

EXHIBIT NO. _____ (RCC-4T)
DOCKET NOS. UE-121697/UG-121705
WITNESS: RALPH C. CAVANAGH

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of) DOCKET NOS. UE-121697
) and UG-121705 (*Consolidated*)
PUGET SOUND ENERGY, INC. and NW)
ENERGY COALITION)
)
For an Order Authorizing PSE to Implement)
Electric and Natural Gas Decoupling)
Mechanisms and to Record Accounting)
Entries Associated with the Mechanisms)
_____)

REBUTTAL TESTIMONY (*NON-CONFIDENTIAL*) OF

RALPH C. CAVANAGH

ON BEHALF OF NW ENERGY COALITION

MAY 8, 2013

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1 I. INTRODUCTION

2 **Q. Are you the same Ralph C. Cavanagh who provided in this proceeding**
3 **Prefiled Supplemental Direct Testimony, Exhibit No. ____ (RCC-3T), and supporting**
4 **exhibits on March 1, 2013, on behalf of the NW Energy Coalition (“the Coalition”)?**

5 A. Yes.

6 **Q. What is the purpose of this rebuttal testimony?**

7 A. I respond to objections that have been raised by witnesses for Public Counsel, the
8 Industrial Customers of Northwest Utilities (ICNU), Kroger and Nucor to the joint decoupling
9 proposal now under consideration by the Commission.¹

10 **Q. Please summarize your rebuttal testimony.**

11 A. Although the opponents of the joint decoupling proposal persist in characterizing
12 revenue decoupling as somehow risky and untried (a contention that I first rebutted before the
13 UTC in 1993), my testimony includes as an exhibit the latest reminder of the extent of the depth
14 and extent of positive regulatory experience with decoupling, which now spans 25 states. It is
15 noteworthy also that the “Response Testimony” from Public Counsel and ICNU contains no
16 citations to any of the extensive testimony or exhibits submitted by the Coalition in support of
17 revenue decoupling in this proceeding; their witnesses attempt to persuade the Commission to
18 reject a carefully crafted joint decoupling proposal while ignoring the evidence presented by the
19 principal authors.²

20 _____
21 ¹ The decoupling proposal in this case began as a revised Coalition/PSE jointly filed proposal on
22 March 1, 2013 and was further refined and filed as part of the Multiparty Settlement Agreement
23 on March 22, 2013. For purposes of this testimony I will refer to the proposal as the “joint
24 decoupling proposal.”

23 ² Indeed, witness Deen’s testimony includes the remarkable statement that “No party has
24 identified any disincentive to conservation that the decoupling mechanism will remove.”
(Exhibit No. ____ (MCD-1T), p. 18:19-20.

1 Mr. Gorman’s opposition for ICNU is grounded in his conviction that “revenue
2 decoupling is an inappropriate and unwarranted departure from traditional ratemaking
3 principles,”³ notwithstanding the Commission’s repeated findings to the contrary.⁴ I address
4 renewed contentions by ICNU and Public Counsel witnesses that the proposed mechanism
5 somehow obstructs or is irrelevant to energy efficiency progress, that it disregards the
6 availability of wholesale markets to compensate for reduced retail sales, that it could be replaced
7 with a lost margin recovery mechanism, and that it should be adopted only in conjunction with
8 prospective reductions in PSE’s authorized return on equity. A final section addresses other
9 miscellaneous objections. I conclude that the joint decoupling proposal responds to the
10 Commission’s call in 2010 for “a properly constructed full decoupling mechanism that is
11 intended, between general rate cases, to balance out both lost and found margin from any
12 source.”⁵

13 II. NATIONWIDE EXPERIENCE WITH REVENUE DECOUPLING

14 **Q. How do you respond to witness Higgins’s contention that “If the Commission
15 were to adopt full revenue decoupling for PSE’s electric service, the Commission would be
16 in the company of a relatively small minority of commissions nationwide” (Exhibit
17 No. ____ (KCH-1T), pp. 13-14)?**

18 A. Exhibit No. ____ (RCC-5), dated March 2013, is a comprehensive review of
19 revenue decoupling in the United States over the past decade. The author, Pamela Morgan, is a

20 ³ Response Testimony of Michael Gorman, Exhibit No. ____ (MPG-1T).

21 ⁴ See, e.g., WUTC, Docket No. U-100522, Report and Policy Statement on Regulatory
22 Mechanisms, Including Decoupling, to Encourage Utilities to Meet or Exceed Their
23 Conservation Targets (Nov. 4, 2010); WUTC, Dockets UE-111048 and UG-111049, Order 08,
p. 167 n.617 (“The Commission remains open to proposals for a full decoupling mechanism,
even to one that may vary somewhat from what is described in our Policy Statement.”).

24 ⁵ WUTC Policy Statement, note 4 above, p. 16.

1 longtime participant in the Northwest utility industry’s evolution and a former senior manager at
2 Portland General Electric, where she had responsibility for both regulatory affairs and
3 distribution system management. She reviewed experience with rate adjustments and other
4 aspects of decoupling since 2005, covering 52 natural gas utilities and 25 electric utilities. This
5 experience was accumulated in twenty-five states, which hardly constitute “a relatively small
6 minority of commissions”; it included more than 1,200 rate adjustments, both up and down, that
7 were used to prevent retail sales fluctuations from affecting utilities’ recovery of authorized
8 nonfuel costs.⁶

9 **Q. Does the extensive national experience with revenue decoupling support**
10 **witness Gorman’s concern that revenue decoupling “would adversely affect customers by**
11 **exposing them to a significantly higher level of financial risk, making it much more difficult**
12 **for them to manage their energy budgets and plan for future power requirements (Exhibit**
13 **No. ____ (MPG-1T), p. 25)”?**

14 A. No. Exhibit No. ____ (RCC-5) indicates that annual rate changes have been
15 “small to minuscule” and did not exceed 2 percent for 85 percent of the electric and 75 percent of
16 the gas rate adjustments, with 37 percent involving refunds to utility customers. Put another
17 way, the typical electric rate adjustment averaged about seven cents a day (up or down). For
18 natural gas utilities, it was less than five cents a day.⁷

19 III. DECOUPLING AND ENERGY EFFICIENCY

20 **Q. Do you agree with witness Gorman that revenue decoupling “penalizes**

21 _____
22 ⁶ Pamela Morgan, *A Decade of Decoupling for US Energy Utilities: Rate Impacts, Designs and*
23 *Observations* (Revised March 2013, attached as Exhibit No. ____ (RCC-5), at p. 2. An earlier
24 version of this study appears in the October 2009 issue of the *Electricity Journal*. I served as a
technical reviewer of both studies, and my employer, NRDC, cosponsored the update.

⁷ *See id.* at pp. 3-4.

1 **customers for undertaking successful, voluntary energy efficiency efforts by increasing**
2 **their distribution charges when their retail consumption levels decline between base rate**
3 **cases” (Exhibit No. ____ (MPG-1T), p. 23)?**

4 A. No. Systemwide revenue decoupling adjustments under the proposed mechanism
5 could go either up or down and would never exceed three percent; an individual or business’s
6 voluntary conservation efforts could easily yield tenfold greater savings.

7 **Q. Do you support witness Gorman’s proposal to replace the joint decoupling**
8 **proposal with “recovery of volumetric base revenues that are lost due to the Company’s**
9 **mandated energy efficiency programs” (Exhibit No. ____ (MPG-1T), p. 21:13-14)?**

10 A. No, for reasons set out at length in my earlier testimony (and ignored by witness
11 Gorman);⁸ as I demonstrated there, his proposal would create perverse incentives, some of which
12 were referenced by the Commission in its first decoupling decision back in 1991: “[T]he
13 Commission believes that a mechanism that attempts to identify and correct only for sales
14 reductions associated with company-sponsored conservation programs may be unduly difficult to
15 implement and monitor. The company would have an incentive to artificially inflate estimates of
16 sales reductions while actually achieving little conservation.”⁹

17 **Q. Witness Finklea contends that “a flaw” of the joint decoupling proposal is**
18 **insufficient attention to incremental natural gas conservation (Exhibit No. ____ (EAF-1T),**
19 **p. 6); do you agree?**

20 A. No. The Commission is now evaluating how best to maximize cost-effective
21

22 _____
23 ⁸ See Exhibit No. ____ (RCC-2), pp. 23-24.

24 ⁹ *Id.*, p. 5:4-8 (quoting Docket No. UE-901183-T, Third Supplemental Order (April 10, 1991), p. 10.

1 natural gas savings in a changing market;¹⁰ anticipating the results in the joint decoupling
2 proposal would have been premature. Once the Commission has completed its investigation, it
3 may be appropriate to revisit this issue with all parties.

4 **Q. Do you agree with witness Deen that the joint decoupling proposal includes a**
5 **conservation target with incremental electricity savings that are likely not cost-effective**
6 **(Exhibit No. ____ (MCD-1T), p. 32:1-16)?**

7 A. No. PSE's commitment to achieve additional conservation is based on
8 accelerating the acquisition of resources already determined to be cost-effective.

9 IV. RETURN ON EQUITY ("ROE") ISSUES

10 **Q. Do you agree with witness Gorman's, witness Hill's, and witness Higgins's**
11 **recommendation for prospective reductions in PSE's allowed return on common equity in**
12 **the event that the Commission approves the joint decoupling proposal?**

13 A. No. None of these witnesses makes any attempt to rebut my own testimony to the
14 contrary at earlier phases of this proceeding,¹¹ nor do they provide any evidence that decoupling
15 has actually reduced any utility's cost of equity, or that either this Commission or any other
16 Commission has ever imposed a prospective reduction on anywhere near the scale recommended
17 by Mr. Gorman (at least 80 basis points). Exhibit No. ____ (RCC-5) shows just how
18 unreasonable that recommendation is, based on 76 Commission decisions that have considered
19 the issue. Testifying on behalf of Public Counsel, Mr. Dittmer provides a reminder that revenue

20 ¹⁰ UG-121207, Commission Investigation into Natural Gas Conservation Programs.

21 ¹¹ See Exhibit No. ____ (RCC-2), p. 22 (citing a Brattle Group study finding no support for "the
22 belief that utilities with decoupling have a lower cost of capital than utilities without
23 decoupling," and concluding that rate adjustments associated with decoupling mechanisms
24 historically are too small to "imply appreciable consequences for company-wide cost of capital,"
a conclusion with which the Arizona Commission had recently concurred. Final ACC Policy
Statement Regarding Utility Disincentives to Energy Efficiency and Decoupled Rate Structures,
Docket Nos. E-00000J-08-0314 and G-00000C-08-0314 (Dec. 29, 2010), p. 31 [item 6].

1 decoupling includes potential downsides as well as upsides for utility shareholders:

2 Arguably under the “full decoupling” mechanism the customer is protected from
3 “over payment” of delivery service revenues in the event actual usage happens to
4 be higher than that estimated . . . when designing ERF base rates due to events
5 such as abnormal weather or increased usage associated with further appliance
6 saturation that might actually exceed reductions stemming from conservation
7 efforts.¹²

8 **Q. Describe Ms. Morgan’s findings in Exhibit No. ____ (RCC-5) regarding**
9 **prospective ROE reductions in the context of revenue decoupling decisions.**

10 A. She determined that out of 76 relevant decisions by Commissions, 60 resulted in
11 no ROE reduction and 9 resulted in a reduction of 10 basis points, with four of those resulting
12 from settlement agreements.¹³ Reductions went as high as 50 basis points in only four cases,
13 which were limited to the jurisdictions of Maryland and Washington, D.C. Ms. Morgan
14 concluded that “decoupling adjustments will be both surcharges and refunds, the actual
15 adjustments are likely to be small, and most commissions have declined to make an ROE
16 reduction in connection with the adoption of decoupling.”¹⁴

17 **Q. Respond to witness Higgins’s and witness Gorman’s contention that “other**
18 **state regulatory Commissions [have] recognized that a downward adjustment to a utility’s**
19 **return on equity is appropriate if revenue decoupling or similar policies are implemented**
20 **(Exhibit No. ____ (MPG-1T), p. 27:6-9)?**

21 A. Both witnesses have cherry-picked the national record, identifying a handful of
22 cases at the extreme of the range canvassed in full by Ms. Morgan.

23 **Q. How do you respond to witness Finklea's contention that “the proposed**

24 ¹² Exhibit No. ____ (JRD-1T), p. 20:20-25.

25 ¹³ Exhibit No. ____ (RCC-5), p. 14.

¹⁴ Exhibit No. ____ (RCC-5), p. 16.

1 **decoupling mechanism lacks any evaluation on the mechanism’s impact on rate of return”**
2 **(Exhibit No. ____ (EAF-1T), p. 5:19-20)?**

3 A. As I have stated before, if the mechanism is allowed to operate for a sufficient
4 period (e.g., 4-5 years), an evaluation could examine whether any quantifiable impacts on ROE
5 have emerged.

6 V. **ADDITIONAL ISSUES RAISED BY OTHER PARTIES**

7 **Q. Would the proposed decoupling mechanism reduce the Company’s incentive**
8 **to control costs, as contended by witness Gorman (Exhibit No. ____ (MPG-1T), p. 24: 19-**
9 **21)?**

10 A. No. As indicated in my earlier testimony, I agree with the Regulatory Assistance
11 Project that “precisely the opposite is true.”¹⁵ The mechanism would provide assurance to PSE
12 and its customers that the utility will recover only authorized revenues. Without the mechanism,
13 PSE’s profit would be tied both to sales growth and cost control. With the mechanism,
14 controlling costs takes on even greater importance, since PSE can no longer increase profits by
15 increasing sales.

16 **Q. Would the proposed decoupling mechanism “reduce the Company’s**
17 **financial incentive to promote economic development in its service territory,” as witness**
18 **Gorman contends (Exhibit No. ____ (MPG-1T), p. 24: 15-16)?**

19 A. Only if one assumes that all economic development requires equivalent growth in
20 kilowatt-hour sales, which hardly fits the philosophy of a state committed by law to securing all
21 cost-effective energy efficiency. The joint decoupling proposal in no way discourages the
22 addition of new customers, which is a much stronger driver of economic development.

23 _____
24 ¹⁵ See Exhibit No. ____ (RCC 2), p. 27:13-22, quoting Regulatory Assistance Project, *Revenue
Regulation and Decoupling: A Guide to Theory and Application* (June 2011), p. 45.

1 **Q. What is your view of witness Gorman’s contention that “if the company is**
2 **financially neutral with respect to the sales volumes for its product, it follows that it would**
3 **be less focused on providing quality customer service and accommodating the needs of its**
4 **customers” (Exhibit No. ____ (MPG-1T), p. 24: 16-19).**

5 A. I disagree, starting with Mr. Gorman’s premise that PSE’s primary retail
6 “product” is bulk energy commodities rather than reliable energy services. I also reject
7 Mr. Gorman’s conclusion that utilities need to be rewarded for boosting sales of kilowatt-hours
8 and therms in order to deliver “quality customer service” and meet “customer needs.”

9 **Q. Do you agree with witness Gorman that “Washington experienced problems**
10 **with rate volatility resulting from the decoupling program it implemented in October 1991**
11 **for PSE” (Exhibit No. ____ (MPG-1T, p. 25: 14-20)?**

12 A. No, and I was a witness in the 1993 proceeding in which the Commission
13 reviewed, endorsed and extended that same 1991 decoupling program. Witness Gorman makes
14 no effort to rebut my summary of this history in the Exhibit to my October 25, 2012 testimony.¹⁶
15 On the issue of rate volatility, witness Gorman may be thinking of the impact of other elements
16 of “a complex system of rate adjustment mechanisms that included the revenue-per-customer cap
17 (along with, e.g., a controversial approach to allocating risks of hydropower fluctuations).”¹⁷
18 Nothing of the sort is presented here, of course.

19 **Q. Respond to witnesses Deen’s objection that the joint decoupling proposal**
20 **includes “no consideration of off-system sales of the power freed up due to increased**
21 **conservation” (Exhibit No. ____ (MCD-1T), p. 23:2-3).**

22 A. As I indicated in the testimony supporting the joint proposal, “PSE’s Power Cost

23 ¹⁶ See Exhibit No. ____ (RCC-2), pp. 3-4.

24 ¹⁷ See *id.*

1 Adjustment (PCA) already responds to this concern; it is designed to strike a reasonable balance
2 between shareholder and customer interests in allocating risks associated with power supply
3 costs and cost recovery at both wholesale and retail levels.”¹⁸ The joint proposal does not create
4 any additional opportunity, outside the PCA, for PSE to recoup any lost power supply revenues
5 from reduced retail sales; these revenues are completely outside the scope of the decoupling
6 mechanism. Witness Deen contends that PSE would automatically gain by shifting sales from
7 retail to wholesale customers, ignoring my earlier testimony that the PCA is likely to
8 undercompensate PSE for lost revenues from retail sales “when wholesale prices drop well
9 below retail rates, which is the case currently.”¹⁹

10 **Q. Witness Higgins points out that the joint proposal, unlike the NWECC**
11 **proposal originally submitted in the PSE GRC, applies to more electric rate schedules**
12 **(Exhibit No. ____ (KCH-1T), p. 24). How do you justify recommending a more inclusive**
13 **decoupling proposal now?**

14 A. I justify it by reference to the very Commission Policy Statement that, in the
15 words of witness Deen,²⁰ “continues as the Commission’s most complete and thorough analysis
16 of decoupling.” The first of the “Criteria for Approval” that the Commission established in that
17 Statement begins with the sentence “Generally, a full decoupling proposal should cover all
18 customer classes.”²¹ While, for example, large industrial customers contribute less on average
19 than other customers to recovery of distribution costs in energy charges, they still make a non-

20
21 _____
22 ¹⁸ See *id.*, p. 16: 9-12.

23 ¹⁹ Compare Exhibit No. ____ (MCD-1T), p. 34 with Exhibit No. ____ (RCC-2), p. 16:15-16.

24 ²⁰ Exhibit No. ____ (MCD-1T), p. 19:10-11.

²¹ WUTC Policy Statement, note 4 above, p. 18.

1 trivial contribution, as witness Deen concedes.²²

2 **Q. Do you support witnesses Finklea’s and Higgins’s proposal to remove**
3 **natural gas transport and interruptible service customers from inclusion in the proposed**
4 **decoupling mechanism (Exhibit No. ____ (EAF-1T), pp. 6-8 and Exhibit No. ____**
5 **(KCH-5T), pp. 13-14)?**

6 A. Given the evidence on how little these customers contribute to non-fuel cost
7 recovery in variable charges, I support removing schedules 85, 85T, 87 and 87T from the joint
8 decoupling proposal.

9 **Q. How do you respond to witness Deen’s objection that “PSE has declined to**
10 **adjust its decoupling mechanism for the effects of weather (Exhibit No. ____ (MCD-1T), p.**
11 **37:5)?**

12 A. This feature of the joint decoupling proposal is unchanged from the Coalition’s
13 original version, and it reflects the preference that the Commission itself included in its Policy
14 Statement (p. 18). Exhibit No. ____ (RCC-5), p. 12 shows that the overwhelming majority of
15 electric and natural gas decoupling mechanisms are not weather-adjusted, and my earlier
16 testimony reviews the benefits to both customers and shareholders from this policy: “customers
17 get prompt relief from cost increases driven by extreme weather events, and PSE avoids
18 downside risk on recovery of its authorized non-production costs.”²³

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

20 A. Yes.

21
22
23 ²² Exhibit No. ____ (MCD-1T), p. 36: 5-6 (citing estimates from my earlier testimony).

24 ²³ Exhibit No. ____ (RCC-2), p. 25:4-6.