

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of) DOCKET NO. UG-060518
)
AVISTA CORPORATION, D/B/A/)
AVISTA UTILITIES,)
)
For an Order Authorizing)
Implementation of a Natural Gas)
Decoupling Mechanism and to)
Record Accounting Entries)
Associated With the Mechanism)
_____)

REBUTTAL TESTIMONY OF
BRIAN HIRSCHKORN (AVISTA)
JOELLE STEWARD (UTC STAFF)
NANCY GLASER (NW ENERGY COALITION)

1 Q. What is the scope of your rebuttal testimony in this proceeding?

1 A. Our rebuttal testimony will address the issues raised by Mr. Steven Johnson for
2 Public Counsel (Exhibit No. ___T (SGJ-1T)) and Mr. Charles Eberdt (Exhibit No.
3 ___T (CE-1T)) for The Energy Project, in their direct testimony filed in this
4 proceeding.

5
6 **Q. Could you please summarize your testimony?**

7 A. Commission approval of the Settlement Agreement, reflecting the proposed
8 decoupling mechanism, would remove the disincentive that presently exists for the
9 Company to further encourage customer conservation of natural gas. The mechanism
10 provides an opportunity for the Company to recover the majority of the lost margin
11 from both Company- and customer-sponsored demand side management (DSM),
12 which would align the interests of both the Company and its customers in fully
13 supporting all conservation.

14 The mechanism is a three-year pilot program that has been refined through
15 input from the parties in this proceeding. There are numerous “checks and balances”
16 to provide reasonable assurance that the mechanism operates within well-defined
17 parameters and achieves the desired results. Included among these “checks and
18 balances” are: (1) an “earnings test”; (2) a “DSM test”; (3) a “2% cap” on annual rate
19 adjustments; (4) an evaluation plan to be agreed upon; (5) quarterly reports on the
20 status of deferrals under the mechanism; (6) an independent review of DSM savings;
21 and (7) the automatic termination of the mechanism at the end of the pilot period
22 unless the company justifies, and the Commission approves, its continuance.
23 Moreover, the Company’s 2006 and 2007 DSM goal, which is an integral part of the

1 mechanism, was established as an aggressive, unbiased target. Finally, even Mr.
2 Eberdt, at page 2 of his testimony, characterizes the mechanism as the “clearest,
3 cleanest proposal to be put forth.”

4
5 **Q. Both Public Counsel and The Energy Project argue that the proposed**
6 **mechanism fails to comply with the PacifiCorp order by not committing to**
7 **incremental conservation. Do you agree with their positions?**

8 A. No. The proposed mechanism includes the establishment of a meaningful and
9 elevated savings target for Avista’s gas efficiency programs. The annual target of
10 1,062,000 therms was properly established by the Company’s 2006 Natural Gas
11 Integrated Resource Plan. This target exceeds the prior target by four times and is 15
12 percent higher than the average savings of the most recent three-year period. We
13 believe this target and the Company’s on-going engagement of its external oversight
14 group, the External Energy Efficiency (Triple-E) Board, is a responsible commitment
15 to gas efficiency.

16 The Commission’s discussion of incremental conservation in the PacifiCorp
17 order was specific to the record in that proceeding and therefore, should not be
18 interpreted to apply to all utilities.¹ The Commission has stated that decoupling must
19 “be designed to fit with the utility’s particular circumstances.”² At the time of the
20 Commission’s order in the PacifiCorp proceeding, PacifiCorp had not done a
21 comprehensive evaluation of the efficiency options in its service area, nor had it

¹ *WUTC v. PacifiCorp, d/b/a Pacific Power & Light Co.*, Docket UE-050684, Order No. 04 (April 17, 2006) at 41-42 ¶¶108-109.

1 committed to do such a study; therefore, a well-informed savings target could not be
2 developed. The parties in the PacifiCorp proceeding were facing different
3 circumstances than the parties in this proceeding.

4 As previously noted, Avista recently completed a natural gas integrated
5 resource plan (IRP) in which it performed a comprehensive assessment of natural gas
6 efficiency measures applicable to Avista's service areas. In its letter acknowledging
7 Avista's compliance with the IRP rule, the Commission noted:

8 Avista has significantly improved both its methodology for assessing DSM as
9 a resource option and the integration of DSM resources in its portfolio. A
10 significant improvement was the inclusion of a comprehensive set of potential
11 energy efficiency measures that were tested in the model and used to create a
12 conservation supply curve... Overall, the Commission commends Avista for
13 the improvements it made to its DSM analysis.³

14
15 The gas savings target that was set for 2006 and 2007, which is the basis for
16 the DSM test in the decoupling mechanism, was an outcome of this analysis.

17 Therefore, we have sufficient information to determine that Avista's efficiency target
18 is appropriate and in the public interest.

19

² *Rulemaking to Review Natural Gas Decoupling*, Summary, Analysis of Comments and Decision to Close Docket Without Action at 10, Docket No. UG-050369 (October 17, 2005).

³ Letter to Scott Morris from Carole J. Washburn, re: Avista Corporation, 2006 Natural Gas Least Cost Plan at 3-4, Docket No. UG-060492 (Sept. 7, 2006).

1 **Q. On page 3 of Mr. Eberdt’s testimony, he states: “It (the mechanism) would**
2 **include reduced consumption caused by customer-sponsored conservation or**
3 **from consumers’ responses to prices or weather.” Doesn’t the proposed**
4 **mechanism exclude the effects of abnormal weather?**

5 A. Yes. The mechanism excludes the effects of abnormal weather and captures only the
6 effect of changes in customer usage after adjusting usage for abnormal weather.
7 Accordingly, the Company remains at risk for lost margin due to weather variations.

8

9 **Q. On page 4 of Mr. Eberdt’s testimony, he argues that customers will pay twice for**
10 **conservation with the proposed decoupling mechanism. Do you agree with his**
11 **assessment?**

12 A. No. A potential decoupling rate adjustment would allow the Company to recover
13 only the fixed costs associated with providing natural gas service that were authorized
14 in the most recent general rate case. Customers pay only once for the conservation
15 program costs through the tariff rider, Schedule 191.

16 The alternative to decoupling to provide recovery of fixed costs is through
17 higher basic charges. Higher basic charges, however, would have a larger bill impact
18 on individual customers, including low-income customers, and would reduce the bill
19 savings the customer could achieve through conservation efforts since less of the bill
20 is subject to the household’s usage. The decoupling mechanism allows us to retain
21 volumetric pricing, which maintains customers’ benefits of lower bills that come

1 from conservation. Moreover, decoupling results in a smaller bill impact because the
2 lost margin is aggregated over the entire class.

3
4 **Q. Turning now to Mr. Johnson’s testimony, on page 6, lines 15-17, he states:**
5 **“Avista retains for shareholders the margin revenues gained by new customer**
6 **use that occurs between rate cases.” Would you comment on this statement?**

7 A. Yes. In this section of his testimony, Mr. Johnson infers that the margin revenues
8 from new customers represent additional short term profits to the company that are
9 not taken into consideration under the proposed mechanism. While the Company
10 does receive margin from new customers, it also incurs incremental fixed costs to
11 provide service. Further, based on an examination of new natural gas customers
12 added since 2004, new customers use less on average, thus providing less margin per
13 customer, than customers connected prior to that time. Regardless of the incremental
14 margins and costs resulting from new customers, the mechanism contains an earnings
15 test to ensure that it does not result in Company earnings that exceed the level
16 authorized by the Commission.

17
18 **Q. On page 7 of Mr. Johnson’s testimony, lines 1-2, he states: “The decoupling**
19 **mechanism deferrals are far out of proportion to the lost margins from Avista’s**
20 **own energy efficiency programs.” Do you have any comments related to this**
21 **area of his testimony?**

22 A. The proposed decoupling mechanism is designed to capture up to 90 percent of the
23 lost margin resulting from all reductions in usage by Schedule 101 customers

1 (normalized for weather). Customers have conserved, and will continue to conserve
2 well beyond the direct results of company-sponsored DSM programs.

3 The Company wants to continue to encourage customers to conserve through
4 increased participation in programmatic DSM but, perhaps more importantly, to
5 conserve beyond programmatic DSM through increased customer education. With a
6 decoupling mechanism in place, the company has a reasonable opportunity to recover
7 lost margin due to all conservation and can continue to encourage customers to
8 conserve natural gas through education, as well as through programmatic DSM. It is
9 important that utility regulation encourage such informational and educational efforts
10 on the part of the company. This is not the case at present; nor is it the case with the
11 alternative proposed by Mr. Johnson on pages 18-23 of Exhibit No. ___(SGJ-1T).

12
13 **Q. Beginning on line 22 of page 9 of Mr. Johnson’s testimony, he states: “The**
14 **Company’s behavior cannot be changed retroactively. The inclusion of January**
15 **2007-June 2007 deferral amounts in rates provides no incentive for a change in**
16 **Company behavior, ...” Has the Company increased its focus on DSM during**
17 **2006?**

18 A. Yes. The potential of a financial incentive associated with the 2006 IRP goal has
19 increased the company’s focus on natural gas DSM during 2006. The Company’s
20 request for a natural gas decoupling mechanism was originally filed through a
21 petition dated April 4, 2006. The mechanism included the proposed IRP goal of
22 1,062,000 therms during 2006 to be used as the DSM test for any 2007 rate
23 adjustment and the Company has been striving to achieve that goal during 2006. The

1 Company is on target to meet the goal for 2006 as a result of this increased focus.
2 The Company has increased resources to achieve higher DSM goals in 2006 and
3 beyond. These resources include the appointment of Mr. Bruce Folsom as Senior
4 Manager over the entire DSM area and a recent increase in the Company's natural
5 gas DSM rider to fund a higher gas DSM budget/goal. As a result of these activities,
6 there has been an increased focus on DSM throughout the entire company during
7 2006.

8

9 **Q. On page 8 of Mr. Johnson's testimony, he projects deferred revenue for the July**
10 **2007–June 2008 period of \$1.444 million. Is his projection reasonable?**

11 A. No. Mr. Johnson has extrapolated and massaged historical results reaching back to
12 1999 to achieve his estimate, as described on page 2 of Exhibit No. __ (SGJ-6). In
13 response to Data Request No. 49 from Public Counsel, the Company provided an
14 estimate of the total deferral amount for the calendar year 2007. The Company's
15 estimated deferral amount for 2007 is approximately \$650,000, which is less than half
16 of Mr. Johnson's estimate. The company's estimate for 2007 compares to a
17 simulation of the mechanism for July '05 – June '06 of \$617,000 based on actual
18 results. This simulation for July '05 – June '06 is attached as Exhibit No. __ (JOINT-
19 3).

20

21 **Q. On page 11 of Mr. Johnson's testimony, he points out that the Settlement**
22 **removes Schedule 111 customers from the mechanism originally filed by the**
23 **Company. Why was Schedule 111 removed?**

1 A. Over 95 percent of the Company's customers that use over 200 therms per month
2 take service under Schedule 111. Upon a closer examination of customers served
3 under the schedule, it became apparent that a significant number are large commercial
4 and industrial customers, whose gas usage can vary substantially because of
5 economic conditions. It is not the Joint Parties' intent to include those customers as
6 part of the decoupling mechanism. Because of the complexities of identifying,
7 tracking and eliminating those customers and their usage from the mechanism, the
8 parties agreed to eliminate Schedule 111 from the mechanism for the pilot.

9

10 **Q. Related to the elimination of Schedule 111 from the mechanism, on page 17 of**
11 **Mr. Johnson's testimony, he expresses a concern regarding the potential**
12 **migration of Schedule 101 customers to another service schedule and the effect**
13 **on the deferrals recorded under the mechanism. Could you please address this**
14 **concern?**

15 A. Yes. Generally, customers who use less than 200 therms per month receive service
16 under Schedule 101 and customers who use more than 200 therms per month receive
17 service under Schedule 111. With both schedules included under the mechanism,
18 migration between the two schedules would not be an issue. The Company monitors
19 customers' historical usage on an ongoing basis and places them on the appropriate
20 schedule. The company was initially hesitant to eliminate Schedule 111 from the
21 mechanism until it researched the effect of migration between the schedules. The
22 Company has now determined that migration occurs fairly uniformly between the
23 schedules, i.e., a similar number of customers (and usage) migrate to Schedule 101

1 from 111 and from 101 to 111. Therefore, the effect of migration between the two
2 schedules is expected to be negligible. In any event, this issue can and will be
3 reviewed as part of the evaluation of the pilot.

4
5 **Q. Related to the removal of Schedule 111, on lines 18-20 of page 11 of Mr.**
6 **Johnson’s testimony, he states: “...the settlement decoupling proposal recovers**
7 **an amount that exceeds the full lost margins for all of Schedule 101, all of**
8 **Schedule 111, and additional amounts on top of that.” Is that true?**

9 A. No. In this section of his testimony, Mr. Johnson is comparing apples to oranges, i.e.,
10 lost margin related to customer conservation funded by the Avista DSM tariff rider
11 compared to the lost margin resulting from all customer conservation (normalized for
12 weather). The mechanism determines the lost margin only from Schedule 101
13 customers that were served during the test year and any rate adjustment is applied
14 only to Schedule 101 customers to recover no more than 90 percent of that lost
15 margin.

16
17 **Q. On page 14 of Mr. Johnson’s testimony, he argues that because there is no**
18 **financial incentive for the Company to exceed 100 percent of the annual DSM**
19 **target, the company could “delay” additional conservation efforts in excess of**
20 **the DSM target until the following year. Do you think this situation is likely to**
21 **occur?**

1 A. No. Delaying additional DSM savings once the goal has been met would not be in the
2 company's long-term best interest. The potential continuation of the mechanism
3 beyond the three-year pilot period will, in part, be based on an evaluation that will
4 include the Company's DSM performance. With the additional oversight of the
5 Company's DSM performance and results, the Company would not want to risk the
6 potential continuation of the mechanism by "gaming" the results.

7 Furthermore, the DSM target is not an insignificant goal and, as previously
8 mentioned, has required the Company to ramp up its efforts in order to achieve it.
9 Also as previously discussed, this target is higher than in the past and is the result of a
10 comprehensive assessment of gas efficiency potential in Avista's service area.

11

12 **Q. On page 14 of Mr. Johnson's testimony, lines 18-19, he states: "Under this**
13 **proposal, Avista has an incentive to suppress its 2008 IRP target to make it**
14 **easier for the company to meet the DSM test ..."** Do you think it is likely that
15 **the Company will suppress the 2008 goal?**

16 A. No. As set forth on page 6 of the Settlement Agreement, the Company will file its
17 2008 IRP goal within the decoupling tariff, thereby providing an opportunity for
18 additional review and comment by interested parties. With the additional oversight
19 of the Company's 2008 goal related to the decoupling mechanism, it will be required
20 to provide supporting evidence that the goal is reasonable.

21 There is always a need to pay close attention to the setting of conservation
22 targets when incentives and/or penalties apply. However this is also true with Mr.
23 Johnson's proposed mechanism (page 18-23 of SGJ-1T). The advantage of our

1 proposal compared to Mr. Johnson's is that it provides for the recovery of lost
2 margin, thereby eliminating the primary disincentive related to conservation.

3
4 **Q. On pages 16 and 17 of Mr. Johnson's testimony, he discusses the "roll-over" of**
5 **deferrals from year one to year two as a result of the company exceeding the**
6 **earnings test in year one. Could you please provide additional clarity around**
7 **any earnings "roll-over"?**

8 A. Yes. In his example provided on lines 7-10 on page 17, he states: "if Avista's lost
9 margins in year 2 are only half of the of the rolled-over excess earnings from year 1,
10 the company will recover all of the year 2 lost margins plus additional amounts up to
11 the total excess earnings rolled over from year 1." It should be remembered, however,
12 that in year 2, the Company can only recover the greater of: 1) the total amount of
13 deferral that would be recorded in year 2, or 2) the amount of excess earnings carried
14 over from year 1. It cannot recover both. Any excess earnings "roll-over" from year
15 1 will be used to offset deferrals that would be recorded in year 2. For example, if the
16 Company carries over \$200,000 from year 1 as a result of the earnings test, the first
17 \$200,000 in deferrals in year 2 will not be recorded. In Mr. Johnson's example, the
18 excess earnings carried over from year 1 exceed the deferrals that would be recorded
19 in year 2. If that situation occurred, no additional deferrals would be recorded in year
20 2 and the Company would be limited to the recovery of the excess earnings carry-
21 over from year 1.

1 **Q. Is the situation described above likely to occur during the pilot term?**

2 A. No. For this situation to occur, customer usage (weather-normalized) would have to
3 increase from year 1 to year 2 and the Company's operating results would have to
4 exceed its authorized rate of return in year 1, resulting in a deferred balance carry-
5 over to year 2.

6

7 **Q. Why does the mechanism contain this deferred balance "carry-over" provision**
8 **related to the earnings test?**

9 A. It allows the Company to avoid writing off a deferral balance that it cannot recover
10 during the current year as a result of the earnings test.

11

12 **Q. On page 18 of Mr. Johnson's testimony, he states: "The settling parties have**
13 **provided no explanation for why this weather normalization methodology is**
14 **appropriate to use (for the mechanism)." Could you please address this issue?**

15 A. Yes. The weather normalization methodology used to calculate deferrals under the
16 mechanism is the same as the methodology used for the 2004 test year in the
17 Company's most recent general rate case. While the methodology used by the
18 Company in that case was not explicitly approved by the Commission, it was
19 accepted as part of the settlement agreement.⁴ As the 2004 weather-normalized usage
20 is used as the "base year" to determine the change in customer usage, using the same

⁴ *WUTC v. Avista Corporation d/b/a Avista Utilities*, Docket Nos. UE-050482 and UG-050483, Order No. 05 (Dec. 21, 2005) at 40 ¶96.

1 methodology for the mechanism provides an “apples-to-apples” comparison of
2 current customer usage to the test year.

3
4 **Q. On pages 18-23 of Exhibit No. __ (SGJ-1T), Mr. Johnson proposes a**
5 **conservation incentive/penalty mechanism as an alternative to the decoupling**
6 **mechanism to encourage Avista to do more conservation. What are your**
7 **thoughts regarding his proposal?**

8 A. While we appreciate Public Counsel’s attempt to develop an alternative mechanism,
9 we believe this proposal falls far short. First, the incentive mechanism does nothing
10 to address the underlying conflict we have in traditional regulation in which fixed
11 costs are recovered through volumetric pricing, which results in a disincentive for the
12 utility to provide an ongoing comprehensive conservation message to its customers.
13 The decoupling mechanism better aligns the need for a constant comprehensive
14 conservation message with ratemaking by severing the link between recovery of fixed
15 costs and the volume of sales.

16 Second, the proposed incentive level (i.e., a maximum of only \$0.13 per saved
17 therm or \$138,000 if the Company exceeds its program target by 30%) is not
18 meaningful. It retains a disincentive for the utility to engage in additional
19 conservation since the margin the company would lose from the conservation
20 programs far exceeds the amount of incentive the utility would receive. Moreover,
21 since conservation savings continue for several years, the annual incentive proposed
22 by Public Counsel compensates for a mere fraction of what the Company has been
23 authorized to collect in rates. It would not provide a meaningful encouragement to

1 conservation. Public Counsel's proposed incentive mechanism is a small band-aid
2 that completely ignores the underlying disease.

3

4 **Q. Lastly, will the recent delay in the procedural schedule affect the proposed**
5 **January 2007 implementation of the mechanism?**

6 A. No. The Company would not make any calculations under the mechanism for the
7 month of January until early February. As long as the Commission issues its order
8 prior to that time, the mechanism could still be made effective January 2007.

9

10 **Q. Does this conclude your rebuttal testimony?**

11 A. Yes.

12

13

14