EXHIBIT NO. _____ (SDW-1T)
DOCKET NO. UG-060256
2006 CASCADE NATURAL GAS CORPORATION
GENERAL RATE CASE
WITNESS: STEVEN D. WEISS

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **CASCADE NATURAL GAS CORPORATION** **Respondent.**	**Docket No. UG-060256**

PREFILED DIRECT TESTIMONY OF STEVEN D. WEISS ON BEHALF OF NW ENERGY COALITION

Natural Gas Decoupling and The Conservation Alliance Plan, Monthly Customer Charges, An Inverted Residential Rate, Low Income Rate Assistance, and Miscellaneous Fees and Charges

August 15, 2006

NW ENERGY COALITION

PREFILED DIRECT TESTIMONY OF STEVEN D. WEISS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Steven Weiss. I am employed by the NW Energy Coalition, 219 First Ave. South, Suite 100, Seattle, WA 98104.

Q. What are your position and responsibilities?

A. I am a Senior Policy Associate and represent the Coalition in regulatory proceedings with the Bonneville Power Administration and in the States of Oregon and Washington. I am also an advocate for clean and affordable energy in many other forums including the NW Power and Conservation Council, Columbia Grid and the Oregon Legislature.

Q. Please summarize your educational background and professional experience.

A. I received a Masters in Science Education from Bucknell University in 1976 and a Bachelor of Arts in Physics and Math from the University of California at Berkeley in 1968. Previous professional experience includes employment as Assistant Professor at Clarion State College in Pennsylvania from 1975-79 and I was elected to the Board of Salem Electric (Co-op) four times from 1982-94. I also owned and operated a retail bicycle shop from 1980-96. I have been employed by the Coalition since 1994 and have participated in numerous Oregon, BPA and regional policy forums and rate cases. I also co-authored Oregon's electricity restructuring law (SB1149). My resume is included as Exhibit ____(SDW-2).

Q. Have you appeared before utility regulatory Commissions in other proceedings?

A. Yes, I have represented the Coalition in numerous dockets, including rulemakings. Examples in Oregon include Northwest Natural's filings regarding its Weather Adjusted Rate Mechanism (UG 152) and decoupling (UG 143), Portland General Electric's decoupling filing (UE 126), and Cascade Natural Gas Corporation's Conservation Alliance Plan, inclusive of a decoupling mechanism (UG 167). In July of this year I served as a witness on decoupling in the Puget Sound Energy (UG-060267/UE-060266) general rate case. I also served as a witness for the Coalition in the 2004 Puget Sound Energy Natural Gas (PSE) rate case, focusing on rate design issues. Also I have represented the Coalition in numerous Integrated Resource Planning Processes, as well as at workshops and conferences over the past dozen years.

Q. Please summarize the contents of your testimony.

A. My testimony focuses on: (1) the Conservation Alliance Plan, a decoupling mechanism, proposed by Cascade Natural Gas witness Jon T. Stoltz [Exhibits ____(JTS-1T, 25-31) and (JTS-9)]; (2) Cascade's proposed increases in monthly customer charges (JTS-1T, pages 23-25); (3) Cascade's proposal for $800,000 of low income bill-payment assistance; and (4) Cascade's proposal to increase a variety of miscellaneous fees and charges.

(1) A properly structured decoupling mechanism provides benefits to both consumers and the utility by: (a) reducing volatility in utility earnings and consumer bills due to weather; (b) reducing volatility in utility earnings due to changes in commodity costs and business conditions; and (c) removing disincentives to the

acquisition and encouragement of energy efficiency and other economically and environmentally efficient resource decisions, such as distributed generation on the customer's side of the meter. All of these benefits lower Company and customer costs. A fair and timely sharing of these benefits is essential if a decoupling mechanism is to be in the public interest. Since the most significant and immediate customer benefit of a well-structured decoupling mechanism is an aggressive investment in cost-effective conservation, I recommend several significant modifications to Cascade's Conservation Alliance Plan (decoupling mechanism) that, if approved by the Commission, would result in a 3-year decoupling pilot for residential customers with annual rate adjustments no greater than 3% and annual recovery of approved margin tied to achievement of ambitious yet achievable energy efficiency targets. However, we recommend that the actual implementation of the decoupling mechanism be deferred until certain details of the mechanism and the Company's energy efficiency commitments are worked out by a formal advisory committee and are subsequently reviewed and approved by the Commission.

(2) I recommend that there be no increase in the monthly customer charges for customer classes who will participate in the decoupling pilot program. Residential customer rates should also be "inverted" as discussed in Mr. Jim Lazar's testimony for Public Counsel (Exhibit ___(JL-1T). Monthly customer charges for other rate classes should be increased no more than the overall percentage rate increase for each of those classes, respectively.

(3) I support Cascade's proposal to provide $800,000 annually for its low income customers. The full $800,000, plus any additional tax credits or benefits

received by the Company pursuant to the delivery of this amount, should be directed to low-income bill-payment assistance in a manner consistent with that proposed by the Energy Project's expert witness, Chuck Eberdt (Exhibit CE-1T). It is neither reasonable nor appropriate for this low income bill-payment assistance funding to be conditioned, as proposed by Cascade, on a waiver of "the prior obligation rule." In addition to bill-payment assistance, the Company should provide a low-income weatherization program. The amount of funding and the delivery mechanism for low-income weatherization should be recommended as part of the advisory committee's review of ambitious yet achievable conservation targets referenced in (1) above.

(4) Cascade's proposed disconnection, reconnection, account activation, equipment service and late payment charges are excessive, regressive and unduly burdensome on low and fixed income customers. The size of these charges should be limited and the interest rate charged on overdue balances should be limited to the Company's cost of capital. Robust low-income bill assistance and weatherization programs are more effective in reducing the frequency and size of late payments, uncollectible accounts, disconnections and reconnections than burdensome fees.

II. Background

Q. What incentives and disincentives are embedded in traditional utility price cap regulation and what effect do they have?

A. All ratemaking regulation provides utilities with incentives or disincentives to behave in a certain manner. Ideally, utilities should be rewarded based on how well they meet their customers' energy service needs. Traditional rate design ties recovery of

fixed costs directly to commodity sales. This encourages increased use and discourages even the most economical investments if they are likely to reduce throughput. If sales go down, Company shareholders forego cost recovery of recognized and prudent costs with every unsold therm. Under this system, supply expansion is the primary response to projected load growth - to the exclusion of investments in energy efficiency, peak load pricing and distributed energy resources. This is economically inefficient because there is a disincentive for the utility to choose the least-cost mix of options to provide energy service or to encourage such investments by customers.

This regulatory paradigm places the utility's interest (to increase sales) in conflict with the customers' interest (to reduce their total energy costs). Not only does this foster a corporate culture that opposes direct utility investments in programs that reduce energy use, but also it further motivates the utility to discourage customer-financed reduction measures and to oppose efforts to tighten building codes and appliance standards.

Current regulation also has the effect of magnifying weather and business cycle risks and volatility to both the utility and to customers. During periods of higher than average usage caused by weather extremes, low commodity prices or economic boom, customers overpay fixed distribution costs, and utilities likely earn more than their allowed return on equity (ROE), essentially a windfall completely unrelated to the utility's behavior. Conversely, with mild weather, high commodity prices, or during more difficult economic times, consumers reduce usage and their payments

fall short of covering approved fixed costs. The utility suffers a loss, again not connected to the utility's actions.

This structure is particularly difficult for low-income customers. During cold winters, for example, they must struggle with paying energy bills which are needlessly inflated by the current rate structure and which provide for more-than-full recovery of distribution costs. Low-income households spend a higher percentage of their annual income on energy costs than average residential customers and face dramatic reductions in their budgets for food, housing, medicine, and other necessities. In warmer winters they can more easily handle their (smaller) utility bills, and the underpayment contained in their bill is not as much of a benefit. In addition, because their shareholders are harmed by reductions in usage, utilities have a disincentive to adequately fund low-income weatherization programs that could help these customers reduce their energy burden.

At the same time, volatility in revenues raises the utility's cost of capital, which also adds to customer costs.

Weather, commodity price and business cycle risks have traditionally been borne both by utilities (between rate cases) and by customers (in the rate of return set in each rate case, and in the purchased gas adjustment mechanism). Risk is often a valuable tool to incent parties to take actions to reduce their exposure. However, risks which are outside of anyone's control serve no other purpose than to raise costs. If those costs can be reduced and shared fairly, both the Company and customers benefit.

Q. How does decoupling, or revenue cap regulation, overcome the disincentives to conserve energy that are embedded in traditional regulation?

A. Breaking the link between the utility's commodity sales and revenues removes both the utility's incentive to increase energy sales and the disincentive to run effective energy efficiency programs or invest in or encourage other activities that may reduce load. Decision-making can then focus on making least-cost investments to deliver reliable energy services to customers even when such investments reduce throughput. The result is a better alignment of shareholder, management and customer interests to provide for more economically and environmentally efficient resource decisions. A decoupling mechanism is essential to establishing a corporate culture that promotes aggressive cost-effective conservation investments. A decoupling mechanism is able to do this much more successfully and comprehensively than other alternatives. It is important to note, however, that while decoupling removes the utility's disincentive to decrease throughput, it does not provide an incentive to do so.

Q. Are there other benefits of a decoupling mechanism?

A. Yes. Decoupling distribution revenues from throughput reduces the volatility and risk of weather and business cycle variability to both customers and the utility. A decoupling mechanism can smooth out over- and under-collections due to these factors for both parties. Exposing utilities and customers to weather and business volatility serves little useful purpose because they are not subject to either party's control. In fact, the one action the Company can take to reduce its downside risk -- encourage increased (and discourage decreased) consumption between rate cases -- is

a policy that increases customer costs and is the key policy we seek to eliminate. Reducing volatility with a decoupling mechanism is a win-win proposition.

As an added benefit, breaking the sales-revenue link can streamline the regulatory process for rate adjustments. For example, contention over the definition of "normal" weather and weather normalization (especially to reflect global warming as proposed by Cascade in Exhibits ___(JTS-1T) and (JTS-7)) can consume extensive resources in a rate case. If the sales-revenue link is broken, these definitions and related calculations have little or no economic impact, so the incentive to game is removed. In this way a comprehensive decoupling mechanism that includes margin adjustments for weather variability can improve the efficiency of the regulatory process and allow attention to focus on matters of broader public import.

Q. But doesn't decoupling reduce the frequency of rate cases, thus limiting valuable oversight by the Commission and other parties?

A. Like other automatic adjustments, decoupling may reduce the frequency of rate cases compared to current ratemaking practice. Some have argued that this is a serious disadvantage to consumers, since it is during a rate case that a thorough review of all of a utility's costs and revenues occurs.

The flaw in this argument lies in the fact that current ratemaking is not symmetrical. Instead, it is tilted in favor of the utility. Under current practice, it is very difficult for any other party than the utility to initiate a rate case. The reason for this is that the burden of proof is placed on the initiating party. Because consumers and staff do not have access to the utility's books , it is very difficult for them to prevail. In Oregon, for example, there have been only two "show cause" proceedings

that I know of in the past two decades or so. The result of this asymmetry is that if a utility is doing very well, it will avoid a rate case, but if it has cause to need more money, it will quickly initiate one. Thus the opportunity to review the utility's costs and revenues is only available when the utility *wants* that review—when its earnings have fallen or it seeks to add to its rate base.

Decoupling won't exacerbate this situation; in fact it may improve it. That is because decoupling adjustments benefit customers if loads grow faster than expected due to, for example, weather, economic conditions or commodity prices. These credits to customers would not occur under current ratemaking.

Our recommendation for a 3-year decoupling pilot, to be extended only after a thorough review as part of a general rate case, addresses this concern.

Q. Could you provide some examples of how decoupling is preferable to alternatives?

A. A more narrowly focused incentive that rewards the utility for running effective conservation programs, for example, does not create a regulatory framework that encourages a broader change in corporate culture. Another proposed alternative, significantly raising the fixed customer charge, is also not as effective as decoupling, because it lowers the marginal price signal customers face, thus making them less likely to participate in conservation programs or adjust usage as a result of the cost of energy.

Q. How does decoupling affect the risks faced by customers and the Company?

A. Some parties mistakenly view risk as a zero-sum game. They see that decoupling reduces the utility's risk and then jump to the false conclusion that it must increase

customers' risk. They perceive decoupling as a shift of risk from shareholders to customers. This argument fails to recognize that customers bear the same weather and business cycle risks that the company does. Customers face the risk of overpayment if usage is more than expected, symmetrically to the utility's risk of under-collection if usage is less than expected. Decoupling is best understood as a trading of risk between customers and shareholders, not a shift.

Q. Why should a decoupling mechanism include weather variability?

A. From the customers' point of view, decoupling works best in countering weather volatility. Rebates can provide relief after especially cold weather, and surcharges are needed only after mild weather. The other important customer benefit comes from reducing the utility's weather risk, thereby reducing its earnings volatility. Especially for a gas utility, this factor is very important. Reducing earnings volatility should lower the utility's cost of capital, another cost ultimately borne by customers.

Q. Do other Northwest gas utilities have decoupling mechanisms that include weather?

A. Yes, NW Natural and Cascade Natural Gas in Oregon both include weather variability in their decoupling mechanisms. NW Natural has a weather adjustment mechanism that works especially well because it adjusts rates in each month's billing cycle.

Q. Are monthly rate adjustments necessary?

A. No. Monthly adjustments are preferred because they are more immediately tied to changes in consumption patterns and act as a perfect weather risk "swap" with the utility. However, they result in customers seeing bill changes each and every billing

cycle which can cause some customer confusion - - exacerbated by the utility's requirement to notify customers in association with each rate change. In addition, not all utilities' billing systems are able to provide monthly adjustments. This is the case for Cascade's present system. A second-best approach is to provide yearly adjustments, so long as there is a reasonable cap on the annual adjustment.

Q. Are there other reasons to require an "annual cap?"

A. Yes. For example, a surcharge necessitated from under-collection of distribution costs during periods of high commodity prices or recession could hit customers just when they can least deal with it. This is a valid concern, and another reason to limit the size of the decoupling adjustment in any one year.

Q. What is the most appropriate rate design with a decoupling mechanism?

A. With decoupling, customer charges are best reduced to a diminishing minimum charge reflecting only meter-reading and billing costs.[1] Decoupling reduces some of the bill volatility due to changes in weather and stabilizes Company margins. In general, the rate changes due to decoupling pale in comparison to the magnitude of reductions that customers can affect in their bills when charged on a volumetric basis. In other words, rates may go up slightly to restore lost distribution revenue from customer reductions, but bills will drop as voluntary reductions and cost-effective

[1] This means that all customers would provide a minimum monthly revenue to the Company sufficient to recover metering and billing costs, but at higher usage levels this "minimum" is rolled into the rate per therm to ensure that incentives for the wise use of natural gas are not adversely affected by the customer charge. Pacific Gas and Electric Company in California currently has such a rate schedule (G-1) for its Residential Service.

efficiency eliminate the need to purchase therms that would have cost more. The utility will distribute less energy with no corresponding loss of distribution revenue, while customers will benefit from avoiding the economic and environmental costs unnecessary energy consumption.

Shifting charges from volumetric to fixed is exactly the wrong signal to give customers, and, moreover, is unnecessary for stabilizing the utility's margin recovery. I find it puzzling that Cascade is proposing *both* decoupling and higher fixed charges. Decoupling solves any lost margin problem, making a higher fixed charge both unnecessary and counterproductive. Rates should be structured to provide clear and strong incentives for customers to use energy as efficiently as possible.

To this end the uniform volumetric rates proposed by the Company should be restructured into an inverted rate design consistent with the testimony of Public Counsel's expert witness, Mr. Jim Lazar, (Exhibit ____JL-1T).

Q. How could a poorly designed decoupling mechanism result in unintended consequences that are harmful to consumers?

A. While decoupling as a general concept seems fairly straightforward, it must be carefully constructed to avoid unintended consequences. I have already discussed one possibility above: a large adjustment due to extraordinary drops in usage. I suggested a cap on yearly adjustments is one way to deal with this.

A more serious problem is that a poorly designed decoupling mechanism could produce a windfall profit to the utility if it fails to take into account a downward trend in usage (sometimes called "attrition"). In addition, it is critical that a decoupling mechanism only be approved for a utility that is delivering an aggressive

conservation program to its customers. I address these latter two issues more fully in the next section of my testimony.

Q. Did the NW Energy Coalition participate in the negotiations and support the Company's decoupling proposals in Oregon docket UG 167?

A. Yes, and that includes becoming a party to the April, 2006 Stipulation between all parties and Oregon Public Utility Commission staff that was adopted by the Oregon Commission.

Q. Is the Company's proposal here the same as the one agreed to in Oregon?

A. In some respects it is, but there are some significant differences. Both the Oregon mechanism and the one proposed by Cascade in this docket use the same basic deferral mechanism, include weather adjustments and include new customers at the same margins as existing customers. (This latter provision is acceptable in Oregon, because that state utilizes a future test year, but if adopted in Washington would provide an undeserved windfall to the Company, because of the use of a historic test year.) However Cascade's Washington proposal does not include, as the Stipulation did in Oregon: (a) a shareholder contribution to conservation and low-income programs; (b) a reduction in cost of capital; (c) a well-defined mechanism to deliver energy efficiency -- in Oregon's case, through providing funds to the non-profit Oregon Trust; or, (d) a Company-sponsored evaluation after 3 years. In addition the Oregon agreement does not raise fixed charges (significantly) or advocate using a warmer-than-average weather scenario in its model.

Due to these many differences, our support for the Oregon agreement should not be taken as uncritical support for Cascade's Washington filing. Instead we offer

in the next section a number of changes. However, I should also note that the parties in Oregon found Cascade's representatives to be quite flexible and creative in their negotiations, giving me hope that a mutually agreeable solution can be worked out here as well.

III. NW ENERGY COALITION'S RECOMMENDED DECOUPLING PILOT

Q. Why is the NW Energy Coalition recommending that the Commission defer the implementation of a gas decoupling pilot mechanism?

A. At a time of unprecedented increases in gas and other energy costs, it is imperative that the Company be both encouraged and required to promote reduced energy usage. Without a well-designed decoupling mechanism, Cascade's management is forced into a position where its interests are opposed to those of its customers. However, implementation of a decoupling mechanism before Cascade Natural Gas demonstrates the initiative and ability to deliver aggressive conservation investments, and certain other details are worked out would be "putting the cart before the horse."

One reason we say this is because of a declining trend in residential per-customer use. Decoupling may well provide margin recovery for this attrition - - a windfall compared to current rates. Thus the benefits of increased conservation investments must start at least at the same time if not prior to implementation of decoupling. I discuss this issue further below.

Q. Do you support Cascade's decoupling proposal?

A. We commend Cascade for proposing a decoupling mechanism in this general rate proceeding but believe it must be modified in several important ways if it is to effectively align shareholder and customer interests.

Q. How does Cascade's decoupling proposal address conservation performance?

A. The Company's proposed decoupling mechanism does not require any defined level of conservation achievement. Nor has Cascade put forward for public review a conservation achievement goal or a proposal for cost-effective delivery of energy efficiency services. Perhaps Cascade's conservation record is not impressive because the Company did not have a decoupling mechanism to protect it from lost margins. Cascade's limited conservation investments in Washington to date were summarized by the Company in its response to NW Energy Coalition's Data Request #7. This response is reproduced in the table below. I note that Cascade's "lost margin" revenues from its 2005 conservation program were less than $25,000[2]. Over the eleven year period from 1995 to 2005, lost margin revenues attributable to Cascade's conservation investments total $102,838 or less than $10,000 a year.[3]

[2] 109,385 therms of conservation in 2005 multiplied by a margin of $0.22658/therm.

[3] 453,869 therms times $0.22658/therm = $102,838.

Cascade Natural Gas Company's Washington Conservation Investments

Year	Total Expenditure	Energy Savings (therms/year)
1995	-	-
1996	$ 49,000	127,791
1997	-	-
1998	-	-
1999	-	-
2000	-	-
2001	-	-
2002	$ 5,500	2,205
2003	$ 250,450	99,832
2004	$ 286,750	114,656
2005	$ 272,500	109,385
TOTALS	$864,200	453,869

This long-term history of limited accomplishment is particularly troubling in light of the obligation each utility company has to invest in a least cost resource portfolio for its customers. In its 2004 Integrated Resource Plan (IRP), Cascade performed a less than thorough review of conservation potential. "For purposes of this [2004 IRP] analysis the company utilized the results from the 2002 IRP, adjusted upward to recognize the increase in the long-term forecast of wholesale gas costs and the estimated increase in pipeline transportation costs …[4]" Cascade estimates in its response to NW Energy Coalition Data Request #9 that it will spend approximately $525,000/year on energy efficiency investments in 2006, 2007 and 2008. Using the Company's information from 2005 listed in the table above, I estimate that such an expenditure would result in about 170,000 therms of conservation each year[5].

[4] Page 17, Cascade Natural Gas Corporation's December 2004 Integrated Resource Plan.

[5] $425,000/$272,500 times 109,385 therms.

By way of contrast, Puget Sound Energy (PSE) identified in its 2005 Least Cost Plan the amount of cost-effective natural gas efficiency that is technically available from 2006 to 2025 as 382,239,120 therms. PSE then estimates that 28% or 105,137,410 therms of the conservation that is *technically* available in its service territory is *achievable* over the twenty-year period. Thus if PSE were to invest in 5.25 million therms of cost-effective conservation each year for 20 years, it would implement its achievable cost-effective conservation. Recognizing that PSE's 2005 residential and commercial customer gas sales were almost three times[6] that of Cascade's 2005 residential and commercial gas sales [7], Cascade's customers are missing out on an extremely large reservoir of cost effective conservation which would lower substantially their energy costs.

Although we believe that decoupling is necessary to allow Cascade to aggressively pursue conservation, we cannot support a decoupling pilot until there are: commitments to concrete programs, funding levels for effective implementation, ambitious performance standards, and evaluation plans to accurately measure conservation achievements.

Q. How do you recommend Cascade estimate the conservation potential for its Washington service territory?

A. In order for there to be a fair and timely sharing of the benefits of a decoupling mechanism, Cascade must deliver an aggressive conservation program to its customers. That is not possible until the Company understands the nature of the

[6] Estimated as 630,000 PSE residential customers at 834 therms/customer plus 46,500 commercial customers at 3470 therms/customer.

[7] 237,678,069 therms as reported on page 17 of Cascade Natural Gas Corporation's 2005 Annual Report

conservation resource in its service territory. Before a decoupling pilot is implemented, Cascade should fund a comprehensive review of the conservation potential in the Cascade service territory in the State of Washington.

Q. What other tasks do you recommend be completed before implementation of a Cascade decoupling pilot mechanism?

A. I model my recommendations on the highly successful 2002 Settlement Stipulation between PSE and parties to UE-011570 and UG-011571[8]. Those "Settlement Terms for Conservation" required:

1. Establishment of a conservation program with no sunset date;

2. Establishment of a formal Conservation Advisory Group with a clear mandate to address, but not be limited to: avoided costs, evaluation and measurement protocols, methodology and scope of the conservation potential assessment, market assessments, delivery mechanisms, cost-effectiveness inputs and calculations, mid-course program corrections, appropriate incentive levels for measures and services, issues related to limited income participation in energy efficiency programs, and ambitious yet achievable conservation targets.

Q. Are conservation targets important in a decoupling mechanism?

A. Yes, aggressive conservation targets are a critical component of an effective decoupling mechanism. The Coalition will support a pilot of a decoupling mechanism with Cascade that provides for rate adjustments when sales fall below expected levels

[8] Exhibit F of Settlement Stipulation for Electric and Common Issues and Application for Commission Approval of Settlement on behalf of Parties, Dockets UE-011570 and UG-011571

if and only if it includes ambitious yet achievable conservation targets. This is the key immediate customer benefit of a decoupling mechanism.

Q. What conservation targets do you recommend?

A. Cascade would earn annual fixed cost true-ups when it achieves ambitious yet achievable gas conservation targets consistent with Commission reviewed and approved conservation targets. Commission action would follow recommendations from both the Company and its formal Conservation Advisory Committee. Conservation achievement in each year of the pilot would define the recovery in the following year. I recommend recovery consistent with this table.

Annual Threshold Achievement (Relative to yet to be established Commission approved targets)	**% Recovery of Approved Margin**
150% of stretch	100%
135% of stretch	75%
120% of stretch	60%
Stretch target (to be determined w/ Advisory Group)	50%
Base target (to be determined w/ Advisory Group)	0
75- 90% of base target	Shareholder Penalty of $ _____
Less than 75% of base target	Shareholder Penalty of $ _____

Q. Why do you recommend increased margin recovery for greater conservation achievement?

A. Implementation of a decoupling mechanism eliminates a strong financial disincentive for ambitious investments in cost-effective conservation. But it is important to note that *removing a disincentive is not the same as providing an incentive*. Decoupling is a *necessary* condition for allowing for a change in corporate culture to support efforts to reduce consumption, but it is not *sufficient* in itself. The Company still needs an incentive to ensure that it will aggressively act to fund and operate conservation

programs. “Pay for performance” is a well-respected and effective principle of compensation. Recent Cascade performance and other utilities’ conservation accomplishments and Least Cost Plans indicate there is considerable room for improved conservation performance. Full margin recovery in a decoupling mechanism should require at least 150% achievement of the Commission approved stretch goal. The Commission will need to establish a stretch goal for each twelve month period of the three year pilot that is informed by the Company’s next Integrated Resource Plan and input from Cascade’s conservation advisory committee.

Q. Why do your recommended percentages not go over 100% for superior performance?

A. Evidence from the Cascade system over the past decade shows that average residential customer usage is trending down. Cascade provided information on the average Washington residential customer use in its response to Public Counsel data request #11. Although that data did not adjust for variations in weather, information on “average therm use per customer” and “heating degree days/year” is included on page 17 of Cascade Natural Gas Corporation’s 2005 Annual Report. I divided the average residential customer use by the heating degree days in each of the last three years to determine that the average residential customer use “per heating degree day” is on a downward trend from 0.137 therms per heating degree day in 2003 to 0.136 therms in 2004 and 0.132 in 2005.

Changes in “weather adjusted” commercial general service customer use can be seen in the data but a declining trend is not clear. Average commercial customer use per heating degree day decreases from 0.689 therms per heating degree day in

2003 to 0.672 therms in 2005. However, in 2004 commercial use per heating degree day is 0.696 therms. This lack of a clear trend is one reason we recommend that only residential customers be included in the first pilot.

The reduction in residential usage is probably due to a combination of factors: significantly lower usage of new homes, higher bills, more efficient replacement appliances, and utility- and customer-financed conservation investments. There is no evidence to suggest that this trend will not continue. Under traditional ratemaking in Washington that uses a historic test year, the lost margin from this downward trend would be absorbed by shareholders (until incorporated in a new rate case).[9] Thus *any* recovery due to decoupling goes directly to shareholders, and is over-and-above what they would have received absent decoupling. Any percentage above 0% is an incentive to the Company beyond what it currently receives, and anything over 100% would, in my opinion, be an unwarranted windfall.

Q. Why are shareholder penalties included in your proposed performance chart?

A. If Cascade implements less than the Commission approved conservation target, costs to customers will rise as they will not be being served in a least-cost fashion. Shareholders should pay a penalty of at least as much as Cascade would have spent to implement the "lost conservation." The Commission could review the Company's conservation budget to determine the best level of penalty or use information from

[9] Because Oregon uses a future test year, the downward trend is incorporated into its load forecast. Thus decoupling in Oregon does not produce a windfall due to attrition. That is one reason we did not insist on treating new customers differently in the Oregon settlement.

another utility as a proxy.[10] Any penalty dollars paid by Cascade should be used to hire a third party to implement an amount of energy efficiency equivalent to this "lost conservation."

Q. Isn't it "penalty enough" for the Company not to recover a share of "lost margin?"

A. No, for three reasons. First, if the Company is not delivering targeted cost-effective conservation to its customers, it is costing customers money, and it is appropriate for shareholders to pay for these services to be delivered by a third party or a redoubled Company effort. Second, there may be years when there is little or no lost margin, depending on other events that affect usage. Thus a penalty for failure to meet minimum targets is appropriate. Finally, as was explained in a response to a previous question, *any* share of lost margin is more than the current regulatory treatment provides.

Q. What customer classes, i.e. rate schedules, should be included in the decoupling mechanism? Why?

A. The Company proposed a decoupling mechanism to apply to all customers served under Schedule 503 (Residential General Service) and Schedule 504 (Commercial General Service). We recommend that only the residential customers on Schedule 503 be included in the initial piloted decoupling mechanism.

Q. Why do you limit decoupling to residential customers?

[10] For example, Puget Sound Energy budgets $12.2 million to implement 4.2 million therms of cost-effective conservation (UG-060267/UE-060266, Exhibit___(CES-5). This means that Puget Sound Energy expects to spend on average $2.9 million for each million therm of conservation.

A. Larger customers' bills are dominated by the commodity cost, so lost margin is much less an issue for them. Also, it is difficult to set a baseline usage for these customers, in that they are much more liable to change usage suddenly due to their own business conditions. Finally, their usage is usually not weather-related, so adjusting for weather provides no benefit. Small customers are the most important for inclusion in the pilot program. The NW Energy Coalition would be open to considering the inclusion of small commercial customers, whose usage is similar to residential customers, but the merit of including additional customer groups in the decoupling mechanism is better considered when the initial pilot is reviewed. This is particularly true given the weather adjusted commercial general service customer use summarized earlier in my testimony does not exhibit a clear downward trend.

Q. Does Cascade's proposed decoupling mechanism appropriately address margin adjustments for new customers?

A. No. The Company's proposed gas decoupling mechanism freezes the margin per customer at a level based on historical usage despite clear information to the contrary. The average usage of new customers is dropping for many reasons - - improved building codes, improved appliance efficiency, a tendency for gas to be installed in multi-family condominiums where use per customer is dramatically lower, installation of heat pumps, etc. The Company's responses to Public Counsel data requests 11 through 13 indicate that the average use of residential customers "new to Cascade's system" is significantly less than the 672 therms average residential customer use in 2005. Residential customers new to Cascade's system in 2003 used

on average 553 therms/year in 2005; those new to the system in 2004 used on average 451 therms/year in 2005. Given that the trend of declining use per customer has been experienced for many years, there is no reason to make any assumption other than that this trend will continue downward.

A properly structured decoupling mechanism must take new customer use into account for each participating customer class so that the margin generated by the mechanism will be equal to that which would be generated under conventional regulation. New customers are subject to a Line Extension Policy and that policy requires them to contribute, in the form of a Contribution in Aid of Construction, an up-front payment to the Company to the extent their average use is insufficient to generate incremental margins to cover incremental Company costs. If new customer margins are fixed at the higher, historic level within the decoupling mechanism, the Company will, in effect, collect twice for the lower usage of new customers - - first through the up-front line extension payment and again in the decoupling adjustment. For this reason, the Company's proposal must be modified.

The Coalition proposes that for each one-year period, the Company would collect for existing customers the margin revenue per customer authorized in its most recent general rate case. In addition, the Company would be permitted a different margin revenue for new customers (new service connections) in participating customer classes. These "new service connection" figures would reflect: a) the fact that average new customer use is considerably less than that of existing customers; and b) the cost assumptions embedded in the Company's existing line extension policies.

Another acceptable alternative would be to exclude all new service connections from the annual decoupling true-up calculations between rate cases so as to avoid over-collection of margin from new service connection customers. One way or the other, it is critical that the treatment of "new customers" in the Company's proposed decoupling mechanism be modified.

I note that the amended decoupling petition Avista proposed to the Commission on August 7th in UG-060518 includes refinements that adjust for "new customer" usage. In fact, the amended Avista decoupling pilot adequately addresses all of the substantive issues, except weather, I have raised in this testimony.

Q. How and when should the benefits of the inclusion of weather variability in Cascade's pilot decoupling mechanism be shared between the Company and its customers?

A. Conventional wisdom would say that Cascade's cost of capital should decline to the extent a weather decoupling mechanism is approved by the Commission. This is especially true for weather-related elasticity for natural gas utilities. Conventional wisdom also recognizes, and supports, the purpose of "regulatory lag" which rewards a utility between rate cases for actions that lower its costs. If all reductions in cost were immediately reflected in lower rates, utilities would have little incentive to be creative or risk investing in cost-cutting initiatives. Balancing the incentive of regulatory lag, however, is the principle of cost-based rates. Customers should not have to pay more than reasonable and prudent costs any longer than is necessary to provide utilities the incentive to reduce costs.

These concerns lead to questions such as: "Will the cost of capital decline, and, if so, when?" And, "If it does, how and when shall any reduced costs be shared between shareholders and the different customer classes?"[11]

Q. Are you aware of evidence that the financial markets recognize the value of decoupling, particularly weather-related decoupling?

A. Yes, the Christensen report[12], evaluating the Northwest Natural Gas decoupling mechanism, specifically cited the weather-related decoupling as a basis for Standard & Poor's (S&P's) assigning a risk profile rating of "1" (the lowest risk profile applicable to any utility). According to S&P, a one-step reduction in the risk profile equates to about a 3% reduction in the required equity capitalization ratio to maintain any given bond rating.[13] This makes intuitive sense since without weather decoupling, a gas utility needs more equity to carry it through warm years without dipping into retained earnings to pay dividends. With decoupling, a gas utility needs less equity to do this.

Q. How might a change in equity structure result in cost savings?

A. We use the idea from Standard and Poor's Revised Financial Guidelines to approximate some cost savings a utility could realize, for example, if it were to modify its capital structure and reduce its common equity. I am not familiar enough with Cascade's capital structure so I repeat here the example I included in my July

[11] For example, because this pilot would only target residential customers, it might be appropriate to target any cost-of-capital savings to only the residential class. But that is the subject of a future rate case.

[12] Christensen Associates Energy Consulting, "A Review of Distribution Margin Normalization as Approved by the Oregon Public Utility Commission for Northwest Natural," March 31, 2005. (4610 University Ave, Suite 700, Madison, WI 53705-2164 (206-231-2266)

[13] Standard & Poor's, "New Business Profile Scores Assigned for U.S. Utility and Power Companies; Financial Guidelines Revised, 02-June-2004.

19th testimony in the 2006 Puget Sound Energy General Rate Case[14]. With Puget Sound Energy 's current 43% equity capital structure , its after tax cost of capital (COC) is 7.013% as calculated in the table below.

Current Capital Structure	COC	Weighted Av COC	After Tax COC
43% Common Equity	10.3%	4.429%	4.429%
0.7% Trust Preferred	8.54%	0.060% x 0.65 =	0.039%
3.75% Preferred Stock	7.61%	0.285%	0.285%
2.68% Short-term Debt	6.19%	0.166% x 0.65 =	0.108%
49.87% Long-Term Debt	6.64%	3.311% x 0.65 =	2.152%
TOTAL PSE Cost of Capital			7.013%

Reducing common equity to 42% by increasing long-term debt to 50.87% would reduce the weighted average "after tax" cost of capital above to 6.954%. At Puget Sound Energy's requested rate base of $1.179 billion, this would reduce the Company's annual costs by roughly $1.1 million:

Requested Rate Base	$1,179.0 million
Return at 43% (rate base x 7.013% /.0.6207) =	$ 133.2 million
Return at 42% (rate base x 6.954% / 0.6207) =	$ 132.1 million
Cost Savings from 1% change in capital structure =	$ 1.1 million

If Puget Sound Energy were to "phase in" to a 40% equity structure over a three-year period, annual cost savings would increase from roughly $1.1 million in 2007 to $3.3 million in 2009. I would expect the same relationship to exist for Cascade, but the cost savings would be smaller because Cascade's rate base is significantly smaller than Puget Sound Energy's. To the extent cost savings such as these could be realized, they could be shared with customers at no cost to shareholders or bondholders, creating a true "win-win." This is an example of the type of "win-win"

[14] UG-060267 and UE-060266, Exhibit ____ (SDW-1T, pages 19-20).

results we hope will emerge if a decoupling mechanism that includes weather is piloted.

Q. Does the Coalition have a recommendation?

A. Yes. The Coalition's expertise is not utility financing, so we do not have a specific recommendation on cost of capital, ROE adjustments or capitalization structure. We do recommend that the Commission require and review a thorough, independent evaluation of the decoupling pilot, including its effect on the Company's cost of capital. We propose that the Company fund that evaluation. The Commission should approve a process by which Cascade works with interested Parties to this proceeding to determine the timing and scope of the evaluation and choice of consultant. Renewal or expansion of the pilot could only occur as part of a general rate case proceeding. Should the Company file a general rate case prior to the conclusion of the pilot, an evaluation of the financial impacts should be conducted at that time. The evaluation will inform the best sharing of any benefits of decoupling between shareholders and customers.

Absent a pilot decoupling mechanism that includes weather adjustments, Cascade's customers may forego substantial savings indefinitely that might result from a reduction of the Company's cost of capital. In that world no one wins. We encourage the Commission to create a decoupling mechanism that includes adjustments for weather.

Q. Would the NW Energy Coalition support a decoupling mechanism that does not include an adjustment for weather variability?

A. Yes, we would support a more limited pilot. However, we emphasize that any pilot should not begin until: (1) Cascade establishes a formal conservation advisory committee that reviews a comprehensive, company funded conservation potential assessment; and (2) the Commission approves a schedule of aggressive annual conservation targets for each twelve month period of the three year pilot pursuant to the recommendations of that advisory committee. The Commission-approved decoupling mechanism must include a schedule of ambitious conservation targets to incent cost-effective energy efficiency investments. And it must appropriately and fairly adjust for "new customer use" that is different than that of existing customers.

IV. MISCELLANEOUS PROPOSED FEE INCREASES

Q. Cascade is proposing to raise a number of other charges, including meter tampering, short-notice locate, disconnection, reconnection, account activation, equipment service and late payment charges. Do you agree with these changes?

A. A. We have no opinion regarding the meter tampering or short-notice locate charges.

For safety reasons it would be very poor policy to raise the equipment service charge, because it might make customers hesitate to call the Company if they suspect a problem.

We disagree with raising the disconnection, reconnection, account activation and late payment charges as proposed by Cascade. These increases are excessive and unduly burdensome on low and fixed income customers. The size of these charges should be limited and the interest rate charged on overdue balances should be limited to the Company's cost of capital.

A better way to deal with lost revenues due to these situations is to have robust bill-payment assistance programs, low-income conservations programs and sensitive, problem-solving customer service representatives. Simply increasing charges to low-income customers who are having difficulty paying their bills is not effective. We recommend no change in the current charges until a thorough study is done of alternative ways to control these costs. The study should be submitted as part of Cascade's next general rate case proceeding. That timing is ideal since we expect the Company to have both bill-payment assistance and low-income-focused conservation plans in operation.

V. CONCLUSION

Q. Please summarize the intent of your overall testimony.

A. The main goal of the Coalition in this proceeding is to align the interests of consumers and shareholders in order to encourage and empower consumers to participate in both utility and non-utility measures that cost-effectively reduce gas usage. The results will be good for both the economy and the environment. Decoupling does this in a comprehensive manner that helps change corporate culture. Decoupling has the additional benefit of reducing a utility's margin recovery volatility. This can translate into a lower cost of capital, thus saving customers' money.

However, the devil is in the details. As David Moskovitz, founder of the Regulatory Assistance Project and author of several decoupling mechanisms, has put it:

2. Get the policies right;

3. Get the structure right;

4. Get the numbers right.

A decoupling proposal that fails to account for the trend in lower usage per customer of both existing and new customers can provide an unwarranted windfall profit. A decoupling proposal that has no concrete commitments and incentives for conservation is also inadequate, because removing a negative incentive is not the same as providing a positive one. A decoupling proposal that fails to cap adjustments can harm customers, especially those with low incomes, in the event a warm winter is followed by a cold one. We believe our proposal addresses these and other pitfalls while preserving the positive benefits of decoupling.

Q. Please summarize your specific recommendations for a decoupling mechanism to be approved by the Commission in this case.

A. The Coalition recommends that the Commission approve the following modifications to the proposal outlined by the Company:

1. A three-year pilot to begin only when the Commission approves the recommendations of a formal conservation advisory committee regarding conservation acquisition mechanism(s) and an ambitious schedule of conservation targets, including those for low-income customers, identified pursuant to a comprehensive, Company-funded conservation potential assessment.

2. The pilot can only be extended as part of a general rate case proceeding. Any deferral balance in existence at the end of the three-year period would be amortized over the next 12 months until it is reduced to zero.

3. The pilot mechanism would apply to Schedule 503 (Residential General Service) only.

4. Margin recovery is for both weather and other non-weather factors that impact customer use.

5. For each one-year period, the Company would collect for existing customers the margin revenue per customer authorized in its most recent general rate case. In addition, the Company would either:

    (1) collect a different margin revenue for new customers (new service connections). These "new service connection" figures shall be based on a forecast of use and would reflect: a) the fact that average new customer use is considerably less than that of existing customers; and b) the cost sharing embedded in the Company's existing line extension policies; or

    (2) exclude all new customers (new service connections) from the decoupling mechanism until they are incorporated as a part of a Commission decision in a new general rate case proceeding.

6. If the Company's margin revenues in a given year exceed those calculated in (5) above, the surplus plus accrued interest is credited back to customers the following year without limitation through a reduction in the per-therm rate.

7. If the Company's margin revenues in a given year are less than those calculated in (5) above, Cascade Natural Gas would receive annual fixed cost true-ups, through an increase in the per-therm rate amortized over the following year, when it achieves ambitious yet achievable gas conservation

targets consistent with a Commission approved recovery schedule structured on the framework below. Conservation achievement in each twelve month period of the pilot defines the eligibility for recovery of any margin shortfall in the following twelve months.

Annual Threshold Achievement (Relative to yet to be established Commission approved targets)	**% Recovery of Approved Margin**
150% of stretch	100%
135% of stretch	75%
120% of stretch	60%
Stretch target	50%
Base target	0
75- 90% of base target	Shareholder Penalty of $
Less than 75% of base target	Shareholder Penalty of $

8. Penalty levels for failure to meet conservation targets should be sufficient to hire a third party to implement "lost conservation."

9. Annual rate adjustments pursuant to this pilot mechanism are limited to a 3% maximum.

10. The Company will fund an independent evaluation of the pilot decoupling mechanism. The Commission will define a process by which Cascade works with interested Parties to this proceeding to determine the timing and scope of the evaluation and choice of consultant. Should the Company file a general rate case prior to the conclusion of the pilot, the evaluation of the financial impacts should be completed for review in that proceeding.

11. Monthly customer charges for residential service customers should not be increased prior to the end of the decoupling pilot program. The Coalition holds

that implementation of a full decoupling mechanism should result in customer charges being reduced to "disappearing minimum bills."

12. An inverted block rate design should be implemented for the volumetric charges for the residential general service class consistent with Public Counsel's testimony by Jim Lazar (Exhibit ____JL-1T)..

13. Other rate class customer charges should be increased by no more than the percentage increase approved for each class, respectively.

14. For safety reasons any equipment charge should be minimal, if at all.

15. No increases in the current charges for disconnection, reconnection, account activation and late payments should be implemented until a thorough study is done of alternative ways to control costs associated with these items. Robust low-income programs are a more cost-effective way to control these costs as shown in the 2002 evaluation of the Oregon Energy Assistance Program attached as (Exhibit ___SDW-3).

16. A full $800,000, plus any additional tax credits or benefits received by the Company pursuant to the delivery of this amount of rate assistance, should be directed to low-income bill-payment assistance programs in a manner consistent with that proposed by the Energy Project's expert witness, Chuck Eberdt (Exhibit___ CE-1T).

Q. Do your recommendations align with guidelines issued by this Commission?

A. Yes. We appreciate the Commission's clarifying earlier this year (Section IIC of Orders 04 and 03 pursuant to Pacificorp's Dockets UE-050684 and UE-050412,

respectively) the specific information, at a minimum, that it would need to review before any decoupling mechanism might be approved. That list included:

- Analysis of implementation costs and its impact on the company's overall revenues and cost of equity;
- Identification of incremental conservation measures expected to be implemented;
- Development of a target for energy conservation to be achieved through this mechanism relative to the baseline conservation programs currently in rates and the Company's Integrated Resource Plan.
- Scope of risk to be covered by the mechanism;
- Scope of fixed costs included;
- Customer classes to be included and whether the baseline would be on an individual or class basis;
- Complete detail of the accounting for and calculation of any true-up;
- Rate of return implications;
- Method of cost recovery;
- Design of pilot test period and evaluation of the mechanism before determining whether to make it permanent;
- Timing and calculation of rate adjustments;
- Impact of new customers on revenue recovery under the mechanism;
- Impact of the mechanism on low-income customers.

We believe that the Commission's list is comprehensive and that our modifications to the Company's proposal are responsive to them.

Q. Does this conclude your testimony?

A. Yes.