Draft Evaluation Plan for Avista Natural Gas Decoupling Mechanism

Avista, Commission Staff, and other interested parties (Parties) have prepared this "draft evaluation plan" for Avista's natural gas decoupling mechanism (Mechanism), as referenced in the Settlement Agreement, included as Appendix A to Order No. 04 (Order) in Docket UG-060518. On page 10 of the Order, paragraph 33, the Commission states: "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." (We can also cite to paragraph 26, finding of fact 7). The Parties use this excerpt from the Order as guidance in the development of this draft evaluation plan and present this plan as a ~~"work in progress" that can be revised as additional issues and/or questions arise during the pilot term of the Mechanism~~ starting point for an independent evaluation of the Mechanism. The next step will be to establish a process to select an independent evaluator.

A decoupling mechanism is intended to remove the alleged disincentive to ~~further~~ promote additional conservation by breaking the link between sales volumes and the recovery of fixed costs (margin) through volumetric sales rates. This draft evaluation plan includes two primary areas of emphasis. First and foremost, the effect of the Mechanism on the company's natural gas Demand Side Management (DSM) program(s) should be fully examined. Second, the "mechanics" of the Mechanism, as well as related information should be reviewed and evaluated. This draft evaluation plan is primarily comprised of a number of questions within these two broad categories that, when answered with the appropriate detail by an independent evaluator, will allow the Commission ~~and other Parties to objectively evaluate the~~to fully examine the Mechanism. The evaluation will focus on objective, factual determinations.

~~On or before March 31, 2009, the company may file a request to extend the term of the Mechanism. Should the company request to extend the term of the Mechanism, the company will submit an~~Whether or not the company requests an extension of the ~~term~~decoupling mechanism, the independent evaluation Report and supporting workpapers ~~of the Mechanism~~ will be filed with the Commission no later than March 31, 2009, allowing concerned parties an opportunity to discover, analyze and respond to the reported facts in support of their position regarding decoupling continuation. ~~at that time, which will provide answers to the questions below. The evaluation should provide the Commission and other interested parties with information to assist in the determination if it is in the public interest to extend the term of the Mechanism and, if so, any changes to the Mechanism that may be appropriate. If the company does not request an extension of the Mechanism, the company will provide the Commission with an evaluation following completion of the pilot term.~~ [Public Counsel note: We think the timing of a filing for extension will need to be revisited to allow the Commission and parties sufficient opportunity to review the final evaluation report.]

Comparison of Margin Lost to Company Sponsored DSM Versus Amount Subject to Recovery via Decoupling

Paragraph 26 of the Commission's Order No. 4 states the key evaluation point – the relationship between "margin lost to company sponsored DSM" versus "the amount subject to recovery." This analysis must be done with care because the "amount subject to recovery" is probably larger than just the decoupling deferrals and also would include any recoveries resulting from the recently settled 2007 rate case, in which baseline margins were updated. The timing of base rate changes will influence when baseline recoveries of lost margins occur (through base rates) and the cumulative impact of baseline updates and deferrals should be combined and compared to margins lost due to utility sponsored DSM. Therefore, the evaluation should focus upon the combined recoveries of margin through updating of baseline values in rate cases as well as the deferrals booked under the decoupling authorization.

In addition, also related to this key evaluation point, the comparison of "margin lost to company sponsored DSM" should include only margin losses from DSM programs for Schedule 101 customers. Thus, margin losses arising from industrial and large commercial DSM programs, as well as any DSM programs for commercial customers not on Schedule 101, would be excluded.

The Evaluation Will be Conducted by an Independent Third Party and Will Not Retained by the Company

All parties agree that the evaluation should be conducted by an independent third-party. The evaluator should have the qualifications described below. Of critical importance, the evaluator should not be retained by Avista and should not have previously performed work on behalf of Avista. The preference of the parties is for the Commission to solicit proposals, select an evaluator with input from the parties, and retain an evaluator. If that is not feasible, the parties agree that _______ will retain the evaluator, and will be reimbursed by Avista for the costs of the evaluation. Avista will not seek recovery of evaluation costs from ratepayers.

The evaluator will have the following key qualifications:

- Core objective of firm is evaluation (vs. regulatory consulting, e.g.). membership in evaluation association.
- No previous working history with Avista.
- No stated position on decoupling by any firm employees, either in favor or against.
- An ability to analyze energy consumption and accounting data, as well as DSM data.

The parties propose the following process and timeline to issue an RFP, review proposals, and select an evaluator. The proposal should include, at a minimum, the following information:

- Proposed budget and timeline for project completion, including submitting draft and final reports.
- Proposed budget and budget narrative.
- Staff who would work on the proposal, including lead author(s), and description of their qualifications.
- Description of the extent to which the firm meets the key qualifications described above.
- References form organizations that have received similar work (minimum 3).
- Samples of prior work.

Proposed Timeline:

May 15, 2008 – Issue RFP

June 15, 2008 – Proposals Due

June 30, 2008 – Parties Meet to Determine Top 2-3 Candidates to Interview

July 15 – 30, 2008 – Representatives from Parties Interview Top 2-3 Candidates

August 15, 2009 – Parties Provide Joint Recommendation to the Commission for approval. In the event Parties are not able to reach agreement, they will make separate recommendations to Commission.

September 1, 2008 – Commission Selects/Approves Evaluator

DSM

Did the company increase its natural gas therm savings through company-sponsored programs over the term of the Mechanism? If not, why not? *~~See comment below for next issue.~~*

Did the company increase the scope or magnitude of its natural gas DSM programs during the term ~~as a result~~ of the decoupling mechanism? What incremental program offerings or expansions were implemented during the term of ~~attributable to~~ the mechanism? *~~How do we know whether incremental program offerings and/or achieved savings can be attributed to the decoupling mechanism?~~ Identification and discussion of other factors that may contribute to Avista's decision to expand the scope or magnitude of its DSM programs, and achieved DSM savings. For example, program design changes such as increased rebate levels, or higher avoided costs, may result in greater customer participation and savings. The evaluation should discuss whether it is possible to determine if incremental program offerings and/or achieved savings can with certainty be attributed to the decoupling mechanism.*

How does Avista's DSM program offerings, and achieved savings, compare with that of Puget Sound Energy, both prior to and during the Pilot period? The comparison should include annual data regarding natural gas DSM program expenditures and therm savings achieved, with customer count information. PSE does not currently have a natural gas decoupling mechanism. This may be information that the Commission Staff can review/provide.

What were the annual audited DSM savings for 2006 – 2008? *And 2009, if data is available. Were there any significant issues regarding the timing of achieved savings that may skew results, such as completion of a major industrial project?(To the extent therm savings from industrial customers are included, a breakdown should be provided to separately show the amount of savings from Avista's "derating" process).*

What were the total revenues collected from ratepayers under the gas tariff rider, by schedule, to fund gas DSM programs beginning in 2006 and through the Pilot period?

How did the Company's DSM savings compare to its IRP goal(s)?

What were the company's WA DSM savings by customer class (residential, commercial, industrial).

Was/i~~I~~s the latest IRP goal still the appropriate DSM incentive to use for the Mechanism? ~~*No comment at this time.*~~

Were there issues with the third-party DSM audit(s)? ~~*No comment at this time.*~~

Was the relationship between the annual level of lost margin recovery and incremental DSM savings reasonable? ~~For the future?~~ *Please clarify what Avista is proposing to examine here – what specific data would be examined, and what is meant by the phrase, "for the future?" This question relates to the table where the level of lost margin recovery is based on the percentage of target DSM savings achieved, shown on Schedule 159A of our decoupling tariff.*

[This explanation sounds to me to say what is being considered is whether the level of lost margin recovery is appropriately tied to the % of target achieved. I want to know how the total funds recovered through this mechanism compares to the total lost margin from the company sponsored energy efficiency in the applicable classes. – CE]

Mechanism mechanics and other information

What was the monthly, annual, and cumulative total of ~~fixed costs recovered~~ revenue deferred for recovery through the decoupling mechanism during the pilot term? How does the amount compare to preliminary estimates developed prior to implementation of the Mechanism?

What was the approximate ~~Company's annual~~ earnings impact of the recorded revenue deferrals ~~change~~ as a result of the pilot?

What was Avista's ~~overall annual~~ recorded ~~gross~~gas margin revenue beginning in 2006 and throughout the Pilot period, before and after recording decoupling deferrals?

What was the total amount of decoupling surcharge revenue collected from ratepayers each month and year during the Pilot period? What was the bill impact for customers? What was the total amount of interest accrued under the mechanism?

What was the amount of lost margin due directly to Company sponsored DSM efforts (installations) since inception of decoupling - compared to the amount of lost margin revenue deferrals calculated under the Mechanism~~?~~ *What was the amount of lost margin due directly to Company sponsored DSM programs for each customer class (residential, commercial, industrial)?* ? **[This last question is not really very informative, since C & I rate schedules are not subject to the mechanism. It would be more informative to know how the reductions that the mechanism collects on correspond to the trends in the various rate classes and where the utility is spending their DSM budget. That is, the mechanism collects based on changes in consumption in the (primarily) residential rate schedules. 1) How does the revenue collected compare to the revenue lost from utility sponsored energy effieciency in that sector? But also 2) how has consumption in the other sectors changed (given the same restrictions regarding new customers, etc., to make the comparison on equal footing)? And 3) how do these effects relate to the Company's allocation of DSM funding by rate schedule? – CE] [Public Counsel note: As described above in the front section, and as Chuck suggests, this analysis must look at achieved therm savings from DSM programs by rate Schedule, so the lost margins from Schedule 101 can be isolated.]**

Were there any issues associated with:

- The annual rate adjustment filing?
- The earnings test?
- The DSM test?
- Calculation of the monthly deferral?
- The 2% annual rate adjustment limitation?

New Customer Adjustment and Recovery of Fixed Costs

The evaluation should also consider trends in total gas margin revenues (actual and weather normalized) to determine the extent to which margin gains arising from new customers is offsetting any margin losses from lower usage due to conservation or price elasticity effects. The evaluation should examine what the impact would have been, had the mechanism been designed to ensure that total margin revenues (after weather normalization) do not grow or decline from rate case approved levels, as compared to the 'partial' decoupling pilot mechanism, which analyzes margin revenues on a usage per customer basis.

What was the impact of the new customer adjustment within monthly decoupling deferral calcuations? Did the adjustment increase or decrease annual deferrals and surcharge revenues, and by how much?

What was the level of gas customer growth during the Pilot period, and how does this compare to Avista's historical levels of gas customer growth and the national average? **[What additional fixed costs has the Company incurred to meet this additional growth? Does the revenue recovered from those customers cover the incremental fixed costs the Company incurred? If not, why not? - CE]** *What is the forecast for future customer growth?*

On a customer class basis, how has ~~natural~~ weather normalized gas use per customer changed during the pilot term of the Mechanism? *How have overall sales volumes changed during the Pilot period, and total sales volumes by customer class? How have overall revenues changed during the Pilot period, and revenues by customer class?*

What has been the change in natural gas rates during the term of the Mechanism?

How many general rate cases has Avista filed during the Pilot period?

What is the forecast for natural gas rates/prices and use per customer in the future?

What is the forecast for overall sales volumes and sales volumes by customer class in the future?

~~Based on the overall evaluation of the Mechanism, does it make sense, and is it in the public interest, to extend the term of the Mechanism? If so, with what (if any) changes should be made to the Mechanism?~~ *This issue is not appropriate for the evaluation process. Once the evaluation is complete, each interested party can then make its own recommendation based on the results of the evaluation and any other analysis or research.*

Evaluation Should Focus on Objective, Factual Determinations

The evaluation plan, and the evaluation itself, should focus on objective factual determinations and not impressions gleaned from management or stakeholder interviews regarding potential "culture change" or perceived shifts in management attitudes at Avista. Such issues are inherently subjective and not verifiable.

~~*Has the company's "corporate culture" and operating practices changed toward conservation? Were there organizational and/or public message changes that can be attributed to this mechanism?*~~ **[Can the Company demonstrate more aggressive outreach for energy efficiency in the rate classes affected by the mechanixm? – CE]**

~~*Interview key stakeholders and vendors regarding Company behavior and attitude toward efficiency and delivery of DSM programs and services.*~~

Financial measures – were there any financial effects to the utility from the new policy? This includes credit-rating agencies' reports and ratings; change in stock prices, etc.

[How does the revenue recovered affect the Company's overall rate of return?]

Comparison of Gas and Electric Usage Per Customer Trends

A stated goal of the decoupling mechanism is to remove the disincentive to further promote additional conservation by "breaking the link between sales volumes and the recovery of fixed costs (margin) through volumetric sales rates." These same considerations apply to the electric utility business, yet Avista has not proposed decoupling for their electric operations. The evaluation should analyze similar data from Avista's electric operations (e.g. sales volumes, usage per customer, and margin revenue data).

The Evaluator Should Not Make a Recommendation Regarding Continuation of the Mechanism

The evaluator should not make a recommendation regarding continuation of the mechanism.

[Public Counsel note: If the evaluator makes a recommendation regarding continuation the evaluator then becomes an advocate, which skews their work and the relationship between the evaluator and the parties. The Commission's Final Order was very clear that there are potential advantages and disadvantages to decoupling. The decision about whether the mechanism should continue will be decided by the Commission, and will be made within a context much broader than the evaluation, as part of a general rate case. As reflected in the Commission's Order 4, that decision involves consideration of various issues, interests, and core ratemaking concepts, such as the matching principle. As such, it is beyond the scope of the evaluation to weigh these factors and make a recommendation regarding continuation.]