

Exhibit No. \_\_\_\_ T (DJR-1T)  
Docket UE-090134/UG-090135  
and UG-060518 (consolidated)  
Witness: Deborah J. Reynolds

**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

<b>WASHINGTON UTILITIES AND</b>	)	<b>DOCKETS UE-090134</b>
<b>TRANSPORTATION COMMISSION,</b>	)	<b>and UG-090135</b>
	)	<i>(consolidated)</i>
<b>Complainant,</b>	)	
	)	
<b>v.</b>	)	
	)	
<b>AVISTA CORPORATION, d/b/a</b>	)	
<b>AVISTA UTILITIES,</b>	)	
	)	
<b>Respondent.</b>	)	
.....	)	
	)	
<b>In the Matter of the Petition of</b>	)	<b>DOCKET UG-060518</b>
	)	<i>(consolidated)</i>
<b>AVISTA CORPORATION, d/b/a</b>	)	
<b>AVISTA UTILITIES,</b>	)	
	)	
<b>For an Order Authorizing</b>	)	
<b>Implementation of a Natural Gas</b>	)	
<b>Decoupling Mechanism and to Record</b>	)	
<b>Accounting Entries Associated With</b>	)	
<b>the Mechanism.</b>	)	
.....	)	

**TESTIMONY**

**OF**

**DEBORAH J. REYNOLDS**

**STAFF OF  
WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION**

**August 17, 2009**

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## **LIST OF EXHIBITS**

Exhibit No. \_\_\_\_ (DJR-2), Bill Analysis Model

TESTIMONY OF DEBORAH J. REYNOLDS  
Dockets UE-090134 and UG-090135  
and UG-060518 (consolidated)

Exhibit No. \_\_\_\_ T (DJR-1T)  
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1 I. INTRODUCTION

2  
3 Q. Please state your name and business address for the record.

4 A. My name is Deborah Reynolds. My business address is the Richard Hemstad Building,  
5 1300 S. Evergreen Park Dr. SW, Olympia, WA 98504-7250. My e-mail address is  
6 [dreynold@utc.wa.gov](mailto:dreynold@utc.wa.gov).

7  
8 Q. What are your professional qualifications?

9 A. I have worked for the Commission since 1999 in the regulatory services division. I am  
10 primarily responsible for reviewing, analyzing, and evaluating conservation programs,  
11 conservation resource planning, rate design, decoupling, reliability, service quality, low-  
12 income issues, and other analyses of general rate case and tariff filings involving electric  
13 and natural gas utilities regulated by the Commission. I have offered testimony before the  
14 Commission and have presented many open meeting items. I provide external technical  
15 assistance for companies on energy regulatory matters.

16 I have a 1994 Bachelor of Science degree in General Studies emphasizing ecology  
17 and statistics and a 2002 Master of Regional Planning degree, both from Washington  
18 State University. I attended the National Association of Regulatory Utility  
19 Commissioners' Annual Regulatory Studies Program in August 2004, the New Mexico  
20 State University's rate case basics workshop in May 2008, Electric Utility Consultants,  
21 Inc.'s cost of service and rate design workshops in August 2008, International Energy  
22 Program Evaluation Conference and training in August 2009, as well as a number of  
23 other utility related seminars, conferences, and training opportunities.

1 **Q. What is the purpose of your testimony?**

2 A. My testimony describes the backdrop against which the Company's request to  
3 permanently extend the decoupling mechanism should be considered. It also reviews  
4 statements from the Commission's orders concerning decoupling and other relevant rate  
5 design issues, briefly describes related filings, responds to Company testimony  
6 concerning decoupling and energy efficiency investment, presents alternatives, and  
7 recommends an alternative regulatory approach to the Company's proposal.

8

9 **Q. What do you recommend regarding continuation of the decoupling mechanism?**

10 A. I recommend the mechanism be phased out over the next year by increasing the Schedule  
11 101 basic charge to \$8 per month, decreasing the Schedule 101 usage charge to the  
12 amount shown in Staff witness Joanna Huang's Exhibit No. \_\_\_ (JH-4), and decreasing  
13 the Schedule 159 margin rate to \$0.19765 per therm effective January 1, 2010. Effective  
14 January 1, 2011, I recommend increasing the basic charge to \$10 per month, adjusting the  
15 usage charge using the methodology shown in Ms. Huang's Exhibit No. \_\_\_ (JH-4), and  
16 discontinuing the decoupling deferral.

17 In the alternative, if the Commission wishes to continue the decoupling  
18 mechanism, the following modifications should be made:

- 19
- Remove the new customer adjustment
  - Add the Schedule 101 and Schedule 111 migration adjustment as
- 20 described by the Company
- 21

22

1 **Q. Do you recommend any changes in Commission oversight of Company conservation**  
2 **programs regardless of whether the decoupling mechanism is continued?**

3 A. Yes. I recommend the Commission direct the Company to convene meetings with Staff  
4 and interested parties to design conservation reporting and stakeholder involvement  
5 protocols, including expansion of the Company's evaluation standards. The results of  
6 these meetings should be filed with the Commission within twelve months of the final  
7 order.

8

9 **II. DECOUPLING BACKGROUND**

10

11 **Q. Please describe the history of the Company's decoupling mechanism to date.**

12 A. On February 1, 2007, the Commission entered a Final Order Approving Decoupling Pilot  
13 Program<sup>1</sup> allowing Avista Corporation (Avista) to implement a mechanism to decouple  
14 its rates for conducting business operations, in part, from its rates for commodity sales.  
15 Company witness Brian Hirschhorn's testimony<sup>2</sup> provides a complete description of the  
16 mechanism on pages thirteen through nineteen. On March 31, 2009, the Company filed  
17 an evaluation of the decoupling mechanism. On May 1, 2009, the Company filed a  
18 request to extend the decoupling mechanism until the Commission completed its  
19 consideration of whether it should be implemented permanently.<sup>3</sup> On May 15, 2009, the

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<sup>1</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Order 04, ¶¶ 1-49 (February 1, 2007).

<sup>2</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Petition, Motion, Direct Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, RE: Order Continuing a Natural Gas Decoupling Mechanism with Associated Accounting Entries, Hirschhorn Exhibit No. \_\_\_\_ (BJH-1T), Pages 13-19 (May 1, 2009).

<sup>3</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Petition, Motion, Direct Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, RE: Order Continuing a Natural Gas Decoupling Mechanism with Associated Accounting Entries (May 1, 2009).

1 Commission consolidated the decoupling docket with the Company's general rate case.<sup>4</sup>  
2 On June 30, 2009, the Commission granted a temporary extension of the decoupling  
3 mechanism.<sup>5</sup>  
4

5 **Q. What is a revenue decoupling mechanism?**

6 A. A decoupling mechanism renders revenue levels immune to changes in sales by adjusting  
7 retail rates either upwards or downwards depending upon how revenues collected through  
8 usage charges for the recovery of fixed costs over a certain period compare with those  
9 fixed costs authorized under the decoupling mechanism.<sup>6</sup> These differences between  
10 collected and authorized revenues may be the result of changes in weather, increases in  
11 customer numbers, or changes in energy efficiency behavior by either the company or the  
12 customers. Limited decoupling mechanisms isolate and remove individual causes of the  
13 differences, such as weather. Partial decoupling mechanisms allow the recovery of only  
14 part of the difference. Avista's decoupling mechanism is both limited, because the effects  
15 of weather are excluded from the tracking mechanism, and partial because up to ninety  
16 percent of the difference from the targeted revenue is allowed for recovery.  
17

18 **Q. What is the intended effect of a revenue decoupling mechanism?**

19 A. It is intended to encourage the company to increase its investment in conservation.  
20

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<sup>4</sup> *WUTC v. Avista Utilities*, Dockets UE-090134, UG-090135, and UG-060518, Order 06, ¶¶ 1-18 (May 15, 2009).

<sup>5</sup> *WUTC v. Avista Utilities*, Dockets UE-090134, UG-090135, and UG-060518, Order 07, ¶¶ 1-36 (June 30, 2009).

<sup>6</sup> Cappers, Peter, et al. *Financial Analysis of Incentive Mechanisms to Promote Energy Efficiency: Case Study of a Prototypical Southwest Utility*. Ernest Orlando Lawrence Berkeley National Laboratory. March, 2009. LBNL-1598E. Page 7.

1 **Q. Has the Commission considered decoupling and other rate design modifications to**  
2 **encourage conservation in other cases?**

3 A. The Commission has considered rate design modifications to encourage conservation for  
4 both electric and natural gas utilities. In Docket UE-060266, the Commission adopted an  
5 electric conservation incentive program for PSE.<sup>7</sup> In Docket UE-050684, the Commission  
6 provided guidance regarding the necessary elements of a proposal to decouple rates from  
7 usage charges.<sup>8</sup> Docket UG-050369 was a rulemaking where the Commission considered  
8 policies to remove the recovery of fixed costs from customers' usage charges. The  
9 Commission closed the rulemaking without adopting new rules, concluding instead:

10 The Commission believes that the wide variety of alternative approaches to  
11 decoupling make it more efficient to address these issues in the context of specific  
12 utility proposals included in general rate case filings rather than through a generic  
13 rulemaking.<sup>9</sup>

14 Since the close of that rulemaking, the Commission has ruled on natural gas decoupling  
15 proposals in two additional proceedings. In Docket UG-060267, the Commission rejected  
16 PSE's request for a natural gas decoupling mechanism because its conservation program  
17 was already well-developed.<sup>10</sup> In Docket UG-060256, the Commission adopted, with  
18 modification, Cascade's decoupling pilot program.<sup>11</sup>

19

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<sup>7</sup> *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-060266 and UG-060267, Order 08 at ¶¶145-158 (January 5, 2007).

<sup>8</sup> *WUTC v. PacifiCorp*, Docket UE-050684, Order 05 at ¶¶ 103-110 (June 28, 2006).

<sup>9</sup> *Rulemaking to Review Natural Gas Decoupling*, Docket UG-050369, Notice of Withdrawal of Rulemaking (October 17, 2005).

<sup>10</sup> *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-060266 and UG-060267, Order 08, ¶¶ 59-63 (January 5, 2007).

<sup>11</sup> *WUTC v. Cascade Natural Gas Corporation*, Docket UG-060256, Order 06, ¶¶ 67-85 (January 12, 2007).





1 **Q. Was the Decoupling Evaluation complete?**

2 A. No. As the final report was being reviewed, Staff strongly urged the Company to allow  
3 the consultant to draw conclusions and make recommendations about the design of the  
4 mechanism as described in the second paragraph of the Evaluation Plan.<sup>21</sup> Other parties  
5 on the Stakeholder Advisory Group resisted this recommendation. Staff believes the key  
6 question to be answered was whether conservation increased as a result of implementing  
7 decoupling. In answering that question, the consultant should have discussed the potential  
8 advantages and disadvantages of the program, including risk factors and any changes in  
9 risk to the customer or the Company, as well as whether price signals were appropriate  
10 under the mechanism, and whether there was evidence of changes in customer behavior  
11 due to the mechanism. These areas are both directly and indirectly related to the  
12 mechanism, and the Commission would have benefited from a more thorough analysis by  
13 the consultant.

14  
15 **Q. Did Staff analyze the mechanism independently, based on the questions and  
16 concerns identified by the Commission in its order granting the pilot mechanism?**

17 A. Yes. The following sections discuss the areas of Commission interest, describe the  
18 Company's response, if any, and present Staff's conclusions.

19  
20 **A. Did the Decoupling Mechanism Increase Conservation?**

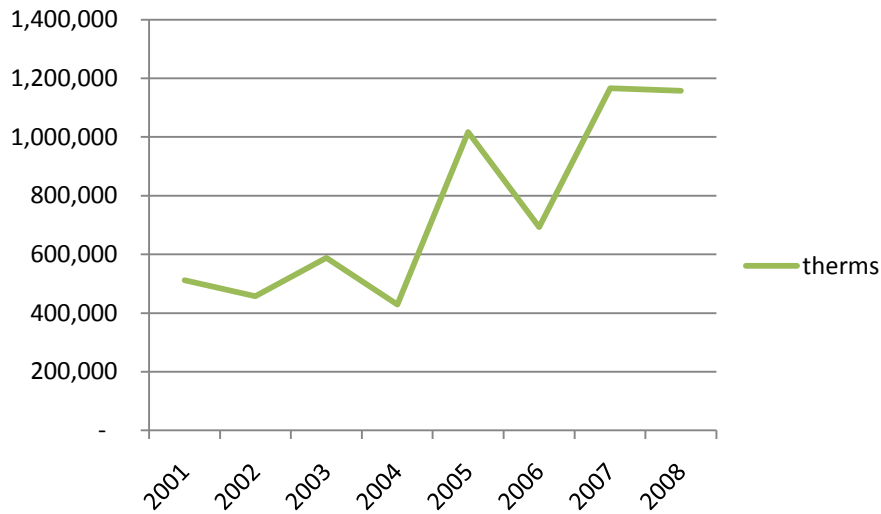
21  
22 **Q. What effect did Avista's decoupling mechanism have on its conservation program?**

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<sup>21</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Evaluation Plan, ¶¶ 2 (filed April 30, 2008).

1 A. Avista had a fairly well developed conservation program before the decoupling  
2 mechanism was put in place. The conservation program spending and therm savings both  
3 increased during the term of the decoupling mechanism. However, during the last four  
4 years, therm savings have fluctuated wildly, decreasing almost as much as they increased.

5 **Avista Therm Savings**



6

7 **Q. Do these fluctuations in therm savings suggest any areas of concern?**

8 A. Yes. The Company does not have a very robust evaluation program. They do not hire  
9 third party consultants to perform conservation potential assessments, nor do they  
10 perform surveys to assess the performance of their programs. Staff recommends that the  
11 Company should be directed to convene meetings with Staff and interested parties to  
12 design conservation reporting and stakeholder involvement protocols, including  
13 expansion of the Company's evaluation standards. The results of these meetings should  
14 be filed with the Commission within twelve months of the final order.

15

1 **Q. Could significant investment in conservation have an eventual effect?**

2 A. Yes. There will always be a probability that significant investment in conservation would  
3 reduce company revenues because a portion of fixed costs are recovered in the usage  
4 charge. However, this would happen over time. Frequent rate cases, with rates reset  
5 based on most recent load levels, have been the company's response to this problem.  
6 Increasing the amount of revenue recovered through the basic charge as recommended in  
7 my testimony will help address this problem.

8

9 **Q: What prior actions of the Commission bear on the cost effectiveness and prudence**  
10 **of Avista's Energy Efficiency Program?**

11 A: In the Staff memo to the Commission on January 29, 2009, Staff recommended that the  
12 Company should include a discussion of "the cost effectiveness of the resource."<sup>22</sup> The  
13 resource in this quote is for demand side resources or DSM.

14

15 **Q: Did the Company present this discussion in the current rate case?**

16 A: Yes. The DSM program is linked to the decoupling mechanism, as the program is  
17 designed to encourage conservation while avoiding a financial penalty to the Company.

18

19 **Q: Has Avista demonstrated that the decoupling mechanism has enhanced their**  
20 **conservation efforts in a cost-effective manner?**

21 A: The answer to this question is not clear. The Company has demonstrated that their  
22 conservation efforts have been enhanced. This is most notably seen in the descriptions of

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<sup>22</sup> Dockets UE-082272 and UG-090052, Staff Open meeting memo, January 29, 2009.

1 their efforts in the “Every Little Bit” campaign as well as their increased budget and  
2 customer paid incentives. This is described in the testimony of Company witnesses  
3 Powell,<sup>23</sup> Hirschhorn,<sup>24</sup> and Folsom.<sup>25</sup>

4 In addition, this has been done in a cost effective manner, as demonstrated by the  
5 fact that they have exceeded their DSM goals in their IRP for 2007 and 2008, achieving  
6 137% of the DSM goals for these years, while maintaining program-wide benefit-to-cost  
7 ratios exceeding 1.0 for gas and electric, for both the Utility Cost Test and the Total  
8 Resource Cost test. This is described in the testimony of Company witnesses Powell,  
9 Hirschhorn, and Folsom as well as in the Company’s response to Staff data request  
10 number 151.<sup>26</sup>

11 However, it is unclear to what extent the price signal under the decoupling  
12 mechanism, which results in very small changes to a customer’s monthly bill, actually  
13 affected customers’ implementation of conservation measures. Other factors such as  
14 programmatic DSM programs, education and social norms may in fact be more  
15 motivational for behavior change for conservation than the small difference in price  
16 experienced by the average consumer. Ultimately, the Company recognizes that it would  
17 be a simpler and appropriate financial method to bill customers directly for actual fixed

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<sup>23</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Petition, Motion, Direct Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, RE: Order Continuing a Natural Gas Decoupling Mechanism with Associated Accounting Entries, Powell Exhibit No. \_\_ (JP-1T), Pp. 2 (May 1, 2009).

<sup>24</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Petition, Motion, Direct Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, RE: Order Continuing a Natural Gas Decoupling Mechanism with Associated Accounting Entries, Hirschhorn Exhibit No. \_\_ (BJH-1T), Pp. 9 (May 1, 2009).

<sup>25</sup> *WUTC v. Avista Utilities*, Dockets UE-090134, UG-090135, and UG-060518, Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, Folsom Exhibit No. \_\_ (BWF-1T), Pp. 3 (January 23, 2009).

<sup>26</sup> Company response to Staff data request 151, Attachment A, page 17, Table 9E (WA).

1 and variable costs.<sup>27</sup> This would certainly reduce some administrative costs to the  
2 Company that flow through to customers. The Company stated that their customers are  
3 “reducing their natural gas usage in ways other than through direct participation in the  
4 Company’s DSM programs.<sup>28</sup>” This may be a fruitful topic of additional inquiry as the  
5 decoupling and DSM programs move forward.  
6

7 **Q: Did Avista acquire the electric and gas conservation resources prudently?**

8 A: Yes. These conservation resources were acquired prudently due to the fact that the IRP  
9 goals were exceeded within benefit-to-cost ratios that were significantly below the  
10 avoided cost and exceeded a 1.0 test threshold for all the Avista programs in Washington.  
11

12 **B. Are Price Signals Correct?**

14 **Q. What factors should be considered in reviewing price signals under the mechanism?**

15 A. A review of price signals should consider low, high, and average use customer  
16 experience under the current tariff and consider what happens to typical customer bills  
17 under multiple conservation scenarios. It should also compare price signals under other  
18 rate designs. The review should also compare the message the customer gets from the  
19 price signal to the impact of that price signal on the Company. The Company does not  
20 provide this kind of analysis. The Evaluation report on pages 42 and 43 provides only

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<sup>27</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Petition, Motion, Direct Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, RE: Order Continuing a Natural Gas Decoupling Mechanism with Associated Accounting Entries, Hirschhorn Exhibit No. \_\_\_\_ (BJH-1T), Page 5 (May 1, 2009).

<sup>28</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Petition, Motion, Direct Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, RE: Order Continuing a Natural Gas Decoupling Mechanism with Associated Accounting Entries, Hirschhorn Exhibit No. \_\_\_\_ (BJH-1T), Page 11 (May 1, 2009).

1 low, high, and average use customer bill impacts under the current decoupling  
2 mechanism.

3 Proponents of decoupling mechanisms suggest that maintaining higher usage  
4 charges are a stronger incentive for customers to conserve, even though that very  
5 situation has the opposite effect on the Company's incentive to invest in conservation  
6 measures. It is very difficult, however, to generalize about incentives to conserve, even  
7 among the same class of customers. In the Company's Schedule 101, for example,  
8 customer use varies from a low of about 18 therms per month for water-heat-only  
9 customers, to a high of 155 therms in the winter months for customers using gas for  
10 space-and-water-heat.

11  
12 **Q. Did Staff perform the needed analysis?**

13 A. Yes. See my Exhibit No. \_\_\_ (DJR-2), a Bill Analysis Model. The Bill Analysis Model  
14 shows what would happen to customer bills when customers conserve under three rate  
15 designs: the current tariff rate design which includes the current decoupling surcharge, a  
16 straight fixed variable rate design, and the Staff proposed rate design. The Bill Analysis  
17 Model also shows a worst case decoupling analysis, using a ten percent reduction in all  
18 Schedule 101 usage to demonstrate what might happen if company investment in  
19 conservation became truly effective. Staff believes a ten percent conservation reduction is  
20 a reasonable analysis because it is less than the decline in use per customer that has  
21 occurred over the last ten years. The model then goes even further and looks at a fifty  
22 percent reduction in all Schedule 101 usage. This amount of conservation is unheard of,  
23 and extremely unlikely. This is intended to evaluate the long term sustainability of a

1 particular rate design. It does not take into account annual rate cases that would true up  
2 the basic and usage charges rather than increase the decoupling surcharge.

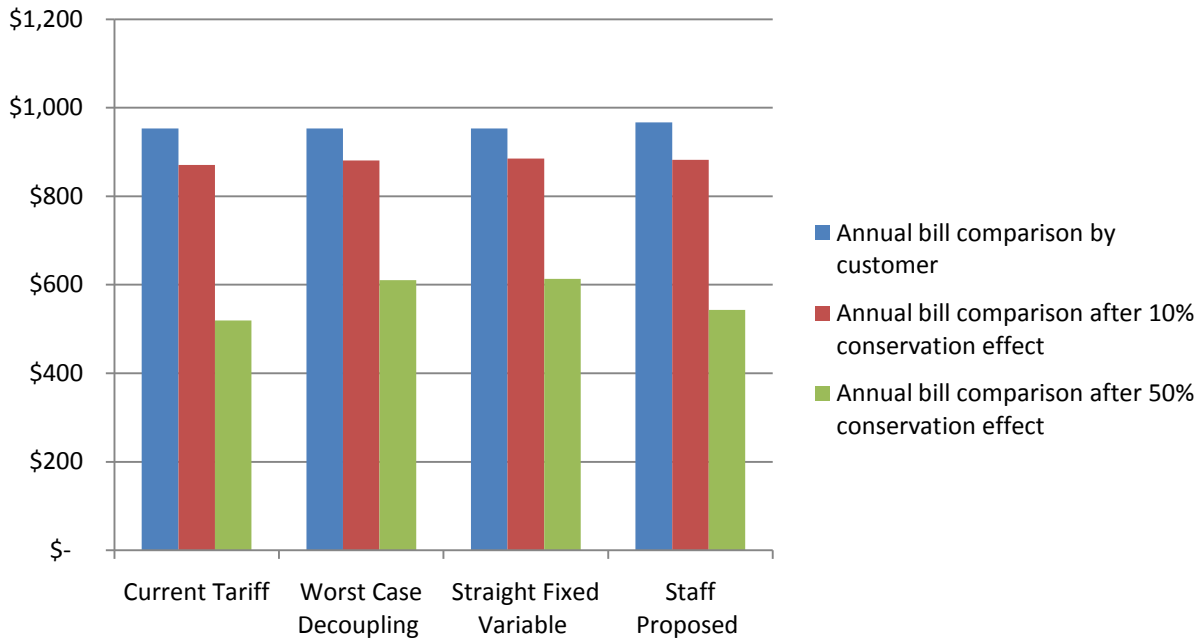
3  
4 **Q. How would an average use customer's bill change if he reduced use by ten percent?**  
5 **By fifty percent?**

6 A. If an average use customer using 70 therms per month reduced his use by ten percent, the  
7 bill would decrease by nine percent under either the current tariff rate design or the Staff  
8 proposed rate design. Under the straight fixed variable rate design, the same average use  
9 customer's bill would decrease by seven percent. If it were possible for an individual  
10 average use customer to reduce his use by fifty percent, the bill would decrease by forty-  
11 six percent under the current tariff rate design. The bill would decrease by thirty-six  
12 percent under either the worst case decoupling mechanism or the straight fixed variable  
13 rate design. Under the Staff proposed rate design, the bill would decrease by forty-four  
14 percent.



1

### Comparison of Decline in Average Use Customer Bill



2

3

There are two points to take away from this analysis. First, the three different rate designs all reward the average use customer when the customer conserves natural gas. Second, the bill impact on an average use customer is almost exactly the same under either the worst case decoupling analysis or the straight fixed-variable rate design. This means that if the Company investment in conservation becomes truly successful, the customer will experience the same bill impacts under either rate design.

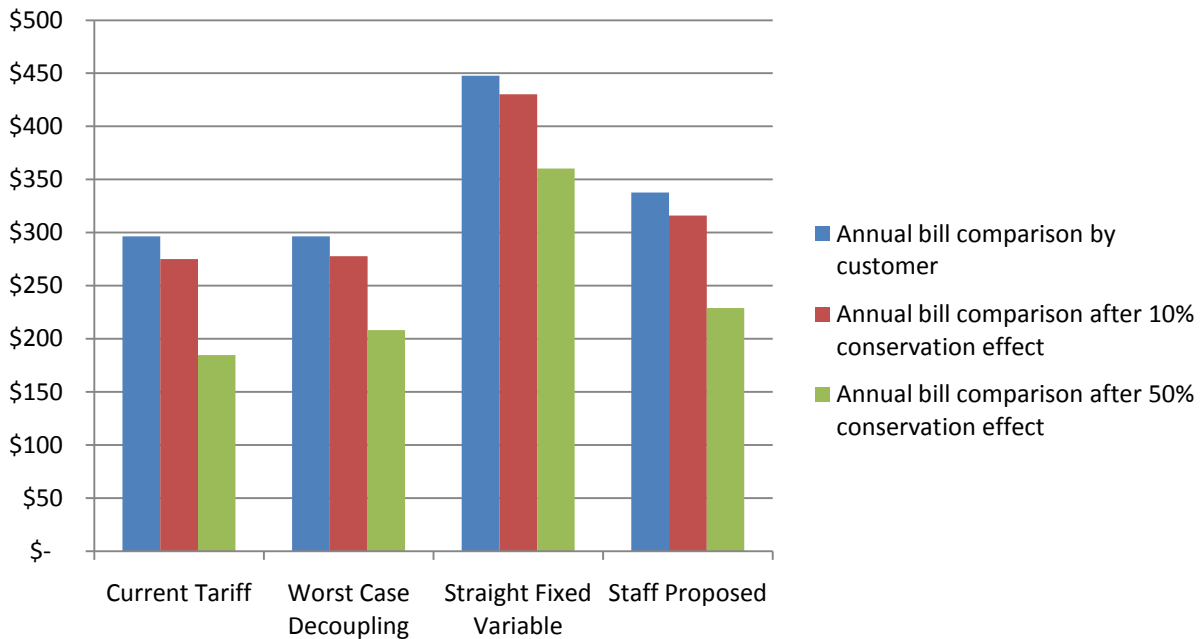
9

10 **Q. How would a low-use customer’s bill change if she reduced her use by ten percent?**  
 11 **By fifty percent?**

12 **A.** If a low-use customer using 18 therms per month reduced her use by ten percent, her bill  
 13 would decrease by seven percent under the current tariff rate design including the  
 14 decoupling surcharge. Her bill would decrease by six percent under the Staff proposed

1 rate design. Under the straight fixed- variable rate design, the same low-use customer's  
 2 bill would decrease by four percent. If it were possible for an individual low-use  
 3 customer to reduce her use by fifty percent, her bill would decrease thirty-eight percent  
 4 under the current tariff rate design, twenty percent under the straight fixed-variable rate  
 5 design, and thirty-two percent under the Staff proposed rate design.

6 **Comparison of Decline in Low-use Customer Bill**



7  
 8 The important point here is that all three rate designs do reward the low-use  
 9 customer for conserving. The low-use customer, while probably a fairly small proportion  
 10 of the company's customer base, does present some unique problems. While the three  
 11 rate designs do not change the annual bill for an average customer, this is obviously not  
 12 the case for the low-use customer. The straight fixed-variable rate design would increase  
 13 a low-use customer's bill by 51 percent. The Staff proposed rate design would increase a  
 14 low-use customer's bill by fourteen percent. Staff believes it is appropriate to gradually

1 increase low-use customer bills until they more closely recover the costs of maintaining  
2 their connections to the system.

3  
4 **Q. What kind of analysis might go into a decision to install a new natural gas hot water  
5 heater?**

6 A. When the water-heat-only customer made her decision about converting to natural gas  
7 water heating, she made her decision based on the capital cost of the improvement and  
8 the return of her investment over time. She may have also considered converting space  
9 heating, but her home may have needed duct work that would be very expensive, so she  
10 elected to only install the gas hot water heater.

11  
12 **Q. What is impact on the Company of the current tariff's price signal to the low-use  
13 customer?**

14 A. According to the Company's current rate presentation, the current average annual fixed  
15 cost for each Schedule 101 customer is about \$270.<sup>29</sup> The current annual amount paid by  
16 a water-heat-only customer is \$296. Assuming the same percentage of fixed costs  
17 collected through the usage charge and including the basic charge, \$123 of that goes  
18 toward the fixed costs of the system, which is only 45 percent of the \$270 it costs the  
19 Company to serve that customer. Therefore, the decision to install the gas water heater  
20 was based on incorrect information. Because of this incorrect price signal, the Company  
21 will be collecting only 45% of the fixed cost associated with this low-use customer until  
22 the rate design changes.

---

<sup>29</sup> Calculated by adding annual basic charge revenues to margin rate times average annual use per Schedule 101 customer. See Exhibit No. \_\_\_\_ (DJR-2).

1 **Q. What are the principles of sound rate design?**

2 A. Sound rate design should be guided by the following policy objectives: simplicity,  
3 encouraging conservation, stability, gradualism, fairness, justness, reasonableness, and  
4 sufficiency.<sup>30</sup>

5 Simple rates are made up of units of service like kilowatt hours or therms that are  
6 easy for customers to understand. If rates are complicated, the price signal may get lost in  
7 the noise. Different rate designs are appropriate for customers with different levels of  
8 sophistication. Residential customers may be best served by a fixed monthly charge and a  
9 charge per unit of use, where large commercial customers may be best served by per unit  
10 charges for both demand and energy.

11 Fair rates should create a system where each customer and each customer class  
12 pays for the costs they impose on the system. This principle, also called cost causation, is  
13 actually very difficult to achieve, because customers within a given class have similar but  
14 not identical usage characteristics. It is also difficult to keep fair rates simple. For  
15 example, rate designs that include demand charges increase the number of elements that  
16 make up a customer bill. This complicates the bill, but more accurately reflects the costs  
17 imposed on the system by a particular customer.

18 Gradualism means that changes in rates to achieve a particular goal are made in  
19 steps, rather than all at once, thus mitigating substantial impacts to any one rate schedule  
20 or customer within a schedule. The idea of gradualism may be used to evaluate overall  
21 bill changes as well as changes in components of bills, such as the customer basic charge.

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<sup>30</sup> Bonbright, James C., Albert L. Danielson and David R. Kamerschen, *Principles of Public Utility Rates*, 2<sup>nd</sup> Ed, (Arlington, VA: Public Utilities Reports, Inc., 1988) Pages 382-388.

1 Sufficiency means that rates provide a reasonable opportunity for a utility to  
2 recover its costs of providing service plus a fair return on its investment. The  
3 Commission has suggested that the right balance point for recovery of fixed costs via the  
4 customer basic charge is about one-fourth of the fixed costs allocated to residential  
5 customers, or about eight to ten percent of a customer's average annual bill.<sup>31</sup>

6 As the costs of the electric and natural gas systems increase, more attention has  
7 been directed toward energy efficiency through the exploration of rate designs that  
8 encourage customers to use the least amount of energy possible to achieve the same  
9 desired comfort levels. Until recently, utilities were encouraged to increase the per unit  
10 charge as much as possible, with the idea that customers will reduce their use when they  
11 see their bills increase. This effect, also called price elasticity, is hard to measure and  
12 even harder to predict.

13  
14 **C. Did the Company Over Earn?**

15  
16 **Q. Did the decoupling mechanism meet the earnings test?**

17 A. Yes. In Docket UG-071863, the Company provided a copy of its 2006 Commission basis  
18 report showing that its annual rate of return with restating adjustments at 7.61 percent  
19 was less than the Commission approved 9.11 percent rate of return. In Docket UG-  
20 081601, the Company provided a corrected copy of its 2007 Commission basis report  
21 showing that its annual rate of return with restating adjustments at 7.79 percent was less  
22 than the Commission approved 8.20 percent rate of return.

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<sup>31</sup> *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-060266 and UG-060267, Order 08, ¶¶ 139 (January 5, 2007).

1 **D. Is Recovery Proportional to Company-Sponsored DSM?**

2

3 **Q. Is the recovery under the decoupling mechanism appropriately proportional to the**  
4 **margin lost to Company-sponsored DSM?**

5 A. No. The Company responds to this question on page 11 of Mr. Hirschorn's testimony.  
6 However, according to the decoupling evaluation report,<sup>32</sup> over the first two years of the  
7 program, the Company deferred \$1,573,628, while it lost \$396,610 of margin due to  
8 company-sponsored DSM. Even if we incorporated multi-year losses, the Company still  
9 deferred \$1,040,329, or three times the impact of its DSM program. This information,  
10 however, does not address whether this is the right proportional relationship. The  
11 evaluation report did not attempt to measure how much of the margin may have been  
12 associated with market transformation or information programs sponsored by the  
13 company. The evaluation report did not attempt to address any hypothetical situations, or  
14 to model any variations in decoupling mechanism design.

15

16 **Q. Should the decoupling mechanism be tied directly to only Company-sponsored**  
17 **conservation?**

18 A. No. The purpose of the decoupling mechanism was to remove the Company's  
19 disincentive to invest in conservation by stabilizing the amount of revenue the Company  
20 could count on collecting. The Evaluation Report did not try to determine the causes of  
21 the non-Company-sponsored conservation. Staff believes it is very difficult to accurately

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<sup>32</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Petition, Motion, Direct Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, RE: Order Continuing a Natural Gas Decoupling Mechanism with Associated Accounting Entries, Hirschorn Exhibit No. \_\_\_\_ (BJH-2), Page 2 (May 1, 2009).

1 identify Company-sponsored versus non-direct reductions in energy use. Therefore, Staff  
2 recommends the decoupling mechanism include all reductions.

3  
4 **E. Does the Mechanism Include the Right Customers?**

5  
6 **Q. Did the Company earn a greater rate of return from Schedule 101 customers than**  
7 **from other customers?**

8 A. Yes. Company witness Mr. Hirschorn shows the present rate of return by schedule  
9 based on the per books amounts. According to his calculations, Schedule 101's present  
10 rate of return is 6.98 percent, while Schedule 111 is 6.93 percent and Schedule 121 is  
11 6.48 percent.<sup>33</sup> If the revenue received from the mechanism were included in the  
12 company's calculations, the return would be even higher. Staff does not accept these  
13 numbers for the purposes of rate spread or rate design. However, even though they do not  
14 include the revenue from the decoupling mechanism, they are still illustrative of a class  
15 inequity that is exacerbated by the decoupling mechanism.

16  
17 **Q. Should other customers be included in the application of the decoupling surcharge?**

18 A. No. The mechanism currently applies to Schedule 101 customers. Schedule 111, Large  
19 General Service customers, typically averaging more than 200 therms per month, are  
20 currently excluded from the mechanism in both its calculation and its rate application.

21 The exclusion of large commercial and industrial customers is appropriate because their  
22 gas usage can vary substantially because of economic conditions and other factors

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<sup>33</sup> *WUTC v. Avista Utilities*, Dockets UE-090134, UG-090135, and UG-060518, Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, Hirschorn Exhibit No. \_\_\_\_ (BJH-7), Page 2 (January 23, 2009).

1 unrelated to conservation. Including these customers in the mechanism would be a  
2 significant shift of risk from the Company to the ratepayers.

3  
4 **Q. Should usage from customers switching between Schedule 101 and Schedule 111 be  
5 removed from the mechanism?**

6 A. The Company is proposing a refinement to remove usage of customers that switch  
7 between Schedule 101 and Schedule 111 during the year from the calculation of the  
8 deferral.<sup>34</sup> According to the Evaluation Report, the net result would have been a \$74,000  
9 decrease in the deferral amount.<sup>35</sup> Staff believes this refinement is appropriate, because  
10 the migration between the schedules turned out to be a bigger amount than was expected.  
11 Staff witness Ms. Huang's testimony discusses minimizing migration through the  
12 application of the rate design. See Exhibit No. \_\_\_\_ (JH-1T).

13  
14 **Q. Should the calculation of the mechanism continue to remove new customers?**

15 A. No. The point of the decoupling mechanism is to stabilize revenues for the Company.  
16 Historical growth in electric revenue has been driven by increases in both use per  
17 customer and customer numbers. However, natural gas has been experiencing a decline in  
18 use per customer for at least ten years. The mechanism's current design assumes that the  
19 Company's costs per customer have no incremental component. This is not correct. The  
20 Company, for example, does not have to go out and buy a new bucket truck every time

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<sup>34</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Petition, Motion, Direct Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, RE: Order Continuing a Natural Gas Decoupling Mechanism with Associated Accounting Entries, Hirschorn Exhibit No. \_\_\_\_ (BJH-1T), Page 13 (May 1, 2009).

<sup>35</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Petition, Motion, Direct Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, RE: Order Continuing a Natural Gas Decoupling Mechanism with Associated Accounting Entries, Hirschorn Exhibit No. \_\_\_\_ (BJH-2), Page 65 (May 1, 2009).



1 they add a customer to the system. There are clear economies of scale that should be  
2 recognized. However, the new customer adjustment is currently so large that removing it  
3 changes the deferral from \$674,000 collected from customers to \$203,000 refunded to  
4 customers.<sup>36</sup> Staff believes an alternative rate design would better serve the policy goal of  
5 stabilizing the Company's revenue.

6  
7 **Q. Why does natural gas use per customer continue to decline?**

8 A. These declines can be attributed to technological improvements in energy codes,  
9 customer response to increasing natural gas prices (elasticity), and company sponsored  
10 demand-side management programs. Natural replacement of failed equipment results in  
11 energy use reductions because new equipment must meet new standards. Even when a  
12 customer buys a minimum efficiency appliance by today's standards, it is typically much  
13 better than what she is replacing. Today's building codes reduce energy intensity, or use  
14 per square foot, in new housing stock compared to old stock. Therefore, even though  
15 housing sizes have been increasing (2,400 square feet<sup>37</sup> for new stock versus 2250 square  
16 feet<sup>38</sup> for all stock) the improvement in energy intensity per square foot over time has  
17 probably contributed to the declining natural gas use per customer, and will probably  
18 continue to contribute to its decline. The Evaluation Report, Docket UG-060518, Exhibit

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<sup>36</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Petition, Motion, Direct Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, RE: Order Continuing a Natural Gas Decoupling Mechanism with Associated Accounting Entries, Hirschhorn Exhibit No. \_\_\_\_ (BJH-2), Page 50 (May 1, 2009).

<sup>37</sup> RLW Analytics, Inc., *Residential New Construction (Single and Multi-Family) Billing Analysis* (Portland, OR: Northwest Energy Efficiency Alliance) <http://www.nwalliance.org> October 11, 2007.

<sup>38</sup> Calculated by Staff from Puget Sound Energy's most recent conservation potential assessment, available in Docket UE-080949.

1 No. \_\_\_\_ (BJH-2),<sup>39</sup> on Page 52, found that there was very little difference between raw  
2 average use per customer and raw average use per new customer. It did not provide  
3 enough information to evaluate whether there was a trend in use per new customer. It is  
4 interesting, if only anecdotally, that average use per new customer actually declined  
5 while average use per customer increased slightly. These numbers are only anecdotal  
6 because they are not weather-normalized, 2008 was a colder than normal winter, and  
7 there is no analysis of statistical significance.

8  
9 **F. Did Risk Shift?**

10  
11 **Q. Did risk shift from the Company to ratepayers as a class?**

12 A. Yes. The Company responds affirmatively to this question on page 19 of Mr.  
13 Hirschorn's testimony. The evaluation report specifically excludes analysis of risk on  
14 page 5. The mechanism captures the effect of changes in customer usage due to  
15 conservation and price elasticity. As a customer class reduces usage, the decoupling  
16 surcharge will increase,<sup>40</sup> and the Company no longer bears a risk of reduced revenue.

17  
18 **Q. Did risk change for the Company?**

19 A. Yes. The Company experiences a reduction in risk from the changes in use due to  
20 conservation. On page 20 of Mr. Hirschorn's testimony, he says "to the extent [...] fixed

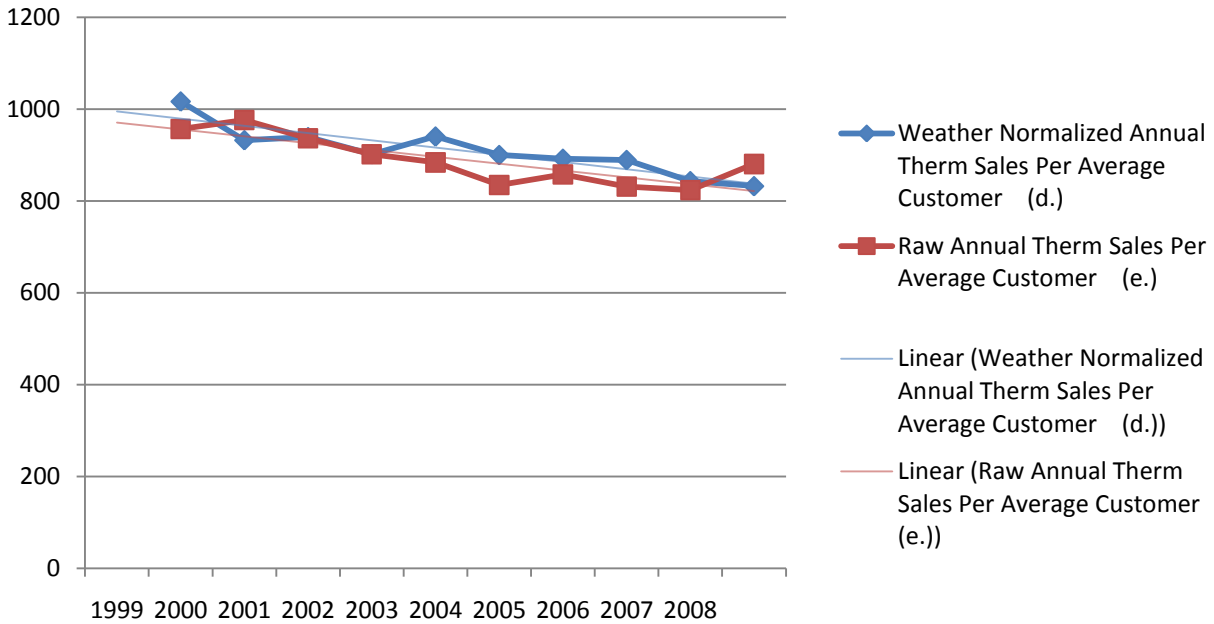
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<sup>39</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Petition, Motion, Direct Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, RE: Order Continuing a Natural Gas Decoupling Mechanism with Associated Accounting Entries, Hirschorn Exhibit No. \_\_\_\_ (BJH-2), Page 52 (May 1, 2009).

<sup>40</sup> *WUTC v. Avista Utilities*, Docket UG-060518, Petition, Motion, Direct Testimony and Exhibits on behalf of Avista Corporation from Kelly Norwood, RE: Order Continuing a Natural Gas Decoupling Mechanism with Associated Accounting Entries, Hirschorn Exhibit No. \_\_\_\_ (BJH-2), Page 4 (May 1, 2009).

1 costs increase, or escalate, over time, the Mechanism does not provide recovery of that  
2 change in costs.” While true, this does not address whether the Company’s risk has  
3 changed. Use per customer has been declining over the last ten years. The decoupling  
4 mechanism alleviates this risk, which is the relevant risk to consider.

5 **Avista Natural Gas Use Per Customer<sup>41</sup>**



6  
7 These efficiency gains are mentioned when justifying investments in plant in  
8 every rate case the Company files. The reduction in risk to the Company is, therefore,  
9 larger than it appears on its face. In addition, as the Evaluation Report shows on page 4,  
10 actual weather adjustments have been much smaller than other changes in usage, calling  
11 into question whether the Company was actually experiencing very much weather risk.

12

<sup>41</sup> Avista Response to Public Counsel Data Request 179, Attachment A.

1 **G. Do Advantages Outweigh Disadvantages?**

2

3 **Q. What are the benefits of Avista's decoupling mechanism?**

4 A. The design of the Avista decoupling mechanism was carefully crafted to overcome the

5 potential drawbacks associated with full decoupling mechanisms. The effect of these

6 limits on the decoupling mechanism caused it to retain, as much as possible, the status

7 quo. Therefore, the benefits of the decoupling mechanism are in large part the same as

8 the benefits of the standard two-part tariff employed as the underlying rate design.

9 Weather risk is still borne by the Company. Increases in customer numbers still result in

10 increases in revenue. Year-over-year rate volatility is still largely the result of changes in

11 gas costs. The only benefit of the decoupling mechanism itself is that it moved individual

12 customer bill experience closer to what would happen under levelized rates, providing an

13 easier transition to the Staff proposed rate design.

14

15 **Q. What are the drawbacks of Avista's decoupling mechanism?**

16 A. The limits on the decoupling mechanism caused it to retain, as much as possible, the

17 status quo. Therefore, the drawbacks of the decoupling mechanism are in large part the

18 same as the drawbacks of the standard two part tariff employed as the underlying rate

19 design. Year-over-year recovery of fixed costs is directly related to sales of therms, rather

20 than number of customers connected to the system. Large residential users still contribute

21 more than their share of fixed costs, and small users still contribute less than their share

22 of fixed costs. Small users are over-incented to connect to the system. The most

23 significant drawback of the decoupling mechanism itself is the significant increase in

1 Company and Staff time for the review and analysis required to ensure that the  
2 mechanism is working as desired.

3  
4 **IV. RECOMMENDED ALTERNATIVE REGULATORY PROPOSAL**

5  
6 **Q. Does Staff recommend any modifications to the decoupling mechanism if it is**  
7 **continued?**

8 A. Yes.

9  
10 **Q. Does Staff recommend the decoupling mechanism be continued?**

11 A. Only temporarily. Instead of a decoupling mechanism, Staff recommends gradually  
12 increasing the Schedule 101 basic charge to \$10 a month and decreasing the usage charge  
13 as shown in Staff witness Ms. Huang's Exhibit No. \_\_ (JH-4). This change increases the  
14 amount of fixed revenue the company collects through the basic charge without  
15 increasing the company's Schedule 101 revenue requirement. This stabilizes the revenue  
16 the company can expect, without creating complicated accounting requirements and  
17 complex rates for Schedule 101 customers.

18  
19 **Q. Should this happen immediately or should it be phased in?**

20 A. Staff recommends a two year phase-in, using the decoupling mechanism through the  
21 2010 rate year combined with a first year increase in the basic charge to \$8 per month  
22 taking effect January 1, 2010. In the second year, the decoupling mechanism should be  
23 suspended and the basic charge should increase to \$10 per month taking effect January 1,

1 2011. This will more gradually move customers to paying more of their fixed costs  
2 through the basic charge, which will help low-use customers (water-heat-only) adjust to  
3 the change. This change is also consistent with the Commission's observations in Order  
4 05, Dockets UE-070804, et al., at paragraph 29:

5 As a general proposition, there are sound reasons supporting  
6 recovery of a greater proportion of a utility's fixed costs in basic or  
7 demand charges, rather than in energy or commodity charges. For  
8 example, in an environment of increasing costs, a rate design that  
9 increases the recovery of fixed costs in fixed charges can promote  
10 rate stability while tempering the need for higher returns by  
11 reducing the risk the Company faces in terms of overall rate  
12 recovery.  
13

14 **Q. Are any other changes necessary to implement this change?**

15 A. Yes. The Schedule 101 usage charge will need an interim adjustment, and the margin rate  
16 set in Schedule 159 will need an adjustment as well. The methodology for the interim  
17 adjustment should follow the rate design methodology found in Staff witness Ms.  
18 Huang's Exhibit No. \_\_\_ (JH-4).

20 **Q. What do you recommend to reduce the effect of this change on low-income  
21 customers?**

22 A. Staff recommends that the Company implement a reduced monthly charge for low-  
23 income customers of \$3 per month. The revenue for this will be recovered through the  
24 Schedule 191 surcharge. Customers that qualify for LIHEAP or LIRAP any time during  
25 the program year (October-October) will be granted the reduced monthly charge through  
26 the end of the program year, at which time they will be restored to the standard charge.

1 **Q. What is the impact to the Schedule 191 surcharge by implementing this**  
2 **recommendation?**

3 A. The rate would increase to approximately \$0.00965 over the next three years, which  
4 would increase the average residential customer's bill (using 70 therms a month)  
5 approximately \$0.11/month.  
6

7 **Q. How much information is reviewed annually for the decoupling mechanism?**

8 A. There are seven reports adding up to over 300 pages that must be reviewed to analyze the  
9 decoupling mechanism. This does not include the 900 pages of exhibits with the  
10 Evaluation Report.

11 **Reporting Required for Mechanism Evaluation**

<b>Aspect of Mechanism</b>	<b>Report</b>	<b>Citation</b>
<b>The Deferral Amount: It deferred 90% of the margin difference, either positive or negative, for later recovery (or rebate) subject to:</b>	Quarterly Report showing monthly deferral calculation and historical monthly balance, general ledger accounts.	UG-060518 Settlement pg 9
<b>An earnings test - Avista could not earn more than its authorized rate of return.</b>	Annual decoupling surcharge filing - relies on annual Commission Basis report.	UG-060518 Settlement pg 5 and 8
<b>A demand side management (DSM) test - recovery based on Avista achieving specific conservation targets.</b>	Annual decoupling surcharge filing - relies on DSM Verification Report (see below)	UG-060518 Settlement pg 7 and 8
<b>Annual Rate Changes: The Mechanism limited annual rate increases due to the Mechanism to 2% annually.</b>	Annual decoupling surcharge filing	UG-060518 Settlement pg 8

<b>Review of DSM Savings: The Company retained an independent third party to audit the results of DSM savings reported for decoupling purposes.</b>	Annual DSM Verification Report required before annual decoupling surcharge filing.	UG-060518 Settlement pg 7 and 9
<b>Decoupling Evaluation: Prior to filing a request to continue the Mechanism beyond its initial term, the Company must evaluate its results.</b>	Evaluation required by March 31, 2009	UG-060518 Order 05
<b>Triple E Conservation Reports including therms saved, dollars budgeted and spent, cost effectiveness calculations, tariff rider expenditures and recovery.</b>	Quarterly conservation reports as part of DSM evaluation and annual conservation rider tariff filing.	UG-090052

1

2 **Q. Would all these reports be necessary if the Staff proposal is adopted?**

3 A. No.

4

5 **Q. Does this conclude your testimony?**

6 A. Yes.