EXHIBIT NO. _____ (SDW-4T Rebuttal)
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 CORP.,** **Respondent.**	**Docket No. UG-060256**

REBUTTAL TESTIMONY OF STEVEN D. WEISS ON BEHALF OF THE NW ENERGY COALITION

September 12, 2006

NW ENERGY COALITION

REBUTTAL 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 ("Coalition"), 219 First Ave. South, Suite 100, Seattle, WA 98104.

Q. Did you file direct testimony in this proceeding?

A. Yes, as Exhibit No. ____(SDW-1T).

Q. Please summarize the contents of your rebuttal testimony.

A. Section II describes a number of central disputes in this docket regarding decoupling as a general concept. In Section III, I outline the sub-issues that must be decided to implement decoupling with the purpose of developing a compromise that will resolve those disputes. Section IV focuses on the direct testimony of Michael L. Brosch, Exhibit No. ____(MLB-1T), appearing on behalf of the Washington Attorney General – Public Counsel Section; and Section V on the direct testimony of Joelle R. Steward, Exhibit No. ____T (JRS-1T), on behalf of the Washington Utilities and Transportation Commission (WUTC) Staff regarding their comments about the Conservation Alliance Plan proposed by Cascade Natural Gas (CNG).

II. DECOUPLING FROM 10,000 FEET

Q. Please explain your intent for this section of your rebuttal.

A. I would like to put aside for the moment a focus on the particular mechanism proposed by CNG, and the modifications proposed by Staff. Instead I want to discuss decoupling from the 10,000 foot level. By that I mean decoupling as a general concept. Of course the details matter. They can turn a good concept into a bad program. But first it is useful to discuss decoupling in general.

Q. What do you see as the fundamental goals that decoupling is meant to provide?

A. First, to remove the utility's incentive to increase commodity sales so that management across the utility can actively support energy efficiency; and second, to reduce the utility's risks.

Q. Do the other parties in this case agree with this assessment of the goals?

A. Yes, I believe they do, though of course they disagree in various ways on both: (a) whether or not those goals are worth the costs and risks decoupling may bring; and, (b) on the various details of particular decoupling mechanisms.

Q. Regarding the first goal—removing the utility's incentive to increase sales—do all the parties believe it is important?

A. Three of the four parties that have testified on decoupling (CNG, Staff, and ourselves) have strongly supported this goal. Public Counsel witness Brosch, however, argues that, "CNG has little influence over gas usage per customer…"(Exhibit ____ (MLB-1T), p. 17), and that with high prices, "Cascade has little choice but to promote the efficient use of natural gas." (Exhibit ____ (MLB-1T), p. 37) In addition, he believes regulators could mandate that the utility pursue conservation and establish direct incentives for it to do so, so decoupling is not needed. He clearly does not indicate

that changing corporate culture is a strong enough reason to incur what he believes are many downsides to decoupling.

The other three parties, however, argue that utilities' efforts to encourage and implement conservation are crucial factors in helping customers conserve, and that decoupling is the best way to change corporate culture and align the Company's interests with customers. They agree that narrow conservation incentives are positive ways to incent the utility to fund demand side management programs. However, only if shareholders are not hurt by reduced sales can the Company really have its heart in promoting conservation—not just through its conservation programs, but also through its entire business role in customer service, education, public information and lobbying efforts. They also point out that the third option for addressing the goals—high fixed charges—has undesired consequences.

Q. What are the parties' positions regarding the second goal—reducing the utility's risk?

A. Two of the parties—Staff and Public Counsel—are silent on this issue and do not seem to think it is an important goal of decoupling, although they do recognize reduction of the Company's risk as an outcome of decoupling. Their focus is on how decoupling might shift that risk to customers. That is, they believe risk is a zero-sum game and that if the utility has less risk, customers must have more.

CNG and the Coalition argue that reducing the utility's risk is an important benefit for customers. Risk, especially the volatility in margin recovery caused by non-normal weather, increases the utility's cost of capital. Since that cost is paid by customers, reducing this cost is a customer benefit that decoupling should bring

regardless of any other effect. That is, even if decoupling were not important for the encouragement of conservation, it should still lower customers' costs at the next rate case.

Q. At this 10,000 ft. level, disregarding for the moment all the details that must be decided to approve an actual mechanism, what are the Parties' positions on decoupling?

A. CNG, Staff and NW Energy Coalition all strongly support decoupling as a concept. All three agree that breaking the link between the Company's profit and sales is an important goal that is best accomplished through decoupling. In addition, CNG and the Coalition view the reduction in the utility's risk due to decoupling as another significant customer benefit. Staff is silent on this latter issue. Public Counsel, however, opposes decoupling.

Q. Please discuss what you see as Public Counsel's reasons for its opposition.

A. Most of Mr. Brosch's opposition to decoupling stems from his skepticism of the benefit of *any* automatic adjustment between ratecases, as much as it is directed against decoupling in particular. Mr. Brosch explains in detail why he believes a general rate case is the best place to make changes in rates, and why any exceptions to this rule should only be, "where there is compelling evidence that piecemeal ratemaking is in the public interest." (Exhibit ___ (MLB-1T), p. 10) He goes on to say that the case for decoupling does not surmount this hurdle.

Q. Why is Mr. Brosch opposed to automatic adjustments?

A. Since Mr. Brosch labels automatic adjustments regulatory "sweeteners" that would "systematically disadvantage ratepayers" (Exhibit ____ (MLB-1T), p. 19) by shifting

costs and risks to ratepayers, I conclude that Mr. Brosch believes automatic adjustments more often result in rate increases than decreases. Mr. Brosch's testimony basically follows this line of reasoning:

a) All automatic adjustments harm customers; therefore,

b) Decoupling must harm customers because it is an automatic adjustment.

c) For any automatic adjustment such as decoupling to be acceptable, it must meet an extraordinary hurdle; but,

d) Because the goals of decoupling aren't too important, it doesn't meet the test.

Q. What do you see as the flaw in this argument?

A. His first premise—all automatic adjustments harm customers—is unsupported by evidence. Of course an automatic adjustment can be poorly designed so that it is asymmetrical and tilts to favor shareholders. In fact I argue that the Conservation Alliance Plan proposed by CNG is currently poorly designed for that very reason: it favors the Company. But that is not an indictment of decoupling in general, only a call to amend the proposal so that it is symmetrical.

Mr. Brosch points out that CNG's proposal favors shareholders, because it fails to take into account that new customers' use is lower than existing customers' use and is trending downward. Staff and I have come to the same conclusion. But instead of offering ways to fix the proposal (as Staff and I have done), Mr. Brosch takes it as evidence that decoupling itself is flawed as a concept. He takes CNG's proposal as evidence that decoupling is harmful to ratepayers, instead of seeing it simply as evidence of a poorly-designed proposal.

Q. Please summarize your recommendation for the Commission on the 10,000 ft. look at decoupling.

A. All parties except for Public Counsel support decoupling. Public Counsel's skepticism toward decoupling is based mainly on a general distaste for automatic adjusters. That skepticism is valuable to emphasize the importance of a well-designed mechanism that does not tilt against customers, but is not warranted as a credible argument against decoupling as a general concept. I recommend that the Commission conclude that decoupling can be a significant benefit to ratepayers that could enjoy broad support from the Parties, but only if it is well-crafted and balanced, and not just a "sweetener" for shareholders.

III. Getting Down into the Details (That Can Make or Break The Proposal)

Q. If the Commission decides that decoupling is a good idea as a general proposition, what implementation issues should it be examining?

A. Parties have discussed a number of aspects of CNG's proposal with which they took issue and in some cases suggested changes needed to secure their support. The main issues include:

a) How should the mechanism deal with new customers?

b) Should the mechanism include a weather adjustment?

c) What classes should be included in this pilot?

d) What commitments should be expected from CNG regarding conservation and low-income programs?

e) What should be the fixed charge?

f) What should be the conditions for revision, extension and expansion of the program?

Q. What is your intent, in this section, as you discuss each of these issues in turn?

A. My intent in this section is not to present arguments on the issues. Instead it is an effort to develop a compromise that may be acceptable to most of the parties. The Coalition proposes this compromise as a package.

Q. Do you believe the parties have such large disagreements on these implementation issues that there is no possibility of creating a compromise that is acceptable to all?

A. Not for the three parties--CNG, Staff and the Coalition--that support decoupling generally. As I discuss each in turn I will suggest a compromise position that I believe can satisfy those three. As for Public Counsel, its position is not clear on every issue, but where it is, I have taken its opinion into consideration as well.

Q. (a) Why is the treatment of new customers an issue?

A. Evidence was offered by several witnesses to show that new customers' usage, especially for residential customers, was systematically lower than existing customers. Because of that fact, CNG's proposal, which does not differentiate between the two, would lead to a higher rate than would occur without decoupling. A complication was also discussed: the company's main extension policy might partially or completely confound this issue because it already provides some margin recovery from new customers whose use is forecasted to be lower than would be needed to recover sufficient Company costs.

Q. What solutions have been offered for this issue?

A. Staff proposed that a different (lower) margin for new customers be incorporated into the decoupling adjustment. Staff proposal is to assume that new residential customers use 50 therms/year less than existing customers. (JRS-1T, p. 12) Staff is silent on the specific adjustment for small general service customers. I proposed two alternatives. The first is that a separate margin should be used for new customers, but it is premature to set an appropriate margin in this proceeding without more investigation. Instead I propose that a Commission-authorized workgroup develop an acceptable approach to addressing new customers, taking into account an estimate of their use and the cost assumptions embedded in the Company's existing line extension policies. My second alternative was simply to exclude new service connections from the decoupling true-up until they can be incorporated in the next general rate case.

Q. Having read all the testimony on this issue, what do you suggest as a reasonable compromise?

A. I would suggest my second alternative: simply leaving new customers out of the mechanism—at least for this pilot period. I recommend this option because the issue is contentious and deserves more investigation--particularly if the pilot includes both residential and small general service customer classes. My suggestion would be to address this issue as part of a general evaluation of the program at the end of the pilot, leaving open the option to include new customers if the program is renewed.

Q. (b) Should weather be included as one of the adjustment factors?

A. Unfortunately, there is no easy compromise that I can see on this issue. Either weather is included, or it is not. Both the Company and the Coalition favor including weather, while Staff and Public Counsel do not. It must be noted that for a gas utility,

weather-caused load swings are the largest uncontrollable risk besides gas cost, so including weather is probably the most important issue for CNG in this discussion. And, because weather is so risky for the company, removing that risk is most likely to lead to a lower cost of capital, a major benefit of decoupling for customers over the longer term.

However, there is reason to be more optimistic about a compromise if one looks closely at the reasons for Staff and Public Counsel's opposition. All parties agree that a weather adjustment itself is symmetric and does not, over the long run, lead to either higher or lower rates. Instead, the issue is that a weather adjustment would cause increased and unacceptable bill volatility. The problem is that Cascade's limited billing system cannot do a real-time adjustment such as NW Natural's WARM decoupling mechanism in Oregon.[1] If adjustments cannot be made on each monthly bill that reflects that month's usage and adjustment, a deferral is generated that is returned to customers at a later date—in CNG's proposal, it is amortized over the following year. The concern is that if a warmer-than-normal winter were followed by a colder-than-normal winter, bills in that second year would be higher than they would be without decoupling. And in a cold winter, that would be an added burden for customers. (Of course, it must be noted that this event would occur only

[1] A variation of the WARM proposal was offered by Joelle Steward in Puget's docket UE 060266/UG 060267 Exhibit ___(JRS-9T), p. 12:

> [T]he current energy charge could be broken down between true fixed and variable costs components. The true variable costs, i.e., gas commodity costs, could be billed on metered volumes and the fixed cost energy component billed on weather normalized volumes. Both of these methods eliminate the need for multi-million dollar deferrals, and stabilize both the Company's earnings and customer bills.

If this mechanism could be accommodated by CNG's billing system, it would solve the problem, but because it is fairly similar in structure to WARM, it is probably not possible for CNG's system.

one-fourth of the time, on average. The other possibilities—warm followed by warm; cold followed by cold; cold followed by warm—are not cause for customer concern. Under the first possibility, two years of warm weather will have resulted in significantly lower bills due to lower use; under the other two possibilities, customers will have received rebates that they would not have received under current rates. Customers can also protect themselves by signing up for the bill-averaging plan.)

Q. What do you recommend as a compromise to deal with this issue?

A. Including weather is worth quite a lot to customers due to its potential to lower the Company's cost of capital. Therefore, to not include weather because of the one-in-four possibility of a warm winter followed by a cold one should not be the first choice. Instead we recommended that a 3% rate change cap be applied to the weather surcharge. In the case that a decoupling adjustment would require a surcharge greater than the cap, the amount above the cap would be further deferred until the next year. We further recommended that the Commission examine this mechanism during the evaluation of the pilot.

An alternative to the cap could be modeled after a feature of CNG's Oregon decoupling mechanism. In that state, rather than a cap, the Commission reviews the surcharge adjustment amount each year and can decide to spread it out over more than just the next year. With this review, the Commission can then take into account other factors such as recent rate changes for other reasons, economic conditions, etc. in deciding how any surcharge should be applied. The parties in Oregon felt that providing this flexibility to the Commission was the best way to deal with this issue. We would also support this type of approach for CNG in Washington.

Q. (c)What classes should be included in the pilot?

A. The Coalition appears to be alone in advocating limiting this first pilot to residential customers. This is not a critical issue for us: we suggested it because we believe in a cautious approach toward any new mechanism. However, we would be willing to accept the inclusion of other customers as recommended by CNG and Staff, and revisit its appropriateness as part of the general evaluation.

Q. (d) What commitments should be expected regarding conservation and low-income programs?

A. Ms. Steward, testifying for Staff (Exhibit ___ (JRS-1T), pp. 19-20) proposes a solution regarding conservation that we could support, with some modifications. She recommends that Staff convene a working group of interested parties that would develop a conservation plan for the Company based on the consultant's survey of conservation potential that is expected to be completed this fall. Included in the plan would be timelines for issuing RFPs and for program implementation and annual benchmarks for program achievement. She also proposes that the Company would need to meet these benchmarks each year in order to recover any deferral balance from the decoupling mechanism. The Company would have to file this plan and targets within three months of the final order in this proceeding.

We recommend that, in addition to the above, the plan include incentives and penalties for conservation achievement like those discussed in my direct testimony Exhibit No. ___(SDW-1T), p. 11. Finally, we recommend that the decoupling mechanism not be implemented until the Commission approves this conservation plan. We are confident that details can be worked out by the Parties. And, given the

assurance of lost margin recovery, CNG has given every indication that it will enthusiastically participate in the development of programs.

In regard to low-income programs, we support and defer to the testimony of The Energy Project.

Q. (e) If decoupling is implemented, what should be the Company's monthly basic service charge?

A. The Company is proposing to raise its basic residential service charge during the six heating season months from $4 to $10 per month. The Company also proposes doubling the monthly fixed charge in other customer classes, including rate schedule 504, small general service. The Coalition, Staff and Public Counsel oppose significant increases to this charge. CNG provides no real evidence in support of its proposed change; but more important, with decoupling this change is not needed to help the Company recover its margin. The decoupling mechanism will compensate the company and customers for any under- or over-recovery. And raising the basic service charge more than recommended by Staff reduces the marginal price signal seen by customers to too great an extent. For that reason it is less encouraging to conservation, so is opposed by Staff, Public Counsel and the Coalition. The Coalition can support the Staff's recommendation of small increases in this charge.

Q. (f) What should be the conditions for revision, extension and expansion of the program?

A. This is a pilot program. It is therefore very appropriate to require a thorough evaluation before it is revised, extended and/or expanded. In particular, I recommend that the following (incomplete) list of questions be investigated by a competent third

party that has experience with decoupling programs (see also Ms. Steward's list in Exhibit No. ___(JRS-1T), pp. 15-16):

a) Should its application to various customer classes be extended or restricted?

b) Should new customers be included in the decoupling mechanism? If so, what is the best way to include them?

c) Have service levels been affected?

d) Have customer complaints been significant?

e) Has there been any affect on the Company's financial standing and cost of capital?

f) Should weather not be included (or be added if not in the pilot)?

g) Has there been a change in Cascade's conservation performance?

h) Has there been a change in Cascade's corporate culture regarding conservation?

i) Can the mechanism be improved to reduce administration costs or to reduce the size of deferrals without compromising other goals?

j) Is the cap on adjustments (if included) appropriate?

k) On balance, is the program fair to customers and the Company?

Q. Should the mechanism be limited to three years?

A. Yes. We concur with Ms. Steward's reasoning (Exhibit ___ (JRS-1T), pp. 16-17) that decoupling addresses the level of revenue, but not the level of costs, so a rate case is needed after a few years. I recommend that the pilot only be extended (and/or revised) in a general rate case. In addition to the reasons cited in Ms. Steward's testimony, cost of capital issues will be raised, if, as expected, the financial markets treat this program favorably. The program should not be extended unless the benefits

of the reduction in risk are shared with customers. That discussion can only take place in a rate case.

Q. Please summarize your recommendations of the compromises on these implementation issues that you believe will satisfy most of the Parties.

A. I believe this package of recommendations, when taken together, is an acceptable compromise that most parties could support. To summarize:

a) New customers should not be included in the mechanism for the pilot, but the evaluation of the pilot should recommend whether or not, and on what terms, they should be included if decoupling is extended.

b) Weather should be included. As soon as CNG's billing system can allow for a real-time adjustment, that mechanism should be adopted. However, in the interim, the Commission should either: (i) implement a 3% annual cap on any surcharge due to decoupling and allow the Company to defer excess surcharges to the subsequent year; or, (ii) commit to annual reviews of surcharge adjustments to determine if any should be spread over a longer timeframe than just the subsequent year.

c) CNG's proposal to apply the mechanism to residential and small commercial customers should be adopted.

d) The Company should work with interested parties to develop and file within 3 months of the final order in this proceeding, for approval by the Commission, an energy efficiency plan that includes targets and incentives/penalties, based on the study that Cascade has commissioned whose report is expected this fall. The Company would need to meet benchmarks in order to recover deferral balances.

f) There should be no significant increase in the basic service charge for any customer class included in the decoupling pilot.

g) An independent third party should conduct a thorough evaluation of the pilot, working with interested parties to develop the criteria for evaluation. The pilot should be limited to three years and only be extended or revised as part of a general rate case.

Q. What is the purpose of your remaining testimony?

A. My remaining testimony is a more detailed response to testimony of Michael Brosch and Joelle Steward. While it is necessary to rebut their testimony in some detail, it is my hope that the Commission will focus on the compromise package that I have just discussed.

IV. Response to Direct Testimony of Michael L. Brosch

Q. Please give your interpretation of the general thrust of Mr. Brosch's direct testimony in Exhibit No. ____(MLB-1T).

A. Mr. Brosch opposes what he characterizes as "piecemeal rate adjustment tariffs for isolated elements of utility revenue requirements in the absence of compelling evidence that such piecemeal rate adjustments are warranted." (Exhibit ____ (MLB-1T), p.3) For that reason, and because he believes such compelling evidence has not been presented, he opposes the specific investment tracking and decoupling mechanisms CNG has proposed.

Q. Will your rebuttal testimony address the investment tracker (SRIAM)?

A. No, I am commenting only on Mr. Brosch's testimony regarding decoupling.

Q. What arguments does Mr. Brosch employ to justify his conclusion?

A. Mr. Brosch makes a number of points, but I will address in turn what I view as his two main arguments. First he argues that traditional regulation achieves a "balanced" (p.3) measurement of revenue requirements and "symmetrical risks and opportunities" (p.16) that are fair to the utility and customers, so changes are generally unwarranted. His second argument is that "CNG has little influence over

gas usage per customer volumes…" (p.17), so the problem caused by the utility's incentive to increase throughput is minimal; and in any case, any lost margins are made up by new customers arriving on the system.

Q. As to his first argument, do you agree that the traditional regulatory scheme achieves a balance of interests between shareholder and customer interests, and provides symmetrical risks and opportunities to the two sides?

A. Mr. Brosch makes a fairly convincing argument that shareholder and customer interests are well-balanced *within* the rate case process, because *all* of the factors related to revenues and rates are simultaneously analyzed. In particular, he makes the point that there are often balancing factors present that mitigate rate adjustments that could not be identified in a tracking mechanism. However, there is one asymmetry in rate cases that Mr. Brosch neglects to mention. Ratepayers fund all the utility's witnesses, lawyers and analysts, while intervenors must rely on their own resources.

Mr. Brosch is less convincing, however, when he argues that *between* rate cases, "Symmetrical risks and opportunities arise for utility ratepayers and shareholders as a result of regulatory lag, because favorable and unfavorable changes in revenue requirement can produce over or under-earnings outcomes until either the utility **or some other party** initiates a new rate case." (p.16, emphasis added)

Q. What do you see as the flaw in this argument?

A. His assertion that the opportunities and risks between rate cases are symmetrical for customers and shareholders is unsubstantiated by any evidence, and in my experience is not borne out in practice. The key flaw in his argument lies in the fact that under current ratemaking, *the ability to initiate a rate case is not symmetrical*. Instead, it is

tilted strongly in favor of the utility. Under current practice, it is very difficult, or virtually impossible, for any party other 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 a couple of "show cause" proceedings that I know of in the past two decades or so. I am not as familiar with Washington, but I believe that Commission- or intervenor- initiated proceedings to reduce rates are all but unknown here as well. 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 revenue, 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. It will never want that review when its costs have declined (or revenues increase) such that earnings have increased. Therefore, contrary to Mr. Brosch's assertion, regulatory lag is very much to a utility's advantage. It is interesting to note that Cascade has not initiated a general rate proceeding in more than 10 years.

Q. How would a decoupling mechanism favor customers?

A. Decoupling doesn't add to the existing utility advantage; in fact it provides some advantages to customers that wouldn't otherwise exist. 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. Instead, the benefit would flow to shareholders because it is simply not true that "some other party" can readily initiate a rate case.

Often those who oppose trackers or other automatic adjustments such as decoupling will cite examples or scenarios where rates would rise without regulatory oversight, but forget that a properly engineered tracker can and should be symmetric, so that it will also result in rate decreases—which generally would not happen under traditional regulatory lag because no rate case would occur. In conclusion, *if* regulatory lag were symmetrical, Mr. Brosch's point would carry some weight. But given how difficult it is for any party except for the utility to initiate a rate case, a well-designed automatic adjustment can provide real benefit to customers. That is because, besides fulfilling other policy goals, a well-designed automatic adjustment can *lower rates when traditional ratemaking would not*.

Q. Do you share Mr. Brosch's generally skeptical view of automatic adjustments?

A. No. Skepticism is warranted, of course, because one can design a tracker that is not fair. But instead of attacking all automatic adjustments, Mr. Brosch should focus on what makes particular adjustments beneficial to customers or not.

Q. What elements make for a fair adjustment?

A. On p.14 of his direct testimony, Mr. Brosch lists five attributes that must be present before he could recommend a tracker or automatic adjustment. I generally agree with them, but would add one more critical element: Adjustments must be symmetric so that net rate impacts over the long term are no more than would have occurred without the mechanism.

Viewed in this light, CNG's proposed decoupling mechanism is not poor policy simply because it's an automatic adjustment; rather it is a poorly-designed mechanism because it does not produce symmetric results. Our critique and

recommendations regarding CNG's proposal are detailed in my direct testimony. The main problem we saw was that the declining usage trend—mostly due to new customers—was not taken account of properly, thus resulting in a windfall to the Company that would not occur absent the mechanism. We recommended changes to fix this problem. I would note that Mr. Brosch's testimony supports that critique. The difference being that he takes that as further evidence that all automatic adjustments are harmful to customers; we suggest fixes that make the mechanism symmetric. Of course without these fixes, our opinion on Cascade's proposal would be just as negative as Mr. Brosch's.

Q. What is Mr. Brosch's other major argument against CNG's decoupling proposal?

A. Besides his general opposition to automatic adjustments that I address above, Mr. Brosch's second argument is more particular to gas utilities. In essence his argument is that decoupling is unnecessary. He states that, "CNG has little influence over gas usage per customer volumes…" (p.17), so removing the Company's incentive to increase throughput is unimportant. Admitting that "utility shareholders will generally benefit when sales volumes increase between test periods and are harmed when sales decline," (p. 36) he argues that management will still encourage conservation:

> …in this era of high-priced natural gas, conservation measures are necessary to attract new customers and to retain existing gas utility customers that may otherwise elect alternative energy sources such as electricity when appliances are being installed or replaced. Cascade has little choice in this environment but to promote the efficient use of natural gas. (p.37)

Q. How do you respond?

A. As indicated in my direct testimony (Exhibit ___ (SDW-1T), p. 16), Cascade's history demonstrates that Mr. Brosch's argument is false. Management has not encouraged conservation in the face of the loss to the bottom line that success would bring. The potential in CNG's territory is not insignificant, as I demonstrated in my testimony pp. 16-17. Part of securing the Company's enthusiastic interest in establishing and meeting aggressive but achievable conservation goals is to ensure that its profits are not threatened by that action. That is what decoupling is all about.

In addition, Mr. Brosch underestimates the impact of a large utility in affecting non-conservation-program policies that incent customers to reduce usage: appliance standards, building codes and zoning, tax policies, public education, market transformation, regulatory policies (such as planning criteria), etc. It is my experience that utilities can be very formidable opponents to enacting and encouraging such policies; just as their support can be crucial.

Q. Mr. Brosch also argues that shareholders really aren't at much risk from conservation, so decoupling is not needed. Do you agree?

A. No. He states that there are, "…productivity gains elsewhere in the business to offset the gradual effects of changing sales volumes " (p. 36). The flaw in this argument is that Mr. Brosch fails to focus on the *marginal* earnings effect from reduced usage. Certainly, productivity gains or other offsetting revenues might make up for earnings lost from conservation, but that does not mean that each therm sold or not sold goes straight to the Company's bottom line. Decoupling can change corporate behavior and culture by removing that disincentive. It is not just a way to give the company

more earnings. In fact, as we have pointed out, a well-designed mechanism will be *symmetrical* and, in the long run, have no effect on earnings directly—though it may reduce the utility's cost of capital by removing volatility.

III. Response to Direct Testimony of Joelle R. Steward

Q. Please give your interpretation of the general thrust of the direct testimony of Joelle Steward in Exhibit No._____ (JRS-1T).

A. First I should note that I will only address Ms. Steward's testimony related to decoupling. In that part of her testimony Ms. Steward supports the goals of decoupling generally, but recommends rejection of CNG's proposal unless it is modified in several ways: (a) it should not include weather; (b) new customers, having below-average usage, should have a different margin adjustment; (c) the decoupling mechanism should be limited to three years; (d) there should be a cap on annual rate changes; (e) the margin rate calculated each year should be based on normal weather, rather than 10% warmer than normal as proposed by Cascade; and, (f) CNG must file an energy efficiency plan within three months of the final order that has timelines, benchmarks and targets, the achievement of which is required in order to continue the decoupling mechanism. (Exhibit ___ (JRS-1T), p.6)

Q. Do you agree with her recommendations?

A. Our recommendations in this docket are similar to many of her points. We agree with her proposal to treat new customers differently, however we note that her suggested 50 therm reduction in annual use for new residential customers should be a 50 therm reduction for each year's cohort of new customers; not a blanket 50 therm per year

reduction for all new customers over the life of the three year pilot. We concur with her recommendation for a three-year pilot and a cap on the level of surcharge that could be imposed each year. We also propose efficiency targets, incentive levels and penalties, and Ms. Steward's testimony, while not specific, seems to allow for that to be included in the conservation planning process she proposes. My most significant point of disagreement is regarding her position on weather-related adjustments, and that is the subject of the remainder of my comments here.

Q. Why does Ms. Steward oppose including sales variations due to weather in the decoupling mechanism?

A. Ms. Steward makes two related arguments. First, "Including weather…results in more **rate volatility** for customers." (p. 7) Second, she states that, "Staff does not see good cause to shift risk to customers through reduced **rate stability** by including weather effects in order to increase revenue stability for the Company." (p.7, emphasis added)

Q. Regarding her first point, does Ms. Steward present any evidence to back up her claim that including weather results in more <u>bill</u> volatility for customers?

A. No. Ms. Steward seems to think that customers care about *rate* stability, and rates would be more volatile under a decoupling mechanism that includes weather. But what she neglects to point out is that customers pay bills, not rates. A customer's *bill* is quite different from a customer's *rate*. A bill, apart from any fixed charge, is calculated by multiplying the rate by the use. And use is very much dependent upon the weather. The beauty of (the weather part of) decoupling is that the same weather that causes use to increase (cold), causes the rate adjustment to be negative, thus

making the overall rate lower. When multiplied together, the bill is reduced from what it would have been without decoupling. On the other hand, when the weather is warmer than normal, usage goes down, but the rate adjustment is positive, making the overall rate higher. So when the rate and use are multiplied together, the bill is higher than what it would have been without decoupling. The net result of decoupling is therefore to *reduce bill volatility*. Bills are lower in cold winters and higher in warm ones, resulting in less variation than without decoupling. If the weather is colder than normal, decoupling prevents customers from over-paying; when it is warmer than normal, it prevents customers from under-paying. That's why it reduces revenue volatility to the utility.

Q. Doesn't that smoothing effect of weather adjustments only happen if the adjustments are done in real time such as in NW Natural's mechanism?

A. NW Natural's billing system can adjust each bill each month to reflect the elasticity of above or below-normal weather, and is thus a perfect weather hedge, or swap, for both customers and the utility. I do not think, however, that Cascade's billing system can do that at this time. Until such time as the Company's system can accommodate such a mechanism I propose a second-best alternative in my direct testimony (Exhibit ____ (SDW-1T), p. 11). The alternative is to spread each year's adjustment over the entire subsequent year, and implement a cap of 3% to protect against a severely warm winter followed by a cold one.

Q. What is Ms. Steward's second point?

A. Her second point is that customers should not absorb risk through reduced rate stability *just to increase revenue stability for the Company*. I have already addressed

her statement that a weather adjustment causes reduced *bill* stability, but will discuss the second part of this argument. Evidently Ms. Steward believes that increasing revenue stability for the Company is of little or no value to customers. However she provides no evidence to support this statement. Reducing revenue volatility for the Company should decrease its cost of capital. Cost of capital is paid for by customers just like any other cost. My direct testimony thoroughly discusses this issue on pp. 25-28. Disregarding the opportunity to cut a utility's cost is a disservice to customers. My testimony demonstrates that a weather adjustment need not increase bill volatility, and that there may be additional benefit to customers to the extent it reduces the utility's cost of capital. Following Ms. Steward's recommendation not to include a weather adjustment in the decoupling mechanism would waste a significant opportunity to reduce costs at no harm to consumers.

Q. Does this conclude your testimony?

A. Yes.