

**Exhibit No. ___ (DJR-1T)
Docket UE-110876/UG-110877
Witness: Deborah J. Reynolds**

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

**AVISTA CORPORATION d/b/a AVISTA
UTILITIES,**

Respondent.

**DOCKET UE-110876
DOCKET UG-110877**

(Consolidated)

RESPONSE TESTIMONY OF

Deborah J. Reynolds

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

Re: The Decoupling Proposal of the NW Energy Coalition

February 24, 2012

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	PURPOSE AND SUMMARY	2
III.	DISCUSSION OF NVEC’S DECOUPLING PROPOSAL	4
A.	Response to Mr. Cavanagh’s “Fixed Cost Recovery” Analysis	6
B.	NVEC’s Proposal is Not Applied to All Customer Classes	8
C.	NVEC’s Proposal Excludes the Impact of Decoupling on the Rate of Return	10
D.	NVEC’s Proposal Does Not Condition Recovery on Conservation Achievement	14
E.	NVEC’s Proposal Does Not Identify Comparable Conservation Benefits to Low-Income Customers	15
F.	NVEC’s Proposal Does Not Describe Incremental Conservation	16
G.	NVEC’s Proposal Does Not Account for the Net Benefits of Off-System Sales and Costs Avoided Due to the Utility’s Conservation Efforts	17
IV.	CONCLUSION.....	20

LIST OF EXHIBITS

- Exhibit No. ____ (DJR-2): UTC Staff’s Response to Bench Request in Dockets UE-111048 and UG-111049
- Exhibit No. ____ (DJR-3): NVEC Cover Letter and Data Requests 2-4 Dated September 1, 2011
- Exhibit No. ____ (DJR-4): Excerpt from “Revenue Regulation and Decoupling: A Guide to Theory and Application” (The Regulatory Assistance Project, June 2011) (Cover page and pages 4, 5, 36-39)

1 I. INTRODUCTION

2

3 Q. Please state your name and business address.

4 A. My name is Deborah J. Reynolds. My business address is the Richard Hemstad
5 Building, 1300 S. Evergreen Park Dr. SW, Olympia, Washington 98504.

6

7 Q. By whom are you employed and in what capacity?

8 A. I am employed by the Washington Utilities and Transportation Commission
9 (“Commission”) as the Assistant Director of the Conservation and Energy Planning
10 Section of the Regulatory Services Division. My employment at the Commission
11 began in 1999.

12

13 Q. Please describe your education and your professional qualifications.

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

1 I am responsible primarily for Staff who review and evaluate conservation
2 programs, conservation resource planning, cost of service, rate spread and rate
3 design, decoupling, reliability, service quality, low-income issues, and other analyses
4 in general rate cases and other tariff filings of Commission-regulated electric and
5 natural gas utilities. I also provide technical assistance to companies on energy
6 regulatory matters.

7 I have participated in the development of Commission rules and examined
8 utility reports for compliance with Commission regulations. I have also presented
9 Staff recommendations at numerous open public meetings. I have filed testimony on
10 decoupling in Avista's consolidated general rate case, Dockets UE-090134, UE-
11 090135 and UG-060518, Staff comments on conservation target filings in Dockets
12 UE-100170, UE-100176, and UE-100177, and testimony on decoupling in Puget
13 Sound Energy, Inc.'s (PSE) consolidated general rate case, Dockets UE-111048 and
14 UG-111049.

15 16 II. PURPOSE AND SUMMARY

17
18 **Q. What is the purpose of your testimony in this proceeding?**

19 A. My testimony responds to the full electric decoupling proposal of the NW Energy
20 Coalition, presented by Mr. Ralph Cavanagh.

21

1 **Q. Have you responded to a decoupling proposal by NWECC in another**
2 **Commission docket?**

3 A. Yes. I filed and defended testimony on this issue in consolidated PSE Dockets UE-
4 111048 and UG-111049.

6 **Q. In those PSE dockets, did Staff file a response to a Bench Request regarding**
7 **decoupling?**

8 A. Yes. In those PSE dockets, the Commission issued the same (or substantially the
9 same) decoupling-related Bench Request that the Commission issued in this general
10 rate case. Although the Commission relieved Staff from filing a response in these
11 Avista dockets, I am including a copy of the Bench Request response Staff filed in
12 the PSE dockets so the Commission will have that information available here.
13 Staff's response is my Exhibit No. ___ (DJR-2).

15 **Q. Please summarize Staff's response to NWECC's decoupling proposal.**

16 A. In its direct testimony in this case, Avista alleged that it is experiencing growth in
17 costs that are not reflected in rates. A decoupling mechanism will not address that
18 phenomenon. Staff recommends an attrition adjustment as the best way to deal with
19 this issue, including any lost revenues due to conservation.

20 The Commission should reject Mr. Cavanagh's decoupling proposal because
21 it does not comply with the Commission's Decoupling Policy Statement.¹ In their

¹ Report and Policy Statement on Regulatory Mechanisms, Including Decoupling, to Encourage Utilities to Meet or Exceed their Conservation Targets, Docket U-100522 (November 4, 2010) ("Decoupling Policy Statement").

1 joint testimony supporting settlement, the Settling Parties, including Staff,
2 recommend that, in the event that the Commission orders further consideration
3 (beyond this Docket No. UE-110876) or adoption of electric decoupling or any other
4 similar mechanism, this should not occur until the Company's next general rate
5 case.² The Settling Parties reserved the right to advocate any position or to offer
6 recommendations regarding the rejection, adoption or implementation of electric
7 decoupling or other similar mechanisms in Avista's next general rate case or in any
8 future proceeding.³

9
10 **III. DISCUSSION OF NVEC'S DECOUPLING PROPOSAL**

11
12 **Q. Please generally describe NVEC's decoupling proposal.**

13 A. NVEC proposes a full decoupling mechanism for Avista's electric operations.
14 Avista's revenues would be based upon a revenue-per-customer ("RPC") value for
15 all electric customers, except the 22 customers Avista serves under Schedule 25,
16 Extra Large General Service.⁴

17 The NVEC proposal would guarantee Avista would recover that RPC
18 through a deferred accounting and true-up process. The true-ups of actual revenue to
19 the RPC level would occur annually, subject to a three percent rate increase cap.

² The Stipulation states that consideration of any ROE adjustment related to decoupling would be at issue with any decoupling proposal. *See* fn. 3 of Exhibit No. 1, Settlement Stipulation.

³ Exhibit No. 2, Joint Testimony at 16:13-19.

⁴ Schedules 1 (Residential), 11/12 (General), 21/22 (Large General), 31/32 (Pumping), 41-49 (Street and Area Lighting).

1 Avista would defer any amount above the cap and recover it in later annual rate
2 changes.

3 NWEC proposes that the mechanism run for at least five years, subject to a
4 future evaluation by an independent contractor. Finally, the proposed mechanism
5 requires annual reports by Avista describing its progress toward conservation
6 targets.⁵

7

8 **Q. Does Staff have any general concerns about implementing NWEC's decoupling**
9 **proposal for Avista?**

10 A. Yes, Staff has two general concerns. First, Avista alleges it is experiencing growth
11 in costs that are not reflected in rates.⁶ It is Staff's view that an attrition adjustment
12 is the best way to deal with this issue, including any lost revenues due to
13 conservation.⁷ Decoupling does not address attrition, as Mr. Cavanagh has conceded
14 in testimony he filed in the PSE rate case currently pending before this Commission.⁸

15 Second, the NWEC proposal fails to comply with the most significant
16 elements of the Decoupling Policy Statement, namely:

- 17
- 18 • It does not appropriately analyze the impact of conservation on Avista;
 - 19 • it is not appropriately applied to all customer classes;
 - 20 • it makes no reduction to cost of capital;
 - 21 • it fails to condition RPC recovery on achieving conservation targets;

⁵ The Commission requires Avista to file similar reports per Docket UE-100176.

⁶ Exhibit No. ___ (MTT-1T) at 9:12-15.

⁷ PSE Dockets UE-111048 & UG-111049, Elgin, Exhibit No. ___ (KLE-1T) at 80:5-9.

⁸ PSE Dockets UE-111048 & UG-111049, Cavanagh, Exhibit No. ___ (RCC-1T) at 10:14.

- 1 • it does not identify comparable conservation benefits for low income customers;
- 2 • it does not describe the incremental conservation the Company should pursue;
- 3 and
- 4 • it fails to net increased wholesale sales due to conservation in the true-up.

5 I explain each of these deficiencies in the following sections of my testimony.

6

7 **A. Response to Mr. Cavanagh’s “Fixed Cost Recovery” Analysis**

8

9 **Q. What is the main premise supporting Mr. Cavanagh’s decoupling testimony?**

10 A. Mr. Cavanagh’s main supporting premise is: “If Avista helped its customers save just
11 one percent of system-wide electricity use per year every year for the next five years,
12 it would automatically lose almost \$38 million in authorized fixed-cost recovery.”⁹

13

14 **Q. Is that testimony accurate?**

15 A. No. Mr. Cavanagh uses an extremely broad definition of “fixed costs” that includes
16 costs that are not “fixed”. As a result, Mr. Cavanagh’s \$38 million over five years is
17 a gross overstatement.

18

19 Mr. Cavanagh believes his definition of “fixed cost” is consistent with how
20 that term is used in a recent publication regarding decoupling by the Regulatory

Assistance Project (RAP), entitled *Revenue Regulation and Decoupling*

⁹ Cavanagh, Exhibit No. ____ (RCC-1T) at 2:12-15 and at 5:20 to 6:20.

1 (June 2011).¹⁰ In fact, that RAP publication did not define “fixed costs”. RAP was
2 addressing decoupling in the context of utilities with fuel adjustment mechanisms
3 that allow for full recovery of production costs. Therefore, RAP needed to
4 distinguish between costs that were covered by “fully reconciled” fuel adjustment
5 mechanisms and costs that were not. RAP uses the terms “production” and “non-
6 production” costs to make that distinction. This is demonstrated in RAP’s discussion
7 on pages 4-5 of its publication, which are in my Exhibit No. ____ (DJR-4).

8 In short, RAP was not trying to distinguish between “fixed” and “variable”
9 costs, as Mr. Cavanagh tries to do in his testimony.¹¹

10 In addition, and perhaps more important, Mr. Cavanagh’s proposed
11 decoupling mechanism includes in the RPC all of Avista’s investment-related costs
12 associated with power supply, including investment in generating facilities and
13 transmission. If full decoupling were in effect, and Avista experienced lower retail
14 sales due to conservation, Avista would be able to sell the unused power in the
15 wholesale market, thus recovering much or all of this cost twice: once through the
16 decoupling mechanism, and once from wholesale customers. Though Mr. Cavanagh

¹⁰ According to his testimony Exhibit No. ____ (RCC-1T) at 5:21 to 6:5, Mr. Cavanagh relies on the Company’s response to NWECC Data Request 2. In NWECC Data Request 2, which I have included as my Exhibit No. ____ (DJR-3), NWECC instructed Avista to use the following definition of “fixed costs”:

please define “fixed costs” as the company’s revenue requirement excluding production costs, which “are those that vary more or less directly with energy consumption in the short run”, including “fuel, purchased power”, and “transmission by others”.

According to those same NWECC data request instructions, these definitions are from: “Regulatory Assistance Project, *Revenue Regulation and Decoupling* (June 2011, p. 4).”

¹¹ The accounting definition of a “fixed cost” is a cost that remains unchanged despite changes in volume or other units of production.

1 correctly excluded these costs in his PSE decoupling proposal, he fails to do so in his
2 Avista proposal.¹²

3

4 **Q. Is Avista’s fuel adjustment clause “fully reconciled,” as RAP uses that term?**

5 A. No. Avista’s Energy Recovery Mechanism (ERM) has a dead band and sharing
6 bands, which means, by definition, Avista does not fully recover all production costs
7 within the mechanism. This not only proves Mr. Cavanagh improperly has taken the
8 RAP publication out of context, but it also presents significant issues for full
9 decoupling. As I discuss in more detail later, NWECA’s proposal fails to address
10 those issues.

11

12 **B. NWECA’s Proposal is Not Applied to All Customer Classes**

13

14 **Q. How does the Decoupling Policy Statement address the application of full
15 decoupling to customer classes?**

16 A. The Commission states that a full decoupling mechanism should include all customer
17 classes, unless it would be lawful or consistent with “the public interest” to do
18 otherwise:

19 *Application to Customer Classes.* Generally, a full decoupling proposal
20 should cover all customer classes. However, where in the public interest and
21 not unlawfully discriminatory or preferential, the Commission will consider a
22 proposal that would apply to fewer than all customer classes.¹³
23

¹² In the current low natural gas price environment, Avista would probably not recover all of its power supply costs through wholesale sales.

¹³ Decoupling Policy Statement at 18, Criterion 1, ¶ 28.

1 **Q. Is the Commission's policy appropriate?**

2 A. Yes. The discrimination and preference statutes are part of the Commission's overall
3 regulation of utilities; although there may be circumstances where excluding a
4 customer class would satisfy those statutes and also be in the "public interest".
5

6 **Q. Does NWECE's proposed decoupling mechanism include all customers?**

7 A. No. NWECE's proposal exempts all 22 customers Avista serves under Schedule 25,
8 Extra Large General Service.¹⁴ Typically, these customers are very large industrial
9 customers.
10

11 **Q. What specific reasons does Mr. Cavanagh give for excluding customers served
12 under Schedule 25 from decoupling?**

13 A. Mr. Cavanagh exempts Schedule 25 customers on the basis that this schedule "has so
14 few members (22) and accounts for a relatively small fraction of the fixed cost
15 revenue requirement that Avista recovers through its energy sales (about 10%,
16 although the class accounts for almost 20% of retail electricity sales)."¹⁵
17

18 **Q. Are these specific reasons sufficient to exempt these customers from
19 decoupling?**

20 A. No, although I do not offer a legal opinion regarding the discrimination or undue
21 preference statutes. The number of customers in a rate schedule or their relative
22 portion of electricity sales are facts, not reasons. Schedule 25 customers participate

¹⁴ Cavanagh, Exhibit No. ____ (RCC-1T) at 10:3.

¹⁵ Cavanagh, Exhibit No. ____ (RCC-1T) at 10:3-6.

1 in Avista's conservation programs. The sample decoupling mechanism found in my
2 Exhibit No. ____ (DJR-2) included all customers.¹⁶

3 In sum, the Commission needs and deserves much more justification than
4 NWECC has supplied before exempting Schedule 25 customers.

5

6 **C. NWECC's Proposal Excludes the Impact of Decoupling on the Rate of Return**

7

8 **Q. What does the Decoupling Policy Statement say with respect to the impact of**
9 **full decoupling on a utility's cost of capital?**

10 A. The Commission contemplates full decoupling will reduce the utility's cost of
11 capital:

12 By reducing the risk of volatility of revenue based on customer usage, both
13 up and down, such a mechanism can serve to reduce risk to the company, and
14 therefore to investors, which in turn should benefit customers by reducing a
15 company's debt and equity costs. This reduction in costs would flow through
16 to ratepayers in the form of rates that would be lower than they otherwise
17 would be, as the rates would be set to reflect the assumption of more risk by
18 ratepayers.¹⁷

19
20 The Commission specifically requires a full decoupling mechanism proposal
21 to evaluate its impact on the return on equity:

22 *Impact on Rate of Return.* Evidence evaluating the impact of the proposal on
23 risk to investors and ratepayers and its effect on the utility's ROE.¹⁸
24

¹⁶ See Exhibit No. ____ (DJR-2), at 8 and 9, and Appendix 1 Workpapers, Electric, at 1c.

¹⁷ Decoupling Policy Statement at 16-17, ¶ 27.

¹⁸ Id. at 17, Element 2, ¶ 28.

1 **Q. Is this policy appropriate?**

2 A. Yes. Full decoupling changes the utility's revenue risk by guaranteeing a specific
3 amount of revenue per customer regardless of typical causes of fluctuation in
4 revenue related to weather, economic conditions, or any other condition. Reduced
5 revenue volatility should translate into lower capital costs, either as a lower required
6 return on equity or the need for less equity in the utility's capital structure.

7

8 **Q. Does NVEC recognize any change to Avista's cost of capital due to full
9 decoupling?**

10 A. No. Apparently, Mr. Cavanagh believes full decoupling could actually *increase*
11 Avista's cost of equity, based on a study by the Brattle Group that found the cost of
12 equity to be higher for the decoupled gas utilities studied.¹⁹

13 In any event, Mr. Cavanagh concludes that the only possible cost of capital
14 benefit will be through a potential reduction in the utility's equity ratio, but, even
15 then, he proposes this capital structure benefit flow to ratepayers if and only if, and
16 only after, the utility actually decreases its equity ratio. He claims the Ratepayer
17 Assistance Project ("RAP") agrees with him on this timing issue.²⁰

18

19 **Q. Should the Commission wait to recognize any cost of capital benefit from
20 decoupling?**

¹⁹ Cavanagh, Exhibit No. ____ (RCC-1T) at 16:13-19.

²⁰ Id. at 17:1-3.

1 A. No. The Commission should reject Mr. Cavanagh's proposal as inconsistent with an
2 important element of the Decoupling Policy Statement: customers should receive the
3 benefits of the revenue risk reduction resulting from decoupling.

4 The Brattle Group study upon which Mr. Cavanagh relies did not attempt to
5 exclude any other variables that may have contributed to the higher cost of equity for
6 the studied utilities, such as market perceptions about the consistency of the
7 regulatory agencies that implement decoupling.²¹ Consequently, its conclusion about
8 higher cost of equity for decoupled gas utilities is suspect, and insufficient as
9 evidence on the appropriate cost of capital for Avista under a decoupling mechanism.

10

11 **Q. Did RAP agree, as Mr. Cavanagh states, that any capital structure benefits**
12 **should be passed through to customers, if and only if, and only when, the utility**
13 **actually achieves those improvements?**

14 A. No. Nowhere in its publication does RAP recommend regulators wait until actual
15 capital structure benefits materialize. In fact, RAP considers it appropriate to
16 recognize cost of capital improvements at the time full decoupling is put into place.

17 In particular, RAP estimates the equity ratio could be lower by three
18 percentage points due to risk-mitigation benefits of decoupling.²² RAP also
19 recognizes cost of capital benefits of full decoupling when it is implemented.²³

²¹ See Exhibit No. ____ (DJR-4) Regulatory Assistance Project, *Revenue Regulation and Decoupling: A Guide to Theory and Application* (June 2011), at 38, section 10.2. "If the risk mitigation measure is put in place only for a limited period, or the regulatory commission has a record of changing its regulatory principles frequently, the ratings agency may not recognize the measure."

²² Id. at 38, first paragraph.

²³ Id. at 39, first paragraph.

1 Though RAP suggests against lowering the cost of equity at the time a
2 decoupling mechanism is implemented, RAP also suggests that regulators may want
3 to lower the utility's equity ratio "when regulators consider how to flow through the
4 risk-mitigation benefits of decoupling to consumers when a mechanism is put into
5 place."²⁴ In other words, RAP agrees with the Decoupling Policy Statement that cost
6 of capital-related reductions may appropriately coincide with the adoption of a
7 decoupling mechanism.

8
9 **Q. Have other commissions lowered a utility's cost of capital when implementing a**
10 **decoupling mechanism?**

11 A. Yes, the Public Service Commission of Maryland, in its approval of a decoupling
12 mechanism for each of its three investor-owned utilities, reduced the return on equity
13 by 50 basis points. The District of Columbia Public Service Commission did the
14 same.²⁵

15
16 **Q. If the Commission approves a decoupling mechanism, how could the**
17 **Commission implement its cost of capital reduction policy?**

18 A. The Commission could reduce the overall rate of return by adopting a return on
19 equity in the lower end of a reasonable range, or by reducing the amount of equity in
20 the company's ratemaking capital structure, or both. However, while the Settlement
21 Stipulation the Commission approved in this docket identifies an agreed overall rate
22 of return, it does not identify a specific capital structure or specific cost rates.

²⁴ Id. at 39, last paragraph.

²⁵ Decoupling Policy Statement, Appendix 6, at 3.

1 Consequently, absent a fuller record on rate of return, the Commission will not be
2 able to apply its cost of capital reduction policy, should it decide to implement full
3 decoupling at this point in this case.

4
5 **D. NWEC’s Proposal Does Not Condition Recovery on Conservation Achievement**

6
7 **Q. What is the Commission’s policy regarding meeting conservation targets and**
8 **revenue per customer recovery by a utility under a decoupling mechanism?**

9 A. It is essential that the decoupled utility meet its conservation targets: “Revenue
10 recovery by the company under the mechanism will be conditioned upon a utility’s
11 level of achievement with respect to its conservation target.”²⁶ Later in the
12 Decoupling Policy Statement, in the discussion about direct conservation incentives,
13 the Commission explains further:

14 However, the EIA, in RCW 19.285.060(4), provides us with the express
15 authority to provide such incentives: “The commission ... may consider
16 providing positive incentives for an investor-owned utility to exceed the
17 targets established in RCW 19.285.040.” We do not read this provision to
18 permit us to provide incentives to acquire conservation that is not cost-
19 effective. Rather, we read this to suggest that, between the biennial
20 conservation targets designed to determine what cost-effective conservation
21 can be required, the electric utility may be able to acquire additional
22 conservation as technology is improved, federal or other matching funds
23 become available, or for other reasons that were not known at the time of the
24 setting of the target.²⁷
25

²⁶ Id. at 17, Description of Mechanism, ¶ 28.

²⁷ Id. at 20, ¶ 31, 32.

1 **Q. Can this policy be practically applied?**

2 A. Yes. On page 14 of my Exhibit No. ____ (DJR-2), Staff's response to the
3 Commission's Bench Request in Docket UE-111048 and UG-111049, Staff
4 identified a Conservation Test that would implement this policy. That test could
5 apply to Avista as well.

6

7 **Q. Does NWEAC's proposal condition Avista's revenue recovery under decoupling
8 with achieving the Company's conservation targets?**

9 A. No.

10

11 **E. NWEAC's Proposal Does Not Identify Comparable Conservation Benefits to
12 Low-Income Customers**

13

14 **Q. What is the Commission's policy on conservation for low income customers in
15 the context of full decoupling?**

16 A. The Commission's policy is:

17 *Low-income.* A utility proposing a full decoupling mechanism must
18 demonstrate whether or not its conservation programs provide benefits to
19 low-income ratepayers that are roughly comparable to other ratepayers and, if
20 not, it must provide low-income ratepayers targeted programs aimed at
21 achieving a level of conservation comparable to that achieved by other
22 ratepayers, so long as such programs are feasible within cost-effectiveness
23 standards.²⁸
24
25

²⁸ Id. at 19, Criterion 4, ¶ 28.

1 **Q. Does NWEC’s proposal satisfy this Commission policy?**

2 A. No. In response to Staff Data Request 12, NWEC states that “Mr. Cavanagh has not
3 conducted such an analysis.”

4
5 **Q. Did Staff independently determine whether Avista’s conservation programs
6 provide benefits to low-income ratepayers that are roughly comparable to other
7 ratepayers?**

8 A. No. Staff does not have the information available to conduct such analysis.

9
10 **F. NWEC’s Proposal Does Not Describe Incremental Conservation**

11
12 **Q. What is the Commission’s policy regarding a utility’s acquisition of more
13 conservation than it would have acquired absent decoupling?**

14 A. The Commission requires a decoupling proposal to contain: “Evidence describing
15 any incremental conservation the company intends to pursue in conjunction with the
16 mechanism”.²⁹

17
18 **Q. Does Mr. Cavanagh address this policy?**

19 A. No. The only specific levels of conservation Mr. Cavanagh refers to are
20 conservation targets that are in place for Avista today, absent decoupling.³⁰

21

²⁹ Id. at 19, Criterion 3, ¶ 28.

³⁰ Cavanagh, Exhibit No. __ (RCC-1T) at 7:1-13.

1 **G. NWEC's Proposal Does Not Account for the Net Benefits of Off-System Sales**
2 **and Costs Avoided Due to the Utility's Conservation Efforts**
3

4 **Q. What is the Commission's policy on increased wholesale sales as a result of**
5 **decoupling?**

6 A. The Commission requires a full decoupling mechanism to account for certain off-
7 system sales and avoided costs, and to net the benefits as part of the true-up:

8 *Accounting for Off-System Sales and Avoided Costs.* A description of the
9 method the company intends to use to determine the financial benefits
10 associated with off-system sales or avoided costs attributable to the utility's
11 conservation efforts and then to net these benefits against the true-up
12 provided in this mechanism.³¹
13

14 In the related footnote, the Commission explains:

15
16 In principle, for every megawatt hour saved through the operation of the
17 utility's conservation program, it has the opportunity to either sell the same in
18 the appropriate market (off-system sales), or avoid having to purchase or
19 produce electricity to meet its load requirements. The accounting of this
20 form of found revenue differs between electric utilities with power cost
21 adjustment mechanisms and those without. After rates have been set for an
22 electric utility that does not have a power cost adjustment mechanism, the
23 marginal avoided cost of producing or buying electricity, or the marginal
24 revenue (net of marginal cost) from the sale of electricity made surplus by
25 conservation not incorporated into the calculation of the power costs, is a
26 direct benefit to the utility shareholders. For utilities with a power cost
27 adjustment mechanism, loads are projected in a future test year, with
28 reductions in the load for the expected conservation levels. Consequently, for
29 the effective rate year following the setting of rates, only conservation above
30 the expected level of conservation would result in an opportunity to reduce
31 power costs or realize additional revenues from incremental sales. In the
32 years after the projected rate year, the marginal avoided cost of producing or
33 buying electricity, or the marginal revenue (net of marginal cost) from a sale
34 of electricity made surplus by conservation, is a direct benefit.³²
35

³¹ Decoupling Policy Statement at 17, Element 4, ¶ 28.

³² Id. at n. 45.

1 **Q. Is this Commission policy appropriate?**

2 A. Yes. When customers conserve energy, the utility should market the electricity the
3 utility would have sold to its own retail customers. Moreover, the utility incurs
4 lower costs due to the wholesale sales, such as reduced line losses, reduced
5 uncollectible expense, and avoidance of the Public Utility Tax, which effectively
6 applies only to retail sales.

7 Under full decoupling, ratepayers guarantee the utility's recovery of a
8 specified level of revenues per customer. It is appropriate for the decoupling
9 mechanism to recognize the benefits of enhanced wholesale sales that may result
10 from decoupling.

11

12 **Q. Can this policy be practically applied?**

13 A. Yes, but not within the decoupling mechanism itself. Rather, this policy could be
14 implemented by revising the ERM. One possible revision could be to eliminate the
15 dead band from the ERM.³³ However, doing that would also eliminate a key feature
16 of the ERM: to provide rate stability to consumers except under extreme
17 circumstances, while giving the Company a very strong incentive to manage power
18 supply costs to avoid such extreme circumstances. Needless to say, addressing this
19 policy will require more detailed analysis than has been presented thus far.

20

³³ In the absence of an energy cost adjustment clause, this part of the decoupling policy would be very difficult and administratively burdensome to apply.

1 **Q. Does NWECC's proposal apply this Commission policy?**

2 A. No. Mr. Cavanagh suggests the Commission ignore this policy on the basis of his
3 belief that Avista's ERM "already responds to this concern" regarding enhanced
4 wholesale sales.³⁴ In short, Mr. Cavanagh chooses to not apply the Commission's
5 decoupling policy on wholesale sales, without adequately supporting that choice.

6
7 **Q. Is Mr. Cavanagh's characterization of Avista's ERM correct?**

8 A. No. Because Avista's ERM has a "dead band" and "sharing bands", the practical
9 result under full decoupling is that ratepayers would not receive the full benefit of
10 incremental wholesale sales occasioned by any reductions in retail sales. This is
11 because any revenues from such wholesale sales likely would fall within the dead
12 band and, therefore, Avista would retain the benefits.³⁵

13
14 **Q. Is it consistent with the Decoupling Policy Statement to allow decoupling while
15 also maintaining Avista's current ERM?**

16 A. No. The current structure of the ERM and the Commission's decoupling policy on
17 enhanced wholesale sales are not compatible. If the Commission wishes to
18 implement full decoupling for Avista, there are two choices: change the ERM, or do
19 not apply the Commission's decoupling policy on wholesale sales.

20

³⁴ Cavanagh, Exhibit No. ___ (RCC-1T) at 12:7-13.

³⁵ Exhibit No. ___ (DJR-2), at 18.

1 **Q. What choice should the Commission make and why?**

2 A. Should the Commission choose to implement full decoupling for Avista, it should
3 maintain its policy regarding wholesale sales. However, Staff believes the
4 Commission does not have a sufficient record in this docket to both address full
5 decoupling and appropriately revise the ERM. Therefore, any decision to adopt full
6 decoupling should await full examination of any required revisions to the ERM.

7

8

IV. CONCLUSION

9

10 **Q. Please summarize your position on the full decoupling proposal offered by**
11 **NWEC.**

12 A. The Commission should reject in its entirety NWEC's full decoupling proposal as
13 inconsistent with the several elements I have identified from the Commission's
14 Decoupling Policy Statement.

15

16 **Q. Should the Commission nevertheless decide to implement full decoupling at this**
17 **time, what issues should be addressed prior to implementation?**

18 A. The Commission should:

- 19 • Require additional evidence quantifying the change in the overall rate of return
20 occasioned by the specific decoupling mechanism adopted by the Commission,
21 or the amount of equity in the ratemaking capital structure the Commission
22 deems appropriate, or both.

- 1 • Adopt the Earnings Test as outlined in Exhibit No. ____ (DJR-2), modifying the
2 Earnings Test dead band as appropriate.³⁶
- 3 • Adopt the Conservation Test as outlined in Exhibit No. ____ (DJR-2).³⁷
- 4 • Require third party evaluation of conservation achievement, which will also
5 identify any incremental conservation.
- 6 • Require third party evaluation of comparable benefits for low-income customers.
- 7 • Require revision of the ERM.

8

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

10 A. Yes.

11

12

³⁶ Exhibit No. ____ (DJR-2) includes an earnings test for discussion purposes that was essentially the same as that addressed by Mr. Cavanagh. It is also very similar to the earnings test in Avista's gas decoupling mechanism, although Avista's gas mechanism does not contemplate the 25 basis point dead band. I would clarify, however, that whatever dead band is chosen by the Commission, it should be based on a rate of return set in the general rate case that implements decoupling. In addition, the dead band should be carefully crafted to provide upside earnings only if the Company can demonstrate a connection between achieved efficiencies beyond those required by statute and its earnings at the high end of any range determined to be fair.

³⁷ Exhibit No. ____ (DJR-2), at 13-14, and Appendix 1 Workpapers, Electric, at 1b.