

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

CASCADE NATURAL GAS
CORPORATION,

Respondent.

DOCKET NO. UG-060256

**INITIAL BRIEF OF CASCADE
NATURAL GAS CORPORATION**

DATED: November 15, 2006

Cascade Natural Gas Corporation

James M. Van Nostrand
Perkins Coie LLP
1120 NW Couch Street, Tenth Floor
Portland, OR 97209-4128

Attorney for Cascade Natural Gas
Corporation

TABLE OF CONTENTS

I.	PROCEDURAL BACKGROUND.....	1
II.	OVERVIEW OF THE CASE.....	3
III.	THE COMMISSION SHOULD ADOPT THE SETTLEMENT AGREEMENT.....	4
	A. The Standard for Approval of the Settlement Agreement	4
	B. The Record Demonstrates That the Settlement Agreement Is Consistent with the Law and Public Interest, and Represents a Reasonable Resolution of the Issues in this Proceeding	5
	1. Revenue Requirement Issues.....	5
	a. Cost of Capital.....	7
	b. Gas Management Services.....	8
	(i) Provisions of the Settlement Agreement.....	8
	(ii) Inter-Relationship with Separate Complaint Proceeding.....	9
	c. Weather Normalization.....	10
	2. Miscellaneous Service Charges.....	10
	3. Low-Income Assistance	11
	4. Decoupling Mechanism	12
	a. Scope of Mechanism.....	13
	b. Weather Normalization Methodology	14
	c. Pilot Program.....	14
	d. Limitation on Deferrals.....	15
	e. Conservation Program and Performance	15
	f. Basis for Approving Settlement Agreement Recommendation to Implement Decoupling.....	18
	5. Rate Spread.....	19
	6. Rate Design.....	20
	a. Transportation Customers.....	20
	b. Basic Charges	21
	c. Other Rate Design Changes	22
	7. SRIAM.....	22
	C. Cascade's Position on the Remaining Contested Issues.....	23
	1. Decoupling Should be Implemented as Provided in the Settlement Agreement, Which Would Remove the Disincentives Associated with Utility Encouragement and Promotion of Conservation.....	23
	2. The Overall Rate of Return Recommendations in the Settlement Agreement Reflect the Impact, If Any, of the Recommended Implementation of Decoupling, and No Further Consideration or Adjustment Is Necessary.....	27
IV.	CONCLUSION	30

TABLE OF AUTHORITIES

<i>WAC 480-07-730(3)</i>	2
<i>WAC 480-07- 740(2)</i>	4
<i>WAC 480-07-750(1)</i>	4
<i>Docket No. UE-032065, Washington Utilities and Transportation Commission v. PacifiCorp d/b/a Pacific Power & Light Company, Order No. 06 at 26, ¶ 59 (October 2004)</i>	5, 7

I. PROCEDURAL BACKGROUND

1. On February 14, 2006, Cascade Natural Gas Corporation ("Cascade" or "the Company") filed tariff sheets seeking a general rate increase of \$11.7 million, or 4.47 percent. The filing was based on normalized results of operations for Washington for the test period ending September 30, 2005. The filing was suspended by the Commission at its March 15, 2006 public meeting.
2. At the prehearing conference on April 11, 2006, Northwest Industrial Gas Users ("NWIGU"), The Energy Project, NW Energy Coalition (the "Coalition"), International Chemical Workers Union, Cost Management Services, Inc. ("CMS"), and Mint Farm Energy Center LLC were granted intervention in the proceeding.
3. Following discovery by the Washington Utilities and Transportation Staff ("Staff") and the other parties on the Company's direct testimony, a settlement conference was convened at the Commission's offices on July 25, 2006. Follow-up discussions were held the following week. On August 15, 2006, Staff, the Public Counsel Section of the Office of Attorney General ("Public Counsel"), NWIGU, The Energy Project, the Coalition and CMS filed opposing testimony. Staff recommended limiting the rate increase to \$1.6 million. No other party submitted testimony regarding an overall revenue requirement recommendation; Public Counsel, the Coalition, and The Energy Project submitted testimony regarding revenues to be recovered from Miscellaneous Service Charges. The Company submitted rebuttal testimony on September 12, 2006; other parties also submitted cross-rebuttal testimony.
4. Following discovery on the rebuttal testimony, the parties re-convened settlement discussions for purposes of resolving or narrowing the contested issues in this proceeding. The Company and Staff reached agreement on various revenue requirement issues, and filed a Stipulation on Revenue Requirement Issues ("Revenue Stipulation") with the Commission on October 4, 2006. The Company, Staff and NWIGU reached agreement on various rate spread

and rate design issues, and filed a Stipulation on Rate Spread, Rate Design Issues ("Rates Stipulation") with the Commission on October 5, 2006.

5. The parties continued settlement discussions on October 5, 6 and 9 in the interests of exploring a broader agreement among all parties. Final agreement on the terms of an agreement (" the Settlement Agreement") was reached on October 10, 2006 by the Company, Public Counsel, NWIGU, the Coalition, The Energy Project, and CMS (collectively, "the Parties" and individually, "a Party"). The Settlement Agreement provides that the previously filed Rates Stipulation and Revenue Stipulation are vacated, and incorporated as appropriate within the Settlement Agreement.
6. Although the Settlement Agreement includes all active parties to the proceeding, it is not a global settlement (*i.e.*, a settlement in which all parties agree on the resolution of all issues presented for settlement). The Settlement Agreement, while an integrated document, actually contains a number of stipulated recommendations on individual issues. Parties agreeing to resolve one contested issue, for example, may or may not have agreed to resolve other issues. Although Public Counsel joined in many of the provisions of the Settlement Agreement, it expressly reserved the right to oppose adoption of the sections in the Settlement Agreement pertaining to decoupling, and reserved its right to present argument on cost of capital, including impacts associated with decoupling.
7. The Settlement Agreement¹ and Narrative Statement Regarding Settlement Agreement (the "Narrative Statement")² were filed with the Commission on October 11, 2006, as a "Multiparty Settlement" pursuant to WAC 480-07-730(3). The Commission convened a hearing on October 12, 2006 for purposes of considering the Settlement Agreement, and to provide an opportunity for Public Counsel to cross-examine witnesses and to present opposing testimony on the issue of decoupling.

¹ *Exh. No. 1.*

² *Exh. No. 2.*

II. OVERVIEW OF THE CASE

8. Cascade has not requested a general rate case increase in Washington since 1995.³ Cascade has been able to avoid seeking rate relief due to an internal culture of pursuing operating efficiencies prior to seeking regulatory assistance, and encouraging and facilitating strong customer growth during a period of relatively low interest rates.⁴ In addition, Cascade has implemented several operating efficiencies since the last rate increase that have helped control costs, including conversion from handheld meter reading to automated meter reading, which allowed Cascade to reduce meter reading staff as well as grow without incurring additional meter reading expenses, and implementation of significant changes in benefit plans for non-bargaining unit employees.⁵ Through these cost control efforts, Cascade has been able to serve more customers with fewer employees.⁶ Since the 1994 test period in the last rate case, Cascade's residential customer count increased 60 percent and commercial customers have increased 32 percent.⁷ The number of employees, however, decreased by 17 percent during this same period.⁸

9. Rate relief is necessary because Cascade has exhausted readily available internal cost control measures.⁹ Cascade is currently facing financial pressures from three directions: revenue loss due to declines in gas usage per customer; costs arising from additional facilities required to continue to provide reliable and safe service in Washington; and cost increases in other areas beyond the Company's control.¹⁰ In addition to the proposed revenue requirement increase, Cascade proposed to implement a number of other initiatives in this proceeding, including a decoupling mechanism, a redesign of industrial non-core rates, and a Safety and Reliability Infrastructure Adjustment Mechanism ("SRIAM").¹¹

10. As discussed below, the Settlement Agreement addresses these issues by recommending:

³ *Stevens, Exh. No. 11-T at 4:3.*

⁴ *Id. at 4:6-8.*

⁵ *Id. at 4:17-5:12.*

⁶ *Id. at 4:9-10.*

⁷ *Id. at 4:10-13.*

⁸ *Id. at 4:12-13.*

⁹ *Id. at 5:24-25.*

¹⁰ *Id. at 5:25-28.*

¹¹ *Id. at 5:28-6:5*

- A revenue requirement increase of approximately \$7.062 million (2.69 percent);
- Implementation of decoupling on a more narrow basis than proposed by Cascade, and for a three-year pilot period subject to achievement of conservation performance targets;
- Proposed rate spread and rate design changes that achieve a better tracking of cost of service, subject to customer impact considerations; and
- Withdrawal of the proposed SRIAM from further consideration.

III. THE COMMISSION SHOULD ADOPT THE SETTLEMENT AGREEMENT

A. The Standard for Approval of the Settlement Agreement.

11. The Commission reviews settlement agreements pursuant to WAC 480-07-740 to determine whether the proposed settlement meets "all pertinent legal and policy standards." Under the Commission's rules, when filing a proposed settlement agreement, the parties must also file "supporting documentation sufficient to show the Commission that the proposal is consistent with the law and the public interest and that it is appropriate for adoption."¹² In determining whether to approve a proposed settlement, the Commission must decide whether it is lawful, whether the settlement terms are supported by an appropriate record, and whether the result is consistent with the public interest in light of all of the information available to the Commission.¹³

12. Additionally, the Commission has explained that in conducting its examination of the individual components of a settlement proposal, it employs the following three-part inquiry:

- (1) We ask whether any aspect of the proposal is contrary to law; (2) We ask whether any aspect of the proposal offends public policy; and (3) We ask if the

¹² WAC 480-07- 740(2).

¹³ WAC 480-07-750(1).

evidence supports the proposed elements of the Settlement Agreement as a reasonable resolution of the issue(s) at hand.¹⁴

The Commission has observed that "ratemaking is not an exact science."¹⁵ Accordingly, when making an examination of specific adjustments, the Commission has stated that "close scrutiny of individual adjustments is not required" as long as "the overall result in terms of revenue requirement is reasonable and well supported by the evidence."¹⁶

B. The Record Demonstrates That the Settlement Agreement Is Consistent with the Law and Public Interest, and Represents a Reasonable Resolution of the Issues in this Proceeding.

13. *The Settlement Agreement addresses each of the contested issues in this proceeding, and recommends a resolution that is consistent with the law and the public interest. The Settlement Agreement is supported by the Narrative Statement submitted by the Parties,¹⁷ as well as the remaining testimony and exhibits stipulated into the record by the Parties before and during the October 12 evidentiary hearing.*

14. The following section will briefly describe the various stipulated recommendations within the Settlement Agreement, and the evidence in the record which demonstrates that these proposed resolutions of the issues are lawful and consistent with the public interest.

1. Revenue Requirement Issues

15. Staff and the Company agreed upon the revenue requirement issues presented in paragraph 12 of the Settlement Agreement;¹⁸ no Party other than Staff and the Company took a position with respect to the revenue requirement adjustments set forth in paragraph 12.¹⁹ The revenue requirement adjustments result in a recommended revenue requirement increase of

¹⁴ Docket No. UE-032065, *Washington Utilities and Transportation Commission v. PacifiCorp d/b/a Pacific Power & Light Company*, Order No. 06 at 26, ¶ 59 (October 2004).

¹⁵ *Id.* at 27, ¶ 62.

¹⁶ *Id.* at 27, ¶ 61-62.

¹⁷ *Exh. No. 2.*

¹⁸ *Exh. No. 1*, ¶ 12.

¹⁹ CMS joined in the agreement on certain issues regarding Gas Management Services in paragraph 12(b) unrelated to the calculation of the revenue requirement.

\$7,061,536, or approximately 2.69 percent.²⁰ This recommended increase represents a reduction of approximately 40 percent from the \$11.7 million originally sought in the Company's direct case. As an additional point of reference, Staff had recommended a revenue requirement increase of \$1.564 million.²¹

16. Staff and the Company agreed upon several individual adjustments in calculating the recommended revenue requirement in this proceeding.²² Attachment A to the Settlement Agreement is a summary sheet showing the calculations supporting the recommended revenue requirement increase. The recommendation reflects the following treatment of the various adjustments proposed by Staff and the Company:

- Elimination of the Company's proposed pro forma adjustments for (1) Gas Management & Risk Management Software, and (2) CIS Hardware Upgrade;
 - Acceptance of the Company's proposed pro forma adjustment for Integrated Resource Planning Costs;
 - Acceptance of Staff's proposed adjustments (1) to reflect escalation clauses in the Company's Special Contracts with various customers, (2) to restate gas costs for Lost and Unaccounted For Gas, (3) to restate Wages and Related Costs, and (4) to restate books to reflect actual Uncollectible Expenses;
 - Acceptance of Staff's proposed adjustment for Pro Forma Wages and Related Costs;
 - Acceptance of Staff's calculation of Working Capital;
 - Adoption of a 34 percent federal income tax rate as proposed by Staff;
 - Acceptance of Staff's proposed adjustment for Conservation Promotional Advertising;
- and

²⁰ *Exh. No. 1, ¶ 12.*

²¹ *Parvinen, Exh. No. 361-T at 4:3.*

- Acceptance of the Company's proposed rate case expense.

The compromises between Staff and the Company on the treatment of these various issues have resulted in an "overall result in terms of revenue requirement [that] is reasonable and well supported by the evidence."²³

a. Cost of Capital

17. Only Staff and the Company presented testimony on the issue of the overall rate of return required for Cascade. A number of issues were in dispute between Staff and the Company with respect to cost of capital, including return on equity, common equity ratio, and whether short-term debt should be included in the capital structure. The Company had requested an overall rate of return of 9.37 percent, comprising a return on equity ("ROE") of 11.15 percent and an equity ratio of 50 percent.²⁴ The revenue requirement return associated with this requested return is \$9.368 million.²⁵ Staff recommended an overall rate of return of 8.33 percent, which included a 9.50 percent ROE, an equity ratio of 41.13 percent and the inclusion of short-term debt.²⁶ The revenue requirement return associated with Staff's return recommendation is \$5.571 million.²⁷
18. Although Staff and the Company were unable to reach agreement on each of the components of the cost of capital, they agreed upon a revenue requirement of \$7,480,632 with respect to the return, as indicated on Attachment A to the Settlement Agreement.²⁸ This revenue requirement for overall return is in the middle of the range between the two Parties' positions on this issue. As discussed further below, Staff's and Cascade's cost of capital witnesses also presented evidence on the impact of adoption of a decoupling mechanism on the Company's required rate of return. Given that the Settlement Agreement includes a recommendation to

²² *Exh. No. 1, ¶ 12(d)*.

²³ *Docket No. UE-032065, Washington Utilities and Transportation Commission v. PacifiCorp d/b/a Pacific Power & Light Company, Order No. 06 at 26, ¶ 59 (October 2004)*.

²⁴ *MacArthur, Exh. No. 192*.

²⁵ *Exh. No. 2, ¶ 5*.

²⁶ *Exh. No. 391-T, 2:11-14*.

²⁷ *Exh. No. 2, ¶ 5*.

²⁸ *Id.*

implement a decoupling mechanism, the recommended rate of return included in the Settlement Agreement reflects any impact on the Company's required rate of return associated with implementation of the recommended decoupling mechanism.

b. Gas Management Services

(i) Provisions of the Settlement Agreement

19. The contested issue in this proceeding involved the treatment of revenues and expenses associated with Gas Management Services provided by Cascade pursuant to its Schedule No. 687. The Company had proposed treating these Services "below-the-line" for ratemaking purposes,²⁹ while Staff proposed that the revenues and expenses be treated "above-the-line" for ratemaking purposes.³⁰ The position reflected in the Settlement Agreement reflects adoption, in part, of the Staff position. Although Staff and the Company agreed to accept the Company's proposed adjustment for "Removal of Non-Core Competitive Services Revenues and Gas Costs," the calculation of that adjustment is revised to reflect the inclusion of \$200,000 in revenues from Gas Management Services for purposes of determining the revenue requirement in this proceeding.³¹ This enables the Company's customers to receive a portion of the profits derived from Gas Management Services for purposes of setting rates in this proceeding.

20. On a going forward basis, the Company will share 50 percent of the net margins realized by the Company for Gas Management Services.³² These amounts will be deferred each month and returned to customers on an equal percentage of margin basis each year as part of the Company's Temporary Deferral Tracking Adjustment filing, commencing as of the filing in Fall 2007.³³ This treatment of gas management services is effective as of the date of the Commission's final order in this proceeding and will continue until the effective date of the final order in the Company's next general rate case.³⁴

²⁹ *Stoltz, Exh. No. 24.*

³⁰ *Parvinen, Exh. No. 361-T, 11:5 – 12:3.*

³¹ *Exh. No. 1, ¶ 12(b)(i).*

³² *Id.* ¶ 12(b)(ii).

³³ *Id.*

³⁴ *Id.*

(ii) Inter-Relationship with Separate Complaint Proceeding

21. Paragraph 12 of the Settlement Agreement also contains an agreement between the Company and CMS regarding certain tariff revisions and matters to be included in a stipulation of facts in a related complaint proceeding filed by CMS against Cascade in Docket No. UG-061256.³⁵ CMS contends in that proceeding that Cascade is not authorized to transact the gas supply transactions under Schedule No. 687 which generated the revenues and expenses at issue, and which form the basis for the proposed resolutions set forth in Section 12(b)(i) and (ii) of the Settlement Agreement.³⁶ If the Commission grants the relief requested by CMS in Docket No. UG-061256, there will be no basis for:

- (1) reducing the revenue requirement by \$200,000 as provided in paragraph 12(b)(i) of the Settlement Agreement, as the activity would be deemed unauthorized and the assumed revenue stream which would be reflected in rates by that adjustment would cease to exist, and
- (2) future sharing of net margins from these services on a 50/50 percentage basis between the Company and its customers, as provided in paragraph 12(b)(ii) of the Settlement Agreement, as these services would cease to exist and no net margins to be shared would be realized.

Accordingly, depending upon the outcome of the contested issues in Docket No. UG-061256, it may be necessary for the Commission to modify the terms of paragraph 12 of the Settlement Agreement to increase the revenue requirement by \$200,000 and to eliminate the sharing of net margins from Gas Management Services on a going-forward basis.

³⁵ *Id.* ¶ 12(b)(iii).

³⁶ *Lehmann, Exh. No. 341-T, 4:9-11.*

c. Weather Normalization

22. Staff and the Company presented competing approaches for calculating a weather normalization adjustment, the purpose of which is to adjust test period loads to normalize them in order to reflect the gas throughput volumes that would have occurred under "normal" weather. These differences in weather normalization methodology resulted in different proposed revenue requirement adjustments. Although Staff and the Company did not reach agreement upon a methodology used to calculate either the "normal" heating degree days ("HDDs") or the weather-sensitive coefficients, they agreed upon a margin adjustment of \$730,779 to normalize test year temperatures for purposes of determining the revenue requirement.³⁷ The Settlement Agreement reflects the adoption of this agreed-upon margin adjustment, which represents a reasonable compromise of the Parties' position that is supported by the evidence in the record on this issue.³⁸

2. Miscellaneous Service Charges

23. The Company in its direct filing proposed to increase several of its charges for miscellaneous services.³⁹ Staff, Public Counsel, the Coalition and The Energy Project filed testimony in opposition to all or portions of the Company's proposed increases.⁴⁰ The Settlement Agreement reflects the compromises reached by the Parties on this issue, which resulted in the following recommended Miscellaneous Service Charges:⁴¹

Disconnect Fee	\$10.00
Reconnect Fee (during work hours)	\$24.00
After Hours Reconnect Fee	\$60.00 (except in case of medical emergency)
Pilot Light Service	\$20.00

³⁷ *Exh. No. 2, ¶ 7.*

³⁸ *Stoltz, Exh. No. 26.*

³⁹ *Stoltz, Exh. No. 29, Sch. 2.*

⁴⁰ *Parvinen, Exh. No. 361-T, 22:1 – 25:8; Lazar, Exh. No. 281-T, 35:19 – 40:17; Weiss, Exh. No. 311-T, 29:11 – 30:9; Eberdt, Exh. No. 351-T, 11:1 – 12:10.*

⁴¹ *Exh. No. 1, ¶ 13.*

Late Fee	1 percent per month, applied to all unpaid balances 30 days past due
Minimum Late Fee	None
Meter Tampering Fee	Actual costs
NSF Check Return Charge	\$18.00
New Premises Charge	\$45.00
Account Activation Fee	No charge
Short Notice Locate Fee	No charge

These Miscellaneous Service Charges were developed as a consensus recommendation of the Parties, taking into account the evidence presented by the Company regarding the costs associated with providing these services as well as the evidence presented by Staff, Public Counsel, the Coalition, and The Energy Project regarding the potential adverse impacts on customers associated with increases in these fees. The Parties also agreed on the level of revenue (\$1,442,480) deemed to be produced from these Miscellaneous Service Charges for purposes of determining the Company's revenue requirement in this proceeding.⁴²

3. Low-Income Assistance

24. The Company proposed to include \$800,000 in funding for low-income customers.⁴³ Staff, The Energy Project, Public Counsel, and the Coalition agreed to support this proposal, which was revised in the Company's rebuttal case to include any Public Utility tax credit received as additional funding for the program.⁴⁴ The \$800,000 will be paid on a pro-rata basis, allocated monthly.⁴⁵ The existing network used by the Washington Department of Community, Trade and Economic Development for the Low Income Home Energy Assistance Program will be used.⁴⁶

⁴² *Id.*

⁴³ *Stevens, Exh. No. 11-T, 9:18 – 10:7; Barnard, Exh. No. 110.*

⁴⁴ *Barnard, Exh. No. 111-T, 7:13-17.*

⁴⁵ *Stoltz, TR. 183:20-22.*

⁴⁶ *Eberdt, Exh. No. 351-T, 6:1 – 7:15; Eberdt, TR. 186:6-10; Exh. No. 1, ¶ 14.*

25. In order to gather additional information for purposes of possible future low-income initiatives, the Company agreed to commence a collaborative effort with Staff, representatives of The Energy Project and other interested parties to track low-income issues by identifying and collecting data pertinent to low-income customers in the Company's Washington service territory.⁴⁷ This collaborative effort will also consider whether the Company should implement an arrearage management project for low-income customers.⁴⁸ The goals for the project would be reducing service terminations, reducing referral of delinquent customers to third-party collection agencies, reducing collection litigation and reducing arrearages, reducing the Company's costs associated with these activities, and increasing voluntary customer payment of arrearages.⁴⁹

4. Decoupling Mechanism

26. The development of Cascade's proposed decoupling mechanism came about in part due to its participation in the Commission's proceedings in Docket No. UG-050369, a Rulemaking to Review Natural Gas Decoupling (the "Decoupling Rulemaking"). This proceeding was a statewide investigation of the potential benefits of alternative decoupling rate designs that could remove the financial disincentives for utilities to promote conservation.⁵⁰ As part of that review, Cascade developed a decoupling concept, which was the primary subject of a May 12, 2005 rulemaking workshop.⁵¹ Stakeholders from throughout the state submitted comments and recommendations on Cascade's decoupling concept and other decoupling mechanisms on June 10, 2005.⁵² The Commission terminated its statewide investigation in October 2005, however, suggesting that utilities could offer decoupling proposals for the Commission's consideration as

⁴⁷ *Id.* ¶ 14(b).

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Stoltz, Exh. No. 21-T at 26:20-22.*

⁵¹ *Id. at 26:5-7.*

⁵² *Id. at 26:7-9.*

part of general rate filings.⁵³ This rate proceeding provides the Commission with an opportunity to evaluate and implement Cascade's proposed decoupling mechanism.⁵⁴

27. The decoupling mechanism proposed in Cascade's direct case, also referred to as the Conservation Alliance Plan ("CAP"), was based in part on stakeholder comments submitted in the Decoupling Rulemaking.⁵⁵ CAP is a deferred accounting type decoupling mechanism designed to capture changes in margin due to the conservation efforts of Cascade's customers and changes in margin due to weather that varies from normal.⁵⁶ Cascade's decoupling mechanism was intended to allow Cascade to assist its customers with the promotion of conservation and the investment in cost effective Demand Side Management ("DSM") programs without the fear of failing to recover its own fixed costs.⁵⁷

a. Scope of Mechanism

28. Paragraph 15 of the Settlement Agreement recommends that the Company be authorized to implement a "partial" decoupling mechanism on a pilot basis for a three-year period.⁵⁸ The decoupling mechanism recommended for the Company is a "partial" decoupling mechanism which would defer margin variances based on weather-normalized volumes (*i.e.*, the mechanism is limited in scope to include only the non-weather related effects that cause changes in usage such as customer conservation and energy efficiency improvements).⁵⁹ The mechanism would apply only to Rate Schedules 503 and 504.⁶⁰ For purposes of calculating the base usage per customer and the resulting deferrals, no adjustment would be made for new customers.⁶¹

⁵³ *Id.* at 26:9-11.

⁵⁴ *Id.* at 26:13-15.

⁵⁵ *Id.* at 26:20-22.

⁵⁶ *Id.* at 27:10-12.

⁵⁷ *Id.* at 25:25-26:2.

⁵⁸ *Exh. No. 1*, ¶ 15).

⁵⁹ *Id.* ¶ 15(a).

⁶⁰ *Id.*

⁶¹ *Id.*; see also, *Weiss, TR. 201:17-24.*

b. Weather Normalization Methodology

29. For purposes of calculating the impacts of weather on use per customer for implementation of the decoupling mechanism, the Company's weather normalization methodology will be used during the pilot period.⁶² It should be noted that this weather normalization methodology will be used only for purposes of calculating deferrals under the decoupling mechanism; neither Staff nor the Company endorses the underlying methodology used to calculate either the "normal" HDDs or the weather-sensitive coefficients.⁶³

c. Pilot Program

30. The Settlement Agreement provides that the decoupling mechanism will be implemented on a "pilot" basis. It would expire, by its terms, three years from the effective date of the tariff sheets implementing the mechanism.⁶⁴ Staff witness Steward described the basis for having the program reviewed after three years before extending it:

The decoupling removes the disincentive and allows recovery of the lost margin. But removing that disincentive does not automatically say a causal relationship with the Company pursuing conservation, and so that's why we have added this condition for the Company to pursue conservation. Conservation has to be ramped up. I mean I think we all know that, and we all expect that to occur. . . . I think after three years, we will have a pretty good idea of how well the Company's contracting processes are going, you know, how well their commitment is going to conservation. I think we can see that in three years.⁶⁵

The mechanism may be extended if (i) such extension is authorized as part of a general rate case to be filed by the Company prior to the expiration of the mechanism, and (ii) such general rate filing includes the results of a thorough evaluation of the mechanism.⁶⁶ This evaluation would be performed by an independent consultant retained by the Company after consultation with interested parties, and would address a number of issues, including the following: (i) the

⁶² *Exh. No. 1, ¶ 15(b).*

⁶³ *Id.*

⁶⁴ *Id. ¶ 15(c).*

⁶⁵ *TR. 214:12-23.*

customer classes to be included within the scope of the mechanism, (ii) the effectiveness of the mechanism in removing Cascade's disincentive to promote energy efficiency, (iii) the bill impacts had the weather-related impact on usage been included, and (iv) any discernible effect on service quality due to the existence of the mechanism.⁶⁷

d. Limitation on Deferrals

31. As an alternative to imposing any specific cap on the level of annual surcharges under the mechanism, paragraph 15(d) of the Settlement Agreement requires the Company to consider the rate impact of the annual surcharge produced by the mechanism.⁶⁸ Mr. Stoltz had testified that an "effective cap can be modeled after the accepted practices in Purchased Gas Adjustment applications [where] the utilities change the amortization of their deferrals to two years or longer if the rate impact of a one-year amortization is too large."⁶⁹ The Company agrees under the Settlement Agreement to extend the amortization period of such deferrals to two years or more to lessen the impact on customers, if necessary due to the magnitude of the deferrals to be amortized.⁷⁰ However, as discussed below, the magnitude of deferrals attributable to the partial decoupling mechanism are expected to amount to less than 1% of revenues.⁷¹

e. Conservation Program and Performance

32. In connection with implementation of the decoupling mechanism, the Company is required to undertake certain activities with respect to its Conservation Program.⁷² The Settlement Agreement includes specific required actions by the Company during 2007, including:

- Convening a conservation advisory group ("Advisory Group") of all interested parties to meet no later than thirty (30) days after the Commission's final order in this proceeding. The Advisory Group shall consider, among other things, the

⁶⁶ *Exh. No. 1, ¶ 15(c).*

⁶⁷ *Id.*

⁶⁸ *Id. ¶ 15(d).*

⁶⁹ *Exh. No. 30-T, 18:9-12.*

⁷⁰ *Exh. No. 1, ¶ 15(d).*

⁷¹ *Steward, TR 276:20-24.*

conservation potential study being performed for the Company by Stellar Processes.⁷³

- Filing a Conservation Plan with the Commission no later than ninety (90) days after the initial meeting of the Advisory Group. The Conservation Plan is required to contain targets and benchmarks based upon the study and the recommendations of the Advisory Group; low-income weatherization; and possible penalties and incentives. The Conservation Plan is required to be submitted to the Commission for approval.⁷⁴ Preparing and filing the Plan will be the Company's responsibility, taking into account the recommendations from the Advisory Group.⁷⁵ In the event elements of the Plan are contested, it is anticipated the Commission would resolve any disputes as part of its approval process.⁷⁶
- Issuing requests for proposals, or RFPs, for third-party implementation of the Plan within thirty (30) days of Commission approval of the Plan. Mr. Stoltz testified during the hearing that "[t]here are entities that are already contacting the Company that are interested in becoming the third-party administrator of these programs," and the Company is confident it "can turn around an RFP very quickly" given this level of interest.⁷⁷ Coalition witness Weiss reiterated that "there's a lot of experience in the region for running these kinds of programs," and

⁷² *Exh. No. 1, ¶ 15(e)*.

⁷³ *Id. ¶ 15(e)(i)*.

⁷⁴ *Id. ¶ 15(e)(ii)*.

⁷⁵ *Stoltz, TR. 203:11-16*.

⁷⁶ *Id.*

⁷⁷ *TR. 205:22 – 206:6*.

the Coalition was "quite easily convinced that this model can work."⁷⁸ According to Staff witness Steward, "third-party contracting will actually help speed things up" by "going to third parties who already have that experience."⁷⁹ Any agreements with third-party contractors are required to include targets and benchmarks, with possible penalties and incentives, to ensure that payment is based on delivery of energy efficiency savings.⁸⁰

- No later than December 31, 2007, the Company must demonstrate to the satisfaction of the Commission that it has the ability to meet the 2008 energy efficiency targets identified in the Plan. This demonstration may be made by showing that the Company has contracted with qualified third-party providers to be able to deliver effectively the energy efficiency programs included in its 2008 target.⁸¹
- The Conservation Plan will include penalties in the event Cascade's performance falls short of the specified benchmarks. The Company currently has commercial programs, low-income weatherization, and rebates for high efficiency furnaces and water heaters.⁸² These programs will be ongoing through 2007 and some savings will be achieved; for 2008 and 2009, the savings will be incremental.⁸³ If the Company fails to meet the performance benchmark for 2007, it will be assessed a penalty in 2008 as prescribed in the Plan. If the Company demonstrates its ability to meet the 2008 energy efficiency target by year-end

⁷⁸ *TR. 208:17-23.*

⁷⁹ *TR. 216:20-21, 217:3-4.*

⁸⁰ *Exh. No. 1, ¶ 15(e)(iii).*

⁸¹ *Id. ¶ 15(e)(iv).*

⁸² *Steward, TR. 211:24 – 212:3.*

2007, it will continue to defer margin revenues pursuant to this decoupling mechanism. In the event the Company fails to meet its 2008 target, it will be assessed a penalty in 2009 as prescribed in the Plan. In the event the Company fails to meet its 2009 target, it will be assessed a penalty in 2010 as prescribed in the Plan.⁸⁴

f. Basis for Approving Settlement Agreement Recommendation to Implement Decoupling

33. The terms of the Settlement Agreement regarding decoupling represent a consensus of the positions of Staff, the Company and the Coalition on this issue. The scope of the Conservation Alliance Plan as proposed in the Company's direct case included both weather-related and non-weather-related changes in use per customer.⁸⁵ The Settlement Agreement reflects the Staff recommendation to narrow the scope of the mechanism to non-weather-related changes in consumption, and to implement the mechanism on a three-year pilot basis.⁸⁶ The Settlement Agreement requires that an evaluation be performed by an independent third party before the mechanism can be extended beyond the pilot period.⁸⁷ With respect to a proposed limitation on deferrals, the Settlement Agreement adopts the Company's proposal that requires consideration of rate impacts when recommending an amortization period for deferrals, rather than imposing any specific cap on the level of annual surcharges under the mechanism (as Staff had proposed).⁸⁸ The Settlement Agreement addresses the Coalition's concerns regarding specific conservation performance targets by including specific required actions in 2007, including the formation of a Conservation Advisory Group and development of a comprehensive Conservation Plan that will include, among other things, enforcement provisions in the event the Company falls short in achieving the implementation of a more aggressive conservation program.⁸⁹

⁸³ *Id.*, TR. 212:6-13.

⁸⁴ *Exh. No. 1*, ¶ 15(e)(iv).

⁸⁵ *Stoltz, Exh. No. 21-T*, 27:8 – 28:27.

⁸⁶ *Steward, Exh. No. 421-T*, 2:10-14.

⁸⁷ *Exh. No. 1*, ¶ 15(c).

⁸⁸ *Id.*, ¶ 15(d).

⁸⁹ *Id.*, ¶ 15(e).

34. The consensus reached among Staff, the Company and the Coalition regarding decoupling, as reflected in the Settlement Agreement, represents a reasonable resolution of this issue. The terms of the Settlement Agreement provide a sound recommendation for implementing decoupling for Cascade on a basis that is limited both in duration (for a three-year pilot period) and in scope (for non-weather-related changes in use) that is reasonable under the circumstances.

5. Rate Spread

35. Staff, the Company and NWIGU agreed upon a proposal for spreading any revenue requirement increase across customer classes.⁹⁰ The rate spread recommendation includes the following elements:

- A reduction of \$1.751 million from current levels in the revenue requirement allocated to Rate Schedules 663 and 664.⁹¹
- An allocation of Miscellaneous Service Charge revenues 90 percent to Rate Schedule 503 and 10 percent to Rate Schedule 504.⁹²
- An allocation of remaining revenue requirement changes to the remaining core rate schedules in accordance with a more detailed rate spread proposal included as Attachment C to the Settlement Agreement.⁹³

This stipulated recommendation on rate spread represents a compromise among the parties' litigation positions on this issue, and produces a reasonable resolution of the issue that is supported by the evidence in the record.⁹⁴

⁹⁰ *Id.* ¶ 16.

⁹¹ *Id.* ¶ 16(b)(i).

⁹² *Id.* ¶ 16(b)(ii).

⁹³ *Id.* ¶ 16(b)(iii).

⁹⁴ See evidence cited in the Settlement Agreement, Exh. No. 1, ¶ 16(c).

6. Rate Design

36. The Parties reached agreement on a number of rate design issues in this proceeding, as set forth in paragraph 17 of the Settlement Agreement.⁹⁵

a. Transportation Customers

37. The Company's direct case had proposed several modifications to the rate schedules and terms of service for its non-core, transportation customers.⁹⁶ NWIGU submitted testimony that opposed many aspects of the Company's proposal and offered alternative recommendations.⁹⁷ The Settlement Agreement includes a number of rate design recommendations with respect to transportation customers under Rate Schedules 663 and 664, including the following:

- Consolidation of Rate Schedules 663 and 664 into one rate schedule.⁹⁸
- Providing two options for electing firm service under this consolidated rate schedule.⁹⁹
- Revising the treatment of lost and unaccounted for gas on the distribution system, by making transportation customers responsible for supplying additional customer-owned gas as fuel-in-kind rather than assigning the current cost of supply to transportation customers.¹⁰⁰ During the hearing, Mr. Stoltz clarified that this fuel-in-kind treatment would be included as part of the Company's tariff.¹⁰¹
- Eliminating the existing 50,000 therm restriction contained in Cascade's Unbundled Distribution System Transportation Service Rules, Rule No. 20, and

⁹⁵ *Exh. No. 1, ¶ 17.*

⁹⁶ *Stoltz, Exh No. 21-T, 20:4 – 22:24.*

⁹⁷ *Schoenbeck, Exh No. 231-T, 14:1 – 21:10.*

⁹⁸ *Exh No. 1, ¶ 17(a)(i).*

⁹⁹ *Id. ¶ 17(a)(ii).*

¹⁰⁰ *Id. ¶ 17(a)(iii).*

¹⁰¹ *TR. 193:5-9.*

replacing it with provisions requiring transporters to keep their nominations and deliveries within the same tolerance band as Northwest Pipeline.¹⁰²

This stipulated recommendation on rate design for transportation customers represents a compromise between the litigation positions of the Company and NWIGU, and produces a reasonable resolution of the issue that is supported by the evidence in the record.¹⁰³

b. Basic Charges

38. The Company's direct case included proposed increases to each rate schedule's basic charge.¹⁰⁴ Staff, Public Counsel, the Energy Project and the Coalition submitted testimony opposing various aspects of these proposals, and offering alternatives regarding changes in the monthly basic charge for each rate schedule.¹⁰⁵ The Settlement Agreement reflects the consensus reached by the Parties on these issues, as follows:¹⁰⁶

Schedule 503 (Residential)	No change (\$4.00)
Schedule 504 (Commercial)	Increase from \$7.00 to \$10.00
Schedule 505 (Industrial)	Increase from \$12.00 to \$24.00
Schedule 511 (Large Volume)	Increase from \$22.00 to \$44.00
Schedule 512 (Compressed)	Increase from \$7.00 to \$14.00
Schedule 570 (Interruptible)	Increase from \$22.00 to \$44.00
Schedule 577 (Ltd. Interruptible)	Increase from \$22.00 to \$44.00

These Basic Charges were developed as a consensus recommendation of the Parties, taking into account the evidence presented by the Company regarding the costs associated with providing basic service as well as the evidence presented by Staff, Public Counsel, the Coalition and The

¹⁰² *Exh. No. 1, ¶ 17(a)(iv).*

¹⁰³ *See evidence cited in the Settlement Agreement, Exh. No. 1, ¶ 17(d).*

¹⁰⁴ *Stoltz, Exh. No. 21-T, 22:26 – 23:24.*

¹⁰⁵ *Steward, Exh. No. 421-T, 24:1-18; Lazar, Exh. No. 281-T, 22:6 – 35:18; Weiss, Exh. No. 311-T, 34:3-5; Eberdt, Exh. No. 351-T, 10:4-22.*

Energy Project regarding the potential adverse impacts on residential customers associated with increases in the basic charge.

c. Other Rate Design Changes

39. Staff and the Company agreed to a number of other rate design changes, as set forth in paragraph 17(c) of the Settlement Agreement.¹⁰⁷

7. SRIAM

40. Cascade in its direct case had proposed a Safety and Reliability Infrastructure Adjustment Mechanism, or SRIAM, that would have authorized the Company to recover through a separate tracker its investment in infrastructure expenditures made for safety or reliability purposes, as well as facility relocations required by public works project.¹⁰⁸ Staff, Public Counsel, and NWIGU opposed the SRIAM proposal on various grounds.¹⁰⁹ On rebuttal, Cascade narrowed the scope of its proposed SRIAM to eliminate system reinforcements from the scope of the mechanism.¹¹⁰ The Settlement Agreement provides that the SRIAM proposal will be withdrawn from consideration in this proceeding.¹¹¹ In the event the Commission approves in the currently pending Puget Sound Energy ("PSE") electric rate case (Docket No. UE-060266) the "depreciation tracker" proposed by PSE or a similar mechanism, the Company reserves the right in a subsequent single-issue filing to seek to implement a mechanism similar to that approved for PSE.¹¹²

¹⁰⁶ *Id.* ¶ 17(b).

¹⁰⁷ *Id.* ¶ 17(c).

¹⁰⁸ *Cummings, Exh. No. 220-T.*

¹⁰⁹ *Parvinen, Exh. No. 361-T, 27:17 – 32:2; Brosch, Exh. No. 251-T, 24:15 – 35:7; Schoenbeck, Exh. No. 231-T, 4:10 – 7:10.*

¹¹⁰ *Cummings, Exh. No. 221-T.*

¹¹¹ *Exh. No. 1, ¶ 18.*

¹¹² *Id.*

C. Cascade's Position on the Remaining Contested Issues.

1. Decoupling Should be Implemented as Provided in the Settlement Agreement, Which Would Remove the Disincentives Associated with Utility Encouragement and Promotion of Conservation.

41. Approval of decoupling would align the interests of Cascade's shareholders with its customers, and would permit the Company to implement a change in corporate culture that would encourage conservation. As Mr. Stevens testified:

[F]rom a cultural standpoint, I think the biggest change is going to be to teach every employee that our drive now is to try to conserve gas, which is almost counter-intuitive to a person that's spent a lifetime in the utility business. I believe the best way to educate is to go around, talk to all the employees, explain on a repetitive basis.¹¹³

As Coalition witness Weiss describes it:

What decoupling does is allows at every level the utility to work with the customer to help the customer save money. . . . [I]t empowers the line people, the front office people, to really help the customers. And they're supported by management in doing that, because I think most corporations know that they want to be on the same side of their customers.

. . .

It's just a whole attitude that they're not afraid of lost sales any more¹¹⁴

42. Public Counsel recommends that the Commission not approve Cascade's proposed decoupling mechanism because it constitutes "piecemeal ratemaking" that is not warranted by extraordinary circumstances.¹¹⁵ More specifically, Public Counsel argues that the mechanism: (1) does not account for increasing margin revenues associated with adding new customers;¹¹⁶ (2) departs from the traditional "holistic test year" approach for establishing just and reasonable rates;¹¹⁷ (3) discourages the regulatory lag incentive for the utility to pursue productivity gains to

¹¹³ TR. 249:14-21.

¹¹⁴ TR. 302:15-17, 303:1-6, 304:12-13.

¹¹⁵ Brosch, Exh. No. 251-T at 3.

¹¹⁶ Id. at 43:10-21.

¹¹⁷ Id. at 41:19-42:5.

optimize earnings between rate cases;¹¹⁸ and (4) would create a significant burden on Staff and other concerned parties to administer.¹¹⁹

43. In response to Public Counsel's objections to the proposed decoupling mechanism, Staff submitted testimony that the Company's decoupling proposal, as modified by Staff's recommendations, would present neither a significant departure from the traditional test year approach nor remove the Company's "incentive" to pursue productivity gains.¹²⁰ Staff also testified that, contrary to Public Counsel's assertions, such a mechanism was "not a significant burden to administer for Staff."¹²¹ As explained in Staff testimony, decoupling relies on a balanced review in a rate case of the cost to serve and revenues at a point in time, *i.e.*, the test year.¹²² The Commission determines a revenue requirement in a rate case; how that revenue requirement is recovered is a product of pricing.¹²³ The Commission's pricing policy has placed most of the fixed cost recovery (*e.g.*, margin) on volumetric rates.¹²⁴ This was intended to provide a price signal to customers that would encourage and reward conservation.¹²⁵ The flip-side of this policy is that for the Company to ensure that it is going to recover the revenue requirement the Commission sets in the rate case (*e.g.*, its costs to serve), the Company must find operational efficiencies and/or maintain or increase customer usage.¹²⁶ The latter creates a disincentive to encourage conservation.¹²⁷ Decoupling aligns the Company's recovery of the costs that were authorized in a rate case with the same regulatory goal to encourage conservation by customers through pricing.¹²⁸

44. During the November 12 evidentiary hearing, Public Counsel pointed out that Cascade apparently was able to increase its net margins in 2004 and 2005, notwithstanding the impacts of

¹¹⁸ *Id.* at 17:8-17.

¹¹⁹ *Id.* at 22:13-23:21.

¹²⁰ *Steward, Exh. No. 421-T* at 7:10-13.

¹²¹ *Id.*

¹²² *Id.* at 7:19-20.

¹²³ *Id.* at 7:20-22.

¹²⁴ *Id.* at 7:22-23.

¹²⁵ *Id.* at 7:23-8:1.

¹²⁶ *Id.* at 8:1-5.

¹²⁷ *Id.* at 8:5.

¹²⁸ *Id.* at 8:5-8.

declining use per customer associated with conservation. Exhibit No. 10 shows, for example, that net margins increased by \$1.6 million in 2004 and by \$1.7 million in 2005 (following a decline of \$1.5 million in 2003). Cascade's ability in recent years to increase net margins is due entirely to its high growth rate: an annual growth rate in customer base of 3 percent to 5 percent over the past five years, which is significantly more than the national average.¹²⁹ In 2005, for example, Cascade added 10,500 new customers, which contributed \$3.1 million in additional margin compared to fiscal 2004.¹³⁰ This increased margin, however, was almost entirely offset by reductions in gas usage per residential and commercial customers of 3.8 percent and 4.4 percent, respectively, which reduced margins by about \$2.5 million.¹³¹

45. This erosion in margins due to reductions in gas usage per customer illustrates the problem that decoupling is intended to address: *so long as a portion of fixed costs is recovered through volumetric rates, the gas utility will suffer an economic penalty when use per customer declines, and therefore will have a disincentive to promote any conservation that would contribute to this declining consumption.* That Cascade happens to be in the fortunate position of having such high customer growth in recent years that it can overcome the consequences of declining use per customer misses the point. Regardless of a particular utility's starting point in terms of operating margins, it is uncontroverted that the impact of declining use per customer due to conservation, in the absence of a decoupling mechanism, is to dampen the recovery of operating margins.¹³²

46. An additional issue that received attention during the October 12 hearing was the ability to isolate the impacts of weather so that the partial decoupling mechanism accurately tracks the impacts of changes in non-weather-related usage. As explained by Mr. Stoltz, in order to remove the weather-related impacts from the scope of the decoupling mechanism, the Company will

¹²⁹ *Stevens, Exh. No. 11-T at 3:1-3.*

¹³⁰ *Exh. No. 20 at 22.*

¹³¹ *Id.*

¹³² Mr. Stevens also testified that the Company was less likely to improve its margins going forward by achieving additional cost savings "by virtue of the fact that [the Company has] been pretty cost conscious over the past ten years." *TR. 225:1-7.*

simply apply the temperature normalization adjustment to "normalize" for the impacts of weather, and the remaining portion is deemed to be conservation-related:

[T]he process will be that we will take the actual consumption, apply a weather normalization to that consumption so that it's based upon normal weather, and then compare it to what we anticipated the consumption should have been, and that difference will be what is captured as change in use and be part of the deferral.¹³³

The vast majority of the changes in use per customer are due to weather impacts.¹³⁴ The effect of the conservation-only aspect of the decoupling mechanism would be to increase rates "on the order of less than 1% of revenue for those individual customer classes" covered by the mechanism.¹³⁵

47. With the scope of the mechanism narrowed to exclude the impacts of weather on use per customer, the impact on a utility's earnings associated with warmer- or colder-than-normal weather is unaffected by the implementation of the decoupling mechanism. Cascade would continue to bear the risks associated with changes in use per customer due to weather conditions. As stated by Chairman Sidran in this exchange with Staff witness Steward:

Q. As I understand it, in the settlement proposal weather is taken out of this decoupling equation, and it therefore is treated as it is now, which is to say that rates are based on normalized weather and the Company bears the risk of warmer weather and the benefit of colder weather, and its' going to be if we adopt this the same as it is today?

A. That is correct.

....

A. The risk stays with the Company.¹³⁶

¹³³ *Stoltz, TR. 199:13-19; see also Stoltz, TR. 263:11-15.*

¹³⁴ *Steward, TR.. 273:12-15.*

¹³⁵ *Id. at 276:20-24.*

¹³⁶ *Id. at 289:21 – 290:3.*

Thus, while Public Counsel points to the circumstance when the winter is colder-than-normal and the conservation-only decoupling mechanism may nonetheless be deferring minimal amounts – "on the order of less than 1% of revenue" – for later recovery in rates, *the decoupling mechanism recommended in the Settlement Agreement does nothing to change the weather-related impacts on a gas utility's earnings*. Under the Company's original CAP mechanism, of course, rates would have been adjusted in response to a colder-than-normal winter to eliminate the possibility of the Company over-earning in that situation. With the decoupling mechanism narrowed as proposed in the Settlement Agreement, however, it is irrelevant to the matters at issue to examine the consequences of risk allocations that are not proposed to be changed.

2. The Overall Rate of Return Recommendations in the Settlement Agreement Reflect the Impact, If Any, of the Recommended Implementation of Decoupling, and No Further Consideration or Adjustment Is Necessary.

48. Under the Settlement Agreement, Public Counsel reserved the right to present argument with respect to cost of capital, presumably related to Public Counsel's opposition to implementation of decoupling for Cascade. While it is not known precisely what position Public Counsel will be advocating, there is considerable evidence in the record regarding any impact between the implementation of decoupling and the cost of capital.

49. Both the cost of capital witnesses offering testimony in this proceeding, Dr. Roger Morin on behalf of Cascade, and David C. Parcell on behalf of Staff, expressed views regarding the impact of adoption of a decoupling mechanism on Cascade's cost of capital. Dr. Morin stated that his recommended ROE of 11.15 percent:

"is based upon anticipated adoption of the decoupling mechanism proposed by the Company in this filing. Rejection of this proposed mechanism would increase Cascade's risk profile and would

therefore require an upward adjustment to this ROE recommendation."¹³⁷

Exhibit No. 175, Dr. Morin's response to Staff Data Request No. 14, provides a more detailed explanation of the "upward adjustment" to ROE required by rejection of the proposed decoupling mechanism. According to Exhibit No. 175, the Company's cost of equity capital would increase by 25-50 basis points in the absence of a decoupling mechanism and a purchased gas cost adjustment mechanism. Dr. Morin bases this estimate on three considerations: (1) the current spread of 40 basis points between utility bonds rated "A" versus "Baa;" (2) an assumed improvement in the S&P business risk profile of one step for a utility with both a purchased gas adjustment and a decoupling mechanism, which translates to a 3-4 percent reduction in the common equity ratio which, in turn, suggests a 30-40 basis point reduction the cost of equity; and (3) an assumed difference of 0.05 in the beta factor under a Capital Asset Pricing Model ("CAPM") analysis between a utility with and without such adjustment mechanisms, which suggests a return adjustment of 35 basis points.¹³⁸

50. Staff witness Parcell, for his part, stated that his recommended ROE should be reduced from 9.75 percent to 9.50 percent if the Commission adopted the Company's proposed decoupling mechanism.¹³⁹

51. Exhibit No. 317 contains the report prepared by Christensen Associates Energy Consulting with respect to NW Natural Gas Company's distribution margin normalization ("DMN") and weather-adjusted rate mechanism ("WARM") currently in place in Oregon ("Christensen Report"). NW Natural's DMN mechanism, as approved by the Oregon Public Utilities Commission ("OPUC") in 2002, decouples revenues associated with 90 percent of the non-weather induced variation in usage for residential and commercial customers. NW Natural's

¹³⁷ *Morin, Exh. No. 161-T at 53:13-16, 4:24-5:2.*

¹³⁸ *Exh. No. 175.*

¹³⁹ *Parcell, Exh. No. 391-T at 3:18-22; 38:13-16.*

WARM tariff, approved by the OPUC in 2003, is a means of reducing weather-related risk for both NW Natural and its customers. According to the Christensen Report, "the combination of WARM and DMN produce effects that are very similar to full decoupling."¹⁴⁰

52. Given that the mechanisms currently in place for NW Natural in Oregon adjust both for weather- and non-weather-related changes in use per customer, they are much broader in terms of any shifting of risks from utility to customer than is provided for in the conservation-only decoupling mechanism recommended in the Settlement Agreement. Even so, the Christensen Report suggests that the impact on capital costs associated with these "full decoupling" mechanisms is difficult to identify and quantify. Pages 48-54 of the Christensen Report states that:

- "[I]t would be difficult to attribute changes in financial outcomes specifically to DMN (given the large number of other factors that can affect stock prices, interest rates, etc.)."¹⁴¹
- NW Natural's CFO reports that "the presence of DMN *and* WARM *contributed to* NW Natural attaining a score of '1' on S&P's business risk profile."¹⁴² (By comparison, Cascade's S&P business risk position is 2.0).¹⁴³
- Based on a comparison between NW Natural's stock prices to an index of utilities, "NW Natural's stock price increased relative to the index around the time that DMN was approved (in August 2002) . . . [and] shortly thereafter . . . reverted to a level closer to the index." Although "[a] number of factors could have affected stock prices over this time period, and because of this we do not claim to provide explanations for changes in the stock prices over time . . . it does appear that NW Natural's stock price

¹⁴⁰ *Exh. No. 317, 13.*

¹⁴¹ *Exh. No. 317, 48.*

¹⁴² *Id. at 50 (emphasis added).*

¹⁴³ *Morin, Exh. No. 161-T at 54:12-13.*

increased relative to the index around the times that DMN and WARM were approved."¹⁴⁴

53. Thus, the record contains considerable evidence regarding the impacts, if any, associated with the implementation of some form of decoupling mechanism for a natural gas distribution utility. Both Staff and the Company – the only parties offering testimony on cost of capital issues – provided testimony suggesting that their ROE estimates would need to be adjusted depending upon the Commission's decision with respect to adoption of Cascade's proposed decoupling mechanism. Staff and the Company (as well as the Coalition) reached agreement on the form of decoupling mechanism to be recommended for the Company, which was much narrower than proposed by the Company in two material respects: (1) the scope is limited to impact on use per customer associated only with non-weather effects, and (2) it is recommended for adoption on only a pilot basis, subject to renewal after three years. Staff and the Company similarly reached agreement on the required rate of return for the Company, taking into account any changes in the Company's risk profile associated with the Settlement Agreement's recommendation on the decoupling mechanism. Thus, to the extent the Commission's adoption of the Settlement Agreement's recommendation to implement a limited form of decoupling for the Company has any impact on the Company's required rate of return, it is captured in the rate of return recommendation set forth in paragraph 12(a) of the Settlement Agreement.

IV. CONCLUSION

54. For the foregoing reasons, the Commission should adopt the Settlement Agreement. The terms of the Settlement Agreement are lawful and consistent with the public interest, and provide a reasonable basis for resolving the issues in this proceeding. Adoption of the Settlement Agreement would:

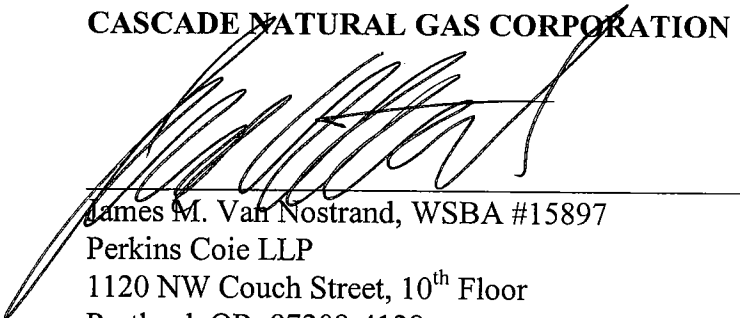
- Authorize a revenue requirement increase of approximately \$7.062 million (2.69 percent);

¹⁴⁴ *Id.* at 51.

- Implement a decoupling mechanism on a pilot basis that would track conservation-related changes in use per customer for later recovery in rates;
- Provide a framework for performance targets to measure the effectiveness of Cascade's conservation program;
- Approve changes in rate spread and rate design that achieve a better tracking of cost of service, subject to customer impact considerations.

Respectfully submitted this 15th day of November, 2006.

CASCADE NATURAL GAS CORPORATION



James M. Van Nostrand, WSBA #15897
Perkins Coie LLP
1120 NW Couch Street, 10th Floor
Portland, OR 97209-4128
Telephone: (503) 727-2162
Facsimile: (503) 346-2162
JVanNostrand@perkinscoie.com

Attorney for Cascade Natural Gas Corporation