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 PUBLIC COUNSEL

NOVEMBER 15, 2006

I. INTRODUCTION

1. Decoupling is a theory looking for an application. Any thorough policy analysis of decoupling must endeavor to evaluate both its *theory* AND its *application* to the particular petitioning utility company.[1] This is not to say there is one theory; there are many, as evidenced by the competing methods and arguments in this Docket.

2. Cascade itself has proposed no less than four separate and distinct decoupling proposals over less than a two-year period. Cascade's first proposal was called the "Conservation Rewards Program" (CRP) and was offered during the Commission's rulemaking on gas decoupling.[2] After the Commission withdrew its rulemaking, Cascade filed an application for a decoupling mechanism in Docket No. UG-051651.[3] This time, Cascade's application offered a very different version of the CRP.[4] In December 2005, before the matter was to be taken up on the Commission's Open Meeting agenda, Cascade withdrew its application. Instead, the Company announced it would be seeking decoupling through a general rate case. Cascade's instant rate case application contains the third of its decoupling proposals.[5] The proposed Settlement Agreement in this case is its fourth iteration, in a form found acceptable only by the settling parties.

3. Beyond the Company's settlement position, there were also a number of competing decoupling proposals offered by other parties in this case. Those decoupling mechanisms proposed in testimony, as well as the one contained in the Settlement Agreement have their own

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[1] The Commission's withdrawal of its gas decoupling rulemaking in Docket No. UG-050369 was largely predicated on this view. *Rulemaking to Review Natural Gas Decoupling*, Docket No. UG-050369, pp. 9-10.
[2] Docket No. UG-050369, Cascade Whitepaper (April 14, 2005).
[3] Docket No. UG-051651, Cascade Application, p. 1, ll. 14-16 and 20-23.
[4] Docket No. UG-051651, Cascade Application, p. 2, ll. 40-42.
[5] Exh. 21-T, p. 26 (Stoltz), Exh. No. 20, p. 5.

theories – their own particular assumptions and predictions. These assumptions and predictions beg examination.

4. Not since the electric restructuring debate of the mid to late 90's has the Commission been faced with such persistent efforts to sweeten the rate case process in favor of shareholders, involving the possible abandonment of tried and true traditional rate of return regulation. During the electric restructuring debate there was some recognition that the break from traditional ratemaking entailed a sizable decision. In addition, significant discussions over the issue occupied both the Legislature and this Commission. Without question, some very intelligent and well meaning people, swept up in the promise of lower rates through market forces, deserted traditional ratemaking.

5. Unfortunately, restructuring dissenters were sometimes viewed as regressive – unwilling to change in the face of new economic realities. Conversely, dissenters viewed supporters as faddists who were being carried away by the herd. In hindsight, the Commission's willingness to buck the prevailing "wisdom," choosing the time-tested history of balanced, traditional ratemaking over the flavor of the day, proved to be historic. After the energy crisis of the 2001 and 2002 crushed power supply on the West Coast, this Commission was lauded for its courageous and prescient decision.

6. Decoupling is a more insidious departure from traditional ratemaking. Failure to start with an acknowledgement of that fact dooms any credible analysis. Like the restructuring debate, the choice to change or not lies in the question "from what to what" i.e., the "now" and the "what may be." Divining that decision in relation to decoupling offers another historic opportunity for the Commission.

7. The promise of restructuring was lower rates through choice. Here, the promised prize is greater utility-sponsored conservation efforts. The cost of this prize is annual piecemeal rate increases to make whole the utility whole for declining gas usage when measured on a per customer basis. The theory is that there needs to be a corporate culture of "indifference" as to whether a company does or does not endeavor to increase its conservation efforts and suffer potentially declining sales to existing customers. Indifference is its raison d'être. Indeed, no party supporting decoupling in this case alleges that decoupling *in any form* offers increased conservation efforts. In that sense, that makes decoupling worse than restructuring because it does not even purport to achieve the policy objective giving rise to its existence.

8. It is because Public Counsel takes conservation so seriously that it has prioritized opposing decoupling. Decoupling is a mallet, when what is needed is a scalpel. Proponents of decoupling advance the theory that if one simply removes management's financial incentive in growing gas sales under traditional regulation, utility-sponsored conservation programs will arrive and somehow flourish and the public interest will be advanced. This is not the place to be sanguine. The record reveals how difficult effective conservation is to plan for and achieve.

9. Despite these difficulties, there are tremendous examples of success that have occurred without decoupling. Perhaps the most effective of these efforts arose out of a historic settlement between Public Counsel, Puget Sound Energy (PSE), and many other parties in 2002. That Agreement established, *inter alia*, a tariff rider allowing the company to recoup the costs of conservation. PSE's program and its successes continue to serve as a model for all other conservation efforts in Washington. In particular, the electric side of that program has been so successful that Public Counsel has gone a step further and supported, along with other parties, direct incentives to further encourage PSEs' electric conservation efforts. The regard for the PSE

model is so strong; the instant Settlement Agreement's advisory group structure apparently attempts to replicate PSE's formal external stakeholder advisory committee, knows as the "Conservation Resource Advisory Group" or "CRAG."

10. Listening to proponents of decoupling one might think that Cascade is no longer a regulated utility. Any serious attempt at achieving aggressive conservation must acknowledge that the Commission already has tools to increase conservation. The Commission's Integrated Resource Planning (IRP) rules require the development of an integrated resource plan with certain minimum standards.[6] The planning process is not an end in itself; utilities are expected to implement their plans. The Commission can actively encourage and expect utilities to actually achieve their IRP goals.

11. Apart from the IRP, the Commission has the authority to require that utilities attain a minimum level of conservation. This would be similar to the Commission's creation and enforcement of service quality standards. Such an aggressive use of authority is not without precedent. When service quality declined miserably at US West in the mid-90s, the Commission used every ounce of its authority – including going to the Washington Supreme Court – to enforce an expectation that there is a minimum level of service quality below which a telephone carrier cannot go. There is no reason not to set minimum conservation standards and enforce them.[7] This is even more urgent when Cascade and other gas utilities continue to purchase and pass through higher and higher costs of natural gas through the Purchase Gas Adjustment (PGA) mechanism. Cascade alone passed through a commodity increase of 26.3 percent in 2005.[8]

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[6] WAC 480-90-238.

[7] The Commission's role with regard to implementing I-937 for investor owned utilities, which appear sizable, will likely significantly expand the IRP and its importance in setting and achieving conservation goals on the electric side.

[8] Docket No. UG-051483, Cascade Application.

12. In light of other available tools, a policy of simply throwing money at a utility – money far in excess of what the company is either spending on conservation or losing from its conservation programs - and hoping it will result in a new age of utility sponsored conservation, could be characterized as irresponsible. A sensible debate must start, not with money, but with results.

13. Proponents of the Settlement Agreement's decoupling mechanism say that it contains a process for setting goals and benchmarks. Yet the Company is already supposed to have goals and benchmarks under the IRP process. Why are the Company's IRP goals insufficient? Indeed, the Company takes the position that it is in compliance with its 2004 IRP and that it has accomplished all of the cost effective utility sponsored conservation possible. Thus, it is unclear how one can justify granting decoupling to inspire conservation goals for a company that set low IRP goals and still failed to meet them. This asymmetry is glaring and without justification.

14. Decoupling proponents in this case also argue that the Company will not be able to continue its decoupling deferrals (beyond three years) if it does not meet some amorphous goals set sometime in the future. This begs the question, why not a tariff rider or direct incentive, which can be filed at any time. These have a proven track record in actually achieving conservation, as experience with PSE shows. Just as importantly, the costs of these programs tend to be in line with the actual benefits received by consumers, while decoupling does not. In the end, a thorough analysis of the decoupling proposal before the Commission reveals that it rests on two shaky and untested assertions. One is the claim that traditional ratemaking is broken and so it must be fixed. The other is that aggressive conservation efforts are only possible by adopting decoupling. After scrutiny, the record in this case does not support either of these assertions. However, should the Commission come to agree with one or both of these claims,

neither justify burdening ratepayers with decoupling rate increases. Therefore, the Settlement should be rejected.

II. BACKGROUND

A. Cascade's 2006 General Rate Case.

15. On February 14, 2006, the Company filed its first rate increase in ten years. Among the Company's main proposals were:

- A $11.7 million revenue increase resulting in a 4.7 percent overall rate increase and 9.5 percent increase for the residential class;[9]

- A rate spread that would have implemented the Company's cost of service study such that the rates would advance each rate class to the overall rate of return;[10]

- A rate design that would increase the monthly basic charge paid by Schedule 503 by $6 and increase Schedule 504 by $7;[11]

- A rate design that would substantially increase existing fees and charges and introduce new fees and charges;[12]

- A return on equity of 11.15 percent (predicated on receiving approval for its tracker mechanisms) and a 50/50 capital structure for an overall rate of return of 9.37 percent;[13]

- A "Safety and Reliability Infrastructure Adjustment Mechanism," which would allow the Company to track capital costs (including $37 million for the next five years) and defer these costs for recovery every year without a rate case;[14] and

- A "Conservation Alliance Plan" which would allow the Company to track declining margins on an average per customer basis and defer this amount of money for yearly recovery.[15]

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[9] Exh. No. 11-T, p. 6:9 (Stevens).
[10] Exh. No. 21-T, p. 19:21-22 (Stoltz).
[11] Exh. No. 21-T, p. 23:1-24 (Stoltz).
[12] Exh. No. 21-T, pp. 15:23-18:15. (Stoltz).
[13] Exh. No. 11-T, p. 6:11 (Stevens); Exh. No. 161-T, p. 4:10 (Morin); Exh. No. 311-T, p. 53:21-23 (Weiss).
[14] Exh. No. 11-T, pp. 6:19-7:21 (Stevens).
[15] Exh. No. 21-T, p. 27:20-21 (Stoltz).

16. Responsive testimony was filed by Commission Staff, Public Counsel, the Northwest Energy Coalition, the Northwest Industrial Natural Gas Users, Cost Management Services, and the Energy Project on August 15, 2006. Rebuttal and Cross-Rebuttal testimony was filed on September 12, 2006, by Cascade, Commission Staff, Public Counsel, and the Northwest Energy Coalition. Public hearings were held in Yakima and Bellingham, on August 29 and September 7, 2006, respectively.

B. The Settlement Agreement Proposed to the Commission in the Instant Docket.

17. On October 11, 2006, the Company filed a partial Settlement Agreement (Settlement Agreement) reflecting agreements between some of the parties on some of the issues. For the purpose of this brief, the only contested issues remaining in this case involve decoupling and the Company's return on equity and capital structure. These issues are contested only by Public Counsel. The pertinent parties' initial position on each of these issues and their ultimate resolution under the Settlement Agreement are outlined in Table 1, attached to this brief.

1. The Initial Decoupling Proposals and Final Settlement Agreement between Cascade, Commission Staff, and the Northwest Energy Coalition.

18. There was little agreement about how to structure the decoupling mechanisms initially supported by the various parties. Table 1, attached, sets forth a summary of the main elements of each proposal along with the terms agreed to in the Settlement Agreement with regard to these elements. Please see Table 1.

2. The Initial Cost of Capital Proposals and Final Settlement Agreement between Cascade and Commission Staff.

19. Like the decoupling chart, Table 2, attached, sets forth a summary of the main elements of each cost of capital proposal along with the terms in the Settlement Agreement.

III. ARGUMENT

A. DECOUPLING IS A RADICAL DEPARTURE FROM TRIED AND TRUE TRADITIONAL RATEMAKING.

20. To contrast decoupling from traditional regulation, this brief discusses basic principles of rate base, rate of return ratemaking. Of course, the Commission has little need for a primer. The purpose of Public Counsel's review of basic ratemaking principles is to address the question of "the now" before moving to the question of "what may be."

1. Traditional Ratemaking Ensures Utilities Recover the Cost of Providing Service and Earn a Reasonable Rate of Return While Protecting Consumers From Paying Too Much.

21. The Commission's ultimate responsibility in a rate case is to ensure that proposed rates are "fair, just, reasonable, and sufficient."[16] Fulfilling that mission requires "a comprehensive review of the company's rate base and operating expenses, determining a proper rate of return, and allocating rate changes equitably among ratepayers."[17] This tenet is at the heart of traditional ratemaking. It is also the basis for the "matching principle" and the prohibition on "single-issue" ratemaking – two concepts inextricably linked with rate of return regulation.

a. The Matching Principle Balances The Measurement Of Test Year Revenues And Costs At A Common Point In Time To Determine the Need For, And Amount Of, Any Rate Increases.

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[16] RCW 80.04.140; *MCI Telecommunications Corp. v GTE Northwest, Inc.*, Docket No. UT-970653, Second Supp. Order at 6 (Oct. 22, 1997).
[17] *Id.*

22. The balancing act of identifying and comparing costs and revenues at a distinct point in time is known as the "matching principle." Traditionally, utilities recover revenues equaling the cost to provide service through rates, including an opportunity to earn a reasonable rate of return.[18] The "general rate case" is the process used to evaluate and measure the cost of service and resulting revenue requirement at a "snapshot in time."[19] This snapshot in time, otherwise known as the "test period," has been consistently employed by the Commission.[20]

23. Indeed, rate increases are generally not granted without a balanced review of the utility's entire regulated operations, including a showing that costs, in fact, exceed revenues.[21] When revenue cannot cover costs, there is a deficiency that warrants a revenue increase. Increased rates, or other revenue increases are set to "match" the utility's costs. Conversely, if revenues exceed costs then the utility is recovering in excess of what it should – it is "over-earning."[22] In those instances, utility rates should be lowered. In most cases, utility pricing flows from this symmetrical matching process.[23]

24. The Commission has a long history of recognizing and reinforcing this principle. In the last PacifiCorp general rate case, the Commission strongly enforced the matching principle. Rejecting the company's proposed "revised protocol" the Commission explained that under the matching principle, "all cost of service components – revenue, investment, expenses, and cost of

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[18] Exh. No. 251-T, pp. 4:5-6 (Brosch), Exh. No. 421-T, pp. 16:23-17:1 (Steward); WAC 480-07-505.
[19] *Id*.
[20] *See, e.g., WUTC v. Avista Corporation*, Docket Nos. UE-991606 and UG-991607, Third Supplemental Order, ¶¶ 14-16 (September 29, 2000). The Commission typically uses a historical test year based on a recent twelve-month period to examine investment and operating results for a rate case, because historical results reflect the relationship between revenues, expenses, and investments. *Id*. at ¶¶ 165, 451; *WUTC v. Pacific Northwest Bell Tele. Co.,* Cause No. U-82-19, Second Supp. Order at 7 (Feb. 10, 1983).
[21] Exh. No. 251-T, p. 11:3-5 (Brosch).
[22] Cascade Natural Gas is currently involved in a "show cause" rate case before the Oregon Commission for over-earning. Oregon Commission Staff seek reductions in Cascade's rates and revenues. Exh. No. 263-T, p. 17:13-15 (Brosch Rebuttal); Exh. Nos. 264 and 265.
[23] Exh. No. 251-T, p. 11:3-5 (Brosch).

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capital – *must* be considered and evaluated at a similar point in time."[24] The revised protocol violated the principle because it failed to include depreciation adjustments that properly matched the inclusion of plant additions used and useful at the start of the rate period.[25]

25. In another recent case, the Commission addressed Avista's proposed adjustment to recover revenue for the Coyote Springs II generating plant from outside of the test year.[26] There, the Commission found that "Avista's use of known and measurable information outside the rate year violates the matching principle."[27] Accordingly, Public Counsel's proposed adjustment reducing Avista's recovery was adopted by the Commission.[28]

26. The matching principle's central role in traditional ratemaking is recognized by all of the parties supporting decoupling in the instant Settlement Agreement.[29] Two of the parties argued their positions on other issues based on this principle.[30] This readily apparent contradiction between the parties' recognition and actual appeal to traditional ratemaking while supporting its violation by decoupling is not addressed in the record. The next section turns to another fundamental tenet of general ratemaking – the prohibition on single-issue ratemaking.

b. Tried and True Traditional Ratemaking Prohibits Single-Issue Ratemaking.

27. Similar to the "matching principle" the prohibition on "single-issue ratemaking" arises from a policy of refusing to consider piecemeal changes in isolation. Ratemaking based on a

[24] *WUTC v. PacifiCorp*, Docket Nos. UE-050684 and UE-050412, Order No. 04 at ¶ 194 (Apr. 17, 2006) (emphasis added).
[25] *Id*., at ¶ 195.
[26] *WUTC v. Avista Corporation*, Docket Nos. UE-050482 and UT-050483, Order No. 5, ¶¶ 111-113 (December 21, 2005).
[27] *Id*.
[28] *Id*.
[29] Exh. No. 421-T, pp. 16:23-17:1 (Steward); Exh. No. 311-T, p. 12:19-21 (Weiss); Exh. No. 21-T, p. 7: 1-2 (Stoltz).
[30] Exh. No. 361-T, p. 28;10-12, 11:12-18 (SRIAM) (Parvinen); Exh. No. 21-T, p. 7:1-2 (Special Contracts) (Stoltz).

single-issue potentially ignores offsetting considerations and risks understating or overstating the overall revenue requirement.[31]

28. Thus, the Commission has said that it "generally will not engage in single issue or 'piecemeal' ratemaking."[32] The Commission generally insists instead on general rate proceedings.[33] As discussed earlier, the Commission's view flows from its statutory obligation to ensure that rates and charges are fair, just, reasonable, and sufficient.[34] RCW 80.36.140 clearly militates towards a comprehensive review of a company's rate base and operating expenses in order to determine a proper rate of return, and allocate rate changes equitably among ratepayers. As such, the Commission has cautioned that such "limited rate cases likely would result in unfair and unequal allocation of rates among the Company's ratepayers, and would not be a productive use of the Commission's resources."[35]

B. EXCEPTIONS TO THE MATCHING PRINCIPLE AND THE PROHIBITION ON SINGLE ISSUE RATEMAKING ARE LIMITED TO EXTRAORDINARY CIRCUMSTANCES AND, CONSEQUENTLY, ARE RARE.

29. Public Counsel has identified two important ratemaking policies adopted by the Commission which prohibit granting rate changes without a full test year review. This section explores the very limited exceptions to the rule that have been allowed in limited instances by regulators.[36] These exceptions arise for cost elements that are definite, large, and volatile, and

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[31] *City of Chicago v. Ill. Commerce Commn.*, 281 Ill. App. 3d 617, 627 (1996). This principle has been annunciated in several WUTC decisions. *See e.g., MCI Telecommunications Corporation v. GTE Northwest, Inc.*, Docket No. UT-970653, Second Supp. Order, p. 5 (October 1997).
[32] *Id.*; *In re U S West Communications, Inc.*, Docket No. UT-920085, Third Supp. Order (April 1993)
[33] *MCI Telecommunications Corp. v GTE Northwest, Inc.*, Docket No. UT-970653, Second Supp. Order at 5 (Oct. 22, 1997).
[34] *Id.*; RCW 80.36.140.
[35] Docket No. UT-970653, at p. 6.
[36] Exh. No. 251-T, p. 8:5-6 (Brosch).

predominately beyond the control of utility management.[37] When these attributes exist in combination, failure to recover for these exceptional changes in the revenue requirement outside of a general rate case might produce unacceptable financial outcomes.[38] This position is strongly supported by Commission Staff witness Michael Parvinen. In the context of the proposed SRIAM, Cascade asked whether Mr. Parvinen believes that "cost of service associated with normal levels of eligible investments should only be recovered in a general rate case."[39] Mr. Parvinen responded:

> In general, the answer is yes. The Commission should only grant special rate making procedures under very limited circumstances and the investments proposed in the SRIAM do not warrant such treatment. Costs that are extraordinary in nature and amount, and also outside the company's control would be an example of a situation when consideration may be given.[40]

30. By far the most common exception to traditional test period regulation is for purchased energy adjustment clauses.[41] These mechanisms authorize periodic adjustment of rates to track changes in the costs of purchased gas for local gas distribution utilities or to track changes in the costs of generation fuel and/or purchased power incurred by electric utilities.[42] As discussed by Public Counsel's witness, Michael L. Brosch, Power Cost Adjustment (PCA) and Purchased Gas Adjustment (PGA) mechanisms are employed by many state regulators because fuel and purchased energy commodity costs are recognized to be:

- Large in relation to the total cost to provide electric service;
- Subject to market forces (rather than management control);
- Volatile and difficult to reasonably quantify in rate cases; and

[37] Exh. No. 251-T, p. 8:6-7 (Brosch).
[38] Exh. No. 251-T, p. 8:7-8 (Brosch).
[39] Exh. No. 382, p. 1.
[40] Exh. No. 382, p. 2 (emphasis added).
[41] Exh. No. 251-T, p. 8:9-10 (Brosch).

- Substantial enough to cause potential earnings volatility if not tracked.[43]

31. Another exception to traditional test period regulation is the concept of deferral accounting or the receipt of an accounting authority order.[44] Such authority allows a utility to deviate from required accounting principles for certain designated transactions or types of costs.[45] Examples might include extraordinary storm recovery costs or merger transaction and transition costs.[46] The purpose of such orders is to limit the financial impact of extraordinary events or match utility merger benefits with costs at the time of the merger.[47]

32. While many utilities, and the parties in support of the decoupling proposal here, attempt to make their recovery proposal look like a PGA, PCA, or one of the other rare exceptions to the general rate case rule, the Commission has been clear in demarcating when such extraordinary exceptions are warranted. For instance, in its recent decision in the PacifiCorp general rate case, the company sought approval for a PCA. In ruling on the matter, the Commission announced certain principles it believes are necessary for a properly designed PCA. In so doing, the Commission recognized that the purpose of the PCA is to recover for existing operating costs necessitated by abnormal or unusual conditions that are beyond the utility's control.[48]

C. DECOUPLING DEFIES THE MATCHING PRINCIPLE AND IMPERMISSIBLY ALLOWS SINGLE ISSUE RATEMAKING, LEAVING THE DOOR OPEN TO OVER-EARNING.

33. To understand exactly how decoupling violates the matching principle and permits single issue ratemaking without fitting into one of the narrow exceptions, it is necessary to recount how

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[42] Exh. No. 251-T, p. 8:9-13 (Brosch).
[43] Exh. No. 251-T, p. 8:13-19 (Brosch).
[44] Exh. No. 251-T, p. 8:20-22 (Brosch).
[45] Exh. No. 251-T, pp. 8:22-9:4 (Brosch).
[46] Exh. No. 251-T, p. 9:4-6 (Brosch).
[47] Exh. No. 251-T, p. 9:7-8 (Brosch). For a more extensive list of principles, *see Id.*, p.13:18-19 (Brosch).

decoupling works, especially in relation to the Settlement Agreement before the Commission. As outlined in Table 1 attached, all of the parties to the Settlement Agreement, and the Agreement itself, support a decoupling mechanism that begins and ends with per customer gas usage.[49] It is the decline in per customer gas usage that determines how much lost margin Cascade will recover through monthly deferrals.[50] Increased margin due to increased sales volume is completely ignored by the tracker.[51] That is one of the reasons that the decoupling tracking mechanism will likely only result in a "deficit" customers will have to fill.[52]

34. First, a benchmark is set for current per customer margin (revenues less gas costs) based on current per customer usage. Second, on a monthly basis, actual per customer margin and per customer usage are measured against the benchmark. Third, the difference between the latter measurement and the former measurement constitutes the amount of money to be deferred. Fourth, once a year, the total amount of money in the deferral account is totaled and a surcharge is created and exacted to recover this amount of money on a piecemeal basis through single-issue rate increases. Fifth, the process for the next year begins again, but the benchmark set prior to the first year remains the same. In other words, the gap is always growing.

35. Cascade witness David Stevens acknowledged that "If decoupling is approved, Cascade will likely receive additional revenue without a rate case."[53] He also agreed that Cascade's revenues could grow for other reasons, with the most likely source being new customers.[54]

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[48] *WUTC v. PacifiCorp*, Docket No. UE-050684, Order No. 4 at ¶ 91 (April 17, 2006).
[49] Steward, TR 268:17-20.
[50] Steward, TR 269:8-11.
[51] Steward, TR 268:17-269:1, 12-17.
[52] Steward, TR 280:24-281:2.
[53] Stevens, TR 223:25-224:17.
[54] Stevens, TR 224:18-23.

Conversely, Cascade could enjoy a decline in its costs.[55] But either way decoupling tracker revenues would go up.[56] Thus, the proposed decoupling mechanism would assure Cascade higher future revenues, even though no showing has been made that such revenue increases are needed to produce just and reasonable future rates.

36. There are a number of significant problems with the mechanism that assuredly violate the matching principle and constitute single issue ratemaking without a compelling reason. These are explored below.

1. Tried and True Traditional Regulation is Working Well For Cascade.

37. Decoupling, as proposed in the Settlement Agreement before the Commission, is a piecemeal tracking device.[57] It is designed to change rate levels between cases for post-test year changes in <u>gas usage per customer</u>.[58] By focusing on a single revenue change after the test year, gas usage per customer, a decoupling tracking mechanism has a strong risk of seriously distorting the policies underlying traditional ratemaking. The proposal before the Commission simply does not take into account declines in utility costs or increases in revenue during the same period.

38. It is unlikely that a utility will seek a rate increase if its costs and revenues are in balance. Cascade is an excellent example of this dynamic. Between 1986 and 2005, Cascade filed only two general rate cases. Before the instant case was filed on February 14, 2006, Cascade has gone a full decade without a need for rate relief, having not filed a general rate case since the 1995 case.

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[55] Stevens, TR 224:24-225:1 and 8-9.
[56] Stevens, TR 225:10-17.
[57] Exh. No. 251-T, p. 10:8-9 (Brosch).
[58] *Id.*

39. The fact that Cascade has not needed to request a general rate case increase in Washington since 1995 is a strong indication that traditional regulation is working well for this Company.[59] In particular it shows that historically, the Company's non-gas costs to provide utility service are not growing any faster than utility margin is growing.[60] Consequently, Cascade's actual earned return on rate base has been consistently positive and has remained within a narrow range of 9.4 percent to 10.6 percent from 2000 through 2004.[61] Only in the very recent past has the rate of return reported by Cascade to the Commission for the 12 months ended September 2005, the test year, shown that it earned 7.65 percent on rate base.[62] These 2005 financials serve as the unadjusted starting point for the instant general rate case filing and the resulting proposed Settlement Agreement. That Agreement, which would give the Company $7.48 million in increased revenues, is (except for the cost of capital) not opposed by any party to this proceeding.[63]

40. While the numbers are compelling, the current merger bid by MDU Resources Group, Inc. confirms that Cascade's financial outlook is bright. Beginning in November 2005, the Cascade engaged JPMorgan "to consider strategic alternatives for the Company."[64] According to CEO David Stevens, JPMorgan's work "included assisting the Company in our Washington rate case and helping the Board evaluate strategic alternatives including a possible business combination."[65]

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[59] Exh. No. 251-T, p. 14:13-14 (Brosch).
[60] *Id*.
[61] Exh. No. 251-T, p. 14:16-20 (Brosch). When measured and reported on a Washington Commission normalized basis in its WAC 480-90-257 monitoring reports. *Id*.
[62] *Id*.
[63] Exh. No. 251-T, pp. 14:20-15:4 (Brosch); Exh. No. 1, p. 4.
[64] Exh. No. 19, p. 3.
[65] *Id*.

41. On July 10, 2006, some eight months after beginning its search for a suitor and five months after it began prosecution of the instant rate case, Cascade announced that it had agreed to be acquired by MDU.[66] Under the terms of the Agreement, MDU Resources would acquire Cascade for $26.50 a share in cash – well over two times book value.[67] When asked how MDU could justify such a high price, Terry Hildestad, President and Chief Operating Officer for MDU, responded: "I think what's more important rather than book value there is what is the rate base and what we – when we look at the rate base it's – our number compares very favorably. Also, the growth potential here, we got to remember about the growth potential in this market."[68] Cascade's strong cash flow and growth are what made it so attractive to MDU who considered twenty mergers in the last ten years and only consummated two – the second being Cascade.[69]

42. The decoupling proposal ignores this strong financial history and future prospects and disregards how any future losses Cascade experiences on a per customer basis will most likely be offset by customer growth and related revenue increases or by cost decreases.[70] This is explored in the next section.

2. Tracking Per Customer Usage Alone Ignores Cascade's Healthy Financial Picture and Throws Open the Door to Over-Earning.

43. By identifying margin revenue declines on a per customer basis for piecemeal rate increase recovery through the decoupling mechanism, Cascade's enormous customer growth and history of cost savings are ignored. This opens the door to Cascade earning in excess of its authorized rate of return – also known as "over-earning."

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[66] Exh. No. 19, p. 3.
[67] *Id.*, at 4, 14.
[68] *Id.*, at 14.
[69] *Id.*, p. 2, 4.
[70] Exh. No. 251-T, p. 11:13-15 (Brosch).

a. Customer Growth is on the Rise.

44. Cascade's revenues continue to increase through customer growth. Revenue from customer growth can help offset any increase in operating expense or replace lost revenues due to declining gas usage.[71] This is particularly true of Cascade, as the decade long hiatus in the Company's need for rate relief indicates how the combination of customer growth and cost control have produced reasonable financial results in spite of per customer conservation measures.

45. According to the Company, "Cascade is one of the fastest growing natural gas utilities in the nation. In the last five years, Cascade's customer base grew at a pace of 3 to 5 percent, which is significantly more than the national average."[72] The Company's 2005 Annual Report trumpets its customer growth, reporting to shareholders that "Our vision is to take our exceptional growth rate – which, at five percent, is twice the national average – and translate that into corresponding growth in our margin."[73] That goal appears extremely realistic since:

> Prospects for continuing strong residential and commercial customer growth are excellent. Good potential also exists for converting homes and businesses located on or near the Company's current line to gas from other fuels as well as expanding the system into adjacent areas.[74]

46. In fact, in 2005, Cascade added about 10,500 new customers and in 2004, about 8,000.[75] In short, for Cascade, customer growth has been good.[76] It is this growth that has produced a strong history of mostly positive margin revenue.[77]

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[71] Exh. No. 251-T, p.11:15-18 (Brosch).
[72] Exh. No. 11-T, p. 3:1-3 (Stevens): Stevens, TR 233:12-15.
[73] Exh. No. 20, p. 4.
[74] Exh. No. 10-T, p. 20.
[75] Exh. No. 20, pp. 22-23; Stevens, TR 235:25-236:3. The Company has also stated that it has "accurately calculating the impact of adding customers" such that not all growth is good. Exh. 11-T, p. 3:19-21(Stevens). Yet when pressed, the Company could never produce a credible calculation that would support its assertion. Exh. No. 17.

47. Indeed, customer growth and increased gas usage from that growth has had the greatest effect on stabilizing Cascade's financial condition. In 2004 and 2005 alone, Cascade experienced an increase in margin of $1.65 million and $1.75 million, respectively.[78] The "net addition of approximately 10,500 billed residential and commercial customers in 2005" made this possible.[79] The Company also explains that its 2004 net income was higher than 2003 mostly due to "[i]mproved margins from residential and commercial customers related to increased per-customer consumption and *growth in the number of customers*."[80]

48. This view is further echoed by CEO David Stevens in Exhibit No. 17 when he says, "The Company receives increased gross margin from the additions of new customers…More generally, while the Company has increased its gross margin by adding new customers, the declining consumption from existing customers has *virtually* eliminated the increase in residential margin from adding new customers."[81] To be clear, when Mr. Stevens uses the term "virtually eliminated" growth in margin in relation to fiscal years 2004 and 2005, he is using that term in the context of an actual $1.65 million and $1.75 million increase in margin.

49. The decoupling story in this Docket emphasizes the negative trend in "per customer" usage while ignoring the very favorable trend of increasing numbers of customers and new sales being experienced by the Company. As has been the trend, customer growth is expected to continue.[82] So while gas usage may decrease on a per customer basis, resulting in lower margin

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[76] Stevens, TR 235:7-9.
[77] Exh. No. 10.
[78] Exh. No. 10; Stevens, TR 242:23-243:9.
[79] Exh. No. 20, p.22.
[80] Exh. No. 20, p. 21 (emphasis added).
[81] Exh. No. 17, p. 1 (emphasis added).
[82] Stevens, TR 234:17-235:6.

per customer, revenue increases in other areas have offset these losses.[83] Not surprisingly, no party is advocating piecemeal rate tracking for customer growth revenue expansion or total sales volumes. Therefore, any decline in Cascade's gas usage per customer has been handsomely offset by customer growth. Despite knowing that future customer growth and the resulting increases in margin are almost guaranteed, the Settlement Agreement would lock in a fixed commodity margin dollar amount per customer for recovery. Thus, even as new customers are added, margin will grow in a mechanical and unyielding fashion because the Company will be allowed to defer any deficits in per customer margin for future recovery in surcharge rate increases, while quietly retaining for its shareholders the revenue growth achieved by serving new customers. The result, based upon anticipated future Residential and Commercial customer counts, is that the decoupling mechanism would produce even larger future margin revenue than Cascade would already receive from both Residential Rate Schedule 503 and Commercial Rate Schedule 504. The increased margin for these classes under decoupling are projected to be as follows:

Table 3: Projected Margin Revenues Under the Settlement Proposal

	FY2006	FY2007	FY2008	FY2009	FY2010
Residential Customers - 503	153,107	157,684	162,415	167,287	172,306
Avg Commodity Margin Per Cust	$ 184.48	$ 184.48	$ 184.48	$ 184.48	$ 184.48
Projected Commodity Margin	$ 28,245,179	$29,089,544	$29,962,319	$30,861,106	$31,787,011
Basic Service Charge	$ 12,860,988	$13,245,456	$13,642,860	$14,052,108	$14,473,704
Total Residential Margin	**$ 41,106,167**	**$42,335,000**	**$43,605,179**	**$44,913,214**	**$46,260,715**
Commercial Customers - 504	22,351	22,567	22,793	23,021	23,251
Avg Commodity Margin Per Cust	$ 721.91	$ 721.91	$ 721.91	$ 721.91	$ 721.91
Projected Commodity Margin	$ 16,135,410	$16,291,343	$16,454,495	$16,619,090	$16,785,129
Basic Service Charge	$ 3,754,968	$ 3,791,256	$ 3,829,224	$ 3,867,528	$ 3,906,168
Total Rate 504 Margin	**$ 19,890,378**	**$20,082,599**	**$20,283,719**	**$20,486,618**	**$20,691,297**

[83] Exh. No. 251-T, p.11:13-15 (Brosch).

50. The parties' blatant failure to incorporate margin increase due to customer growth skews the regulatory scheme against traditional regulation and towards automatic, unwarranted and unjust revenue recovery. Moreover, knowing that new revenues from customer growth will (more likely than not) offset losses in per customer sales declines, the decoupling parties request intentional (or at least reckless) ignorance about Cascade's actual performance. It is difficult to see how a utility showing around $1.7 million in increased margin in 2004 and 2005, and with a burgeoning customer base that will continue to drive that growth, should be allowed to recover additional revenues outside of a general rate case. Facially, without accounting for new customers, the decoupling proposal sought here challenges the boundaries of what is fair, just and reasonable. Finally, no showing has been made by the settling parties that Cascade will need additional future revenues from decoupling, on top of expected customer growth revenues, to have an opportunity to earn a reasonable return in Washington.

b. Cost Savings and Other Efficiencies have Produced Significant Income.

51. While customer growth is a primary factor offsetting any decreases in Cascade's gas usage per customer, customer growth is not the only factor that the decoupling proposal ignores. The decoupling tracker also fails to acknowledge productivity savings achieved by the Company between rate cases. Public Counsel's witness, Michael L. Brosch, explained how savings and efficiencies fit into the matching principle.[84]

> Once revenues and costs are measured within the rate case test period, all changes such as cost reductions or sales margin growth cause improvements in the achieved actual return level, relative to Commission-authorized returns, and are "favorable" from the shareholder perspective. Shareholders are rewarded with higher earnings between test years when management is able to successfully

[84] Exh. No. 251-T, pp. 6:16-7:6 (Brosch).

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> minimize cost increases, maximize productivity gains, or add profitable new customers to the system. Conversely, unfavorable changes between test years, such as cost increases or sales revenue declines, can contribute to earnings below authorized levels. Punishment in the form of reduced earnings occurs when expense increases or sales and margin losses between rate case test periods are not fully offset by revenue gains. In this way, regulatory lag provides a symmetrical incentive for management that can either reward cost containment and the profitable growth in sales or temporarily punish excessive cost increases until the time when a new rate case can be litigated.

52. This dynamic is good both for utility customers and shareholders. Customers eventually get the benefit of the cost savings or efficiencies when they are captured in a rate case test year. Shareholders get the benefit of higher earnings <u>between</u> rate cases until such savings are explicitly recognized in determining the revenue requirement.

53. In this case, Cascade points to a sizable number of savings initiatives it has undertaken, which would have only now been accounted for in the revenue requirement. CEO Stevens explained the Company's attempts at cost savings and how these savings averted having to file rate cases historically, saying:

> 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. In addition, Cascade has implemented several operating efficiencies since the last rate increase that have helped control costs. Through these cost control efforts, we are able to serve more customers with fewer employees. Since the 1994 test period in the last rate case, Cascade's residential customer count has increased 60 percent and commercial customers have increased 32 percent. The number of employees, however, has decreased by 17 percent during this same period.
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> …In 2002 the Company began converting from handheld meter reading to automated meter reading (AMR). The $16 million dollar investment allowed the Company to reduce its meter reading staff from 25 positions down to 5, which represents approximately $1.3 million per year in annual savings over the 2002 meter reading expense levels (approximately $1 million in Washington). Additionally, the technology allows the Company to grow without incurring additional meter reading expenses, which was estimated at an increase of 1 full-term equivalent (FTE) per year to keep up with the Company's growth. This

increased FTE level would substantially increase meter reading costs from the 2002 level if the AMR equipment were not installed.[85]

54. Mr. Stevens also identified 2003 cost cutting efforts with regard to labor costs, including changes in benefit plans for non-bargaining unit employees. Some of the changes were freezing accruals for salaried and executive employees to their respective retirement plans in favor of 401(k) plans, reducing medical benefits for salaried employees and retirees and implementing monthly contributions to the medical plan for salaried employees and retirees.[86] These changes resulted in the 2004 benefit expenses being approximately $5 million less than the 2003 level, reducing the cost of Washington operations by about $3.9 million.[87] Since the Company did not seek a rate increase in 2004, that $3.9 million either boosted Washington jurisdictional earnings or prevented a rate increase. In addition to these changes, the Company began centralizing its customer service functions in January 2005.[88] Instead of district offices, the Company organized a centralized call center located in Bellingham.[89] That move is estimated to produce annual savings of approximately $600,000 for Washington operations.[90]

55. In the context of decoupling, future rates would be increased on a single-issue basis to make the Company whole for declining usage on a per customer basis (ignoring growing in usage from new customers). Historically, without any decoupling tariff in place, Cascade has managed to achieve reasonable financial results without rate increases for a decade. If Cascade has any ongoing success in the future with its cost savings initiatives, the decoupling tariff would increase rates and revenues while ignoring the potential for such cost savings to offset declining

[85] Exh. No. 11-T, p. 4:5-25 (Stevens).
[86] Exh. No. 11-T, p. 4:27-5:8 (Stevens).
[87] Exh. No. 11-T, p. 5:10-12 (Stevens).
[88] Exh. No. 11-T, p. 5:14-18 (Stevens).
[89] *Id.*
[90] *Id.*

usage per customer. This is another example of tracker regulation that discards the all important matching principal.

c. The Decoupling Proposal's Planned Ignorance Throws Open the Door to Over-Earnings.

56. As discussed earlier, the mismatch problem is not something that may happen sometime in the theoretical future. It is not something that will self-correct in a short period of time. Implementation of a decoupling tracking tariff instantly violates the matching principle because tracking changes in usage per customer in isolation fails to address other factors impacting the Company's finances.

57. To its credit, Commission Staff does not dispute the point that revenues can quickly exceed costs after the adoption of a decoupling mechanism and that the Company will continue to receive decoupling even after that becomes the case.[91] Such a situation would clearly violate the matching principle. Staff witness Joelle Steward reflects this concern when she discusses why the mechanism should not go on too long without a rate case. If decoupling goes on to long without a rate case, she said: "We risk violating the cost-based principle of regulation, creating a potential mismatch between current costs and rates."[92] According to Ms. Steward, "Any approved mechanism should then be in place for only a relatively short period of time to minimize any potential mismatch of revenues and costs over time."[93] Consequently, she recommends that the mechanism expire after three years and be renewed only through a general

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[91] Steward, TR 275:14-17; Exh. No. 426. Ms. Steward says in part b of that exhibit, "Concerns [about mismatch] are increased with the implementation of a decoupling mechanism, due to the fact that a level of revenue (one side of the equation) is secured in decoupling and the company has the ability to file a rate case if costs exceed the secured revenue."

[92] Exh. No. 421-T, p. 16:21-23 (Steward).

[93] Exh. No. 421-T, p. 17:4-6 (Steward).

rate case.[94] By seeking to "minimize" the mismatch, Ms. Steward admits that once decoupling is in place, a mismatch will swiftly come into play.

58. Ms. Steward confirmed the likelihood of a mismatch between the revenues that the Company is receiving and its expenses saying, "You're not going to keep it in line constantly because you have all these different factors going into both sides that are constantly in flux, so that's the case as it is now."[95] Asked whether, without an overall review of revenue and costs during the pilot period, there would be any way to see if a mismatch problem exists, Ms. Steward answered that such a review would come only at the end of the three-year pilot when Cascade files a new rate case.[96] In other words, there is little doubt that a mismatch of some magnitude will occur during the pilot, and there will be no way under the proposed mechanism to correct the imbalance.

59. Commission Staff recognizes that costs and revenues are in flux between rate cases such that they can "mismatch" and recognizes that the likelihood of a mismatch under decoupling; yet, incredibly, it refuses to acknowledge the possibility of over-earning during that period. For instance, Ms. Steward was asked if it was possible that the Company could receive revenues in excess of what it rightly deserves during the three year period. Her response was that she did not agree that it was possible and would not have proposed the mechanism if she thought it would.[97] Ms. Steward took this position even after acknowledging that Cascade is over-earning in Oregon, where it has a decoupling mechanism.[98]

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[94] Exh. No. 421-T, p. 17:4-7 (Steward).
[95] Steward, TR 276:10-16.
[96] Steward, TR 275:21-25.
[97] Steward, TR 277:17-20.
[98] Steward, TR 278:17-22.

60. Also acknowledging the possibility of a "windfall" from decoupling is Northwest Energy Coalition witness, Steven Weiss. In his testimony Mr. Weiss uses the term windfall no less than seven times.[99] Asked to define the term, he offered the following definition:

> What I mean is a receipt of profit that is unrelated to the Company's actions and that would not -- and in this particular context would not have occurred absent the decoupling proposal. So you look at what would have happened under conventional current ratemaking, and then you look at what would have happened in decoupling, and if there is additional net revenues to the Company that didn't have anything to do with cost cutting or, you know, their own activities, that that would be a windfall.[100]

61. Mr. Weiss' testimony offers a multitude of ways in which such a windfall could occur.

- When higher than average usage caused by weather extremes, low commodity prices or economic boom causes customers to overpay fixed distribution costs and utilities earn more than their allowed return on equity (ROE), this would be a windfall completely unrelated to the utility's behavior.[101]
- A poorly designed decoupling mechanism could produce a windfall profit to the utility if it fails to take into account a downward trend in usage (sometimes called "attrition") by both existing and new customers. Decoupling may well provide margin recovery for this attrition and could produce a windfall compared to current rates. Indeed, any recovery greater than one-hundred percent of what the Company receives now would be an unwarranted windfall. [102]
- A poorly designed decoupling mechanism that fails to require an aggressive conservation program to its customers could result in a windfall because of a declining trend in residential per customer use that has nothing to do with conservation.[103]

62. To remedy what he described as the "windfall" problems associated with a poorly designed decoupling mechanism, Mr. Weiss proposes a number of protections. The Coalition

[99] Weiss, TR 291:9-13.
[100] Weiss, TR 291:16-25.
[101] Exh. No. 311-T, p. 5:17-21 (Weiss).
[102] Exh. No. 311-T, pp. 12:19-21, 14:15-19, 21:11-13, 31:3-5 (Weiss).
[103] Exh. No. 311-T, pp. 12:19-21, 14:15-16 (Weiss).

proposed the following windfall protections, for the following reasons and then abandoned them in the Settlement Agreement. In part, these proposed protections amounted to:[104]

1. Margin recovery should include weather because this protects customers from the windfall that could result from very cold weather causing customers to overpay fixed distribution costs and utilities earn more than their allowed return on equity (ROE).

2. The decoupling mechanism should contain different margin revenue for new customers or exclude all new customers. The reason for this protection is that per customer usage for new customers will definitely decline without any Company effort because of increased efficiency in housing stock and home appliances.

3. The Company would only receive the deferred decoupling revenues for a given year when it achieves ambitious yet achievable gas conservation targets consistent with a Commission approved recovery schedule for the prior year. This would prevent the Company from the windfall of recovering lost margin having nothing to do with conservation efforts.

4. The Company should be subject to penalties for failure to meet conservation targets. Again, this would prevent the Company from the windfall of recovering lost margin having nothing to do with conservation efforts.

5. Annual rate adjustments for the mechanism would be capped at no more than 3 percent. This would put a limit on the size of mismatch problem resulting from decoupling.

63. Despite this rather extensive list of conditions, the Northwest Energy Coalition signed a Settlement Agreement <u>without</u> a requirement that Cascade have a conservation in place before a decoupling mechanism is approved, <u>without</u> a symmetrical sharing of the risk of colder or warmer than normal weather, <u>without</u> a requirement that Cascade meet hard conservation targets each year in order for the program to continue, <u>without</u> tying decoupling revenues to meeting these targets, and <u>without</u> capping total decoupling revenues at 3 percent a year.[105]

64. The Northwest Energy Coalition's support for this Agreement cannot be explained away as merely compromising its litigation position. The protections it sought in litigation were

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[104] Exh. No. 311-T, pp. 31:13-34:19 (Weiss).

predicated on the fact that a decoupling mechanism without these protections would result in windfall earnings and therefore, should not be approved. The alarm sounded so clearly and loudly in Mr. Weiss' testimony, with regard to the likelihood of decoupling leading to a windfall for the Company, cannot and should not be ignored.

65. This would not be the first time that Mr. Weiss supported decoupling without clear protections against over-earnings. In his testimony, Mr. Weiss proudly proclaims his support for the Cascade decoupling proposals in Oregon that led to an April 2006 Stipulation subsequently adopted by the Oregon commission.[106] With the ink barely dry on Mr. Weiss' signature, it became apparent to the Oregon Commission Staff that Cascade is over-earning.[107] In fact, it was clearly over-earning at the time the settlement was struck and had been for "several years."[108] The Oregon PUC has since initiated a show-cause rate case seeking reductions in Cascade's rates and revenues.[109] There should be little doubt that the Oregon excess earnings case will reconsider the reasonableness of issues thought to be resolved in the Stipulation in which Mr. Weiss was intimately involved. The fact that an unprecedented rate reduction investigation is needed so soon after the Oregon Stipulation was approved may be an indication that Mr. Weiss' characterization of decoupling as a potential rate "windfall" is fairly accurate.

66. Any assertion that over-earning during the first three years of the pilot can be as easily overcome is simply false. Washington, unlike Oregon, does not have show cause authority. To the contrary, once decoupling is approved, the regulatory scheme in Washington would shift the burden onto any party alleging over-earning, including the Commission. To review whether the

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[105] Exh. No. 1. *See also*, Table 1, attached.
[106] Exh. No. 311-T, p. 13:3-7 (Weiss).
[107] Exh. No. 251-T, p. 17:13-15 (Brosch).
[108] Exh. No. 264
[109] Exh. Nos. 264 and 265.

rates are fair, just and reasonable, Cascade would have to file a rate case – which it would not in that instance – or the Commission or an intervener must file a complaint. Consequently, over-earning of a significant magnitude could occur for the entire period of the pilot and even after any renewal period and it would be very difficult to correct.

67. The cost of capital terms of the Settlement Agreement are discussed below. We note in passing here that the Settlement Agreement fails to contain a stated authorized rate of return. Without an authorized rate of return, it would be even more challenging to allege overearnings despite knowing that the Company, at a common sense level, was overearning.

D. DECOUPLING DOES NOT GUARANTEE UTILITY SPONSORED CONSERVATION EFFORTS, CAN HURT CUSTOMER DRIVEN EFFORTS AND IGNORES MUCH MORE EFFECTIVE MEANS OF ACHIEVING CONSERVATION.

68. The parties to the decoupling Settlement Agreement argue that aggressive conservation efforts are only possible by adopting decoupling. This one of the assertions that undergirds the parties' decoupling proposal. The truth is that decoupling does not require conservation. At best, it makes the company indifferent to it. For this reason, a conservation "add-on" must be crafted to cast decoupling as a conservation effort. The fact is that the conservation add-ons to decoupling mimic existing conservation programs like tariff riders and incentive programs. These stand-alone conservation programs are well-known to the Commission and unlike decoupling have a proven track record.

1. Decoupling is advertised as a mechanism to prevent utilities from discouraging per customer usage.

69. One of the almost philosophical claims of the decoupling advocates in this case is that decoupling is critical to ensuring that utilities are not opposed to energy efficiency programs.[110] For instance, Cascade witness Jon Stoltz testified that "Traditional rate design methods would continue to discouraged [sic] Cascade from promoting conservation."[111] Consequently, "The Company proposes to create a new regulatory tradition that eliminates the disincentive for utilities to promote and pursue conservation and Demand Side Management opportunities through our proposed decoupling mechanism."[112] Similarly, Cascade witness David Stevens testified that with decoupling, "We will be able to promote conservation without fear of being unable to provide a fair return to shareholders."[113] In short, the Company's argument in favor of decoupling is that it changes the regulatory framework in such a way that removes shareholder pressure to discourage conservation.

70. Commission Staff also claims that decoupling will remove the alleged disincentive. In her direct testimony, Staff witness Joelle Steward offers one of the more persistent decoupling arguments when she says, "Utilities are motivated to promote gas sales... Decoupling removes the motivation to promote sales and makes the company indifferent to changes in customer usage."[114] Indifference is important, says Ms. Steward, because it "removes a utility's disincentive to promote energy efficiency."[115] The problem with current ratemaking, according to Ms. Steward, is that "Revenues are largely generated through volumetric charges; therefore,

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[110] Exh. No. 311-T, p. 19:24-25 (Weiss).
[111] Exh. No. 21-T, p. 23:20-24 (Stoltz).
[112] *Id.*
[113] Exh. No. 11-T, p. 8:19-20 (Stevens).
[114] Exh. No. p. 421-T, 3:13-16 (Steward) (emphasis added).
[115] Exh. No. p. 421-T, p. 3:19-4:5 (Steward).

reducing energy use may result in lower profits for the utility, and may compromise the ability of the utility to recover its fixed costs."[116] The conclusion Ms. Steward reaches, is that "A decoupling mechanism, which restores to the utility the margins 'lost' due to customer efficiency, would then allow the utility to pursue energy efficiency without losing profits and make it more likely that it would recover its fixed costs."[117]

71. The Northwest Energy Coalition also argues that a disincentive exists. Witness Steve Weiss explains the alleged disincentive this way:

> Traditional rate design ties recovery of fixed costs directly to commodity sales. This encourages increased use and discourages even the most economical investments if they are likely to reduce throughput. If sales go down, Company shareholders forego cost recovery of recognized and prudent costs with every unsold therm. Under this system, supply expansion is the primary response to projected load growth - to the exclusion of investments in energy efficiency, peak load pricing and distributed energy resources. This is economically inefficient because there is a disincentive for the utility to choose the least-cost mix of options to provide energy service or to encourage such investments by customers.
>
> This regulatory paradigm places the utility's interest (to increase sales) in conflict with the customers' interest (to reduce their total energy costs). Not only does this foster a corporate culture that opposes direct utility investments in programs that reduce energy use, but also it further motivates the utility to discourage customer-financed reduction measures and to oppose efforts to tighten building codes and appliance standards.[118]

72. In sum, the fundamental goal of decoupling is indifference. None of the parties supporting decoupling in this case even pretend that decoupling alone will actually encourage Cascade to increase its conservation efforts. Ms. Steward explained at hearing that "They're related [decoupling and conservation] but they're also kind of separate."[119] Decoupling "removes the disincentive and allows for recovery of lost margin. But removing the disincentive does not

[116] Exh. No. p. 421-T, p. 3:20-4:2 (Steward).
[117] Exh. No. p. 421-T, p. 4:2-4:5 (Steward).
[118] Exh. No. p. 311-T, p. 4:23-5:15 (Weiss).
[119] Steward, TR 214:11-12.

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automatically…[create] a causal relationship with the Company pursuing conservation."[120] It is because of this flaw in decoupling that Staff added a condition that the Company would have to pursue conservation.[121] A bargain has been struck – decoupling for the Company and the promise of conservation for Staff and the Energy Coalition. This brief hopefully shows why this bargain is bad for Cascade's customers and should be rejected.

2. There is no evidence whatsoever supporting the disincentive theory of decoupling.

73. The high-level theory behind decoupling, while not outside the realm of plausibility, lacks any evidentiary support in this case. A theory is a "principle that guides action or assists comprehension or judgment."[122] It is not necessarily true and it may or may not conform to reality. The validity of any theory depends on its supporting evidence and the testing of that evidence. The decoupling theory in the instant case has no support and cannot stand the test.

74. Actually, Cascade witness David Stevens admitted that the Company is not against investing in conservation programs that reduce gas usage, is not discouraging customers from using their own resources to reduce energy usage and has not opposed efforts to improve energy efficiency through better appliance standards or building codes.[123]

75. In fact, Cascade claims it had been doing all of the cost-effective conservation possible. The Northwest Energy Coalition's sponsored testimony, contained very strong criticism of the Company's conservation programs. In particular, Mr. Weiss had stated that without having effective conservation programs in place before beginning decoupling it was like putting the cart

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[120] Steward, TR 214:12-15.
[121] Steward, TR 214:16-17.
[122] *American Heritage Dictionary of the English Language*, *available at* http://bartleyby.com/61/ (visited Nov. 14, 2006).
[123] Stevens, TR 232:9-22.

before the horse.[124] The rebuttal testimony of Cascade witness Katherine Barnard addressed this charge.[125] Ms. Barnard explained:

> The lack of utility sponsored conservation programs during the 1995 through 2000 time period was due not to a lack of evaluation, but to the fact that such resources were not cost-effective at the time based on then current long-term gas price forecasts. The Company is required to acquire *cost-effective* conservation, not conservation measures at any cost. In each of the IRPs, the Company evaluated adding additional programs as well as evaluated the cost-effectiveness of pilot programs it had performed in the 1992-1993 time period. Also in its 1993 Plan, Cascade proposed and implemented a joint pilot program with Idaho Power that targeted efficiency measures for schools. Unfortunately, the Company learned through that pilot program that it was not cost effective due to the high cost of the underlying engineering study that was necessary to assess the conservation alternatives for each facility. That reason, along with the continuing decline in the long-term gas price forecasts, resulted in the Company not pursuing a further expansion of the pilot.[126]

76. Explaining the Company's conservation efforts since 2000, Ms. Barnard said:

> Initially, when natural gas prices sky-rocketed in the winter of 2000/2001, many experts thought the price spike was a temporary response to supply and demand and that prices would stabilize again in the $2 range. Beginning in 2002, however, we began to see the long–term forecasts increase sufficiently to revaluate the cost-effectiveness of conservation programs. Programs with lower administrative costs (such as equipment rebate programs which provide a rebate for installing higher-efficiency equipment) tend to be more cost-effective than those programs that require an energy audit or inspection. The Company's evaluation resulted in the implementation of the Company's high efficiency equipment rebate program by Spring 2002 in Oregon and then 6 months later in Washington.[127]

77. Responding to the Northwest Energy Coalition's allegation that Cascade had failed to perform a thorough conservation assessment for its 2004 IRP, Ms. Barnard disagreed with the criticism.[128] Again, Ms. Barnard insisted that the Company had engaged in an assessment that

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[124] Exh. No. 311-T, p. 14:14 (Weiss).
[125] Exh. No. 111-T, p. 7:19 (Barnard).
[126] Exh. No. 111-T, p. 8:1-19 (Barnard) (Emphasis in original).
[127] Exh. No. 111-T, pp. 8:20-9:10 (Barnard).
[128] Exh. No. 111-T, p. 9:11-17 (Barnard).

allowed it to identify those cost effective programs worth pursuing.[129] Moreover, Cascade claims that the Company's evaluation of potential utility sponsored conservation measures *actually exceeds* what is required by this Commission.[130]

78. When asked about whether Cascade's business plan followed the traditional model of selling more to increase profits, Mr. Stevens said that was not the Company's goal.[131] Instead, Mr. Stevens responded:

> That would be correct in a normal business world. I will tell you that we no longer have that in our company. We no longer have incentive plans for our sales forces directly related to that. Everybody is on a I call it a Three Musketeers plan, it's all for one and one for all, it's basically global goals on safety, customer service, and then bottom line income, so we don't have a particular association to sales. Now I'm not going to say that we don't have sales people out trying to sell more gas, because that would be an incorrect statement, we definitely do that, but primarily trying to attract new customers to the system, new gas and electric customers and sales associated with that.[132]

79. The point is that as a regulated entity that still faces competition Cascade must pursue other goals like safety and customer service in order to survive. Its sales growth - its business plan – is to attract new customers to the system. All of the evidence shows this to be the case and it confirms Public Counsel witness Mr. Brosch's testimony that conservation is not inconsistent with traditional regulation because, like customer service and safety, Cascade must promote energy efficiency to succeed:

> Utility shareholders will generally benefit when sales volumes increase between test periods and are harmed when sales decline. Sales volumes are influenced by the addition of new customers and by changes in usage levels of existing customers, suggesting that utility promotion of energy conservation by existing customers might be actively discouraged by management.

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[129] Exh. No. 111-T, pp. 9:11-10:17 (Barnard).
[130] Exh. No. 111-T, p. 11:6-10 (Barnard).
[131] Stevens, TR 247:23-248:16.
[132] *Id.*

> However, in this era of higher-priced natural gas, conservation measures are necessary to attract new customers and to retain existing gas utility customers that may otherwise elect alternative energy sources such as electricity when appliances are being installed or replaced. Cascade has little choice but to promote the efficient use of natural gas.[133]

80. The other problem with the decoupling theory is that Cascade loses a truly miniscule margin from its own conservation programs. Mr. Weiss's direct testimony contains a discussion of exactly how many therms the Company claims it lost through its conservation programs and the margin associated with these lost therm sales. Cascade's "lost margin" revenues from its 2005 conservation program were less than $25,000.[134] From 1995 to 2005, lost margin revenues attributable to Cascade's conservation investments totaled $102,838 or less than $10,000 a year.[135] It is difficult to see how shareholders would care about these "losses." Moreover, there is no evidence in the record that Cascade's shareholders do care about lost therm sales from conservation. It is much easier to imagine shareholders are focused on how pleased they are with a stock offering valued at two times book value.

81. Mr. Weiss, who claims in his testimony some very specific anti-conservation behavior by some utilities, could not identify any instance in which Cascade had engaged in such behavior. Specifically, Mr. Weiss claimed that the current "regulatory paradigm places the utility's interest (to increase sales) in conflict with the customers' interest (to reduce their total energy costs)."[136] He continues, "Not only does this foster a corporate culture that opposes direct utility investments in programs that reduce energy use, but also it further motivates the utility to discourage customer-financed reduction measures and to oppose efforts to tighten building codes

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[133] Exh. No. 251-T, p. 31:1-6.
[134] Exh. No. 311-T, p. 15:12-15.
[135] *Id.*
[136] Exh. No. 311-T, p. 15:10-15.

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and appliance standards."[137] Similarly, in Mr. Weiss' cross rebuttal testimony he criticizes Public Counsel witness Michael Brosch, saying:

> … Mr. Brosch underestimates the impact of a large utility in affecting non-conservation program policies that incent customers to reduce usage: appliance standards, building codes and zoning, tax policies, public education, market transformation, regulatory policies (such as planning criteria) et cetera. It is my experience that utilities can be very formidable opponents to enacting and encouraging such policies; just as their support can be crucial.[138]

82. Asked whether he had evidence of Cascade fighting for increased usage by opposing better appliance standards, Mr. Weiss said he had no evidence.[139] The same was true for stronger building codes or zoning and tax policies that encourage conservation – Mr. Weiss admitted that he knew of no efforts by Cascade in this regard. Instead, Mr. Weiss discussed other utilities in Oregon, further admitting "I have no experience with Cascade."[140]

83. Statements, such as these, that make general assertions about the world while lacking any factual basis, are endemic in the decoupling debate. With no evidence that the Company is actively opposing conservation efforts, is discouraging customers from using their own resources to reduce energy usage or has opposed efforts to improve energy efficiency through better appliance standards or building codes, decoupling remains a theory looking for an application.

3. Gas conservation is a goal of the utmost priority but decoupling will not get us there and may actually hurt conservation efforts.

84. Because decoupling only removes the utility's alleged disincentive to engage in utility sponsored conservation, decoupling alone cannot guarantee conservation. It is should be somewhat revealing that Commission Staff and the Northwest Energy Coalition have seen it

[137] *Id.*
[138] Exh. No. 311-T, p. 20:9-14 (Weiss).
[139] Weiss, TR 300:1-4.
[140] Weiss, TR 300:1-25.

necessary to propose "add-ons" to the Company's decoupling proposal in an effort to actually increase conservation, apparently admitting that removal of the alleged disincentive is insufficient alone to accomplish this goal. In this way, conservation is not central to the Company's activities; it is the price Cascade is made to pay for decoupling. It is a great deal for the Company because there is no question that decoupling will allow it to collect lost margin far in excess of any margin lost due to its own conservation, while ensuring that ratepayers will overpay for any conservation programs that may result.

85. As discussed earlier, Cascade is losing a miniscule amount of money from its own energy efficiency programs. Indisputably, the overall declines in per customer usage far exceed what is caused by utility sponsored conservation. These per customer sales volume declines are actually totally unrelated to the Company's conservation activities. The main drivers of per customer usage variations are (1) weather abnormalities, (2) price elasticity, (3) customers replacing inefficient old appliances furnaces, (4) improved building codes, and (5) customer financed conservation investments.[141]

86. The decoupling mechanism in the Settlement Agreement would allow all of these changes in gas usage (except weather abnormalities) to be swept together indiscriminately within the decoupling mechanism for piecemeal rate recovery. Each of the signatory parties admits this to be the case. At the panel supporting the Settlement, Commission Staff witness Ms. Steward stated it succinctly, saying " What's included are all the non-weather related changes in consumption."[142] Cascade witness Mr. Stoltz confirmed that "It would capture all changes in

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[141] Exh. 251-T, p. 8:1-9.
[142] Steward, TR 197:25-198 (emphasis added).

consumption other than that caused by weather."[143] Thus, decoupling is admittedly overreaching as a remedy for lost usage caused by utility-sponsored conservation programs.

87. Table 3 sets forth the individually significant drivers of gas sales volume changes and indicates whether gas usage changes caused by that variable would be subject to rate recovery through the decoupling tariff proposal of each of the parties:

Table 3: Rate Recovery of Sales Volume Drivers

SALES VOLUME DRIVER	GENERAL ONGOING SALES VOLUME IMPACT	Settlement Decoupling Proposal
Number of Customers	Increasing	No
Weather Abnormality	Variable	No
Price Elasticity	Decreasing	Yes
Replacement of Inefficient Old Appliances / Furnaces	Decreasing	Yes
Construction of Buildings Improved Building Codes	Decreasing	Yes
Customer Financed Conservation Investments	Decreasing	Yes
Utility Sponsored Conservation Investments	Decreasing	Yes

88. This summary illustrates several important points. First, it shows (in the row named "Number of Customers") that the Settlement Agreement decoupling mechanism is imbalanced in favor of shareholders, because they would ignore continuing growth in the number of customers being served. Customer growth can be expected to continue to offset much or all of the sales volume drivers negatively impacting sales volumes.[144] The summary table also shows that most of the causes of sales declines that would be tracked through decoupling have nothing to do with

[143] Stoltz, TR 199:1-2.

utility-sponsored conservation programs that are thought to be subject to disincentives under traditional regulation.[145] For example, the summary shows that the decoupling recommended by Cascade, Staff, and the Coalition would allow decoupling rate increases when customers adjust thermostats or otherwise react to commodity price increases experienced through the PGA.[146] Additionally, the table shows that Cascade would be allowed decoupling rate increases between rate cases for sales volume declines caused by normal replacement of old and inefficient appliances, furnaces and housing/buildings.[147] Further, if customers elect to invest in conservation retrofits at their own expense, the decoupling proposals would allow Cascade to increase rates to account for any resulting sales declines caused by such customer-financed conservation.[148] The decoupling settlement constitutes an unreasonably broad response to concerns about regulatory disincentives to utility-sponsored conservation programs. Most of the drivers of sales volumes are not sensitive to regulatory incentives directed at utility management.

a. The Company will recover for price elasticity, customer sponsored conservation and building code changes, thereby creating a perverse incentive against these important drivers of lower gas usage.

89. As noted previously, decoupling is an expansive tariff tracker that will increase future rates to customers whenever usage per customer declines, without regard to the causes of the reduced usage. Decoupling will actually punish customers with future decoupling rate increases when they spend their own money on conservation measures or reduce their comfort levels to conserve usage. Nowhere has the perverse incentive been better stated than at the Bellingham Public Hearing. There, Ms. Carol Whitling, a private citizen, testified to the following:

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[144] Exh. No. 263-T, pp. 8:4-9:22 (Brosch Rebuttal); Exh. No. 1.
[145] *Id.*
[146] *Id.*
[147] *Id.*

I live here in Bellingham and I'm a Cascade customer. I would like to say that I moved to Bellingham a year ago and as a retiree on a fixed income. And I spent my first year here discovering that the place I rented wasn't insulated. And that is my problem with my landlord, but I did spend a lot of time at the library, because I wanted to conserve on using the heat. And I was concerned about how much it would cost, since the rate had gone up, I think 25 percent last year.

And I just wanted to say I was totally flabbergasted when it talked about there being an impingement on people who are trying to conserve. It just didn't make any sense to me that as a customer, I would be getting charged a higher rate for being careful about my use on the natural gas in the place that I live in.

I'm not very good at economics, but it just didn't make sense to me that here I tried to turn off lights for the electrical company, and try not to turn the gas on too long. And I just don't understand why I should be penalized for conserving or trying to conserve on the use.[149]

At hearing, Mr. Stevens agreed that Ms. Whitling would pay more for her sacrifice.

Q. …You do agree that people like Ms. Whitling, people who turn down the thermostat or go to the library to save gas, could pay higher rates on your decoupling if per customer usage continues to decline?

A. You mean pay higher rates than what they would have under a historical methodology without decoupling?

Q. Yes.

A. That would be correct.

Q. And that per customer usage could decline in part exactly because of Ms. Whitling's sacrifices, yes?

A. I think from this standpoint it sounds like she's already done the conservation, and since we would be setting off at this point, the likelihood – people like her, potentially yes, to answer your question directly, but in her particular case that may not be the case. And also from the standpoint of the landlord not, you know, insulating the home, I hope would be that we would be able to fund programs to target landlords and people like that so that we could do some things in addition to what she's doing from a personal sacrifice standpoint to help conserve.

[148] *Id.*
[149] Whitling, TR 127: 23–128: 19.

Q. I understand that, but the perverse incentive that I'm trying to point out is if Ms. Whitling goes to the library more than she did this year because it's colder, per customer usage could go down more, and the company could recover more from that?

A. Could recover that as a conservation portion, that is correct.[150]

90. Besides, price elasticity, as in Ms. Whitling's case, the Company admits that declines in per customer usage resulting from customers replacing inefficient old appliances furnaces, customer financed conservation investments and improved building codes would also result in higher rates for these customers.[151] Over and over again Cascade concedes that it is these factors driving lower usage per customer – not utility sponsored conservation. From the 2005 Annual Report:

- The addition of more efficient homes and businesses, reduced consumption per consumer, and slightly warmer weather compared to last year drove the lower consumption rates;[152]
- Overall revenues and margins are also negatively impacted by higher efficiency in new home and commercial building construction, higher efficiency in gas-burning equipment, and customers taking additional measures to reduce energy usage;[153]
- The increasing cost of energy in recent years, including the wholesale cost of natural gas, continues to encourage such measures."[154]

91. David Stevens confirmed that these factors – warmer weather, price elasticity, customer-sponsored conservation, stronger housing codes and replacing old appliances – drove per customer usage down in 2005.[155] Indeed, overall residential customer usage was down 3.8 percent in 2005 and commercial usage dropped 4.4 percent.[156] Nonetheless, even with this

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[150] Stevens, TR 230:2-231:6.
[151] Stevens, TR 231:7
[152] Exh. No. 20, p. 22.
[153] Exh. No. 20, p. 19.
[154] Exh. No. 20, p. 22.
[155] Stevens, TR 240:22-241:16.
[156] Stevens, TR 240:16-21.

coalescence of events driving down usage, Cascade added $1.75 million in additional margin in 2005.[157] And that was after adding $1.65 million in margin in 2004.[158] Cascade takes the position that "Just because usage declines for reasons other than a utility sponsored program, does not mean that the utilities shareholders need to suffer."[159] Clearly, the utility is not suffering. Nonetheless the premise of Mr. Stoltz' claim should not be ignored – Cascade is intentionally shifting the risk of declining gas sales <u>for any reason</u> onto its 503 and 504 customers.[160]

92. At hearing, Commission Staff also agreed that price elasticity, customer sponsored conservation, housing codes and replacing old appliances has an effect on per customer usage.[161] When asked to identify projected sales declines due to these factors, Ms. Steward could not provide this information in response to a Public Counsel data request or to Commissioner Jones at hearing.[162] Nor could Mr. Stoltz provide this information when asked by a Public Counsel data request and by Commissioner Oshie.[163] Finally, Mr. Weiss was unable to produce the information.[164]

93. The point is none of the parties can segregate causation and none of the parties even attempted to offer a way to do so. This is one of the reasons why it is not possible to fix a decoupling mechanism such as this one. By its nature it will always allow Cascade to recover far, far more than lost therms resulting from utility sponsored conservation. That is, cumulative revenue declines from other factors will always swamp revenue declines related to utility sponsored conservation. Decoupling is an ill-conceived and overly broad program of piecemeal

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[157] Stevens, TR 242:16-243:6; 244:4-6; Exh. No. 10.
[158] Stevens, TR 243:7-9; Exh. No. 10.
[159] Exh. 30-T, 21:21-22:2 (Stoltz).
[160] Stoltz, TR 261:6-15.
[161] Steward, TR 270:21-271:5.
[162] Exhibit No. 242; Steward TR 218:24-219:13.
[163] Stoltz TR 198:17-199:2-19; Exh. No. 133.

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rate increases to protect the utility against any lost usage per customer (from any causes), while ensuring strong future customer-driven revenue growth to the utility in the absence of any showing that such piecemeal decoupling rate increases will be financially needed.

b. Identifying non-weather related changes is not easy.

94. Setting aside the fundamental problem that decoupling is scoped far beyond the alleged "disincentive problem," the settling parties are also confronted with the challenge to isolate and remove weather effects to implement what they have agreed upon. The problem of teasing out customer usage changes due to weather was raised by Commissioner Oshie. The question to the panel was how it intended to segregate weather related demand from demand that has been reduced "by conservation or vacations or price elasticity or customer driven changes to their appliances."[165] Mr. Stoltz responded 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 that 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".[166] The weather normalization methodology used will be the one Cascade proposed in the case.[167]

95. While seemingly simple, obtaining an accurate weather normalization model to divine weather related changes in usages is exceedingly difficult and always controversial. Indeed, it was a contentious issue in this case.[168] Commission Staff's original decoupling proposal adopted the methodology proffered by Staff witness Dr. Yohaness Mariam.[169] Cascade strongly opposed

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[164] Exh. No. 321.
[165] Oshie TR 199:3-12.
[166] Stoltz TR 199:14-19.
[167] Stoltz TR 199:20-23.
[168] Stoltz, TR 263:20-23.
[169] Steward, TR 272:2-4.

this methodology.[170] Mr. Stoltz sponsored three exhibits dedicated solely to rebutting Staff's methodology.[171] In return, Commission Staff strongly opposed the methodology sponsored by Company witness Dr. Philip Mote.[172] Dr. Mariam was unequivocal in his testimony when he said "Cascade's proposed methodology is both overly simplistic and statistically flawed and, for the reasons set forth in my testimony, should be rejected by the Commission."[173]

96. Once again it is too easy to point to the dispute and say that the parties merely abandoned there litigation positions. The issue boils down to whether a mechanism exists that will properly tease out weather related usage. Mr. Stoltz acknowledged segregating weather requires a good methodology.[174] Commission Staff somewhat acknowledged the problem by admitting the statistical nature of the methodology, which by its nature includes assumptions:

> Q. Isn't it possible that without an accurate methodology for calculating the effect of weather on usage, the Company could be significantly overrecovering for lost margin strictly caused by weather?
>
> A. I guess it's the accurate methodology, it's statistical methodology, so how well you say it's accurate, you know, it's statistics.[175]

c. There are so many better ways for achieving effective conservation why not try one.

97. As pointed out by all of the parties, the need for aggressive conservation is even more imperative as Cascade and other gas utilities continue to purchase and pass through higher and

[170] Steward, TR 272:5-8; Exh. No. 21-T, p. 8:15 (Stoltz).
[171] Exh. No. 30-T, p. 2:11-13 (Stoltz Rebuttal); Exh. Nos. 32-34.
[172] Exh. No. 201-T (Mote).
[173] Exh. No. 441-T, pp. 3:11-4:2 (Mariam).
[174] Stoltz, TR 263:4-20.
[175] Steward, TR 272:16-22.

higher costs of natural gas via their Purchase Gas Adjustment (PGA) mechanisms. Cascade alone passed through a commodity increase of 26.3 percent in 2005.[176]

98. Northwest Energy Coalition witness Steven Weiss got it right when he said that Cascade should be both encouraged and required to pursue utility sponsored conservation.[177] Decoupling does neither. Indeed, Mr. Weiss freely admitted that decoupling is not the only way to increase utility sponsored conservation efforts.[178] The section below discusses more effective ways to achieve conservation.

(1) Required conservation efforts.

99. Listening to proponents of decoupling one might thing that Cascade is no longer a regulated utility. The Commission's rule regarding integrated resource plans (IRP) requires Cascade to file a plan every two years "describing the mix of natural gas supply and conservation designated to meet current and future needs at the lowest reasonable cost to the utility and its ratepayers."[179] The planning process is not expected to be an end in itself; utilities are expected to implement their plans. Thus, the Commission already has significant capacity to increase conservation.

100. The Northwest Energy Coalition also believes that the IRP process can result in increased conservation.[180] The concern raised by Mr. Weiss about the IRP at hearing was one of enforcement. That is, the IRP was focused on planning and had no enforcement mechanisms.[181]

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[176] Docket No. UG-051483.
[177] Exh. No. 31-T, p. 14:19.
[178] Weiss, TR 292:8-10.
[179] WAC 480-90-238(2)(a).
[180] Weiss, TR 292:14-293:3.
[181] *Id.*

Unfortunately for Mr. Weiss, the same could be said of the Settlement Agreement before the Commission.[182]

101. Even apart from the IRP rules, the Commission has the authority, similar to its enforcement of service quality standards, to enforce a minimum level of utility conservation. It is difficult to imagine that Cascade would attain this minimum standard in the near future. Any hesitation to set hard targets for aggressive conservation because these may result in conservation that is not cost effective should be set aside. Cascade itself claims that the rising wholesale price of gas has significantly raised the bar regarding what is cost effective.[183] Moreover, new trends in Washington support setting tougher achievement goals.[184]

(2) Conservation cost recovery through a tariff rider.

102. Another widely acknowledged way to achieve more conservation is through a tariff rider designed to directly fund conservation programs. Mr. Weiss' direct testimony lauded Puget Sound Energy's tariff rider conservation program in particular.[185] The PSE program is the product of a 2002 Settlement Agreement stemming from a rate case.[186] At hearing, Mr. Weiss testified that he believe Puget has a corporate culture that supports conservation without decoupling and is far ahead of Cascade when it comes to conservation. It is no coincidence that PSE is better; its conservation efforts have greatly increased since the 2002 settlement, without any decoupling tariff.

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[182] Exh. No. 1.
[183] Exh. No. 21-T, pp. 20:8-22:10 (Stoltz).
[184] The Commission's role with regard to implementing I-937 for investor owned utilities, which appear sizable, will likely significantly expand the IRP and its importance in setting and achieving conservation goals on the electric side.
[185] Exh. 311-T, p. 17:1-11.
[186] *WUTC v. PSE*, Docket Nos. UE-011570 & UG-011571, Final Order, Exhibit F - Conservation Stipulation (June 20, 2002).

103. A summary of the PSE program helps contrast a tariff rider with decoupling. In PSE's case, the tariff rider addresses conservation on both the gas and electric side and is intended to achieve all savings that are cost-effective to the Company.[187] It creates is a process for establishing electric and natural gas savings targets over a two-year period and if PSE fails to achieve those savings, the company is subject to potential penalties ($200,000 to $750,000 depending on performance).[188] Any penalty funds are used to fund cost-effective energy efficiency programs for PSE customers through a third party vendor.[189] PSE can file a petition for mitigation of penalty amounts, if it can demonstrate that certain occurrences beyond their control negatively impacted customer participation in the program.[190] Remarkably, in comparison to the instant Settlement Agreement, PSE has a much more aggressive program under a tariff rider than Cascade would have under decoupling.

104. Testimony at hearing in this regard was very revealing and shows why a tariff rider would make more sense. When asked what the cost of Cascade's new conservation plan would be Mr. Stoltz answered that he thought it would cost in the $200,000 to $400,000 range on an annual basis.[191] The Company said something different in response to a Public Counsel data request, Exh. No. 141. In that exhibit the Company identified approximately $525,000 in program costs annually. At hearing, the Energy Coalition estimated the cost at 1.25 percent of revenues or $3 million.[192] Commission Staff agreed with the Coalition, estimating the cost at a little less than $3 million range.[193] Indisputably, these are fairly disparate projections. The

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[187] *Id.*
[188] *Id.*
[189] *Id.*
[190] *Id.*
[191] Stoltz, TR 220:24.
[192] Weiss, TR 221:9-10.
[193] Steward, TR 221:19-23.

problem stems from the lack of any defined conservation program whatsoever. This simply does not happen with well designed tariff riders even though they are far less risky and costly than decoupling. A conservation tariff rider, like a low-income tariff rider, is unlikely to receive approval without sufficient details. Here, the settling parties want the Commission to go forward with a conservation for decoupling trade on a trust-me-basis.

105. Given the known effectiveness of the PSE model, and the fact that Cascade's conservation efforts are admittedly nascent and entirely undefined, the better policy would appear to be a well designed tariff rider and not decoupling. Public Counsel would support and participate in the development of a well-designed tariff rider for Cascade dedicated to increasing conservation at the levels set in the PSE program.

(3) Incentives with penalties are also an option for increasing conservation.

106. Conservation incentives with penalties can also be a very important tool in increasing utility sponsored conservation. An incentive program will always be better than decoupling because it requires tracking of utility sponsored conservation efforts and the results of these efforts. In the current Avista decoupling case, Public Counsel has offered a detailed gas incentive program.

107. In addition, Commission Staff, the Energy Coalition and Public Counsel are all supporting some form of incentives for electric in the current Puget Sound Energy general rate case. That support, however, comes after PSE developed a significant conservation record over a number of years in its electric business.

108. Should the Commission conclude that Cascade needs more financial motivation to pursue conservation than it would get from a tariff rider, Public Counsel believes that an incentive and

penalty mechanism is a better choice than decoupling. But while an incentive/penalty program is preferable to decoupling, it remains a large step for a utility like Cascade.

E. Since the Settlement Agreement Does Not Contain Any Information about the Adopted Cost of Capital, Capital Structure or Overall Rate of Return it is Impossible to Know Whether Rates are Fair, Just and Reasonable Now and in the Future.

109. Commission Staff and Cascade are the only signatories to the Cost of Capital section of the Settlement Agreement. Table 2 attached to this brief shows the parties' original proposals. In the cost of capital section of the Agreement, the parties simply supplied a number allegedly reflecting the overall rate of return, $7,480,632, and this was allegedly based on the agreed-to revenue requirement, $7,061,536.[194] Therefore, absent from the Settlement Agreement are (1) a rate of return on equity (ROE), (2) a capital structure, including short and long term debt and (3) an overall percentage rate of return.

110. Commission Staff witness Michael Parvinen testified at hearing that "We didn't really identify a capital structure."[195] He further explained that without a capital structure it is "virtually impossible to then come up with pro forma debt calculation."[196] Yet, Assistant Attorney General Gregory Trautman, speaking for the cost of capital settling parties, told the Commission that the Settlement Agreement proposal "contains an agreement of cost of capital that is in the <u>middle of the range</u> between the positions of Staff and the Company on this issue."[197] Determining whether the cost of capital adopted in the Settlement Agreement fits into the settling parties' range requires a capital structure, which would include long term and short term debt. For the two statements to be consistent, one must read Mr. Parvinen's statement to say that there is an

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[194] Exh. No. 1, p. 4.
[195] Parvinen, TR 195:24.
[196] Parvinen, TR 195:25-196:1-2

agreed-to capital structure but it is not identified in the Settlement Agreement. However, we cannot know.

111. For the reasons outlined below, the Commission cannot perform its statutory function without a stated overall rate of return. So while "black box" settlements are sometimes appropriate, the failure to lay out a rate of return in the Settlement Agreement is arguably fatal to its stated revenue requirement. In addition to the general problem of failing to identify an overall rate of return, there are a number of problems with using a "black box" settlement in this particular case. These problems are discussed more below.

112. First, the Commission has consistently taken the position that ensuring rates are "fair, just, reasonable, and sufficient" requires "a comprehensive review of the company's rate base and operating expenses, determining a proper rate of return, and allocating rate changes equitably among ratepayers."[198] Without a rate of return in the Settlement Agreement, the Commission cannot determine whether the rate of return is proper, cannot determine the appropriate revenue requirement and cannot determine if rates are fair, just and reasonable.

113. Second, as identified earlier, because the Settlement Agreement does not contain an authorized rate of return there is no way to know in the future whether the Company is over earning. Beyond a comprehensive test year rate case review determining the proper rate of return, the Company's future operations must also meet the fair, just and reasonable test. To track the ongoing rate of return, the Commission adopted WAC 480-90-257. This rule requires a company filing called a "Commission Basis Report." Without an authorized rate of return, there is no benchmark by which we can value the Commission Basis Report. This is especially

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[197] Trautman, TR 178:19-22 (emphasis added).

troubling where Cascade is reportedly over earning in Oregon. It is also troubling because Cascade could potentially over earn here under decoupling and the burden of showing over earning will have been shifted onto the Commission or other parties. Usually, if a Complaint is made, one can show over earnings by showing that the actual rate of return exceeds authorize rate of return. Without a clear authorized rate of return, the Commission and other parties would be stuck in the less than crystal clear world of the fair, just and reasonable standard. Any argument that the revenue requirement set in this case would be evidence of what is fair, just and reasonable in the future would suffer from the circular argument problem since the instant revenue number was set without an explicit rate of return. Moreover, as time passes and circumstances change, a test year revenue requirement becomes less and less reflective of actual financial conditions, landing back in the murkier world of fair, just and reasonable.

114. Third, while we are opposing decoupling, we do agree that any shift in risk of the magnitude brought by decoupling must be reflected in a downward adjustment to the Company's ROE. One of the Commission's principles for a "well-designed decoupling mechanism" is that any proposal must address the rate of return implications.[199] The Settlement Agreement proposed to the Commission not only fails to address the rate of return implications, it does not contain a rate of return.

115. All of the proponents of decoupling support a downward adjustment to return on equity if decoupling is approved. Mr. Weiss claimed that an ROE adjustment is an important benefit to

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[198] RCW 80.04.140; *MCI Telecommunications Corp. v GTE Northwest, Inc.*, Docket No. UT-970653, Second Supp. Order at 6 (Oct. 22, 1997) (emphasis added).
[199] *WUTC v. PacifiCorp*, Docket Nos. UE-050684 and UE-050412, Order No. 04 at ¶¶ 108-109 (Apr. 17, 2006) (emphasis added).

customers.[200] Yet there is no way to know whether there has been such an adjustment since there is no ROE.

IV. CONCLUSION

116. Decoupling radically departs from the Commission's long-held principles protecting customers from paying more than they should for the utility services they receive. While exceptions to these principles have been made, they are rare - limited to extraordinary circumstances beyond the company's control. Because decoupling violates these traditional principles, its adoption throws open the door to over earnings, and thus risks creating a problem not easily be remedied.

117. Departing from traditional ratemaking is even more unwarranted in the case of Cascade, where it is clearly working. The only fissure identified by the decoupling proponents is that per customer gas usage is declining. As has been discussed at length, tracking per customer usage alone ignores Cascade's healthy financial picture. Cascade's customer growth is on the rise and with it come new revenues. Cost savings and other efficiencies have produced significant income.

118. Decoupling proponents do not even attempt to argue that decoupling guarantees utility sponsored conservation efforts. It is advertised as a mechanism to prevent utilities from discouraging per customer usage but there is no evidence whatsoever supporting the disincentive theory of decoupling. Rather, instead of increasing Company efforts, the evidence shows the decoupling can actually hurt customer driven efforts. That is because reduced gas usage from

[200] Exh. No. 311-T, p. 10:12-13 (Weiss).

price elasticity, customer sponsored conservation and building code changes will ironically directly cause rates to rise under the decoupling mechanism.

119. Decoupling is not the answer. There are so many better ways for achieving effective conservation without the amount of money and risk associated with decoupling. For these reasons, decoupling should be rejected.

120. Regarding the cost of capital question, without a rate of return, the appropriateness of the revenue requirement cannot be determined. If the revenue increase is not sufficiently justified it would appear it must be rejected. However, even if Cascade is allowed the revenue requirement set in the Settlement Agreement, despite its lack of support, there is still the question of decoupling. Under the *PacifiCorp* principles, decoupling should be rejected without a rate of return analysis. Therefore, if decoupling is adopted over Public Counsel's objections, the Commission should reopen the Settlement to ensure a downward adjustment to Cascade's ROE.

121. DATED this 15TH day of November, 2006.

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