BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. CASCADE NATURAL GAS CORPORATION, Respondent.	DOCKET NO. UG-060256

REPLY BRIEF OF PUBLIC COUNSEL

DECEMBER 5, 2006

I. INTRODUCTION

1. On November 15, 2006, Cascade Natural Gas Corporation, Commission Staff and the Northwest Energy Coalition ("settling parties" or "decoupling proponents") submitted initial briefing in support of, *inter alia*, the decoupling section of the Settlement Agreement in the instant case. Part of the proponents' arguments appealed to the well-regarded public policy of encouraging settlement over litigation whenever possible. In particular, the Northwest Energy Coalition (NWEC) stated, that "the Commission [should] reward the good-faith efforts that went into negotiating the settlement by giving it your approval."[1] Cascade echoed this view, saying the "consensus reached among Staff, the Company and the Coalition regarding decoupling, as reflected in the Settlement Agreement, represents a reasonable resolution of this issue."[2]

2. Settlement agreements should be strongly encouraged. But that doesn't mean they should not be tested. To the contrary, to be approved by the Washington Utilities and Transportation Commission (WUTC), settlement agreements must contain sufficient factual support showing that they will result in desirable public policy.[3] Without such a showing, the settlement cannot withstand legal review and must be rejected by the Commission.[4] It is notable in the instant case that the Settlement Agreement is not unanimous and elements of it remain hotly contested, as more fully stated below.

3. Undoubtedly, the decoupling proposal contained in the Settlement Agreement was the result of hard-fought negotiations between proponents with divergent viewpoints. Indeed, the parties have spoken to the many compromises they made to secure the Agreement. In urging

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[1] Northwest Energy Coalition Initial Brief (NWEC Brief), p. 3, ¶ 6.
[2] Cascade Natural Gas Corporation Initial Brief (CNG Brief), p. 19, ¶ 34.
[3] WAC 480-07-700; WAC 480-07-750(1).
[4] *Id.*

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rejection, Public Counsel does not intend ingratitude for these efforts. Rather, our position is that the decoupling section in the Settlement Agreement should be rejected because it will result in policies inconsistent with "the public interest in light of all the information available to the commission," and therefore, unlawful.[5]

II. ARGUMENT

A. GRANTING CASCADE DECOUPLING REVENUES IN EXCESS OF ITS TEST YEAR REVENUE REQUIREMENT VIOLATES THE PUBLIC INTEREST BALANCING TEST.

4. Cascade acknowledges that pursuant to WAC 480-07-740, "The Commission must determine whether a proposed settlement meets all pertinent legal and policy standards." That determination "involves the consideration of a record, the weighing of evidence… and an evaluation of whether the proposal is consistent with the public interest."[6] In each and every instance in which rates are increased, the Commission is obligated to weigh the evidence and balance the interests of investors with those of consumers.[7]

5. For investors, the Commission ensures that a utility receives the opportunity to earn a reasonable return on its investment.[8] For customers, the Commission's charge is to secure safe, adequate and sufficient utility services at just, fair, and reasonable rates.[9] The Commission's search for that delicate balance and its approximate achievement results in a decision that is

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[5] WAC 480-07-750(1).

[6] *WUTC v. PacifiCorp*, Dockets No. UE-020417 and UE-991832, Sixth Supp. (July 15, 2003), ¶ 40; *In re GTE Northwest Incorporated*, Docket No. UT-931591, Third Supp. Order (December 1994), p. 2.

[7] *Id.*

[8] *US West Communications, Inc. v. Wash. Util. & Transp. Comm'n*, 134 Wn.2d 74, 121, 949 P.2d 1337 (1997), (quoting *Wash. Energy Resources (POWER) v. Util. & Transp. Comm'n*, 104 Wn.2d 798, 808, 819, 711 P.2d 319 (1985)).

[9] RCW 80.28.010-020; RCW 80.04.130. (Public Counsel inadvertently referred to RCW 80.04.140 and RCW 80.36.140 in its Initial Brief).

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consistent the public interest. As such, the Commission weighs these interests in the most deliberate fashion.

1. Cascade admits that the Settlement Agreement provides the Company an adequate revenue requirement with a reasonable rate of return.

6. As part of the Settlement Agreement, Cascade would receive a $7.062 million increase in its revenue requirement.[10] Accounting for Staff and the Company's unspecified increase in Cascade's rate of return, the Company's revenue increase amounts to $7.480 million overall.[11] In its November 15 Initial Brief, the Company justified its proposed revenue increase on the following "financial pressures:" (1) lower revenues from declines in per customer gas usage, (2) costs arising from the need for additional facilities and (3) unidentified costs increases beyond the Company's control.[12]

7. The Settlement Agreement and the accompanying Narrative acknowledges that the proposed revenue Cascade would receive is sufficient.[13] Presumably, all of the "financial pressures" and the revenues and costs associated with them were identified and recovered from the normalized test year as well as those future accounting changes the Company could show were "known and measurable." However, despite the Agreement's proposed $7.062 million increased revenue requirement, Cascade says it should receive revenue in excess of that amount through a decoupling mechanism, which allows future rate surcharges even though the Company cannot currently prove any need.[14] What is missing in this record is any evidence whatsoever that any future balance between just, fair and reasonable rates and the Company's rate of return

[10] Exh. No. 1, p. 4, sec. 12; Exh. No. 2, pp. 2-3, ¶ 4; CNG Brief, pp. 5-6, ¶ 15.
[11] *Id.*
[12] CNG Brief, p. 3, ¶ 9.
[13] CNG Brief, p. 3, ¶ 10 and 7, ¶ 17; Exh. No. 2, pp. 2-3, ¶ 4.
[14] Exh. No. 431.

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will be preserved under decoupling. Actually, as discussed below, all of the evidence is otherwise.

8. The argument appears to be that since Cascade will likely see future lost margin from per customer usage declines, it doesn't matter if this alleged revenue shortfall isn't part of the test year in this case. Yet, Cascade never sought to reflect these lost revenues as "known and measurable" accounting adjustments to test year operations. In fact, Commission Staff conceded that the "level of energy usage in the future is not known and measurable."[15] Moreover, neither the Company nor Staff performed attrition studies supporting the theory that Cascade's future financial situation requires extraordinary measures, including abandonment of traditional ratemaking principles.[16]

9. In sum, Cascade should receive only that which it is entitled to based on the test year. By its own admission, the Company already recovered cumulative historical declines in per customer usage as part of the test year revenue requirement in this rate case. However, under decoupling, any unknown but expected future declines in usage per customer will be translated into piecemeal rate increases to be paid by customers. Therefore, with decoupling, Cascade almost certainly will earn in excess of what it is entitled to receive based upon the test year evidence. This would be unlawful absent the decoupling tracker anomaly proposed in this case.[17]

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[15] Exh. No. 431.
[16] Exh. No. 431.
[17] *See e.g., WUTC v. US West*, Docket No. 950200, Fifteenth Supp. Order (April 11, 1996) p. 148-149. "The rates and charges for telecommunications service in USWC's existing tariff produce revenues and net operating income that exceed reasonable compensation for providing telecommunications service in the State of Washington and are not fair, just, or reasonable. Revisions of rates and charges made in accordance with the findings and instructions in this Order will yield a fair rate of return on USWC's rate base found proper herein, and if filed pursuant to the authorization herein will be fair, just, reasonable, and sufficient."

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10. Because of its deliberate violation of test year accounting without a showing of extraordinary need, the decoupling section of the Settlement Agreement fails the public interest test entirely. These reasons are explored in more detail below.

2. Any careful balancing of Cascade and its customers' interests will result in a rejection of the Settlement Agreement.

11. The balancing test is required by law. There is no basis, either factually or legally, to ignore it in this instance. But this is what the Settlement Agreement asks of the Commission. Giving Cascade money that is not supported by test year review or justified in some other extraordinary way, cannot possibly qualify as a careful balancing of interests. It cannot be balanced because it not at all clear what is being weighed i.e., what are the tradeoffs. The Commission has always articulated the exact nature of the interests to be weighed when deliberating over these questions.[18] Here, there is no extraordinary need, no concern about the financial viability of Cascade. In fact, all evidence points to the contrary, as discussed in Public Counsel's Initial Brief.

12. The only settling party addressing the balancing test in opening brief was Commission Staff, who asserted that the decoupling proposal appropriately balances the interests of the Company and customers.[19] Staff's argument is stated as follows:

> …decoupling will appropriately balance the interests of the Company and customers. As noted above, it provides the Company recovery of margin costs authorized in a general rate case despite declining customer usage. At the same time, decoupling retains volumetric pricing, which allows customers to retain the benefits of conserving from lower bills—as opposed to having sharp increases in basic charges or a straight fixed/variable rate design, which would substantially reduce the potential bill savings for customers.[20]

[18] *WUTC v. PacifiCorp*, Dockets No. UE-020417 and UE-991832, Sixth Supp. (July 15, 2003), ¶ 40; *In re GTE Northwest Incorporated*, Docket No. UT-931591, Third Supp. Order (December 1994), p. 2.
[19] Staff Brief, p. 4, ¶ 7.
[20] *Id.*

13. Essentially, Staff asserts customers' interest in accepting decoupling is that it will prevent increases in basic charges or adoption of straight fixed/variable rates. The problems with Staff's argument are many. Higher basic charges or straight fixed/variable rate design are not before the Commission. Cascade did propose a higher residential basic charge but abandoned that proposal. The proposal now before the Commission maintains Cascade's basic charge at the current level. Public Counsel signed the rate design portion of the Agreement that includes the residential basic charge without signing the decoupling section. Any argument that decoupling was exchanged for the avoidance of rate design changes is asserting a bargain no one agreed to make.

14. What Staff seeks is to have the Commission weigh the possibility that sometime in the future such a situation could arise. That is, Staff wants the Commission to give weight to speculation. Of course speculation carries little or no weight. Staff's argument should be rejected. Therefore, none of the three parties establish that this proposed decoupling Agreement satisfies the balancing test.

15. To be fair, if one looks hard enough there is perhaps a colorable balancing test argument to be made. That argument would go something like: *violation of test year rate making (benefit to the Company) should be weighed against increased conservation (benefit to customers).* Public Counsel disagrees with this characterization for the many reasons discussed in our Initial Brief. In short, there is no correlation between decoupling and increased utility sponsored conservation, something acknowledged by all of the parties involved in the decoupling dispute.

16. Even assuming, *arguendo*, that decoupling tariff surcharges granted outside of a general rate case could properly be weighed against enhanced utility conservation efforts, the exact

measurement of what we are balancing cannot be derived from this record. We simply do not know, even in the most general way, either individually or in relation to one another, (1) how much conservation will be received and (2) how much will be paid in surcharges. Without that information, the scales are superfluous and the public interest test without application. That is why the decoupling proposed in the Agreement can never successfully pass the public interest test. Unattached to any objective, verifiable facts – such as those ensured by traditional ratemaking – the decoupling proposal before the Commission cannot be weighed.

3. Commission Staff confuses the relationship between the revenue requirement authorized in this rate case and the decoupling mechanism.

17. Commission Staff confounds the relationship between the authorized level of revenue that would be established in this case and its relationship with future decoupling deferrals. Staff says that the decoupling mechanism "gives the utility recovery of deviations in actual revenue from its authorized level of revenue, through rate surcharges and credits."[21] Reading this statement one might think the deferral mechanism allows Cascade to recover the difference between its actual revenue and the revenue requirement set in the instant case. That is completely false.

18. There is no question that the decoupling mechanism would implement revenue surcharges that have not been justified, based upon any objective and balanced financial review of all elements of the revenue requirement, such as that found in a general rate case. The only relevance of the soon-to-be-established revenue requirement to the decoupling mechanism is that it will be the basis for setting the per customer margin benchmark. The revenue requirement associated with the applicable customer class will be divided by the current number of customers

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in that class.[22] The resulting dollar figure is the benchmark for margin per customer. It is when future per customer margin falls below this benchmark amount that deferrals begin.[23] A yearly surcharge will recover for the Company the difference in usage between the per customer revenue benchmark and that future years' actual per customer margin.[24] As discussed in our Initial Brief, Cascade would be guaranteed additional revenue if per customer usage declines for any reason including economic downturns or customer sponsored-conservation, without a full review of all the Company's revenues and costs. Therefore, contrary to Staff's implication, decoupling quickly jettisons the total revenue requirement now before the Commission for schedules 503 and 504 without a rate case.

19. Moreover, there exists no provision within the decoupling mechanism proposed to determine how much future margin is needed by Cascade on a per customer basis. This "need" will very likely change over time but to determine such a need, another test year revenue requirement determination is required. Without a test year review, the benchmark and actual need will almost certainly diverge considerably. Therefore, in the absence of a rate case, decoupling rate increases are hopelessly piecemeal in nature and not proven to be needed to maintain the financial condition of the Company in the future.

4. It's not enough to say rates will "look" fair, just and reasonable under the decoupling Settlement Agreement.

20. The decoupling proponents focus on how, allegedly, the decoupling rate increases will amount to only 1% of 503 and 504 revenues per year.[25] This is supposed to mollify concerns

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[21] Staff Initial Brief (Staff Brief), p. 2, ¶ 3, citing Exh. No. 421T, 3:10 (Steward) (emphasis added).
[22] Exh. No. 421T, p. 4:8-22 (Steward).
[23] *Id.*
[24] *Id.*
[25] CNG Brief, p. 26, ¶ 46, citing Steward, TR. 276:20-24. Weiss, TR. 309:15-16, citing same.

about the decoupling Agreement.[26] Even if 1% is a credible estimate, and it's not, a $2.078 million (and growing) yearly rate increase shouldn't give anyone comfort.[27]

21. Actually, the amount of yearly rate increases will likely be far more than $2.078 million dollars because the 1% estimate is without support. The Company's sole support for the 1% figure is a quote from Commission Staff witness Joelle Steward who said: "I mean we're looking at…simulations we have done, both the Company and myself…we're looking at something on the order of less than 1% of revenue for those individual customer classes."[28] Ms. Steward even cited this number when explaining why the decoupling proposal would not result in a windfall.[29]

22. While Ms. Steward's discussion of simulations was quoted by the Company, Staff did not offer these simulations or their results on brief. And if the Company had confidence in its own simulations, it would not be quoting Ms. Steward. Evidentiary cross-sourcing between parties is common but at least one of the sources must have a valid basis to carry any weight at all.

23. Unfortunately, there is no evidence in the record determining what the surcharge will be in any given year. It is irresponsible to proffer an unsupportable number, especially when so much is at stake. In light of the 1% prediction under the Settlement Agreement, it is curious that Staff and the Coalition's pre-filed testimony sought caps on surcharges of 1.5% and 3%, respectively.[30] The Company, on the other hand, proposed in testimony that any excessive surcharge would be amortized. If everyone felt confident that the rate increase would be 1%, these proposals would

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[26] Exh. No. 1, Appendix C (supplemented). In Staff Brief, p. 9, ¶ 23, it says: "Furthermore, as Mr. Weiss indicated in response to questions from Chairman Sidran, decoupling likely will not have a differential impact on low income customers. Many of them are quite low users, and may have already conserved because of price pressures perhaps as much as they can conserve." Mr. Weiss offers no basis at all in the record for his statement and it is likely without any foundation. Given the gravity of this issue, such groundless assertions should be given no weight.
[27] That begs the question, *if it's only $2.078 million, then why would shareholders care?*
[28] Steward, TR. 276:20-24.

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have been unnecessary.

24. The surcharge in any given year is likely unknowable. It will depend on a multitude of factors. Therefore, any modeling requires a multitude of assumptions which may or may not be correct. Perhaps this is why the settling parties really cannot say for sure – in an evidentiary sense – what will happen.

25. Putting aside the 1% prediction, the Commission's public interest balancing test reveals why it is patently insufficient to determine the fairness of a rate increase on a *prima facie* review of what looks fair. The public interest test makes it clear that fairness exists in relation to the other side of the scale – it is a relational analysis. In this case, rates are measured against the revenue requirement and what the reasonable rate of return should be. In other words, rates are not a stand alone proposition. As discussed above, since a revenue requirement will not be established every time rates increase, the resulting surcharges are *de facto* unfair.

26. Furthermore, if 1% annual rate increases were automatically reasonable, why would any utility go to the trouble of filing a general rate cases in which all of its costs and revenues were subject to careful review unless serious upward cost pressures indicated 1% increases were inadequate.[31] In Cascade's case, a decade-long hiatus in rate case activity, despite a supposed long-term trend of declining customer usage, suggests that yearly 1% future increases may create excess earnings and lead to the problems in Oregon.[32]

27. The Agreement's deliberate decision to grant Cascade an almost certain ability to earn revenues in excess of what the Company acknowledges is a sufficient revenue requirement and a fair rate of return without a rate case determination blatantly violates the public interest test.

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[29] Steward, TR. 276:20-24.
[30] CNG Brief, p. 15, ¶ 311; Exh. No. 421T, p. 17:12 (Steward) ; Exh. No. 311T, p. 32:18-19 (Weiss).
[31] WAC 480-07-505.

5. The gap between what Cascade is entitled to receive from a test year review and what it actually receives in increased revenue will grow under the decoupling Settlement Agreement, which further violates the public interest test.

28. As was shown in Public Counsel's Initial Brief, decoupling, on the facts of this case, will result in Cascade exceeding its current revenue requirement.[33] Again, the only question is by how much. All of the evidence shows that Cascade's customer growth and cost savings have far exceeded any losses from per customer usage declines and will likely continue to do so.[34] Since the decoupling mechanism ignores Cascade's enormous customer growth and the Company's historic trend in cost savings while allowing recovery of per customer margin revenue declines, it is likely that decoupling recovery will quickly "mismatch" other rate base costs and revenues. This will result in Cascade earning in excess of its authorized rate of return and in excess of what it would receive if forced to undergo a new test year review. Indeed, Cascade admits as much in its Initial Brief when it says:

> During the November [sic] 12 evidentiary hearing, Public Counsel pointed out that Cascade apparently was able to increase its net margins in 2004 and 2005, notwithstanding the impacts of declining use per customer associated with conservation. Exhibit No. 10 shows, for example, that net margins increased by $1.6 million in 2004 and by $1.7 million in 2005 (following a decline of $1.5 million in 2003). Cascade's ability in recent years to increase net margins is due entirely to its high growth rate: an annual growth rate in customer base of 3 percent to 5 percent over the past five years, which is significantly more than the national average. In 2005, for example, Cascade added 10,500 new customers, which contributed $3.1 million in additional margin compared to fiscal 2004. This increased margin, however, was almost entirely offset by reductions in gas usage per residential and commercial customers of 3.8 percent and 4.4 percent, respectively, which reduced margins by about $2.5 million…
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> …That Cascade happens to be in the fortunate position of having such high customer growth in recent years that it can overcome the consequences of declining use per customer misses the point. Regardless of a particular utility's starting point in terms of operating margins, it is uncontroverted that the impact of

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[32] Public Counsel Initial Brief (PC Brief), p. 28, ¶¶ 65-66.
[33] PC Brief, p. 17, ¶ 43 – p. 24, ¶ 55.
[34] *Id.*

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declining use per customer due to conservation, in the absence of a decoupling mechanism, is to dampen the recovery of operating margins.[35]

29. Cascade makes light of two incredibly important issues for this Commission's consideration. Instead, it advances for the Commission's consideration the "planned ignorance" approach. Consistent with this approach, the settling parties, despite all evidence to the contrary, claim that revenue increases from explosive customer growth somehow will fail to offset Cascade's "projected" per customer usage declines.

30. Similarly, the Coalition inexplicably refuses to acknowledge that decoupling gives Cascade "steadily increasing margin revenues associated with new customers."[36] That is an untenable position given that it was the Coalition that argued that Cascade would receive a windfall if new customer growth was not accounted for in the decoupling mechanism.[37] These issues are explored further below.

a. Per customer usage declines are actually only one of many factors comprising Cascade's overall financial condition.

31. Cascade argues that it is "uncontraverted" that per customer gas usage declines will "dampen" the recovery of operating margins. Actually, this is a highly contested issue at the heart of the litigation. Certainly one must admit that in a financial sense "dampen" is a fairly loose and undefined term. Regardless of whether "dampening" has or will occur, one wonders why Cascade thinks a general rate case is an insufficient option should a decline in per customer usage actually "dampen" operating margins to the point that the Company cannot recover fixed costs. After all, the Company agreed to a 2010 rate case in the Settlement Agreement in order to

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[35] CNG Brief, pp. 24-25, ¶ 44 – p. 25, ¶ 45.
[36] NWEC Brief, p. 4, ¶ 8.
[37] Exh. No. 311T, p. 32:5-13 (Weiss).

continue the decoupling mechanism.[38] Moreover, the instant case shows that it may receive additional revenue in such instances; it will likely do so here. The question is why a utility would be afraid of a rate case. Usually the reasons are not good ones – at least for consumers.

32. The most obvious conclusion is that Cascade simply does not want a test year review because, even with per customer declines in future usage, it likely could not demonstrate a revenue deficiency under traditional matching principles and therefore, could not generate the same level of revenue it hopes to receive from decoupling.

b. Customer growth will swamp losses from per customer declines.

33. Cascade rejects Public Counsel's argument that the high customer growth of recent years will almost certainly to overcome the financial consequences of declining usage per customer, as it has historically. Cascade says we miss the point because increased revenues from customer growth will be offset by losses from per customer margin declines. Actually, this is exactly our point. To be sure, the Company's revenues aren't as high as they would be if they had huge customer growth and maintained test year levels of per customer usage through decoupling surcharges. Just because these revenues aren't as high doesn't mean they aren't sufficient, however. Instead, all of the evidence shows the Company trending towards increasing overall margin.

34. The data for 2005 is unequivocal on this point. In 2005, Cascade earned $1.75 million in additional margin despite a residential per customer usage decline of 3.8% and a commercial per customer usage decline of 4.4%.[39] Cascade explains the usage decline on warmer weather, increased customer sponsored conservation, higher wholesale prices and higher efficiency

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[38] Exh. No. 1, p. 11.
[39] Stevens, TR. 243:10-244:6.

appliances and buildings.[40] So even in a year in which there was a confluence of forces pushing usage downward, resulting in lower per customer usage, Cascade nevertheless increased its margin significantly. That 2005 margin increase is the direct result of Cascade's customer growth, which the Settlement Agreement patently asks the Commission to ignore.

35. Similarly, in 2004, taking into account per customer usage declines and overall customer growth, the Company earned additional Washington margin of $1.6 million.[41] The Company asks the Commission to ignore this as well. Despite Cascade's efforts to portray it otherwise, there should be no doubt that new customer revenue growth alone offsets (and may exceed) any per customer usage declines.

36. In its Initial Brief, Cascade appears to intimate that its loss of margin in 2003 was due to an inability to overcome per customer usage decline. It is not at all clear the margin lost in 2003 was due to declining per customer use.[42] Setting aside the reasons for the decreased margin, however, it was obviously of insufficient impact to earnings to cause the Company to seek a rate increase at that time. One could just as easily correlate high costs since the oft discussed cost cutting initiative described by the Company occurred around that same time.[43]

37. Cascade cannot show that the Commission's traditionally balanced test year measurement of rate base, sales and revenues, expenses and cost of capital under rate of return regulation is broken, generally, or as applied to this company. To the contrary, Cascade has earned handsomely under such regulation over the past decade and without any piecemeal rate tracking tariffs to increase rates as per-customer usage was declining.

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[40] *Id.*
[41] Exh. No. 10.
[42] CNG Brief, pp. 24-25, ¶ 44.
[43] A 2003 cost cutting effort related to labor, benefit and pension costs resulted in significant savings. Exh. No. 11T, p. 4:27-5:8 (Stevens).

c. The parties' allegation that new customers bring high costs is unsubstantiated in the record.

38. Faced with an undeniable customer growth trend, the decoupling parties weakly assert that increased costs associated with that growth counteract revenue gains. Coming to the Company's defense, the Northwest Energy Coalition attacks Public Counsel witness Michael Brosch for his testimony that "decoupling would enable CNG to collect 'steadily increasing margin revenues associated with adding new customers.'"[44] The Coalition argues that Public Counsel fails to distinguish between margin and net margin revenue in our analysis.[45] Public Counsel has established a record showing that decoupling is expected to increase both gross and net margins in the future at the same time growth from new customers is expected to increase gross and possibly net margins.[46] Regardless of the extensive record created by Public Counsel, it is the decoupling proponents who retain the burden to prove the proposal meets the public interest standard.[47] Public Counsel, while eager to assist the Commission's decision-making, possesses neither the burden of production nor persuasion in this case.

39. Along the same lines, the Coalition also criticizes Mr. Brosch for making "unproven assumptions" regarding the impact of customer growth on overall revenues.[48] It is remarkable that the Coalition would characterize the economic analysis of Michael Brosch as based on "unproven assumptions." Mr. Brosch is a well respected certified public accountant who has testified in a number of cases before this and many other state utility commissions. His extensive testimony is predicated on facts obtained through data requests to the Company. Mr. Weiss, on the other hand, admitted he performed no financial analysis in this case and could not

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[44] NWEC Brief, p. 4, ¶ 8.
[45] NWEC Brief, p. 4, ¶ 9.
[46] *See e.g.*, Exh. No. 251T, pp. 39:3-43:21. (Brosch)
[47] RCW 80.04.130.

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make a prediction about Cascade's actual future financial condition with or without decoupling.[49]

40. In the face of our substantial evidence, the Coalition says, "[a]dditional 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."[50] Public Counsel concedes that it is possible that new customers could create new costs. But Mr. Weiss has not performed this or any other financial analysis to show such costs. Interestingly, neither has Staff or Cascade.

41. Additionally, NWEC ignores Mr. Brosch's testimony in which he says very clearly, "New customers increase utility sales volumes, yielding margin revenues…that contribute toward recovery of the fixed costs of the business. <u>Some incremental non-fuel costs may also be caused by adding new customers, if facilities extensions are required that exceed advances or contributions pursuant to tariff or rule.</u>"[51] Public Counsel does not ignore the possibility of higher costs associated with customer growth; we just cannot find anything in the record that shows this is the case for Cascade.

42. Should any increased costs associated with growth fail to be offset by other cost reductions or increased revenues, Cascade has an opportunity to recover these additional costs in its rate base. Costs to connect and serve new customers are undoubtedly included in the test year rate base in this Docket and are included in the proposed revenue requirement in the Agreement. The point is that the Company must <u>show</u> these additional costs for recovery, at which time a complete accounting for all costs against customer growth takes place in the test year. Without

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[48] NWEC Brief, p. 5, ¶ 9.
[49] Weiss, TR. 301:6-13.
[50] NWEC Brief, pp. 4-5, ¶ 9.

evidence showing higher costs from new customer costs in this case, there is no showing that these costs are significant enough to in any way "dampen" revenue. NWEC appears to want to credit Cascade for costs it has failed to show.[52] This is exactly the purpose of rate cases – to avoid speculation and guessing about what a company should receive, i.e. to establish fair, just, reasonable and sufficient rates that are not arbitrary and capricious.

6. The matching principle guiding rate base rate of return regulation guards against upsetting the delicate balance between company and customer interests and thereby, furthers the public interest.

43. The Coalition in particular seems eager to downplay the importance of the "matching principle" while at the same time inadvertently supporting it. The Coalition takes the position that ratemaking is actually not "symmetrical" since "if a utility is doing very well, it will avoid a rate case, but if it has cause to need more money, it will quickly initiate one. Thus the opportunity to review the utility's costs and revenues is only available when the utility wants that review — when its earnings have fallen or it seeks to add to its rate base."[53]

44. First, it's difficult to see how giving Cascade cost increases without ANY review is better than the theoretical situation the Coalition describes. Second, as appears to be the trend, the Coalition posits a theory that avoids the facts of this case and this Company. Whatever unfortunate scenario it imagines is not reflected here.

45. There is no evidence that Cascade failed to file a Washington rate case in the last ten years because it was earning above its authorized rate of return. Actually, the record shows that Cascade earned enough money to avoid a rate case but not enough money to exceed its rate of return. When the Company could no longer maintain revenues through existing rates, it initiated

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[51] Exh. No. 251T, p. 11, n. 4.
[52] Again NWEC takes a financial position without offering a financial analysis.

a general rate case in 2006 – the instant case. As a result of that filing, the Settlement Agreement gives the Company a 2.69% rate increase.[54] By any objective measure, the matching principle inherent in rate base rate of return regulation is working for the Company and its customers.

46. Perhaps the Coalition is confusing Cascade's Washington operations with Oregon. There, the Company indeed failed to initiate a rate case for many years because it was clearly over-earning.[55] The planned ignorance approach favored by decoupling proponents, however, could not pick up this fact. Decoupling was adopted without regard for the financial reality of the Company. That same approach is being encouraged here even when the Coalition recognizes the possibility of a windfall but is willing to gamble and see how it goes.[56]

47. Commission Staff, steeped in years of rate base, rate of return ratemaking, cannot dismiss the matching principle so easily. At least it could not do so in its prefiled testimony. Public Counsel discussed Staff's extensive matching principle statements in our Initial Brief, including Staff's strong opposition to Cascade's proposed infrastructure tracker on this basis.[57] Understandably, Staff can only muster a half-hearted defense of its violation of the principle. The first defense is that the mismatch will not be too bad and the second is that even if it is, the Settlement Agreement limits the pilot to three years.

48. In support of the "minimal mismatch" assertion Staff's Initial Brief says, "[t]wo regression analyses on decoupling prepared in the early 1990's found that, on a short-term basis, neither factor [customers or sales] was superior to the other to track costs. However, these

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[53] Exh. No. 311T, p. 9:1-5 (Weiss).
[54] CNG Brief, p. 6, ¶ 15.
[55] Exh. No. 264.
[56] NWEC Brief, p. 5, ¶ 10.
[57] PC Brief, pp. 24-25, ¶¶ 57-59.

findings were based upon short-term studies."[58] Staff witness Joelle Steward explained at hearing:

> On a short-term basis, the previous research that was done on decoupling in the early '90's looked at that relationship between cost and sales and cost and customers and found that on that short-term basis one was no better determinate of cost than the other, one being sales versus the number of customers. So on a short-term basis, that's why we're willing to go forward with the decoupling in order to remove that disincentive for conservation.[59]

49. The 1990's research discussed by Staff comes from a mere mention in a 2004 report.[60] The actual 1990's research is not in the record. Accordingly, Staff never put any stock in this "research" prior to the Settlement Agreement. Staff never offered it into evidence through prefiled testimony. Staff never identified it as a cross-exhibit. Rather, it was produced in response to a Public Counsel Data Request and it was entered into evidence by Public Counsel as an attachment to that Data Request.

50. It is easy to see why Staff never relied on this research before. It is from the early 1990's. It has nothing to do with Cascade. In fact, it is a discussion about electricity costs and electric customers. It is at least double hearsay.[61] Finally, Staff acknowledged that the research is limited since it only looked at costs and customer growth on "a short term basis." Staff does not even attempt to define the term "short term" to support its position. For these reasons, the research should carry weight in only one respect; it reveals the dearth of support for Staff's willingness to violate the matching principle.[62]

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[58] Staff Brief, pp. 5-6, ¶ 10, citing Exh. No. 431 (Steward). Staff does not cite a page in the report but it is likely referring to pages 8 and 9 of that report.
[59] Steward, TR. 274:13-24.
[60] Exh. No. 431.
[61] By noting the double plus hearsay nature of the report Public Counsel wishes to focus on its weight not its admissibility.
[62] Staff cites other reports on brief it gave little weight to prior to the Settlement Agreement. For instance, it says, "[i]mplementation of decoupling, by removing the Company's disincentive to promote conservation and energy efficiency, will assist customers to cope with these rising gas commodity costs. A recent study

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51. Without this support, Staff must acknowledge that violation of the matching principle could be severe over time.[63] Therefore, its only defense is the statement that any mismatch will not go on too long because the Agreement contains a three-year pilot to be followed by a rate case.[64] The problems with this argument are addressed extensively in Public Counsel's Initial Brief and above with regard to the public interest test.[65] Staff's three-year pilot/rate case provision offers ratepayers cold comfort.

B. CASCADE'S ATTEMPT TO CLOAK ITSELF AS A PRO-CONSERVATION DECOUPLING CANDIDATE IS CONTRARY TO ALL OF THE EVIDENCE.

52. Cascade represents that the decoupling mechanism in the Settlement Agreement is "intended to allow Cascade to assist its customers with the promotion of conservation and the investment in cost effective Demand Side Management ("DSM") programs without the fear of failing to recover its own fixed costs."[66] According to the Company, decoupling assuages a fear of failing to recover fixed costs.

53. Thus, according to this statement, it does not matter whether the fear is justified; simply that the fear exists. In fact, any such fear is unjustified. Cascade cannot show that it is anywhere near losing its ability to recover its fixed costs. Utility sponsored conservation would not change that situation. And, as discussed previously, even the most irrational fear should be soothed by the availability of a general rate case to recover additional revenues should such a situation develop.

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suggests that accelerated energy efficiency and renewable energy investment in the Pacific Northwest may help bring down natural gas prices by up to 38%." Staff Brief, p. 3, ¶ 5. However, when asked by Cascade whether she thought the 38% estimate was true, Ms. Steward replied that she did not have an opinion. Exh. No. 425

[63] PC Brief, pp. 24-25, ¶¶ 56-59.

[64] Staff Brief, p. 5, ¶ 10.

[65] PC Brief, pp. 24-25.

[66] CNG Brief, p.13, ¶ 17 (emphasis in original).

54. In exchange for decoupling, which allegedly relieves this fear, Cascade is willing to accept in the Settlement Agreement some of the conservation provisions sought by NWEC.[67] Those provisions have been discussed by all of the parties. Public Counsel discusses only some of the provisions here in order to identify some of the problems with the Agreement generally.

55. Instead of putting a specific proposal before the Commission, the settling parties have set out a partial framework in which the advisory group will work to fill in the missing pieces. That means a lot of important pieces are absent. First, there is no conservation potential study in the record to evaluate despite the Company's representation that one (the Stellar Processes Report) would be produced by September 30, 2006.[68] Second, there will be no goals, targets or benchmarks for conservation at all in 2007.[69] Even Mr. Weiss admitted that the "actual amount of conservation that's done in 2007 may be zero."[70] Third, there are currently no goals for 2008 and 2009 as part of the Agreement. Staff says that the 2008 and 2009 utility sponsored conservation will be incremental to current programs but does not define this incremental expectation.[71] Fourth, there are no penalties.[72] Staff and Cascade assert that penalties could be levied. This is highly misleading. "Could" means that the Conservation Advisory Group could get Staff and Cascade (both of whom opposed penalties in testimony) to agree that penalties could be levied.[73] Only after there was agreement that penalties could be levied, could a penalty be considered in a particular situation and then it may or may not be imposed. So there are at least three layers of decision-making before a penalty exists. Fifth, there are no guidelines for

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[67] CNG Initial Brief, p. 18, ¶ 33.
[68] Exh. No. 111T, p. 12:3; Staff Initial Brief, p. 6, ¶ 12.
[69] Stoltz, TR. 202:18-203:6.
[70] Weiss, TR. 211:11-12.
[71] Steward, TR. 212:12-13.
[72] Weiss, TR. 203:17-204:2.
[73] *Id.*

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the development of requests for proposals and no contingencies for what would occur if third party contractors are inadequate to the task. This is highly problematic since Staff acknowledges that the gas conservation industry is not as developed as electric and so contractors are harder to find.[74]

56. The lack of a comprehensive plan puts a heavy emphasis on the advisory group to, *inter alia*, set goals, create programs, write and review requests for proposals, consider penalties and perform assessments. Cascade does not currently have this kind of stakeholder group in place. Indisputably, utility sponsored conservation cannot be achieved without the utility acting as the driving force.[75] No matter how committed the stakeholders, only the utility can carry the day because it alone possesses all of the resources necessary to succeed. Should the Settlement Agreement be approved, it will be the Company's legal and practical responsibility to ensure that all that is promised by the Agreement is achieved. It alone carries this burden.

57. Cascade is simply not up to the task. Cascade continues to exhibit the kind of problematic conduct and attitudes that has caused it to lag considerably behind other utilities in offering utility sponsored conservation.[76] On November 1, 2006, Cascade requested a waiver of WAC 480-90-238, the Commission's Integrated Resource Planning (IRP) Rule for regulated gas companies. The Company's request asked the Commission to waive the deadline for submitting its IRP from December 14, 2006 to April 15, 2007.[77] Cascade represented that it needed the waiver to analyze the results of the Stellar Processes Report – a report it was supposed to receive in September 2006 and has yet to produce.[78] Staff said that Cascade employees were distracted

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[74] Steward, TR. 209:7-11.
[75] NWEC Initial Brief, p. 8, ¶ 16 ("it's hard to push on a wet noodle").
[76] Exh. No. 311T, pp. 15:12-16:28 (Weiss).
[77] *Cascade Waiver Petition*, Docket No. UG-061670 (Nov. 1, 2006).
[78] *Id.*

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by prosecuting the rate case.[79] That a Company would seek a decoupling mechanism in a general rate case predicated on its commitment to conservation and at the same time fail to engage in the IRP process is highly problematic.

58. The decoupling proposal in the Settlement Agreement and the IRP process are directly linked. In response to a question from Commissioner Oshie about how the decoupling mechanism will work, Cascade Witness Jon Stoltz said:

> We will be filing DSM, demand side management plans, as we do currently with our integrated resource plan process. We certainly want to pursue cost effective conservation for rate payer money that will ultimately be the responsibility of the ratepayers. So we will invest in these DSM programs that are cost effective similar to the mechanism we have in place in the IRP's and recover those and defer those expenses and recover them in future PGA type applications.[80]

59. It should be remembered that Cascade's testimony offered almost no concrete conservation efforts that would result from decoupling.[81] Reviewing the correspondence, reports and testimony, the record is replete with Cascade's rationalizations as to why it has failed to put together a real utility sponsored conservation plan or, when it put together a sub par plan, why it failed to implement it.[82] Mr. Stoltz's statement in his direct testimony is indicative of the kind of excuses Cascade offers: "While Cascade can offer programs and promote conservation, we cannot force customers to accept our programs."[83]

60. By any standard, the conservation provisions in the Agreement are more aspirational than directive. It is a promise by all parties to work within the framework to create multi-year utility

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[79] *Staff Open Meeting Memo*, Docket No. UG-061670 (Nov. 29, 2006).
[80] Stoltz, TR. 210:6-15.
[81] Exh. No. 311T, p. 15:5-6 (Weiss).
[82] Cascade has recently filed its petition for approval of a merger with MDU Resources Group. *In the Matter of MDU Resources and Cascade*, Docket No. UG-061721 (Nov. 13, 2006). The rate case excuse raises a question about whether the merger will further impact conservation planning and implementation.
[83] Exh. No. 30T, p. 21:6-7.

sponsored conservation effort. Cascade's IRP waiver request is the final proof that it cannot keep its promise and is not up to this task. As discussed in Public Counsel's Initial Brief, there are better, less expensive and more time-tested ways to do conservation, it is time for Cascade to try one and succeed.[84]

C. CASCADE AND STAFF'S REPRESENTATIONS REGARDING THE AGREEMENT'S COST OF CAPITAL TERMS ARE UNVERIFIABLE.

61. Commission Staff and the Company have very broad leeway to characterize the cost of capital provision in the Agreement because whatever they say is, at the moment, unverifiable. Staff and the Company are offering a black box settlement with the troubling feature that the settling parties characterize the box while non-settling parties are precluded from saying what is actually inside.

62. In our Initial Brief, Public Counsel discussed the settling parties' representation that the cost of capital adopted was somewhere in-between that proposed by Staff and the Company. We noted that this statement opened the box. To know the cost of capital, one would need to know a number of other decision points that are not in the record, including capital structure and, long and short term debt. Therefore, the Commission cannot verify that the cost of capital is in the "middle" simply on the representations of the parties.

63. Now, incredibly, the parties go further and represent that the cost of capital agreed to by the parties reflects the inclusion of a partial decoupling mechanism.[85] Of course Public Counsel opposes decoupling and seeks its rejection. But if the Commission accepts decoupling, we

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[84] Staff and NWEC argue that incentive mechanisms are hard to measure and so decoupling is better. Putting aside other statements made by the parties about how decoupling is not conservation, it is difficult to see why one wouldn't prefer a program with imperfect measurements to one with no measurements at all. It is also difficult to see why incentives are fine on the electric side but not the gas side, as proposed in the PSE general rate case.

[85] Staff Initial Brief, p. 8, ¶ 19; CNG Initial Brief, pp. 7-8, ¶ 18; 30, ¶ 53.

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believe that given the magnitude of risk shifting involved, that shift should be reflected in a downward adjustment to the Company's return on equity.[86]

64. Staff and Cascade know that neither the Agreement nor the Narrative facially address the rate of return implications of adopting the decoupling mechanism, and therefore, the Agreement does not comply with the Commission's *PacifiCorp* Order.[87] In an eleventh-hour attempt to remedy this vulnerability, they represent that the parties considered the implication in agreeing to the Settlement. This is unsubstantiated in the record.[88] Moreover, it is unverifiable and provides no basis for a Commission finding on this point.

65. Making matters worse, non-settling parties are precluded from discussing settlement negotiations and so cannot support or rebut the settling parties' representations. Without all parties able to characterize the negotiations behind the Agreement, Staff and the Company should not be allowed to do so and maintain the black box. They should not be permitted to have it both ways.

66. The only solution is to (1) set aside Staff and Cascade's representations of what the cost of capital figure is or (2) reopen the Settlement to ensure it meets various cost of capital concerns, such as its reasonableness and, should it be necessary, its relationship with decoupling. We add this recommendation to those found in our Initial Brief.

D. PUBLIC COUNSEL DISPUTES CERTAIN STATEMENTS MADE BY CASCADE IN ITS INITIAL BRIEF.

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[86] Public Counsel Brief, pp. 51-52, ¶¶ 114-115.
[87] *WUTC v. PacifiCorp*, Docket Nos. UE-050684 and UE-050412, Order No. 04 at ¶¶ 108-109 (Apr. 17, 2006) (emphasis added).
[88] It appears that it was never addressed in the October 12, 2006, witness panel on the subject.

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67. There are some imprecise representations in Cascade's brief that require clarification. In at least two places, in relation to miscellaneous service charges and the basic charge, Cascade inaccurately characterizes Public Counsel's position as solely based on equitable concerns. Cascade says,

> These Miscellaneous Service Charges were developed as a consensus recommendation of the Parties, taking into account the evidence presented by the Company regarding the costs associated with providing these services as well as the evidence presented by Staff, Public Counsel, the Coalition, and The Energy Project regarding the potential adverse impacts on customers associated with increases in these fees.[89]

68. Of course Public Counsel supports this section of the Agreement. And no one doubts that Public Counsel is very concerned about the impact of policy decisions on customers. In this instance, Public Counsel is concerned both with potential bad effects and the Company's inability to set forth evidence to support the costs it claimed justified higher and new fees.

69. The same is true for the basic charge. There the Company says,

> These Basic Charges were developed as a consensus recommendation of the Parties, taking into account the evidence presented by the Company regarding the costs associated with providing basic service as well as the evidence presented by Staff, Public Counsel, the Coalition and The Energy Project regarding the potential adverse impacts on residential customers associated with increases in the basic charge.

70. Again, we support this section of the Agreement. Again, we want to make clear that the cost basis for the basic charge was disputed by Public Counsel. Actually, Public Counsel's testimony showed that the basic charge should be lower than the $4.00 current charge.[90] Our testimony on the costs related to the basic charge was in addition to concerns about negative

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[89] Cascade Brief, p. 11, ¶ 23.
[90] Exh. No. 281T, pp. 22:14-23:6 (Lazar).

financial impacts on consumers and the creation conservation disincentives created by high fixed charges.[91]

71. Finally, Public Counsel did not sign a number of sections of the Agreement nor did we "oppose" those sections. We want to make clear in the record that where there was failure to "oppose" unsigned sections of the Agreement it was our intention to remain neutral. In other words, silence does not equal acceptance - it equals silence.

III. CONCLUSION

72. A careful balancing of the public interest is central to the Commission's decision-making in this matter. Cascade admits that the Settlement Agreement provides the Company an adequate revenue requirement with a reasonable rate of return. If Cascade is allowed to collect at least $2 million through higher customer rates each year – an amount of money above its test year revenue requirement – that balance will be lost. The matching principle protects against upsetting this delicate balance between company and customer interests. The safeguards proposed by Staff are insufficient because a mismatch will begin well before the three year pilot ends. Any mismatch violates the balancing test because it sets rates that do not reflect the Company's financial need.

73. Cascade cannot credibly represent that it is committed to conservation. Cascade has not demonstrated the dedication or the ability to meet the many requirements of the Settlement Agreement's conservation provisions. Without Cascade's leadership, the conservation advisory panel and its work will likely be unsuccessful.

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[91] *Id.*, 23:7-10.

74. Finally, Cascade and Staff make unverifiable representations about the cost of capital provisions. Either the parties must reveal the cost of capital in the black box revenue figure or their representations must be dismissed.

75. DATED this 5th day of December, 2006.

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