BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of 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.	DOCKET NO. UG-060518

PRE-HEARING BRIEF OF PUBLIC COUNSEL

WASHINGTON STATE ATTORNEY GENERAL'S OFFICE

DECEMBER 14, 2006

I. INTRODUCTION

1. This case presents to the Commission a further variation on the decoupling theme. Unlike the decoupling proposals in the Puget Sound Energy (PSE) and Cascade dockets that have already been submitted for consideration, this proposal is presented outside the context of a general rate case. The Avista proposal, agreed to with some modifications by Commission Staff and the Northwest Energy Coalition, shares many of the same fundamental structural defects as the decoupling proposals in other dockets. In addition, some of the special characteristics of this proposal give rise to problems unique to this case.

2. In this pre-hearing brief, Public Counsel will review the primary concerns that have led us to oppose the settlement and to propose an alternative for the Commission's consideration. On each point the brief will summarize the testimony and other evidence in support of our position, and then discuss the responses presented by the Joint Parties. In a number of important areas, the Joint Parties concede Public Counsel's points. Overall, Public Counsel does not believe that the Joint Parties have effectively or adequately responded to the significant problems with their proposal.

II. THE JOINT PARTIES' DECOUPLING PROPOSAL IS CRITICALLY FLAWED IN SEVERAL MAJOR AREAS

A. Deferrals Generated by the Proposal for Collection in Rates are Far Out of Proportion to the Problem Assertedly Being Solved.

1. Impact of the Avista proposal.

3. Avista's original testimony ties the justification for decoupling closely to energy efficiency and conservation, and supports its initial proposal by arguing that decoupling will

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"break the link between the volume of therm sales and the recovery of fixed costs and would provide for *increased focus on energy efficiency and conservation*." [1] The Company represents that customers will benefit from decoupling because "[a]pproval of a decoupling mechanism would further promote energy efficiency and conservation."[2] The Joint Parties echo the theme, stating in the Settlement Agreement that the agreed proposal will "serve the broader interest of removing disincentives to engage in additional conservation."[3]

4. The decoupling proposal here, however, does far more than compensate the Company for sales lost to their own conservation efforts (Company-sponsored conservation). In addition, the mechanism recovers for sales declines due to price elasticity, customer-sponsored conservation, appliance upgrades, more efficient building codes, overall economic conditions, and changes in commercial/industrial customer activity levels.[4]

5. There are significant financial implications for ratepayers when the net is cast so wide, as Mr. Johnson details in his testimony for Public Counsel. For example, looking at the simulation period of July 2005-June 2006 presented by the Company, the decoupling proposal deferral would have totaled $617,000 if the mechanism had been in place. By comparison, Avista only lost $141,000 in margins during that same period as a result of their own conservation efforts. This is a margin of 4.4:1.[5]

6. This mechanism is seriously disproportionate to the magnitude of any financial disincentive for Avista to pursue its own energy efficiency programs. Avista is compensated for

[1] Exh. No. ___ (BJH-1T), p. 4:1-2 (emphasis added); *See also*, p. 3:12-21 (Hirschkorn).
[2] *Id.*, p. 5:20-21.
[3] Settlement Agreement, p. 2, ¶ 5.
[4] Exh. No. ___ (SGJ-1T), p. 5:7-17 (Johnson).
[5] *Id.*, p.8:3-10 and Table 1.

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factors over which it has no control and, importantly, which can be expected to continue regardless of Avista's activities.

2. Joint Parties' rebuttal concedes this point.

7. The Joint Parties commented in their rebuttal on Mr. Johnson's testimony that "[t]he decoupling mechanism deferrals are far out of proportion to the lost margins from Avista's own energy efficiency programs."[6] Their testimony agrees with Public Counsel's analysis of their proposal:

> The proposed decoupling mechanism is designed to capture up to 90 percent of the lost margin resulting from *all reductions in usage* by Schedule 101 customers (normalized for weather). Customers have conserved, and will continue to conserve *well beyond the direct results of company-sponsored DSM programs*."[7]

This response is notable in three respects. First, the Joint Parties acknowledge, as they must, that the proposal goes far beyond the impact of the Company's own programs and captures "all reductions" except for weather.

8. Second, the rebuttal does not dispute Mr. Johnson's testimony cited above that for the simulation period, the decoupling proposal's deferrals are over four times the lost margins from the Company's own programs.[8] Nor does the rebuttal testimony contest Mr. Johnson's

[6] Rebuttal Testimony of Hirschkorn, Steward, and Laser (hereinafter Joint Rebuttal), Exh. No. __ (Joint-2T), p. 5:18--6:4.
[7] *Id,* p. 6:1-4 (emphasis added).
[8] The rebuttal testimony challenges Mr. Johnson's extrapolation for the July 2007-June 2008 period, arguing that he "extrapolated and massaged historical results." Exh. No. ___ (Joint-2T), p. 7:13 (Joint Rebuttal). One problem with the response is that it compares Avista's calendar year projection for 2007, to the 2007-2008 period that Mr. Johnson used, a mismatch that excludes six months of continued decline. Mr. Johnson's look back to 1999 parallels Mr. Hirschkorn's use of 1999 data in his testimony to portray declines in customer use. Exh. No.___ (BJH-1T), p. 4:5-7 (Hirschkorn). Avista's estimated deferral amount of $650,000 for 2007 contained in the response to Public Counsel Data Request No. 49 is itself only a projection, based on assumptions not stated or explained in the response. Mr. Johnson's estimates are supported and explained in his testimony and exhibits. Exh. No. ___ (SGJ-1T, p. 8 , Table 1, n. 11 (referencing exhibits supporting data in table) (Johnson).

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testimony that for the calendar year 2005 the decoupling deferral would have been $209,582, compared to lost margins from Avista-sponsored DSM of only $56,284, a ratio of 3.7:1.[9]

9. Third, the sole justification offered by Joint Parties for this disproportionate response is that it will help the Company encourage customers to "conserve beyond programmatic DSM through increased customer education."[10] This raises many questions. Interestingly, education is described, without explanation, as more important than Avista's programmatic DSM. There is no evidence in this record of what education programs are being referred to, or the magnitude of their cost. Nor is there any explanation of why encouragement of education would by itself warrant expenditures over four times larger than lost margins due to DSM programs. In the end, this is a weak reed upon which to support such disproportionate revenue deferrals.

B. The Exclusion of Schedule 111 Customers Creates Unfairness and Cross-Subsidization.

1. Schedule 101 residential and small commercial customers are unfairly burdened by the proposal.

10. Avista's original proposal included both Schedule 101 and Schedule 111 customers.[11] The Settlement Agreement now excludes Schedule 111 and recovers the full amount of eligible decoupling revenues from residential and commercial customers in Schedule 101. However, 41 percent of all therms saved by Company-sponsored energy efficiency in the two schedules is attributable to Schedule 111 customers.[12]

11. Exclusion of Schedule 111 creates at least two problems. First, to the extent that Avista

[9] Exh. No. ___ (SGJ-3), p. 1 (Johnson).
[10] Exh. No. ___ (Joint-2T), p. 6:5-13 (Joint Rebuttal).
[11] *Id.*, p. 8:1-11.
[12] Exh. No. ___ (SGJ-1T), p. 11:11-22 (Johnson).

undertakes incremental DSM efforts as a result, Schedule 111 customers will be "free riders," getting the benefits of those DSM efforts, while Schedule 101 customers incur the full rate burden.

12. Second, as noted above, the total dollar amounts deferred for recovery from Schedule 101 customers are so large that they exceed the lost margins due to Company–sponsored conservation from Schedule 101, plus Schedule 111, and amounts beyond that.[13] This amounts to a cross-subsidy between the schedules, and may violate RCW 80.28.090 or RWC 80.28.100.

2. Joint Parties' rebuttal.

13. The Joint Parties have no satisfactory response to this issue. They explain that the Schedule 111 customers were removed to avoid "the complexities of identifying, tracking, and eliminating those customers and their usage from the mechanism."[14] It is significant, however, that the Joint Parties do not contest, or even address, the fact that this schedule represents over 40 percent of the total Company-sponsored conservation for the two schedules. In addition, the Joint Parties do not rebut or address Mr. Johnson's point that Schedule 111 will receive the benefit of any claimed incremental Avista DSM efforts, while bearing none of the rate burden of decoupling.

14. The Joint Parties do take issue with Mr. Johnson's testimony that the mechanism recovers from Schedule 101 customers amounts that exceed the lost margins for Schedules 101, 111, and additional amounts besides, saying that he is comparing "apples to oranges."[15] The Joint Parties

[13] *Id.*
[14] Exh. No. ___ (Joint-2T), p. 8:9-11 (Joint Rebuttal). This is another example of the myriad complexities which decoupling design seems to create.
[15] *Id.*, p. 9:9-19.

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argue that their mechanism only recovers lost margins from Schedule 101. Their rebuttal misunderstands Mr. Johnson's point. His testimony points out, accurately, that the total dollar amount of the deferrals to be collected from Schedule 101 (that is, the total lost margins for the selected cohort of customers) actually exceeds in dollar terms, the amount of lost margins *due to Company-sponsored conservation* for Schedules 101 and Schedule 111.

15. Again, that is because, as discussed in the previous section and conceded by the Joint Parties, the mechanism recovers "lost margin resulting from all reductions in usage by Schedule 101 customers."[16] While it is technically true that the Joint Parties do not calculate the Schedule 101 deferrals on the basis of Schedule 111 losses, the deferral dollars generated by their mechanism are so disproportionate to the narrower Avista DSM-related lost margins that they easily encompass those margins for both schedules and additional sums besides. In terms of dollars, therefore, because of the scale of the deferrals, Schedule 101 customers pay not only for their own lost margins, but also for those of Schedule 111 customers, and for declines from other sources. It is ironic that the Joint Parties refer to this as an "apples to oranges" comparison, because that is the core of the problem with their entire approach, addressing the "apples" — small lost margins from Company efforts, by recovery of "oranges" — all lost margins from many causes. With the failure of this argument as well, the Joint Parties are left with no response to the Schedule 101/111 problem identified by Public Counsel's testimony.

[16] *Id.*, p. 6:2-3.

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C. The Joint Proposal Does Nothing to Advance Energy Efficiency.

1. Avista will be rewarded for energy efficiency efforts (and other sales declines) that occurred in the past.

16. Public Counsel witness Steve Johnson points out in his testimony that the DSM test to determine deferral amounts in the initial period of the plan (January-June 2007) is based on Company-sponsored conservation achievement for the year 2006.[17] Inclusion of these amounts rewards Avista for behavior that has already occurred in the past. There is a further aspect of improper retroactivity in the proposal. This arises because the mechanism uses the 2004 test period as the starting point to measure usage declines. Thus, the deferrals capture the effect of conservation and usage declines that have already occurred and cannot possibly be affected by any future change in Company behavior. There is simply no logical connection between this design and the claimed purpose of the program — to affect Company incentives or disincentives.[18]

17. The Joint Parties only response to Public Counsel's first point about the use of the 2006 IRP goal is the assertion that "[t]he potential of a financial incentive"[19] from approval of decoupling caused greater efforts to reach the 2006 goal. There is certainly no way for any other party to verify this subjective assertion. Indeed, Avista already has strong motivations to achieve its IRP goals, whether or not this proposal is adopted — the legal requirements of integrated resource planning and prudency. How much of its 2006 achievement was due to the "financial incentive" and how much due to these latter factors is speculation. In any event, the reward is

[17] Exh. No. ___ (SGJ-1T), p. 9:17- 10:3 (Johnson).
[18] *Id.*, p. 10:4-16.
[19] Avista's reference to decoupling as a "financial incentive" is another example of the conceptual confusion surrounding decoupling and whether it is designed to create an incentive, or simply remove a disincentive.

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still essentially retroactive in nature, establishing a level of compensation for Avista at a time after the behavior to be encouraged has already occurred. Finally, the Joint Parties do not address at all the issue Mr. Johnson raises about the use of the 2004 test year, which has the effect of reaching back and capturing usage changes even earlier than 2006, and even more remote to any Company behavior that would be affected by this plan.

2. The proposal contains no commitment for incremental energy efficiency.

18. The proponents of the decoupling proposal have not established that the proposed settlement will produce additional or incremental conservation as compared to the existing regulatory framework on a going-forward basis.[20] The Joint Parties response is to rely exclusively on the 2006 IRP target as demonstrating a "responsible commitment to gas efficiency."[21] This does not address the concern. The Joint Parties have not presented any evidence that the IRP target was additional to the level that would have been set without decoupling, nor has Avista made any commitment to any additional conservation measures.

19. If the term "incremental" means anything in this context, it means that in return for the added financial burden of decoupling, consumers and regulators should be able see some additional commitment to conservation measures that would not have occurred otherwise. As Mr. Johnson points out, the IRP process is an independent legally required process with its own methodological integrity, independent of decoupling.[22] In particular, to characterize as "incremental" conservation an IRP target set in the past, in a pre-existing IRP process, even if it

[20] Exh. No. ___ (SGJ-1T), p. 12:1-11 (Johnson).
[21] Exh. No. ___ (Joint-2T), p. 2:9-16 (Joint Rebuttal).
[22] Exh. No. ___ (SGJ-1T), p. 12:12-23 (Johnson)

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represents an increase over prior levels, is wholly inappropriate. It simply rewards the utility for what it is doing anyway, and indeed is legally required to do.

20. The Joint Parties cite the Commission's statement in acknowledging Avista's 2006 IRP.[23] The statement is not germane to the question here. It simply addresses the plan on its own terms, not in relation to whether it is incremental to some level that would have been established in the absence of a future decoupling mechanism.

21. The Joint Parties conclude their rebuttal on this point by arguing, inconsistently, that there is no need for a Company to show an incremental commitment to energy efficiency in any event. This is unpersuasive for two reasons. First, there is nothing in the PacifiCorp order regarding decoupling that states that the Commission's guidance is limited by its terms to the PacifiCorp company. On the contrary, the Commission prefaces its list of required components with general commentary on conservation and decoupling and the nature of a "well-designed decoupling mechanism."[24]

22. Second, however the PacifiCorp order is interpreted, requiring a showing of incremental conservation is sound public policy. The entire *raison d'etre* of decoupling is that it will improve the climate for energy efficiency by overcoming the defects of the existing regulatory process and that it will "further promote energy efficiency and conservation."[25] Allegedly, this is what makes it "worth it" for ratepayers to assume the new risks and financial burdens of this approach. If in the end, decoupling proponents are allowed to retreat from this promise, and will commit to no better achievement than existing regulation accomplishes, the bargain looks more

[23] Exh. No. ___ (Joint-2T), p. 3:10-15 (Joint Rebuttal).
[24] *WUTC v. PacifiCorp*, Docket No. UE-050684, Order No. 04, ¶108.
[25] Exh. No. ___ (BJH-1T), p. 5:20-21 (Hirschkorn).

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than questionable. Indeed, it would be reasonable to conclude that if existing regulation has resulted in the aggressive targets established in the 2006 Avista IRP, then existing regulation is working, and there is no need to experiment with the expensive alternative proposed here.

3. The settlement decoupling proposal potentially creates negative incentives.

23. Under the program design, as Steve Johnson points out in his testimony, once Avista achieves the DSM target savings, no further deferrals are permitted under the DSM cap component. This potentially creates a disincentive incentive for Avista to achieve further DSM savings during the evaluation period.[26] In addition, because of the amounts of money at stake, the decoupling proposal could have a skewing effect on the IRP process itself, putting downward pressure on goals set in the next process in order to make them easier to reach.[27]

24. As to the first point, the Joint Parties' response does not deny that the disincentive is created, but says only that given the regulatory oversight "the Company would not want to risk" continuation of the mechanism by gaming the results. It is no answer to this concern to acknowledge the disincentive, but to argue that the Company would never do such a thing for fear of detection. Moreover, Mr. Johnson's point goes to the permanent design of the program. It is not a feature that goes away after the three year pilot.

25. On the second problem, skewing of the IRP, again the Joint Parties do not contest that this pressure would be present, but argue that there are safeguards. Public Counsel suggests that it is better not to create the negative incentives in the first instance than to rely upon the regulator or intervenors to "catch" the distortion of targets after the fact. Detection of such "suppression"

[26] Exh. No. ___ (SGJ-1T), p. 14:2-13 (Johnson).
[27] *Id*., pp. 14:14-15:2.

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of goals would inherently be a very difficult task. The Joint Parties argue that the same pressures are present with Mr. Johnson's proposal for an incentive mechanism. They do not mention the difference in scale between the two programs.

D. There are Other Weaknesses in the Joint Parties' Rebuttal.

26. In addition to the points above, there are other important issues where the rebuttal testimony either concedes Public Counsel's position, does not effectively address it, or is silent.

27. Mr. Johnson's testimony pointed out that the "earnings cap" in the proposal is actually "porous."[28] Indeed, the Joint Parties expressly acknowledge this in their rebuttal testimony when they state:

> **Q. Why does the mechanism contain this deferred balance "carry-over" provision related to the earnings test?**
>
> A. It allows the Company *to avoid writing off* a deferral balance that it cannot recover during the current year as a result of the earnings test.[29]

The joint rebuttal simply describes how the proposal works. Public Counsel also accurately described the proposal. The Joint Parties apparently miss Public Counsel's point, which is that if excess earnings from one year are deferred into another because of the earnings cap, they can still be recovered to their full amount, even if there would otherwise be no deferrals from sales declines in the second year, or if those declines were less than the excess earnings carry-over. In other words, the "earnings cap" doesn't actually fully cap recovery of excess earnings. As the quoted testimony above indicates, that is exactly the purpose of the "carry-over" provision.

28. Public Counsel's testimony points out that Avista does not claim in this case that its

[28] *Id.*, p. 16:3, 20-23.
[29] Exh. No. ___, (Joint-2T) p. 12:13-16 (emphasis added) (Joint Rebuttal).

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current rates are not fair, just, and reasonable, nor does it argue that is in such dire financial straits that it is entitled to interim or emergency relief.[30] The Joint Parties do not respond to or address this point.

29. The rebuttal does not address Mr. Johnson's testimony pointing out that because this request is not filed in the context of a rate case there is no opportunity for the Commission to look at an appropriate adjustment to return.[31] Mr. Johnson testified that the proposal constitutes single issue ratemaking and that it violates the "matching principle."[32] The rebuttal is silent on these points as well.

E. Public Counsel's Alternative Gas Energy Efficiency Proposal Is Reasonable

30. Through Steve Johnson's testimony in this case, Public Counsel proposed an alternative to decoupling — a gas conservation incentive mechanism.[33]

31. The rebuttal criticizes the amount generated by the mechanism as an inadequate incentive. This criticism highlights again the fundamental flaw in the entire decoupling proposal. The actual lost margins experienced by Avista as a result of its own energy efficiency programs are really quite small. As Mr. Johnson details in his testimony, the incentive amounts are basically scaled to be in the same ball park as these actual impacts of conservation. No doubt, Avista would prefer to recover much larger amounts, and may well argue that larger sums provide larger incentives. The evidence in this case shows that these higher amounts are unjustified. It is simply unfair to ask ratepayers to fund this approach.

[30] Exh. No. ____(SGJ-1T) p. 3:12-4:4 (Johnson).
[31] *Id.*, p. 16:4-14.
[32] *Id.*, p. 4:12-5:6.
[33] *Id.*, pp. 18-23.

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III. SCOPE OF THE HEARING

32. In this case, there are two proposals before the Commission, the decoupling proposal of the Joint Parties, and Public Counsel's alternative gas energy efficiency proposal. Both can be and should be addressed and resolved by the Commission in its final order. The Administrative Procedures Act (APA), RCW 34.05.461(3), requires, in pertinent part that:

> Initial and final orders shall include a statement of findings and conclusions, and the reasons and basis therefore, *on all the material issues of fact, law, or discretion presented on the record*…. (emphasis added).

Pursuant to this statutory provision, in cases where there is a non-unanimous settlement, the opponents of a proposed settlement are entitled to an order which addresses material issues of fact or law which they have raised, even though those issues may have not been addressed in the non-unanimous settlement. In this case, Public Counsel has proposed an alternative means of addressing the material issue of Avista's incentives to pursue energy efficiency. While the Joint Parties may argue that the only authority this Commission has at this point is to approve, reject, or modify the settlement, that is not consistent with the APA. The Commission should decline this invitation to read its own powers so narrowly.

33. A non-unanimous settlement should be viewed, as the current rule states, as simply "an agreement of some, but not all, parties on one or more issues [that] may be offered as their position in the proceeding along with the evidence they believe supports it."[34] When opposing parties present evidence in support of their "preferred result," i.e., an alternative to the settlement, as permitted by WAC 480-07-740 (2)(c), they are entitled under the APA to an order

[34] WAC 480-07-730 (3). This is how multi-party settlements have been treated in the pending PSE general rate case, Dockets UE-060266, UG-060267.

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which makes findings on the material issues of fact and law which they have raised. The fact that the issues may not have been encompassed within the provisions of the non-unanimous settlement should have no bearing on whether the Commission addresses them in the final order.

IV. CONCLUSION

34. For the foregoing reasons, Public Counsel respectfully asks the Commission to reject the Joint Parties' decoupling proposal. If the Commission wishes to adopt a mechanism to provide a financial incentive for Avista to pursue gas energy efficiency, Public Counsel requests that the Commission adopt its proposal in this docket.

35. DATED this 14th day of December, 2006.

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