 1994 \text{ customers}) / 1994 \text{ customers} \times 100 = 41 \text{ percent}$.

1 **B. The Decoupling Mechanism Deferrals Are Far Out Of Proportion To The**
2 **Lost Margins From Avista’s Own Energy Efficiency Programs.**

3 **Q. Can you please provide a short summary of how the monthly deferral calculation**
4 **in the decoupling settlement works?**

5 A. The decoupling proposal uses a monthly deferral mechanism that compares the total
6 therm use of the cohort of 2004 customers with those same customers’ use in a
7 specified future period. Schedule 101 applies to residential and small commercial
8 customers. The future periods are:

- 9 • January 2007-June 2007
- 10 • July 2007 – June 2008
- 11 • July 2008-June 2009

12 The calculations and deferrals are done on a monthly basis. The therm decline between
13 those periods is multiplied by the Schedule 101 margin rate (\$.20595/therm) and 90
14 percent is put in a deferral account.

15 **Q. Have you prepared a comparison of lost margin due to Company-sponsored**
16 **conservation and the deferral amounts in the decoupling proposal?**

17 A. Yes. The table below shows the estimated deferral amount for the various deferral
18 periods. It also shows the cumulative Schedule 101 lost margins from Company-
19 sponsored conservation.

20 //

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22 ////

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	Table 1: Deferral Periods Analyzed¹¹ (settlement deferral periods in bold) (Numbers rounded to \$1,000)			
	Calendar 2005	July 05 – June 06	January 2007 - June 2007 (projection)	July 2007 - June 2008 (projection)
Decoupling deferral amount (based on \$.20595 margin rate)	\$207,000	\$617,000	\$464,000	\$1.444M
Sch. 101 lost margin due to total Company-sponsored conservation target	\$56,000	\$141,000	\$365,000	\$675,000

2

3 **Q. What is the comparison between the deferral amount in the Company’s simulation**
 4 **period of July 2005- June 2006 and the Schedule 101 lost margin for the same**
 5 **period?**

6 A. The deferral amount in the simulation period is 4.4 times the Schedule 101 lost margins
 7 due to Company-sponsored conservation.¹² The Settlement Agreement and supporting
 8 testimony is silent on the necessity of the additional \$476,109 in the deferral, over and
 9 above the margin lost to Avista conservation efforts. This is excessive, bears no
 10 relationship to the alleged “disincentive” and is burdensome to the ratepayers.

11 **Q. What is the comparison between the deferral amount in the simulation period**
 12 **June 2005-2006 provided by the Company and the total Company lost margins**
 13 **due to Company sponsored conservation?**

¹¹ Calculations in the table are shown in attached exhibits as follows: Calendar 2005 data is from Exhibit No. __ (SGJ-3). July 05 - June 06 data is from Exhibit No. __ (SGJ-4) spreadsheet. January 2007 - June 2007 data is from Exhibit No. __ (SGJ-5). July 2007 – June 2008 data is from Exhibit No. __ (SGJ-6).

¹² Avista provided a simulation of the effect of the monthly deferral calculation in its original decoupling proposal for the period July 2005-June 2006. Avista Response to Public Counsel Data Request No. 17.

1 A. The deferral amount is still 3.3 times more than the total Company lost margins due to
2 Company-sponsored conservation.¹³ The difference between the total Company lost
3 margins and the deferral amount is \$427,000.¹⁴ Neither the settlement, nor the
4 supporting testimony, nor Avista's pre-filed testimony, justifies why this additional
5 money beyond its lost margin is necessary in order to remove the "disincentives to
6 engage in additional conservation."¹⁵

7 **Q. Are the deferral amounts expected to grow?**

8 A. As Table 1 shows the deferral amount grows in each period. The decline in use by the
9 cohort of 2004 customers in calendar year 2005 is captured again by the decoupling
10 mechanism's deferral calculation and is added to the decline in use that occurs in the
11 next year and so on. Referring to the table, the deferral for 2005 is \$207,000. In the
12 next period, only a six month shift forward in time, the deferral amount essentially
13 triples to \$617,000. Using a projection of average decline in customer use, the July
14 2005-June 2006 deferral of \$617,000 more than doubles to \$1.444 million dollars two
15 years later. In percentage terms, these are very large increases that will continue to
16 balloon in future years.

17 **Q. Will the January 2007-June 2007 deferral encourage or remove the disincentive**
18 **for achieving the DSM Target set in the settlement?**

19 A. No. The DSM test to determine how much of the January 2007-June 2007 deferral
20 amount will be placed in rates is based on the Company-sponsored conservation
21 achievement for the year 2006. However, most of that year will have passed by the time
22 the Commission issues a ruling. The Company's behavior cannot be changed

¹³ Exhibit No. ____ (SGJ-4), tab Total Lost Therms.

¹⁴ Id.

¹⁵ Exhibit No. ____ T(JOINT-1T), p. 7, ll. 6-7.

1 retroactively. The inclusion of January 2007-June 2007 deferral amounts in rates
2 provides no incentive for a change in Company behavior, yet it may require Schedule
3 101 customers to pay nearly \$464,000.

4 **Q. If the \$464,000 in deferral does not change the Company's behavior, what does it**
5 **do?**

6 A. It provides rate stabilization. It reaches back from the 2007 deferral period to the 2004
7 test period to assure that the Company collects margins on a level of therm use that the
8 cohort of 2004 customers no longer wants to buy from the Company.

9 **Q. Is it necessary for the deferral calculation to reach back to the 2004 test year**
10 **period to remove the disincentive for achieving Company-sponsored**
11 **conservation?**

12 A. No. The decline in use, the Company sponsored conservation, and the lost margins
13 have already occurred. The Company has engaged in conservation efforts from 2004
14 through almost of all 2006. There is no logical basis for a mechanism that is intended
15 to encourage more conservation to retroactively reimburse the Company for
16 conservation efforts (and other declines in use) that have already occurred.

17
18 **C. The Decoupling Settlement Unfairly Burdens Schedule 101 Residential**
19 **Customers.**

20 **Q. Are the decoupling deferral revenues collected only from residential and small**
21 **commercial customers under the settlement proposal?**

22 A. Yes, as I noted above, the full amount of eligible decoupling revenue (that is, 90
23 percent of the lost sales amount) is placed in a deferral account for eventual collection
24 in Schedule 101 rates, subject only to DSM and earnings tests.

25 **Q. Did the originally filed mechanism include other schedules?**

1 A. Yes. The Company's original filing included Schedule 111 commercial customers in
2 the deferral calculation. Avista's original proposal also provided for recovery of
3 deferred amounts from the decoupling mechanism in Schedule 111 rates. In settlement,
4 Schedule 111 was removed. The settlement does not explain why this occurred or
5 provide a justification for the change.

6 **Q. Why be concerned with this?**

7 A. The monies involved are significant. For the period July 2005-June 2006, for example,
8 the Schedule 101 residential customers would incur \$617,000 of deferral for collection
9 in rates.¹⁶ This amount could easily increase to \$1.4 million in the July 07 – June 08
10 period.

11 **Q. Why is this important?**

12 A. This change has created a very significant new flaw with the proposal. This is because
13 41 percent of all the therms saved by Company-sponsored energy efficiency in the two
14 schedules are attributable to Schedule 111 customers.¹⁷ Under the settlement proposal
15 however, only Schedule 101 customers now pay for decoupling. This creates two
16 serious problems. First, if any incentive effect does occur as a result of decoupling, it
17 will benefit Schedule 111 customers who will not be paying anything to remove the
18 "disincentive." Second, the settlement decoupling proposal recovers an amount that
19 exceeds the full lost margins for all of Schedule 101, all of Schedule 111, and
20 additional amounts on top of that. In effect, therefore, Schedule 101 customers are
21 paying not only for their own lost margins, but for all Avista's lost sales volumes for all
22 customer schedules. This amounts to a cross-subsidy.

¹⁶ Avista Response to Public Counsel Data Request No. 1 (as revised pursuant to Public Counsel's request for update), and as revised by Exhibit No. __ (SGJ-4) to reflect the \$.20595 margin rate of the deferral mechanism.

¹⁷ Exhibit No. __ (SGJ-2).

1 **D. The Decoupling Settlement Does Not Encourage Energy Efficiency.**

2 **Q. Does the decoupling proposal in the settlement agreement contain incremental**
3 **conservation?**

4 A. No. In the PacifiCorp Order the Commission required an identification and
5 commitment to “incremental conservation measures.”¹⁸ There is insufficient evidence
6 in this docket to show that the proposed settlement will produce “additional” or
7 incremental conservation as compared to conservation under the existing regulatory
8 framework on a forward-going basis. While the settlement parties claim there will be
9 “additional conservation”,¹⁹ they fail to support this claim with any evidence and do not
10 direct the commission to any causative relationship between the decoupling mechanism
11 and incremental conservation.

12 **Q. How does Avista’s Integrated Resource Planning (IRP) process relate to this**
13 **issue?**

14 A. As a general proposition, the least cost planning, or integrated resource planning
15 process operates independently of decoupling. It is, of course, already in existence as a
16 well-developed regulatory requirement. Thus, the setting of specific DSM targets is a
17 function of the empirical analysis that occurs during the IRP process, as a result of
18 Company and stakeholder collaboration. Therefore, the mere fact that the IRP process
19 might yield a higher savings target in a given cycle does not satisfy the PacifiCorp
20 Order’s requirement for incremental conservation. The 2006 IRP DSM target currently
21 in place for Avista is adopted as the target for the decoupling proposal for deferral
22 periods through June of 2008. The decoupling mechanism’s DSM target for the July
23 2009-June 2010 deferral period will use Avista’s not yet determined 2008 IRP DSM

¹⁸ PacifiCorp Order, ¶¶ 108-109.

¹⁹ Settlement Agreement, p. 2.

1 target, but makes no requirement for the 2008 IRP DSM target to be higher than the
2 level that would otherwise result from WAC 480-90-238, which currently governs the
3 IRP process. While it is not possible to rule out a future increase in conservation
4 targets in the 2008 IRP, speculation does not establish an assurance of the incremental
5 conservation that is necessary to be should be shown in connection with a decoupling
6 proposal. It is certainly far too weak a showing to risk the excessive amounts of
7 ratepayer dollars proposed in the settlement.

8 **Q. Wouldn't the decoupling DSM test create incremental conservation by**
9 **encouraging the company to achieve their DSM target?**

10 A. No. While it is true in theory that additional conservation could be achieved in the
11 future if Avista improved its substandard savings performance to bring it up to DSM
12 target levels, the Company and the settlement parties do not claim that the Avista is
13 failing the obligation set in the 2006 IRP DSM goal. There is no claim that Avista is
14 withholding efforts to achieve the goal currently or will withhold efforts in the future if
15 the Commission does not approve a decoupling mechanism. In Avista's Response to
16 Public Counsel Data Request No.13, Avista states it is making all efforts to meet the
17 IRP goal. It has made similar commitments to acquire all cost-effective natural gas-
18 efficiencies in its 2006 IRP.²⁰

19 **Q. Is there any evidence that current regulation is causing Avista to fail to meet its**
20 **energy efficiency targets?**

21 A. No. In fact Avista has been achieving above its target.²¹ Current regulation is inducing
22 the behavior the decoupling mechanism claims to encourage. Indeed, as I discuss
23 below, the decoupling proposal in this case may actually create a disincentive and may

²⁰ Avista's 2006 Gas IRP, pp. 3-20, ¶ 1.

²¹ See Avista 2006 Gas IRP, pp. 3-15, Figure 3.2 Gas DSM Acquisition.

1 lead to *reduced* conservation.

2 **Q. Does the decoupling mechanism encourage additional conservation above the**
3 **target level?**

4 A. No. Under the DSM test in the decoupling mechanism, once the Company achieves its
5 DSM target savings it is not rewarded to achieve additional conservation above the
6 DSM goal. One of the consequences of the DSM test design, therefore, is to provide an
7 incentive *not* to achieve above the target. Toward the end of the DSM test year, when
8 the Company knows it has achieved its target, the DSM test actually makes it
9 advantageous for Avista to delay additional conservation efforts. For example, in the
10 fall of the DSM test year, the Company could delay mailing out coupons or flyers for
11 its conservation programs, waiting until December so the redemptions begin arriving in
12 the new DSM test year. The savings would then be counted toward the decoupling
13 “reward” in the next year.

14 **Q. Does the settlement decoupling mechanism create other disincentives for**
15 **additional conservation?**

16 A. Yes. There is a risk that, because of the amounts of money at stake, the decoupling
17 mechanism will skew the traditionally more objective and balanced process of setting
18 DSM targets in the IRP process. Under this proposal, Avista has an incentive to
19 suppress its 2008 IRP target to make it easier for the company to meet the DSM test
20 and receive the largest revenue increase available under the test. For example, if Avista
21 is able to lower its 2008 IRP target by 10 percent, it could receive an additional
22 \$144,000 in rates in the 2009 surcharge. By contrast, under current regulation, if the
23 Company is able to reduce its 2008 IRP DSM Goal by 10 percent it avoids
24 approximately \$21,000 in reduced margin revenue due to reduced therm use. For

1 example, Avista could suppress the 2008 IRP DSM goal by avoiding new or innovative
2 conservation programs.

3 **Q. Are there other concerns you have about the DSM aspects of the settlement?**

4 A. Yes. The DSM test is poorly structured and not in the public interest. Rates are
5 increased even if Avista fails to meet its 2006 IRP DSM Goal. Avista can achieve as
6 low as 70 percent of the DSM goal and still have 60 percent of the deferral amounts
7 placed in rates. As demonstrated earlier, 60 percent of the deferral amount can be
8 multiples of Avista's margin loss due to Company-sponsored conservation. The DSM
9 test does not include any penalty, regardless of how badly Avista fails to meet its DSM
10 target. From the ratepayer perspective, a balanced regulatory approach would require
11 Avista to pay a penalty for failing to reach the DSM target if ratepayers are required to
12 pay money to Avista to achieve a DSM target.

13 Also, as I already noted, the DSM test does not provide for graduated incentives
14 above the 100 percent level, thus creating a disincentive for the company to pursue
15 conservation beyond the target.

16 **Q. Are there other consequences of the decoupling mechanism?**

17 A. Yes. Under the current regulatory environment Avista has no monetary incentive to
18 meet its IRP goal with non cost-effective conservation. On the other hand, since under
19 the decoupling mechanism Avista is rewarded for achieving its IRP goal with ratepayer
20 monies, Avista has an incentive to achieve its target even with non-cost effective DSM
21 programs. The decoupling proposal does not explicitly bar Avista from using non cost
22 effective conservation to meet the DSM target. While I do not believe the settlement
23 intends to allow Avista to use non-cost effective conservation to meet its target, the
24 decoupling mechanism would now require regulatory review of the new disincentive to

1 deploy cost-effective conservation.

2

3 **E. Ratemaking Issues, the Porous Earnings Cap, and Other Flaws.**

4 **Q. The decoupling proposal is not proposed in a general rate proceeding, is this a**
5 **problem?**

6 A. The large and increasing deferral amounts under the decoupling mechanism raise
7 concern about the effect on the Company's overall rate of return. Outside a general rate
8 proceeding it is difficult to analyze the effect of deferral amounts and is not possible to
9 alter Avista's rate of return to provide a remedy. The Commission's notice closing
10 decoupling rulemaking recommended that companies file their decoupling proposals in
11 conjunction with a rate case.²² PacifiCorp, PSE, and Cascade Natural Gas have all
12 followed that guidance. Here, Avista seeks to base decoupling on a 2004 test year
13 which will be three years old when the settlement proposal goes into effect and offers
14 the commission no ability to look at an appropriate adjustment to return.

15 **Q. Could you discuss the "roll-over" feature of the earnings test proposed in the**
16 **settlement?**

17 A. The ever-increasing monthly deferral amount points to the possibility that the
18 mechanism could have significant positive effects on the Company's earnings. The
19 settlement parties were apparently aware of this when they included an earnings test.
20 While the earnings test attempts to guarantee that over-earning will not occur during a
21 particular year, it is not a true cap. Instead, the amounts deferred in a given year (year
22 1) which exceed the earnings cap are saved and used to assure earnings in the following
23 year (year 2).

²² *Notice of Withdrawal of Rulemaking*, Docket No. UG-050369.

1 **Q. But doesn't the proposal require these "roll-over" earnings to be offset against any**
2 **further declining margins?**

3 A. Yes, but that only applies if there are declining margins in year 2 that equal or exceed
4 the rolled-over excess earnings carried forward from year 1. If, for example, there are
5 no declines in use in year 2, Avista will still recover 100 percent of the excess earnings
6 amount from the roll-over from year 1 (subject to the earnings and DSM cap applied in
7 year 2). In another example, if Avista's lost margins in year 2 are only one half of the
8 rolled-over excess earnings from year 1, the Company will recover all of the year 2 lost
9 margins plus additional amounts up to the total of excess earnings rolled over from year
10 1. This savings or "roll-over" of the over-earnings from one year to shore up earnings
11 in another provides an earnings stabilization.

12 **Q. Are there other design flaws with the settlement proposal?**

13 A. Yes. The proposal does not deal with the migration of customers between schedules
14 and does not resolve weather normalization issues.

15 **Q. Is there any provision for migration of customers into and out of Schedule 101?**

16 A. No. Schedule 101 is the only schedule covered by the decoupling mechanism. If
17 customers leave Schedule 101 for another Company schedule, Avista will have a
18 decline in therm usage which is added to the amount deferred for collection from
19 Schedule 101 ratepayers. Avista will also collect the margin Avista is due for serving
20 those customers on the schedule to which they migrate. Avista should not also be
21 allowed to continue to collect margin revenue on that same customer in the decoupling
22 mechanism.

23 **Q. Is there an agreed upon weather normalization methodology?**

24 A. The settlement parties have agreed to use the methodology proposed by Avista. This

1 methodology was not approved in the previous rate case. In that case, Staff and the
2 Company did not come to agreement on a methodology but instead committed to
3 working together to design one.²³ This design work did not result in resolution of the
4 issue and weather normalization is again postponed as an issue in this proposal. The
5 settling parties have provided no explanation for why this weather normalization
6 methodology is appropriate to use.

7
8 **IV. PUBLIC COUNSEL'S PROPOSED GAS CONSERVATION**
9 **INCENTIVE PROGRAM**

10 **Q. Why are you proposing an incentive/penalty mechanism for conservation?**

11 A. If the goal is to encourage Avista to do more energy conservation, an incentive
12 mechanism is a better mechanism for a pilot program than a decoupling mechanism. .
13 It is conservative with ratepayer money, creates less regulatory burden, is simple to
14 calculate (and therefore less prone to error), and builds on and is more consistent with
15 the existing regulatory framework, including the least cost planning requirements
16 under WAC 480-90-238.

17 **Q. Are there any reservations you have about proposing an incentive mechanism?**

18 A. Yes. As discussed earlier in my testimony, the record in this case does not demonstrate
19 that the decoupling mechanism will achieve incremental conservation beyond what will
20 be achieved under the current regulatory regime. While my incentive proposal is a
21 better alternative to the decoupling mechanism presented in the settlement, it too only
22 has a possibility, not a certainty, of meeting the incremental conservation requirement
23 the Commission required for decoupling in the PacifiCorp Order. The incentive

²³ Avista 2005 GRC Settlement Order, ¶ 11.

1 mechanism, however, places far less ratepayer money at risk with fewer unintended
2 consequences.

3 **Q. How did you arrive at the incentive levels you propose?**

4 A. I examined the Commission's total set of regulatory tools and authority for inducing
5 conservation. In addition, I examine existing incentives for Avista to provide
6 conservation programs as well as Avista's existing public service obligation. I also
7 examine benchmark calculations of my own and those submitted by parties in this case.

8 **Q. What requirements exist now for Avista to have and achieve company sponsored
9 conservation and what commitments has Avista made to achieve company
10 sponsored conservation?**

11 A. WAC 480-90-238(2)(a) directs the Company to submit a plan "describing the mix of
12 natural gas supply and conservation designated to meet current and future needs at the
13 lowest reasonable cost to the utility and ratepayers." Section (3)(b) goes on to require,
14 "an assessment of commercially available conservation, including load management, as
15 well as a assessment of currently employed and new policies and programs needed to
16 obtain the conservation improvements." Avista has also filed with the Commission its
17 commitment in the 2006 IRP plan to meet all cost effective conservation, stating at
18 page 3-20:

19
20 The company recognizes that this commitment to acquiring all cost-
21 effective natural gas-efficiency potential is not limited by the therm
22 acquisition goals established within this IRP. Avista' implementation of
23 the results of this planning effort will be sufficiently flexible to realize
24 those opportunities even if they are well in excess of expectations.
25 Human and financial resources will be made available to the extent
26 necessary to achieve the cost-effective potential without regard to those
27 goals.
28

29 Avista also states on the same page:

30
31 This uncertainty [customer response to new programs] does not preclude

1 the company from pursuing the planned aggressive ramp-up of natural
2 gas-efficiency programs throughout the service territory.

3 In Public Counsel Data Request No. 13, Avista was asked, “Does the company
4 currently pursue all cost effective conservation measures it is aware of?” The
5 Company responded, “Yes, to the extent the necessary resources are available.”
6 The Company has stated that they believe they are on track to achieve these
7 commitments for the year 2006.²⁴ this has occurred without a decoupling mechanism.
8 The Commission has the authority to take these commitments into account when it
9 reviews prudence, as it noted in its order amending the least cost planning rules.²⁵ For
10 companies with failing records on conservation, therefore, one possible sanction is that
11 additional gas purchase expenses can be disallowed in prudence review. The
12 implementation of the IRP goals are also review by Avista’s Triple External Energy
13 Efficiency Board (Triple E) stakeholders. The Triple E is a stakeholder process for
14 reviewing the Avista’s company sponsored conservation efforts. It allows for the
15 dissemination of technical information and a review of Avista’s implementation of its
16 programs.

17 **Q. Did you consider Avista’s existing public service obligation?**

18 A. Yes. When Avista seeks to persuade new customers to convert to natural gas, it can
19 point to its conservation programs as an example of how the company stands ready to
20 help its new customers manage the cost of their energy services.
21 When natural gas rates increase, Avista can use its conservation programs to help
22 customers meet there energy service needs. Avista’s customers are largely captive, but
23 that does not mean Avista is not obligated to help customers meet their energy services

²⁴ Avista’s Response to Public Counsel’s Data Request No. 45.

²⁵ *In the Matter of Amending WAC 480-90-238 and 480-100-238 Relating to Least Cost Planning For Gas and Electric Companies*, General Order No. R-526, ¶ 28.

1 need. As with service quality, there are public service obligations the Company is
2 required to meet. Customers have also come to expect this service from their utility.

3 **Q. Please describe your incentive program.**

4 A. The incentive program is straightforward. The Company would receive a prescribed
5 reward amount for meeting various achieved levels of conservation. Exhibit No. ____
6 (SGJ-7) shows the incentive bands for achieving the conservation goal and the amount
7 paid for each level of achievement. The bands are the same size as those in the
8 decoupling mechanism. However, unlike the decoupling mechanism, there are no
9 payments to Avista for achieving savings below the target. Instead, there is a deadband
10 in which no incentive is received or penalty accrued. If the Company achieves less
11 than 80 percent of the conservation goal, penalties are assessed. The penalties stop
12 increasing at 60 percent below the target. Failure to meet the DSM target can be
13 pursued as a prudence issue.

14 **Q. How would the DSM target be set and what would it be?**

15 A. The DSM target for the first year of the pilot (2007) would be the 2006 IRP DSM goal.
16 The 2008 IRP DSM goal would be the DSM target for years 2008 and 2009. The 2008
17 IRP DSM target would be submitted in this docket for approval as the target for the
18 incentive program.

19 **Q. Can you describe the evaluation requirements?**

20 A. The conservation incentive program requires an evaluation of the achievement of DSM
21 target in the same way that the decoupling mechanism does. The Triple E report would
22 come out in the spring of the year and be filed in this docket for review. An
23 independent auditor would be hired to evaluate the conservation efforts and submit its
24 findings in the docket just as required in the Settlement Agreement. The auditor would

1 be chosen with stakeholder consent/input. For the year 2008 and 2009 the DSM target
2 would be the 2008 IRP DSM target.

3 **Q. Which rate schedules would pay the conservation incentive?**

4 A. The incentive amounts would be collected 60/40 split between Schedule 101 and
5 Schedule 111. This approximately mirrors the historic distribution of Company-
6 sponsored conservation achieved in the two rate Schedules. If large changes in this
7 ratio occur, parties and the Commission would have discretion to alter the distribution
8 of the collection between the rate Schedules. Unlike the decoupling mechanism, the
9 incentive mechanism does not involve large sums of money. The maximum amount
10 placed in rates annually is \$138,000 as compared to \$1.4 million in the first full year
11 deferral period of the decoupling mechanism.²⁶

12 **Q. Is there a need for an earnings test?**

13 A. No. The amount of ratepayer money at risk in this pilot is a fraction of that at risk in the
14 decoupling mechanism. The more conservative approach to ratepayer's money is the
15 hallmark of the incentive mechanism.

16 **Q. How would the pilot be reviewed?**

17 A. An evaluation plan would be developed among interested parties and submitted to the
18 Commission no later than December 31, 2007.

19 **Q. How does your incentive payment compare to the proposed settlement decoupling
20 mechanism?**

21 A. The incentive mechanism does not involve any complicated calculation to determine
22 the incentive given to the company. Unlike the decoupling mechanism, it does not
23 increase every year. Unlike the decoupling mechanism, which is based on a calculation

²⁶ This is based on the 2006 IRP target of 1 million therms.

1 mostly unrelated to Company efforts, the incentive is properly scaled to Avista's own
2 energy efficiency efforts.

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

4 A. Yes.