**EXHIBIT NO. ___(RJA-11T)**
**DOCKET NO. UE-060266/UG-060267**
**2006 PSE GENERAL RATE CASE**
**WITNESS: RONALD J. AMEN**

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

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| **WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,**<br><br>**Complainant,**<br><br>**v.**<br><br>**PUGET SOUND ENERGY, INC.,**<br><br>**Respondent.** | **Docket No. UE-060266**<br>**Docket No. UG-060267** |

# PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF RONALD J. AMEN ON BEHALF OF PUGET SOUND ENERGY, INC.

**AUGUST 23, 2006**

**PUGET SOUND ENERGY, INC.**

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF RONALD J. AMEN**

**CONTENTS**

**PUGET SOUND ENERGY, INC.**

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF RONALD J. AMEN**

## I. INTRODUCTION

**Q. Are you the same Ronald J. Amen who submitted prefiled direct testimony in this proceeding on February 15, 2006, on behalf of Puget Sound Energy, Inc. ("PSE" or "the Company")?**

A. Yes. Additionally, I hereby adopt the prefiled direct testimony of Janet K. Phelps Exhibit No. ___(JKP-1T), and all exhibits thereto, submitted on behalf of the Company on February 15, 2006.

**Q. Please summarize the purpose of your rebuttal testimony.**

A. My prefiled rebuttal testimony responds to the prefiled response testimony of Steven D. Weiss on behalf of NW Energy Coalition regarding the various elements of his proposed decoupling pilot and related rate design, the prefiled response testimony of Joelle R. Steward on behalf of the Staff of the Washington Utilities and Transportation Commission ("Commission Staff") regarding natural gas decoupling, the prefiled response testimony of Michael L. Brosch on behalf of Public Counsel regarding his views on rate tracking mechanisms generally and his specific criticisms of PSE's proposed Gas Revenue Normalization Adjustment ("GRNA"), and the prefiled joint response of Jim Lazar, Donald Schoenbeck and

Joelle Steward ("Joint Parties") on behalf of Public Counsel, the Energy Project, Northwest Industrial Gas Users, and Commission Staff regarding rate design. Lastly, I describe minor changes to the pro forma revenue that was presented in the prefiled direct testimony of Janet K. Phelps.

**Q. Please summarize your recommendations with regard to the aforementioned testimony.**

A. Based on my review of the points and the underlying support presented by witnesses Weiss, Steward, Brosch, and the Joint Parties concerning the Company's proposed GRNA and other rate design proposals, I have reached the following conclusions and recommendations:

(i) While I concur with the views of NWEC witness Mr. Weiss on the merits of decoupling and its attendant symmetrical benefits for *both* customers and the Company, his specific recommendations with regard to the appropriate rate design to accompany a decoupling mechanism would undermine the effectiveness of the decoupling mechanism and frustrate the bill and revenue stability benefits available through decoupling.

(ii) The modification proposed by Commission Staff witness Ms. Steward to exclude weather from the Company's proposed GRNA is without adequate foundation and misplaced when viewed against the key factors driving the need for the GRNA, including particularly the need to insulate customers and the Company from margin over and under payment and recovery, respectively.

(iii) The criticisms of the GRNA proposal raised by Pubic Counsel's witness, Mr. Brosch, do not address the merits and attempt to cloud the fact that the GRNA benefits both customers and the Company. The Commission should reject the arguments presented by Mr. Brosch and should approve the proposed GRNA for the reasons previously stated in my direct testimony and in this rebuttal testimony.

(iv) The opposition of the Joint Parties to several of the Company's rate design proposals is without either an evidentiary or a rational basis. The Commission should give no weight to their opinion.

I will address these points in detail when I respond to each of the specific criticisms raised by these parties and accompanying recommendations concerning the Company's proposed GRNA and its other rate design proposals.

## II. DECOUPLING

### A. Decoupling reduces the volatility and risk of weather and business cycle variability, and the benefits of this lower volatility and risk flow to both the Company and customers equally.

**Q. Do you have any general observations concerning Mr. Weiss' prefiled response testimony, his discussion of the concept of decoupling, its benefits for utilities and their customers, and his proposed modifications to PSE's proposed GRNA mechanism?**

A. Yes. I agree with Mr. Weiss' conclusion at page 6 of his prefiled response testimony that "decoupling distribution revenues from throughput reduces the volatility and risk of weather and business cycle variability to both customers and the utility." The benefits of this lower volatility and risk flow to both the company and customers equally. However, decoupling should not be tied to specific conservation goals. Such a tie would unnecessarily condition the customers' benefits of decoupling on realizing conservation goals.

**Q. At page 8 of his response testimony, Mr. Weiss provides his views on the most appropriate rate design to accompany a decoupling mechanism. Specifically, he suggests that customer charges should be minimized to include only meter reading and billing costs in order to avoid sending the wrong signal to customers. Do you agree with his position with regard to customer charge levels?**

A. No. Mr. Weiss essentially takes the concept of "price signals" to an extreme, ignoring all other customer-related fixed costs, and presents a pricing scenario that is grounded in the misplaced rationale that *more is better* when it comes to volumetric rates and the "magnitude of reductions that customers can affect in their bills when charged on a volumetric basis." As Mr. Hoff demonstrates in the section of his prefiled rebuttal testimony addressing the criteria offered by Commission Staff witness Ms. Steward for evaluating customer charge levels, an increase in the residential monthly customer charge reduces customer bill volatility, alleviates margin recovery instability, is fair, is understandable, and sends a superior price signal with respect to recovery of margin, and does all this without undue bill impact. Mr. Weiss has it exactly backwards when he states that "shifting charges from volumetric to fixed is exactly the wrong signal to customers."

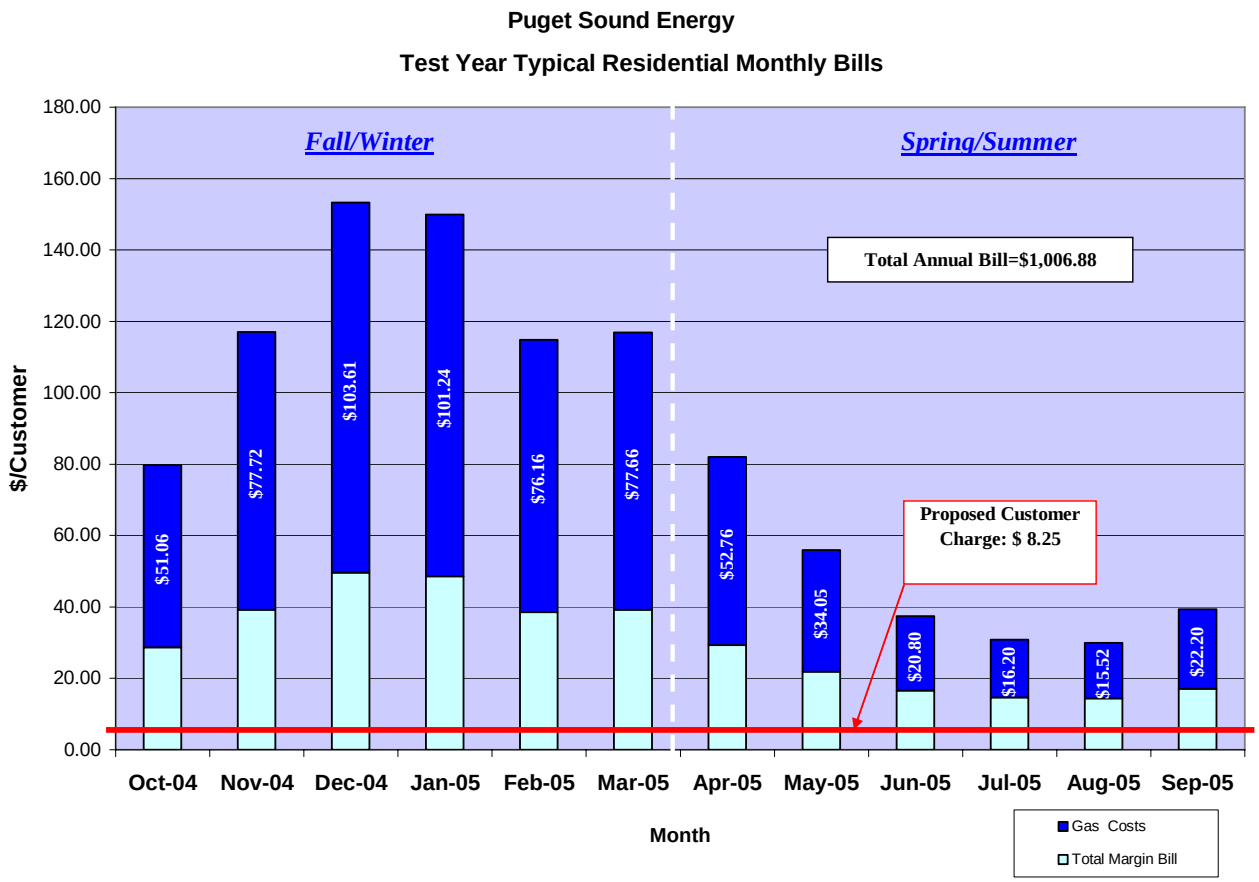
**1. Increases in customer charges will not discourage conservation of natural gas.**

**Q. Do increases in monthly customer charges, such as those proposed by PSE, discourage conservation of the commodity--natural gas?**

A. No. The Company initially proposed a charge of $8.25 per month with adoption of the GRNA and a charge of $17 if the GRNA is rejected. As described by Mr. Hoff in his prefiled rebuttal testimony, Exhibit No. ___(DWH-6T), the Company now believes it would be appropriate to increase the customer charge (and decrease the delivery charge correspondingly) to a level significantly greater than $8.25, up to as much as $17.00.

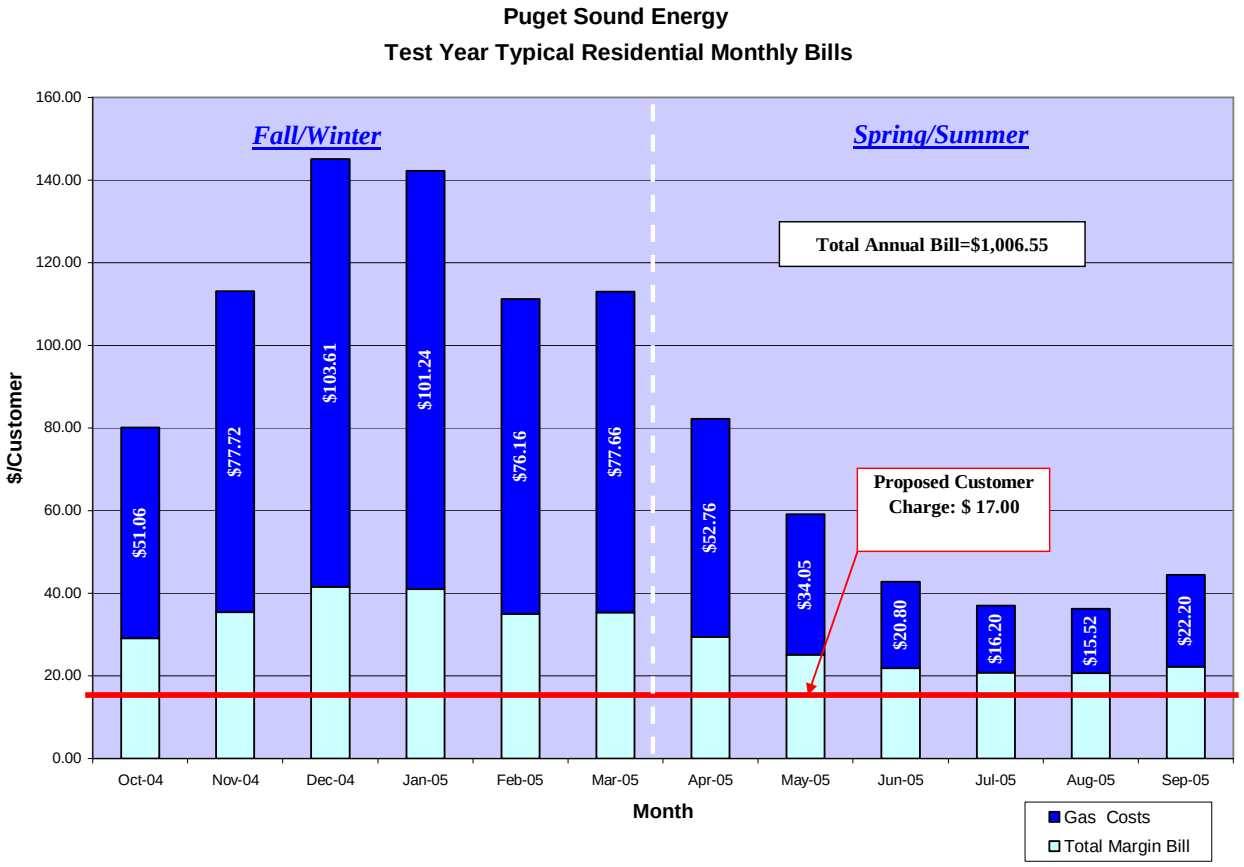
Under the Company's proposed increase to its residential monthly customer charge, customers will continue to have a financial incentive to pursue energy efficiency measures.

First, the portion of the customer's gas bill represented by the Company's monthly customer charges is small relative to the combined total bill, including the gas commodity charges incurred by the customer. As depicted in the chart below and on the accompanying Exhibit No. ___(RJA-12), the portion of the typical residential customer's annual bill represented by the initial proposed customer charge level of $8.25 per month is less than 10% of the total bill.




For a typical residential customer (using 819 Ccf per year), approximately $.002 per Ccf is represented by the proposed increase in the residential monthly customer charge of $2.00. This is a small amount, roughly 0.2% of the customer's average bill under proposed rates of approximately $1.23 per Ccf. The portion of the customer's bill (64%) related to the Company's commodity cost of gas (currently $0.7921 per Ccf) would continue to provide a strong price signal that drives the customer's ongoing gas consumption decisions, as illustrated above.

The following chart, and on the accompany Exhibit No. ___(RJA-13), shows the effect of raising the customer charge to $17 per month. Even at that level, the customer charge is less than 11% of the total bill for January, the month in which the most gas is consumed.




For a typical residential customer (using 819 Ccf per year), approximately $.013 per Ccf is represented by the proposed increase in the residential monthly customer charge of $10.75. This is still a small amount, roughly 1.1% of the customer's average bill under proposed rates of approximately $1.23 per Ccf. As with the prior scenario, the portion of the customer's bill (64%) related to the Company's commodity cost of gas (currently $0.7921 per Ccf) would continue to

provide a strong price signal that drives the customer's ongoing gas consumption decisions, as illustrated above.

In my opinion, the relatively small decrease under either scenario in the amount of fixed costs that would otherwise be recovered in the volumetric rate will not materially affect a customer's decision to use more or less gas.

**2. PSE's rate design proposal to increase the level of its customer charges best aligns the price signals to customers with the underlying costs of providing delivery service.**

**Q. Is there a fundamental presumption underlying Mr. Weiss' position with regard to the nature of the price signals provided to customers under his preferred rate design?**

A. Yes. The presumption is that his volumetrically weighted rate design provides the most appropriate prices signals to customers related to gas consumption. In reality, however, such a rate design conveys improper price signals to customers, because it recovers fixed costs through the volumetric components of the utility's rate structure. When this undesirable situation exists, it can: (1) increase revenue variability that then must be corrected through the operation of the decoupling mechanism; (2) fail to account for cost differences between and within customer classes; (3) promote inefficient use of the gas utility's system; and (4) needlessly inflate bills in the winter months, when customers face the greatest pressure on their household budgets from utility bills. PSE's rate design proposal to increase the level of its customer charges moves in the right direction to minimize these

undesirable effects and best aligns the price signals to customers with the underlying costs of providing delivery service.

**Q. Is PSE's approach to collecting a greater share of customer-related costs via monthly customer charges unusual in the gas distribution industry?**

A. No. As discussed in a June 2006 White Paper prepared by the Policy Analysis Group of the American Gas Association ("AGA"),[1] many utilities are finding it difficult, like PSE, to achieve authorized rates of return in this increasingly volatile natural gas market, due in part to declining use per customer and significant swings in the commodity price of natural gas. Gas utilities have proposed increases to their monthly service or customer charges to more closely reflect their fixed costs of service in rates. Among the benefits cited by the AGA report of increased customer charges are the following:

- Volatility in customer bills is moderated
- Utility margin recovery and thus earnings are less dependent on sales volumes
- Cash flow is improved
- Winter bills for low-income customers are reduced

Other reported ratemaking solutions providing similar benefits that have been approved by regulators include weather normalization adjustment clauses,

[1] Natural Gas Utility Rate Structure: The Customer Charge Component, American Gas Association, dated June 7, 2006.

revenue decoupling mechanisms and "straight-fixed variable" rate designs.

**Q. How do PSE's proposed customer charges relative to its fixed delivery service costs compare with other gas utilities?**

A. In the spring of 2006, AGA asked its member companies, "What percentage of the utility's fixed costs do you estimate is recovered in the monthly customer/service charge?" Companies representing more than ninety rate jurisdictions in forty-two states and the District of Columbia responded. The typical response was that only one-third of the fixed costs were recovered in the customer charge. The median percentage for all respondents was 32.1%. At the proposed $8.25 per month residential customer charge level, only about 27% of the fixed distribution costs or margin attributable to PSE's residential class (shown in the Company's cost of service study) is recovered through the customer charge.

A $17 per month residential customer charge would recover essentially all of the customer related costs allocated to the residential class in the Company's cost of service study. This charge would recover about 56% of the total fixed distribution costs or margin attributable to PSE's residential class.

**Q. Have other gas utilities and regulators gone further to embrace the concept of increasing monthly customer charges to achieve the aforementioned benefits referenced in the AGA survey?**

A. Yes. Certain gas utilities and regulators have adopted a "straight-fixed variable" ("SFV") rate design, so-called because all fixed costs incurred by the utility are recovered from customers through fixed charges, while all variable costs are recovered through variable charges. This pricing concept was first adopted in the gas pipeline industry, and in more recent times, it has been adapted for use by gas distribution utilities. One difference in the application of the concept is that gas pipelines' fixed costs are recovered through monthly demand charges, which are assessed to customers based on their pre-determined contract demand levels, while for gas distribution utilities, the fixed costs are recovered through monthly customer or service charges. An SFV rate structure achieves a fundamental objective of ratemaking--the proper alignment of costs with revenues and rates.

**Q. Please list some recent examples where this type of rate design has been pursued.**

A. The North Dakota Public Utility Commission recently approved a straight-fixed variable type rate design that recovers the vast majority of Xcel Energy's fixed distribution costs in a monthly fixed charge (Ref. Case No. PU-04-578, June 1, 2005). The Oklahoma Corporation Commission approved a customer choice program for Oklahoma Natural Gas where residential customers could choose a

straight-fixed variable rate design or a more traditional, largely volumetric rate structure (Ref. Case No. PUD200400610). Kansas Gas Service recently filed for a similar customer choice rate design with the Kansas Corporation Commission (Case No. 06-KGSG-1209-RTS). Two other gas utilities, Semco Energy in Michigan (Case U-14-893) and Missouri Gas Energy in Missouri (Case No. GR-2006-0422), have filed proposed straight-fixed variable rate designs with customer charges in excess of $20.00 per month.

**Q. Under an SFV rate design, what would be the level of the Company's monthly fixed charge for its residential service class?**

A. At proposed revenues, the monthly fixed charge under an SFV rate design for the Company's residential heating service class would be equal to the SFV Rate calculated by Mr. Hoff in his prefiled rebuttal testimony, Exhibit No. ___(DWH-6T), which is a customer charge of $29.76 per month. While the SFV rate design would increase the average customer's bills in the summer and shoulder months, when customer bills are at their lowest levels, it would decrease or moderate the increase in customers' bills in the winter months, when bills are at their highest levels. This could provide relief for customers when they most need it and reduce the volatility in their gas utility bills caused by high and widely fluctuating seasonal gas prices.

### 3. Mr. Weiss' preference for low customer charges conflicts with his other stated rate design objective of bill stability for low income customers.

**Q. Does Mr. Weiss' preferred rate design appear to be in conflict with any of his other implied ratemaking objectives?**

A. Yes. At page 4 of his prefiled response testimony, Mr. Weiss discusses the challenges faced by low-income customers under traditional rate design, which "ties recovery of fixed costs directly to commodity sales." He points out how, during cold winters, low-income customers "must struggle with paying energy bills which are needlessly inflated by the current rate structure and which provide for more-than-full recovery of distribution costs." While PSE's GRNA mechanism will correct for any over-collection of distribution costs on an annual and class basis, Mr. Weiss' preference for reducing the customer charge to a bare bones level and loading up the volumetric portion of the Company's distribution rate will only magnify weather risk and exacerbate the winter utility bills for low-income customers. This is the adverse situation I assume he would seek to alleviate.

**Q. Would increasing the level of the volumetric distribution rates pose a problem for the Company's recovery of its distribution margin under the parameters of Mr. Weiss' recommended decoupling pilot?**

A. Yes. Increasing the amount of PSE's margin revenues subject to collection in the

volumetric portion of its distribution rates will only heighten the likelihood that a surcharge resulting from the under-collection of distribution costs will bump up against Mr. Weiss' proposed "annual cap" on the amount of the decoupling adjustment in any one year. Although Mr. Weiss' testimony is silent on the point, any under-collection of distribution costs that remains un-recovered due to the application of an annual rate adjustment cap should be deferred for recovery in the subsequent annual period.

Mr. Weiss' proposal to cap the annual decoupling adjustment and his proposal to minimize the customer charge each undermine the effectiveness of the decoupling mechanism. With a low customer charge, more, not less, decoupling adjustment is necessary – but his proposed cap would limit the adjustment. Therefore, Mr. Weiss' proposals would frustrate the revenue and bill stability benefits available through decoupling.

**Q. Mr. Weiss states at page 17 of his prefiled response testimony that "[A] properly structured decoupling mechanism must take new customer use into account for each participating customer class so that the margin generated by the mechanism will be equal to that which would be generated under conventional regulation." Do you concur?**

A. Yes. However, Mr. Weiss misinterprets the relationship between PSE's line extension policy as it applies to new customers and the reflection of new customers in the proposed GRNA when he states that the Company "will, in

effect, collect twice for the lower usage of new customers – first through the up-front payment [Contribution in Aid of Construction] and again in the 'new customer growth adjustment'." PSE's gas line extension policy applies a "life-of-asset" test to ensure that the expected revenues from a new customer over time will provide the company with an adequate rate of return on the associated capital investment, in addition to covering any incremental customer-related costs. Any resulting up-front contribution by the customer is netted against and reduces the capital investment that is included in the Company's rate base. The collection of a contribution from a new customer is not a recovery of margin. In any event, because the Company's rates are set to recover average embedded cost, revenues from new customers will not initially provide the full return on (nor the return of) the capital invested to extend service to them. To suggest that including the new customers in the GRNA at historical consumption levels will result in a double recovery of margin related to an expectation of lower use from these new customers is incorrect.

**4. Many of the Company's peer group members used for cost of equity comparison purposes have weather tracking or decoupling mechanisms in place in their respective jurisdictions.**

**Q. Mr. Weiss discusses at page 18 of his prefiled response testimony how the benefits of a decoupling mechanism that adjusts for weather variability could be shared between PSE and its customers. As part of that discussion, he poses the question, "[W]ill the cost of capital decline, and, if so, when?"**

**What is your reaction to this discussion?**

A. Mr. Weiss does not make a specific recommendation on cost of capital, stating that the "Coalition's expertise is not utility financing." Dr. Morin's prefiled rebuttal testimony, Exhibit No. ___(RAM-15T) addresses the effect on the Company's cost of common equity of not adopting the mechanisms proposed by the Company, such as the Power Cost Adjustment, decoupling mechanism and depreciation tracker. I would, however, point to the list of utilities in my Exhibit No. ___(RJA-14) that comprise the peer group of companies used for cost of equity comparison purposes by the Company and the other cost of capital witnesses in this general rate proceeding. A number of these utilities (eleven, including four with mechanisms in multiple state jurisdictions) already have weather tracking or decoupling mechanisms in place in their respective jurisdictions. Some others, Laclede (Missouri), which employs a "Weather Mitigation Rate Design" as well as AGL Resources (Georgia) and Xcel Energy (North Dakota), with their Straight-fixed Variable rate designs, have gas margin revenues that are insulated from weather variability.

## B. Weather variability is one of the primary reasons driving the need for PSE's proposed GRNA decoupling mechanism and is widely recognized by utility regulators as appropriate for periodic rate adjustments.

**Q. Do you have any general observations concerning Ms. Steward's opposition to the inclusion of weather in the proposed GRNA?**

A. Yes. Weather variability is a factor that is widely recognized by utility regulators in allowing gas utilities to make periodic and automatic adjustments to their rates through weather normalization adjustment ("WNA") mechanisms. WNA mechanisms, like the GNRA, help insulate utilities and their customers from the risks of weather variability. Ms. Steward's opposition is surprising to me because weather variability is one of the primary reasons cited in my prefiled direct testimony that is driving the need for PSE's proposed GRNA.

Exhibit No. ___(RJA-15) presents a survey conducted by Navigant Consulting, Inc., with input from a previous American Gas Association survey, which identifies utility companies located in the U.S. that have WNA clauses in effect. The results of that survey indicate that many gas utilities, across a wide geographic area, have implemented WNA mechanisms. Specifically, the survey results indicate that there are 21 states that have approved WNAs for gas companies serving 40 different service areas.

**Q. What is the nature of Ms. Steward's opposition to the inclusion of weather variability in PSE's GRNA?**

A. Ms. Steward erroneously asserts that inclusion of weather variability in the GRNA would cause increased bill volatility that reduces bill stability and results in a shift in risk to customers. This mistaken belief is the basis of her objection to the inclusion of weather variability in the proposed GRNA.

In fact, the proposed GRNA will result in a uniform monthly adjustment that will

change only once each year. This adjustment could be scheduled to coincide with a Purchased Gas Adjustment ("PGA") rate change, which typically occurs once a year. The annual adjustment to the GRNA amount cannot fairly be characterized as volatile or unstable. Indeed, such adjustment may offset a contemporaneous PGA rate change. Further, the effect of the GRNA is to correct for overpayment and underpayment of fixed costs over time. Such correction does not shift risk to customers, but rather reduces risk for both customers and the Company. Therefore, inclusion of weather variability in the GRNA will not cause increased bill volatility, reduce bill stability nor shift risk to customers.

Ms. Steward offers Exhibit No. ___(JRS-3) to show the differences in projected increases from operation of the GRNA with and without weather, which is modeled on three years of historical weather patterns at the Company's proposed rate levels. However, this exhibit does not demonstrate that weather should be excluded from the GRNA. The maximum difference in any one year between Ms. Steward's "with" and "without" weather scenarios is 2.01% of revenues for the residential class, which translates to about $.024 per therm or $1.65 per month for a typical residential customer.

**Q. Do you find Ms. Steward's comment at page 9 of her prefiled response testimony regarding the 69% of the Company's revenues that are currently "protected from variations in weather" to be relevant to the inclusion of weather variability in a decoupling mechanism?**

A. No. This portion of the Company's revenues to which Ms. Steward refers consists of gas supply related costs, which are recovered from sales to customers on a dollar-for-dollar basis via the PGA mechanism, which has absolutely no bearing on the recovery of the Company's margin.

## C. The GRNA preserves the regulatory balance advocated by Public Counsel's witness, Mr. Brosch.

**Q. Please summarize the specific assertions made by witness Brosch to which you will respond.**

A. Mr. Brosch objects to the Company's proposed GRNA and other tracking mechanism as "piecemeal rate tracking devices" and makes the following arguments:

1. Rate trackers such as PSE's proposed GRNA represent a "significant departure" from the "balanced" traditional test-period rate case utility regulation.

2. Utility regulators should only allow rate trackers as "exceptional" rate treatment and in "limited instances."

3. Implementation of rate tracking reduces the management efficiency incentives normally caused by regulatory lag.

4. Rate trackers, and specifically PSE's GRNA, shift cost responsibility and risk to ratepayers "who are least able to influence cost levels or sales levels."

5. PSE's GRNA tariff will not fully decouple changes in sales volumes from the margin revenues that the Company will collect from adding new customers.

6. Rate tracking tariffs add to complexity in regulatory processes and "PSE employees and WUTC Staff personnel would be burdened

with significant additional work if the GRNA were adopted."

**Q. Does the Company's proposed GRNA represent a "significant departure" from "balanced" traditional test-period rate case utility regulation advocated by Mr. Brosch?**

A. No. The Company's proposed GRNA actually preserves the balance advocated by Mr. Brosch because PSE's margin (i.e., its non-gas cost of service) is subjected to a "balanced review" in this rate case – and will continue to face a similar review in future rate cases. The Company's costs recovered in rates are subject to review in each general rate case, and the effect of the GRNA is to help ensure that those costs are not over or under-recovered. The Company's authorized margin will reflect the desirable "matching" of revenues and the sum total of all cost elements (expenses, rate base and rate of return) contained in its base rate revenue requirement. The Company's proposed GRNA represents an effective solution to a widely recognized margin recovery problem

**Q. Mr. Brosch describes at page 8 of his prefiled response testimony two examples of the "limited instances" under which utility regulators should consider adoption of tracking tariffs. Aside from Purchased Gas Adjustment ("PGA") and Power Cost Adjustment ("PCA") mechanisms, what other types of rate tracking mechanisms have been approved by utility regulators?**

A. There is a wide range of other rate tracking mechanisms besides those that are

related to gas costs, fuel, or purchased power that have been proposed by utilities and approved by their regulatory agencies. They include the following:

1. Weather normalization
2. Revenue decoupling
3. Bad debt/uncollectible expense
4. Environmental protection or remediation costs
5. Property taxes
6. Contributions in Aid of Construction ("CIAC")
7. Pension expense
8. Infrastructure cost recovery (capital and related O&M expenses)
    i. Infrastructure improvement
    ii. Pipeline integrity (mandated safety programs)
    iii. Public improvement projects
9. Energy efficiency/DSM program costs
10. Stranded or transition costs as a result of industry restructuring
11. Alternate fuel sensitive margins
12. Transportation service margins

The foregoing list of ratemaking mechanisms are increasingly becoming an integral part of the utility ratemaking process, which highlights the critical issues, important financial implications, and operational expectations faced today by utilities. The prevalence of these mechanisms, and their acceptance by a greater number of regulators, is growing as the challenges in the utility industry become more evident and pronounced. As I mentioned earlier in my testimony, weather

normalization adjustment mechanisms have gained broad acceptance in the gas side of the utility industry.

**Q. Can many of these tracking mechanisms be found in the tariffs of the utilities that comprise the peer group of companies used for cost of equity comparison purposes by the Company and the other cost of capital witnesses in this general rate proceeding?**

A. Yes. As shown in my Exhibit No. ___(RJA-14), a significant number of the peer group utilities have one or more of the tracking mechanisms from the foregoing list in place in their respective jurisdictions. This list includes the eleven utilities referenced earlier that have weather tracking or decoupling mechanisms, including four with mechanisms in multiple state jurisdictions.

**Q. What are the common characteristics among these rate trackers that would account for utilities' interest in them and that support their ultimate approval by utility regulators?**

A. Each of the aforementioned rate trackers have been considered as an appropriate regulatory method for cost recovery because they embody attributes that Mr. Brosch believes should warrant "preferential rate recovery treatment," such as:

1. Potential material impact on revenue requirements and the financial performance of the utility between rate cases,
2. Beyond the control of utility management, and

3. Straightforward and simple to administer.

Where these attributes exist, the use of rate recovery mechanisms such as rate trackers and decoupling mechanisms become effective ratemaking solutions to properly and reasonably reflect a utility's costs in its rates. The GNRA is not a rate tracker that tracks and recovers varying costs. Rather, the GNRA tracks the variance in the recovery of margin. Rate mechanisms, like the GNRA, help insulate customers and utilities from margin over and under payment and recovery, respectively.

**1. The GRNA addresses the attributes that Mr. Brosch believes warrant "preferential rate recovery treatment."**

**Q. Does the GRNA address these attributes?**

A. Yes. My prefiled direct testimony, Exhibit No. ___(RJA-1T), demonstrates that the recovery of a portion of the margin through a volumetric charge results in volatility in the margin recovery and that the absence of a decoupling mechanism has a potential material impact on revenue requirement recovery and the Company's financial performance. The GRNA corrects for the over and under recovery of margin that is beyond the control of the Company, such as weather. Mr. Brosch acknowledges as much at page 17 of his prefiled response testimony when he states that the Company, "has little influence over gas usage per customer volumes because most of such fluctuation between rate cases is caused by weather variation and by customer usage impacts caused by appliance

efficiency improvements, price elasticity and other externalities."

My prefiled direct testimony, Exhibit No. ___(RJA-1T), illustrates that the GRNA is straightforward and simple to administer. The simplicity and ease of administration of the GRNA are further discussed later in this testimony. And finally, I have discussed earlier in this testimony that the Company's costs recovered in rates are subject to review in each general rate case. The effect of the GRNA is to help ensure that those costs are not over or under-recovered. Accordingly, rates are not unbalanced and test period relationships are not distorted by the GRNA.

**Q. At page 17 of his prefiled response testimony, Mr. Brosch discusses the implications for rate tracking tariffs on regulatory lag and the related "incentive to utility management that is created by it." Will PSE's proposed GRNA reduce management's incentive to manage costs?**

A. No. PSE's proposed GRNA adjusts rates only for changes in use per customer. The proposed mechanism does not guarantee that PSE will achieve the financial performance approved by this Commission, so management still must actively manage each of the cost elements that comprise the Company's total non-gas cost of service.

**2. Decoupling balances the interests of, and benefits to, utilities and their customers by addressing both sets of sales risk equally.**

**Q. At page 18 of his prefiled response testimony, Mr. Brosch claims that the Company's GRNA "promises higher prices paid by consumers" without recognizing the shifting of sales volume risks to customers. Do you accept his assertion?**

A. No. Mr. Brosch statements mischaracterize the nature of sales or volumetric risk and its equal application to both PSE and its customers. Just as utilities' risk relates to usage reductions due to weather, conservation and other factors such as demand response to changes in gas prices, cited by Mr. Brosch, the corresponding risk for customers is associated with usage increases due to weather, favorable changes in gas commodity prices and improved economic conditions. Decoupling balances the interests of, and benefits to, utilities and their customers by addressing both sets of sales risk equally. As I stated earlier, I concur with NWEC witness Mr. Weiss' observation that risk, in this context, is not a zero-sum game. Customers face the risk of overpayment for their delivery service if consumption is greater than expected and the utility bears the risk of under-collection of its fixed costs if usage is less than expected. As Mr. Weiss correctly concludes in his prefiled response testimony, little useful purpose is served by subjecting utilities and their customers to sales risk caused by weather and business-related volatility, as they are not subject to either party's control.

**3. The adjustment for changes in customers included in the Company's GRNA helps to provide a better matching of the incremental costs and revenues favored by Mr. Brosch under his view of "traditional test period regulation."**

**Q. Mr. Brosch suggests that PSE's proposed GRNA will not "fully decouple" sales volumes and will allow the Company to retain for its shareholders the favorable effects of sales growth from new customers, "by not tracking" margin revenues associated with sales growth caused by adding new customers. Do you concur with his assessment?**

A. No. Mr. Brosch's argument that PSE will retain for its shareholders the favorable effects of sales growth from new customers completely ignores the cost side of customer growth. Annually, PSE makes significant capital investments and incurs additional costs to connect new customers to its system. The margin revenues received from these new customers serve to partially compensate the Company for the added capital investment costs. As I described earlier in my response to Mr. Weiss' testimony on the subject, PSE's line extension policy serves to ensure that customer growth is profitable over the life of the investment. However, the Company will initially experience earnings attrition until the added rate base is reflected in its rates in a subsequent general rate case. Therefore, the adjustment for changes in customers included in the Company's GRNA helps to provide a better matching of the incremental costs and revenues favored by Mr. Brosch under his view of "traditional test period regulation." If the added margin revenues provided by new customers were not treated in this manner in the

GRNA, the intended funding of incremental investment costs would not be achieved.

**Q. Have there been other decoupling mechanisms adopted by gas utilities and accepted by their regulators that incorporate adjustments for changes in the number of customers, similar to PSE's approach in its proposed GRNA mechanism?**

A. Yes. On August 25, 2005, the Public Service Commission of Oregon approved the extension of NW Natural's partial decoupling mechanism for four years, following an independent study to determine whether the mechanism had been effective since its implementation. This study concluded that the mechanism had functioned as intended and had been effective.[2]

On October 15, 2005, Washington Gas announced that the Maryland Public Service Commission had approved a Revenue Normalization Adjustment ("RNA") mechanism to reduce the effect of weather fluctuations and gas demand on its customers' bills. It operates in a fashion similar to the Company's proposed GRNA, including an adjustment for the monthly change in customers that does not differentiate the usage per customer between new and existing customers.

On October 19, 2005, the North Carolina Utilities Commission approved a full

[2] Mr. Weiss suggests that the decoupling mechanism should attribute a level of gas consumption to new customers that is lower than the average customer consumption and suggests that this would be consistent with the Company's line extension policy. None of the other decoupling mechanisms I have reviewed attribute a lower usage level to new customers. Further, the Company's line extension policy

decoupling mechanism (designated as a "Customer Utilization Tracker") for Piedmont Natural Gas Company. The utility's request to terminate its WNA, because the ratemaking treatment of weather-related changes in use per customer was incorporated into the utility's decoupling mechanism proposal, was granted.

Finally, Baltimore Gas and Electric's full decoupling mechanism, which has been in operation since 1999, similarly incorporates an adjustment for changes in number of customers in its monthly rate adjustment calculations that does not differentiate the usage per customer between new and existing customers.

The acceptance of these types of decoupling mechanisms reflects the appropriateness of the inclusion of customer changes in revenue decoupling mechanisms in the gas distribution industry.

**4. The Company's GRNA will not add complexity to regulatory processes and administrative burdens to PSE and WUTC Staff.**

**Q. Mr. Brosch contends that tracking tariffs add complexity to regulatory processes and administrative burdens to PSE employees and WUTC Staff personnel. On page 43 of his prefiled response testimony, he claims that for the calculations underlying the GNRA "to be readily audited on an expedited basis, Staff and other concerned parties would need to dedicate significant resources to the analysis of cumulative deferrals, the annual re-**

attributes to new customers predetermined standard consumption levels set out in the Company's tariff based on historical usage data.

**determination of this rate and the required true-up of prior year over or under-recoveries." Do you agree with his contention?**

A. No. In my opinion, PSE's proposed GRNA would cause Company personnel or the Commission Staff to incur very little incremental expense to administer because of the computational simplicity of the mechanism. Referring to the GRNA supplemental tariff schedule in my Exhibit No. ___(RJA-9), Section 4, Decoupling Adjustment Account ("DAA"), it is readily apparent that the underlying computations of the monthly GRNA deferral are quite simple.[3]

More generally, decoupling mechanisms such as PSE's proposed GRNA rely on basic ratemaking formulas, well established deferral accounting methods and related interest calculations that have been utilized for decades by utilities. This promotes an ease of verification under customary audit processes by the appropriate parties. In Commission Staff's Response to Public Counsel's Data Request No. PC-5 (a copy of which is provided as Exhibit No. ___(RJA-16), Ms. Steward states, "There are no incremental costs for Staff to review, audit and administer the pilot. Based on our experience with other deferral mechanisms listed in PC-5 c), a rough estimate of analyst's time is between 15 and 30 hours a year."

[3] The computations consist of three multiplication steps, one addition step, and one subtraction step to derive the Decoupling Adjustment Amount. Annually, an additional division step is required to develop a rate per therm adjustment to the Delivery Charge.

## III. OTHER RATE DESIGN ISSUES

### A. Rate Schedule Structural Issues

**Q. Ms. Steward states on page 5 of her prefiled response testimony, Exhibit No. ___(JRS-1T), that the Company should review its current gas rate schedules before its next general rate case and consider how these could be combined or separated. Would such a review be appropriate?**

A. Yes. The Company has been and is reviewing its gas rate schedules. An example of this review is reflected in the Company's recommended rate design for Schedule 41 in this proceeding. The proposed modifications to Schedule 41 were initiated in the Company's 2001 general rate case with support from the Commission Staff. The Company intends to continue reviewing its gas rate schedules and welcomes the participation of Commission Staff and other interested parties in this endeavor.

### B. Specific Rate Schedule Recommendations

#### 1. Schedule 41

**Q. Do you agree with the Joint Parties' proposal for Schedule 41?**

A. No. Schedule 41 is an optional schedule intended for large volume, high load factor customers. The Joint Parties oppose the Company's proposed rate design because of its impact on small customers. Their opposition ignores the fact that

Schedule 41 is an optional schedule and that small, low load factor customers can and should migrate back to the schedule intended for them, Schedule 31. With such migration, small, low load factor customers will avoid the adverse impact of the proposed adjustments to the demand charge and the customer charge under Schedule 41. Those proposed charges were developed to send price signals that will encourage large, high load factor customers to take service under Schedule 41 and encourage smaller, low load factor customers to take service under Schedule 31, which better fits their load characteristics.

**2. Balancing and Procurement Charges**

**Q. Do the Joint Parties propose consistent approaches to the balancing charge and the procurement charge?**

A. No. The Joint Parties say that rate spread and rate design should be guided by the cost of service study, but it appears they have ignored the cost of service study with regard to both the balancing charge and the procurement charge.

The Joint Parties oppose PSE's proposed increase to the balancing charge, although they did not present any specific arguments against it. They indicated in their prefiled response testimony, Exhibit No. ___(JOINT-1T), that their rate design adjustments were intended to narrow the disparity between Schedules 57 and 87. Under present rates, Schedule 57 customers pay a total of $4,900 for the non-gas portion of balancing service. This amount is far below the cost associated with the use of the Jackson Prairie storage facility to provide balancing

service. The Company's proposed increase to the balancing charge was designed to make its rates more consistent with the cost of balancing service provided to these customers. The Joint Parties propose to increase the procurement charge above the cost of service level, whereas the Company proposes to increase it to the cost of service level.

In short, the Joint Parties propose a balancing charge that is only 4% of the cost of providing the service and a procurement charge that is 130% of the cost of providing the service.

**3. Reallocation of Demand-related Gas Costs**

**Q. Should the Commission accept the Company's proposed allocation of demand-related PGA gas costs rather than the Joint Parties' recommendation that the Commission continue to use the current methodology for the allocation?**

A. Yes. In this proceeding, the Company has proposed, for Schedules 101 and 106, an allocation of demand-related PGA gas costs that would replace an allocation methodology that has been utilized since 1994. For the reasons stated in the prefiled direct testimony of William F. Donahue, Exhibit No. ___(WFD-1T), the methodology for the allocation of demand-related PGA gas costs should be updated. The Joint Parties have opposed the updated methodology, stating only as follows at page 14 of Exhibit No. ___(JOINT-1T): "Because not all of the Joint Parties accept that methodology, we recommend that the Commission

continue to use the current methodology."

The Company previously proposed, when it filed its 2005 PGA, to allocate demand-related gas costs consistent with the cost of service study that was settled in the 2004 general rate case. However, at that time, Commission Staff indicated that the change should be made in a general rate case. In this proceeding, the Joint Parties are now indicating that the change should not be made in this general rate case. The Company's proposal would make its rates more consistent with the costs of providing the gas commodity.

## IV. REVISIONS TO PRO FORMA REVENUE FROM NATURAL GAS OPERATIONS

**Q. Are there any changes to the pro forma revenue that was presented in the direct testimony of Janet K. Phelps?**

A. Yes, there are three changes to pro forma revenue. In the course of this proceeding, PSE discovered two errors that caused pro forma revenue under existing rates to be understated. The revisions to correct these errors increase pro forma revenue from rentals by $300,649, and Schedule 41 revenue by $32,530, for a total increase of $333,179. In addition, the adjustment for Everett Delta has been revised to $74,312, which decreases pro forma revenue by $209,743. The revised pro forma revenue under existing rates of $961,025,139 is presented in Exhibit No.__(RJA-17).

## V. CONCLUSION

**Q. Please summarize your rebuttal testimony.**

A. I concur with NWEC witness, Mr. Weiss' views on the merits of decoupling and its attendant symmetrical benefits for both customers and the Company. However, his specific recommendations with regard to the appropriate rate design to accompany a decoupling mechanism will undermine the effectiveness of the decoupling mechanism and would frustrate the revenue and bill stability benefits available through decoupling. The modification proposed by Staff witness Ms. Steward to exclude weather from the Company's proposed GRNA is without adequate foundation and misplaced when viewed against the key factors driving the need for the GRNA. The criticisms of the GRNA proposal raised by Pubic Counsel's witness Mr. Brosch attempt to cloud the issue of why the GRNA is a necessary margin recovery mechanism and beneficial for the Company and its customers. The Commission should approve the proposed GRNA, as it is in the best interest of the Company and its customers for the reasons previously stated in my prefiled direct testimony. Finally, the opposition of the Joint Parties to several of the Company's rate design proposals is without either an evidentiary or a rational basis. The Commission should give no weight to their opinion.

**Q. Does that conclude your prefiled rebuttal testimony?**

A. Yes.