Exhibit No.___(MCD-5T)
Docket Nos. UE-111048/UG-111049
Witness: Michael C. Deen

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENRGY, INC., Respondent.	)	Docket Nos. UE-111048/UG-111049 *(Consolidated)*

CROSS-ANSWERING TESTIMONY OF MICHAEL C. DEEN

ON BEHALF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

January 17, 2012

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Michael C. Deen, and my business address is 900 Washington Street, Suite 780, Vancouver, Washington 98660. I am employed by Regulatory and Cogeneration Services, Inc. ("RCS"), a utility rate and consulting firm.

Q. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY IN THIS PROCEEDING?

A. Yes. I provided responsive testimony on behalf of the Industrial Customers of Northwest Utilities ("ICNU") in this proceeding regarding Puget Sound Energy's ("PSE" or the "Company") power supply costs and proposed cost of service study.

Q. WHAT IS THE PURPOSE OF YOUR CROSS-ANSWERING TESTIMONY?

A. The purpose of this testimony is to address 1) the December 7, 2011 "UTC Staff Response to Bench Request on Full Decoupling" (Staff Response); 2) the decoupling proposal of the Northwest Energy Coalition ("NWEC"); and also 3) Staff's proposal regarding "regulatory lag" described in Exhibit No. ___(KLE-1T).

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.

A. ICNU does not believe that any of the decoupling proposals in this proceeding are appropriate for industrial customers. To the extent that the full or partial decoupling mechanisms are pursued further, it should be in the context of a separate, later proceeding with time to more fully analyze the proposals before any decision is reached. ICNU also does not support Staff's proposal to allow PSE to file an "expedited" rate case proceeding either concurrently with or immediately following this proceeding.

II. DECOUPLING PROPOSALS

Q. PLEASE SUMMARIZE THE BACKGROUND OF DECOUPLING PROPOSALS IN THIS PROCEEDING.

A. In this proceeding, PSE included a "Conservation Savings Adjustment" ("CSA") that was purportedly designed to "mitigate the negative financial effects" of conservation on its cost recovery.[1/] ICNU, Public Counsel, Staff, and others have presented testimony demonstrating that the CSA is an unfair limited decoupling scheme that does not consider the Washington Utilities and Transportation Commission's ("WUTC" or the "Commission") Policy Statement providing guidance on decoupling. The WUTC directed, through a bench request, that Commission Staff examine full decoupling for PSE, present the critical elements of a full decoupling proposal, and indicate whether or not a decision on decoupling could be made by the end of this rate case. Staff's proposal was filed on December 7, 2011, and parties are invited to respond to the proposal in cross-answering testimony, due on January 17, 2012. This testimony analyzes Staff's proposal in light of the WUTC's Policy Statement on Decoupling and responds to some issues raised in testimony by the NWEC.

Q. THE COMMISSION HAS INVITED PARTIES TO ADDRESS THE DECOUPLING PROPOSALS FILED IN RESPONSE TO THE BENCH REQUEST. HOW DOES ICNU VIEW THESE PROPOSALS?

A. Besides PSE, both Staff and the NWEC have proposed decoupling mechanisms. ICNU does not believe that any of these proposals are appropriate or necessary for promoting industrial conservation. The Commission has stated that the purpose of considering decoupling is to "remove barriers to utilities acquiring all cost-effective conservation or

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1/ Exhibit No. __ (TAD-1T) at 10:8-10.

to encourage utilities to acquire all cost-effective conservation."[2/] None of the decoupling mechanisms presented would accomplish either of these goals.

Washington law mandates conservation. The Energy Independence Act ("EIA" or "I-937") requires PSE to acquire all cost-effective conservation available to it. PSE has not demonstrated that any barriers are preventing it from acquiring all cost-effective conservation; in fact, PSE has not even alleged that it is failing to meet its state-mandated conservation targets. This demonstrates that no barrier to the acquisition of cost-effective conservation needs to be removed.

PSE has not indicated that it needs further incentive to acquire more cost-effective conservation than its state mandated target requires. The EIA requires PSE's conservation target to include all cost-effective conservation available, and the Company has neither claimed nor demonstrated that there is more cost-effective conservation available than required by its conservation target. PSE does not need further incentive to reach its conservation target. In the words of the Commission, "the EIA already provides ample incentive."[3/]

This means that a decoupling scheme will likely have no actual effect on PSE's conservation efforts. It will neither remove existing barriers nor supply a needed incentive. The only change decoupling would likely bring is greater certainty of revenue to the Company regardless of quality of service, economic conditions, or changes in customer use. The cost of this certainty would be borne by ratepayers.

2/ WUTC Docket No. U-100522, Report and Policy Statement ¶ 12(Nov. 4, 2010).

3/ Id. at ¶ 24.

Q. IF DECOUPLING WERE MANDATED BY THE COMMISSION, SHOULD INDUSTRIAL CUSTOMERS BE INCLUDED?

A. No. Large industrial customers are fundamentally differently situated than customers in other classes. Many of PSE's large industrial customers purchase their power on the market, not from PSE. This means that PSE's conservation efforts do not impact the amount of power that PSE sells, and PSE has no actual or theoretical disincentive to invest in industrial conservation. During the development of the Commission's Policy Statement, Avista Utilities noted that large industrial customers should be excluded from decoupling programs because they are "much more prone to changes in general economic and business climate, and . . . any decrease in use per customer is often not related to conservation programs . . . ." [4/]

PSE has requested decoupling because it claims that it needs to recover fixed costs. Yet, the fixed costs of serving industrial customers are very low. NWEC has recognized that it would be unfair to extend a decoupling mechanism to industrial customers in this case. NWEC has proposed that a PSE decoupling mechanism should exclude customers in rate schedules 40, 46 and 49, as well as 448, 449 and 459 because these schedules have very few members and account for only 4% of energy charges but 14% of retail sales.[5/] More specifically, based on NWEC's Exhibit No. ___(RCC-2), the industrial schedules account for only 4.5% of the Company's overall fixed costs. This means that industrial customers could end up subsidizing other classes if they were to pay decoupled rates on their large share of retail sales despite being responsible for only a small fraction of the fixed costs being recovered.

4/ WUTC Docket No. U-100522, Comments of Avista at 9 (June 4, 2010).
5/ Direct Testimony of Ralph C. Cavanagh, Exhibit No. __ (RCC-1T) at 13.

Further, the Company itself has implicitly acknowledged in this proceeding that conservation efforts among its industrial customers have extremely minimal impacts on the recovery of fixed costs. PSE's Exhibit No. ___(JAP-17) supporting the proposed CSA mechanism shows that the "Unrecovered Fixed Cost Amount" for the total industrial rate classes is only $78,055, less than 1% of the total identified in the exhibit.

Finally, large industrial customers have widely disparate load shapes and have unique service requirements. Because these classes contain a few unique customers, the loss of load caused by even a single customer changing usage habits or going out of business during times of economic difficulty could drastically change the class-generated revenue. This could activate a decoupling mechanism and raise prices for the few remaining customers in the class, despite the lack of any connection to PSE's conservation efforts. For these reasons, I agree with NWEC's proposal to exclude customers in rate schedules 40, 46, and 49, as well as 448, 449, and 459 from any potential decoupling mechanism.

Q. WHAT CONCLUSION DOES STAFF REACH REGARDING DECOUPLING?

A. Staff notes that the Commission probably will not be able to make a final decision on full decoupling by the end of this rate case. PSE proposed the CSA, a pro-forma limited decoupling mechanism, rather than full decoupling or an attrition adjustment, both of which the Commission discussed as mechanisms it would consider in its Report and Policy Statement on Regulatory Mechanisms.[6/] As a result, Staff has essentially been required to create a decoupling mechanism from scratch without the benefit of access to all of PSE's internal data and records. Staff notes that the Decoupling Mechanism it

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6/ Report and Policy Statement ¶ 34.

presents simply does not contain the level of detail necessary to actually implement decoupling, and its proposal leaves many elements unsettled.[7/]

Staff also reaches the conclusion that an attrition adjustment, one of the alternative mechanisms suggested by the Commission in its Report and Policy Statement, would better address both the Commission's concern with disincentives to promote conservation and PSE's argument that it is not able to recover fixed costs. Staff notes that PSE has chosen not to conduct a proper attrition study at this time, which is a prerequisite for any attrition adjustment.

Q. DO YOU AGREE WITH STAFF'S CONCLUSIONS?

A. Staff is correct that it is not likely or reasonable to make a final decision regarding a full decoupling mechanism before the end of this case. Staff is also correct that PSE has not presented evidence demonstrating the need for an attrition adjustment. If either decoupling or an attrition adjustment is necessary, it should be considered in a future rate case when PSE has met its burden to present evidence to the Commission in support of such alternative regulation.

ICNU witnesses have previously suggested that a separate, bifurcated proceeding like that ordered in Avista's 2011 rate case would be necessary if the Commission were determined to implement full decoupling in the current rate case.[8/] As Staff suggests, given the complexities of adopting decoupling, such a proceeding could not be finished before a final order is issued in the current case. The WUTC has made clear that a decoupling mechanism should be adopted in the context of a general rate case so that the effect of decoupling on the cost of capital, the criteria for exclusion of customer classes,

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7/ Staff Response to Bench Request at 3; n.8.

8/ See Exhibit __ (DWS-1CT) at 18-19; Exhibit __ MPG-1T at 4.

and many other issues could be considered in context.[9/] Because a final order in this case will set rates before the parties are able to design a workable full decoupling mechanism for the Commission to consider, the burden should be upon PSE to design a decoupling mechanism or attrition study that complies with Commission standards and present it in a future rate case where it can be considered in proper context. This would comport with the Commission's requirement that "[a] utility's request for a full decoupling mechanism must be made in its direct testimony of its rate case filing . . . ."[10/]

Q. DOES THE MECHANISM PROPOSED BY STAFF CONFORM TO THE COMMISSION'S POLICY STATEMENT?

A. Unlike PSE's CSA, Staff's mechanism conforms to many of the principles discussed by the Commission in its Policy Statement. Nonetheless, Staff's mechanism does not appear to conform to the Commission's stated preference for per-class decoupling, and its conservation test conflates full decoupling and affirmative conservation incentives– separate mechanisms with distinct requirements. Application of the conservation test would overstep the Commission's own statements regarding the limits of its statutory authority.

Additionally, the mechanism includes some elements that, while reasonable interpretations of the Policy Statement, do not function to eliminate disincentives to conservation, but rather solely operate to generate additional utility revenue. These include an unnecessarily high cap for true-ups that will capture revenue beyond the utility's allowable rate of return ("ROR") and the possibility of four-year periods in which the mechanism would function with minimal Commission scrutiny.

9/ Report and Policy Statement ¶ 28.

10/ Id.

In order to fully conform to the Policy Statement and protect customers, any potential full decoupling mechanism should be administered per-class, should not attempt to function as an affirmative conservation incentive, and should contain an earnings test and time structure that protect customers while removing the disincentive to promote conservation.

Q. ARE THERE ANY OTHER ISSUES YOU WISH TO ADDRESS?

A. Yes. The Commission has noted that a decoupling mechanism shifts market risk away from the utility, and this should be reflected in the return on equity ("ROE") the utility is allowed to earn. Staff notes the proper ROE for a decoupled utility is at or below the low end of the otherwise reasonable range but does not thoroughly discuss the issue.

Q. PLEASE EXPLAIN WHAT YOU MEAN BY PER-CUSTOMER AND PER-CLASS DECOUPLING.

A. One study identifies per-customer decoupling as a system that sets a revenue-per-customer rate, meaning that when a utility's customer base grows, so does the total revenue the utility is entitled to receive through the true-up.[11/] On the other hand, per-class decoupling (sometimes called "rate-cap" decoupling) divides a utility's revenue requirement proportionately among classes, and trues-up each class to this amount. While both methods ultimately assign a revenue requirement per customer, the primary difference is that under straight per-customer decoupling, when new customers join the system, the utility automatically raises its revenue requirement.

11/ See Pamela Lesh, Rate Impacts and Key Design Elements Of Gas and Electric Utility Decoupling, 7 (2009); WUTC v, Avista Corporation, Docket No. UE-090134, Brief of NW Energy Coalition, App. A (Nov. 10, 2009).

Q. HAS THE COMMISSION INDICATED WHETHER PER-CUSTOMER OR PER-CLASS DECOUPLING IS APPROPRIATE?

A. Yes. The WUTC Policy Statement explicitly states that a true-up should track customer use by class, and recover "revenue attributed to each affected class of customer," rather than revenue per-customer.[12/] This deliberate choice is consistent with the rest of the Policy Statement, where the WUTC stated that the revenue produced by additional customers is a constituent of "found margin," meaning that it would offset reductions due to conservation, weather, or economic malaise.[13/] If additional customers simply add to the revenue requirement, then the revenue they produce cannot offset reductions.

Should a utility later demonstrate that there is no longer "reasonable balance" between this found margin and the cost to serve new customers, the Commission suggested that the utility's line extension tariffs could be amended, or some portion of this found margin could be excluded from the true-up. [14/] ICNU believes this demonstrates that the Commission's articulation of a per-class mechanism was intentional.

An adjustment to line extension tariffs, if necessary, directly addresses the costs of serving new customers. Per-customer decoupling is a blunt instrument that primarily removes an important segment of found margin from the true-up. Further, the Report and Policy statement indicates that it should be the responsibility of the utility to demonstrate an actual inequity before it would be corrected through a line extension tariff adjustment or removal of some new customer revenue from found margin.[15/]

12/ Report and Policy Statement ¶ 28.
13/ Report and Policy Statement ¶ 11.
14/ Report and Policy Statement ¶ 28, n.44.
15/ Id.

Q. DOES STAFF'S MECHANISM USE PER-CLASS DECOUPLING?

A. Staff appears to confuse per-customer and per-class decoupling. Staff's Response acknowledges the Commission's decision to implement decoupling based on revenue attributed to each class, but Staff proposes decoupling by customer.[16/] The mechanism could lead to a scenario in which an amended line extension tariff compensates the company's costs of serving additional customers, while an upward adjustment to the revenue requirement through per-customer decoupling potentially doubly compensates the company for the same costs and removes additional customer revenue from found margin.

Q. HOW COULD THIS OUTCOME BE AVOIDED?

First and foremost, the distinction between these kinds of decoupling shows that there are far too many issues to resolve to adopt decoupling before the end of this rate case. If the Commission decides to adopt a decoupling mechanism now, it is important that the revenue requirement established in this General Rate Case ("GRC") remain in effect, and that the Company's revenues be trued-up to that amount on a per-class basis for participating classes. This means that if a decoupling mechanism is adopted, it should function as described in the WUTC's Policy Statement, and it should exclude industrial customers.

This Commission has long assumed that a properly adjusted historic test year creates the most accurate relationship between costs and revenues. Lost margin due to conservation and the found margin represented by additional customer revenue are only two of the multitude of factors affecting a utility's ability to recover its costs. There is no

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16/ Compare Staff Response at 7 with id. at App. 2, pp. 1-2.

reason to depart from this sound regulatory practice to allow a utility to automatically increase its revenue requirement outside of a rate case, as Staff's mechanism would do. Rather, a per-class decoupling mechanism would assure that lost and found margin remain in reasonable balance.

Q. HOW DO YOU RECOMMEND STAFF'S MECHANISM BE ADJUSTED?

A. Under the WUTC standards, a utility's revenue requirement is established in a GRC, and that revenue is allocated by class according to accepted ratemaking principles. This would maintain current practice during the GRC.

One year after the GRC, the utility would calculate the difference, per class, between the revenue projected by the adjusted historic test year and the actual revenue attributable to each included class. Subject to a conservation test and an earnings test, any over collection would be returned to the customer class over the following rate year and any under collection would be charged to the customer class over the following rate year.

Q. IS STAFF'S DECOUPLING MECHANISM CONDITIONED UPON A UTILITY'S LEVEL OF ACHIEVEMENT WITH RESPECT TO ITS CONSERVATION TARGET?

A. Yes. Staff includes a conservation test that only allows a utility to recover the percentage of any true-up that is commensurate with the percentage of its conservation resource target that it acquires.

Q. IS THE CONSERVATION TEST CONSISTENT WITH THE COMMISSION'S POLICY STATEMENT?

A. No. Staff's conservation test goes beyond decoupling and attempts to create an affirmative, direct conservation incentive by allowing the Company to collect up to 120%

of the true-up amount if the Company acquires up to 120% of its conservation target. This contradicts the Commission's findings in the Policy Statement and potentially creates an incentive for the Company to pursue conservation resources that are not cost-effective. Decoupling should never be a mechanism that simply results in higher rates.

The Policy Statement repeatedly acknowledges that the function of full decoupling is to remove the risk of revenue volatility based on customer usage. In other words, full decoupling eliminates what is known as throughput incentive–the incentive to avoid conservation and promote electric consumption in order to increase revenue. The Commission recognizes that direct conservation incentives may also be appropriate to encourage conservation, but identifies these as an entirely different regulatory tool. Part "C" of the Policy Statement discusses direct conservation incentives and crafts a reasoned framework that includes minimum requirements for any incentive mechanism. The Staff mechanism does not meet the requirements of section C. Further, PSE has not met its burden of showing that it is not meeting its I-937 conservation requirements or that additional cost-effective conservation is available.

Q. IN WHAT WAYS DOES THE CONSERVATION TEST FAIL TO MEET THE REQUIREMENTS FOR DIRECT INCENTIVES THAT WERE SET BY COMMISSION?

A. First, direct incentives should be proposed 120 days before the required biennial filing under the Energy Independence Act ("EIA"), which sets conservation targets. The incentives would then be consolidated with the biennial conservation target docket.[17/] The full decoupling mechanism is part of a GRC, not an EIA docket.

17/ Report and Policy Statement ¶ 33.

Second, PSE must demonstrate through direct evidence that all conservation eligible for incentives will be cost effective.[18] The conservation test proposed by Staff would allow a direct incentive of 20% of the true-up without such a showing.

Third, electric utilities that demonstrate achievement above their EIA target must present direct evidence that the actions resulting in additional conservation were not part of the conservation program at the time the EIA target was set, and must show why the additional conservation was not part of their initial EIA forecast before they can be eligible for incentives.[19] The conservation test proposed by Staff does not appear to require any such showing.

Q. WHAT UNDERLYING REASONS FOR THESE REQUIREMENTS MAKE THE CONSERVATION TEST INAPPROPRIATE?

A. While Staff's conservation test amounts to a direct incentive that does not follow the procedure outlined by the Commission and should be rejected or modified on that basis, it also fundamentally violates the underlying policy reasons that the Commission's procedure is meant to avoid.

Washington law requires a utility to acquire all feasible, reliable conservation that is cost-effective. Thus, a utility's conservation target is set to include all cost-effective conservation. The implication is that any additional conservation is not cost-effective. The Commission has stated that it is not permitted "to provide incentives to acquire conservation that is not cost-effective."[20] A utility can propose an incentive program that captures only that limited amount of new conservation that becomes cost-effective because of external events, such as the development of new technology or the appearance

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[18] Id.
[19] Id.
[20] Id. at ¶ 32.

of newly available federal or other matching funds. By allowing the utility to collect revenue 20% higher than the true up if it has installed up to 20% more conservation than its target, the utility could have an incentive for acquiring conservation that might not be cost-effective.

Q. WHAT DO YOU SUGGEST REGARDING THE CONSERVATION TEST?

A. A conservation test is important and must be included to ensure that the decoupling mechanism actually functions to promote conservation, not simply to guarantee revenue or automatic rate increases to the utility. However, it should be capped at 100% of the true-up amount, not 120%. This will ensure that it does not act as an improper direct incentive.

Q. DOES THE STAFF PROPOSAL INCLUDE AN EARNINGS TEST?

A. Yes. However, Staff's test is set too high, meaning that the Company could recover from customers even if its earnings before the true-up surpassed its allowed ROR. I recommend that the true-up be capped at the allowable ROR, not 25 basis points above the ROR.

Q. CAN YOU COMMENT ON THE DISTINCTION BETWEEN USING ROR OR ROE IN THE EARNINGS TEST?

A. Yes. ROR, of course, represents the Company's weighted average return on capital investment, including both debt and equity components. ROE is only the return on the equity portion of the Company's authorized capital structure. Although Staff's Mechanism uses ROR as the basis for the Earnings Test, ROE could be used instead. ICNU does not see a theoretical basis for preferring either type of test but notes that the ROR test could have differential effects on the Company's actual realized ROE under changing economic conditions. For example, in periods of declining debt costs, an overall ROR earning test would allow a utility to earn a higher ROE. Conversely, in periods of rising debt costs, an ROR earnings test would lower the ROE. If the Commission decides to pursue decoupling this distinction should be considered in the type of earnings test that is ultimately adopted.

Q. WHY IS A CAP 25 BASIS POINTS ABOVE THE COMPANY'S AUTHORIZED ROR INAPPROPRIATE?

A. Decoupling is meant to enable a utility to recover its costs and have the opportunity to earn the ROR that the Commission finds appropriate. The Commission notes lost margin is only "one decrease in revenue among many decreases and increases in revenues and expenses."[21/] Thus, if a utility is able to meet the ROR set by the Commission, the matching principle is functioning properly and increases in revenue are offsetting decreases. To allow a true-up beyond the ROR would function purely as a transfer of wealth from ratepayers to shareholders. If a utility believes that it is unable to earn a fair ROR, the proper way to address this is by filing a GRC. A utility should be required to prevail in a full rate case to receive a higher ROR, rather than be allowed to increase its ROR by 25 basis points through an automatic mechanism intended to promote conservation.

Q. IS A 25 BASIS POINT REVENUE BAND NECESSARY TO INCENTIVIZE GOOD MANAGEMENT BY UTILITY EXECUTIVES?

A. No. ICNU shares Staff's concern that instituting decoupling will lessen a utility's incentive to carefully manage costs. Nonetheless, Commission supervision functions more effectively to incentivize good management than allowing true-ups that exceed

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21/ Report and Policy Statement ¶ 9, ¶ 28.

allowable ROR. PSE and other Washington IOUs are owned by sophisticated shareholders who will understand that decoupling eliminates throughput as a profit driver, leaving cost management as the only way to improve earnings. Further, PSE has made a practice of filing frequent rate cases, ensuring Commission and intervenor scrutiny of management practices. While frequent rate cases are not desirable, avoiding cost scrutiny through automatic rate increases is worse for customers.

Q. WHAT OTHER CHANGES MIGHT ENSURE THAT THE UTILITY AGGRESSIVELY CONTROLS COSTS?

A. Staff's proposal directly addresses the issue of a potential disincentive to reduce costs. Staff states that "[w]hile it is possible management would become less vigilant over costs under full decoupling, because revenues are assured, the period rate case requirement assures continuing Commission scrutiny . . . ."[22] Staff suggests that a rate case be required every four years.

Decoupling programs should be scrutinized more often. Some state commissions approve decoupling programs that sunset after one or two years, or make renewal contingent upon full review in a subsequent rate case. ICNU recommends that any decoupling program adopted for PSE be subject to a full review after 12 months, and that it be reviewed at least every two years thereafter. This would obviate the need to provide incentives for prudent management by allowing true-ups beyond the Company's ROR.

Q. DO YOU AGREE WITH STAFF'S SUGGESTION THAT FULL DECOUPLING SHOULD BE REFLECTED IN THE COMPANY'S ROE?

A. Yes. ICNU experts have testified that if the CSA or a full decoupling mechanism is adopted, the Commission should reflect the risk reduction by selecting an ROE at the low

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[22] Staff Response at 12-13.

end of the reasonable range.[23/] This of course also lowers the Company's overall authorized ROR for any given capital structure. It is commonly accepted that mitigation of revenue variability via electric decoupling changes a company's risk profile. In a great majority of the electric decoupling programs currently in place, the decoupled utility's ROR has been adjusted downward to reflect that change in risk (either through a direct reduction to ROE or by reducing the equity component of the capital structure).

Q. NWEC OFFERED TESTIMONY IN THIS DOCKET THAT CONCLUDED AN ROE ADJUSTMENT IS IMPROPER. HOW DO YOU RESPOND?

A. NWEC based its conclusion primarily on two sources that it claims demonstrate that no ROE adjustment is necessary.[24/] The first is a study by the Brattle Group, and the second is a white paper by the Regulatory Assistance Project ("RAP"). The study by the Brattle Group is completely inapplicable to electric decoupling and should not be relied on in this proceeding. Ironically, the RAP white paper cited by NWEC addresses and debunks the usefulness of the Brattle Study. Further, the RAP white paper does not conclude that no ROE adjustment is necessary; the section cited to by NWEC primarily considers what type of ROE adjustment is proper when full decoupling is adopted.

Q. PLEASE ELABORATE.

A. The Brattle Study relies exclusively on data drawn from gas utilities but tries to apply its findings to all types of utilities and all types of decoupling. As an example, Brattle claims that only a minority of jurisdictions have adjusted ROE to reflect decoupling.[25/] This may be true for the study's sample group, which overwhelmingly consists of limited

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23/ See Exhibit No. __ (MPG-1T) at 4.
24/ Exhibit No. __ (RCC-1T) at 20.
25/ WHARTON ET AL., THE IMPACT OF DECOUPLING ON THE COST OF CAPITAL, 2, The Brattle Group, (March 2011).

decoupling and straight-fixed-variable rate design (arguably not decoupling at all), but my review of electric decoupling cases currently in operation suggests that an overwhelming majority of Commissions approving full decoupling for electric utilities have had made downward ROE adjustments.[26/]

The study was conducted exclusively on an entirely separate industry. There is no reason assume that electric companies, facing different risks than gas companies, would have identical risk profiles. Second, and more importantly, Brattle Study is not applicable to full-decoupling because full decoupling eliminates risk from any revenue reduction rather than limiting recovery to conservation-specific losses.

The RAP report cited by NWEC states that the Brattle Study "focused on only one approach to measure the cost of capital . . . [and] did not consider the reduction in systematic risk . . . ."[27/] The paper explains that decoupling "will reduce systematic risk (reduced earnings volatility due to economic cycles) because sales variations in business cycles do not affect earnings under decoupling."[28/] Thus, RAP concludes that the Brattle Study, focused on limited decoupling, does not even consider the primary risk reduction effect of full decoupling, and based on this flaw, RAP finds the study unconvincing and recommends adjustments to a decoupled utility's ROE.

Q. WHAT DOES THE RAP REPORT SUGGEST REGARDING RISK REDUCTION?

A. The RAP report notes that it would be unfair to shift market risk away from the utility and force customers to wait until the bond market reflects the change in market risk. This

26/ Exhibit No. ___ (MCD-6).

27/ Revenue Regulation and Decoupling: A Guide to Theory and Application, The Regulatory Assistance Project (June 2011), 39 n. 31.

28/ Id.

is because the lag to a bond market upgrade can be years, or even a decade. If customers must wait for the bond market to respond to decoupling, savings for customers will be phased in slowly over many years while the benefits of guaranteed revenue for the Company and assured dividends for the shareholders accrue immediately. Thus, RAP states that a regulator should recognize the reduction in business risk either by an ROE reduction or by lowering the equity component of the utility's capital structure.[29/] RAP prefers the latter method, but Commissions in most jurisdictions I have examined have chosen the former.

Q. WHAT IS ICNU'S RECOMMENDATION?

A. ICNU witness Gorman stated that the most appropriate response to any potential decoupling in this case is to select an ROE at the low end of the range the Commission finds reasonable, rather than at the midpoint.

Exhibit No. ___ (MCD-6) shows that of 16 currently active decoupling programs that I have examined, 11 were adopted in conjunction with an ROE adjustment. While most of these reductions were a specified number of basis points, the preferable method is that used by Massachusetts and Hawaii, and suggested by ICNU Witness Gorman. ICNU agrees with the Commission's own statement that "if it is necessary [to reflect reduced risk in rates] . . . we think it is more appropriate to make a direct adjustment to return on equity, for example, moving to the low end of a range of reasonable returns . . . ."[30/]

[29/] Id. at 37.

[30/] Re PacifiCorp, WUTC Docket No. UE-061546, Order No. 8 ¶ 106, n.67 (June 21, 2007).

Q. DOES ICNU SUPPORT NWEC'S PROPOSED DECOUPLING REGIME?

A. No. NWEC's proposal does not conform to the Commission's Policy statement, particularly in regard to adjustments for return on equity. ICNU agrees with NWEC that industrial customers should be exempted from any decoupling mechanism, if the Commission decides to impose one.

Q. PLEASE SUMMARIZE ICNU'S RECOMMENDATIONS REGARDING DECOUPLING IN THIS PROCEEDING.

A. ICNU disagrees with a number of specific recommendations in Staff's Response. However, ICNU fundamentally agrees that it would be impractical to implement a fully considered decoupling mechanism before the end of this proceeding. As such, any pursuit of decoupling for PSE should take place in a future proceeding and be supported by the Company in its own direct case. Further, it is inappropriate to include large industrial customer classes as part of a decoupling mechanism, due to their relatively small contribution to the fixed-cost recovery issues related to utility conservation programs and also their unique load characteristics. Finally, ICNU also does not support the NWEC decoupling proposal (except for the exclusion of large industrial classes) and finds the lack of adjustment to ROE in light of decoupling particularly problematic.

III. STAFF'S REGULATORY LAG RECOMMENDATION

Q. WHAT PROPOSAL HAS WUTC STAFF MADE REGARDING REGULATORY LAG IN THIS PROCEEDING?

A. Based on Company testimony regarding cost pressures,[31/] Staff is proposing an "expedited" rate case mechanism which would allow the Company's rates to be set on an updated test year following the completion of a general rate case. This proceeding would

31/ Direct Testimony of Susan McLain, Exhibit No. ___(SML-1T) (June 13, 2011).

include only restating adjustments and no changes to either rate design or rate or return. Under Staff's proposal, the Company would be able to file these expedited cases for up to two years following a "traditional" rate case.

Q. DOES ICNU SUPPORT THIS PROPOSAL FOR EXPEDITED RATE PROCEEDINGS?

A. No. ICNU strongly opposes this proposal on the basis that it is fundamentally unnecessary and is also procedurally unfair to ratepayers.

Q. WHY IS THIS TYPE OF SPECIAL REGULATORY TREATMENT UNNECESSARY FOR THE COMPANY AT THIS TIME?

A. The Company, like all utilities, faces cost pressure as it replaces and expands its infrastructure and also meets its regulatory compliance obligations while providing reliable service. However, it is a significant leap to conclude that the Company's circumstances are therefore so adverse as to require special regulatory treatment. The type of cost pressures described by the Company have been faced by all electric utilities regulated by the Commission and have been adequately handled through the traditional rate case process. The fact that the Company is facing cost pressures is not evidence that the standard regulatory process has somehow failed and prohibited the Company from operating reliably, maintaining financial integrity, attracting capital, or providing returns to its investors. Indeed, ICNU's view is that the Company's current regulatory treatment by the Commission is fully adequate to maintain the Company's financial and operational wellbeing. Indeed, to quote directly from a different section of Mr. Elgin's testimony:

> In my opinion, the relevant question is whether the Commission treats its utilities consistently and fairly over time. My experience is that the Commission has done so. The Commission has provided PSE many special accounting and ratemaking treatments for many different items of expense and investment. In fact,

> Moody's identifies the Commission as providing, "Collaborative Regulatory Relationships and Credit Supportive Regulatory Practices."[32/]

Q. WHY WOULD THE PROPOSED EXPEDITED PROCESS BE UNFAIR TO RATEPAYERS?

A. ICNU does not believe the proposed expedited process would allow enough time for parties to properly evaluate and audit the Company's case, even given a relatively limited scope of issues compared to a "traditional" rate case. This is particularly true in the area of power supply costs. Even in the type of proceeding proposed by Staff, the Company's power supply costs would still require the same scope of review as a traditional rate case but with much shorter time. Given the extremely dynamic nature of power markets, the Company's power supply cost proposal could be controversial in a number of areas in terms of market forecasts, modeling, or others. A perfect example of this phenomenon is in the current PacifiCorp rate case before the Commission. PacifiCorp filed what it characterized as a streamlined, "make whole" proceeding, yet power supply and even restating adjustments have been contested.

Q. CAN YOU PROVIDE A SPECIFIC EXAMPLE OF HOW THE TIMING OF THE PROPOSED EXPEDITED PROCESS WOULD BE PROBLEMATIC?

A. Yes. Assume the Company filed for an expedited proceeding immediately following the Commission decision in the present case. Receiving and analyzing the Company's case (including workpapers) might easily take through most of June 2012. A reasonable discovery process could take at three least rounds of data requests and responses, which, given the 10 day response time allowed for data requests, could take an additional two months. It would then potentially be September 2012 before parties would be able to file

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32/ Direct Testimony of Kenneth L. Elgin, Exhibit No. ___(KLE-1T) at 78:4-9.

fully supported testimony on power supply issues. At this point, there would still need to be rebuttal or cross-answering testimony, additional discovery, a hearing, and time for the Commission to provide a duly considered ruling on contested issues. For this all to occur in time to implement new rates for the heating season (at the latest November 1, 2012) does not appear practical while maintaining the procedural ability of parties to fully analyze and respond to the Company's filing. Further, ICNU does not believe that this scenario would provide any substantial relief to either the Commission or parties from the perspective of rate case cost or administrative burdens.

Q. DO YOU HAVE ANY OTHER CONCERNS REGARDING THE PROPOSED EXPEDITED RATE CASE PROCESS.

A. Yes. Staff characterizes the expedited process proposal on page 81, lines 16-18 of Exhibit No. ___(KLE-1T), as follows:

> It is a form of decoupling since rates will be adjusted in a timely manner to capture the effects of DSM, which theoretically reduces load, and captures the rate effects of load with new rate base additions.

To the extent that the Staff proposal in this instance is a form of decoupling and would enhance the Company's ability to recover its fixed costs and earn closer to its authorized rate of return, the proposal systematically shifts risk away from the Company and its shareholders. This shift in risk should be accompanied by consideration of its effect on the Company's appropriate cost of capital and equity structure. Particularly, Mr. Gorman's recommendation of selecting an ROE at the low end of his range would be appropriate.

Q. PLEASE SUMMARIZE ICNU'S RECOMMENDATION REGARDING THE PROPOSAL FOR EXPEDITED RATE PROCEEDINGS TO ADDRESS REGULATORY LAG.

A. ICNU does not support the recommendation for an expedited rate case process for the Company at this time. There has not been adequate demonstration that the cost pressure described by PSE cannot be dealt with through the normal regulatory process. Further, the expedited rate case proposal does not provide parties or the Commission with adequate time to properly analyze and respond to the Company's filing, particularly in the area of power supply costs and modeling. Finally, the proposal could inappropriately shift risk to ratepayers without offsetting consideration regarding the Company's capital cost and structure. Given all of these concerns and the difficult economic circumstances facing the Company's customers, the type of additional special regulatory contemplated by the Staff proposal is inappropriate and will likely lead to higher costs.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.