EXHIBIT NO. _____ (RCC-7T)
DOCKET NO. UE-120436, et al.
2012 AVISTA CORPORATION GENERAL RATE CASE
WITNESS: RALPH C. CAVANAGH

BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION

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<tr><td>WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

vs.

AVISTA CORPORATION d/b/a AVISTA
UTILITIES,

Respondent.</td><td>DOCKET NOS. UE-120436, et al.
(Consolidated)</td></tr>
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REBUTTAL TESTIMONY (NON-CONFIDENTIAL) OF

RALPH C. CAVANAGH

ON BEHALF OF NW ENERGY COALITION

September 19, 2012

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Q. Please state your name and business address.

A. Ralph Cavanagh, c/o NRDC, 111 Sutter Street, 20th Floor, San Francisco, California 94104.

Q. Are you still testifying for the NW Energy Coalition?

A. Yes.

Q. Have there been any changes in the qualifications you reported in your direct testimony?

A. No.

I. SUMMARY OF TESTIMONY

Q. Why are you filing testimony in this proceeding?

A. I am responding to other parties' comments on the NW Energy Coalition's ("Coalition" or "NWEC") initial revenue decoupling proposal for Avista, which appears in my November 3, 2011 testimony in Dockets No. UE-110876/UG-110877. By order of the Washington Utilities and Transportation Commission ("WUTC" or "Commission"), these issues have been carried over to the current docket. I also address the Commission's discussion of a very similar proposal that the Coalition filed in the most recent Puget Sound Energy ("PSE") rate case, which underscores my conclusion that the Coalition's original Avista decoupling proposal is in the public interest and should be adopted.

Q. Please summarize your testimony.

A. Many of the objections to the Coalition's decoupling proposal resurrect other parties' longstanding opposition to full decoupling, and are not responsive to the findings and analysis of the Commission's November 2010 Policy Statement or its subsequent analysis of full decoupling in the PSE rate case. For example, Public Counsel's testimony to the contrary notwithstanding,[1] the Commission clearly has considered and rejected the proposition that the mere existence of Initiative 937's energy efficiency mandate preempts the case for full decoupling, and the Commission has confirmed that the Coalition's very similar revenue decoupling proposal for PSE "is consistent in intent and general design" with the Policy Statement itself.[2] Other objections rest on apparent misunderstandings, such as Staff's contention that the Coalition proposal "fails to net increased wholesale sales due to conservation in the true-up",[3] and that "it does not describe the incremental conservation the Company should pursue."[4] Public Counsel incorrectly claims that the proposal includes no earnings test,[5] "is limited to a select group of customers,"[6] and was "brought forward subsequently" following the settlement of a general rate case.[7] In fact, however, the Coalition's testimony does address wholesale transactions, incremental conservation and an earnings test. It also applies to virtually all Avista customers, and it originated prior to the settlement of Avista's last general rate case in response to a Notice of Bench Request inviting intervenors to provide the Commission with full decoupling proposals.

In previously filed testimony, Avista makes a number of constructive suggestions on implementing revenue decoupling, with which I am largely in agreement, although modest

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[1] Exhibit No. ___ (DED-1T), p. 6:5-18.

[2] See my Direct Testimony, Exhibit No. ___ (RCC-1T), at p. 7:17-21 (noting that the Policy Statement itself quotes the relevant section of I-937 before declaring the Commission's receptiveness to "applying a well-designed full decoupling mechanism for either electric or gas utilities"); WUTC, Order 08, Dockets UE-111048 and UG-111049 (May 7, 2012), p. 167, paragraph 455 (commenting on the Coalition's proposal).

[3] Exhibit No. ___ (DJR-1T), p. 6:4.

[4] Id., p. 6:2-3.

[5] Exhibit No.___ (DED-1T), p. 25:16-18.

[6] Id., p. 40:18.

[7] Id., p. 25: n.29.

differences remain on the issues of how to conduct evaluations, whether to aggregate rate classes for purposes of true-ups and whether to exclude the large industrial class from the mechanism.

Staff, Public Counsel, and ICNU all reaffirm their well-established view that the Commission should include in any revenue decoupling order a downward reduction in Avista's authorized return on equity ("ROE"). I respond with renewed emphasis on the Coalition's balanced approach to cost of capital issues, which follows the recommendation of the Regulatory Assistance Project not to link approval of revenue decoupling to a targeted ROE reduction,[8] while also ensuring that any cost reductions associated with changes in utilities' capital structure (regardless of source) are passed through to customers.

II. CONSISTENCY WITH THE COMMISSION'S POLICY STATEMENT

Q. Does the Coalition's decoupling proposal comply with the Commission's Report and Policy Statement on Regulatory Mechanisms, Including Decoupling, to Encourage Utilities to Meet or Exceed Their Conservation Targets?

A. Yes, even though by its terms the Commission's requirements for a full decoupling proposal apply only to "*[a] utility's* request for a full decoupling mechanism,"[9] and the Commission recently reaffirmed that it is open to proposals that "may vary somewhat" from those described in its Policy Statement.[10] The Commission identified three features in the Coalition's revenue decoupling proposal for PSE that it deemed "inconsistent with the guidance

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[8] Staff acknowledges (Exhibit No. ___ (DJR-1T), p.13:1-2) that "RAP suggests against lowering the cost of equity at the time a decoupling mechanism is adopted."

[9] WUTC, Report and Policy Statement on Regulatory Mechanisms, Including Decoupling, to Encourage Utilities to Meet or Exceed Their Conservation Targets, Docket U-100522 (November 2010), p. 17, paragraph 28.

[10] The Commission's recent PSE order (note 2 above) reaffirms in note 617, p. 167 that "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."

offered by the Policy Statement": these were the lack of an earnings test, the lack of a "per class" approach to authorized revenue recovery, and the failure to analyze "a potential reduction in ROE."[11] The Commission "commend[ed] NWEC for its proposal" and found it otherwise "consistent in intent and general design" with the Policy Statement.[12]

My direct testimony includes a specific recommendation for an earnings test and an analysis rejecting a prospective reduction in ROE (including a citation to two comprehensive empirical studies and a recent review of the issue by another Western Commission).[13] Although my Avista testimony (like its PSE counterpart) recommends a per-customer rather than per-class approach to decoupling, I note in section V below that the Policy Statement includes no specific criticism of the per-customer approach, and I explain why it is appropriate here.

III. STAFF'S TESTIMONY

Q. Respond to Staff's contention that the Coalition's proposal "is not appropriately applied to all customer classes."[14]

A. The Coalition's proposal excludes only the Extra Large General Schedule 25 class, "because it has so few members (22) and accounts for a relatively small fraction of the

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[11] Order 08, note 2 above, p. 164, n.605.

[12] Id. at p. 166 (commendation) and 167 (consistency).

[13] See Exhibit No. ___ (RCC-1T), p. 12:1-3 (earnings test); pp. 16-17 (ROE impact evaluation, including citations to the two studies and to the conclusions from the Arizona Commission's recent assessment of this issue); pp. 10-11 (treatment of customer classes). With regard to the Brattle Group study upon which I rely in part for my ROE recommendation, ICNU witness Dean incorrectly asserts (Exhibit No. ___ (MCD-1T), p. 13:10-12) that the study involved only utilities receiving compensation for "conservation-specific losses"; as its title indicates, it is in fact a comprehensive assessment of the impact of full revenue decoupling on the cost of capital for natural gas distribution utilities. The Brattle Group, The Impact of Decoupling on the Cost of Capital: An Empirical Investigation (Mar. 2011) (attached as Exhibit No. ___ (RCC-8)).

[14] Unless otherwise indicated, Staff contentions addressed in this section appear in Exhibit No. ___ (DJR-1T), pp. 5-6.

fixed cost revenue requirement that Avista recovers through its energy sales."[15] The Commission's Policy Statement explicitly allows for exclusions of this kind, "where in the public interest and not unlawfully discriminatory or preferential."[16]

Q. Respond to Staff's contention that the Coalition's proposal "makes no reduction to cost of capital."

A. My testimony is consistent with the Commission's Policy Statement in recommending that "the company should pass through to customers any cost savings associated with changes in [the utility's] capital structure following adoption of the decoupling mechanism."[17]

Q. Respond to Staff's contention that the Coalition's proposal "does not identify comparable conservation benefits for low income customers."

A. I disagree. My testimony addresses low-income customers' interests, and endorses a proposal (also supported by Avista and other parties) to "target energy efficiency services and payments specifically to low-income customers . . . and to increase efforts to reach more customers who qualify for those programs."[18] Additional background on Avista's low-income programs appears in Mr. Ehrbar's testimony, in support of the contention that "the Company's conservation programs do provide benefits to limited-income ratepayers that are comparable to other ratepayers."[19]

It bears emphasis also that, in a response to the Bench Request in the Puget Sound

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[15] Exhibit No. ___ (RCC-1T), p. 10:3-6.

[16] Policy Statement, p. 18, item 1.

[17] Exhibit No. ___ (RCC-1T), p. 16:3-7.

[18] Id., pp. 14-15.

[19] Exhibit No. ___ (PDE-9T), pp. 26-27.

Energy general rate case, Staff itself acknowledges "difficulty applying the criterion described in the Decoupling Policy Statement because it is not clear whether the Company could comply with this criterion by showing that the design of the Company's low-income programs provides an opportunity for 'roughly comparable' access to conservation programs for customers across the economic spectrum."[20] While I agree with Staff that that analysis of "comparability" is challenging in this context, I remain of the view that it is wholly appropriate to encourage expansion of conservation program offerings to low-income customers to ensure greater customer participation and energy savings.

Q. Respond to Staff's contention that the Coalition's proposal "does not describe the incremental conservation the Company should pursue."

A. The Commission's Policy Statement refers not to "the incremental conservation the Company should pursue," but instead to "incremental conservation that the company intends to pursue in conjunction with the mechanism."[21] Only the company can speak to that issue, but my testimony does address "the potential for incremental conservation" and notes specifically that "Avista's average electricity use per residential customer has barely budged since 2000 and actually increased in 2009 and 2010."[22]

Q. Do you agree with Staff's statements that the Coalition's proposal "does not appropriately analyze the impact of conservation on Avista" and "fails to net increased wholesale sales due to conservation in the true-up?"

A. No. Staff believes that I overstate the impact of conservation on Avista's finances, because I assume that conservation reduces recovery of non-fuel costs associated with

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[20] See Staff Response to Bench Request, 12-7-11, UE-111048/UG-111049, p. 15.

[21] Policy Statement, p. 18, item 3 ("Incremental Conservation").

[22] See Exhibit No. ___ (RCC-1T), p. 7:7-9.

generation and transmission as well as distribution, even though in Staff's opinion "Avista would be able to sell the unused power in the wholesale market, thus recovering much or all of this cost twice: once through the decoupling mechanism, and once from wholesale customers." Of course, Staff's testimony also concedes that "[in] the current low natural gas price environment, Avista would probably not recover all of its power supply costs through wholesale sales."[23] But my reasons for disagreeing go deeper.

I do not think that there is any distinction, for purposes of Avista's financial health, between a dollar of non-fuel costs associated with distribution, transmission or generation. When any such dollars go unrecovered because of reductions in retail sales, the company is harmed financially. Staff is right that off-system sales could make up all or part of that difference, but both my and Avista's testimony agree that "Avista's Energy Recovery Mechanism ("ERM") already responds to this concern; it is designed to net revenues from off-system power sales against production costs incurred by the company to generate those sales . . . the ERM is designed to transfer to customers any margin on wholesale transactions in excess of the company's generation and transmission costs."[24]

Q. But Staff points out that "Avista's Energy Recovery Mechanism has a dead band and sharing bands"; doesn't that prevent a full transfer back to customers of margins on wholesale transactions?

A. Conceivably, but it also of course ensures that customers do not face all the potential risks and losses associated with those wholesale transactions (which take on special relevance in light of recent adverse market conditions, as Staff's testimony recognizes). I addressed this issue specifically in my testimony, in a section to which Staff does not respond:

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[23] See Exhibit No. ___ (DJR-1T), pp. 7-8 & n.12.

[24] See Exhibit No. ___ (RCC-1T), p. 12:7-13 and Exhibit No. ___ (PDE-9T), p. 32:1-9.

"The deadband presumably reflects a judgment by the Commission that the Company and its customers should share risks associated with wholesale transactions up to a certain level; if the Commission wants to revisit that balance I would have no objection, but I don't think that retail revenue decoupling is relevant to the appropriate sharing of risks associated with wholesale power transactions."[25] That conclusion is underscored by the fact that—as the Staff testimony itself suggests—variations in wholesale electricity prices primarily reflect regional factors independent of changes in retail load related to energy efficiency, such as the price of natural gas for thermal generation, the level of hydroelectric generation (driven by snowpack and runoff), and the recent addition of significant wind generation with variable output patterns.

Q. How do you respond to Staff's objection that "NWEC's proposal does not condition [revenue per customer] recovery on [Avista's] conservation achievement?"[26]

A. The Commission's Policy Statement declares that "[r]evenue recovery by the company under the mechanism will be conditioned upon a utility's level of achievement with respect to its conservation target."[27] This puts utilities and all other parties on notice that the Commission expects utilities with revenue decoupling mechanisms to meet or exceed their conservation targets, and I am in full accord.

IV. AVISTA'S TESTIMONY

Q. Respond to Avista witness Patrick Ehrbar's perspective on revenue decoupling.

A. I agree with Mr. Ehrbar on the substantial financial penalty associated with reductions in Avista's electricity sales as a result of lost margins (absent decoupling), and I

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[25] Exhibit No. ___ (RCC-1T), pp. 12-13.

[26] Exhibit No. ___ (DJR-1T), p. 14:5.

[27] Policy Statement, p. 17, paragraph 28.

certainly share his concern about the company now being in the position of needing increased retail electricity sales to meet its financial goals. I also concur that any decoupling mechanism should proceed in conjunction with an authorized non-fuel revenue requirement reflecting the utility's costs of service (if the authorized revenue requirement is set below those costs, decoupling by itself will do nothing to fill the gap). Finally, although I do not understand him to be advocating this (any more than I would), I agree with Mr. Ehrbar that "a rate design which allowed for the full recovery of fixed costs in the fixed monthly charge" would require residential customers to pay almost $50 per month in fixed charges.[28] This underscores my preference for revenue decoupling as the clearly preferred way to break the linkage between Avista's financial health and its retail utility sales.

Q. Respond to Avista's comments on and recommended modifications to the Coalition's decoupling proposal.

A. Mr. Ehrbar's constructive and specific recommendations begin with a detailed proposal fleshing out "the specific mechanics of the mechanism," which I support.[29] I agree with him that "the actual level of kWhs in the rate period [should] not be adjusted or normalized for the effects of weather," for reasons explained in my testimony.[30] I concur that Schedules 41-48 do not need to be included in the mechanism, because they "are billed on a flat monthly rate" and consequently do not contribute through variable charges to Avista's nonfuel revenue recovery.[31] Mr. Ehrbar and I are in accord on earnings test implementation, annual rate increase limits, accounting for off-system sales, and the program's initial duration (at least five years). We both

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[28] Exhibit No. ___ (PDE-9T), p. 13:13-15.

[29] Id., pp. 14-23.

[30] Compare id., p. 21:8-21 with Exhibit No. ___ (RCC-1T), p. 11:5-9.

[31] Exhibit No. ___ (PDE-9T), p. 24:25-29.

conclude that "[t]he adoption of decoupling would not result in a reduction of efforts by the Company to operate efficiently."[32] Mr. Ehrbar objects to my proposed allocation of decoupling adjustments to baseline and tailblock rates for residential customers, although my testimony includes an alternative that we both support: "simply to spread rate true-ups equally across all residential kWh sales."[33]

Q. Do any significant disagreements remain between you and Mr. Ehrbar on the appropriate structure of a decoupling mechanism?

A. The short answer is no, although three relatively modest areas of disagreement bear mention. Unlike me, Mr. Ehrbar would include the 22 members of Extra Large General Schedule 25 in the mechanism, and he would dispense with my recommended independent evaluation, on the ground that any party retains the right to commission its own evaluation.[34] He also disagrees with my proposal to average decoupling adjustments across all classes, because he thinks that "averag[ing] the adjustment could result in cross-rate-schedule subsidization."[35] My response is that any short-term (and necessarily modest) cross-rate-schedule transfers should balance out over time, and that the downside of the Avista proposal is larger annual rate fluctuations for each class (subject of course to the 3% limit) and greater likelihood of unrecovered balances that could accumulate over time. I would not withdraw my support of the mechanism if the Commission adopted Avista's position on per-class adjustments and inclusion of Schedule 25, and I reaffirm my view that an independent evaluation is needed to look at a

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[32] Id. at p. 28:22.

[33] Compare Exhibit No. ___ (RCC-1T), p. 15:9-10 with Exhibit No. ___ (PDE-9T), p. 28:1-6.

[34] Id., pp. 24:25-29 (scope of mechanism) & 28:13-17 (evaluation). The Commission's Policy Statement (p. 19, item 6) indicates that "the Commission may require the utility to file periodic reports so the Commission may evaluate the success and impact of the program."

[35] Exhibit No. ___ (PDE-9T), p. 22:11-13.

number of issues, including the impact on low-income customers, along with "annual reports on rate impacts and energy efficiency progress, available to all interested parties."[36]

V. OTHER INTERVENORS

Q. Public Counsel and ICNU renew in their testimony long-standing objections to revenue decoupling; what is your response?

A. Most of the issues they raise are addressed either in my Direct Testimony or in earlier sections of this testimony. These parties and their two witnesses obviously are doctrinaire decoupling opponents; Mr. Dismukes even goes so far as to "particularly disagree with the assertion that utilities are discouraged from investing in energy efficiency," and to reargue weather normalization issues that should have been put to rest by the Commission's support for "including the effects of weather in a full decoupling proposal."[37] Michael Deen introduces the novel claim that "an overwhelming majority of Commissions approving full decoupling for electric utilities have made downward ROE adjustments,"[38] but his supporting Exhibit addresses only 16 mechanisms, and of those only the ones from Maryland and the District of Columbia turn out to have involved prospective ROE adjustments of more than ten basis points tied specifically to revenue decoupling.[39] In thirty years of experience throughout the Western United States with revenue decoupling for electric utilities, I have seen Commissions adopt a grand total of one prospective ROE adjustment when adopting a mechanism: a reduction of ten

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[36] Exhibit No. ___ (RCC-1T), p. 15:18-19.

[37] Compare Exhibit No. ___ (DED-1T), p. 6 (conservation disincentives) & pp. 26-30 (extended argument about weather effects) with Policy Statement at p. 18, item 2 (addressing weather effects in the context of full decoupling).

[38] Exhibit No. ___ (MCD-1T), p. 13:4-6.

[39] Id., Exhibit No. ___ (MCD-3). The three outliers involve PEPCO and BGE adjustments of 50 basis points, imposed by the Maryland and DC Commissions. The other ROE reductions cited by Mr. Deen are either trivial (10 basis points) or not linked specifically to a full decoupling mechanism.

basis points for PGE in Oregon, to which the company explicitly agreed in advance.[40]

Messrs. Dismukes and Deen do raise one relatively new issue that also figures in a footnote of the Commission's PSE decision: the Commission says there that its Policy Statement "favors" a "per class" rather than "per customer" approach to setting the non-fuel revenue requirements used in revenue decoupling,[41] and both the ICNU and Public Counsel testimony criticize the Coalition for preferring a per customer approach. As my Direct Testimony indicates, Washington's experience with per-customer decoupling dates back to 1991,[42] and the principal advantage of the approach lies in its simplicity: between rate cases, the authorized non-fuel revenue requirement adjusts in proportion to easily verified changes in the utility's customer count.[43] The alternative is to find a more complex (and inevitably contested) formula that bases annual changes in the authorized non-fuel revenue requirement on an index or indices of economic activity and/or inflation. In Pamela Morgan Lesh's comprehensive survey of revenue decoupling mechanisms, revenue-per-customer approaches led index-based mechanisms nationwide by a factor of more than three to one (26-8), while only four of the forty mechanisms she reviewed adopted Mr. Deen's preferred approach, which would freeze the authorized per-class revenue requirement between rate cases (despite the likelihood that costs would increase over that time).[44] Obviously such an approach would meet with fierce and understandable

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[40] This case is cited in Mr. Deen's Exhibit No. ___ (MCD-3), p. 2.

[41] Order 08, note 2 above, n.605 (although in n.617 the Commission goes on to say that it "remains open" to a full decoupling mechanism that "may vary somewhat from what is described in our policy statement.")

[42] Exhibit No. ___ (RCC-1T), p. 2:21-22.

[43] For a detailed explanation of how this would work, <u>see</u> Mr. Ehrbar's Exhibit No. ___ (PDE-9T), pp. 14-15.

[44] Pamela Lesh, Rate Impacts and Key Design Elements of Gas and Electric Decoupling: A Comprehensive Review, Electricity Journal (Oct. 2009), p. 70 (attached as Exhibit ___ (RCC-9)).

opposition from Avista, since status quo regulation allows non-fuel revenue recovery to grow between rate cases in direct proportion to increases in electricity use. For all these reasons, I reaffirm my support for a per-customer methodology, even as I note that the Commission included no specific criticism of such a methodology in its Policy Statement, and recently affirmed that it is "open to" a decoupling proposal that "may vary somewhat from what is described" in that statement.[45]

Q. Does this conclude your testimony?

A. Yes.

[45] Order 08, note 2 above, p. 167, n. 617. Setting authorized revenue recovery on a "per class" basis (instead of per customer) is of course not the same as allocating annual decoupling-related rate adjustments by class; see text at note 33 above.