

**BEFORE THE
WASHINGTON UTILITIES & TRANSPORTATION COMMISSION**

<p>IN RE: WUTC V. CASCADE NATURAL GAS CORPORATION DOCKET NO. UG-060256</p>	<p>POST-HEARING BRIEF OF NW ENERGY COALITION</p>
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I. NW ENERGY COALITION SUPPORTS THE SETTLEMENT AGREEMENT AND URGES THE COMMISSION TO APPROVE IT IN WHOLE WITHOUT CONDITIONS.

1. The NW Energy Coalition (“Coalition”) supports the Settlement Agreement negotiated with the Parties to this proceeding and filed with the Commission on October 11, 2006. The Settlement is the result of intense good-faith negotiations by the Parties and represents an agreement that serves the public interest. In considering the Settlement, the Commission should appreciate the varied interests of the settling parties and understand that significant compromises were made to produce a comprehensive package. Reaching such a broad consensus is a challenge in a case such as this.

2. The subject of this Brief is narrowly focused on the one issue that did not achieve consensus in settlement: decoupling.

A. IT IS IN THE PUBLIC INTEREST FOR THE COMMISSION TO ENCOURAGE AND HONOR SETTLEMENTS.

3. While the Commission’s first priority is to decide this case on its merits, it should appreciate that its actions have important secondary impacts on future proceedings. The Coalition has long experience with issues that come before this and the other northwest utility commissions, as well as at Bonneville, various siting authorities, the four northwest state legislatures and Congress. One important lesson stands out: for a solution to be meaningful, durable and followed-through by all the parties involved, it must be a win-win compromise. But just as important, each party must have enough stake in both the substance

and *process* that developed the compromise that it will support the agreement for the long-haul, even when opportunities arise to break or undermine the deal. A corollary benefit is that those parties will then be encouraged to negotiate and honor additional successful settlements in the future.

4. However, this cycle of creative negotiations and trust can quickly break down if the Commission does not encourage settlements. It is therefore incumbent upon the Commission to support settlements, if otherwise in the public interest, in order to incent follow-through by the parties and future good-faith negotiations on other issues. Parties must know that holding out for the “perfect,” as opposed to a “good” solution, is not an effective strategy. Otherwise no party will negotiate seriously.

5. During both rounds of these proceedings, the Coalition made the case for implementation of a decoupling mechanism for Cascade Natural Gas (CNG) so long as it is designed correctly. The Settlement does not include all of our recommendations, so in our opinion is not “perfect.” However, by design it is a pilot program that will undergo thorough evaluation before renewal, or termination. All Parties will have the opportunity to help shape the evaluation to ensure that the independent consultant conducts an in-depth examination of the pilot and recommends potential modifications. The program is not set in stone, and we believe it is a reasonable experiment with little downside risk. Public Counsel’s claims of enormous harm and distortion of the regulatory framework (Exhibit 251T, page 19:8-11) are based upon speculation rather than fact and are premature given the limited duration of the pilot and the oversight and review it

will receive. We urge the Commission to reward the good-faith efforts that went into negotiating the settlement by giving it your approval.

II. IT IS NOT NECESSARY TO REPRISER THE ROBUST RECORD IN THIS CASE THAT SUPPORTS THE SETTLEMENT AGREEMENT.

6. We shall not tire the Commission with yet another long exhortation in support of decoupling. The Coalition's witness, as well as other Parties to the Settlement (Staff and CNG), have presented those arguments to the point of repetition, especially in light of the recent Puget Sound Energy UE-060266/UG-060267 record.¹ Except for Public Counsel, whose arguments we address below, the only real differences among the Parties were due to various implementation details. These disagreements have been worked out in the Settlement Agreement. It is understood by all that these details matter, but for the purposes of a pilot, and to ensure CNG's conservation programs are up and running expeditiously, those disagreements should not, and did not, lead to irreconcilable impasse. In addition, the Settlement requires a thorough evaluation that will allow these particulars to be investigated and corrected, if necessary, after three years.

¹ It is interesting (and gratifying) to see that the three decoupling dockets now open (PSE, CNG and Avista) have evolved in a progressive and collaborative manner. The PSE case, coming first, has seen the most detailed testimony and full litigation. This docket, on the other hand, has resulted in a settlement after two rounds of testimony. Avista (and most other Parties to that docket) have built upon these discussions to *begin* the proceeding with a comprehensive, if not global, settlement.

III. CONTRARY TO ASSERTIONS OF PUBLIC COUNSEL, DECOUPLING IS NOT HARMFUL TO CUSTOMERS IF PROPERLY IMPLEMENTED.

7. The NW Energy Coalition believes Public Counsel’s fears of cost shifts (Exhibit 251T, pages 18:16-19:11) are exaggerated and certainly not worth rejection of the Settlement. Public Counsel’s assertions that decoupling is a regulatory “sweetener” that would “distort the Washington regulatory framework and would systematically disadvantage ratepayers....” (Exhibit 251T, page 19:8-11) are theoretical, exaggerated and unsubstantiated.

A. DECOUPLING DOES NOT PROVIDE AN UNWARRANTED “WINDFALL” TO THE COMPANY.

8. Public Counsel witness Michael Brosch asserts, with little evidence, that a decoupling plan similar to that proposed in the Settlement (“decoupling”) “promises higher prices paid by consumers” (Exhibit 251T, page 18:16-17), labeling it a regulatory “sweetener” (Exhibit 251T, page 19:8). Brosch attempts to substantiate this claim by showing that decoupling would enable CNG to collect “steadily increasing margin revenues associated with adding new customers.” (Exhibit 251T, page 38:13-15)

9. The flaw in this argument is that Brosch mistakes an increase in margin revenue with an increase in profit (*net* margin revenue). Additional customers generate additional revenue, but they also create additional costs. Thus without further analysis, including any possible effect of CNG’s line extension policy, it is impossible to know whether adding new customers is sweet or bitter for the

Company. In fact, only a few pages after making his claim that new customers
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create unwarranted shareholder profit, Brosch contradicts his own argument: “I would encourage the Commission to **not accept any unproven assumptions** regarding whether or not customers added to Cascade’s gas delivery system between rate cases are financially harmful or beneficial to the Company....” (Exhibit 251T, page 43:17-20, emphasis added) We urge the Commission to follow Brosch’s own advice by not giving any weight to his unproven assumption that the Company benefits from new customers due to decoupling.

10. Coalition witness Weiss also discussed new customers and the possibility of creating an unwarranted “windfall” profit if decoupling were not properly designed. (Exhibit 311T, page 12:20-22) He noted that under current ratemaking, the utility absorbs lost margins due to new customers using less gas than existing customers. Under decoupling, CNG would recover those lost margins, so the regulatory change has the potential to create extra profits unrelated to its actions: a “windfall.” Of course, notwithstanding this possibility, the question of how large, if any, a windfall would be is a factual question that depends on how much gas new customers actually use *and how much it costs to serve those new customers*, as we noted above.

11. Unlike Mr. Brosch, the Coalition recognized that the issue of net revenues from new customers was an empirical question, rather than a theoretical one. We originally recommended using a different margin revenue baseline for new customers based on analysis of incremental revenues and costs (Exhibit 311T, page 24:16-23). The Settlement Agreement, however, assumes that new customers should not be treated differently. While, again, not a “perfect”

solution, we were willing to accept this compromise for a number of reasons. First, it is simpler to treat all customers the same. Second, while the Company is growing fairly rapidly, over the three-year pilot period, the difference between existing and new customer residential margins does not represent a significant amount of money. Staff testimony demonstrated that the difference is around 50 therms per residential customer per year, resulting in about \$11 per year per new residential customer gain for the Company. (Exhibit 421T, page 12:5-10 and Table 2). And, it should be noted, this estimate did not consider whether the cost of serving a new customer might be quite different (and higher) than serving an existing one. With more analysis, it may turn out that the difference in costs of serving new customers may more than make up for this \$11 difference. Finally, counteracting the small gain from new residential hook-ups may be a loss from new Schedule 504 customers that Staff shows (Exhibit 421T, Table 3, page 14) are using more gas, on average, than existing customers.

12. As Ms. Steward testified, “The new customer adjustment is a relatively small part of the mechanism. Recovering lost margin for current customers is the primary driver of decoupling...” (Exhibit 421T, page 14:3-4). Given the fact that this issue will be subject to further discussion and possible modification following an evaluation at the end of the pilot, we believe Public Counsel’s concerns about new margins are overblown.

B. DECOUPLING DOES NOT SIGNIFICANTLY BREAK THE MATCH BETWEEN COSTS AND REVENUES BETWEEN RATECASES.

13. Public Counsel witness Brosch's other major argument against decoupling is that rate trackers that adjust rates between ratecases, such as decoupling, are "piecemeal rate adjustments" that violate the matching principle in ratemaking. This principle requires that all revenue and cost issues should be considered at a single point in time: a ratecase. That is because these elements are constantly moving targets that can offset each other, so must be considered together when setting rates (Exhibit 251T, pages 10:19-12:7).
14. The Coalition's witness, Mr. Weiss, rebutted this argument by noting that the fundamental asymmetry in initiating ratecases undermines Brosch's argument. For example, if the Company cuts costs or increases revenues between ratecases, the resulting profit flows to shareholders even though it is not subject to a tracker. This "mismatch" (or over earning) continues unabated, since it is virtually impossible for any other party to drag the utility in for a ratecase. Mr. Weiss concludes that customers should not oppose all trackers, as Mr. Brosch argues, but only those that are badly designed so lead to asymmetric results (Exhibit 314T, pages 16:20-18:10). Thus decoupling, if designed well, actually maintains the matching principle better than the current regime where the utility controls if and when it will come in for a ratecase.

IV. CONTRARY TO ASSERTIONS OF PUBLIC COUNSEL, OTHER MECHANISMS TO SPUR THE COMPANY TO SUPPORT CONSERVATION ARE NOT AS EFFECTIVE AS DECOUPLING.

15. Public Counsel has questioned why decoupling is needed to ensure CNG commits to aggressive conservation goals. Mr. Brosch argues first that no incentives are needed, since least cost planning rules mandate that conservation be considered if it is the lowest cost way to serve customers. (Exhibit 251T, page 37:13-17) In addition, if the Commission is concerned about the possible disincentive to promote conservation, it could design more targeted incentives that provide compensation for only the margin dollars actually lost to utility conservation programs. (Exhibit 251T, page 37:18-38:2)

16. The answer to the first argument is that it's hard to push on a wet noodle. It is our long experience that it is very difficult to force a utility to enthusiastically do something that negatively impacts its bottom line. It is much better to align the interests of the utility with those of its customers and the Commission: toward finding the most cost-effective and environmentally benign way to serve, without causing harm to the Company.

17. It is interesting to note that Mr. Brosch emphasizes that between-rate-period incentives *are important to motivate the Company* to reduce costs:

...one obvious and desirable incentive created by regulatory lag is that management is encouraged to control and minimize operating expenses and capital expenditures at economically efficient levels so as to optimize achieved earnings between rate cases.” (Exhibit 251T, page 16:10-13)

He even goes on to say that such incentives are so powerful that:

...management faces an incentive to attempt revisions to the traditional regulatory framework, either through legislative initiatives or regulatory proceedings, in an effort to change the methods and procedures through

which cost of service changes can be translated into increased revenues.
(Exhibit 251T, page 16:13-17)

It is telling that in these cases his answer is *not* to have the Commission simply “mandate” that the Company ignore the incentive created by regulatory lag. Thus it is unreasonable to believe that the Commission can effectively mandate CNG to enthusiastically pursue conservation, and disparage as unnecessary a mechanism (decoupling) that removes the utility’s current incentive to discourage conservation. This clear contradiction in Mr. Brosch’s logic cannot be ignored. The disincentive to encourage conservation created by regulatory lag is just as important and motivating to the Company as its incentive to control costs, because both directly affect the bottom line.

18. Staff witness Steward rebutted the second argument--that the Commission could design more targeted mechanisms to get the Company to support conservation--by noting that lost margin mechanisms: (a) bring high administrative costs; (b) leave a disincentive for the utility to pursue harder-to-measure educational efforts or to support other independent efficiency efforts; and (c) do not remove the utility’s incentive to promote use in other ways. (Exhibit 421T, page 10:3-19). The Coalition adds that incentive mechanisms alone cannot incent a more holistic change to a traditional utility corporate culture, because profit and success will still be caused and measured by increased sales and growth (Exhibit 311T, page 9:14-20).

19. It is counter-productive in the long run to punish a company through lost profits for its success in helping customers lower their bills. Rejecting the decoupling portion of the Settlement Agreement would give CNG, and the other

regional utilities that are watching this process, a terrible signal that regulatory innovation that enables a utility to pursue conservation without the consequence of lost profits is not welcomed in this state.

V. CONCLUSION. THE COMMISSION SHOULD APPROVE THE SETTLEMENT AGREEMENT WITHOUT MODIFICATION.

20. The Commission should take this opportunity to align customer and shareholder interests to invest aggressively in cost-effective conservation by approving the Settlement Agreement in whole. Is it perfect? Probably not. Is it good? Definitely. The Settlement will result in a significant and immediate increase for conservation and low-income programs. But just as important, it will allow CNG to support fully the efforts of its customers to save gas.

21. The decoupling Settlement is a pilot. The Settlement Agreement explicitly includes an evaluation process that may lead to modification or termination.

22. Finally, the settlement process involved a successful search for innovative and acceptable compromises that could meet the needs of every Party, for the most part. The results of that effort should be supported to encourage collaboration in future proceedings and to not reward holdouts looking for perfection in an area where there are undoubtedly multiple paths to success.

DATED: November 15, 2006

By: _____

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