**EXHIBIT NO. \_\_\_(EAF-1T)
Docket Nos. UE-121697/UG-121705
WITNESS:  Edward A. Finklea**

**BEFORE THE**

**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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| In the Matter of the Petition ofPUGET SOUND ENERGY, INC. and NW ENERGY COALITIONFor an Order Authorizing PSE To Implement Electric and Natural Gas Decoupling Mechanisms and To Record Accounting Entries Associated With the Mechanisms |  | Dockets UE-121697 and UG-121705 *(Consolidated)* |

**RESPONSE TESTIMONY OF EDWARD A. FINKLEA**

**ON BEHALF OF**

**THE NORTHWEST INDUSTRIAL GAS USERS**

**April 26, 2013**

**RESPONSE TESTIMONY OF EDWARD A. FINKLEA**

# I. INTRODUCTION AND SUMMARY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

**A.** My name is Edward A. Finklea. My business address is 326 Fifth Street, Lake Oswego, OR 97034.

Q. PLEASE DESCRIBE YOUR BACKGROUND AND EXPERIENCE.

**A.** I currently serve as the Executive Director of the Northwest Industrial Gas Users and am also an adjunct professor of Law and Economics at Lewis and Clark Law School. Prior to my current positions, I was Senior Counsel for Nisource Corporate Services, serving as regulatory counsel for an interstate pipeline on matters before the Federal Energy Regulatory Commission. For over two decades I was in the private practice of law and the Northwest Industrial Gas Users were one of my clients. My complete qualifications are included with this testimony as Exhibit No.\_\_\_(EAF-2).

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

**A.** I am testifying on behalf of the Northwest Industrial Gas Users (“NWIGU”). NWIGU is a non-profit trade association whose members are large volume customers served by local distribution utilities throughout the Pacific Northwest, including Puget Sound Energy (“PSE” or “Company”).

**Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

**A.** The purpose of this testimony is to address the Amended Petition for Decoupling Mechanisms (“Amended Petition”) submitted jointly by PSE and the Northwest Energy Coalition (“NWEC”) that is being supported by the Staff of the Washington Utilities and Transportation Commission (“Commission”) as part of the proposed multiparty settlement of issues related to Dockets UE-121697 and UG-121705 (the “Decoupling Docket”), Docket UE-121373 (relating to the acquisition of Coal Transition Power), and PSE’s Expedited Rate Filing (“ERF”) in Dockets UE-130137 and UG-130138. This settlement proposal is also referred to as the “Global Settlement.”

**Q. PLEASE DESCRIBE IN SUMMARY TERMS WHAT THESE DOCKETS MEAN FOR NATURAL GAS CUSTOMERS.**

As stated in the testimony of Michael Deen on behalf of NWIGU, these dockets represent an expedited rate filing which updates natural gas margin revenues from the last general rate case to a test year ending June 2012 and a decoupling proposal that includes annual 2.2% increases for delivery related costs (i.e. non- purchased gas costs) for the two to three year duration of the proposed settlement. Issues related to PSE’s proposed acquisition of Coal Transition Power are also addressed in the Global Settlement but those issues are strictly related to electricity service and have no significance for natural gas customers.

**Q. DOES YOUR TESTIMONY RELATE TO EITHER THE ERF DOCKET OR THE COAL TRANSITION POWER DOCKET?**

**A.** No. NWIGU’s testimony relating to the ERF Docket and the Coal Transition Power Docket is being submitted through Michael Deen. My testimony will address issues relating only to the Decoupling Docket.

**Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS FOR THE DECOUPLING DOCKET.**

**A.** NWIGU has found that the Global Settlement as proposed, which adopts the proposed Decoupling Mechanism without modification, is not in the public interest and would not produce fair, just, and reasonable rates for natural gas service from PSE to its customers. The proposed decoupling mechanism does not provide any gas conservation benefits. The proposal also attempts to provide PSE with the benefits of guaranteed cost recovery without capturing any benefits of lower capital and equity costs that should otherwise flow to PSE’s gas customers. Moreover, the record is void of any legitimate basis for applying the Decoupling Mechanism to PSE’s industrial customers – especially those industrial customers on a transportation schedule.

For these reasons, and reasons stated in the testimony of Michael Deen, NWIGU recommends that the Global Settlement and its constituent parts should be rejected in their entirety. However, if the Commission wishes to continue with the Global Settlement construct, NWIGU has a number of recommendations to make the proposal more balanced for consumers, in addition to the recommendation presented in the testimony of Michael Deen:

* The Decoupling Mechanism should be modified to exclude its application to gas customers on schedules 85/85T and 87/87T.
* Cost of capital should be considered as an issue in the Global Settlement.

**II. ANALYSIS OF THE DECOUPLING MECHANISM**

**Q. What is the purpose of PSE’s Decoupling Mechanism?**

**A.** According to page 4 of the Amended Petition, the primary purpose of the Decoupling Mechanism is to “substantially diminish the throughput incentive that exists under PSE’s current ratemaking structure.” As a variation on this purpose, that same portion of the Amended Petition describes an effort to solve a “predicament” whereby PSE alleges it is unable to recover delivery costs when it successfully implements its conservation programs.

**Q. YOU DESCRIBED A “PRIMARY” PURPOSE. IS THERE ANOTHER PURPOSE BEHIND PSE’S DECOUPLING MECHANISM.**

**A.** Yes. Independent of PSE’s efforts to address an alleged “throughput incentive,” and as stated on page 4 of the Amended Petition, the Decoupling Mechanism is also intended to address “revenue shortfall between rate cases that the decoupling mechanism on its own does not resolve.”

**Q. Has the commission provided guidance On what factors, if any, it will consider as part of a full decoupling mechanism?**

**A.** Yes. PSE’s and NWEC’s justification for the proposed Decoupling Mechanism relies heavily on the Commission’s investigation into energy conservation mechanisms as part of Docket U-100522 in 2010. The outcome of that docket was a policy statement that would be used to guide the Commission’s consideration of future decoupling proposals.[[1]](#footnote-1) Although the commission expressed some reluctance in the Policy Statement to consider full decoupling in the future, it did state that a properly constructed proposal could be a useful tool. Specifically, the Commission saw potential benefits to customers because decoupling would reduce a company’s debt and equity costs.[[2]](#footnote-2) Those benefits would flow to customers by yielding rates that would be lower than they otherwise would be to account for a reduction in overall risk to the utility.[[3]](#footnote-3)

**Q. CAN YOU DESCRIBE THE ELEMENTS OF FULL DECOUPLING THAT THE COMMISSION’S POLICY STATEMENT ANTICIPATED?**

**A.** The Commission clearly stated in the Policy Statement that it would consider a full decoupling proposal in the context of a general rate case. Moreover, the Commission stated that a full decoupling mechanism would have to be conditioned upon a utility’s level of achievement with respect to its conservation target. The Commission then set out some minimum elements that must be included in such a decoupling mechanism: (1) a true-up mechanism; (2) an evaluation of impact on rate of return; (3) a proposed earnings test; and (4) accounting for off-system sales and avoided costs.

**Q. WHAT IS MEANT BY “CONDITIONED UPON A UTILITY’S LEVEL OF ACHIEVEMENT WITH RESPECT TO ITS CONSERVATION TARGETS”?**

**A.** The Commission has made it clear that a decoupling mechanism should be approved only where it results in a quantifiable increment of conservation that would not otherwise be achieved. The Commission lists that expectation as one of the criteria for approval in the Policy Statement.

**Q. DOES THE PROPOSED DECOUPLING MECHANISM INCLUDE THE MINIMUM ELEMENTS THE COMMISSION SET FORTH IN THE POLICY STATEMENT?**

**A.** No. The proposed Decoupling Mechanism lacks any evaluation on the mechanism’s impact on rate of return.[[4]](#footnote-4) This oversight is significant in light of the Commission’s statement that it is willing to consider full decoupling only because of the potential reduction in a company’s debt and equity costs.

**Q. DOES THE PROPOSED DECOUPLING MECHANISM CONTAIN ANY OTHER FLAWS?**

**A.** Yes. As noted earlier in my testimony, the Commission stated that full decoupling would be conditioned upon a utility’s level of achievement with respect to conservation targets. More precisely, the Commission contemplated that a full decoupling proposal would result in some additional increment of conservation achievements. PSE and NWEC appear to acknowledge this in the Amended Petition on page 5 where they argue that decoupling will remove disincentives for conservation and that “the decoupling mechanism proposed in this petition will require PSE to stretch even farther – **beyond its Commission-approved target** – to accelerate conservation savings.”[[5]](#footnote-5) The promise to stretch even farther, however, is a hollow one with respect to PSE’s gas operations. PSE has simply failed to describe *any* additional conservation that will result from the decoupling proposal. In fact, PSE has been quite candid that its gas conservation achievements will remain identical with or without the decoupling mechanism.[[6]](#footnote-6)

**Q.** **IN ADDITION TO THE LACK OF ANY INCREMENTAL GAS CONSERVATION ACHIEVEMENTS, DOES NWIGU FIND ANY OTHER FLAWS IN THE PROPOSAL?**

**A.** Yes. PSE has provided no rationale, consistent with the goals of the proposal, for applying the mechanism to gas transportation customers. A common goal of any decoupling mechanism is to break the link between a utility’s recovery of fixed costs and its revenue from volumetric charges. Or, as PSE and NWEC describe it, the goal is to remove the “throughput incentive,” which is the utility’s incentive to sell higher volumes in order to recover its fixed costs. That linkage, however, does not exist for gas transportation customers because those customers purchase their own gas and the utility provides no incentives to those customers to invest in conservation measures. Gas transportation customers, under well-established commission precedent, do not participate in company funded conservation programs. Simply put, PSE does not face any risk that company-funded conservation investments will result in lower cost recovery from gas transportation customers.

**Q. HOW DO PSE AND NWEC RESPOND TO THAT CRITICISM?**

**A.** When asked in a data request, neither PSE nor NWEC could state how the proposed Decoupling Mechanism actually reduces the Company’s throughput incentive with respect to gas transportation customers. Instead, PSE and NEWEC each avoided that question and offered a separate reason, unrelated to the throughput incentive, for applying the mechanism to gas transportation customers. Specifically, each stated that the mechanism would stabilize the Company’s revenue by serving as a disincentive for customers to switch back and forth between rate schedules.[[7]](#footnote-7) This is not a well-reasoned response. First, that response fails to explain how switching rate schedules creates any impact to the Company, and fails to grapple with the fact that there are customer benefits to having flexibility in a choice of schedules. Second, PSE’s tariffs are already structured in a way to prevent arbitrary switching between rate schedules that could otherwise be used to “game the system.” For example, PSE’s tariffs impose conversion penalties that essentially commit a customer to a specific rate schedule for a specified time period. Third, the better way to address the problem PSE has identified with potential switching is to not apply the decoupling mechanism to Schedule 85 and 87 sales and transportation customers.

**Q. ARE THERE OTHER REASONS GAS TRANSPORTATION CUSTOMERS SHOULD NOT BE INCLUDED IN THE MECHANISM?**

**A.** Yes. Another expressly stated goal for full decoupling put forward by PSE and NWEC is to reduce the impact of Company-sponsored conservation on the Company’s ability to recover fixed costs. The decoupling proposal ignores the fact that gas transportation customers do not pay into or receive any benefits from company-sponsored conservation. To the extent that the Company’s ability to recover revenue is limited by its conservation efforts, that dynamic is unique to non-transportation customers and cannot be used as a basis for applying the mechanism to gas transportation customers.

**Q.** **PSE and NWEC appear to rely heavily on the fact that the Commission has already analyzed and provided tacit approval for the proposed mechanism. What is your testimony with RESPECT to that position?**

**A.**  On page 11 of the Amended Petition, PSE and NWEC state the following: “In sum, the Commission has recently completed a full analysis of decoupling in general and for PSE specifically, including a decoupling proposal that included most elements of the decoupling proposal that PSE and the Coalition are presenting in this case.” This is a common theme in the Amended Petition and the supporting testimony, and also appears to be the basis for Staff’s approval of the Global Settlement, which would adopt the Amended Petition without any modification. That viewpoint, however, is highly misleading. The Commission’s review of NWEC’s prior proposal in PSE’s last rate case was not a “full” analysis because it did not include a proposal for the Company’s gas operations. Mr. Cavanaugh acknowledges as much in his testimony and in response to a data request on this matter.[[8]](#footnote-8) The Commission’s only other recent review of a decoupling mechanism in the gas context was in Avista’s last general rate case. The distinction there, obviously, is that the Avista decision was made as part of a general rate case, when the Commission had the ability to take into consideration all of the various costs components impacting that utility’s operations. The Commission was able to expressly consider rate of return with that proposal, unlike here, where PSE has gone to great lengths to avoid any consideration of rate of return. It is disingenuous for the Company and NWEC to act as if there is no new ground being broken here. Not only is the proposal new ground for this Commission, but I am not aware of any decoupling program in Washington or other states that applies to gas transportation customers. When asked, NWEC was also unable to identify any existing program that applies to gas transportation customers.[[9]](#footnote-9)

**Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

**A.** Yes.

1. *In re WUTC Investigation into Energy Conservation Incentives*, Docket U-100522, Report and Policy Statement on Regulatory Mechanisms, including Decoupling, to Encourage Utilities to Meet or Exceed Their Conservation Targets (Nov. 4, 2010) (hereinafter, “Policy Statement”). [↑](#footnote-ref-1)
2. *Id.* at p. 16. [↑](#footnote-ref-2)
3. *Id.* at pp. 16-17. [↑](#footnote-ref-3)
4. *See* Exhibit No.\_\_(JAP-1T) at 33:3-5*.* [↑](#footnote-ref-4)
5. Emphasis added. [↑](#footnote-ref-5)
6. Exhibit No.\_\_(EAF-3) at p.1 (PSE’s Response to NWIGU DR No. 011). [↑](#footnote-ref-6)
7. Exhibit No.\_\_(EAF-3) at pp. 2-3 (PSE Response to NWIGU DR No. 013 and NWEC Response to NWIGU DR No. 3). [↑](#footnote-ref-7)
8. *See, e.g.,* Exhibit No.\_\_(RCC-3T), 2:3-5. [↑](#footnote-ref-8)
9. Exhibit No.\_\_(EAF-3) (NWEC Response to NWIGU DR No.5). [↑](#footnote-ref-9)