**[Service Date February 1, 2007]**

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

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| In the Matter of the Petition of | ) | DOCKET UG-060518 |
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| | ) | |
| AVISTA CORPORATION, D/B/A | ) | ORDER 04 |
| AVISTA UTILITIES, | ) | |
| | ) | |
| | ) | FINAL ORDER APPROVING |
| For an Order Authorizing | ) | DECOUPLING PILOT PROGRAM |
| Implementation of a Natural Gas | ) | |
| Decoupling Mechanism and to | ) | |
| Record Accounting Entries | ) | |
| Associated With the Mechanism. | ) | |
| . . . . . | ) | |

1 ***Synopsis:*** *The Commission grants Avista's request for approval of a decoupling mechanism pilot program, and requires an analysis of the pilot program's results. The Order accepts a proposed multiparty settlement, subject to conditions limiting accumulation of interest and carry-over of benefits between periods, and denies requests by other parties to reject the proposal.*

2 **NATURE OF PROCEEDING.** Docket UG-060518 involves a petition by Avista Corporation for authority to implement a mechanism to decouple its rates for conducting business operations, in part, from its rates for commodity sales.

3 **HEARING.** The Washington Utilities and Transportation Commission (Commission) convened a hearing in this docket at Olympia, Washington on December 22, 2006, before Chairman Mark Sidran, Commissioners Patrick Oshie and Philip Jones and Administrative Law Judge C. Robert Wallis.

4 **APPEARANCES.** David Meyer, attorney, Spokane, Washington, represents Avista Corporation (Avista). Simon ffitch, Assistant Attorney General, Seattle, Washington, represents the Public Counsel Section of the Washington Office of the Attorney General (Public Counsel). Greg Trautman, Assistant Attorney General, Olympia, Washington, represents the Commission's regulatory staff (Commission Staff or Staff). Ron Roseman, attorney, Seattle, represents intervenor The Energy Project. Nancy Glaser, Seattle, represents Intervenor The Northwest Energy Coalition, and Ed

Finklea and Chad Stokes, attorneys, Portland, represent Intervenor Northwest Industrial Gas Users, or NWIGU.

*5* **MULTIPARTY SETTLEMENT:** All parties except Public Counsel and The Energy Project have settled their differences and propose a settlement of all issues. Public Counsel and The Energy Project oppose the proposal.

*6* **HEARING AND BRIEFING.** The Commission convened an evidentiary hearing in the proceeding on December 22, 2006. The parties submitted prehearing briefs on December 14, 2006, and presented closing arguments at the conclusion of the evidentiary hearing.

*7* **DECISION.** The Commission finds that the benefits of this pilot program sufficiently outweigh its potential disadvantages and should be approved. The pilot program, supported by Staff as well as industrial and environmental interests, will allow a test of decoupling from which the parties can obtain objective data and analysis. The proposal is of relatively small scale and includes provisions to ameliorate the minor risk to ratepayers.

## BACKGROUND

*8* Decoupling is a ratemaking and regulatory tool intended to break the link between a utility's recovery of fixed costs and a consumer's energy consumption by reducing the impact of energy consumption on a utility's recovery of its fixed costs. Conservation advocates view decoupling as an important tool to promote greater conservation efforts by the utility by removing financial discentives.

*9* Under traditional ratemaking structures, utilities recover a large portion of their fixed costs through charges based on the volume of energy that consumers use. Consequently, a reduction in energy consumption may lower the probability that the utility can fully recover its fixed costs. Energy consumption may be lower for a variety of reasons. Consumers may lower their thermostats or take shorter showers. More energy efficient building codes and appliances, better and more efficient insulation, and warmer than normal weather can also reduce energy use. Conversely, an increase in energy consumption may lead to a utility over-recovering its fixed costs. The traditional financial incentives rewarding higher sales, some argue, create an environment in which utilities do not support conservation because it is inconsistent with their economic interests.

*10* Promoting energy conservation is a goal that we strongly support, and provides a highly appealing rationale for decoupling on its face. Our states' laws and policies encourage us to look with favor upon incentives to stimulate increased energy conservation as well.[1] Our statutory responsibility to regulate in the public interest, however, requires us to look beyond the abstract and examine the specific evidence to determine whether the facts support this rationale for Avista.[2]

*11* Some of the parties to this proceeding reached agreement on all disputed issues. The settling parties are the Company, the Commission Staff, NWIGU, and the NWEC, (the Northwest Environmental Coalition), collectively the "Joint Parties."[3] Along with the Northwest Industrial Gas Users (NWIGU) they support adoption of a three-year pilot "partial" decoupling mechanism that they propose as a multiparty settlement.[4]

*12* Public Counsel and the Energy Project oppose the proposal.

## STANDARDS FOR REVIEWING SETTLEMENT AGREEMENTS

*13* The Commission's procedural rules govern the process for reviewing proposed settlement agreements. The Commission "may accept [a] proposed settlement, with or without conditions, or may reject it."[5] The Commission must "determine whether a proposed settlement meets all pertinent legal and policy standards."[6] The Commission may approve settlements "when doing so is lawful, when the settlement

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[1] *See* RCW 80.28.024, RCW 80.28.025, and RCW 80.28.260.
[2] The Commission has determined that it is not desirable to take a blanket approach to decoupling. "The Commission believes that the wide variety of alternative approaches to decoupling make it more efficient to address these issues in the context of specific utility proposals included in general rate case filings rather than through a generic rulemaking." Rulemaking to Review Natural Gas Decoupling, Docket UG-050369, Notice of Withdrawal of Rulemaking (October 17, 2005). This is the third in a recent series of decoupling proposals we have considered, including one for Puget Sound Energy, Inc., *WUTC v. Puget Sound Energy, Inc.*, Order 08, Dockets UE-060266 and UG-060267 (2007), and the other for Cascade Natural Gas, *WUTC v. Cascade Natural Gas*, Order 05, Docket UG-060256 (2007). Each proposal has unique qualities and a unique setting which has shaped our analysis and determined our decision.
[3] Though a sponsor of the settlement stipulation, NWIGU did not sign on to the joint testimony, joint rebuttal testimony, or the pre-hearing brief.
[4] WAC 480-07-730.
[5] WAC 480-07-750(2).
[6] WAC 480-07-740.

terms are supported by an appropriate record, and when the result is consistent with the public interest in light of all the information available to the Commission."[7]

*14* In reviewing the proposed settlement, we must consider the terms of the decoupling proposal, and whether those terms are lawful, are supported by the record and are in the public interest.

## TERMS OF THE PROPOSED SETTLEMENT

*15* The main features of this proposed pilot decoupling mechanism include the following:[8]

- **Term**: It would begin January 1, 2007. Recording of deferred revenue will end on June 30, 2009. However, the amortization period would begin on November 1, 2007 and end on October 31, 2010.

- **Application**: It would apply only to schedule 101 (residential and small commercial customers).

- **New Customer Adjustment**: It would remove the usage associated with new customers added since the corresponding month of the test year.

- **The Deferral Amount**: It would defer 90% of the margin difference, either positive or negative, for later recovery (or rebate).

- **Recovery**: It would subject recovery of deferred costs to:

    - *An earnings test* – Avista could not earn more than its authorized 9.11% rate of return.

    - *A demand side management (DSM) test* – recovery based on Avista achieving specific conservation targets.

[7] WAC 480-07-750(1).
[8] *See* Exh. 15 (Settlement), ¶¶6A-6J.

| Actual vs. Target DSM Savings | Amount Deferred |
|---|---|
| < 70% | 0% |
| > 70% and < 80% | 60% |
| > 80% and < 90% | 70% |
| > 90% and < 100% | 80% |
| 100% | 90% |

- Any deferred amount not recovered due to the earnings or DSM tests would carry over and offset future deferrals.[9]
- Variations due to weather will be excluded from calculations of savings.

- **Review of DSM Savings**: The Company will retain an independent third party to audit the results of DSM savings reported for decoupling purposes.

- **Annual Rate Changes**: The mechanism would limit annual rate increases due to the mechanism to 2% annually.

- **Decoupling Evaluation**: Prior to filing a request to continue the mechanism beyond its initial term, the company must evaluate its results.

*16* According to the Joint Parities, the stipulated decoupling mechanism would "break the link between the volume of therm sales and the recovery of fixed costs and would provide for an increased focus on energy efficiency and conservation." They argue that the resulting "increased conservation would not only benefit the individual customers participating in those measures through reduced bills, but would also reduce the overall demand for natural gas, which would help to reduce natural gas prices for all customers."[10] The Joint Parties further assert that the proposed decoupling mechanism "would align the Company's interest with that of its customers with an increased focus on effective DSM programs."[11]

*17* Decoupling, like many other departures from traditional ratemaking structures that have come before this Commission, has both potential advantages and disadvantages.

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[9] We address this provision, and require modification, below.
[10] *See* Exh. 10 (Joint Testimony), 7:1-15.
[11] *Id*, 7:22-8:2.

A key disadvantage, as Public Counsel points out, is the potential shifting of risk to ratepayers.[12] Under the stipulated proposal, the risks of changes to weather-normalized consumption would shift to customers. All customers, regardless of their individual efforts to lower use, will experience a surcharge in rates should consumption by class fall below the expected level. This points us to a second potentially serious problem—the distortion of price signals and consequent dampening of customer conservation initiatives.

*18* Balancing fixed-cost recovery on an annual basis via a surcharge or credit mechanism diminishes the value of rates as a means to send appropriate price signals to customers. Based on changing energy market conditions, price signals undoubtedly affect customer choices to conserve or not. This price signal may be weakened if customers conserve and then are faced with paying a surcharge that reduces their financial benefit. In those circumstances, decoupling actually may prove counterproductive to its laudable purpose. Just as we must be concerned that in some instances the absence of decoupling or something similar may prove a disincentive to a company promoting conservation, the implementation of decoupling, and associated surcharges, may prove a disincentive to customers who might be inclined to conserve if it is to their financial advantage.

*19* A third potential problem, vigorously argued by Public Counsel, is the risk over time of distorting the "matching principle " through single issue ratemaking.[13] Under this principle, revenues and costs are balanced at a common point in time, i.e., a rate case, to determine fair, just, reasonable and sufficient rates. If a company is largely assured recovery of fixed costs and most variable costs are routinely passed through to customers (e.g., via purchased gas adjustment mechanisms and the like), then the company has fewer reasons to file a general rate case. In this context, any cost savings achieved by the company are not shared with customers. The result risks over-earning by the company and over-paying by the customers.

*20* Considering these concerns, we must examine carefully the stipulated proposal to determine whether the record is sufficient to prove the potential advantages from decoupling outweigh its potential disadvantages in this case.

*21* A fundamental test in this regard is the likelihood of increased conservation as a result of implementing a decoupling program. A key complaint of Public Counsel and the

[12] Public Counsel Initial Brief, ¶ 91.
[13] *Id*., ¶¶ 22-28, 56-59.

Energy Project is that there is no guarantee that the decoupling proposal would increase conservation. Public Counsel argues that the stipulation's use of the 2006 Integrated Resource Plan's (IRP) savings level as the conservation target does not satisfy the "requirement for incremental conservation."[14] The Energy Project also expresses skepticism over whether the proposed decoupling mechanism would increase conservation and recommends a higher conservation target.[15]

*22* The Joint Parties respond that Avista performed a comprehensive assessment of natural gas efficiency measures to establish its gas savings targets as part of the IRP[16] development process. This effort was carried out with the help of an external oversight group, the External Energy Efficiency Board. As a result, the Joint Parties claim that the savings target is "meaningful and elevated" as well as being "appropriate and in the public interest."[17] The Joint Parties further assert that with the stipulated decoupling program, the Company can continue to encourage customers to conserve natural gas through education, as well as through programmatic DSM.[18] Finally, the Joint Parties claim that the prospect of a decoupling mechanism has already increased the Company's focus on natural gas DSM. The Company has increased resources "to achieve higher DSM goals in 2006 and beyond."[19]

*23* We note that the stipulated decoupling mechanism includes a DSM test whereby Avista must achieve *at least* the 2006 IRP's targeted savings level to maximize recovery of deferred costs. Moreover, the Joint Parties point out the 2006 IRP target was based on a comprehensive assessment of available efficiency measures and is about four times the goal of the previous 2004 IRP.[20] Finally, it appears that Avista has recently made efforts to increase its conservation program in anticipation of this decoupling mechanism. Ms. Glaser, testifying on behalf of the Northwest Environmental Council, emphatically supported this view. Together, these factors lead us to conclude that the proposed decoupling mechanism has some potential to increase Company conservation.

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[14] *See* Exh. 51 (Public Counsel Testimony), 12:4-20.
[15] *See* Exh. 60 (Energy Project Testimony), 5.
[16] Integrated Resource Plan, a means by which utilities identify resources to meet likely future loads. *See,* WAC 480-107.
[17] *See* Exh. 11 (Rebuttal Joint Testimony), 3:8-9, 4:17-18.
[18] *Id,* 7:3-11.
[19] *Id,* 7:18-8:7.
[20] *Id,* 3:8-15.

*24* Public Counsel also asserts that deferrals under the decoupling mechanism would be far out of proportion to the lost margins from Avista's energy efficiency programs. Of the $617,000 deferral simulated by the Company for the July 2005-June 2006 time period, it alleges that only $141,000 (less than 25 percent) was due to Avista's own conservation efforts.[21] The Joint Parties argue that Public Counsel "fails to recognize that the [decoupling] mechanism is intended to capture up to 90 percent of the lost margin resulting from all reductions in usage… even conservation beyond that which results from the Company's sponsored DSM programs." The Joint Parties further imply that some of the customer conservation results from Company education efforts."[22]

*25* Public Counsel makes a strong argument that the decoupling mechanism may recover lost margin far out of proportion to losses from effects of Avista's efficiency programs. As noted above, we are concerned that the mechanism not simply be a way to shift from the Company to customers the risk of falling individual natural gas consumption. That said, it is reasonable to assume, as the Joint Parties do, that company-sponsored educational efforts have an effect on individual efficiency decisions. It is also reasonable to conclude that the application of an earnings cap and the exclusion of weather from the mechanism will prevent such a significant shift in risks that the Company would earn windfall profits—especially over the three-year test period proposed in the stipulation.

*26* To ensure that the program does not result in inappropriate benefit to the Company, we require two changes to the proposal. First, any funds that are not deferred due to the "earnings" and/or the "DSM" test may not be carried over to the next period. Second, the Company may not record interest on deferrals until we approve the deferrals for recovery.[23] In light of these changes, we do not find Public Counsel's argument sufficiently strong to prevent implementation of the multi-party settlement. However, the proportion of margin lost to company sponsored DSM relative to the amount subject to recovery is of great interest to us, and we will closely scrutinize this factor in reviewing the results of this pilot decoupling program.

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[21] *See* Public Counsel Pre-Hearing Brief ¶ 5.
[22] *See* Joint Parties Pre-Hearing Brief ¶ 35.
[23] Generally, interest on deferred amounts should be limited to instances where a utility's investors have provided a direct investment. In this instance, the deferral is the amount of money the company would have made if they had earned their authorized rate of return. Since deferral is not derived from investors' finds that are expensed or capitalized, it should also not earn interest.

*27* Public Counsel claims that eliminating schedule 111 from the decoupling mechanism creates two serious problems. First, he argues that any incentive resulting from decoupling will benefit Schedule 111 (large user) customers who will not be paying anything to remove the "disincentive." Second, he argues that since the settlement decoupling proposal recovers the full lost margins for all rate schedules, Schedule 101 (residential) customers are paying not only for their own lost margins, but for all Avista's lost sales volumes for all customer schedules. This, he alleges, amounts to a cross-subsidy.[24]

*28* The Joint Parties respond that Schedule 111 has a significant number of large commercial and industrial customers, whose gas usage can vary greatly due to economic reasons. These customers should not be part of the pilot decoupling mechanism and it would be difficult to identify, track and remove them from the mechanism. So the Joint Parties agreed to eliminate all of Schedule 111 customers. The Joint Parties further assert that the mechanism determines lost margin only from Schedule 101 customers and any adjustment applies only to those customers. Any lost margin associated with Schedule 111 customers would not be included in the decoupling mechanism.[25]

*29* We find little merit in the assertion that decoupling proposal would result in Schedule 101 customers subsidizing Schedule 111 customers. The lost margins would be calculated solely for and apply only to Schedule 101 customers. We also do not agree with the apparent argument that a cross subsidy occurs simply because the conservation tariff rider applies to all customers, but all customers may not equally share in the conservation acquired through the rider. The tariff rider creates a public benefit by providing a pool of funds to acquire the most conservation at the least cost, wherever that may occur. The argument that this creates a cross-subsidy could equally apply to other utility programs such as rate relief provided to some low-income customers.

*30* In prior reviews of proposed decoupling mechanisms, we have noted the importance of the information accompanying a general rate case to making a fully informed decision. Although this petition is not part of a general rate case, the fact that Avista

[24] *Id*, 11:12-22.
[25] *See* Exh. 11 (Rebuttal Joint Testimony), 10:9-15.

had such a case before us within the past *13* months is sufficient in this context to guide our decision.[26]

*31* Public Counsel raises substantive concerns as to the appropriateness of decoupling. We conclude that an appropriately designed pilot program with adequate safeguards to protect ratepayers is in the public interest, because it will test the hypothetical benefits of decoupling generally and the specifics of this mechanism set forth in the settlement agreement. This proposal, as conditioned, has many limitations and safeguards to protect the public; it follows a review adequate for the purpose in a rate proceeding decided recently; and it is low-risk, putting ratepayers to a minimal exposure.[27] As modified, this proposal constitutes an acceptable form for a pilot program.

*32* To ensure an adequate review of the program and its accomplishments, we require that the program be reviewed at its conclusion in a general rate case.

## CONCLUSION

*33* The Commission favors the resolution of contested issues through settlement "when doing so is lawful and consistent with the public interest."[28] We have carefully considered the design of the stipulated partial decoupling mechanism, including the public protections afforded by the DSM test and the earnings test on recovery of deferred costs. After reviewing all of the arguments, we determine that it is in the public interest to allow the Company to proceed with this pilot program. However, we agree with Public Counsel and the Energy Project that the proposal is not without potential flaws. The settling parties should consider our approval as an opportunity to demonstrate that decoupling mechanisms do indeed increase utility sponsored conservation and that the potential flaws do not outweigh the program's benefits. We will carefully evaluate the mechanism, and will only consider an extension upon a convincing demonstration that the mechanism has enhanced Avista's conservation efforts in a cost-effective manner.

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[26] We note in contrast our rejection of Avista's petition for a power and transmission cost update outside a general rate case. See, Order 04, docket UE-061411 (2006).
[27] The mechanism limits annual rate increases to a maximum of 2%. Avista's study indicates that if the mechanism had been effective between July 2005 and June 2006, ratepayer exposure would have been 35 cents per month for a typical residential customer. Exh. No. 1, p.11.
[28] WAC 480-07-700.

## FINDINGS OF FACT

*34* Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated above our findings and conclusions upon issues in dispute among the parties and the reasons supporting the findings and conclusions, the Commission now makes and enters the following summary findings of fact, incorporating by reference pertinent portions of the preceding detailed findings:

*35* (1) The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate rates, rules, regulations, practices, and accounts of public service companies, including gas companies.

*36* (2) Avista Corporation is a "public service company" and a "gas company," as those terms are defined in RCW 80.04.010, and as those terms are used in RCW Title 80. Avista is engaged in Washington State in the business of supplying utility services and natural gas to the public for compensation.

*37* (3) Avista filed a petition on April 5, 2006, requesting an order authorizing a natural gas decoupling mechanism which would defer certain costs and revenues in order to potentially recover fixed costs unrelated to consumption.

*38* (4) Four parties entered into a multi-party Agreement resolving their differences and agreeing to a pilot program. The settling parties included the Company, Commission Staff, and the Northwest Environmental Coalition (NWEC). In addition, the Northwest Industrial Gas Users (NWIGU) supports the proposed settlement. The Settlement Agreement is attached to this Order as Appendix A.

*39* (5) Public Counsel and the Energy Project oppose the settlement proposal.

*40* (6) The proposed pilot decoupling program includes sufficient elements, mechanisms and commitments to protect ratepayers and real incentives for the Company to deliver on the promise of conservation. It is likely to increase Company conservation.

*41* (7) An evaluation of the pilot, partial decoupling program, regardless of whether Avista seeks to continue the program after the three-year pilot period expires,

is important to determining the value of decoupling mechanisms for regulated utilities in Washington State.

## CONCLUSIONS OF LAW

*42* Having discussed above all matters material to this decision, and having stated detailed findings, conclusions, and the reasons therefore, the Commission now makes the following summary conclusions of law incorporating by reference pertinent portions of the preceding detailed conclusions:

*43* (1) The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of, and parties to, this proceeding. *RCW Title 80.*

*44* (2) Informal settlements in administrative proceedings are encouraged. *RCW 34.05.060.* The Commission may approve settlements "when doing so is lawful, when the settlement terms are supported by an appropriate record, and when the result is consistent with the public interest in light of all the information available to the commission." *WAC 480-07-750(1).*

*45* (3) The Settlement Agreement is supported by the record, and is consistent with the law and public interest.

*46* (4) Avista's petition should be granted, authorizing accounting treatment effective January 1, 2007, as described in the Settlement Agreement to implement a decoupling mechanism pilot program, but only subject to the following conditions: First, any funds that are not deferred due to the "earnings" and/or the "DSM" test may not be carried over to the next period. Second, the Company may not record interest on deferrals until such time as the deferrals are approved for recovery by the Commission. If the parties fail to accept these conditions, this Order shall become void and Avista's petition shall be set for a full hearing on the merits.

*47* (5) The Commission should retain jurisdiction over the subject matter of and the parties to this proceeding to effectuate the terms of this Order. *RCW Title 80.*

## O R D E R

*48* The Commission approves, subject to condition, the Joint Parties' proposal and authorizes Avista to implement accounting treatment, as described in the Settlement agreement, to effect a decoupling mechanism pilot program. For the approval to become effective, the settling parties must each agree within ten business days to a settlement agreement modification containing the following changes: First, any funds that are not deferred due to either the "earnings" and/or the "DMS" test may not be carried over to the next period. Second, the Company may not record interest on deferrals until such time as the deferrals are approved for recovery by the Commission.

*49* The multi-party Settlement Agreement filed in this proceeding on October 27, 2006, attached to this Order as Appendix A and incorporated herein by this reference as if set forth in full, is accepted and approved, subject to conditions, as set out in the body of this Order.

Dated at Olympia, Washington, and effective February 1, 2007.

WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

MARK H. SIDRAN, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner

**NOTICE TO PARTIES: This is a final order of the Commission. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 or RCW 81.04.200 and WAC 480-07-870.**

# APPENDIX A

# PROPOSED SETTLEMENT