BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION Complainant, v. NORTHWEST NATURAL GAS COMPANY, d/b/a NW NATURAL Respondent.	DOCKET UG-181053

NORTHWEST NATURAL GAS COMPANY

Post-Hearing Brief on Decoupling

September 12, 2019

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Statutes

Washington Utilities & Transportation Commission Orders

Other Authorities

I. INTRODUCTION

1 Northwest Natural Gas Company, d/b/a NW Natural ("NW Natural" or "Company") respectfully requests that the Washington Utilities and Transportation Commission ("Commission") approve the Partial Multi-Party Settlement Agreement on Decoupling ("Multi-Party Settlement") as a fair and reasonable resolution of the sole disputed issue in the Company's rate case, which is the form of revenue decoupling that should be adopted for NW Natural. The Multi-Party Settlement proposes a full decoupling mechanism—consistent with the Commission's recent decisions on decoupling—and is supported by NW Natural, Commission Staff, the Alliance of Western Energy Consumers ("AWEC"), and The Energy Project ("TEP") (collectively, "Settling Parties"). The Public Counsel Unit of the Washington Office of Attorney General ("Public Counsel") is the lone party opposing the Multi-Party Settlement.

2 The Multi-Party Settlement's decoupling proposal ("Stipulated Decoupling Proposal") aligns with the Commission's policies and precedent, and is almost identical to those decoupling mechanisms already approved and implemented for each of the other investor-owned energy utilities in Washington. The Stipulated Decoupling Proposal severs the link between gas usage and revenues, thereby removing any disincentive for the Company to continue to promote conservation and energy efficiency,[1] and the proposal mitigates the impact

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[1] As a technical matter, energy efficiency is discrete from conservation. According to the Energy Information Administration ("EIA"), energy efficiency refers to the use of technologies that require less energy to perform the same service—such as using a higher efficiency gas furnace to heat one's home; by comparison, conservation refers to behavior that results in the use of less energy—such as turning down the heat at night. *See* EIA, "Use of Energy Explained," available at: eia.gov/energyexplained/use-of-energy/efficiency-and-conservation.php. However, the Commission and others commonly use the term "conservation" to refer to both energy efficiency *and* conservation. *See, e.g., In the Matter of the Wash. Utils. & Transp. Comm'n's Investigation into Energy Conservation Incentives*, Docket U-100522, Report and Policy Statement on Regulatory Mechanisms, Including Decoupling, to Encourage Utilities to Meet or Exceed Their Conservation

on customers' bills and the Company's revenues of year-to-year volatility in weather. In addition, the Stipulated Decoupling Proposal protects customers from excessive rate increases and ensures that customers share equally in any over-earnings that might be realized by the Company.

3 Public Counsel stands alone in arguing against the Stipulated Decoupling Proposal, incorrectly claiming that it will result in a "windfall" to NW Natural. Specifically, Public Counsel argues that revenue-per-customer decoupling will cause the Company to significantly over-recover its costs because NW Natural anticipates significant customer growth over the coming years, purportedly creating a "found margin" associated with new customer revenues. This view is simply mistaken, as it ignores the high—and steadily rising—costs of providing new customers with service. In fact, NW Natural's analysis demonstrates that the Company will not over-recover costs under revenue-per-customer decoupling. On the contrary, the Company's calculations show that, even under the Stipulated Decoupling Proposal, the high cost of adding new customers will result in a revenue shortfall over the next six years of $5.6 million.[2] Therefore, Public Counsel's claims that NW Natural will receive a "windfall" is unsupported by the record in this case and should be rejected.

4 By extension, there is no need to adopt Public Counsel's outlier proposal to implement rate-class decoupling in place of revenue-per-customer decoupling. Rate-class decoupling has never been adopted in Washington and would inappropriately penalize the Company for providing service to new customers—service that the Company is statutorily required to

Targets ¶ 3 (Nov. 4, 2010) ("Decoupling Policy Statement"). Therefore, in the interests of consistency, NW Natural will use the term "conservation" to refer to both energy efficiency and conservation, except where otherwise specified.

[2] Walker, Exh. KTW-4Tr at 16:6-8; Walker, Exh. KTW-5.

provide.[3] Indeed, rate-class decoupling would be more financially harmful to NW Natural than forgoing decoupling entirely.

5 In sum, the evidence confirms that the Multi-Party Settlement is in the public interest, is consistent with this Commission's policies and precedent, and should be approved.

II. THE STIPULATED DECOUPLING PROPOSAL IS CONSISTENT WITH COMMISSION PRECEDENT.

6 Decoupling is a regulatory mechanism that works to sever the link between a utility's revenues and its sales volumes.[4] Traditionally, a utility's rates are set based on the utility's forecast for its sales under normal weather conditions. However, once rates are implemented and usage fluctuates over time—due to conservation efforts, weather, or other factors—actual revenues may exceed or fall short of the anticipated revenues. Most critically, if customers decrease their consumption, the utility's revenues will also *decrease*—which arguably creates a disincentive for a utility to promote conservation on its system. As a result, and in response to legislative directives to consider regulatory tools to increase conservation,[5] this Commission has adopted decoupling policies that better align a utility's incentives with the goal of implementing improved conservation.[6] Following the issuance of its Decoupling Policy Statement in 2010, the Commission has adopted decoupling mechanisms for all of Washington's investor-owned energy utilities except for NW Natural, and specifically has

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[3] RCW 80.28.110. In addition to the direct costs associated with new customers, the calculation of which are discussed *infra* Section III.B, customer growth can result—and has resulted—in the Company needing to reinforce its distribution system through system reinforcement projects, such as those recently performed to address customer growth in Southwest Washington. Anderson, Exh. DHA-1T at 10:1-10.

[4] *In the Matter of the Petition of Puget Sound Energy, Inc., and Nw. Energy Coal. for an Order Authorizing PSE to Implement Elec. and Nat. Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms*, Dockets UE-121697 & UG-121705, Order 07 ¶ 24 (June 25, 2013).

[5] RCW 19.285.060.

[6] *See, generally*, Decoupling Policy Statement.

consistently adopted "full" decoupling mechanisms that encompass all causes of variable gas consumption, including weather.[7] As will be discussed in detail below, the Stipulated Decoupling Proposal is consistent with the guidelines laid out in the Decoupling Policy Statement as well as the decoupling mechanisms adopted by the Commission for other utilities.

A. Summary of the Stipulated Decoupling Proposal

7 The Stipulated Decoupling Proposal is a full decoupling mechanism that will enable the Company to recover allowed per-customer revenues, regardless of fluctuations in gas consumption. Under the proposal, all usage variations due to any cause would be captured by the decoupling mechanism.[8] The Stipulated Decoupling Proposal would, on a monthly basis, compare (a) the allowed per-customer revenues set in the Company's last general rate case, multiplied by the current number of customers to (b) the Company's actual revenues, with the difference between the two values tracked on the Company's balance sheet through a deferral.[9] On an annual basis, and following a prudence review, the deferred balance would be "trued-up."[10] Thus, if a particularly cold winter caused the Company to recover over the amount of normalized revenues in a given year, those over-recoveries would be shared with customers the following year through customer bill credits.[11] Conversely, if a particularly warm winter caused the Company to recover below normalized revenues, then the balance would be

[7] Dockets UE-121697 & UG-121705, Order 07; *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-170033 & UG-170034, Order 08 (Dec. 5, 2017); *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-140188 and UG-140189, Order 05 (Nov. 25, 2014); *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light Co.*, Docket UE-152253, Order 12 (Sept. 1, 2016); *Wash. Utils. & Transp. Comm'n v. Cascade Nat. Gas Corp.*, Docket UG-152286, Order 04 (July 7, 2016).
[8] Walker, Exh. KTW-1T at 9:19-21.
[9] Walker, Exh. KTW-1T at 10:10-15. The balancing account would earn interest at the Federal Energy Regulatory Commission interest rate. Walker, Exh. KTW-1T at 13:1-4.
[10] Walker, Exh. KTW-1T at 10:10-12, 12:18-13:1; Liu, Exh. JL-1T at 5:13-17.
[11] Walker, Exh. KTW-1T at 10:12-13.

amortized and included in customer rates the following year through surcharges.[12] Similarly, declines in usage due to conservation efforts would be tracked and would potentially trigger a customer surcharge, depending on the impacts of other variables such as weather and broader economic trends.

8 Critically, under the Stipulated Decoupling Proposal any surcharges would be subject to a five-percent "soft cap" to further limit customer impacts.[13] If the soft cap were reached and a deferral balance remained, that residual amount would be carried forward for inclusion in rates the following year (albeit still subject to the five-percent cap).[14] The soft cap would not apply to rate decreases—only to rate increases.[15]

9 Moreover, the Stipulated Decoupling Proposal is subject to an earnings sharing mechanism, whereby the Company would share with customers 50 percent of any before-tax operating revenues that exceed the Company's authorized rate of return.[16] These revenues would be shared on an equal cent-per-therm basis with decoupled customers.[17] Specifically, if NW Natural experiences a decoupling credit balance by earning more than its authorized rate of return, then the Company would share 50 percent of any before-tax operating revenues in excess of the rate of return through amortization in rates.[18] Similarly, if the Company has a decoupling surcharge balance and has earned more than its authorized rate of return, then the Company would share 50 percent of the before-tax operating revenues that exceed the authorized rate of return—effectively reducing the surcharge balance, and with any remaining

[12] Walker, Exh. KTW-1T at 10:14-15.
[13] Walker, Exh. KTW-1T at 17:7-13; Joint, Exh. JT-3T at 5:15-16.
[14] Walker, Exh. KTW-1T at 17:18-19.
[15] Walker, Exh. KTW-1T at 17:18-20.
[16] Walker, Exh. KTW-1T at 14:1-14.
[17] Walker, Exh. KTW-1T at 14:15-16.
[18] Walker, Exh. KTW-1T at 14:7-9.

decoupling surcharge shared on an equal cent-per-therm basis with decoupled customers.[19]

10 The Stipulated Decoupling Proposal applies to all residential and commercial firm and interruptible sales customers, which are the same customer classes eligible to participate in the Company's conservation programs.[20] The decoupling mechanism would not apply to industrial customer classes, in part because these customers are not included in the Company's conservation programs.[21]

11 In addition, the Stipulated Decoupling Proposal incorporates specific changes from NW Natural's original proposal, as requested by Staff and AWEC:

12 ***First***, "Actual Revenue" received by the Company will be calculated with tariff rates and billing determinants, rather than with the Company's proposed weighted average group rate.[22] Calculating "Actual Revenue" provides more detail (and transparency) from total, or "gross," revenues and prevents the revenue-per-customer amount from shifting on an annual basis, as it would if the amounts were tied to the weighted average group rate.[23]

13 ***Second***, NW Natural initially proposed to establish this decoupling mechanism on a permanent basis.[24] Under the Stipulated Decoupling Proposal, the Company must request reauthorization within five years after the mechanism takes effect, with flexibility to seek Commission approval either as part of or separate from a general rate case.[25] The Settling Parties agree that this provision would allow the Commission to reassess the performance of the decoupling mechanism and to determine whether any adjustments must be made before

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[19] Walker, Exh. KTW-1T at 14:13-16.
[20] Walker, Exh. KTW-1T at 3:15-18.
[21] Walker, Exh. KTW-1T at 15:5-8.
[22] Joint, Exh. JT-3T at 7:14-16.
[23] Joint, Exh. JT-3T at 8:7-11.
[24] Walker, Exh. KTW-1T at 16:13-14.
[25] Joint, Exh. JT-3T at 7:17-19.

allowing the mechanism to continue.[26]

14 ***Third***, the revised decoupling mechanism now combines residential customers on Rate Schedule 3 with commercial customers on Rate Schedule 3 for application of the mechanism.[27] This revision merely corrects an oversight in NW Natural's initial proposed mechanism. Rate Schedule 3 residential customers are generally apartment buildings or condominiums that have large loads with a single meter, and receive the same rates as Rate Schedule 3 commercial customers.[28] However, Rate Schedule 3 residential customers get marked as "residential" for purposes of receiving safety-related notices.[29] Given the fact that these customers' underlying rates are identical, they are appropriately treated as a single pool for purposes of decoupling.[30]

15 ***Fourth***, the Stipulated Decoupling Proposal now includes separate decoupling classes for commercial customers on Rate Schedule 1 and Rate Schedule 3 (referred to as C1 and C3 customers, respectively).[31] C1 customers typically have different usage patterns than C3 customers, with C1 customers being relatively low use consumers that do not use gas for space-heating, while C3 customers generally use gas for space-heating and are by extension more sensitive to temperature changes.[32] C3 customers use, on average, roughly twice the amount of gas as C1 customers.[33] By aligning the consumption patterns within the decoupled customer classes, the revised decoupling mechanism avoids cross-subsidization while also minimizing

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[26] Joint, Exh. JT-3T at 8:14-19.
[27] Joint, Exh. JT-3T at 7:20-21.
[28] Joint, Exh. JT-3T at 9:5-10.
[29] Joint, Exh. JT-3T at 9:6-7.
[30] Joint, Exh. JT-3T at 9:7-8.
[31] Joint, Exh. JT-3T at 8:1-2; Liu, Exh. JL-1T at 16:9-15.
[32] Liu, Exh. JL-1T at 16:18-17:1.
[33] Liu, Exh. JL-1T at 17:1-2.

in-group volatility.[34]

16 ***Fifth***, industrial customers are not subject to the mechanism, given that industrial customers have not historically been recipients of the Company's conservation programs.[35] While this condition is consistent with the Company's proposed decoupling mechanism, the point was made explicit as part of the Settling Parties' comprehensive agreement.[36]

B. The Stipulated Decoupling Proposal is Consistent with the Commission's Decoupling Policy Statement.

17 The Commission set forth its initial decoupling guidelines in its 2010 Decoupling Policy Statement. In that report, the Commission highlighted two central benefits of a full decoupling mechanism: (1) "minimiz[ing] the risk to both the utilities and to ratepayers of volatility in average use per customer by class regardless of cause;"[37] and (2) protecting utilities from earnings erosion resulting from conservation efforts, given that the more successful a utility's conservation, the lower the utility's earnings.[38]

18 Both of these goals are effectively achieved through the Stipulated Decoupling Proposal. The full decoupling mechanism reduces volatility—in both utility revenues and customer bills—caused by conservation and weather by establishing an allowed revenue amount based on per-customer consumption for a normal year and then providing for a true-up to address higher or lower consumption. The Stipulated Decoupling Proposal will also

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[34] Dockets UE-170033 & UG-170034, Order 08 ¶ 277 (Dec. 5, 2017) ("Establishing greater homogeneity within groups will reduce the potential for cross subsidies and reduce rate volatility by better aligning customers with similar load profiles.") Note, while the Commission has occasionally used the term "rate volatility," this brief distinguishes between volatility in utility revenues ("revenue volatility") and in customer bills ("bill volatility")—both of which the Commission seeks to reduce through decoupling. Decoupling Policy Statement ¶¶ 12, 27.
[35] Joint, Exh. JT-3T at 8:3.
[36] Joint, Exh. JT-3T at 9:21-23.
[37] Decoupling Policy Statement ¶ 12.
[38] Decoupling Policy Statement ¶ 6.

forestall further revenue erosion as NW Natural continues to invest significantly in conservation programs that have already created—and will continue to create—a "lost margin," undermining the Company's ability to reliably recover its fixed costs.[39]

19 In addition, the Stipulated Decoupling Proposal addresses all of the considerations described in the Commission's Decoupling Policy Statement, including specific elements relevant to full decoupling mechanisms:

- ***True-up Mechanism:*** Decoupling mechanisms must include an annual true-up mechanism whereby utilities may recover the reduction in sales volume.[40] Here, the Stipulated Decoupling Proposal includes a true-up mechanism to capture any revenue above or below the normalized revenue-per-customer amount.[41]
- ***Impact on Rate of Return:*** Decoupling proposals must provide evidence evaluating the proposal's impact on risk to investors and ratepayers.[42] Here, NW Natural provided testimony from Dr. Bente Villadsen on the impact of decoupling on the cost of capital.[43] Dr. Villadsen described her company's statistical analysis, which concluded that there is as yet a lack of statistical support for sometimes-voiced concern that decoupling results in a decrease in the cost of capital.[44] Accordingly, there is no reason for the Commission to consider reducing NW Natural's cost of capital based on the adoption

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[39] As discussed in more detail below, these fixed costs include the need to recover the additional costs associated with interconnecting new customers. *See, infra,* Section III.B. While the Commission has recognized that new customer revenues may be excluded from a decoupling mechanism when these revenues are not offset by accompanying costs, Decoupling Policy Statement ¶ 28 n.44, such a concern is inapplicable where, as here, new customer costs exceed the associated revenues.
[40] Decoupling Policy Statement ¶ 28.
[41] Walker, Exh. KTW-1T at 12:18-21.
[42] Decoupling Policy Statement ¶ 28.
[43] Villadsen, Exh. BV-1T at 56:8-58:11.
[44] Villadsen, Exh. BV-1T at 56:8-57:2.

of the Stipulated Decoupling Proposal.

- ***Earnings Test:*** Decoupling proposals must include an earnings test to be applied at the time of true-up.[45] Here, the Stipulated Decoupling Proposal includes an earnings test as part of the Company's annual Commission Basis Report filing, with the decoupling revenues replacing the existing weather normalization adjustment.[46] This earnings test also provides that 50 percent of any over-collections are shared with customers.[47]
- ***Accounting for Off-System Sales and Avoided Costs:*** Decoupling proposals must describe how the utility will determine the financial benefits associated with off-system sales or avoided costs attributable to the utility's conservation efforts.[48] These benefits are then netted against the true-up mechanism.[49] Here, there is no need to account for off-system sales and avoided costs because all gas costs are already passed through to customers on an annual basis through the Purchased Gas Adjustment.[50]
- ***Application to Customer Classes:*** Full decoupling proposals generally cover all customers, but can apply to fewer than all customers where the distinction made is not discriminatory or preferential.[51] Here, the Stipulated Decoupling Proposal applies to all customers eligible to participate in the Company's conservation programs, thereby ensuring maximum participation without cost-shifting between groups that do and do not have access to conservation and related programs.[52]

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[45] Decoupling Policy Statement ¶ 28.
[46] Walker, Exh. KTW-1T at 13:22-25.
[47] Walker, Exh. KTW-1T at 14:3-4.
[48] Decoupling Policy Statement ¶ 28.
[49] Decoupling Policy Statement ¶ 28.
[50] Walker, Exh. KTW-1T at 14:18-19.
[51] Decoupling Policy Statement ¶ 28.
[52] Walker, Exh. KTW-1T at 14:21-23.

- ***Weather Adjustment Mechanism:*** The Commission supports including the effects of weather in a full decoupling mechanism.[53] Here, the Stipulated Decoupling Proposal includes weather effects by basing the decoupling on a revenue-per-customer baseline that reflects average weather conditions over the last 20 years.[54]
- ***Incremental Conservation:*** A full decoupling proposal must describe any incremental conservation that the utility intends to pursue in conjunction with the mechanism.[55] Here, and as described more fully below, the Stipulated Decoupling Proposal is accompanied by NW Natural's commitment to continue to pursue cost-effective conservation, building upon the Company's record of conservation efforts to achieve additional incremental conservation.[56]
- ***Low-Income:*** A utility proposing a full decoupling mechanism must ensure that conservation programs provide comparable benefits to low-income customers, to the extent feasible.[57] Here, NW Natural has described the scope of its existing conservation assistance and bill assistance programs available to low-income customers, which provide comparable benefits to those available to other customers.[58]
- ***Duration of Program and Demonstrated Need:*** The Commission supports full decoupling mechanisms for a set period, and the burden lies with the utility to demonstrate its need for the mechanism.[59] Here, the Stipulated Decoupling Proposal is term-limited, requiring NW Natural to seek reauthorization from the Commission

[53] Decoupling Policy Statement ¶ 28.
[54] Walker, Exh. KTW-1T at 16:1-5.
[55] Decoupling Policy Statement ¶ 28.
[56] *See, infra,* Section III.B.
[57] Decoupling Policy Statement ¶ 28.
[58] Walker, Exh. KTW-1T at 18:1-11.
[59] Decoupling Policy Statement ¶ 28.

within five years.[60]

Moreover, NW Natural has clearly demonstrated its need for a full decoupling mechanism to reduce the ongoing and substantial volatility in both residential and commercial gas usage. Over the past five years alone, annual usage has fluctuated between 58.8 million and 78.4 million therms.[61] These annual variations have a significant impact on the Company's ability to recover its fixed costs because 66 percent of the Company's fixed costs are recovered through volumetric rates.[62]

As described in more detail below, NW Natural has implemented extensive conservation programs without the benefit of an accompanying decoupling mechanism.[63] As a result of this mismatch, NW Natural has effectively reduced gas consumption below that used to set NW Natural's original rates—creating a recovery gap referred to as "lost margin."[64] It is this ongoing disconnect, combined with the variations in gas consumption due to weather, that NW Natural seeks to alleviate through a decoupling mechanism.

- ***Reporting:*** Full decoupling mechanisms may be accompanied by periodic reporting requirements to allow the Commission to evaluate the success and impact of the program.[65] Here, the Stipulated Decoupling Proposal would expand the Company's existing monthly report on the gas cost deferred balance accumulations/amortizations filed with the WUTC to include the proposed decoupling mechanism.[66]

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[60] Joint, Exh. JT-3T at 7:17-19.
[61] Walker, Exh. KTW-1T at 7:3-5, Figure 1.
[62] Walker, Exh. KTW-1T at 6:2-3.
[63] Walker, Exh. KTW-1T at 8:1-9:16.
[64] Walker, Exh. KTW-1T at 9:7-15.
[65] Decoupling Policy Statement ¶ 28.
[66] Walker, Exh. KTW-1T at 16:17-20.

- ***Other Factors Impacting the Public Interest:*** The Commission has made clear that the above factors are not exhaustive, and that it retains authority "to review other factors affecting its analysis of full decoupling as a regulatory tool[.]"[67] Here, the Stipulated Decoupling Proposal accounts for additional possible impacts in case of unusual reductions in gas use from, for example, extreme warm weather, by implementing a 5 percent annual rate cap.[68] This cap prevents rates from increasing by more than 5 percent in a given year, regardless of the extent of the Company's prior year's under-earnings.

20 In sum, the Stipulated Decoupling Proposal clearly conforms to the Commission's policy guidance and NW Natural has amply demonstrated the appropriateness of implementing a full decoupling mechanism.

C. The Stipulated Decoupling Proposal Aligns with Other Commission-Approved Decoupling Mechanisms.

21 The Stipulated Decoupling Proposal is nearly identical to decoupling mechanisms previously approved by this Commission.[69] So far, the Commission has approved full decoupling mechanisms for all of the investor-owned energy utilities in Washington, except for NW Natural: Puget Sound Energy ("PSE") in 2013 and 2017;[70] Avista Corporation ("Avista") in 2015;[71] Pacific Power & Light Company in 2016;[72] and Cascade Natural Gas Corporation ("Cascade") in 2016.[73] Each of the prior mechanisms approved by this

[67] Decoupling Policy Statement ¶ 28.
[68] Walker, Exh. KTW-1T at 17:3-6.
[69] *See* Liu, Exh. JL-2 for an itemized comparison.
[70] Dockets UE-121697 & UG-121705, Order 07; Dockets UE-170033 & UG-170034, Order 08.
[71] Dockets UE-140188 and UG-140189, Order 05.
[72] Docket UE-152253, Order 12.
[73] Docket UG-152286, Order 04.

Commission have involved (1) full decoupling, (2) incorporated a revenue-per-customer methodology, (3) applied to discrete customer groups by Schedule, (4) included a soft cap on rate increases of either 3 or 5 percent, and (5) provided for sharing excess earnings equally with customers. All of these components match the Stipulated Decoupling Proposal in this case.[74]

22 The Stipulated Decoupling Proposal is also consistent with the Commission's most recent decision to renew PSE's full decoupling mechanism as part of that utility's 2017 general rate case. In that case, the Commission approved revenue-per-customer decoupling over Public Counsel's objections that customer growth would result in found margin for PSE and reaffirmed the revenue-per-customer methodology: "the Commission's approach to decoupling, going forward, should continue to use a revenue-per-customer approach for most costs."[75] Additionally, PSE's decoupling mechanism raised the soft cap on rate increases to 5 percent for gas decoupling, and set another four-year renewal provision.[76] More generally, the Commission noted that fixed revenue erosion is a relevant concern for those customers—generally residential and small commercial customers—whose fixed costs are recovered through volumetric rates (or "energy charges")—as is the case for NW Natural.[77]

23 Finally, while the Stipulated Decoupling Proposal protects NW Natural from revenue erosion that would otherwise result from continued conservation efforts, customers who engage in conservation will nevertheless be rewarded through lower bills.[78] This is true because conservation results in fewer therms used, which translates to direct savings on the

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[74] *See* Liu, Exh. JL-2.
[75] Dockets UE-170033 & UG-170034, Order 08 ¶¶ 261, 294.
[76] Dockets UE-170033 & UG-170034, Order 08 ¶ 9.
[77] Dockets UE-170033 & UG-170034, Order 08 ¶ 278.
[78] The question as to whether decoupling eliminates economic benefits to conserving customers was raised at hearing. Chrm. Danner, TR. Vol. III. 110:2-5.

volumetric charges on customer bills. On the other hand, any decoupling surcharge resulting from reduced revenues due to aggregate conservation efforts will be spread over all utility customers, including both those who engage in conservation and those that do not—thus continuing to result in a net savings for customers who conserve.

24 In sum, the Stipulated Decoupling Proposal fully aligns with the Commission's policy guidance and actual practice, and closely mirrors other utility decoupling mechanisms in the state.

D. NW Natural Will Continue its Conservation Programs and Achieve Incremental Conservation.

25 While requests for decoupling are often accompanied by proposals for new conservation programs or goals, the Commission does not always require that decoupling be tied to a particular conservation effort.[79] In this particular case, where NW Natural has already been engaging in ongoing robust conservation efforts, new programs are unnecessary. Indeed, Commission Staff recently "commend[ed]" NW Natural for its "continued upward trajectory in achieving cost-effective savings."[80] In light of this record of continual incremental success, the Stipulated Decoupling Proposal appropriately intends to support the continued expansion of existing programs.

26 NW Natural first requested that the Commission grant its proposal for a decoupling mechanism in its 2008 general rate case—when it also proposed the addition of a new

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[79] The Commission has not always tied decoupling programs to specific conservation goals, as evidenced by the Commission's approval of Cascade's decoupling mechanism, which was not linked to a particular conservation target or program. Docket UG-152286, Order 04 ¶ 8.

[80] *Nw. Nat Gas Co.'s 2018 Conservation Program Commitments*, Docket UG-171163, Compliance Letter at 2 (May 30, 2019).

conservation program.[81] However, through the settlement in that case, NW Natural agreed to withdraw its request for a decoupling mechanism, and to hold any future decoupling proposal until after Avista's pilot decoupling program had provided an initial evaluation of that company's mechanism.[82] Nonetheless, NW Natural committed to undertake substantial new conservation measures with the collaboration of a new Energy Efficiency Advisory Group ("EEAG"), and to implement an energy efficiency pilot program through the Energy Trust of Oregon ("ETO").[83] While the stipulating parties in that case recognized that pursuing these conservation measures in the absence of a decoupling mechanism could result in "lost margins," the parties agreed that NW Natural would not seek approval for a mechanism to recover these lost margins for at least six months after the conservation programs were approved and implemented.[84]

27 Since the 2008 rate case, NW Natural has continued to pursue substantial conservation across its service territory.[85] As agreed in UG-080546, the ETO implemented the Company's incentive program for a one-year pilot, during which time the EEAG monitored the program's performance and assessed whether the ETO should continue to implement the energy efficiency program. On May 25, 2011, NW Natural made a compliance filing in UG-080546, stating that it was the EEAG's recommendation that the ETO continue delivering the Company's energy efficiency incentive programs in Washington.[86]

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[81] *Wash. Utils. & Transp. Comm'n v. Nw. Nat. Gas Co.*, Docket UG-080546, Edmonds, Exh. WRE-1T at 1:16-20 (noting that the Company filed for a conservation program and that this program related to the simultaneous decoupling proposal); *see also* Docket UG-080546, Miller, Exh. CAM-1T at 9:14-10:2 (describing the proposed decoupling mechanism and its relationship to conservation efforts).
[82] Docket UG-080546, Order 04 ¶ 27 (Dec. 26, 2008).
[83] Docket UG-080546, Order 04 ¶ 24.
[84] Docket UG-080546, Order 04 ¶ 26.
[85] Walker, Exh. KTW-1T at 8:1-9:6.
[86] Docket UG-080546, 2011 Q1 Report on behalf of Northwest Natural Gas Company (May 25, 2011).

28 Specifically, NW Natural's existing programs include both the Energy Efficiency Services Program (also known as "Schedule G") and the Low-Income Energy Efficiency ("LIEE") program (also known as "Schedule I").[87] Schedule G is available to all residential customers served under Schedules 1 and 2 and to all commercial firm and interruptible sales customers served under Schedules 1, 3, 27, 41, and 42.[88] Participating customers can receive cash incentives to offset the cost of installing high-efficiency equipment and for installing other energy conservation measures (such as high-efficiency windows or improved building insulation).[89]

29 NW Natural's LIEE program is available to low-income residents that rely on gas as a primary heat source, providing rebates, allowances and reimbursements for health, safety, and repair measures.[90] NW Natural's recently-filed 2019 Energy Efficiency plan includes two pilot programs designed to improve access to Schedule I services and to increase the number of households served under the program.

30 Through these programs, NW Natural has steadily increased its investments and more than tripled its annual total of therms saved[91]:

	2009-2010	2011	2012	2013	2014	2015	2016	2017	Total
Therms Saved	120,897	240,372	213,486	221,172	253,988	201,446	263,184	391,606	1,906,151
Cost	$ 506,744	$ 705,152	$ 1,355,138	$ 1,327,854	$ 1,346,787	$ 1,682,462	$ 1,847,776	$ 2,297,298	$ 11,069,211

[87] Walker, Exh. KTW-1T at 8:2-3, 8:19-20.
[88] Walker, Exh. KTW-1T at 8:3-5.
[89] Walker, Exh. KTW-1T at 8:5-8. At hearing, Mr. Rubin suggested that a certain amount of conservation would result without the utility's efforts because most new appliances are more energy efficient. Rubin, TR. Vol. III. 109:18-20. However, in NW Natural's experience, providing cash incentives can speed the transition to the more efficient appliances that are on the market.
[90] Schedule I; Walker, Exh. KTW-1T at 8:19-9:3.
[91] Walker, Exh. KTW-1T at 8:17 (Figure 2).

31 On top of the ongoing conservation gains described above, NW Natural has committed to set, meet, and report on new annual conservation targets that include acquiring all available cost-effective conservation resources as part of the Joint Settlement Agreement.[92] The Joint Settlement Agreement also specifically anticipates that new energy efficiency mandates are forthcoming, namely through the recent passage of HB 1257.[93] This new legislation provides that all gas companies "must identify and acquire all conservation measures that are available and cost-effective," establishing biennial acquisition targets and explicitly accounting for the costs of greenhouse gas emissions.[94]

32 Similarly, the Company has already recognized the need for robust conservation goals necessary to respond to climate change, and has created a program known as the "Low-Carbon Pathway" to set a path towards dramatic conservation and decarbonization.[95] First, NW Natural established ambitious conservation targets, which are designed to create carbon savings equivalent to 30 percent of the Company's 2015 emissions by the year 2035.[96] Second, the Company hired Energy and Environmental Economics to conduct an economy-wide deep decarbonization study for Washington and Oregon to provide guidance on how NW Natural's system can be used to ensure energy reliability while dramatically reducing greenhouse gas emissions over the next three decades—reinforcing the need for gas to provide a bridge to "deep decarbonization."[97] Thus, the Company has a clear path forward to develop additional incremental conservation on top of its existing record of conservation improvements.

33 In sum, NW Natural has established a strong record of improving conservation for its

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[92] Joint Settlement Agreement ¶ 20 (May 23, 2019).
[93] Joint Settlement Agreement ¶ 20.
[94] Energy Efficiency Act, Laws of 2019, ch. 285, § 11.
[95] Anderson, Exh. DHA-1T at 7:5-19.
[96] Anderson, Exh. DHA-1T at 7:5-12.
[97] Anderson, Exh. DHA-1T at 8:1-8.

customers, and has committed to set, meet, and report on new conservation targets as part of this rate case. NW Natural believes that the Stipulated Decoupling Proposal will effectively address the Company's ongoing lost margins associated with these conservation efforts, while also reducing the Company's revenue volatility due to increasingly variable weather extremes.

III. THE EVIDENCE DOES NOT SUPPORT PUBLIC COUNSEL'S CONCERN THAT THE REVENUE-PER-CUSTOMER APPROACH WILL RESULT IN A WINDFALL.

34 Public Counsel opposes the Stipulated Decoupling Proposal, erroneously arguing that its adoption will result in a windfall to NW Natural. Specifically, Public Counsel's expert witness, Scott Rubin, argues that because new customers on average use less gas than existing customers (a claim that NW Natural does not dispute) revenue-per-customer decoupling creates an artificial "shortfall" in revenues that all customers are required to make up.[98] And given that NW Natural expects significant growth over the coming years, Mr. Rubin mistakenly concludes that the Company will over-recover its costs by approximately $12 million over the next six years.[99]

35 Mr. Rubin's reasoning is wrong because it is based on a flawed calculation of the costs NW Natural incurs when it adds new customers. In fact, NW Natural's costs to serve new customers far exceed the incremental revenues that can be expected from those customers, meaning that there is no "found margin" associated with the addition of new customers. On the contrary, far from producing a windfall, NW Natural estimates that, even under the Stipulated Decoupling Proposal, the Company will experience a shortfall in revenues over the next several years of approximately $5.6 million.

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[98] Rubin, Exh. SJR-1T at 10:1-10.
[99] Rubin, Exh. SJR-1T at 23:11-24:4.

A. Public Counsel's Proposal Grossly Understates the Capital Costs to Serve New Customers.

36 NW Natural has recently experienced substantial customer growth in Washington. Between 2013 and 2018, the Company's customer base was growing at an annual rate of 2.9 percent.[100] At the same time, and despite the Company's diligent efforts to control expenditures,[101] the incremental costs associated with adding new customers has increased substantially—with a compound annual growth rate of 4.6 percent—resulting in a growing shortfall in necessary revenues.[102] Unfortunately, while new customers are becoming more energy efficient (and thus consuming less gas), the costs associated with establishing service for such customers has become increasingly expensive. The cost to extend new lines, with the accompanying construction, permitting, and related costs, has grown steadily over the last three to five years in particular.[103]

37 As explained in the pre-filed testimony of Kyle Walker, the Company tracks both the number of new residential customers added to the system as well as dollars spent to connect those customers. Part of the costs associated with serving new customers consists of capital costs. The Company classifies capital costs in three general buckets: main extensions, new service, and conversion service. To determine the capital cost per customer, the Company adds all costs associated with these three buckets and reduces the amount by customer contributions. The Company then adds construction overhead and divides the cost by the total number of newly added meter sets to get a total construction cost per customer of $3,507. After

[100] Liu, Exh. JL-1T at 8:9-10.
[101] Moncayo, Exh. JOM-1T at 8:1-11:10.
[102] Liu, Exh. JL-1T at 8:11-13.
[103] Walker, TR. Vol. III. 98:23-99:3.

taking into account the depreciation and return components of the capital expense, as well as the property tax on capital, federal income taxes, revenue sensitive items and operations and maintenance ("O&M") expense associated with serving new customers, the cost to provide service to a new customer is $508 in the first year.[104]

38 On the other hand, Mr. Rubin's windfall argument is based on his assumption that the cost to connect a new customer is only $1,300, with a $141 cost of service for the first year. These estimates are demonstrably flawed, based on a series of errors made by Mr. Rubin.

39 First, in calculating the cost to serve new customers, Mr. Rubin entirely excluded the costs associated with main extensions, which are inarguably required to serve new customers not already served by mains (as is always the case in new developments).[105] In his written testimony, Mr. Rubin explained that he excluded main extension costs because the Company had originally provided data that included both residential and non-residential main extension projects. However, Mr. Rubin acknowledged at hearing that the Company had subsequently updated its main extension data to exclude non-residential projects and revised its calculation accordingly.[106] And importantly, the correction did not significantly change the Company's ultimate assessment of costs necessary to serve new customers.[107] In addition, Mr. Rubin also claimed that the costs per customer for main extensions was too high, and therefore must be excluded in their entirety.[108] However, at hearing Mr. Rubin acknowledged that he based this statement on an erroneous calculation in which he mistakenly assumed that each main

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[104] Walker, Exh. KTW-4Tr at 5:12-6:16.
[105] Walker, Exh. KTW-4Tr at 8:3-10.
[106] Rubin, TR. Vol. III. 84:18-22.
[107] Walker, Exh. KTW-4Tr at 10:1-9.
[108] Rubin, Exh. SJR-1T at 22:2-6.

extension project served only 1 customer—when in fact each main extension project serves an average of 16 customers—and thus Mr. Rubin's assumed cost per customer for mains was 16 times the actual amount.[109] And while at hearing, Mr. Rubin stated that even the correct per-customer cost for main extensions "seemed" too high, he provided no support for his suspicion.[110] Thus, both of Mr. Rubin's criticisms of the costs associated with main extensions are wholly unfounded.

40 Second, Mr. Rubin's calculation of the cost to serve new customers fails to include amounts for construction overhead. As Mr. Walker explained, all capital items receive an overhead cost when plant is providing a utility service and the project is closed out. Therefore, all capital assets on the Company's books include the overhead, as well as the depreciation expense derived from those assets.[111] Moreover, at hearing, Mr. Walker provided further detail on the types of costs that are included in construction overhead, explaining that these costs are attributable to certain capital projects, but not directly assigned.[112] For instance, while the costs of construction crews are generally directly assigned to a capital project, the costs of engineers designing the project, or employees obtaining permits, would not be directly assigned, but would be included in construction overhead.[113] Importantly, Mr. Walker further explained that the Company performs studies every year to determine the appropriate amount of construction overhead to be included in capital projects, and while that amount changes from year to year, the level included in this case is relatively consistent with the past several years. Moreover,

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[109] Rubin, TR. Vol. III. 88:4-18.
[110] Rubin, TR. Vol. III. 93:9-23.
[111] Walker, Exh. KTW-4Tr at 11:3-6.
[112] Walker, TR. Vol. III. 57:23-25.
[113] Walker, TR. Vol. III 59:10-60:3.

the level used by the Company is audited every year by PriceWaterhouseCoopers.[114] Thus, while at hearing Mr. Rubin persisted in his view that he could not state what the overhead numbers represented,[115] his assumption that it should be "zero" is unjustifiable.

41 Third, Public Counsel's assessment of the cost to serve new customers fails to include incremental O&M expense attributable to new customer additions. As Mr. Walker explained at hearing, in determining the O&M expense attributable to customer additions, the Company calculates total O&M expense for those categories of costs associated with new customers, such as costs associated with meter reading, billing, payment processing and collections. The Company takes those total costs and then divides them by the number of current customers to derive a per-customer O&M expense—an approach that the Company has found is consistent with incremental costs incurred as new customers are added.[116]

42 At hearing, Mr. Rubin defended his decision to omit O&M expense altogether, claiming that the Company had not demonstrated to his satisfaction that the Company is "hiring new employees or purchasing new trucks and so on in order to serve *a new customer*."[117] This concern is misguided. As explained by Mr. Walker, given that the Company adds approximately one thousand customers a month, it is impossible to determine which customer triggers a particular new investment[118]—information that would not be particularly helpful in any event. Instead, the Company calculates an average per-customer amount, which over the years has proved to be quite consistent.[119] On the other hand, Public Counsel's assumption that the Company incurs *no* incremental O&M expense to add new customers is plainly

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[114] Walker, TR. Vol. III. 59:14-19.
[115] Rubin, TR. Vol. III. 93:12-15.
[116] Walker, Exh. KTW-4Tr at 5:11-17.
[117] Rubin, TR. Vol. III 93:5-11 (emphasis added).
[118] Walker, TR. Vol. III 53:4-17.
[119] Walker, TR. Vol. III. 54:10-21.

unreasonable.

B. NW Natural's Costs Associated with New Customers Exceed Revenues.

43 Given the significant costs that the Company incurs to add new customers, the overall financial impact to the Company associated with adding new customers is *negative* in the early years of the new service, even accounting for increased revenues. In his testimony, Mr. Walker demonstrated that, under the Stipulated Decoupling Proposal, over the same six-year period considered by Mr. Rubin to arrive at his "windfall" estimate, the Company will actually experience a revenue shortfall of approximately $5.6 million dollars, assuming average gas usage of 678 therms per year. NW Natural also analyzed the financial impact on the Company of various additional consumption scenarios under the Stipulated Decoupling Proposal—shown in the following table:[120]

Usage	Annual Revenue	Year 1 Cost of Service	Breakeven Year
500	$329	$508	Year 20
550	$352	$508	Year 17
600	$375	$508	Year 15
650	$398	$508	Year 12
700	$422	$508	Year 9
750	$445	$508	Year 7
800	$468	$508	Year 4

As shown above, even with *above-average* consumption, the net impact of new customers is a net negative for at least the first several years of service.[121] As a result, revenue-per-customer decoupling, which assumes a break-even on costs and revenues, will certainly not result in a "windfall" for NW Natural.[122]

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[120] Walker, Exh. KTW-4Tr at 16:17.
[121] Walker, Exh. KTW-4Tr at 17:1-2.
[122] Walker, Exh. KTW-4Tr at 17:2-4.

44 Perplexingly, having raised the issue of the revenue benefits associated with new customers, Public Counsel goes on to describe any recovery of the offsetting costs as a form of "special recognition" to compensate the Company for the cost of growth.[123] This characterization misstates the central purpose of the Stipulated Decoupling Proposal. NW Natural did not propose decoupling in this docket to account for growth, but rather to account for ongoing revenue erosion from the Company's conservation efforts and bill volatility associated with weather. NW Natural addressed the costs associated with new customers solely to respond to Public Counsel's concerns that decoupling would result in a "windfall" for the Company associated with those new customers—a concern that is clearly baseless given the evidence presented. Indeed, Public Counsel's witness acknowledged that the issue of capital investment associated with new customers "is irrelevant to the decoupling mechanism itself."[124] The fact that offsetting costs will preclude the existence of a "windfall" does not mean that the purpose of the decoupling mechanism is to compensate the Company for growth.

45 Notably, Public Counsel made a similar argument against a revenue-per-customer approach in PSE's recent rate case.[125] In that case, Public Counsel similarly argued that the revenue-per-customer approach should be abandoned because it purportedly rewards the utility for the continuous addition of new customers.[126] The Commission rejected Public Counsel's approach, noting that it "ignores salient facts," such as the incremental costs associated with serving new customers.[127]

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[123] Rubin, TR. Vol. III. 95:19-21.
[124] Rubin, TR. Vol. III. 107:1-2.
[125] Dockets UE-170033 & UG-170034, Order 08 ¶¶ 289, 291-94.
[126] Dockets UE-170033 & UG-170034, Order 08 ¶¶ 290-91.
[127] Dockets UE-170033 & UG-170034, Order 08 ¶¶ 291, 294.

46 In sum, Public Counsel's arguments that NW Natural will be overcompensated under revenue-per-customer decoupling is without factual basis and should be rejected.

IV. THE COMMISSION SHOULD REJECT PUBLIC COUNSEL'S ALTERNATIVE DECOUPLING PROPOSAL.

47 Public Counsel recommends that, if the Commission determines that decoupling is appropriate, it should instead adopt rate-class decoupling.[128] Under rate-class decoupling, the revenue baseline for a class of customers is set based on the test year, and remains unchanged regardless of the number of utility customers.[129] This means that the Company would be able to collect only those revenues approved in its last rate case and not any incremental revenue associated with customer growth, with the exception of the fixed monthly charge. Therefore, under rate-class decoupling the Company would be unable to recover any incremental costs to serve new customers—except the additional fixed charge.[130] Public Counsel's proposal should be rejected for three reasons.

48 First, rate-class decoupling will penalize the Company for connecting new customers, and have a deleterious impact on earnings. As discussed above, NW Natural expects significant customer growth over the coming years—and its costs to connect those new customers far exceed any corresponding expected revenues. Given these facts, NW Natural estimates that Public Counsel's proposal would likely lead to a revenue deficiency of $27.7 million.[131] Indeed, even Public Counsel explicitly recognizes that its proposal "would not provide the Company with a full return on its investment" associated with customer growth,

[128] Rubin, Exh. SJR-1T at 3:12-14.
[129] Rubin, Exh. SJR-1T at 8:4-11.
[130] Walker, Exh. KTW-4Tr at 17:18-19.
[131] Walker, Exh. KTW-4Tr at 20:10.

despite providing for some incremental increase in revenues over a six-year period.[132] As a result, far from reducing the number of rate case filings, Public Counsel's proposal would create the need for more rate cases than if the Company had no decoupling mechanism at all.[133]

49 Second, and in a related sense, rate-class decoupling subverts rather than promotes one of the key goals of decoupling, which is to reduce the risk of revenue volatility. And this reduction in costs flows through to utility customers in the form of lower rates.[134] In contrast, as demonstrated by NW Natural, and acknowledged by Public Counsel, rate-class decoupling would ensure rather than avoid revenue erosion, which would undermine the Company's earnings.

50 Third, this Commission has never previously adopted rate-class decoupling as proposed by Public Counsel; and further, Public Counsel's witness could point to only one or two states in the entire country that have adopted rate-class decoupling—despite the fact that a majority of the states have adopted some form of decoupling for their jurisdictional utilities.[135] Indeed, rate-class decoupling is clearly an outlier proposal, which is likely to harm utilities like NW Natural that are experiencing customer growth coupled with high costs to connect.

51 At hearing, Public Counsel's witness sought to justify rate-class decoupling by pointing out that the Company is projecting significant customer growth over the next five years, and accordingly would see an overall increase in its sales volumes—arguing that this fact is "inconsistent" with the Company's stated goal of reducing gas consumption.[136] This argument makes no sense. The purpose of decoupling is not to discourage utilities from serving new

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[132] Rubin, Exh. SJR-1T at 24:13-14; *see also* Rubin, TR. Vol. III. 90:9-19.
[133] Walker, Exh. KTW-4Tr at 20:19-20.
[134] Decoupling Policy Statement ¶¶ 16-17.
[135] Rubin, TR. Vol. III. 91:20-92:12.
[136] Rubin, TR. Vol. III. 108:21.

customers, but rather to encourage conservation and energy efficiency on the part of the customers served by the utility. Indeed, the very term "energy efficiency" denotes the reduction of waste per amount consumed, and is agnostic as to the overall volume of energy sales. It was this energy *efficiency* that was the focus of the Commission's Decoupling Policy Statement—not a broader goal of preventing *new* customers from joining NW Natural's system and consuming gas. Indeed, to achieve Public Counsel's goal of overall reductions in sales volumes, NW Natural would need to turn away new customers, in violation of its obligation to serve.[137]

V. CONCLUSION

52 NW Natural asks the Commission to approve a Stipulated Decoupling Proposal supported by Staff, AWEC, and TEP to implement a decoupling mechanism that is almost identical to those previously approved for each of the other investor-owned energy utilities in Washington. The Stipulated Decoupling Proposal is entirely congruent with the Commission's policies and precedent, and will effectively mitigate both revenue and bill fluctuations sparked by the Company's growing conservation efforts and weather volatility. Far from creating the "windfall" Public Counsel contends, the Stipulated Decoupling Proposal is a reasonable, fair, and balanced proposal that will effectively break the link between consumption and revenues.

53 In contrast, Public Counsel's recommendation for rate-class decoupling represents an unsupported and unprecedented proposal that would fail to address revenue volatility and would penalize NW Natural for meeting its mandate to serve new customers. Such a proposal would be worse than no decoupling at all, prompting the need for NW Natural to file more

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[137] RCW 80.28.110.

frequent rate cases.

54 For the reasons set forth above, the Commission should reject Public Counsel's proposal and instead adopt the Multi-Party Settlement as proposed.

Respectfully submitted this 12th day of September, 2019.

/s/ Lisa Rackner

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