

**BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND)	DOCKET UG-060256
TRANSPORTATION COMMISSION,)	
)	ORDER 05
Complainant,)	
)	FINAL ORDER ACCEPTING
v.)	SETTLEMENT, SUBJECT TO
)	CONDITIONS; REJECTING
CASCADE NATURAL GAS)	TARIFF SHEETS;
CORPORATION,)	AUTHORIZING AND
)	REQUIRING COMPLIANCE
Respondent.)	FILING
)	
.....)	

- 1 **SYNOPSIS:** *This Order accepts, subject to conditions, the parties’ multi-party settlement resolving all contested issues in Cascade’s request for a general rate increase. The resulting increase in rates will allow Cascade to recover an additional \$7,061,536 in revenue, representing an increase in rates of approximately 2.7 percent.*

- 2 *We condition our acceptance of the Settlement Agreement on the parties stipulating to an overall rate of return for Cascade of 8.85 percent for purposes of calculating the Company’s cost of capital. Further, we accept the portion of the Settlement authorizing the establishment of a pilot program for decoupling, subject to our approval of a Conservation Plan which must include an earnings cap and penalties for failure to meet benchmarks. Cascade must also conduct an evaluation of the pilot decoupling program regardless of whether it seeks to continue the program after the three-year period expires. Finally, we accept the proposal for prospective treatment of gas management services revenues in paragraph 12(b)(ii), conditioned on the Company complying, within 30 days of the effective date of this Order, with statutory requirements to file tariffs and contracts with the Commission.*

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SUMMARY

- 3 **PROCEEDING.** On February 14, 2006, Cascade Natural Gas Corporation (Cascade or the Company) filed revisions to its tariffs in Docket UG-060256 seeking to increase its annual revenues from Washington operations by \$11.7 million, or about 4.5 percent.¹ The Washington Utilities and Transportation Commission (Commission) suspended the proposed tariffs by order entered on March 15, 2006, prior to the stated effective date of March 16, 2006.
- 4 The Commission convened a prehearing conference at Olympia, Washington on April 11, 2006, before Administrative Law Judge C. Robert Wallis.² The Commission conducted public comment hearings in Yakima, Washington on August 29, 2006, and in Bellingham, Washington on September 7, 2006. The Commission held a hearing on a multi-party, multi-issue settlement in Olympia, Washington, on October 12, 2006, before Chairman Mark H. Sidran, and Commissioners Patrick J. Oshie and Philip B. Jones, assisted by Administrative Law Judge Ann E. Rendahl. This order resolves all remaining contested issues.
- 5 **PARTY REPRESENTATIVES.** James Van Nostrand, Perkins Coie, LLP, Portland, Oregon, represents Cascade. Judith Krebs, Assistant Attorney General, Seattle, Washington, represents the Public Counsel Section of the Washington Office of the Attorney General (Public Counsel). Gregory J. Trautman, Assistant Attorney General, Olympia, Washington, represents the Commission's regulatory staff (Commission Staff or Staff).³ Edward A. Finklea and Chad M. Stokes, Cable Huston Benedict Haagensen & Lloyd LLP, Portland, Oregon, represent the Northwest Industrial Gas Users (Nwigu). Nancy Glaser and Danielle Dixon, Seattle,

¹ A glossary of acronyms and terms used in this Order is attached for the convenience of readers.

² While Judge Wallis conducted the prehearing conference, Administrative Law Judge Karen Caillé was the assigned presiding officer for this proceeding. In June, the matter was reassigned to Administrative Law Judge Ann E. Rendahl, who presided over the remainder of the proceeding.

³ In formal proceedings, such as this case, the Commission's regulatory staff functions as an independent party with the same rights, privileges, and responsibilities as any other party to the proceeding. There is an "ex parte wall" separating the Commissioners, the presiding

Washington, represent the Northwest Energy Coalition (NWECC). Brad Purdy, attorney, Boise, Idaho, represents The Energy Project. John A. Cameron, attorney, Davis Wright Tremaine LLP, Portland, Oregon, represents Cost Management Services, Inc. (CMS). Scott Magie, project director, Longview, Washington, represents the Mint Farm Energy Center LLC. Vincent J. Diaz, Fox Island, Washington, represents the International Chemical Workers Union Council/UFCW Local 121-C.

6 **COMMISSION DETERMINATION.** The Commission suspended and set for hearing the rates Cascade initially proposed. After all parties had filed testimony and exhibits addressing Cascade's request, and just prior to hearing, the parties filed a multi-party, multi-issue settlement agreement (Settlement Agreement or Settlement) addressing all of the contested issues presented in Cascade's request for increased rates. In this Order, we accept the parties' proposed Settlement Agreement, subject to conditions, finding the Settlement results in rates that are fair, just, reasonable and sufficient.

7 We determine that the Settlement Agreement is consistent with the law and public interest, and is fully supported by the record evidence. We condition our acceptance of the Settlement on the parties stipulating to an overall rate of return of 8.85 percent for purposes of calculating the Company's cost of capital. While we accept the stipulated pilot program for decoupling in principle, we condition approval of the Company's Conservation Plan on the Plan including an earnings cap and penalties for the Company's failure to meet targets and benchmarks. We require Cascade to conduct an evaluation of the pilot decoupling proposal regardless of whether it seeks to continue the program after the three-year period expires. Finally, we accept the proposal for prospective treatment of gas management services revenues in paragraph 12(b)(ii), conditioned on the Company complying, within 30 days of the effective date of this Order, with statutory requirements to file tariffs and contracts with the Commission.

- 8 Should the parties accept these conditions, we determine that Cascade should be authorized and required to file tariff rates in compliance with our decisions. The resulting rates will be fair, just, reasonable and sufficient, and neither unduly discriminatory nor preferential.

MEMORANDUM

I. Background and Procedural History

- 9 On February 14, 2006, Cascade filed revisions to its currently effective Tariff WN U-3 for natural gas service. The proposed tariff revisions bore an effective date of March 16, 2006. Cascade proposed a general rate increase of \$11.7 million or about 4.8 percent for its Washington operations. The Commission suspended the proposed tariff revisions by order entered on March 15, 2006, and set the matter for hearing.
- 10 Cascade serves approximately 235,000 customers in Washington and Oregon. The Company's Washington customers are located in three operational regions: Western, including the Kitsap Peninsula, Grays Harbor area, and Kelso/Longview; Northwest, including Bellingham, Mt. Vernon, and Oak Harbor/Anacortes; and Central, including Sunnyside, Wenatchee/Moses Lake, Tri-Cities, Walla Walla, and Yakima.
- 11 In its filing, Cascade sought an overall rate of return of 9.37 percent, a rate of return on common equity of 11.15 percent, a capital structure with 50 percent common equity, a redesign of the Company's rates for transportation customers based on a proprietary cost-of-service study, new and modified fees and charges, and a number of adjustments to its revenue requirement. Cascade also proposed two regulatory mechanisms, a decoupling mechanism, referred to as the Conservation Alliance Plan, and a tracking mechanism, referred to as the Safety and Reliability Infrastructure Adjustment Mechanism (SRIAM), to adjust rates annually for investment in non-revenue producing pipeline infrastructure.
- 12 The Commission conducted a prehearing conference on April 11, 2006, before Administrative Law Judge Wallis. On April 13, 2006, the Commission entered two orders; Order 02, which granted various pending petitions to intervene, authorized

formal discovery, and established a procedural schedule, and Order 03, a protective order. Administrative Law Judge Rendahl assumed responsibility as presiding officer in this proceeding during June 2006. The Commission held public comment hearings in Yakima and Bellingham, Washington during the evening hours of August 29 and September 7, 2006, respectively.

- 13 On August 15, 2006, Staff, Public Counsel, NWIGU, NWECA, The Energy Project and CMS filed response testimony. Only Staff addressed the Company's cost of capital and revenue requirement adjustments. Staff recommended a net decrease in revenue requirement of \$321,588 after recognizing additional revenue from fees and charges.⁴ Because the decrease was so small, Staff recommended the decrease in revenue requirement not be reflected in rates.
- 14 Staff, Public Counsel, NWIGU and NWECA objected to the Company's decoupling and infrastructure tracking mechanisms, as well as the Company's rate design and rate spread proposals. Staff and NWECA offered alternative decoupling proposals, and Staff and NWIGU proposed alternative proposals for rate design and rate spread. The Energy Project addressed the Company's proposal to increase funding of low-income assistance programs. CMS addressed its concerns about the Company's authority to sell natural gas to non-core, transportation-only customers at retail under tariff Schedules 663 and 664, issues CMS also raised in a separate complaint against Cascade in Docket UG-061256.⁵
- 15 On September 12, the Company filed rebuttal testimony in which it concurred with NWIGU's position on rate design and rate spread and modified its SRIAM proposal, but did not modify its revenue requirement proposal. Staff, NWECA, Public Counsel and The Energy Project filed responsive and cross-rebuttal testimony addressing decoupling and low-income assistance programs.

⁴ Parvinen, Exh. No. 361-T at 5.

⁵ We resolve the issues identified in CMS' complaint against Cascade in Order 03 in Docket UG-061256 entered concurrently with this Order.

- 16 On October 4, 2006, the Company and Staff filed a stipulation with the Commission reflecting their agreement on various revenue requirement issues. On October 5, the Company, Staff and NWIGU filed a stipulation reflecting their agreement on various rate spread and rate design issues.
- 17 After further discussion among all parties, on October 11 the parties filed a multi-party, multi-issue settlement addressing all of the contested issues in the rate case. The Settlement Agreement is attached to this Order as Appendix A. The Company, Staff and NWIGU agree in this Settlement to withdraw their October 4 and 5 stipulations. Public Counsel joined the Settlement Agreement, in part, but opposes the portions of the Settlement concerning cost of capital and the proposed decoupling mechanism.
- 18 The Commission conducted a hearing on the multi-party Settlement Agreement in Olympia, Washington on October 12, 2006, before Chairman Mark H. Sidran, Commissioner Patrick J. Oshie and Commissioner Philip B. Jones, assisted by Administrative Law Judge Rendahl. The Company, Staff, NWEC, NWIGU and Public Counsel presented witnesses in support of the Settlement Agreement. Public Counsel cross-examined witnesses concerning the contested decoupling proposal. Altogether, the record includes more than 350 exhibits, including the Settlement Agreement and a supporting Narrative Statement. Out of 197 comments that the Commission received from the public on Cascade's request for a rate increase, 193 were opposed to the increase.⁶
- 19 The parties filed Initial Briefs on November 15, 2006, and Reply Briefs on December 5, 2006. The Commission here enters its Final Order accepting the parties' multi-party Settlement Agreement subject to conditions, resolving the remaining disputed issues, and granting appropriate relief considering the full record of proceedings and the parties' arguments based on that record.

⁶ See Exh. No. 491.

II. Discussion and Decisions

A. The Settlement Agreement

20 On the eve of evidentiary hearings, the parties entered a multi-party, multi-issue settlement addressing all of the contested issues in this case, including:

- Various adjustments to the Company’s revenue requirement
- Cost of capital
- Redesigned rates for transportation customers, based on NWIGU’s cost-of-service study
- New and modified fees and charges
- Decoupling, and
- The Company’s proposed infrastructure tracking mechanism, referred to as the SRIAM.

21 The Settlement is not a global agreement in which all of the parties agree on all of the issues. While Staff and the Company agree on revenue requirement issues and cost of capital, no other party joins them. Staff, the Company, Public Counsel, NWECA and the Energy Project agree on changes to miscellaneous service charges, basic charges, and funding for low-income assistance. Staff, the Company and NWIGU agree on rate spread and certain rate design provisions, and the Company agrees to withdraw its SRIAM proposal. While Staff and the Company agree on the overall cost of capital and the Company, Staff and NWECA agree on a partial, pilot decoupling program, Public Counsel contests those Settlement provisions pertaining to the decoupling mechanism and the cost of capital.

B. Standards for Accepting Settlement Agreements

22 The Commission’s procedural rules govern the process for reviewing and accepting settlements. First, the Commission “may accept the proposed settlement, with or without conditions, or may reject it.”⁷ The Commission must “determine whether a proposed settlement meets all pertinent legal and policy standards.”⁸ The Commission may approve settlements “when doing so is lawful, when the settlement terms are supported by an appropriate record, and when the result is consistent with the public interest in light of all the information available to the commission.”⁹

⁷ WAC 480-07-750(2).

⁸ WAC 480-07-740.

⁹ WAC 480-07-750(1).

23 In a decision accepting a settlement in a prior rate case, the Commission described this standard as “a three-part inquiry”:

(1) We ask whether any aspect of the proposal is contrary to law; (2) We ask whether any aspect of the proposal offends public policy; and (3) We ask if the evidence supports the proposed elements of the Settlement Agreement as a reasonable resolution of the issue(s) at hand.¹⁰

24 In that decision, the Commission noted that settlements “are by nature compromises of more extreme positions that are supported by evidence and advocacy.”¹¹ The Commission further held that “[r]atemaking is not an exact science” and accepted the settlement on the basis that “the overall result in terms of revenue requirement is reasonable and well supported by the evidence.”¹² Based on this decision, both Cascade and Staff request the Commission approve the proposed settlement in this proceeding.¹³

25 Thus, in reviewing the proposed Settlement, we must consider not only the merits of the contested issues – the decoupling proposal and resolution of cost of capital issues, but whether the uncontested portions of the Settlement are lawful, supported by the record and are in the public interest.

C. Uncontested Settlement Provisions

1. Revenue Requirement Adjustments

26 In paragraph 12 of the Settlement Agreement, Staff and the Company agree to a revenue requirement increase for Cascade of \$7,061,536, which would result in an overall 2.7 percent increase relative to current rates. The Settlement proposal reflects an approximately 40 percent decrease from the Company’s original proposal.¹⁴ Staff

¹⁰ *Washington Utilities and Transportation Commission v. PacifiCorp d/b/a Pacific Power & Light Co.*, Docket UE-032065, Order 06 at 26, ¶ 59 (October 2004) [Hereinafter *WUTC v. PacifiCorp*, Docket UE-032065, Order 06].

¹¹ *Id.*, ¶ 61.

¹² *Id.*, ¶ 62.

¹³ See Cascade Initial Brief, ¶¶ 11-12; Staff Reply Brief, ¶¶ 18-19.

¹⁴ Cascade Initial Brief, ¶15.

and the Company derived this amount by agreeing to the treatment of a number of contested restating and proforma adjustments.¹⁵

- 27 Other than CMS's stipulation in paragraphs 12(b)(iii) and (iv) of the Settlement and Public Counsel's objection to the resolution of cost of capital issues in paragraph 12(a), no party other than Staff and the Company took a position or objected to the stipulations in paragraph 12 of the Settlement Agreement.
- 28 In resolving an adjustment for weather normalization, Staff and Cascade stipulate to a margin adjustment of \$730,779 to normalize test year temperatures to reach a revenue requirement number, but do not agree on a weather normalization methodology.¹⁶ The weather normalization adjustment adjusts "test period loads to normalize them to reflect the gas throughput volumes that would have occurred under 'normal' weather."¹⁷
- 29 One of the stipulated adjustments concerns the treatment of revenues and costs for Cascade's gas management services to non-core customers, i.e., those taking transportation-only service. Cascade provides certain services to non-core customers on a competitive basis. These services include transportation, pipeline capacity, balancing, gas supply, and gas management services. Cascade sought to remove the revenues and expenses associated with these services, including gas supply sales, from the revenue requirement calculation, asserting the services are authorized exclusively under rules and orders of the Federal Energy Regulatory Commission (FERC).¹⁸
- 30 Staff contested the treatment of revenues Cascade earned for these services, arguing the revenues and costs should be included in the calculation of revenue requirement.¹⁹ While Staff agreed that the services are competitive, Staff argued the services are provided under Cascade's tariff Schedule 687, which the Commission approved on

¹⁵ Exh. No. 1, ¶ 12(d), Att. A.

¹⁶ *Id.*, ¶ 12(c); Exh. No. 2, ¶ 7.

¹⁷ Cascade Initial Brief, ¶ 22.

¹⁸ Stoltz, Exh. No. 21-T at 7:3-10.

¹⁹ Parvinen, Exh. No. 361-T at 11:9-17.

condition that Cascade show in future rate cases that the services are not adverse to core customers.²⁰

- 31 CMS, one of Cascade's competitors for gas supply services, requests the Commission order Cascade to remove language from tariff Schedules 663 and 664 that implies the Company may sell natural gas at retail under FERC regulations.²¹ In a separate complaint in Docket UG-061256, CMS argues that Cascade is violating RCW 80.28 by selling natural gas at retail – the same sales at issue in the dispute over treatment of gas management services revenues and costs – without tariffs or special contracts on file with the Commission allowing it to do so.²² CMS asserts that FERC regulations apply to sales for resale, not retail sales.²³ CMS also asserts that Schedule 687, which addresses gas management services, does not govern sales of gas supply.²⁴
- 32 In response, Cascade argues its gas supply sales are not subject to Commission jurisdiction, that the Company's shareholders bear the risk for these services and that the revenues and costs should remain below the line, or excluded from the revenue requirement calculation.²⁵
- 33 In paragraph 12(b)(i) of the Settlement Agreement, Staff agrees to the Company's proposal to remove the revenues and costs of gas management services from the revenue requirement calculation, but Staff and the Company agree to include \$200,000 of gas management service revenues in determining the Company's revenue requirement. The Company also agrees to share with customers 50 percent of the net margins the Company realizes on these services in the future.²⁶ In addition, CMS and the Company agree that Cascade will remove language from Schedules 663 and 664 referring to authority under FERC regulations for blanket marketing certificates, and agree to stipulated facts for purposes of the record in the complaint proceeding.²⁷

²⁰ *Id.* at 11:9-14; *see also* Parvinen, Exh. No. 366.

²¹ Lehmann, Exh. No. 341-T at 3:24 – 4:11.

²² CMS Complaint, ¶¶ 9-18, 33-39.

²³ *Id.*, ¶¶ 19-32.

²⁴ CMS Answer to Cascade's Cross-Motion for Summary Determination at 7-10.

²⁵ Stoltz, Exh. No. 30-T at 3:3 – 5:23.

²⁶ Exh. No. 1, ¶ 12(b)(ii).

²⁷ *Id.*, ¶ 12(b)(iii) and (iv).

34 Cascade expresses concern that if the Commission grants CMS' requests in Docket UG-061256, the gas supply sales would be deemed unauthorized, requiring rejection of the Settlement provisions to reduce revenue requirement by \$200,000 and to provide for prospective sharing of net margins.²⁸ The Settlement Agreement is not contingent on resolving the complaint. The Company has agreed to certain terms and takes the risk of an adverse ruling on issues in the complaint.

35 Given Cascade's concern, our decision concerning this portion of the Settlement Agreement must begin with our decision in the complaint proceeding in Docket UG-061256. The facts and circumstances underlying our decision in that docket are set forth in detail in Order 03 therein, entered concurrently with this Order. There we find that Cascade relied improperly on FERC regulations for authority to make retail sales of gas,²⁹ and that Cascade's gas supply sales violate RCW 80.28.050, RCW 80.28.080 and WAC 480-80-143 by failing to have governing tariffs and contracts on file.³⁰ Finally, we find that the Commission's error in allowing Cascade to cancel its gas supply tariffs does not relieve Cascade from its responsibility to comply with the law.³¹

36 We assess penalties of \$5,000 against the Company in Order 03 in Docket UG-061256 for its failure to file gas supply contracts with the Commission in violation of RCW 80.28.050 and WAC 480-80-143.³² We also direct the Company to file with the Commission, within 30 days of the Order, new gas supply tariffs and any existing special contracts or we may initiate appropriate action against the Company, including additional penalties.³³ We do not void existing contracts, as doing so would be harmful to Cascade's customers who should not suffer adverse consequences caused by Cascade's actions.³⁴

²⁸ Cascade Initial Brief at 9.

²⁹ *Cost Management Services, Inc. v. Cascade Natural Gas Corp.*, Docket UG-061256, Order 03, ¶ 48 (Jan. 16, 2007).

³⁰ *Id.*, ¶¶ 61, 63.

³¹ *Id.*, ¶¶ 56, 91.

³² *Id.*, ¶¶ 66, 92.

³³ *Id.*, ¶¶ 66, 93-95.

³⁴ *Id.*, ¶¶ 97-98.

37 Although the Commission's action does not relieve Cascade of its responsibility to comply with state law, we find it inequitable to deny appropriate ratemaking treatment to services the Commission allowed Cascade to pursue without a tariff on file. Cascade's gas supply sales cannot be deemed to be completely unauthorized activity. Thus, we accept the parties' treatment in the Settlement of gas management services revenues and costs, including the stipulation in paragraph 12(b)(i) to reduce revenue requirement by \$200,000 for revenues gained in gas management services and retail sales. We find it appropriate to allow core customers to benefit from Cascade's actions. We also accept the proposal for prospective treatment of revenues in paragraph 12(b)(ii), conditioned on the Company complying with statutory requirements within 30 days of the effective date of this Order and Order 03 in Docket UG-061256.

38 The provisions in paragraph 12 of the Settlement Agreement addressing restating and proforma adjustments, weather normalization and the treatment of competitive gas management services revenues meet our standards for accepting settlements. The provisions are neither contrary to law nor the public interest. The provisions reasonably resolve all contested revenue requirement issues in the rate case and are supported by the record, specifically the prefiled testimony and exhibits of Staff and Company witnesses Parvinen, Stoltz and Barnard.³⁵

2. Miscellaneous Service Charges

39 In its initial filing, Cascade proposed numerous changes to existing service charges and proposed several new charges.³⁶ Staff, Public Counsel, NWEC and The Energy Project objected to Cascade's proposal, but differed in their proposed alternatives.³⁷ Cascade modified its proposed changes to service charges in responsive testimony.³⁸

40 In paragraph 13 of the Settlement, the Company, Staff, Public Counsel, NWEC and The Energy Project reach agreement on the miscellaneous service charges, as follows:

³⁵ Parvinen, Exh. Nos. 361-T, 362, 363, 364, 366, 367; Stoltz, Exh. Nos. 21-T, 26, 30-T, 31; Barnard, Exh. Nos. 91-T and 92; *See* Exh. No. 1, ¶¶ 12(d), (e).

³⁶ Stoltz, Exh. No. 21-T at 14-18.

³⁷ Parvinen, Exh. Nos. 361-T at 22-25 and 365; Weiss, Exh. No. 311-T at 29; Lazar, Exh. No. 281-T at 36; Eberdt, Exh. No. 351-T at 11.

³⁸ Stoltz, Exh. No. 30-T at 32-35.

Disconnect Fee	\$10.00
Reconnect Fee (during work hours)	\$24.00
After Hours Reconnect Fee	\$60.00 (except in case of medical emergency)
Pilot Light Service	\$20.00
Late Fee	1% per month, applied to all unpaid balances 30 days past due
Minimum Late Fee	None
Meter Tampering Fee	Actual costs
NSF Check Return Charge	\$18.00
New Premises Charge	\$45.00
Account Activation Fee	No charge
Short Notice Locate Fee	No charge

The parties agree that these charges will produce revenues of \$1,442,480.³⁹

41 We accept the parties' stipulation to miscellaneous fees and charges and the resulting projected revenues. The stipulation reflects a consensus of the parties, based on evidence presented by the Company concerning the cost of service, and by other parties on the adverse effects on customers of increasing the fees and charges.⁴⁰ Furthermore, the stipulated fees will lessen the harmful impact on low-income customers.⁴¹ For these reasons, we find the compromise to be in the public interest.

3. Low Income Assistance

42 In its initial filing, Cascade proposed to provide \$800,000 to community action agencies in its service territory for bill assistance to low-income customers.⁴² While Public Counsel and The Energy Project supported the Company's proposal, Staff rejected the proposal claiming the Company had not shown how the monies would be

³⁹ Exh. No. 1, ¶ 13.

⁴⁰ See, *supra*, nn.36-38; see also Cascade Initial Brief, ¶ 23.

⁴¹ Energy Project Brief at 1-2.

⁴² Stevens, Exh. No. 11-T at 9-10.

spent.⁴³ In rebuttal testimony, Cascade concurred with The Energy Project's proposals for how to implement a low-income assistance program.⁴⁴

43 In paragraph 14(a) of the Settlement, Staff, the Company, The Energy Project, Public Counsel and NWECA agree that the Company's proposal for \$800,000 in annual funding for low-income assistance should be included in revenue requirement. The Settlement provides that Cascade will apply for Public Utility tax credits for the low-income program and that any and all credits will be added to the base fund for the program. The Settlement describes how Cascade will implement a low-income assistance program using the network created by the Washington Department of Community, Trade and Economic Development. In addition, in paragraph 14(b), the Company agrees to work together with The Energy Project, Staff and other parties to collect data related to low-income customers. These parties will also consider whether the Company should implement an arrearage program to address delinquent customers and collection efforts.

44 The provisions in paragraph 14 reasonably resolve the contested issues concerning whether to include monies for a low-income assistance program in the revenue requirement, and are well supported by record evidence. The stipulated provisions are in the public interest, resulting in increased funds available to low-income customers for bill assistance.⁴⁵

4. Rate Spread

45 Cascade proposed to spread any revenue increase across all rate schedules based on the results of its cost-of-service study, rather than as an equal percentage of margin.⁴⁶ Staff, Public Counsel and NWIGU opposed the Company's cost-of-service study asserting it did not follow Commission-approved principles for such studies.⁴⁷ Staff, Public Counsel and NWIGU also opposed the Company's rate spread proposal, but

⁴³ Eberdt, Exh. Nos. 351-T at 3-7 and 352-T at 2-4; Lazar Exh. No. 281-T at 39-40; Parvinen, Exh. 361-T at 20-21.

⁴⁴ Stevens, Exh. No. 12-T at 6-7.

⁴⁵ Energy Project Brief at 3.

⁴⁶ Stoltz, Exh. No. 21-T at 18-19.

⁴⁷ Mariam, Exh. No. 441-T at 21:11 – 22:13; Schoenbeck, Exh. No. 231-T at 8:17 – 9:17; Lazar Exh. No. 281-T at 10:5 – 11:15.

agreed there was a need to move closer to cost-based rates.⁴⁸ Staff and NWIGU proposed modified studies following the Commission's guidelines, and Public Counsel recommended use of the NWIGU study.⁴⁹ In rebuttal, Cascade continued to propose cost-based rates and to oppose a rate spread based on an equal percent of margin, but agreed to partial movement to cost-based rates, supporting the use of NWIGU's cost-of-service study with modifications.⁵⁰

46 In paragraph 16 of the Settlement Agreement, Staff, the Company and NWIGU agree to spread any revenue requirement increase across customer classes in accordance with the rate spread proposal in Attachment C to the Settlement. The parties agreed to reduce revenue requirement allocated to rate Schedules 663 and 664 – transportation schedules – by \$1.751 million, and to allocate 90 percent of Miscellaneous Service Charge revenues to residential customers (Schedule 503) and 10 percent to commercial customers (Schedule 504).

47 The provisions in paragraph 16 of the Settlement reasonably resolve the contested issues concerning rate spread and are supported by evidence in the record, e.g., testimony and exhibits filed by the Company, Staff, Public Counsel, and NWIGU. We also find the stipulated provisions are consistent with the law and the public interest.

5. Rate Design

48 In its initial filing, Cascade proposed to double the basic charges for all rate schedules, and to redesign transportation Schedules 663 and 664 based on the results of its cost-of-service study.⁵¹ Staff supported the changes to basic service charges, while Public Counsel and The Energy Project opposed the proposal.⁵² NWIGU opposed the Company's proposal, and recommended a different proposal for

⁴⁸ Steward, Exh. No. 421-T at 20-21; Lazar, Exh. No. 285-T at 41; Schoenbeck, Exh. No. 231-T at 10.

⁴⁹ Mariam, Exh. No. 441-T at 21:17 – 23:8; Schoenbeck, Exh. Nos. 231-T at 9:18 – 12:9 and 233; Lazar, Exh. No. 285-T at 15:13 – 16:5.

⁵⁰ Stoltz, Exh. No. 30-T at 25-29.

⁵¹ Stoltz, Exh. No. 21-T at 19.

⁵² Steward, Exh. No. 421-T at 24; Lazar, Exh. No. 281-T at 22-24; Eberdt, Exh. No. 351-T at 10-11.

redesigning the transportation schedules.⁵³ In rebuttal, Cascade announced it had reached a compromise with NWIGU to consolidate Schedules 663 and 664, modify treatment of lost and unaccounted for gas, and adopt the Northwest Pipeline's rules for transportation service.⁵⁴

49 Paragraph 17 of the Settlement includes three separate agreements concerning rate design. First, Staff, the Company and NWIGU agree to consolidate transportation Schedules 663 and 664 into one schedule, modify tariff provisions for options for electing firm service and lost and unaccounted for gas, and adopt the Northwest Pipeline's rules for transportation service. Second, Staff, the Company, Public Counsel, NWEC and The Energy Project agree to modify monthly basic service charges for certain schedules, without changing the residential basic service charge:⁵⁵

Schedule 503 (Residential)	No change (\$4.00)
Schedule 504 (Commercial)	Increase from \$7.00 to \$10.00
Schedule 505 (Industrial)	Increase from \$12.00 to \$24.00
Schedule 511 (Large Volume)	Increase from \$22.00 to \$44.00
Schedule 512 (Compressed)	Increase from \$7.00 to \$14.00
Schedule 570 (Interruptible)	Increase from \$22.00 to \$44.00
Schedule 577 (Ltd. Interruptible)	Increase from \$22.00 to \$44.00

Finally, the Company and Staff agree to flatten blocks for Schedules 504, 505 and 511.

⁵³ Schoenbeck, Exh. No. 231-T at 13-16.

⁵⁴ Stoltz, Exh. No. 30-T at 27, 32.

⁵⁵ Because of our general policy in favor of settlements, we accept the parties' agreement concerning basic service charges. However, we believe sound public policy requires that a reasonable balance be struck between a utility recovering its fixed costs via fixed rather than volumetric charges. A rate design that provides for a utility to recover a disproportionate amount of its fixed costs in volumetric rates fails to recognize the importance of reflecting in rates the nature of fixed costs incurred to provide utility service. When Cascade next files a general rate case, we require the Company to base its filing on a transparent cost-of-service study that follows the Commission's guidelines for such studies. A properly prepared study will be a useful tool in considering the appropriate balance for recovering fixed and volumetric charges.

50 As with the stipulated provisions concerning rate spread issues, we find the provisions addressing rate design reasonably resolve the contested issues, are well supported by the record evidence, and consistent with the law and public interest.

6. SRIAM

51 In its initial filing, Cascade proposed an infrastructure investment tracking mechanism, which it referred to as the Safety and Reliability Infrastructure Adjustment Mechanism, or SRIAM. Cascade sought to include annually in rates the cost of service associated with certain investments in its pipeline and other facilities, i.e., safety or reliability investments and facility relocations, without a general rate case.⁵⁶

52 Staff, Public Counsel and NWIGU recommended the Commission reject the SRIAM proposal arguing it is poorly designed, represents piecemeal or single-issue ratemaking, and that Cascade has not demonstrated the need for the mechanism.⁵⁷ Cascade modified the SRIAM proposal in its rebuttal testimony, but continued to assert a need for the tracker.⁵⁸

53 In paragraph 18 of the Settlement, Cascade agrees to withdraw its proposal for an infrastructure investment tracking mechanism. However, if the Commission approves Puget Sound Energy's (PSE) proposal for a depreciation tracker in Docket UE-060266, Cascade reserves the right to seek a single-issue filing similar to the depreciation tracker.

54 We accept Cascade's agreement to withdraw its SRIAM proposal as reasonable. Given our recent rejection of PSE's proposal for a depreciation tracker in Order 08 entered in Docket UE-060266, Cascade's reservation of right to seek a similar mechanism is moot. As a condition of our approval, that provision of the Settlement Agreement is stricken.

⁵⁶ Stoltz, Exh. No. 30-T at 32.

⁵⁷ Parvinen, Exh. No. 351-T at 27-30; Brosch, Exh. No. 251-T at 3, 8, 25; Schoenbeck, Exh. No. 231-T at 2, 6.

⁵⁸ Cummings, Exh. No. 221-T at 2-4, 14-15.

D. Contested Settlement Provisions

1. Cost of Capital

- 55 Prior to reaching agreement in this case, the Company and Staff presented competing proposals for Cascade's capital structure and return on equity. The resulting difference in overall rate of return accounted for approximately \$4.0 million (34 percent) of the gap between the Company's original revenue request and the Staff's original recommendation.⁵⁹
- 56 Cascade sought an overall rate of return of 9.37 percent based on a hypothetical capital structure of 50 percent equity and 50 percent debt and a return on equity of 11.15 percent.⁶⁰ The Company asserted that this rate of return was necessary for it to attract capital to finance approximately \$58 million (Washington share) of new mains and services over the next five years.
- 57 The Staff recommended an overall rate of return of 8.43 percent based on the Company's actual capital structure at the end of calendar year 2005 and a return on equity of 9.75 percent.⁶¹ Staff recommended adjusting the return on equity downward by 25 basis points to 9.5 percent, producing a rate of return of 8.33 percent if the Commission approved decoupling.⁶²
- 58 Prior to settlement, the principle issues separating the Company and Staff were whether to (1) base cost of capital on a hypothetical capital structure or on actual capitalization, (2) include short-term debt, (3) adjust return on equity to reflect greater than average business risk or the effects of decoupling and other mechanisms that reduce risk, and (4) adjust the results of return on equity methods for flotation costs.

⁵⁹ We calculate the difference as follows: [(Company rate of return – Staff rate of return) times Company rate base] divided by the conversion factor: [(.0937-.0833)*239,332,551]/.631369.

⁶⁰ Morin, Exh. No. 161-T at 53:7-23; McArthur, Exh. No. 191-T at 2-5.

⁶¹ Parcell, Exh. No. 391-T at 37:13 – 39:2.

⁶² *Id.*, at 17:5-6; *see also* Parvinen, Exh. No. 361-T at 3:9-13, where Staff uses the 8.33 rate of return in its revenue requirement recommendation to reflect that Staff recommends a decoupling mechanism.

59 Staff and the Company do not resolve in the Settlement their disputes over capital structure, debt costs or return on equity.⁶³ Instead, in paragraph 12(a) of the Settlement Agreement, the settling parties recommend a “revenue requirement with respect to the return” of \$7,480,632 which they represent falls at the mid-point of the \$9.368 million associated with Cascade’s requested rate of return of 9.37 percent and the \$5.571 million associated with the Staff’s recommended rate of return of 8.33 percent.⁶⁴ The Company and Staff assert that this negotiated result includes the effect of an unquantifiable reduction in risk associated with the Settlement’s decoupling proposal.⁶⁵

60 Public Counsel objects to the parties’ stipulation, asserting that it is impossible to determine whether the stipulated revenue requirement produces rates that are fair, just and reasonable because the stipulation does not specify a capital structure, return on equity or overall rate of return.⁶⁶ Public Counsel asserts that it is not possible to tell whether the settlement cost of capital falls in the middle of the range advocated by Staff and the Company because the capital structure and return on equity are not identified. Public Counsel contends that failure to lay out a rate of return is “arguably fatal to the stated revenue requirement” for three reasons:⁶⁷

- 1) It does not allow the Commission to undertake a “comprehensive review of the company’s rate base and operating expenses, determining a fair rate of return, and allocating rate changes among rate payers.”⁶⁸
- 2) Without an authorized rate of return, the Commission cannot determine whether the Company is over-earning between rate cases using the Commission Basis Reports required by WAC 480-90-257.

⁶³ Staff and the Company are the only parties that filed testimony concerning the cost of capital and capital structure. *See, supra*, paragraphs 56-57.

⁶⁴ Exh. No. 2, ¶5.

⁶⁵ Cascade Initial Brief, ¶18; Staff Responsive Brief, ¶23.

⁶⁶ Public Counsel Initial Brief at 49.

⁶⁷ *Id.* at 50-51.

⁶⁸ Public Counsel cites erroneously to RCW 80.04.140 (Orders requiring joint action by two or more public service companies) for this proposition. Public Counsel also offers a citation to a 1997 telecommunication order for the quoted language. Cascade asserts in reply that the law cited and the telecommunication case involve RCW 80.36.140—telecommunication law that does not apply to natural gas or electricity companies. *See* Cascade Reply Brief, n.38.

- 3) The settlement does not adequately address a risk adjustment to rate of return to reflect a reduction in risk associated with decoupling.

61 In its Reply Brief, Public Counsel asserts that the representations of the Staff and Company regarding cost of capital and consideration of reduction in risk attributable to decoupling are unverifiable and not grounded in the record. According to Public Counsel, the Commission cannot determine that the cost of capital is “in the middle” simply by representation by the parties. Public Counsel argues that the settling parties’ claim that a risk adjustment is incorporated in the Settlement is unsubstantiated in the record, unverifiable, and provides no basis for a Commission finding. Public Counsel asserts that that it cannot support or rebut representations regarding the settling parties’ agreement because the Settlement is a “black box.” According to Public Counsel, the Commission should either set-aside Staff and Company representations regarding cost of capital or “reopen” the Settlement to ensure that it is reasonable.⁶⁹

62 We address each of these contentions in turn, having previously identified our standards for reviewing settlements.⁷⁰ First, their nature, settlements are the product of negotiation and therefore are often opaque as to some of the methods, details and calculations that produce a result on which the parties can agree. A settlement can take many forms. In some cases the Commission has determined that an agreed adjustment to revenue requirement is acceptable even if it does not identify a specific rate of return.⁷¹ In other cases, the Commission has approved settlements that include a rate of return but no detail concerning capital structure or the cost for the equity and debt components of capitalization.⁷² In still other examples, approved settlements have been explicit about all of the components of the cost of capital.⁷³ In all of these examples, it was the end result of the proposed settlement’s terms and revenue requirement that mattered, not the specific detail about how the result was achieved.

⁶⁹ Public Counsel Reply Brief at 24-25.

⁷⁰ See, *supra*, ¶¶ 22-25.

⁷¹ See *Washington Utilities and Transportation Commission v. Northwest Natural Gas Company*, Docket UG-031885, Order 04 ¶ 8 (June 23, 2004).

⁷² See *WUTC v. PacifiCorp*, Docket UE-032065, Order 06 ¶ 24.

⁷³ See *Washington Utilities and Transportation Commission v. Avista Corporation*, Dockets UE-011514 and 011595, Fourth Supplemental Order ¶ 23 (Mar. 4, 2002).

We conclude that the lack of detail concerning cost of capital in this proposed settlement does not preclude its being a fair and reasonable resolution of the case, or prevent us from performing our statutory function of setting fair, just, reasonable and sufficient rates.

63 Second, while an identified rate of return is not a necessary condition for accepting a settlement, the lack of an identified and authorized rate of return makes it more difficult for parties and the Commission to monitor a company's earnings. We strongly disagree with both Staff and the Company on this point.⁷⁴ Identifying an authorized rate of return is particularly important in circumstances, as we have here, where new regulatory mechanisms heighten concerns that a utility's earnings may exceed a reasonable rate of return. In any event, contrary to Public Counsel's arguments, we can fairly estimate a stipulated rate of return in this proceeding. Staff and the Company have made it clear in the Settlement, Narrative Statement, and in response to a Commission Bench Request, that the agreed-upon overall rate of return is 8.85 percent.⁷⁵ The 8.85 percent rate of return falls at the mid-point of the 9.37 percent rate of return originally requested by the Company and the Staff's recommended risk-adjusted 8.33 percent rate of return.

64 We find the evidence sufficient to support this provision of the settlement. We also find the stipulated rate of return provides a benchmark against which to measure any potential complaints regarding over-earning.⁷⁶ The stipulated rate of return is also a useful metric for implementing the proposed three-year pilot decoupling program we accept in principle in this Order. As we discuss further below, we require that the

⁷⁴ Staff Reply Brief at 9; Company Reply Brief at 10-12.

⁷⁵ Exh. No. 1, ¶ 12(a); Exh. No. 2, ¶5; Staff Reply Brief, ¶ 20; *see also* Staff and Cascade's Responses to Bench Request No. 4, in which they concur that: "Using the evidence set forth in the Settlement Agreement, ... the parties agreed on net income available for return before adjustments are made for the items listed in Attachment A to the Agreement. ... [The] net income for return [is estimated] to be \$20,484,254 (net income per books plus the settlement "revenue requirement of \$7,480,632 with respect to return" adjusted to net income by the conversion factor). Applying this net income to the settlement rate base of \$231,493,760 yields an overall return of 8.85 percent."

⁷⁶ For example, in *WUTC v. PacifiCorp*, Docket UE-032065, Order 06 ¶ 24, the Commission observed that the overall rate of return specified in a settlement "would establish a benchmark against which the Company's future performance can be measured." This settlement included only a rate of return with no detail on return on equity or capital structure.

Company's Conservation Plan include an "earnings cap" using the stipulated rate of return.

65 Finally, the evidence supports a finding that the stipulated rate of return includes a risk adjustment for decoupling. Both Staff and Cascade note that the settlement provides for a "revenue requirement related to return" that falls near the midpoint of what would have been produced by the rates of return advocated by Company and Staff.⁷⁷ These advocated rates of return each included an adjustment for risk reduction.⁷⁸ We concur with Cascade's assertion that the actual effect of decoupling on risk is difficult to identify and quantify.⁷⁹ While the exact adjustment is not clear, the evidence demonstrates that the stipulated rate of return includes a risk adjustment.

66 We reject Public Counsel's request to "set-aside" the Company and Staff's representations or to "reopen" the Settlement to test its reasonableness. The record supports the parties' stipulation, and our finding that the rates resulting from the settlement are fair, just, reasonable and sufficient, consistent with state law. Accepting the stipulation is also in the public interest, in that it allows the Commission to establish an overall rate of return for use as a benchmark for over-earning generally, as well as for use in implementing and evaluating the proposed pilot decoupling mechanism.

2. Decoupling Mechanism

67 Decoupling is a ratemaking and regulatory tool intended to break the link between a utility's recovery of fixed costs and a consumer's energy consumption by reducing the impact of energy consumption on a utility's recovery of its fixed costs. Conservation advocates view decoupling as an important tool to promote greater conservation efforts by the utility.

⁷⁷ Staff Initial Brief at 9-10; Exh. No. 2, ¶ 5.

⁷⁸ Staff Initial Brief at 8; Cascade Initial Brief at 27-28, citing Morin, Exh. No. 161-T at 53:13-16, 4:24-5:2; Exh. No. 175; Parcell, Exh. No. 391-T at 3:18-22; 38:13-16.

⁷⁹ Cascade Initial Brief at 28-30, citing Exh. No. 317, the Christensen Associates Energy Consulting study of the Northwest Natural Gas Company (NW Natural) decoupling mechanism approved in Oregon. The Company argues that the decoupling mechanism included in the

- 68 Under traditional ratemaking structures, utilities recover a large portion of their fixed costs through charges based on the volume of energy that consumers use. Consequently, a reduction in energy consumption may lower the probability that the utility can fully recover its fixed costs. Energy consumption may be lower for a variety of reasons. Consumers may lower their thermostats or take shorter showers. More energy efficient building codes and appliances, better and more efficient insulation, and warmer than normal weather can also reduce energy use. Conversely, an increase in energy consumption may lead to a utility over-recovering its fixed costs. These base incentives, some argue, create an environment in which utilities do not support conservation because it is inconsistent with their economic interests.
- 69 The Company, Staff and NWECA propose in paragraph 15 of the Settlement Agreement that the Company be allowed to implement a three-year pilot "partial" decoupling mechanism. Cascade would defer for future recovery revenue lost to lower than expected energy sales due to conservation and other non-weather related reasons. Staff asserts that in conjunction with the stipulation's requirement for a conservation plan, the decoupling proposal would align Cascade's ratemaking with Commission policy supporting energy efficiency.⁸⁰ Public Counsel vigorously opposes this portion of the Settlement arguing, among other things, that at best the proposed decoupling mechanism would make the Company indifferent to conservation.⁸¹
- 70 The main features of the stipulated decoupling mechanism include:⁸²
- Deferred margin⁸³ variances based on weather normalized consumption volumes. The stipulation uses the weather normalization methodology the Company proposed for use in this case.

settlement is narrower in scope than the NW Natural mechanism in Oregon and would be expected to have a smaller effect on risk. *Id.* at 28-30.

⁸⁰ Staff Initial Brief, ¶ 6.

⁸¹ Public Counsel Initial Brief, ¶¶ 7, 68-72.

⁸² See Exh. No. 1, ¶ 15(a)-(e).

⁸³ The term "margin" refers to the revenue necessary for a utility to recover its total cost of service net of purchased gas expenses and other expenses treated as "flow-through" items in rates (*e.g.*, revenue taxes, conservation program riders). See Steward, Exh. No. 421 at 3, n.1. A utility's per customer margin revenue is simply its total cost of service, as determined in the most recent general rate case, divided by the number of customers.

- Application only to rate schedules 503 and 505, i.e., residential and commercial customers. (Hence, its “partial” application).
- No adjustment made for new customers.
- If necessary due to the magnitude of the deferrals to be amortized, the Company would extend the amortization period of such deferrals to two years or more to lessen the impact on customers.
- In connection with the decoupling mechanism, the stipulation requires Cascade to undertake specific conservation activities during 2007:
 - o Within 30 days of the Commission's final order in this proceeding, Cascade must convene a conservation advisory group ("Advisory Group") of interested parties to consider the conservation potential study being performed by Stellar Processes.
 - o Within 90 days of the initial meeting of the Advisory Group, Cascade must file a Conservation and Low-Income Weatherization Plan. The Conservation Plan is to contain targets and benchmarks based upon recommendations of the Advisory Group and possible penalties and incentives.
 - o Within 30 days of Commission approval of the Conservation Plan, Cascade must issue requests for proposals to implement the Plan. Agreements with third-party contractors must include targets and benchmarks, with possible penalties and incentives, so that payment is based on delivery of energy efficiency savings.
 - o By December 31, 2007, Cascade must satisfy the Commission that the Company can meet the Plan's 2008 energy efficiency targets.
- The mechanism may only be extended as part of a general rate case, and only after a thorough evaluation of the mechanism performed by an independent consultant.

71 Promoting energy conservation is a goal that we strongly support, and provides a highly appealing rationale for decoupling on its face. Our states' laws and policies encourage us to look with favor upon proposals to stimulate increased energy conservation as well.⁸⁴ Our statutory responsibility to regulate in the public interest, however, requires us to look beyond the abstract and examine the evidence to determine whether the facts support this rationale for Cascade.⁸⁵

⁸⁴ See RCW 80.28.024, RCW 80.28.025, RCW 80.28.260.

⁸⁵ The Commission has determined that it is not desirable to take a blanket approach to decoupling. “The Commission believes that the wide variety of alternative approaches to

- 72 Like many proposed departures from traditional ratemaking structures, decoupling also has both potential advantages and disadvantages. A key disadvantage, as Public Counsel points out, is the potential shifting of risk to ratepayers.⁸⁶ Under the stipulated proposal, the risks of changes to weather-normalized consumption would shift to customers. Indeed all customers, regardless of their individual efforts to lower use, will experience a surcharge in rates should consumption by class fall below the expected level. This points us to a second potentially serious problem – the distortion of price signals and consequent dampening of customer conservation initiatives.
- 73 Balancing fixed-cost recovery on an annual basis via a surcharge or credit mechanism diminishes the value of rates as a means to send appropriate price signals to customers. Based on changing energy market conditions, price signals undoubtedly affect customer choices to conserve or not. This price signal may be weakened if customers conserve and then are faced with paying a surcharge that reduces their financial benefit. In those circumstances, decoupling actually may prove counterproductive to its laudable purpose. Just as we must be concerned that in some instances the absence of decoupling or something similar may prove a disincentive to a company promoting conservation, the implementation of decoupling, and associated surcharges, may prove a disincentive to customers who might be inclined to conserve if it is to their financial advantage.
- 74 A third potential problem, vigorously argued by Public Counsel, is the risk over time of distorting the “matching principle” through single issue ratemaking⁸⁷ Under this principle, revenues and costs are balanced at a common point in time, i.e., a rate case, to determine fair, just, reasonable and sufficient rates. If a company is largely assured recovery of fixed costs and most variable costs are routinely passed through to customers (e.g., via purchased gas adjustment mechanisms and the like), then the company has fewer reasons to file a general rate case. In this context, any cost

decoupling make it more efficient to address these issues in the context of specific utility proposals included in general rate case filings rather than through a generic rulemaking.” Rulemaking to Review Natural Gas Decoupling, Docket UG-050369, Notice of Withdrawal of Rulemaking (October 17, 2005).

⁸⁶ Public Counsel Initial Brief, ¶ 91.

⁸⁷ *Id.*, ¶¶ 22-28, 56-59.

savings achieved by the company are not shared with customers. The result risks over-earning by the company and over-paying by the customers.

- 75 Considering these concerns, we must examine carefully the stipulated proposal to determine whether the record is sufficient to prove the potential advantages from decoupling outweigh its potential disadvantages in this case.
- 76 A fundamental test in this regard is the likelihood of increased conservation as a result of implementing a decoupling program. Cascade's record of encouraging and achieving significant amounts of conservation is a concern. Currently, the Company provides incentives for high-efficiency furnaces and water heaters to residential customers, high-efficiency equipment and insulation for commercial and industrial customers, and weatherization for low-income customers. Staff observes that the commercial and low-income programs went into effect in the fall of 2005. Apparently, the Company began implementing these programs only after evaluating their feasibility in its integrated resource plan.⁸⁸
- 77 Public Counsel asserts that decoupling does not guarantee utility-sponsored conservation, but at best, makes the Company indifferent to conservation.⁸⁹ NWEC presents the countervailing view that decoupling is an important tool in shaping corporate culture over the longer term so that utilities will aggressively implement, or at least be open to implementing incremental conservation measures.⁹⁰ At this point we are uncertain what effect decoupling would have on Cascade's corporate culture. While the Company's history suggests some corporate ambivalence towards conservation, Cascade has recently taken steps to initiate some conservation programs.
- 78 We note that the stipulation requires Cascade to develop a Conservation Plan that includes targets and benchmarks, and *possible* penalties and incentives.⁹¹ Cascade has contracted with a consultant to prepare an assessment of the energy efficiency program potential in its service area in Washington. This report should provide a

⁸⁸ See Steward, Exh. No. 421-T at 19:19-20:1.

⁸⁹ Public Counsel Initial Brief, ¶¶ 7, 68-72.

⁹⁰ Weiss, Exh. No. 311-T at 7:9-11.

⁹¹ See Exh. No. 1 at 39, ¶ 15(e)(ii).

foundation for developing the Conservation Plan and savings targets.⁹² The stipulation also commits Cascade to issuing requests for proposals, or RFPs, for third-party implementation within 30 days of Commission approval of the Plan.⁹³ The inclusion of the Conservation Plan, with its mechanisms and commitments to ensure the Company delivers on the promise of conservation through real incentives and penalties, leads us to conclude that the proposed decoupling mechanism may increase company-sponsored conservation.

79 Another significant concern regarding decoupling mechanisms is the potential for so-called windfall profits. Public Counsel argues that Cascade loses a very small margin from its conservation programs – less than \$10,000 a year – and that decoupling could produce “windfall” revenues for the Company because all changes in gas usage (except weather variations) would be swept together for rate recovery.⁹⁴ Staff and NWEAC acknowledge that windfall recovery could occur after implementing a decoupling proposal.⁹⁵ NWEAC proposes several mechanisms to prevent or address such a windfall.⁹⁶ Even Cascade’s President David Stevens acknowledges that if decoupling is approved, Cascade will likely receive additional revenue without a rate case.⁹⁷ Both Cascade and NWEAC contend, however, that Public Counsel’s reference to the Company’s over-earning in Oregon is not relevant to decoupling since any over-earning occurred before decoupling was implemented for Cascade in Oregon.⁹⁸

80 The Commission favors the resolution of contested issues through settlement “when doing so is lawful and consistent with the public interest.”⁹⁹ While we find merit in the Company’s commitments for increased conservation should we allow Cascade to implement the stipulated three-year pilot, partial decoupling mechanism, we are concerned about the shift in risk that might allow the utility to receive a potential unwarranted financial windfall. This concern is not adequately addressed by the stipulation. The testimony in this case leads us to conclude that the stipulated

⁹² Steward, Exh. No. 421-T at 19:7-10.

⁹³ Cascade Initial Brief, ¶ 32.

⁹⁴ Public Counsel Initial Brief, ¶¶ 60-67, 80, 85-86, 93.

⁹⁵ Weiss, Exh. No. 311-T at 5:17-21, 12-19-21, 14:15-19, 21:11-13, 31:3-5; Steward, Exh. No. 421-T at 17:4-7; *see also* Public Counsel Initial Brief, ¶¶ 58-61, 66.

⁹⁶ Weiss, Exh. No. 311-T at 31:3 – 34:19.

⁹⁷ Stevens, TR. 223:25 – 225:17.

⁹⁸ Cascade Reply Brief, ¶¶ 18-19; NWEAC Reply Brief at 5-6.

⁹⁹ WAC 480-07-700.

decoupling proposal should include a mechanism to prevent such potential over-earning.¹⁰⁰

- 81 Therefore, we condition our full acceptance of the proposed decoupling mechanism pending review and approval of the Company's Conservation Plan. We condition our approval of the Plan under paragraph 15(e)(ii) of the Settlement on inclusion of an earnings cap based on a stipulated overall rate of return of 8.85 percent and an appropriate and verifiable mechanism to assess how the earnings would be determined and compared to the authorized rate of return. We believe including these conditions on the Settlement will provide an effective safeguard against potential over-earning, and allow us to assess its usefulness during the pilot program.
- 82 To ensure that the pilot mechanism increases the potential for increased conservation, we also condition our approval of the Conservation Plan on it definitively including penalties for the Company's failure to meet conservation targets and benchmarks, including limiting Cascade's collection of surcharges under the proposal. The Settlement provides only that "[t]he Plan shall include *possible* penalties and incentives."¹⁰¹ This is not sufficiently clear to ensure that the Company has strong incentives to achieve the targets set forth in the Conservation Plan.
- 83 We note that paragraph 15(d) of the Settlement Agreement implies that the Company may choose whether to amortize deferrals under the pilot mechanism depending on the size of the deferrals. We remind the parties that any amount the Company seeks to defer or amortize is subject to our approval. The Commission will determine whether amortization is appropriate in considering the Company's annual deferral tracking mechanism.
- 84 Finally, we require that the evaluation of the mechanism proposed in paragraph 15(c) of the Settlement be performed and submitted to the Commission regardless of whether Cascade chooses to file a general rate case after the three-year pilot period expires. The Settlement implies that the evaluation will be performed only if Cascade opts to file a general rate case to continue the program. We find that an evaluation of

¹⁰⁰ See, *supra*, nn.95-97.

¹⁰¹ See Exh. No. 1 at 39, ¶15(e)(ii) (emphasis added).

this pilot program is important to determining the value of decoupling mechanisms for regulated utilities in Washington State.

85 The settling parties should consider our conditional approval of a partial three-year pilot decoupling mechanism as an opportunity to demonstrate that decoupling mechanisms promote incremental increases in utility-sponsored conservation. We will closely scrutinize the evaluation of the mechanism. Any extension will depend upon demonstrable proof that the mechanism enhanced Cascade's conservation efforts and achievements without unduly harming the interests of customers.

E. Conditional Acceptance of the Settlement

86 Consistent with prior decisions, we note that settlements "are by nature compromises of more extreme positions that are supported by evidence and advocacy."¹⁰² Finding that "[r]atemaking is not an exact science," we accept the parties' multi-party, multi-issue Settlement Agreement, subject to our conditions, on the basis that "the overall result in terms of revenue requirement is reasonable and well supported by the evidence."¹⁰³

87 We include the following conditions on our acceptance of the Settlement Agreement:

- 1) The Company must comply within 30 days of the effective date of this Order with statutory requirements for filing tariffs and contracts governing its gas supply operations, or the proposal for prospective treatment of revenues in paragraph 12(b)(ii) of the Settlement Agreement is rejected;
- 2) The Company must strike the second sentence of paragraph 18 governing Cascade's reservation of right to make a single-issue filing similar to PSE's request for a depreciation tracking mechanism;
- 3) The parties agree to stipulate to an overall rate of return for Cascade of 8.85 percent for purposes of calculating the Company's cost of capital under paragraph 12(a) of the Settlement Agreement;

¹⁰² *WUTC v. PacifiCorp*, Docket UE-032065, Order 06 ¶ 61.

¹⁰³ *Id.*, ¶ 62.

- 4) The parties to the Advisory Group must agree to include in the Conservation Plan contemplated in paragraph 15(e) of the Settlement an earnings cap based on the stipulated overall rate of return, a verifiable mechanism to assess whether earnings are within the rate of return, and penalties for the Company's failure to meet targets and benchmarks; and
- 5) The Company must conduct an evaluation of the pilot decoupling proposal regardless of whether it seeks to continue the program pursuant to paragraph 15(c) of the Settlement after the three-year pilot period expires.

88 These conditions do not alter the ability of Cascade to recover necessary revenues, or the rates or charges resulting from the Settlement Agreement. The conditions impose safeguards, primarily upon the implementation and evaluation of the three-year pilot decoupling mechanism that we accept in principle in this Order. Should the parties accept the conditions, we determine that Cascade should be authorized and required to file rates in compliance with our decisions. When implemented via the compliance filing we require the Company to make, we find that the resulting rates will be fair, just, reasonable and sufficient, and neither unduly discriminatory nor preferential.

FINDINGS OF FACT

89 Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated findings and conclusions upon issues in dispute among the parties and the reasons therefore, the Commission now makes and enters the following summary findings of fact, incorporating by reference pertinent portions of the preceding detailed findings:

- 90 (1) The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate rates, rules, regulations, practices, and accounts of public service companies, including gas companies.

- 91 (2) Cascade Natural Gas Corporation is a “public service company” and a “gas company,” as those terms are defined in RCW 80.04.010, and as those terms otherwise are used in RCW Title 80. Cascade is engaged in Washington State in the business of supplying utility services and natural gas to the public for compensation.
- 92 (3) Cascade filed revisions to its tariffs on February 14, 2006, requesting an increase in annual revenues from Washington operations of \$11.7 million, or about 4.5 percent. The Commission suspended the proposed tariff revisions on March 15, 2006.
- 93 (4) After the parties filed testimony addressing the contested issues in this proceeding, the parties entered into a multi-party, multi-issue Settlement Agreement addressing all contested issues, and providing for an increase in revenue requirement of \$7,061,536, which would result in an overall 2.7 percent increase relative to current rates. The Settlement Agreement is attached to this Order as Appendix A.
- 94 (5) Public Counsel contests the provisions in the Settlement Agreement concerning the resolution of the Company’s cost-of capital and a proposal for a “partial” pilot decoupling program.
- 95 (6) The Company and Staff agree that an overall rate of return for the Company of 8.85 percent can be fairly estimated from the terms of the Settlement Agreement and the record evidence.
- 96 (7) The stipulated overall rate of return falls near the midpoint of what would have been produced by the rates of return advocated by Staff and the Company.
- 97 (8) The rates of return advocated by Staff and the Company each included an adjustment for risk-reduction assuming Commission approval of a decoupling mechanism.

- 98 (9) The stipulated decoupling program, with the inclusion of the Conservation Plan and its mechanisms and commitments to ensure the Company delivers on the promise of conservation through real incentives and penalties, has merit and may increase Company conservation.
- 99 (10) The stipulated decoupling mechanism does not adequately address the possibility that the resulting shift in risk might allow the utility to receive a potential unwarranted financial windfall.
- 100 (11) Conditioning approval of the Company's Conservation Plan on including an earnings cap based on a stipulated overall rate of return of 8.85 percent and an appropriate and verifiable assessment mechanism will provide an effective safeguard against potential over-earning, and allow the Commission to assess its usefulness during the pilot program.
- 101 (12) An evaluation of the pilot, partial decoupling program, regardless of whether the Company seeks to continue the program after the three-year pilot period expires is important to determining the value of decoupling mechanisms for regulated utilities in Washington State.

CONCLUSIONS OF LAW

- 102 Having discussed above all matters material to this decision, and having stated detailed findings, conclusions, and the reasons therefore, the Commission now makes the following summary conclusions of law incorporating by reference pertinent portions of the preceding detailed conclusions:
- 103 (1) The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of, and parties to, this proceeding. *RCW Title 80.*
- 104 (2) The rates proposed in the tariff revisions filed by Cascade and suspended by prior Commission order, were not shown to be fair, just or reasonable and should be rejected. *RCW 80.28.010.*

- 105 (3) Cascade’s existing rates for natural gas service provided in Washington State are insufficient to yield reasonable compensation for the service rendered. *RCW 80.28.010; RCW 80.28.020.*
- 106 (4) Cascade requires relief with respect to the rates it charges for natural gas service provided in Washington State. *RCW 80.01.040; RCW 80.28.060.*
- 107 (5) The Commission must determine the fair, just, reasonable, and sufficient rates to be observed and in force under Cascade’s tariffs that govern its rates, terms, and conditions of service for providing natural gas to customers in Washington State. *RCW 80.28.020.*
- 108 (6) The Commission may approve settlements “when doing so is lawful, when the settlement terms are supported by an appropriate record, and when the result is consistent with the public interest in light of all the information available to the commission.” *WAC 480-07-750(1).*
- 109 (7) The uncontested provisions of the Settlement Agreement reasonably resolve contested issues in this case, are supported by evidence in the record and are consistent with the law and the public interest.
- 110 (8) The Settlement Agreement, as modified by the conditions we set in this Order, is supported by the record, and is consistent with the law and public interest.
- 111 (9) It would be inequitable to deny appropriate ratemaking treatment to gas supply services the Commission allowed Cascade to pursue without a tariff on file.
- 112 (10) Cascade should be authorized and required to make a compliance filing to recover its revenue deficiency of \$ 7,061,536 for natural gas service, as discussed in this Order. *WAC 480-07-880(1).*
- 113 (11) The rates, terms, and conditions of service that will result from this Order are fair, just, reasonable, and sufficient. *RCW 80.28.010; RCW 80.28.020.*

- 114 (12) The rates, terms, and conditions of service that will result from this Order are neither unduly preferential nor discriminatory. *RCW 80.28.020.*
- 115 (13) The Commission Secretary should be authorized to accept by letter, with copies to all parties to this proceeding, a filing that complies with the requirements of this Order. *WAC 480-07-170; WAC 480-07-880.*
- 116 (14) The Commission should retain jurisdiction over the subject matters and the parties to this proceeding to effectuate the terms of this Order. *RCW Title 80.*

ORDER

THE COMMISSION ORDERS:

- 117 (1) The proposed tariff revisions Cascade Natural Gas Corporation filed on February 14, 2006, which were suspended by prior Commission order, are rejected.
- 118 (2) The multi-party Settlement Agreement filed in this proceeding on October 11, 2006, which is attached to this Order as Appendix A and incorporated by reference as if set forth in full in the body of this Order, is accepted subject to the conditions set forth in paragraph 87 of this Order.
- 119 (3) If the parties accept the conditions on the Settlement Agreement set forth in this Order, Cascade Natural Gas Corporation is authorized and required to file tariff sheets following the effective date of this Order that are necessary and sufficient to effectuate its terms.

- 120 (4) The Commission Secretary is authorized to accept by letter, with copies to all parties to this proceeding, a filing that complies with the requirements of this Order.
- 121 (5) The Commission retains jurisdiction to effectuate the terms of this Order.

Dated at Olympia, Washington, and effective January 12, 2007.

WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

MARK H. SIDRAN, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner

NOTICE TO PARTIES: This is a final order of the Commission. Any stipulating party may within 10 days reject the conditions proposed in this order, pursuant to WAC 480-07-750(2), in which case this order will become void and the matter set for hearing. If this order is not voided by rejection of the conditions, judicial review may be available. Administrative relief from the terms of this order may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 or RCW 81.04.200 and WAC 480-07-870.

APPENDIX A
Settlement Agreement

GLOSSARY