Exh. KTW-4Tr
Docket UG-181053

Witnesses: Kyle T. Walker

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. NORTHWEST NATURAL GAS CORPORATION, Respondent.	DOCKET UG-181053

NORTHWEST NATURAL GAS COMPANY

Rebuttal Testimony of Kyle T. Walker

*IN SUPPORT OF
PARTIAL MULTI-PARTY SETTLEMENT AGREEMENT ON DECOUPLING*

July 18, 2019

Revised August 13, 2019

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I. INTRODUCTION

Q. Are you the same Kyle Walker that provided direct testimony on behalf of NW Natural in this case?

A. Yes.

Q. Did you also provide testimony in support of the Partial Multi-Party Settlement Agreement on Decoupling ("Decoupling Agreement") filed on May 23, 2019?

A. Yes, I contributed to the multiparty joint testimony in support of the Decoupling Agreement, which was filed on June 6, 2019.

Q. Please describe your background and qualifications.

A. I describe my educational background and professional experience in Exhibit KTW-1T at 2 and Exhibit JT-3T at 2, as part of the multiparty joint testimony.

Q. What is the purpose of this Rebuttal Testimony?

A. This Rebuttal Testimony ("Rebuttal Testimony") addresses the Response Testimony of Scott J. Rubin ("Response Testimony") on behalf of Public Counsel Unit of the Washington Office of Attorney General ("Public Counsel"), filed on July 3, 2019. Public Counsel's Response Testimony addresses and critiques the Decoupling Agreement filed on May 23, 2019, in this proceeding among Northwest Natural Gas Company d/b/a NW Natural ("NW Natural" or the "Company"), Staff of the Washington Utilities and Transportation Commission ("Staff"), the Alliance of Western Energy Consumers ("AWEC"), and The Energy Project ("TEP") (individually, "Party"; collectively, "Parties"). The purpose of this Rebuttal Testimony is to reply to the arguments raised by Public Counsel in its Response

Testimony and to support the Decoupling Agreement, and request that the Washington Utilities and Transportation Commission ("Commission" or "WUTC") approve the Decoupling Agreement in its entirety and without condition.

Q. Mr. Walker, please provide a brief summary of your Rebuttal Testimony.

A. I address Public Counsel's testimony, highlighting the following points:

- NW Natural's proposed revenue decoupling mechanism is appropriate even with forecasted customer growth due to the incremental cost of adding new customers exceeding the revenues received from those customers;
- Public Counsel's assumptions about the cost to connect new customers are erroneous and the Commission should instead rely on NW Natural's calculation of the average cost to serve new customers;
- Public Counsel's claim that the Company would receive a "windfall" of $12 million over six years under the revenue-per-customer approach is incorrect, and instead adding new customers will in fact cause a revenue deficiency of $5.6 million over that same time period;
- Public Counsel's proposal for rate class decoupling would result in a revenue deficiency of $27.7 million;
- Public Counsel's argument that revenue-per-customer decoupling will result in intra-class cost shifting between new customers and existing customers is a red herring, because arguably there would also be some degree of cost-shifting that would occur among existing customers as certain customers choose conservation measures and others do not, and in any event, the amount of cost shifting that would occur is minimal; and

- The Decoupling Agreement is in the public interest and the Commission should adopt it in its entirety.

II. THE REVENUE-PER-CUSTOMER APPROACH IS APPROPRIATE FOR NW NATURAL

Q. What is Public Counsel's primary criticism of the Decoupling Agreement?

A. Public Counsel's primary criticism of the Decoupling Agreement relates to the use of a revenue-per-customer approach, which Public Counsel claims is inappropriate in this case because the Company expects a period of significant growth for the next six years. Specifically, Public Counsel argues that the incremental revenue per customer will substantially offset the costs to connect new customers, and as a result, the use of the revenue-per-customer approach during a period of significant growth for the Company will result in a "windfall" for the Company of approximately $12 million dollars.

Q. How do you respond to Public Counsel's claim that the Company will receive a "windfall?"

A. The Company will not receive a "windfall." While the Company is forecasting growth in the next few years, Public Counsel grossly understates the cost to serve new customers. As a result, Public Counsel's claim that the Company will experience a significant "windfall" is simply untrue. In fact, the Company expects that it will instead experience a revenue shortfall of $5.6 million based on the projected customer additions over the next six years.[1]

A. Overview of the Revenue-Per-Customer Approach

Q. What is the revenue-per-customer approach to decoupling?

A. The revenue-per-customer approach proposed in the Decoupling Agreement will provide a baseline, or set amount, of revenue to be collected from each applicable customer. The approach will decouple base revenue, or margin revenue, derived from the volumetric base rate portion of each applicable rate schedule. The mechanism would not factor in the monthly Customer Charge, temporary rate adjustments, any amortizations built into the permanent (base) rate, or cost of gas revenue. Although some items are not factored into the decoupling mechanism approach, the Company would disclose the actual revenue and remove the items described above to reach margin revenue for better transparency to all stakeholders.

Q. Why did NW Natural propose to use the revenue-per-customer approach?

A. The Company proposed a revenue-per-customer approach because it has been well-documented, analyzed and proven from other Washington gas utilities. Additionally, the revenue-per-customer approach is consistent with the Commission's policy goal of eliminating the throughput incentive, aligning NW Natural with conservation efforts, and protecting customers and the Company from volatility in usage.

[1] See Exh. KTW-5.

B. NW Natural's Expected Customer Growth and Cost to Serve New Customers

Customer Growth

Q. Public Counsel comments that the Company's data provided in response to Public Counsel's Data Request ("DR") 203 forecasts adding more than 20,000 residential customers over the next six years, increasing customer base by more than 25 percent.[2] Do you agree with Public Counsel's comments about customer growth?

A. Yes, the forecasted customer counts and overall growth are consistent with Company projections. The Company expects to see three to four percent customer growth each year in the next six years.

NW Natural's Approach to Calculating the Cost to Serve New Customers

Q. Please explain how NW Natural calculated the capital cost to connect customers.

A. The Company tracks all new residential customer additions by both count and dollars spent to connect those customers. It classifies capital costs in three general buckets: main extensions, new service, and conversion service. To determine the cost per customer, the Company adds all costs associated with these three buckets and reduces the amount by customer contributions.[3] It then divides the cost by total number of newly added meter sets (i.e., customer counts) to get a total construction cost per customer without overhead. The Company's estimated overhead charge is

[2] Exh. SJR-1T at 18.

[3] Customer contributions are the amount of money customers pay to receive gas service. This amount would be the total construction cost to serve less the amount allowed per customer as provided under Schedule E of the Company's tariff.

38 percent, so it then grosses up the total construction cost per customer by the overhead amount to get the total capital cost per new meter set.

Q. What is NW Natural's calculation of the cost to serve a new customer?

A. Taking all of the costs I just described into account, the cost to serve a new customer is $508 for the first year the customer is in service. This estimate includes $3,507 in invested capital to install the service.[4] Because the capital asset placed into service is expected to last many years, the capital portion is depreciated over time. The first year of depreciation expense, among other items, is included within the $508 total cost in year one. Please see Exhibit KTW-6 and the Company's revised response to WUTC DR 202, attached as Exhibit KTW-7, for the Company's estimated cost to serve a new customer.

Q. You mention depreciation expense, among other items, are included in your $508 cost of service. What other items are included?

A. We included incremental O&M, as described in WUTC DR 204 and in Exh. KTW-8, property tax on capital, federal income taxes and revenue sensitive items (e.g., franchise fees and regulatory commission fees).

Q. Are there other costs that may be incurred to serve new customers that are *not* reflected in your estimate?

A. Yes. I believe our estimate of the cost to serve new customers is conservative because it does not include certain "step costs" or "lumpy costs." Such costs are

[4] This amount has changed slightly from the data response provided to Parties in WUTC DR 202, as the Company has been able to completely isolate residential customer costs from commercial customer costs. An amended response to WUTC DR 202 was filed on July 12, 2019.

incurred to serve new customers once the Company experiences a certain level of growth and the addition of new customers requires additional infrastructure, full-time employees, or other O&M type charges.

For example, as more customers are connected to the Company's system, it may have additional costs to add pipe, gate stations or other infrastructure to ensure integrity of the system. These types of projects are continually analyzed by the Company's engineers and the related costs are incurred when needed to ensure the reliability of its system.

<u>Public Counsel's Estimate of Costs to Serve New Customers</u>

Q. What is Public Counsel's estimate of the cost to serve new customers?

A. Public Counsel considers only capital costs associated with service to new customers, and claims that $1,300 is the amount of capital needed. A $1,300 capital investment would be approximately $141 cost of service for the first year.[5]

Q. How did Public Counsel derive its estimate of the cost to connect new customers in the amount of $1,300?

A. As explained in his testimony, Mr. Rubin reviewed the Company's data and "removed costs associated with significant extension projects that either had a combination of residential and non-residential customers or that appear to be backbone projects where just a few customers had connected in the year of completion (resulting in extremely high costs per customer)." [6] As presented in

[5] This assumes no incremental O&M expenses, property taxes, or revenue sensitive items (e.g., franchise fees and regulatory commission fees).

[6] Exh. SJR-1T at 22.

SJR-11, Public Counsel removed all main extensions to arrive at $1,300 of capital to serve new customers.

Q. Please address Public Counsel's proposed removal of all main extension projects.

A. It is inappropriate to remove main extensions from the cost to serve new customers because these are direct costs incurred by the Company to serve new customers. In fact, main extension costs are incurred when a developer constructs a new neighborhood where many customers will be added to the Company's system.[7] In addition, if a conversion customer requires a main extension, the costs get included, but are netted with customer contributions.[8]

Q. Why did Public Counsel suggest that there may have been main extension projects with extremely high costs per customer?

A. As shown in Public Counsel's Exhibit SJR-11, Public Counsel's witness misapplied the data in WUTC DR 202, Attachment 1 to reach the conclusion that certain projects had extremely high costs per customer. Attachment 1 of WUTC DR 202 categorizes the number of project orders and costs by new construction and conversion residential new service as well as provides the total new customers added to the Company's system. Public Counsel mistakenly assumed that the data provided for the "Number of Orders – Washington," were the number of customers

[7] New construction customers get added under category "SM02" which incur both "MX System Expansion" and "New Residential Service" costs included in Exh. KTW-7.

[8] Customer contributions are derived from construction costs exceeding the construction allowance as described in Schedule E of the Company's tariff. Both conversion and new construction customers are subject to Schedule E and the construction allowance offered by the Company.

connected for each project, when in fact, the data provided were the total number of projects—and each project resulted in 16 new customers on average in 2018.

Q. Can you describe in detail how Public Counsel misapplied the data in WUTC DR 202?

A. Yes. As shown in WUTC DR 202[9], the "Number of Orders – Washington" refers to the number of project orders. Meanwhile, in SJR-11, Public Counsel uses these project orders as customers. In 2018, there were 177 system main extension projects at a total cost of $2,337,803. Public Counsel mistakenly assumed that each main extension only served one customer, and calculated the cost per customer as $13,208.[10] In actuality, those 177 main extensions were installed to support developers building new neighborhoods that served 2,499 new residential customers.[11] Therefore, the cost per customer for those system main extension projects is approximately $877, which is significantly lower than Public Counsel's calculation.[12]

Q. Do you agree with Public Counsel's adjustments for "significant extension projects that . . . had a combination of residential and non-residential customers"?

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[9] Amended and attached as Exh. KTW-7. The amended version of WUTC DR 202 removed all commercial project orders. The original number of main extension project orders in 2018 was 177 and after removal of commercial projects, the number was amended to 159.

[10] Exh. SJR-11.

[11] Customers brought onto the Company's system are the number of service line orders under SM02, New Residential Service included in Exh. KTW-7.

[12] See Exh. KTW-7. "MX System Expansion" represents the main pipeline investment to a new development.

A. No, with a limited exception that I describe below. Public Counsel correctly pointed out that the data the Company had provided in response to WUTC DR 202 included some costs associated with main extensions for commercial customers. The Company since has made adjustments to isolate residential costs and provided an amended response to WUTC DR 202 on July 11, 2019. However, the impact of this adjustment is extremely minor. The capital amount originally included in response to WUTC DR 202 was $3,585, and the revised amount is $3,507. Thus, the amended response to WUTC DR 202 provides a slight correction, but does not change the overarching takeaway.

Q. Have you prepared an updated analysis that appropriately excludes costs associated with non-residential customers?

A. Yes. The amended WUTC DR 202 is included as Exhibit KTW-7 with my testimony. The resulting analysis uses capital costs associated with only residential customers in the amount of $2,541, prior to overhead costs. This is only slightly lower than my previous estimate of $2,598. After applying overhead, the capital amount to serve new customers is $3,507. The analysis is included within Exhibit KTW-7.

Q. Do you have any other concerns about Public Counsel's approach to calculating the incremental capital cost to serve new customers?

A. Yes. Public Counsel did not include overhead in its estimate of incremental capital costs.

Q. Why is it appropriate to include overhead when calculating incremental capital costs?

A. All capital items receive an overhead cost when plant is providing utility service and the project is closed out.[13] Therefore, the capital assets on the Company's books would include the overhead, as well as, the depreciation expense derived off those assets.

Q. Beyond the incremental capital investment required to provide service to new customers, are there other costs to provide service to new customers?

A. Yes. As explained in the Company's response to WUTC DR 201 (included as Exh. JL-4), providing service to new customers includes the following cost components apart from capital costs:

- Operations and Maintenance ("O&M") Costs – Meter reading, billing, payment processing, collections
- Other Costs – Property tax, public utility tax, income tax, WUTC regulatory fee, depreciation

Q. Does Public Counsel's analysis take into account these additional non-capital costs?

A. No. Public Counsel's analysis does not include incremental O&M expense (including inflation on O&M), property taxes, and revenue sensitive items.[14]

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[13] See the Company's response to WUTC DR 192.

[14] "Revenue sensitive items" include franchise fees and regulatory commission fees.

Q. Public Counsel also specifically notes a significant increase in administrative and general ("A&G") expense in 2018.[15] How do you respond?

A. Regarding A&G expense, this did increase in 2018, but the vast majority of this expense is not included in the incremental customer cost calculation.

Q. Please elaborate.

A. Not all of the A&G expense is included in the Company's incremental O&M costs to serve new customers. Accordingly, I filtered the Company's 2018 O&M data by the O&M accounts included within its cost of service for newly added customers (response to WUTC DR 202 Attachment 2), which are specifically related to providing service to customers (meter reading, bill processing, etc.). After applying this filter, the A&G amounts that are included within the 2018 calendar year data, at the system level (Oregon and Washington), were only $23 thousand. This equates to only three cents per customer.[16]

Q. Why is it essential to have an accurate understanding of the cost to provide service to new customers when evaluating whether to adopt revenue-per-customer decoupling?

A. As described in the Commission's policy statement, a decoupling mechanism may result in "found margin," which occurs when there is an increase in per-customer usage or the addition of new customers that provide increased revenues, potentially

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[15] Exh. SJR-1T at 29-30.

[16] See Exh. KTW-9.

causing the utility to earn in excess of its authorized rate of return.[17] Thus, to understand whether there is "found margin"—or any margin at all—from new customers, a critical first step is understanding the true cost to serve those new customers.

C. Revenue-Per-Customer Decoupling Will Not Result in a "Windfall" or "Found Margin" for the Company

Q. In its policy statement regarding decoupling, the Commission indicated that "a properly constructed full decoupling mechanism" could be used to "balance out both lost and found margin from any source," which in turn "benefits both the company and its ratepayers."[18] Has the Commission further elaborated on the purpose of full decoupling?

A. Yes. In its Order in PacifiCorp's 2014 rate case, the Commission commented that a decoupling mechanism "should aid the company when revenue per customer decreases and aid the customer when revenue per customer increases." The Commission added that "[b]y 'decoupling' sales from revenues, a utility should no longer be encouraged to sell more energy, and conserve less, in order to earn more profit," and "[e]nding this so-called 'throughput incentive' is the essence of a full decoupling mechanism."[19]

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[17] *In re Wash. Utils. & Transp. Comm'n Investigation into Energy Conservation Incentives,* Docket U-100522, Report and Policy Statement on Regulatory Mechanisms, including Decoupling, To Encourage Utilities To Meet or Exceed Their Conservation Targets at ¶11 (Nov. 4, 2010) ("Decoupling Policy Statement").

[18] Decoupling Policy Statement at ¶27.

[19] *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light Co.*, Dockets UE-140762, *et al.*, Order 08, ¶221 (Mar. 25, 2015).

Q. How has the Commission implemented this policy guidance?

A. The Commission has approved full decoupling mechanisms for all of the investor owned energy utilities in Washington, except for NW Natural. The Commission approved full decoupling for Puget Sound Energy, Inc. ("PSE") in 2013 and again in 2017, for Avista in 2014, and for Cascade and PacifiCorp in 2016.[20]

Q. Please explain Public Counsel's theory of how revenue-per-customer decoupling will result in a "windfall" to customers.

A. Public Counsel argues that new customers are generally consuming less gas, and, under revenue-per-customer decoupling, the Company would be collecting revenue based on higher usage assumptions associated with existing customers. Because Public Counsel also has assumed that the cost to serve these customers is artificially low—$1,300—Public Counsel claims that the Company will receive a major "windfall."

Q. Public Counsel claims that the Company will receive a "windfall" of $12 million.[21] How did Public Counsel make this calculation?

A. Public Counsel first calculates an additional $24.4 million in revenue to account for the Company's projected customer growth over the next six years. Then, based on

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[20] *In the Matter of the Petition of Puget Sound Energy Inc., and Nw. Energy Coalition for an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms to Record Accounting Entries Associated with Mechanisms*, Dockets UE-121697, *et al.*, Order 07 (June 25, 2013); *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-170033 and UG-170034, Order 08 (Dec. 5, 2017); *Wash. Utils. & Transp. Comm'n v. Avista Corp. d/b/a Avista Utils.*, Dockets UE-140188 and UG-140189, Order 05 (Nov. 25, 2014); *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light Co.*, Docket UE-152253, Order 12 (Sept. 1, 2016); *Wash. Utils. & Transp. Comm'n v. Cascade Natural Gas Corp.*, Docket UG-152286, Order 04 (July 7, 2016).

[21] Exh. SJR-1T at 23-24.

their artificially low calculation of the capital investment required to serve new customers (based on the exclusion of main extensions), they include $1,300 per new customer into rate base. Public Counsel then states that "without getting extremely precise, we can estimate that a reasonable return on that investment, including taxes and depreciation, would be about 15 percent annually, or approximately $0.35 million in the first year (one-half of a year), $1.05 million in the second year, and so on," ultimately concluding that $12.6 million over six years would be the return requirement for the Company. Finally, Public Counsel concludes that because the return requirement would only be $12.6 million, the Company would thus receive a "windfall" of approximately $12 million.

Q. Do you agree with Public Counsel's calculation?

A. No. Public Counsel's claim that there will be a "windfall" is based on its calculation of the "reasonable return" for the Company. The calculation of the reasonable return for the Company is incorrect because it is premised on an unreasonably low amount of capital investment for new customers. Additionally, when evaluating the cost to serve new customers, Public Counsel fails to include incremental O&M, property taxes and revenue sensitive items.

Q. When you include the actual costs to serve a new customer, what is the impact to the Company?

A. When we consider historical data, the impact to the Company of adding new customers is negative. For instance, under the scenario where a customer uses 678 therms per year,[22] the Company's cost is $96.21 more than the revenue collected by the customer. In 2018, the Company added 2,969 residential customers to its system, generating a loss to the Company of $285,693 ($96.21 x 2,969 = $285,693).

Q. Did you also consider the impact to the Company using the same forward-looking six-year period that Public Counsel used?

A. Yes, and after including all the costs to serve new customers, the Company calculates it will experience a revenue deficiency of $5.6 million over a six year period (see Exhibit KTW-5). Clearly, the Company will not experience a windfall as a result of new customers.

Q. Public Counsel also argues that the "windfall" would occur under both average and lower than average consumption scenarios, and that the impact to customers would be worse under the lower than average consumption scenario. How do you respond?

A. The Company has analyzed various consumption scenarios and the revenue each scenario would produce. Below is a summary of the costs, revenues and break-even year for multiple consumption scenarios:

Usage	Annual Revenue	Year 1 Cost of Service	Breakeven Year
500	$329	$508	Year 20
550	$352	$508	Year 17
600	$375	$508	Year 15
650	$398	$508	Year 12
700	$422	$508	Year 9
750	$445	$508	Year 7
800	$468	$508	Year 4

[22] This 678 therms is the baseline Rate Schedule 2 residential annual therm usage established in this docket in accordance with the Partial All-Party Settlement Agreement.

As you can see, even with above average consumption, the Company does not recover its investment for several years. Therefore, due to the substantial cost to serve new customers, it is impossible for the Company to earn a "windfall" from new customers.

III. PUBLIC COUNSEL'S PROPOSED RATE CLASS DECOUPLING APPROACH WOULD NOT PROVIDE THE COMPANY WITH THE OPPORTUNITY TO EARN A REASONABLE RETURN

Q. What does Public Counsel propose instead of the revenue-per-customer approach?

A. Public Counsel recommends that if the Commission determines that decoupling is appropriate, it should instead adopt rate class decoupling.[23] Its proposal would allow the Company to retain the amount of revenue up to the agreed upon revenue requirement in the pending rate case, but only recover the Company's fixed monthly charge (i.e. customer charge) from new customers.

Q. How is rate class decoupling different from revenue-per-customer decoupling?

A. Rate class decoupling would require the Company to decouple the revenue requirement from the Company's last rate case at an aggregated, versus per-customer, level. This means that the Company would only be able to collect its approved revenue requirement from the last rate case and not any incremental revenue obtained from customer growth, with the exception of the fixed monthly charge. Therefore, any costs incurred above the Company's revenue requirement plus the fixed charge from new customers would be borne by the Company and

[23] Exh. SJR-1T at 25.

produce under earning results, likely pushing the Company to file more and more general rate cases.

The revenue-per-customer approach decouples usage from revenue from each individual customer. This means that the Company would be able to collect revenue requirement on a per customer level at the baseline usage established in its last rate case. This baseline usage would get reset during each filed general rate case.

Q. Do you agree with Public Counsel's proposal for rate class decoupling?

A. No. Public Counsel's proposal is needlessly punitive to NW Natural. Removing the ability to collect volumetric revenues from new customers would disproportionally harm NW Natural by creating a revenue deficiency of $27.7 million, as described in greater detail below and in Exh. KTW-10. As described above, only a fraction of the incremental costs incurred to serve new customers would be recovered under Public Counsel's proposal, whereas under a revenue-per-customer mechanism, the Company would collect more, but not all, costs associated with incremental customers.

Q. Public Counsel argues that using rate class decoupling would provide the Company with an additional $6 million in revenues over a six year period, which would likely not provide the Company with its full return on investment, "but depending on how the Company financed the new plant it might be sufficient to compensate the Company for its incremental cost of

capital to serve new customers."[24] Would an additional $6 million in revenues be adequate to recover the incremental capital costs to serve customers?

A. No. If the Company finances the capital costs consistent with the capital structure agreed upon in the all-party settlement in this rate case, the Company would significantly under recover the costs associated with new customers. If the Company finances the capital costs from equity alone, the Company's financial performance metrics would decline, potentially hurting the Company's credit metrics and attractiveness from equity investors, which could ultimately affect the Company's cost of debt in the Company's next general rate case.

Q. Public Counsel acknowledges that the Company may not be able to earn its authorized return if rate class decoupling is adopted.[25] What impact would rate class decoupling have on the Company's ability to earn the return included in the settlement agreement?

A. The Company's earnings would be significantly eroded if rate class decoupling were authorized. The Company would not be able to recover routine escalation in costs over time, and it would have minimal recovery of capital invested in new customer growth. Therefore, allowing new customers to connect to the Company's existing system would immediately be a detriment to the Company. This is caused by the current rate structure of significant fixed costs being recovered on a

[24] Exh. SJR-1T at 24.

[25] Exh. SJR-1T at 24.

volumetric basis and Public Counsel's rate class decoupling proposal to fix volumetric revenues at the rate case revenue requirement level.

Q. Can you further elaborate on how this would be calculated?

A. Yes. If a new customer costs $508 per year and the Company is able to retain the annualized monthly fixed charge of $96 ($8 x 12 months = $96), but credit the remaining revenue back to customers through decoupling, the Company would be under recovering $412 per customer, per year (assuming Public Counsel's new customer usage of 522 therms per year). Multiplying this under recovery by the number of residential customers the Company expects to adopt over the next six years produces a revenue deficiency of $27.7 million, or an average of $4.6 million per year.[26] This does not include the general escalation of costs through time or the capital invested to maintain the integrity of the Company's system. Therefore, based on the Company's analysis of the likely impact of rate class decoupling, the Company would have no opportunity to earn its authorized return, and would need to immediately file another rate case.

Q. Public Counsel suggests that if the Company finds it is not earning its return that it can remedy the situation simply by filing another rate case.[27] Do you agree with this approach?

A. No. NW Natural believes that proposals that lead to more rate cases, such as the one suggested by Public Counsel, should not be supported. We should seek out

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[26] See Exh. KTW-10.

[27] Exh. SJR-1T at 24.

solutions that provide a fair, just and reasonable outcome for our customers that minimize, or at least do not increase the need for, the time- and resource-consuming process of rate cases. Public Counsel's proposal would actually result in a situation where NW Natural would be more likely to stay out of a rate case longer by continuing the status quo (without decoupling) than it would with Public Counsel's proposed rate class decoupling as a result of the severe earnings erosion. This misalignment of interests should not be accepted by the Commission.

Q. Public Counsel also makes the claim that new customers provide more revenue per dollar of rate base investment than existing customers and charging new customers the settled rates is fair compensation to the Company. Is this comment accurate?

A. No. Of course new customers would pay more per dollar of rate base, because the assets associated with a new customer have not been depreciated. Existing customers have assets associated with them that have been in service for decades. The comparison simply is inapposite.

Q. To your knowledge, has the Commission ever approved rate class decoupling?

A. No. My understanding is that the Commission has never approved rate class decoupling, and instead has in recent years (following issuance of the Commission's policy statement on decoupling) approved revenue-per-customer decoupling in all but two instances. As described in Ms. Liu's testimony, the two exceptions included the following: "(1) For the period of July 2013 through December 2017, the Commission authorized the combination of K factor and revenue per customer for PSE. (2) In the 2017 PSE Order, the Commission authorized the decoupling mechanism for PSE's fixed production revenue based on a fixed dollar amount."[28]

IV. OTHER ISSUES IN PUBLIC COUNSEL'S ANALYSIS

A. New Customers and New Housing Stock

Q. Please explain Public Counsel's argument about new housing stock.

A. Public Counsel argues that the Company is experiencing growth and adding new customers, and that the new housing stock will be more energy efficient than existing housing stock.[29] In general, Public Counsel asserts that new customers will consume less than existing customers.

Q. How do you respond to Public Counsel's assertions about new housing stock and new customers?

A. The largest change the Company has seen in new housing stock is the adoption of tankless hot water heaters, as Public Counsel noted. Additionally, the Company continues to see very high use of high-efficiency natural gas furnaces, about 94 percent of newly added customers. However, the Company does not apply blanket assumptions about customer usage to new customers because there are a number of variables (such as home size, appliances, etc.) that may dictate actual usage. Additionally, existing customers may make conservation-related changes, such as adding smart thermostats or trading out old appliances for newer and more efficient

[28] Exh. JL-1T at 6, n.13.

models that also will impact actual usage among existing customers who are choosing conservation measures.

B. Fairness and Cost-Shifting

Q. Please describe Public Counsel's arguments about cost-shifting and overall fairness of revenue-per-customer decoupling.

A. Public Counsel states that it believes the Company's customer growth primarily will be attributable to service connections for new and more efficient homes. Public Counsel argues that the new customers will consume less gas than the Company's existing customers, and if a revenue-per-customer approach is used, existing customers will be charged more to make up the difference in consumption. According to Public Counsel, this results in cost-shifting, requiring existing customers to pay more to make up for less consumption from new customers.

Q. How do you respond to Public Counsel's arguments regarding cost-shifting associated with newer customers consuming less natural gas?

A. If new customers use less, the revenue-per-customer mechanism arguably would have surcharge pressure from these new customers in a normal weather scenario. However, the surcharge pressure is *exactly the same* as that from an existing customer choosing to add conservation measures.

Q. Is the amount of cost-shifting significant?

A. No. The amount of cost-shifting is minimal because, as proposed in the Decoupling Agreement, the surcharges are spread to all customers—including both new and existing customers. See the summary table below, which shows the customer impact, assuming Public Counsel's new customer usage of 522 therms for the next six years. Also see Exhibit KTW-11r for the full analysis.

	2019	2020	2021	2022	2023	2024
Monthly Decoupling Impact on Customer Bills	$0.38	$1.15	$1.65	$2.15	$2.62	$3.08
~~Impact as percentage of total bill~~	~~0.7%~~	~~2.1%~~	~~3.1%~~	~~3.9%~~	~~4.8%~~	~~5.6%~~

	2019	2020	2021	2022	2023	2024
Monthly Decoupling Impact on Customer Bills	$0.11	$0.33	$0.55	$0.77	$0.97	$1.17
Impact as percentage of total bill	0.2%	0.6%	1.1%	1.5%	1.9%	2.3%

Q. Public Counsel argues that "[i]f the purpose of decoupling is to ensure that the utility collects the revenues established in the rate case, it is illogical to say that adding new customers somehow creates a revenue shortfall. Yet, that is exactly the result under per-customer decoupling. It is grossly unfair to existing customers to guarantee that those new customers should provide even higher revenues than it is reasonable for the Company to expect to receive."[30] Do you agree with the premise underlying Public Counsel's concern regarding cost-shifting?

A. No. First, the purpose of decoupling is not "to ensure that the utility collects revenues established in the rate case"—instead, the purpose of decoupling is to promote conservation by "remov[ing] barriers to utilities acquiring all cost-effective conservation" and "encourag[ing] utilities to acquire all cost-effective conservation,"[31] which is achieved by "reduc[ing] the 'throughput incentive'."[32]

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[30] Exh. SJR-1T at 17.

[31] Decoupling Policy Statement at ¶12.

[32] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-170033 and UG-170034, Order 08 at ¶311 (Dec. 5, 2017).

Second, as I explained above, any cost-shifting that occurs is minimal given that a surcharge would be spread across all customers. Conservation is likely to continue with both existing and new customer homes as technology evolves. And ultimately, the end result is that new and existing customers will consume natural gas more efficiently, promoting the goal of acquiring all cost-effective conservation and reducing the throughput incentive.

C. Earnings Sharing Mechanism and Soft Cap Will Protect Customers

Q. Public Counsel argues that the earnings sharing mechanism and 5 percent soft cap are inadequate to protect customers if per-customer decoupling is adopted, because the earnings sharing mechanism will not prevent the Company from over-earning and the soft cap will only limit the increase that will be imposed in one year.[33] How do you respond?

A. It has been very clear throughout my testimony that the cost to add a new customer far exceeds the revenues received. Adding new customers and having a revenue-per-customer decoupling mechanism will not drive the Company to over-earn. However, in the event that over-earning were to occur, the earnings sharing mechanism will protect customers. The Commission has previously found that an earnings sharing mechanism is an appropriate safeguard to protect customers in the event that there is overearning as a result of decoupling:

> We recognize that there is some potential for PSE to capture found margin from new customers that will more than offset the cost of

[33] Exh. SJR-1T at 30.

> serving those customers. However, it seems equally plausible that PSE's cost per customer will continue to increase and outstrip increased revenue from new customers. . . Given the uncertain future, the Commission will wish to monitor carefully the actual results of customer growth in terms of earnings over the next several years and rely on the protection of the earnings test, as modified by this Order, that will keep any excess earnings that may be attributable in part to customer growth from becoming a windfall for PSE.[34]

Regarding the soft cap, the Company believes that use of the soft cap will protect customers from significant rate changes as a result of decoupling.

Additionally, the Decoupling Agreement provides for a limited five-year term for the decoupling mechanism, which will allow the Commission to review and consider any potential adjustments to the mechanism, if needed.

V. DECOUPLING AGREEMENT IS IN THE PUBLIC INTEREST

Q. Public Counsel disagrees that the Decoupling Agreement "strikes a reasonable balance between the interests of the Company and its customers," and argues that the use of per-customer decoupling is not consistent with the public

[34] *In the Matter of the Petition of Puget Sound Energy Inc., and Nw. Energy Coalition for an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms to Record Accounting Entries Associated with Mechanisms*, Dockets UE-121697, *et al.*, Order 07, ¶116 (June 25, 2013).

interest and will not result in rates that are just and reasonable.[35] How do you respond?

A. The Decoupling Agreement has adequate safeguards to protect customers such as the earnings sharing mechanism, 5 percent soft cap and re-authorization after five years. In addition, the Company is more likely to stay out of rate cases longer which avoids costs that customers would bear, such as increased rate base, and/or cost of capital, among many other items as compared with Public Counsel's rate class decoupling proposal. Furthermore, it is worth noting that all other parties of this docket have signed the Decoupling Agreement as being in the public interest.

Q. Is Public Counsel's proposal for decoupling consistent with the public interest?

A. No. Public Counsel's proposal is punitive and would not allow the Company the opportunity to earn its authorized return, potentially forcing the Company into more frequent rate cases, as discussed above.

Q. What action do you recommend the Commission take with respect to the Decoupling Agreement?

A. I recommend that the Commission find that the Decoupling Agreement is in the public interest and would produce rates for the Company that are fair, just, reasonable, and sufficient. Accordingly, I recommend that the Commission adopt the Decoupling Agreement in its entirety.

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[35] Exh. SJR-1T at 27.

Q. Does this conclude your Rebuttal Testimony?

A. Yes.