BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,

Complainant,

v.

AVISTA CORPORATION d/b/a AVISTA UTILITIES,

Respondent.

DOCKET NOS UE-090134 & UG-090135 (*consolidated)*

---

In the Matter of the Petition of

AVISTA CORPORATION, D/B/A AVISTA UTILITIES,

For an Order Authorizing Implementation of a Natural Gas Decoupling Mechanism and to Record Accounting Entries Associated With the Mechanism

Docket No. UG-060518 (*consolidated)*

# DIRECT TESTIMONY OF MICHAEL L. BROSCH (MLB-1T)

ON BEHALF OF

PUBLIC COUNSEL

**AUGUST 17, 2009**

DIRECT TESTIMONY OF MICHAEL L. BROSCH (MLB-1T)
DOCKET NO. UE-090134, UG-090134 and UG-060518

## TABLE OF CONTENTS



## CHARTS



## EXHIBIT LIST

## I. INTRODUCTION AND SUMMARY

**Q. Please state your name, employer, and present position and role in the case?**

A: My name is Michael L. Brosch. My business address is PO Box 481934, Kansas City, Missouri 64148-1934.

**Q: By whom are you employed?**

A: I am a principal in the firm Utilitech, Inc., a consulting firm engaged primarily in utility rate and regulation work. The firm's business and my responsibilities are related to special services work for utility regulatory clients. These services include rate case reviews, cost of service analyses, jurisdictional and class cost allocations, financial studies, rate design analyses and focused investigations related to utility operations and ratemaking issues.

**Q. On whose behalf are you appearing in this proceeding?**

A. I am appearing on behalf of the Washington Attorney General – Public Counsel Section (Public Counsel). Utilitech entered into a contract with Public Counsel to review and respond to the Petition of Avista Corporation (Avista or Company) to continue the existing pilot decoupling mechanism (Decoupling or Mechanism). The petition was consolidated with the Company's filing for an increase in its electric and gas rates and revenues.

**Q. Will you summarize your educational background and professional experience in the field of utility regulation?**

A. Exhibit No.___ (MLB-2) is a summary of my education and professional qualifications. I have testified before utility regulatory agencies in Arizona,

Arkansas, California, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Michigan, Missouri, New Mexico, Ohio, Oklahoma, Texas, Utah, Washington and Wisconsin in regulatory proceedings involving electric, gas, telephone, water, sewer, transit, and steam utilities. Exhibit No.___(MLB-3) is a listing of the testimony I have submitted in regulatory proceedings since 1978. In Washington I have testified in several telecommunications matters including Sprint's spinoff of its local telecommunications division (UT-051291), US West rate cases (UT-950200, UT-970766), the US West/Qwest merger (UT-991358), the most recent Verizon rate case (UT-040788) and the regulatory accounting for, and later sale of Qwest's directory publishing business (UT-98048 and UT-021120). I also presented testimony in several non-traditional energy ratemaking proposals including the rate adjustment clause proposals recently advanced by Puget Sound Energy (UE-060266 and UG-060267) that included its "GRNA" decoupling proposal and the Cascade Natural Gas Company (UG-060259) decoupling proposal.

**Q. Have you previously participated in energy utility regulatory proceedings?**

A. Yes. I have participated in many electric and gas regulatory proceedings, as listed and described in Exhibit No.___(MLB-3). While much of my experience involves traditional rate increase or rate reduction cases, I have also addressed rate adjustment clause tariffs as well as deferral accounting proposals on many prior occasions.

**Q. What is the purpose of your testimony in this docket?**

A. My testimony is intended to respond, on behalf of Public Counsel, to the proposal of Avista that the Commission continue, on a permanent basis with minor modification,

the decoupling mechanism that was implemented as a pilot project in Docket No. UG-060518. My testimony explains why Avista's proposed continuation of the decoupling mechanism should be rejected by the Commission and how alternative measures could be developed to more directly and proportionately encourage and reward utility investments in energy efficiency measures in place of decoupling.

**Q: What exhibits are you sponsoring in this proceeding?**

A: Aside from my qualifications Exhibit Nos. ___ (MLB-2) and (MLB-3), I am sponsoring no other exhibits.

**Q: Please summarize the recommendations that are set forth in your testimony.**

A: I recommend that the Commission not approve the continuation of decoupling for Avista, as proposed by Company witnesses Mr. Hirschkorn and Mr. Powell. My testimony explains how information presented in the *Evaluation of Avista Natural Gas Decoupling Mechanism Pilot* Final Report to Avista and Stakeholder Advisory Group that was prepared by Titus (Evaluation Report or Titus Report) supports termination, rather than continuation, of the decoupling mechanism. I also describe specific flaws within Avista's existing pilot decoupling mechanism that argue for its termination. This includes the flawed New Customer Adjustment that results in excessive compensation under the design of the current Mechanism and does not truly break the link between sales and profits. Finally, I present a general form of an alternative to decoupling that the Commission might consider, so as to encourage continued cost-effective energy efficiency program sponsorship by Avista for the benefit of its ratepayers.

**Q: How is the balance of your testimony organized?**

A: My testimony is arranged by major topical area. A Table of Contents appearing at the beginning of the testimony sets forth this organization.

## II. AVISTA DECOUPLING HISTORY

**Q: What is the origin of the Avista decoupling pilot program?**

A: Avista petitioned the Commission for approval of a natural gas decoupling mechanism in April of 2006 in Docket No. UG-060518. Avista, the WUTC Staff and two other parties reached a non-unanimous settlement agreement in that Docket to initiate a Decoupling Mechanism (Mechanism) pilot program that was for a limited term with revenue deferrals from January 1, 2007 through June 30, 2009. Additionally, the Mechanism was applied only to gas rate Schedule 101 and was limited to a 90 percent deferral of weather normalized margin revenue differences that could only be recovered if Avista satisfied an earnings test and a DSM test against a specified achievement percentage grid. Rate changes due to the Mechanism were also limited to two percent annually and Avista was required to subject the Mechanism to a formal Decoupling Evaluation with formal reporting to the Commission.[1] The Titus Evaluation Report submitted as Avista Exhibit No.___(BJH-2) with Mr. Hirschkorn's testimony is that formal Evaluation Report.[2]

[1] A more detailed discussion of decoupling, as practiced by Avista in the pilot program, is set forth in the Titus Evaluation Report at p. 8 and pp. 35-44, which has been designated Avista Exhibit No. ___(BJH-2). Calculations of the monthly Deferred Revenue Entries are presented in Avista Exhibit No. ___(BJH-3).
[2] Certain revisions to the Titus Evaluation Report were identified as necessary by Avista on August 10 and are incorporated into this Testimony.

**Q: In approving the decoupling mechanism as a pilot program, did the Commission express a number of concerns regarding the potential disadvantages of the Mechanism?**

A: Yes. In Order 04 issued in Docket No. UG-060518, the Commission identified both potential advantages and disadvantages associated with decoupling. The Commission observed that proponents of decoupling state that the central advantage intended from decoupling is to foster within utility management an increased "focus on energy efficiency and conservation" by "breaking the link" between energy sales and fixed cost recovery.[3] On the other hand, the Commission identified in Order 04 a series of concerns regarding decoupling that included:

- Decoupling may produce revenue deferrals that are far out of proportion to the lost margins from Avista's energy efficiency programs.[4]
- Decoupling is single issue ratemaking that violates the "matching principle" by assuring recovery of fixed costs while ignoring any potential cost savings that would be captured in a rate case.[5]
- Decoupling distorts price signals from conservation and can produce a consequential dampening of customer conservation.[6]

/ /

/ / /

[3] Docket No. UG-060518, Order 04, February 1, 2007; Final Order Approving Decoupling Pilot Program, ¶¶ 8-10 and 16.
[4] *Id.*, ¶¶ 24-26.
[5] *Id.*, ¶ 19.
[6] *Id.*, ¶ 17.

> Decoupling shifts the risk of changes in weather normalized consumption from shareholders to ratepayers.[7]

These characteristics and concerns about decoupling, as noted by the Commission, will be referenced throughout my testimony as the merits of the Company's proposed continuation of the Mechanism are evaluated.

**Q: What are Avista's stated reasons why the Company believes that the Commission should approve continuation of the decoupling mechanism?**

A: Avista witness Brian Hirschkorn states, "The Mechanism has achieved its intended results: 1) The Company has substantially increased its natural gas DSM efforts and results during the term of the pilot, and 2) The Mechanisms has allowed the Company to recover a substantial portion of its fixed natural gas distribution costs through relatively small rate adjustments between general rate filings. Additionally, the Mechanism is consistent with current national energy policy that supports utility incentives and mechanisms that provide for further promotion of energy efficiency."[8] The first two points mentioned by Mr. Hirschkorn are examined in the Titus Report in the next section of this testimony. I will explain how changes in Avista gas DSM spending and therm savings do not appear to have been significantly influenced by the decoupling pilot and how the decoupling deferral amounts recorded by Avista compare to the lost gas margin revenues actually caused by DSM programs. With respect to national energy policy supportive of promotion of energy efficiency, I will explain why Avista's pilot decoupling mechanism is a blunt instrument that is not

[7] *Id.*
[8] Avista Exhibit No. ___(BJH-1T).

directly linked to the promotion of energy efficiency and that has been shown in the Titus Report to be excessively compensatory to Avista at ratepayers' expense when compared to estimated DSM lost gas margins.[9]

## III. THE TITUS EVALUATION REPORT

**Q: What was the intended purpose of the Titus Report?**

A: A Decoupling Evaluation Report was required to be performed under the terms of the non-unanimous Settlement Agreement that was approved by the Commission in Order 04.[10] At Finding of Fact (7) in Order 04, the Commission stated, "An evaluation of the pilot, partial decoupling program, regardless of whether Avista seeks to continue the program after the three-year pilot expires, is important to determining the value of the decoupling mechanisms for regulated utilities in Washington State." The work performed by Titus is described in the Evaluation Report.

**Q: Does the Evaluation Report provide any recommendations regarding the appropriateness of decoupling in general or the design of the Avista pilot decoupling mechanism?**

A: No. The Titus Report explicitly excludes any advocacy regarding decoupling in general or as applied by Avista in the pilot Mechanism, instead focusing upon

[9] In this testimony, gas "margins" and gas "margin revenue" is the revenue earned by Avista that is other than from recovery of gas commodity and upstream pipeline costs.
[10] See p. 10, ¶ J. of the Docket UG-060518 Settlement Agreement attached to and incorporated into Order 04 by reference.

providing factual answers to specific questions that were posed in the Evaluation Plan that was developed by Avista and an Advisory Group.[11]

**A. DSM Savings Trends**

**Q: According to Mr. Hirschkorn, "The Company has substantially increased its natural gas DSM efforts and results during the term of the pilot."[12] Does the Titus Report support a conclusion that decoupling has caused Avista to increase gas DSM expenditures?**

A: No. Table C9-A of the Titus Report shows an increase in Avista gas utility DSM expenditures from 2004 to 2008, with a total increase in Washington spending from $1.1 million in 2004 to $6.3 million in 2008.[13] However, it also clearly shows that substantial increases in Avista gas DSM spending had occurred within periods prior to commencing decoupling in 2007. As shown in the graph below, the increase in Avista's gas DSM spending occurred both before and after the decoupling pilot Mechanism was implemented.

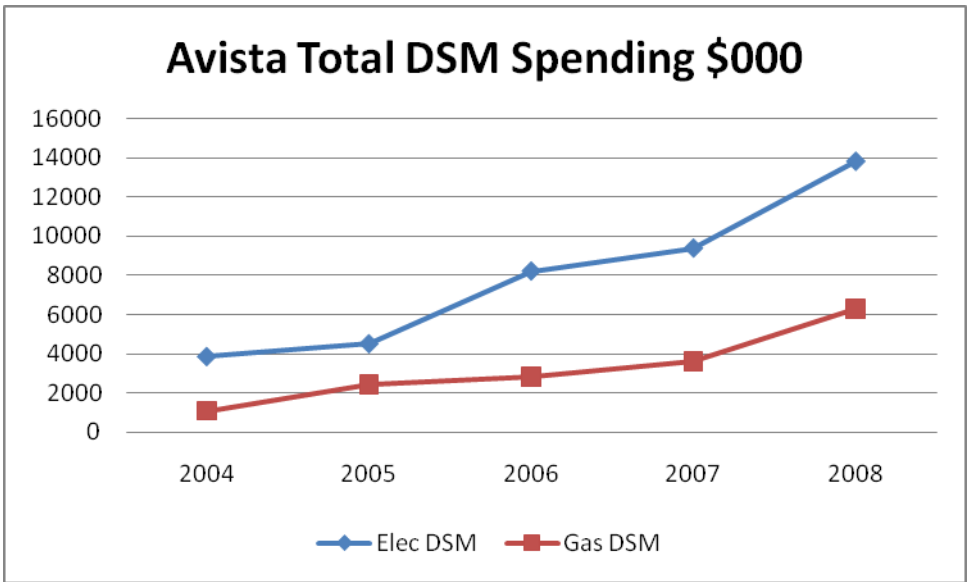
**Q: Did Avista increase its electric DSM spending during this period, even though decoupling is not applicable to the Company's Washington electric utility business?**

A: Yes. Avista actually spent more on electric DSM than gas DSM during this period and has consistently done so since 2004. This is shown in the following graph displaying annual electric and gas DSM spending across both the Idaho and

[11] *Id,* p. 2.
[12] Direct Testimony of Brian J. Hirschkorn on behalf of Avista, Exhibit No. ___ (BJG-1T), p. 4, ll. 9-10.
[13] *Id.*, pp. 28-33.

Washington service areas served by Avista from 2004-2008:

**Chart 1: Avista DSM Spending**




Source: Avista's Responses to Public Counsel Data Request No. 187c, Public Counsel Data Request No. 274a, Evaluation Rpt. p.28, Table C9-A.

**Q: What areas of Avista's service territories have decoupling programs?**

A: The decoupling pilot applied only to gas utility service and not to electric service in Washington. It is my understanding that Avista also has no decoupling authority for its electric or gas service in Idaho, such that only the Company's Washington gas utility business is subject to a decoupling mechanism. The Titus Report does not support a conclusion that changes in Avista DSM funding are specifically correlated with the inception of the gas utility pilot decoupling mechanism.

**Q: Does it make sense for gas and electric utilities to participate in DSM programs that may reduce their sales in the absence of decoupling rate adjustment mechanisms?**

A: Yes. Many energy utilities participate in DSM programs without decoupling rate adjustment mechanisms and have done so for many years. Some states, including Washington, have least cost planning requirements that require acquisition of cost-effective demand side resources.[14] State and federal public policy increasingly emphasize the importance of energy efficiency in the provision of utility services. As a general business policy, it is important for utilities to recognize and respond to the needs of their customers. The best way to promote energy products is to recognize customers' interests in efficiency and affordability when using utility services. Wasteful utilization of energy is simply not sustainable and the financial success of the utility is tied to the financial viability of its ratepayers. Additionally, the reality is that any regulated business must also be sensitive to its public image and its relationship with regulatory agencies and other policy makers and this also requires support for energy efficiency messaging and programs.[15]

**B. DSM Results and Trends**

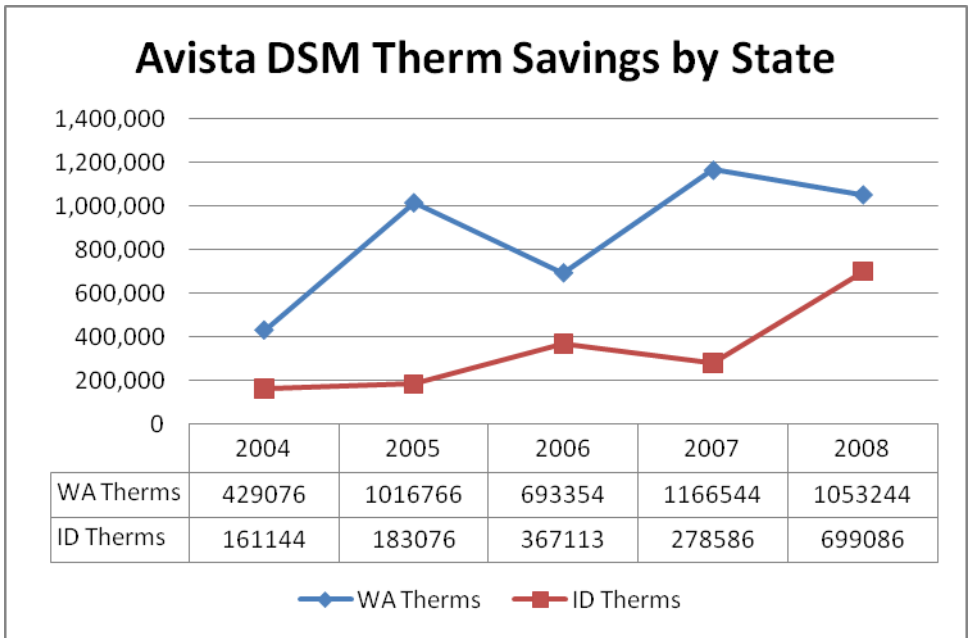
**Q: Have the Company's increased gas DSM expenditures caused Avista to experience significant increases in therm savings results by its gas customers in Washington?**

[14] WAC 480-90-238.

[15] For example, in a March 6, 2008 presentation by the American Gas Association's Vice President of Regulatory Affairs, it was noted as important to "profile natural gas utilities as good stewards of consumer energy needs by promoting efficient use of natural gas," to "promote direct use of natural gas as part of a near-term, low-cost plan to address energy security and environmental quality" and to "support opportunities for natural gas utilities to build value in an increasingly challenged business environment." At that time, the AGA had surveyed 53 Active LDC Natural Gas Energy Efficiency Programs in 27 states, with 5 pending and 8 new planned programs. A complete copy of this document is available at: http://www.aga.org/Events/presentations/comm/2008/PRMarketingCommCommitteeMeeting/NatGasEnergyEfficiencyNatural.htm.

A: No. Therms savings have increased only modestly from 2005 levels, as shown in the following graph derived from the therm data presented in the Titus Report at Table C1-A on page 10:

**Chart 2: DSM Therm Savings**




This data suggests that Washington annual therm savings resulting from DSM activity has increased since 2006, after therm savings had declined from 2005 levels. However, the most dramatic recent increase in therm savings can be observed in the Idaho data from 2007 to 2008, where therm savings increased from 278,586 therms to 699,086 therms, an increase of 151 percent. The largest comparable increase in Washington occurred prior to the decoupling pilot, from 2004 to 2005, when therm savings increased from 429,076 to 1,016,766 therms, an increase of 137 percent. As the data suggests, therm savings trends do not appear to be strongly correlated to the introduction of decoupling in Washington.

**Q: Does the Titus Report provide a convincing demonstration that the decoupling Mechanism has enhanced Avista's conservation efforts in a cost-effective manner?**

A: No. Avista's conservation funding for Washington gas customers has not been significantly enhanced, relative to the growth in the Company's DSM spending in Idaho and for its electric utility business where decoupling does not exist. Similarly, the therm saving trends from gas DSM in Washington are not demonstrably better than in Idaho where Avista has no decoupling opportunity. The structure of the pilot decoupling Mechanism in Washington ensures that it cannot be cost effective as an tool to enhance conservation efforts, because of the excessive scope and unreasonable design of the Mechanism, as more fully discussed in the following testimony.

**C. Lost Margins - Proportionality**

**Q: Please describe the relationship between therm savings resulting from Avista gas DSM programs and lost gas margin revenues. Do the therm savings caused by Avista gas DSM programs translate into lost gas margin revenues?**

A: Yes. Therm savings that result from Avista gas DSM program activity will reduce gas margins earned by the Company, until therm usage is updated in the Company's next rate case test year analysis. In the absence of a decoupling mechanism, shareholders would absorb the effects of any changes in sales volumes that occur between test years, including the therms "saved" due to DSM. I understand that this

linkage between DSM therm savings and margin losses was instrumental in Commission approval of the decoupling pilot, so as to make Avista indifferent with respect to lost margins and therefore more supportive of DSM activity.

**Q: Has the decoupling mechanism resulted in recovery of deferrals in excess of total lost margins resulting from DSM?**

A: Yes. Avista has been able to do much more than just offset its DSM therm savings lost margins since the inception of the Washington decoupling Mechanism pilot in 2007. The disproportionate size of decoupling deferrals, in relation to lost margins, is a result of the overly broad scope of the Mechanism and the unreasonable New Customer adjustment provided for in the Mechanism.

**Q: Please explain your reference to the "overly broad scope" of the Mechanism in the previous answer.**

A: The Mechanism approved by the Commission in Order 04 does not attempt to link or limit decoupling revenue deferral amounts to utility-funded DSM therm savings in any direct way. As a result, the decoupling deferral amounts indiscriminately capture the effects of all non-weather influences upon Rate Schedule 101 therm sales volumes, including therm sales reductions that may be caused by:

- Overall economic conditions, including reduced employment and incomes resulting from the present economic recession.
- Increases in the price of natural gas commodities in 2007 and 2008, and any

price elasticity impacts upon sales volumes.[16]

- Normal ongoing customer home improvements and construction of new homes with corresponding installations of weatherization features that are compliant with modern building codes.
- Normal replacement of older, less-efficient appliances and space/water heating devices with new equipment that must conform to current energy efficiency standards.
- Ratepayer-funded conservation measures that are undertaken without the benefit of utility DSM rebates.

These systemic changes have contributed to persistent reductions in residential per customer gas usage for decades, as evidenced by the chart below. If Avista's decoupling mechanism is intended to induce and reward utility-sponsored DSM activity, the pilot Mechanism clearly is overly broad for this purpose.

**Q: Please describe the issue of proportionality of decoupling deferrals in relation to DSM gas lost margins.**

A: This issue was raised by Public Counsel in Docket No. UG-060518 and the Commission noted its intent to "closely scrutinize" this issue in its Order 04 at page 8:

> *26* To ensure that the program does not result in inappropriate benefit to the Company, we required two changes to the proposal. First, any funds that are not deferred due to the "earnings" and/or the "DSM" test may not be carried over to the next period. Second, the Company may not record interest on deferrals until we approve the

[16] In Avista's Response to Public Counsel Data Request No. 275e, Avista produced a confidential natural gas elasticity study performed for the company by a third party.

> deferrals for recovery. [footnote omitted] In light of these changes, we do not find Public Counsel's argument sufficiently strong to prevent implementation of the multi-party settlement. However, the proportion of margin lost to company sponsored DSM relative to the amount subject to recovery is of great interest to us, and we will closely scrutinize this factor in reviewing the results of this pilot decoupling program. [emphasis added]

The question of "proportionality" is critical to the alleged justification of decoupling to "break the link" between sales and fixed cost recovery so that utilities will be more supportive of DSM efforts. If the size of decoupling revenue deferrals is not at or near parity with the gas margin revenues actually foregone by Avista as a result of DSM therm savings, it is obvious that decoupling as a regulatory remedy is not proportional and ratepayers will be made to pay rates that are not reasonable.

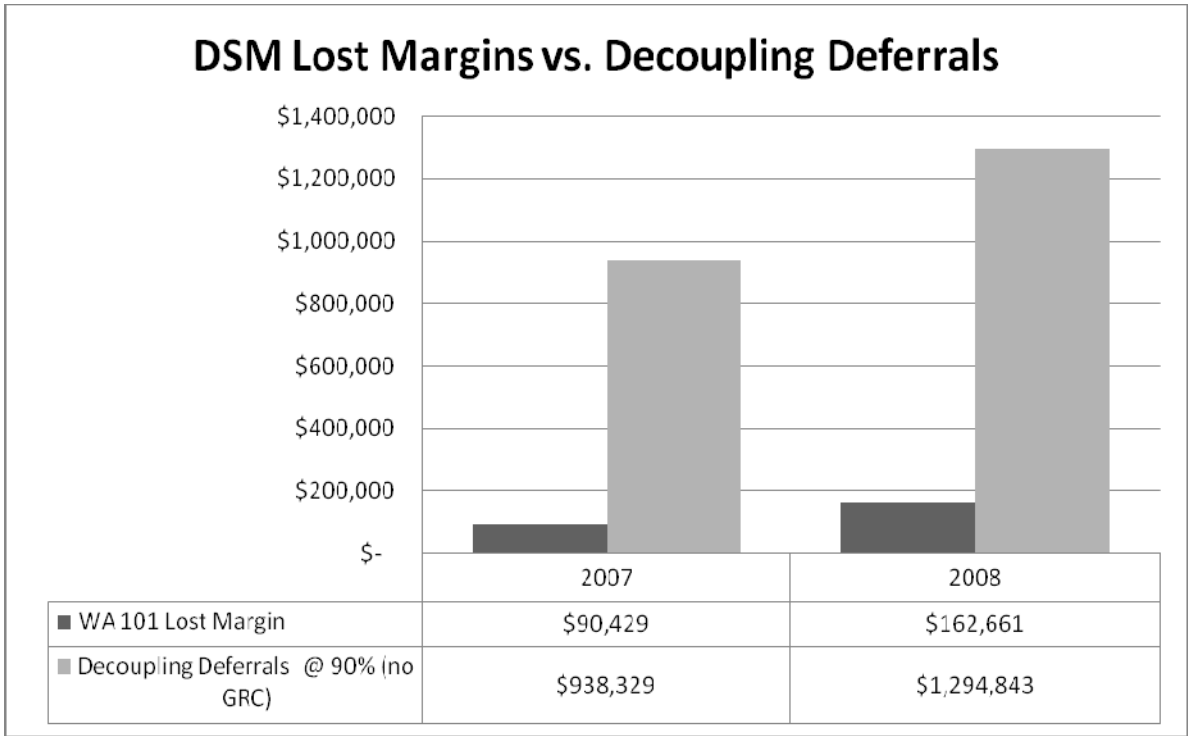
**Q: Did the Titus Report address the proportionality issue?**

A: Yes. Section E of the Titus Report recites the Commission's paragraph 26 interest in this issue and compares the Washington "DSM Lost Margin" revenues in 2007 and 2008 to the amounts of Decoupling Deferrals that are allowed under the Mechanism.

**Q: What were the recorded amounts during the pilot period for both lost margins and deferrals?**

A: I have summarized this data in the following graph, comparing the lost margin revenue values to the corresponding 90 percent Decoupling Deferral revenue amounts for the years 2007 and 2008:

**Chart 3: DSM Lost Margins Compared to Decoupling Deferrals**




Source: Titus Report, p. 45, Table E-2.

Chart 3, which is based upon data set forth in the Titus Report, clearly shows the disparity between the lost margin "cost" to Avista of sponsoring gas DSM programs and the "benefit" to the Company created by decoupling deferrals. In 2007, the ratio of deferrals to lost margins is over 10 to 1, while in 2008 the proportions are about 8 to 1.

**Q: Is the size of decoupling deferral entries that are recorded by Avista influenced by the timing of general rate cases?**

**A:** Yes. Whenever a rate case test year occurs, the lower usage per customer experienced in the test year is "rolled in" to base rates, such that decoupling entries re-start at zero from that lower base. Notably, the comparison

shown in Chart 3, above, assumes no general rate case (GRC) in 2008 so as to show the full impact of continuous application of the decoupling Mechanism, even though Avista actually submitted a rate case and rolled in the lower customer usage for the updated 2006 test year used in Docket No. UG-070805.[17]

**Q: The Titus Report notes that the DSM lost margins displayed therein are the first-year lost margins and do not reflect the multi-year impact of the DSM measures. Is this a significant consideration?**

A: No. Given the vast disparity between lost margin amounts and the decoupling deferrals, as shown in Chart 3, including multiple year allowances for installed DSM lost margins would not significantly change the outcome. The Mechanism is not proportional to Avista's gas utility DSM results.

**Q: Public Counsel witness Mary Kimball concludes that actual Schedule 101 therm savings are likely lower than those set forth in the Titus Report when restated to remove the impact of new savings estimates for 2008. How would lower therm savings levels impact the issue of proportionality of Avista's decoupling deferrals?**

A: Lower therm savings estimates would translate directly into lower lost margin values. This change would show the decoupling deferrals to be even more excessive than is now indicated in Chart 3.

[17] The impact of general rate cases upon decoupling deferral amounts is more fully explained in the Evaluation Report at pp. 46-47.

**Q: Is the decoupling Mechanism cost-effective in relation to the therm savings resulting from Avista DSM programs in Washington?**

A: No. The Mechanism is excessively costly to ratepayers because of its unreasonably broad scope, its imprecise accounting for the actual lost margins caused by DSM and the unjustified exclusion of the added margin revenues from serving new customers. Washington ratepayers must already bear the substantial burden of all DSM program funding through Rate Schedule 191[18] and the Mechanism clearly burdens ratepayers with excessive additional revenue requirements that are not proportional to lost margins actually being experienced by Avista as a result of DSM program.

**D. Customer Outreach Programs**

**Q: Please describe the Company's "Every Little Bit" customer outreach program addressed at page 4 of Avista witness Mr. Powell's Direct Testimony.**

A: Customer outreach programs are informational campaigns that use various media such as media advertising, printed brochures, electronically distributed information and bill stuffers to make customers aware of the importance of energy conservation and steps that can be taken to conserve energy. According to the About Energy Efficiency page of Avista's "Every Little Bit" website, "Every Little Bit is here to help you learn more, get

[18] According to the Evaluation Report at p. 27, Table C-8A, the annual DSM program funding burden upon ratepayers has grown to approximately $3 million annually in 2007 and 2008, before the added costs of the decoupling Mechanism are considered.

involved and take advantage of rebates and incentives. Make a difference. Start saving today."[19] Other links within the website direct the user to available utility rebate programs, energy savings tips and enable viewing of TV and radio messages on these subjects.

**Q: Should any estimated therm savings or lost margins be added to the Titus Report results for Avista's outreach programs?**

A: No. Mr. Powell admits that energy savings from Avista's outreach programs are "difficult to quantify and are not included in our DSM savings results."[20] In the Evaluation Report at pages 25-27, the discussion of such "…customer educational, informational and marketing programs related to DSM" notes that one of the two primary messages of the "Every Little Bit" program is a "call to action to look at our rebates on our website and use them." If successful, this message may have influenced the customer participation rates in Avista's other DSM programs that <u>are</u> explicitly measured and counted within therm savings and lost margin amounts stated in the Report. The other primary message is said to be "..an understanding for an emerging efficiency consciousness relating to energy and sustainability." Measurement of therm savings resulting from such "consciousness" changes is not practically possible. In any event, Avista's total spending on such outreach programs is set forth in Table C7-B of the Evaluation Report and the Washington Gas share of such amounts was only

[19] *See*: http://www.everylittlebit.com/AboutEnergyEfficiency.aspx.
[20] *Id*, p. 5.

$144,567 in 2008, which amount represents an insignificant share of the broader Washington DSM Expenditures amount of $4.4 million for which results have been measured. It is unlikely that such a modestly funded program yields any significant additional therm savings that have not been measured directly.

**E. New Customer Adjustments in the Mechanism are Unreasonable**

**Q: In prior testimony, you mentioned an "unreasonable New Customer Adjustment" within the pilot Mechanism. What is unreasonable about the New Customer Adjustment?**

A: The New Customer Adjustment has not been shown to be needed by Avista on any cost basis and has the effect of unreasonably increasing the decoupling deferrals that are recorded by the Company. I will explain this concern in more detail in this section of my testimony.

**Q: Please explain how gas distribution utilities can experience sales volume and corresponding revenue growth between rate cases?**

A: Gas utilities can experience sales volume and revenue growth in one of two ways, either by increasing the number of customers being served or by increasing the average usage per customer. For many gas utilities and for Avista, the trends are opposite for these two variables, with gradual growth in the number of customers offsetting the gradual decline in weather-adjusted usage per average customer.

**Q: What trends have been experienced by Avista with regard to the number of customers served on gas Schedule 101 and the average annual therm usage per customer after weather normalization?**

A: Avista has experienced persistent growth in the number of customers being served on Schedule 101, with 141,000 average customers in 2008 relative to only 116,000 million in 1999, representing overall customer growth of about 22 percent across the period. Weather normalized therm usage per customer has declined from 993 annual therms in 1999 to 833 therms in 2008, a reduction of about 16 percent across this same period. These trends are displayed on the following graph that was developed from information provided by Avista's in Response to Public Counsel Data Request No. 179:

/ /

/ / /

/ / / /

/ / / / /

/ / / / / /

/ / / / / / /

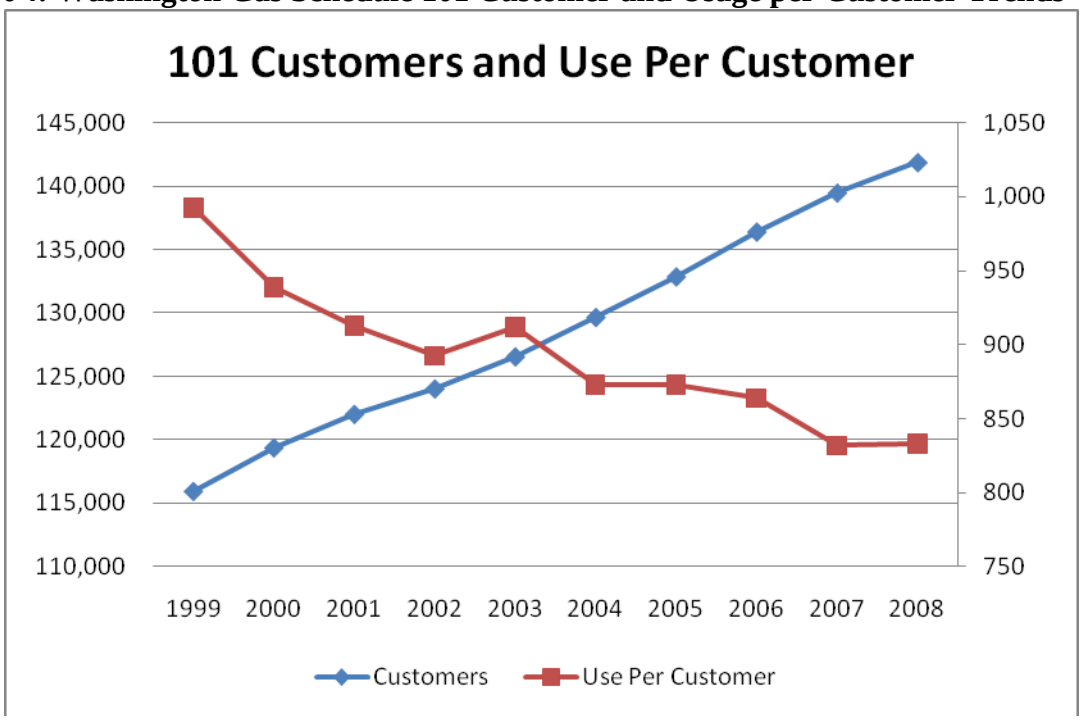
/ / / / / / / /

/ / / / / / / / /

/ / / / / / / / / /

/ / / / / / / / / / /

**Chart 4: Washington Gas Schedule 101 Customer and Usage per Customer Trends**



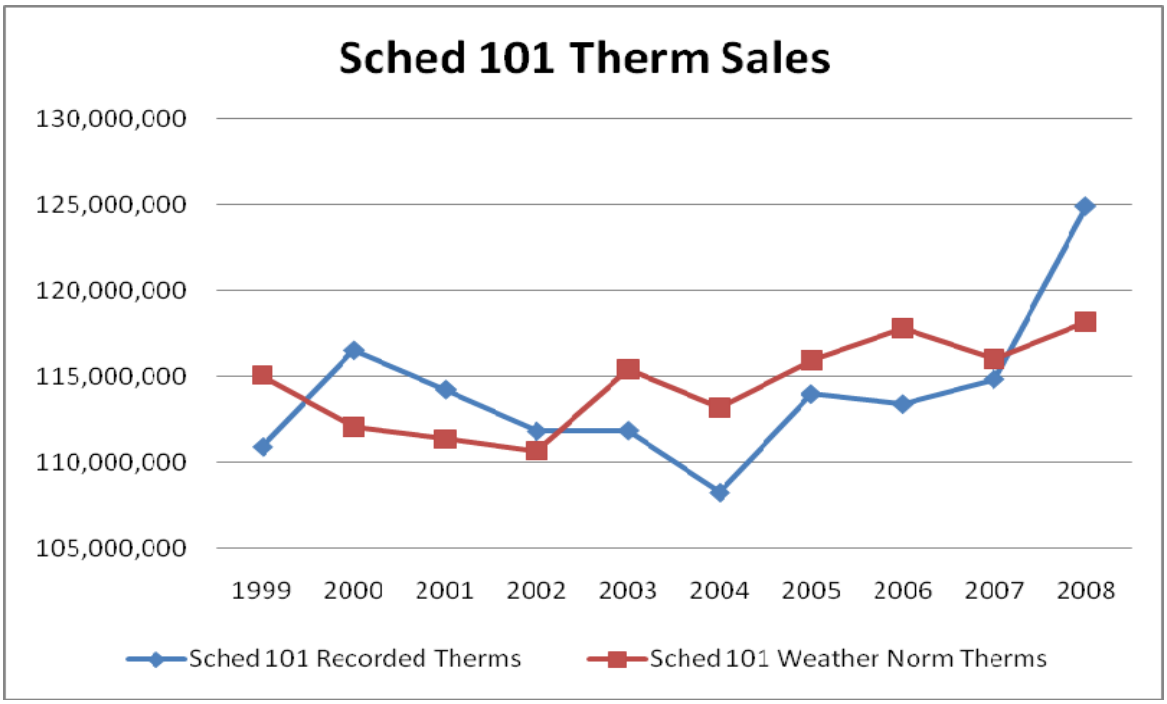

The result of these opposite trends has been that Avista Schedule 101 therms and associated gas margin revenues have been increasing in spite of declining therm usage per customer, because of the Company's increasing numbers of customers taking service on Schedule 101.

**Q: When the Company's increasing Schedule 101 customer count and declining usage per average customer are combined, does Avista suffer from any inability to recover its fixed costs between rate cases due to overall therm volume changes?**

A: No. As noted, Avista's overall Schedule 101 therm sales trends are generally increasing. The interaction between persistent customer growth, offset somewhat by declining usage per customer, has produced a generally positive trend in the

Company's overall Schedule 101 therm sales since 1999, as shown in the following graph:

**Chart 5: Schedule 101 Therm Sales Trends**




Source: Avista's Response to Public Counsel Data Request No.179, Attachment A.

**Q: If Avista's Schedule 101 weather normalized therm sales have been increasing, is decoupling needed in order to stabilize the Company's ability to recover its fixed costs?**

A: No, decoupling is not needed by Avista to stabilize its gas margin revenues or its recovery of fixed costs. The Company's Schedule 101 therm sales volumes and the resulting margin revenues have been stable and generally increasing without decoupling since 2002, when viewed on a weather normalized basis.[21]

[21] In this discussion, constant Schedule 101 rate/price levels are assumed. Given the stable and generally increasing Schedule 101 therm sales experienced by the Company, rate increases from general rate cases would further increase gas margin revenues.

**Q: Given the Commission's observation that the central advantage intended from decoupling is to foster within utility management an increased "focus on energy efficiency and conservation" by "breaking the link" between energy sales and fixed cost recovery, does the Avista decoupling Mechanism break the link between energy sales volumes and fixed cost recovery?**

A: No, it does not. The Avista Mechanism does not "break the link" or assure the full recovery of the Company's fixed costs for two reasons. First, a complex weather normalization calculation is inserted within the Avista Mechanism to limit its scope to only deviations in therm sales after weather-normalization is performed on Rate Schedule 101 actual sales. This limitation in scope has the effect of stabilizing margin revenues for only the modest impacts of per-customer usage variations driven by factors other than weather – leaving the more dramatic weather-driven sales and margin revenue fluctuations outside the Mechanism. Avista may not fully recover the intended gas margin revenues authorized in rate cases for fixed cost recovery in years when weather is abnormally mild and will probably over-recover such costs when weather is abnormally cold.

Another reason why the Avista Mechanism does not assure the recovery of only Commission-approved levels of fixed costs is the treatment of new customers within the Mechanism. In its present form, the Mechanism allows Avista to carve out and retain for its shareholders the incremental margin revenues earned from serving new customers. This New Customer Adjustment appears to be based upon an unproven assumption that Avista has some financial need to retain the incremental

new margin revenues earned from serving new gas customers to recover some incremental costs, but there has been no showing that the New Customer Adjustment is cost-based or equitable to ratepayers. The New Customer Adjustment has the effect of not stabilizing gas margin revenues, but instead rewarding Avista for promoting gas service while assuring more rapid growth in gas margin revenues between rate cases.

**Q: What is the impact of the New Customer Adjustment that was approved as part of Avista's pilot decoupling mechanism?**

A: The New Customer Adjustment causes the decoupling mechanism to create new deferred revenues to help Avista make up for declining weather-normalized average usage per customer, while carving out all of the growth in therms and revenues being experienced by Avista from serving new customers and letting those incremental margin revenues be retained for shareholders. This New Customer provision of the Mechanism is markedly one-sided in favor of Avista and is another reason why the decoupling pilot should be discontinued. Alternatively, if decoupling is continued over the objections of Public Counsel, the New Customer Adjustment should be removed in an effort to effect more complete decoupling that provides balanced treatment of both the favorable customer trends and unfavorable usage trends that are being experienced by the Company.

**Q: Does the Titus Report quantify the financial impact of the New Customer Adjustment upon the decoupling deferrals?**

A: Yes. According to page 47 of the Report, for 2007 and 2008 combined, the new customer usage adjustment significantly impacted the deferral calculations, representing 5.6% of Schedule 101 usage and 152% of the calculated decoupling deferral baseline usage reduction in the decoupling quarterly reports. Table G3 on page 50 of the Titus Report shows the dramatic dollar impact of the New Customer Adjustment upon the monthly revenue deferral amounts recorded by Avista.[22]

**Q: In your opinion, has the Titus Report reasonably quantified the estimated financial impact of the New Customer Adjustment in Table G3 on page 50 of the Report?**

A: Yes. The electronic workpapers supporting Mr. Hirschkorn's Exhibit No.___ (BJH-3) provide a convenient illustration of the substantial impact of the New Customer Adjustment. The magnitude of the "Deduct New Customer Usage" therms can be readily observed by noting that the therms removed on the second line of Exhibit No. ___ (BJH-3) are very large when compared to the "Therm Difference" near the bottom of Exhibit No. ___ (BJH-3) that is subject to deferral. This indicates that, in fact, decoupling would actually produce negative deferrals (credits) to the benefit of ratepayers in most months if new customer therms and revenues were <u>not</u> being retained for shareholders under the Mechanism.

[22] At the bottom of page, Titus notes the complexity surrounding quantification of this adjustment in stating, "There were other interpretations of how to answer this question that are not included in this report." In Avista's Response to Public Counsel Data Request No. 309, Attachment A, Avista provided its "interpretation of Table G3 Decoupling Deferrals – New Customer Impact" which produced vastly different amounts than presented in the Evaluation Report. However, the Company's calculations in Public Counsel Data Request No. 309 do not accurately present decoupling deferral calculations with and without the New Customer Adjustment.

**Q: How did Avista explain the purpose of the New Customer Adjustment previously in Docket No. UG-060518?**

A: In the Joint Rebuttal Testimony sponsored by Mr. Hirschkorn and the settling parties in Docket No. UG-060518, the response to Public Counsel's argument regarding the new customer adjustment was presented in the following form:

> **Q. Turning now to Mr. Johnson's testimony, on page 6, lines 15-17, he states: "Avista retains for shareholders the margin revenues gained by new customer use that occurs between rate cases." Would you comment on this statement?**
>
> A. Yes. In this section of his testimony, Mr. Johnson infers that the margin revenues from new customers represent additional short term profits to the company that are not taken into consideration under the proposed mechanism. While the Company does receive margin from new customers, it also incurs incremental fixed costs to provide service. Further, based on an examination of new natural gas customers added since 2004, new customers use less on average, thus providing less margin per customer, than customers connected prior to that time. Regardless of the incremental margins and costs resulting from new customers, the mechanism contains an earnings test to ensure that it does not result in Company earnings that exceed the level authorized by the Commission.[23]

**Q: Do these arguments justify inclusion of a New Customer Adjustment as part of the Mechanism?**

A: No. The first argument regarding alleged "incremental fixed costs to provide service" to new customers was apparently unsupported by any factual evidence in Docket No. UG-060518 and is highly questionable. The only costs that can reasonably considered as incremental fixed costs to provide service to new customers are the costs to install and maintain a new service line and meter and any incremental

[23] Rebuttal Testimony of Brian Hirschkorn (Avista) Joelle Steward (UTC Staff) and Nancy Glaser (NW Energy Coalition) in Docket No. UG-060518, p. 6.

monthly meter reading, billing and remittance processing costs.[24] These costs tend to be minimal in comparison to the monthly margin revenues earned from the customer and volumetric service charges to the new customer, because such charges are designed to recover a proportional contribution to the utility's overall fixed costs to provide service.

**Q: Does the Company's gas cost of service and rate design evidence support your view that only minimal incremental fixed costs are involved in serving new customers?**

A: Yes. Mr. Hirschkorn's gas rate design Direct Testimony in this Docket states that, "average monthly fixed cost for Schedule 101 customers associated only with the meter, service line, meter reading and billing is $8.07."[25] Notably, any such allocated accounting cost values represent an allocation of the designated customer-related fixed costs. This would exceed the actual "incremental" monthly cost to serve a new customer because the Company's automated customer service and

[24] For example, each new customer will impose nominal monthly costs for bill forms and envelopes, postage and remittance processing, but will likely not discretely require Avista to hire a new meter reader or invest in expanded billing system capacity.

[25] Docket Nos. UE-090134 and UG-090135, Direct Testimony of Brian J Hirschkorn, Exhibit No. ___(BJH-1T), p. 22. A more inclusive and somewhat larger allocated monthly customer cost is suggested in the Direct Testimony of Ms. Tara Knox (Avista Exhibit No. ___TLK-1T), where she indicates at page 29 that, "Meter installation and services investment is allocated by the number of customers." In her Exhibit No. ___(TLK-6) at p. 4, Ms. Knox identifies "Customer service, customer information and sales expenses are the core of the customer relations functional unit which is included with the distribution cost category. For the most part these costs are classified as customer related." When her gas utility cost of service study results are considered, as presented in Exhibit No. __(TLK-7) at p. 3, the total average "Customer Cost per Customer per Month" at the Company's proposed rate of return is $14.41. Avista's Response to Public Counsel Data Request No. 442(b) suggests a monthly incremental cost for average new residential customers as high as $32.42 and clarification follow-up questions were pending with the Company at the time this testimony was due to be filed with the Commission.

billing systems and the personnel and facilities to support customer interaction represent largely fixed costs that do not change as each new customer is added.

**Q: If we conservatively assume that Avista's monthly average cost to serve a new customer may be as high as $8.07, do these costs justify making a New Customer Adjustment when calculating the monthly decoupling calculations?**

A: No. If we use the "New Customer Average Usage" value of 828 therms that is calculated in Table G-5 of the Evaluation Report at page 52, the new margin revenues from an average new customer would be about $22.45 per month at current rate levels.[26] This new source of revenue exceeds any reasonable estimate of the short-term incremental change in fixed costs that Avista may incur to serve new customers.

**Q: In Docket No. UG-060518, the settling parties argued that "new customers use less on average, thus providing less margin per customer, than customers connected prior to that time.[27]" How do you respond?**

A: This argument is largely a distraction, given the absence of any need to extract new customers to begin with. According to the Evaluation Report at page 52, Table G-5, this argument is also not supported by the data. In 2007 and 2008 the average new customer used approximately the same annual number of therms as an existing customer.

[26] Avista Exhibit No. ___(BJH-3) in Docket No. UG-060518 shows the Current Margin rate per therm for Schedule 101 to be $0.24201. Annual volumes of 828 therms represents 69 therms per month, taken times this rate, or approximately $16.70 in volumetric margin recovery, plus the current monthly customer charge of $5.75, for a total monthly average margin per new customer of $22.45.

[27] Rebuttal Testimony of Brian Hirschkorn (Avista) Joelle Steward (UTC Staff) and Nancy Glaser (NW Energy Coalition) in Docket No. UG-060518, p. 6.

**Q: In Docket No. UG-060518, the settling parties also argued that inclusion of an earnings test would cure the problem of over-recovery caused by the "New Customer Adjustment."[28] How do you respond?**

A: This argument suggests that any poorly designed or excessively compensatory rate adjustment clause should be approved, so long as some form of earnings test is appended. In my opinion the Commission should not approve any piecemeal rate adjustment mechanisms that may overcharge customers based upon the premise that an abbreviated, but well intentioned "earnings test" may reasonably backstop the mechanism and protect ratepayers. The adequacy of existing revenue levels and the need for incremental new revenues necessarily involves the careful consideration of all test year rate base, expenses, cost of capital and other matters that are undertaken in formal rate case proceedings. These efforts should not be shortcut by necessarily summary calculations intended to serve as an "earnings test," where no discovery or rigorous analysis can practically be applied to accurately determine earnings or revenue requirements.

/ /

/ / /

/ / / /

/ / / / /

[28] *Id.*

## V. OTHER CONCERNS WITH THE MECHANISM

**Q: Has Avista proposed any changes in the Mechanism responding to the concern stated in the Commission's Order 04, that decoupling shifts the risk of changes in weather normalized consumption from shareholders to ratepayers?[29]**

A: No. The fundamental purpose of decoupling from an industry perspective is to shift a persistently negative business trend, gradually declining gas utility usage per customer, from shareholders to ratepayers. Average residential natural gas per-customer consumption trends experienced by gas local distribution companies (LDC) in the United States have been declining for many years, long before utility-funded conservation rebate programs became popular. This long term trend can be observed in the following table published by the Energy Information Administration in August of 2007:[30]

/ /

/ / /

/ / / /

/ / / / /

/ / / / / /

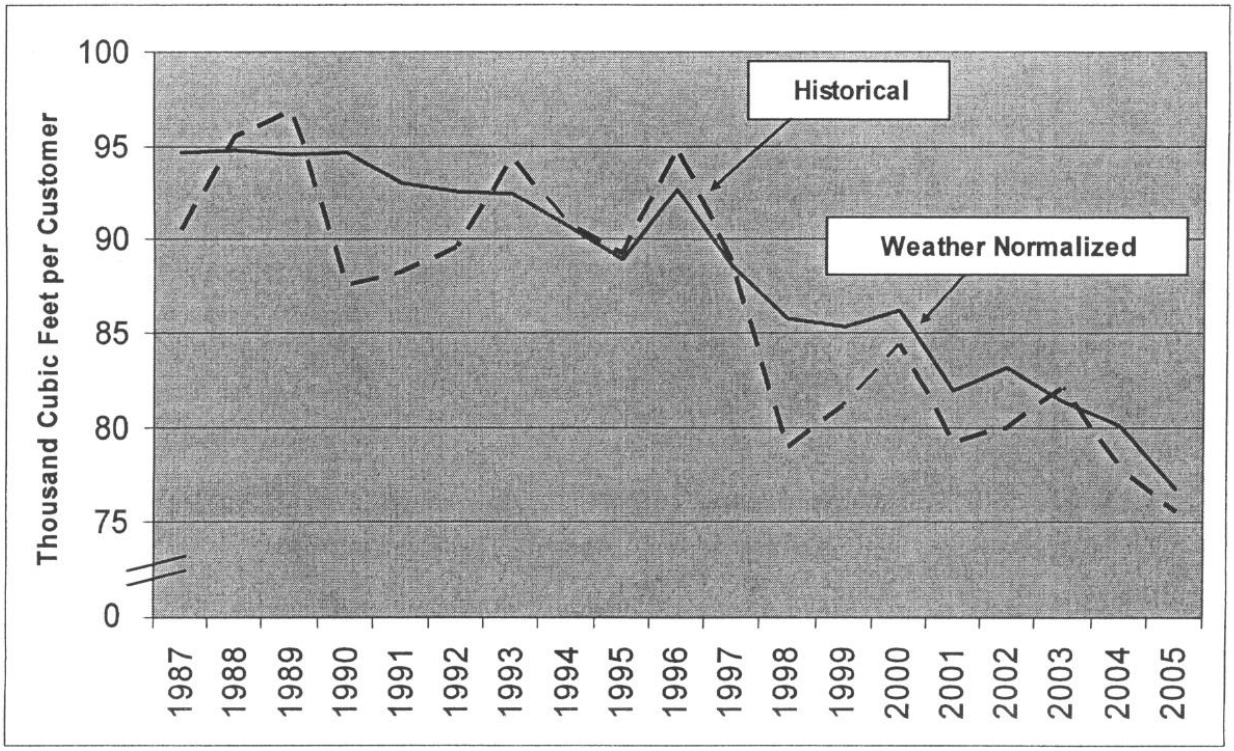
/ / / / / / /

/ / / / / / / /

[29] Order No. 4 in WUTC Docket No. UG-060518, at ¶ 17.

[30] Impact of Higher Natural Gas Prices on Local Distribution Companies and Residential Customers, Energy Information Administration, August 2007, p. 12 (labeled therein as "Figure 3. Average Consumption per Residential Customer, 1987-2005." I have changed the title and label in order to maintain consistent labeling of charts within my testimony.) Available at: http://www.eia.doe.gov/pub/oil_gas/natural_gas/feature_articles/2007/ngpristudy/ngpristudy.pdf.

**Chart 6: US Average Consumption per Residential Customer, 1987-2005**




Source: Energy Information Administration, Natural Gas Division, derived from EIA data published in the *Natural Gas Monthly* (consumption) and *Natural Gas Annual* (number of customers); and EIA's Short-Term Integrated Forecasting System (heating degree-days and normal heating degree-days).

Because of the long term negative usage per customer trend, it is no surprise that Avista and other LDC utilities have sought special regulatory treatment to automatically adjust delivery rates via decoupling, producing relatively automatic rate increases between formal rate cases to offset this trend. Usage per customer trends have been generally favorable in the electric utility industry, causing decoupling to be only rarely advocated by electric utilities.

**Q: In Order 04, the Commission noted its concern that decoupling may distort price signals from conservation and can produce a consequential dampening of**

**customer conservation.[31] Has Avista formulated any modification to the Mechanism that would answer this concern?**

A: No changes have been proposed by Avista that would change the fundamental outcome of decoupling, which is that gas delivery prices will rise more rapidly as per-customer usage declines, effectively punishing ratepayers with higher delivery prices that dilute the savings they would otherwise experience from conserving. Decoupling has the effect of creating two sub-classes of customers because of this feedback effect: those that actively conserve and have their gas cost savings diluted by higher delivery rates and those that do not conserve and are burdened with higher delivery rates with no corresponding savings in gas costs to moderate such impacts.

**Q: In Order 04, the Commission also noted its concern that decoupling is single issue ratemaking that violates the "matching principle" by assuring recovery of fixed costs while ignoring any potential cost savings that would be captured in a rate case.[32] Why is the matching principle important to any consideration of continuation of decoupling?**

A: The matching principle lies at the heart of traditional utility regulation, where all elements of the revenue requirement including sales/revenue levels, operating expenses, rate base and the cost of capital are simultaneously considered within an internally consistent test year. This synchronized and balanced measurement of all elements of the revenue requirement within a single test year assures the regulator that cost increases, productivity gains, changes in the volume of business and all

[31] Order No. 4 in WUTC Docket No. UG-060518, at ¶ 17
[32] Order No. 4 in WUTC Docket No. UG-060518, at ¶ 19.

other determinants of the overall cost to provide service are fairly considered. Single-issue ratemaking via cost-tracking tariffs or revenue decoupling arrangements tend to upset this balanced measurement approach, by selectively updating the revenue requirement calculations for only isolated changes on a piecemeal basis, while potentially offsetting changes are not considered.

**Q: What are the most common types of exceptions to the standard approaches to test period rate case regulation of energy utilities that you have described?**

A: Exceptions to the synchronized test period review of revenues and costs have been allowed in limited instances by regulators for certain large and volatile cost elements that are beyond the control of utility management and that might produce unacceptable financial outcomes if not allowed special treatment. The most common exception to traditional test period regulation is the widespread utilization of fuel adjustment clauses to periodically adjust rates, so as to track changes in the costs of purchased gas for local gas distribution utilities or to track changes in the costs of fuel used to generate electricity and/or the costs of purchased power. Power Cost Adjustment (PCA) and Purchased Gas Adjustment (PGA) mechanisms are used by many state regulators because fuel and purchased energy commodity costs are recognized to be:

- Large in relation to the total cost to provide utility service, and
- Subject to market forces (rather than management control), and
- Volatile and difficult to reasonably quantify in rate cases, and
- Substantial enough to cause potential earnings volatility if not tracked.

These concerns have justified the widespread use of purchased gas adjustment (PGA) clauses for gas distribution utilities in Washington and other states.

Another exception to traditional test period regulation that occurs with some regularity is the concept of deferral accounting, which is sometimes referred to as an accounting authority order. For designated transactions or types of costs, the utility may be allowed to deviate from the accounting otherwise required under Generally Accepted Accounting Principles (GAAP) or the Federal Energy Regulatory Commission (FERC) accounting principles set forth in the Uniform System of Accounts (USOA). Examples of accounting deferral orders might include extraordinary storm recovery costs or deferral of costs associated with merger transaction and transition costs, in an effort to mitigate the financial impact of extraordinary events or to better match cost recognition to the periods thought to benefit from a merger of utility entities. Here, Avista is seeking to make permanent deferral accounting for the changes in margin revenues caused by therm volume fluctuation within Schedule 101, after removal of New Customer volumes and the effects of weather normalization – with such accumulated deferrals translated into revenue changes on an annual basis.[33]

**Q: Does Avista's decoupling mechanism satisfy any of these general criteria for an exception to the policy against piecemeal ratemaking?**

[33] See Titus Evaluation Report, p. 8, pp. 35-44.

A: No. The decoupling deferrals recorded by Avista in 2007 and 2008 totaled $938,329 and $673,508, respectively.[34] The Washington lost margins for those same periods were reported in the Titus Report as $90,429 and $162,661, respectively.[35] These amounts, compared to Avista's proposed annual gas margin revenues of $56.0 million in the test year,[36] are minimal in relation to Avista's overall cost to provide LDC services. Decoupling deferrals are not needed to mitigate this negligible level of earnings volatility. The costs (actually foregone revenues) of declining gas usage are also not volatile or difficult to quantify within rate cases. In fact, rate cases represent an ideal forum for updating of customer usage, the number of customers, and all other elements of the revenue requirement determination.

**Q: Are the foregone revenues that are addressed by the Mechanism beyond the control of management, thus satisfying the final generalized criteria for piecemeal rate adjustment that you mentioned above?**

A: The criterion that would permit piecemeal rate treatment only when costs (or foregone revenues) are beyond utility management control would seem to be inapplicable to decoupling. Utilities have some control over the design and conduct of DSM programs and expenditure levels. Indeed, the premise advanced by decoupling proponents is that decoupling is needed because of management's inherent financial disincentive against, and thus presumed control over energy conservation. However, in reality, I believe that Avista management likely has very

[34] Avista Exhibit No. ___(BJH-2) Titus Evaluation Report at p. 2, Table 1.
[35] Titus Report, Table E-2.
[36] Avista Exhibit No.___(TLD-7), p. 2 of 3, l. 32, column f.

little control over much of the observed decline in weather-normalized gas usage per residential customer that has occurred historically and continues to occur. The long-standing downward trend in gas use per customer is driven largely by the continual replacement of inefficient older homes and appliances and ratepayers' independently funded efforts to conserve, particularly in response to recently high natural gas prices. In my view, the commendable desire among regulators to promote unfettered utility management support for conservation has provided the LDC industry with a convenient opportunity to promote piecemeal ratemaking in the form of decoupling for the long-standing negative residential gas usage trend, arguing that decoupling would "remove the disincentive" and make utility management indifferent with respect to sales volumes.

## VI. COMPLEXITY AND ADMINISTRATIVE BURDENS

**Q: How do piecemeal ratemaking tariffs like the decoupling mechanism impact regulatory complexity and administrative costs?**

A: The addition of piecemeal ratemaking tariffs such as Avista's decoupling mechanism add complexity to regulatory processes in several ways. First, each new piecemeal tariff creates new regulatory accounting and reporting in support of periodic price changes that must be created by utility company staff and then reviewed by Commission personnel and other interested parties. Then, it may be necessary for Commission Staff to organize and conduct audits of the financial data underlying the filings, since customer prices are directly impacted by such data. If any disputes arise from either informal review procedures or more comprehensive audits, it may

be necessary to develop formal discovery and dispute resolution procedures. When applicable review procedures are completed, the utility must implement the rate change along with any customer disclosures that may be required and then be ready to respond to customer inquiries arising from rate changes. Unfortunately, because tracking tariffs are designed to facilitate expedited rate changes, the processes just described must often occur within a compressed timeline that can frustrate efforts for thorough review and contribute to increased costs to the utility, the regulatory agency and other concerned parties.

**Q: Are there particular attributes of the Avista decoupling Mechanism that contribute to its complexity?**

A: Yes. Several characteristics of the Avista Mechanism add complexity and potential controversy to the process of reviewing and verifying the Mechanism:

- Decoupling calculations exclude gas usage fluctuations caused by abnormal weather. This characteristic requires every month's decoupling deferral calculations to be dependent upon accurate calculation of weather normalization adjustments.
- Decoupling deferrals are subject to a DSM savings achievement test, requiring periodic verification audits of DSM therm savings claims to determine amounts recoverable from ratepayers. The complexity of evaluating DSM program results is discussed in Ms. Kimball's testimony for Public Counsel.

- As presently structured, the decoupling deferral calculations require a specific accounting for new customers' therm usage, as a carve-out for retention of related margins for shareholders.
- Decoupling is applied only to Schedule 101 customers. The net effect of customers switching between rate schedules (primarily to and from Schedule 111) can improperly impact deferral calculations. Mr. Hirschkorn has proposed, at page 13 of his testimony, revisions to the Mechanism, "to adjust actual monthly usage to remove the net effect of customers switching between schedules during the month."[37]
- An earnings "test" is applied, requiring the submission and verification of achieved earnings as a condition of decoupling deferral recovery.

Thorough regulatory review of all of these elements would entail significant costs be borne by the Commission Staff and all concerned interveners, to be sure that decoupling charges to customers are reasonably determined.[38]

**Q: Did the Titus Report identify areas of complexity that make administration of the Mechanism difficult?**

A: Yes. The Evaluation Report noted several issues and errors that have required attention and/or accounting corrections during the initial term of the pilot Mechanism:

[37] Avista's Response to Public Counsel Data Request No. 277 explains how a rate schedule comparison report could be used prospectively to identify and quantify the adjustment required each month for customers switching rate schedules.
[38] These administrative costs can be expected to expand proportionately if additional Washington utilities are permitted to commence decoupling on the same terms as the Avista pilot program.

- Double counting for revenue-related gross-up factors is described at page 37 of the Evaluation Report.
- Errors were discovered by Avista in the program used to isolate therm usage needed for the new customer adjustment, as noted on pages 37 and 49 of the Evaluation Report.
- Changed methodologies to calculate weather normalization were implemented January 1, 2008, according to page 37 of the Evaluation Report, impacting the determination of the decoupling deferral weather adjustment.
- Accumulated Deferred Income Tax entry errors and rate of return calculation errors were noted at page 38 of the Evaluation Report.
- Customer migrations occurring between Rate Schedules 101 and 111complicate the accurate calculation of deferrals, as noted at page 65 of the Evaluation Report.

The complexity of the Mechanism is revealed by the issues that have already been encountered during the pilot period, indicating the significant resource commitment that will be needed to administer and monitor any continuation of decoupling for Avista or for other Washington utilities. It is simply not a rational use of resources to create an on-going regulatory mechanism of such multi-level analytic and administrative complexity in order to address lost margin revenue impacts that totaled only $90,429 in 2007 and $162,661 in 2008.

## VII. ALTERNATIVES TO DECOUPLING

**Q: If the Commission concludes that there is a need for financial incentives to encourage Avista DSM, does Public Counsel propose any alternative to decoupling?**

A: Yes. Public Counsel supports a direct incentive approach, more narrowly tailored to address the Company's conservation performance. Such an approach would be more favorable and equitable to ratepayers than decoupling because it could be designed to be proportional to the lost margins actually experienced by Avista when its gas customers participate in DSM programs and could be more broadly applied beyond Schedule 101 to recognize that other rate schedules also participate in and benefit from DSM.

**Q: What should be the key elements of such an incentive mechanism?**

A: I have not been asked by Public Counsel to develop or recommend any specific mechanism. However, the desirable components of a reasonable DSM incentive mechanism would include:

- Clearly defined DSM performance targets, with meaningful measurement, verification and reporting of results achieved by the utility relative to such targets.
- Incentive structures designed to encourage Avista to manage DSM programs in a cost-effective manner.
- Incentive amounts that are proportional to replacement of the lost margins actually experienced as a result of DSM performance.

- Administratively simple, so as to not consume excessive resources of the utility, the Commission and other concerned parties.

**Q: How should be Commission proceed if this approach is viewed as desirable?**

A: If the Commission favors this approach, the parties to this proceeding should be directed to work collaboratively toward agreement upon such a mechanism, for implementation in the next Avista general rate case.

## VIII. CONCLUSION AND RECOMMENDATION

**Q: What conclusions are supported by your testimony?**

A: My testimony explains how the Titus Report answers certain questions raised by the Commission and other parties at the time the pilot decoupling mechanism was first approved for use by Avista. The Titus Report shows that:

- The lost margins associated with gas DSM programs in Washington are a small fraction of the gas margin revenues collected by Avista via decoupling deferrals, indicating that the Mechanism is not reasonable or proportional as a tool for mitigating lost margins from DSM.
- Avista's Washington gas DSM expenditures have increased, but more significant DSM spending increases have occurred for the gas business outside Washington and within Avista's electric DSM programs.DSM gas therm savings have changed more dramatically in Idaho, where there is no decoupling, than in Washington after the pilot had commenced.
- There is no proven causal connection between Avista DSM savings and expenditures and Avista's decoupling program.

- The decoupling deferrals recorded by Avista were increased significantly as a result of the New Customer Adjustment.

With these facts in hand, my testimony explains how the many concerns identified in the Commission's Order No. 04 that initiated the pilot Mechanism now support a conclusion that the Mechanism should be terminated rather than continued. Finally if the Commission finds that some incentive is needed to encourage utility support for ongoing DSM, a direct incentive approach driven by measured and verified DSM performance achieved by Avista could be a reasonable replacement for the flawed decoupling mechanism.

**Q: Does this conclude your testimony at this time?**

A: Yes.