EXHIBIT NO. _____ (SDW-1 Rebuttal)
DOCKET NOS. UG-060267 & UE-060266
2006 PSE GENERAL RATE CASE
WITNESS: STEVEN D. WEISS

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UG-060267** **Docket No. UE-060266**

REBUTTAL TESTIMONY OF STEVEN D. WEISS ON BEHALF OF NW ENERGY COALITION

August 23, 2006

NW ENERGY COALITION

REBUTTAL TESTIMONY OF STEVEN D. WEISS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Steven Weiss. I am employed by the NW Energy Coalition, 219 First Ave. South, Suite 100, Seattle, WA 98104.

Q. Did you file provide direct testimony in this proceeding?

A. Yes, as Exhibit No. _____(SDW-1T).

Q. Please summarize the contents of your rebuttal testimony.

A. My rebuttal will first focus on the direct testimony of Michael L. Brosch, Exhibit No. ____(MLB-1T) appearing on behalf of the Washington Attorney General – Public Counsel Section; and then on the direct testimony of Joelle R. Steward Exhibit No. ____(JRS-1T) on behalf of the Washington Utilities and Transportation Commission (WUTC) Staff regarding their comments about the Gas Revenue Decoupling Mechanism proposed by Puget Sound Energy (PSE).

II. Response to Direct Testimony of Michael L. Brosch

Q. Please give your interpretation of the general thrust of Mr. Brosch's direct testimony in Exhibit No. ____(MLB-1T).

A. Mr. Brosch opposes what he characterizes as "piecemeal rate adjustment tariffs for isolated elements of utility revenue requirements in the absence of compelling evidence that such piecemeal rate adjustments are warranted." (p.3) For that reason,

and because he believes such compelling evidence has not been presented, he opposes the specific depreciation tracking and decoupling mechanisms PSE has proposed.

Q. Will your rebuttal testimony address the depreciation tracker?

A. No, I am commenting only on Mr. Brosch's testimony regarding decoupling.

Q. What arguments does Mr. Brosch employ to justify his conclusion?

A. Mr. Brosch makes a number of points, but I will address in turn what I view as his two main arguments. First he argues that traditional regulation achieves a "balanced" (p.3) measurement of revenue requirements and "symmetrical risks and opportunities" (p.16) that are fair to the utility and customers, so changes are generally unwarranted. His second argument is that "PSE has little influence over gas usage per customer volumes…" (p.17), so the problem caused by the utility's incentive to increase throughput is minimal; and in any case any lost margins are made up by new customers arriving on the system.

Q. As to his first argument, do you agree that the traditional regulatory scheme achieves a balance of interests between shareholder and customer interests, and provides symmetrical risks and opportunities to the two sides?

A. Mr. Brosch makes a convincing argument that shareholder and customer interests are well-balanced *within* the rate case process, because *all* of the factors related to revenues and rates are simultaneously analyzed. In particular, he makes the point that there are often balancing factors present that mitigate rate adjustments that could not be identified in a tracking mechanism. For example, while a tracker might provide an adjustment for an increased cost, it would not be able to factor in some other

untracked compensating decrease that in a ratecase would mitigate the need for a rate increase.

He is less convincing, however, when he argues that *between* rate cases, "Symmetrical risks and opportunities arise for utility ratepayers and shareholders as a result of regulatory lag, because favorable and unfavorable changes in revenue requirement can produce over or under-earnings outcomes until either the utility **or some other party** initiates a new rate case." (p.16, emphasis added)

Q. What do you see as the flaw in this argument?

A. His assertion that the opportunities and risks between rate cases are symmetrical for customers and shareholders is unsubstantiated by any evidence, and in my experience is not borne out in practice. The key flaw in his argument lies in the fact that under current ratemaking, *the ability to initiate a rate case is not symmetrical*. Instead, it is tilted in favor of the utility. Under current practice, it is very difficult, or virtually impossible, for any other party than the utility to initiate a rate case. The reason for this is that the burden of proof is placed on the initiating party. Because consumers and staff do not have access to the utility's books, it is very difficult for them to prevail. In Oregon, for example, there have been only a couple of "show cause" proceedings that I know of in the past two decades or so. I am not as familiar with Washington, but I believe that Commission-initiated proceedings to reduce rates are all but unknown here as well. The result of this asymmetry is that if a utility is doing very well, it will avoid a rate case, but if it has cause to need more revenue, it will quickly initiate one. Thus the opportunity to review the utility's costs and revenues is only available when the utility *wants* that review—when its earnings have fallen or it

seeks to add to its rate base. It will never want that review when its costs have declined (or revenues increase) such that earnings have increased. Therefore, contrary to Mr. Brosch's assertion, regulatory lag is very much to a utility's advantage.

Q. How would a decoupling mechanism favor customers?

A. Decoupling doesn't add to the existing utility advantage; in fact it provides some advantages to customers that wouldn't otherwise exist. Decoupling adjustments benefit customers if loads grow faster than expected due to, for example, weather, economic conditions or commodity prices. These credits to customers would not occur under current ratemaking. Instead, the benefit would flow to shareholders because it is simply not true that "some other party" can readily initiate a rate case.

Often those who oppose trackers or other automatic adjustments such as decoupling will cite examples or scenarios where rates would rise without regulatory oversight, but forget that a properly engineered tracker can and should be symmetric, so that it will also result in rate decreases—which generally would not happen under traditional regulatory lag because no rate case would occur. Steward's testimony in Exhibit No. ____(JRS-1T) on behalf of the WUTC Staff, for example, conveniently presents an example (p. 9) showing how a weather adjustment could raise rates, failing to note that it could just as often lower rates.

In conclusion, *if* regulatory lag were symmetrical, Mr. Brosch's point would carry some weight. But given how difficult it is for any party except for the utility to initiate a rate case, a well-designed automatic adjustment can provide real benefit to

customers. That is because, besides fulfilling other policy goals, a well-designed automatic adjustment can *lower rates when traditional ratemaking would not*.

Q. Do you share Mr. Brosch's generally skeptical view of automatic adjustments?

A. No. I believe Mr. Brosch is generally suspicious of automatic adjustments because he thinks they will lead to rate increases that would not have otherwise occurred under conventional ratemaking. He fails to realize that when well-designed they can also lead to rate decreases that would not have occurred as well. Skepticism is warranted, of course, because one can design a tracker that is not fair. But instead of attacking all automatic adjustments, Mr. Brosch should focus on what makes particular adjustments beneficial to customers or not.

Q. Define further what you mean by a "well-designed" adjustment.

A. On p.14 of his direct testimony, Mr. Brosch lists five attributes that must be present before he could recommend a tracker or automatic adjustment. I agree with them, but would add one more critical element: Adjustments must be symmetric so that net rate impacts over the long term are no more than would have occurred without the mechanism.

Viewed in this light, PSE's proposed decoupling mechanism is not poor policy simply because it's an automatic adjustment; rather it is a poorly-designed mechanism that does not produce symmetric results. Our critique and recommendations regarding PSE's proposal are detailed in my direct testimony. The main problem we saw was that the declining usage trend—mostly due to new customers—was not taken account of properly, thus resulting in a windfall to the Company that would not occur absent the mechanism. We recommended changes to

fix this problem. I would note that Mr. Brosch's testimony supports that critique. The difference being that he takes that as further evidence that all automatic adjustments are harmful to customers; we suggest fixes that make the mechanism symmetric. Of course without these fixes, our opinion on PSE's proposal would be just as negative as Mr. Brosch's.

Q. What is Mr. Brosch's other major argument against PSE's decoupling proposal?

A. Besides his general opposition to automatic adjustments that I addressed above, Mr. Brosch's second argument is more particular to gas utilities. In essence his argument is that decoupling is unnecessary. This has two parts. First, "PSE has little influence over gas usage per customer volumes…" (p.17), so removing the Company's incentive to increase throughput is unimportant. Admitting that "utility shareholders will generally benefit when sales volumes increase between test periods and are harmed when sales decline," (p.40) he argues that management will still encourage conservation:

> …in this era of high-priced natural gas, conservation measures are necessary to attract new customers and to retain existing gas utility customers that may otherwise elect alternative energy sources such as electricity when appliances are being installed or replaced. PSE has little choice in this environment but to promote the efficient use of natural gas. (p.40)

In addition, though per-customer usage has declined fairly significantly, he argues that most of that reduction is not due to utility programs. Instead it is due to replacement of housing and appliances or price elasticity (p.42). He points out that even PSE's "stretch" goal of 2.1 million therms is only about 0.2 percent of PSE's sales:

> Such a small impact upon annual sales from utility sponsored conservation efforts is insufficient cause to introduce a complex new rate tracker that addresses all variations in usage per customer, most of which variation is likely caused by other factors including weather, price elasticity and continuing turnover of old appliances and housing. (p.42)

Q. How do you respond?

A. First, just to be accurate I must point out that 2.1 million therms is closer to 0.25% of Puget's non-transportation sales, not 0.2%. But more important, it is about 20% of the Company's sales *growth*, quite a significant number. Also, NW Energy Coalition has long argued that 2.1 million therms per year is an inadequate goal, representing only about 40% of what PSE's 2005 Least Cost Plan identified as achievable—5.25 million therms per year. (Exhibit___ (SDW-1T), p.10) If the Company could be motivated to agree to that level of conservation, it would represent over *half* of its sales growth. These programs are not insignificant. Part of securing the Company's enthusiastic interest in establishing and meeting these more aggressive but achievable goals is to ensure that its profits are not threatened by that action. That is what decoupling is all about.

In addition, Mr. Brosch underestimates the impact of a large utility in affecting non-conservation-program policies that incent customers to reduce usage: appliance standards, building codes and zoning, tax policies, public education, market transformation, regulatory policies (such as planning criteria), etc. It is my experience that utilities can be very formidable opponents to enacting and encouraging such policies; just as their support can be crucial.

Q. Mr. Brosch also argues that shareholders really aren't at much risk from conservation, so decoupling is not needed. Do you agree?

A. No. Citing growth in the number of customers, he states that, "Any ongoing conservation effects among existing customers may very well be offset by productivity gains that reduce expenses or with new revenues from added customers." (p.40) The flaw in this argument is that Mr. Brosch fails to focus on the *marginal* earnings effect from reduced usage. Certainly, productivity gains or other offsetting revenues might make up for earnings lost from conservation, but that does not mean that each therm not sold goes straight to the Company's bottom line. Decoupling can change corporate behavior and culture by removing that disincentive. It is not just a way to give the company more earnings. In fact, as we have pointed out, a well-designed mechanism will be *symmetrical* and, in the long run, have no effect on earnings directly—though it may reduce the utility's cost of capital by removing volatility.

III. Response to Direct Testimony of Joelle R. Steward

Q. Please give your interpretation of the general thrust of the direct testimony of Joelle Steward in Exhibit No._____ (JRS-1T).

A. First I should note that I will only address Ms. Steward's testimony related to decoupling (Gas Revenue Normalization Adjustment). In that part of her testimony Ms. Steward supports the goals of decoupling generally, but recommends rejection of PSE's proposal unless it is modified in several ways: "The partial decoupling mechanism that I propose takes into account that new customers have lower than average usage, is limited to three years, and has a cap on the level of surcharge that

could be imposed each year." (p.2) In addition, she argues that it should only recover variations in sales that are non-weather related.

Q. Do you agree with her recommendations?

A. Our recommendations in this docket are similar to many of her points. We agree with her proposal to treat new customers differently; a three-year pilot; and a cap on the level of surcharge that could be imposed each year. (We also propose certain efficiency targets, incentive levels and penalties, but Ms. Steward's testimony does not address those issues so I will not address them here.) My only point of disagreement is regarding her position on weather-related adjustments, and that is the subject of the remainder of my comments here.

Q. Why does Ms. Steward oppose including sales variations due to weather in the decoupling mechanism?

A. Ms. Steward makes two related arguments. First, "Including weather effects in the mechanism, as proposed by PSE, results in more **bill** volatility for customers." (p. 9, emphasis added). Second, she argues that including weather shifts risk to customers: "Customers should not absorb yet another shift in risk through reduced bill stability in order to increase revenue stability for the Company." (p.9)

Q. Regarding her first point, does Ms. Steward present any evidence to back up her claim that including weather results in more <u>bill</u> volatility for customers?

A. Not really. She presents Exhibit No.___(JRS-3) that purports to show that including weather nearly doubles the revenue adjustment to be collected in a surcharge, and that it also creates larger swings in the year-to-year adjustments. However, there are several problems with her table and the interpretations she attempts to draw from it.

First, as she states in footnote 4 of p. 9, the data behind the exhibit are based on three years of above-normal weather. These years would have, of course, resulted in a surcharge, but they can in no way be seen as a representative sample. A larger number of years used to define "normal" weather would be symmetrical and result in no net adjustment over time. Without a more representative sample of years, one should place no weight on the evidence provided in the Exhibit.

The second flaw in her argument, and more important, is the fact that looking at a table of *rate* adjustments says nothing about *bill volatility*. A customer's *bill* is quite different from a customer's *rate*. A bill, apart from any fixed charge, is calculated by multiplying the rate by the use. And use is very much dependent upon the weather. The beauty of (the weather part of) decoupling is that the same weather that causes use to increase (cold), causes the rate adjustment to be negative, thus making the overall rate lower. When multiplied together, the bill is reduced from what it would have been without decoupling. On the other hand, when the weather is warmer than normal, usage goes down, but the rate adjustment is positive, making the overall rate higher. So when the rate and use are multiplied together, the bill is higher than what it would have been without decoupling. The net result of decoupling is therefore to *reduce bill volatility*. Bills are lower in cold winters and higher in warm ones, resulting in less variation than without decoupling. If the weather is colder than normal, decoupling prevents customers from over-paying; when it is warmer than normal, it prevents customers from under-paying. That's why it reduces revenue volatility to the utility.

Q. Doesn't that smoothing effect of weather adjustments only happen if the adjustments are done in real time such as in NW Natural's mechanism?

A. NW Natural's billing system can adjust each bill each month to reflect the elasticity of above or below-normal weather, and is thus a perfect weather hedge, or swap, for both customers and the utility. I do not know if Puget's billing system can do that. I proposed a second-best alternative in my direct testimony (Exhibit ____ (SDW-1T), p. 8). The alternative is to spread each year's adjustment over the entire subsequent year, and implement a cap of 3% to protect against a severely warm winter followed by a cold one.

Q. What is Ms. Steward's second point?

A. Her second point is that customers should not absorb risk through reduced bill stability just to increase revenue stability for the Company. I have already addressed her statement that a weather adjustment causes reduced bill stability, but will discuss the second part of this argument. Evidently Ms. Steward believes that increasing revenue stability for the Company is of little or no value to customers. However she provides no evidence to support this statement. Reducing revenue volatility for the Company should decrease its cost of capital. Cost of capital is paid for by customers just as any other cost is. My direct testimony thoroughly discusses this issue on pp. 18-21. Disregarding the opportunity to cut a utility's cost is a disservice to customers. My testimony demonstrates that a weather adjustment need not increase bill volatility, and that there may be additional benefit to customers to the extent it reduces the utility's cost of capital. Following Ms. Steward's recommendation to not

include a weather adjustment in the decoupling mechanism would waste a significant opportunity to reduce costs at no harm to consumers.

Q. Does this conclude your testimony?

A. Yes.