Exhibit No. ___T (JRS-4T)
Docket UG-060256
Witness: Joelle Steward

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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

RESPONSE TESTIMONY OF

JOELLE R. STEWARD

STAFF OF WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Natural Gas Decoupling

September 12, 2006

I. INTRODUCTION

Q. Please state your name and business address.

A. I am Joelle Steward. My business address is 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA 98504.

Q. Have you previously offered testimony in this proceeding?

A. Yes, I filed testimony on behalf of Commission Staff on natural gas decoupling, rate spread and rate design.

Q. What is the purpose of your cross-answering testimony?

A. I respond to the testimony of Steven Weiss (NW Energy Coalition) and Michael Brosch (Public Counsel) on the decoupling mechanism, and I present a revised rate spread proposal.

II. DECOUPLING MECHANISM

Q. Please summarize Mr. Weiss's testimony on behalf of NWEC on decoupling.

A. Mr. Weiss recommends that the Commission defer implementation of a decoupling mechanism for Cascade until energy efficiency improvements are worked out by a formal advisory committee and approved by the Commission. Further, he recommends the following for any decoupling mechanism the Commission approves: it should 1) include weather effects; 2) apply to only residential customers; 3) adjust for new customer use that is different than that of existing

customers; 4) tie recovery of any deferral to achievement of conservation exceeding a stretch target; and 5) cap annual rate adjustments to three percent.

Q. Do you have concerns about Mr. Weiss' testimony regarding decoupling?

A. Yes. I disagree with: 1) his contention that including weather effects in decoupling decreases the customer's bill volatility; and 2) his proposal tying recovery of margin to efficiency achievement exceeding a savings target.

Q. First, please discuss your concern with Mr. Weiss's contention that including the effects of weather in his proposed decoupling mechanism decreases bill volatility.

A. In his testimony, Exhibit No. ___ T (SDW-1T), on page 6, lines 3 through 6 and on page 10, lines 8 through 10, Mr. Weiss implies that including weather effects in his decoupling proposal stabilizes customer's bills on a real-time basis. In fact, he states, "From a 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."[1]

His proposal, however, actually increases the likelihood of customer bill volatility because it involves the use of deferred accounting. Mr. Weiss's proposal, like Cascade's, addresses weather and associated earnings volatility through an accounting means—a deferral mechanism. The customer is still billed the basic charge and commodity charges based on actual metered volumes (actual weather).

[1] Exhibit No. ___ T (SDW-1T) at 10:8-10.

Cascade then makes a two-sided accounting entry on its books to reflect revenues as if weather was normal. The customer's bill is unchanged, but only for now.

As an example, in a warm year Cascade would book additional revenue to reflect normal weather with an offsetting entry to its balance sheet to reflect a receivable (deferral account) from customers to pay back the next year. Now, assume the next year is colder than normal and a higher rate is put in place to collect last year's under-collection. Not only is the customer's bill higher because of colder weather, but he is also paying a higher rate on increased volumes to make up for last year's underpayment.[2]

Q. Are you opposed to any weather stabilization mechanism?

A. No, I'm not opposed, if benefits to both customers and Cascade can be realized. I believe Mr. Weiss's contention that stabilizing both the customer's bill and Cascade's earnings could be a win-win situation. However, Cascade's and Mr. Weiss's revenue deferral proposals do not achieve both objectives.

Q. Are there ways to achieve both objectives?

A. Yes. Rate designs that reflect actual fixed and variable costs would achieve both objectives. Weather normalized billing could also achieve both objectives (although there are many implementation issues).

[2] Mr. Weiss does cap the recovery of any surcharge to three percent, but this still increases the customer's bill volatility and is magnified when the recovery year is colder than normal.

Q. How would a rate design that better reflects fixed and variable costs achieve these goals?

A. More fixed costs would be collected through monthly basic charges and less through the variable energy charges. I discuss this type of rate design in my direct testimony on page 9. This rate design would stabilize both the Company's earnings and reduce the customer's bill volatility.

Q. How might weather normalized billing achieve both goals?

A. Basic and energy rates could remain as is; however, the current energy charge could be broken down between true fixed and variable costs components. The true variable costs, i.e., gas commodity, 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.

Q. Do you recommend that the Commission adopt either one of these methods at this time?

A. No. I believe my proposal for increases to the customer charge, along with my recommendation on gas decoupling, is an appropriate move in the direction to help resolve both objectives outlined above. Staff's response case attempted to resolve the goal of eliminating the disincentive by the Company to promote conservation and to minimize any customer bill impacts by eliminating weather from the deferral. My goal with the partial decoupling mechanism is to remove the disincentive for

conservation and allow Cascade recovery of fixed costs from the test year regardless of changes in customer usage. These goals can be accomplished without including weather effects in the mechanism.

Q. Next, please discuss your concern with Mr. Weiss's proposal to tie recovery of deferrals to conservation achievement beyond the target.

A. Mr. Weiss proposes a tier structure that ties recovery of margin to the achievement gas savings exceeding not just a base target but a stretch target for conservation savings. Staff's goal with the partial decoupling mechanism is to remove the Company's disincentive to pursue conservation by restoring lost margins. The Company would be indifferent to any programmatic or customer-pursued efficiency efforts. Creating a high threshold for recovery of margin deferral may be counter-productive to the goal of removing the disincentive for conservation because the value of higher revenue from increased usage that still exists may exceed the incremental value of partial margin recovery through his mechanism.

Making the Company indifferent to conservation is not the same as creating an incentive to pursue more conservation. However, requiring the Company to establish a savings target based on the study underway, and setting benchmarks to be achieved each year in order to recover any deferral balance, is sufficient. Creating incentives can lead to unintended consequences with an added burden to verify savings.

Q: What kind of unintended consequences could result?

A: I am concerned about several potential unintended consequences. First, setting the target may become very contentious by creating a temptation for the Company to set the target below what it expects to achieve.

Second, as with any type of incentive mechanism, there is an added burden to verify the savings. The timing of the mechanism may not allow adequate time to do this.

Additionally, NWEC's proposal includes no provision for cost-effectiveness or for the budget required to achieve the savings exceeding the "stretch" goal. These costs are passed on to ratepayers. We need to look at the savings and costs together. To put forth an "incentive" to achieve 150 percent of the target without any consideration of the costs or some cost-containment provision, is reckless.

Q: Please summarize Mr. Brosch's testimony on behalf of Public Counsel on decoupling.

A: Mr. Brosch recommends that the Commission not approve Cascade's proposed decoupling mechanism, the Conservation Alliance Plan (CAP), because it constitutes piecemeal ratemaking that is not warranted by extraordinary circumstances. More specifically he argues that the mechanism: 1) does not account for increasing margin revenues associated with adding new customers; 2) departs from the traditional "holistic test year" approach for establishing just and reasonable rates; 3) discourages the regulatory lag incentive for the utility to pursue productivity gains to optimize

earnings between rate cases; and 4) would create a significant burden on Staff and other concerned parties to administer.

Q: Are these concerns you share with Mr. Brosch?

A: In part, yes, and that is why I have proposed an alternative partial decoupling mechanism that is more constrained than Cascade's proposed CAP. My proposal addresses some of Mr. Brosch's concerns by making an adjustment for new customers to reflect their actual revenue, which then mirrors traditional regulation for new customers, and by limiting the mechanism's implementation to three years in order to minimize the potential mismatch of revenues and costs over time. However, I would disagree that the mechanism I propose presents a significant departure from the traditional test year approach or removes the Company's "incentive" to pursue productivity gains. It is also not a significant burden to administer for Staff.

Q: Please explain why your partial decoupling mechanism is not a significant departure from the traditional approach of taking a balanced review of all ratemaking elements at a common point in time to determine a revenue requirement.

A: Decoupling does rely on a balanced review in a rate case of the cost to serve and revenues at a point in time, i.e., the test year. The Commission determines a revenue requirement in a rate case. How that revenue requirement is recovered is a product of pricing. The Commission's pricing policy has placed most of the fixed cost recovery (*e.g.*, margin) on volumetric rates. This was intended to provide a price

signal to customers that would encourage and reward conservation. The flip-side of this policy is that for the Company to ensure that it is going to recover the revenue requirement the Commission sets in the rate case (*e.g.*, its costs to serve), the Company must find operational efficiencies and/or maintain or increase customer usage. The latter creates a disincentive to encourage conservation. Decoupling allows us to align the Company's recovery of the costs that were authorized in a rate case to the same regulatory goal to encourage conservation by customers through pricing.

Q. Do you think there are compelling circumstances in the industry right now to support decoupling?

A. Yes. As I discussed in my response testimony, the unprecedented rise in gas costs is sufficient reason for the Commission to re-evaluate its regulatory framework. In the last three years, Cascade's customers have seen gas costs go up 32 percent. There is no indication that these commodity costs will decline any time soon. There is a compelling public interest to do all we can to help customers combat these rising costs and possibly mitigate on-going gas price volatility. Removing the Company's incentive to encourage sales is one step.

Q. How does your partial decoupling mechanism retain the Company's incentive to pursue productivity gains?

A. The more the Company can reduce its operating costs below the authorized revenue requirement the Commission sets in a rate case, which is the baseline for calculating

authorized revenue in Staff's partial decoupling mechanism, the more it can maximize its earnings. This incentive is the same with or without decoupling.

Q. Lastly, will your partial decoupling mechanism be a significant administrative burden for Staff?

A. No. Staff has a lot of experience in handling deferred accounting. Annual review of the mechanism is expected to take somewhere between 15 to 30 hours of an analyst's time.

Q. Does this conclude your response to NWEC and Public Counsel on decoupling?

A. Yes.

III. RATE SPREAD

Q. Do you have revisions to your testimony on rate spread that appeared on page 22 in Exhibit No. ___ T (JRS-1T)?

A. Yes. As a result of the errata filed by Dr. Mariam for his testimony on cost of service, I have revised Table 4 on rate spread below to reflect his revenue to cost ratios.

Revised Table 4

Customer Class	Schedule	Percent of Average Increase
Residential	503	100%
Res/Com Dry-out	502	50%
Res/Com Air Conditioning	541	150%

Commercial General	504	125%
Com/Ind Large Volume	511	75%
Compressed Natural Gas	512	25%
Industrial Firm General	505	125%
Interruptible General	570	75%
Interruptible Institutional	577	75%
Transportation	663	0%
Transportation Large Vol	664	75%

Q. Does this conclude your response testimony?

A. Yes.