BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

WUTC V. PSE

DOCKET NOS. UE-060266 AND UG-060267

CROSS-ANSWERING TESTIMONY OF MICHAEL L. BROSCH (MLB-4T)

ON BEHALF OF

PUBLIC COUNSEL

DATED AUGUST 23, 2006

Q. Please state your name and business address.

A. My name is Michael L. Brosch. My business address is 740 North Blue Parkway, Suite 204, Lee's Summit, Missouri 64086.

Q. Are you the same Michael L. Brosch who submitted Direct Testimony identified as Exhibit No. ___ (MLB-1TC) in this matter on behalf of Public Counsel?

A. Yes. My qualifications and previous utility regulation experience are described in Exhibit No. ____(MLB-1TC) and also within Exhibit Nos. ____(MLB-2) and (MLB-3).

Q. What is the purpose of your Cross-Answering Testimony?

A. My Cross-Answering Testimony is responsive to the Prefiled Direct Testimony of Mr. Steven D. Weiss on behalf of the Northwest Energy Coalition (NWEC) and to the Prefiled Direct Testimony of Commission Staff (Staff) witness Ms. Joelle Steward on the topic of revenue decoupling. These two witnesses reject the specific revenue decoupling proposal and tariff advanced by Puget Sound Energy (PSE), but recommend alternative revenue decoupling approaches. These alternatives should not be accepted by the Commission, for the reasons described herein and in my Direct Testimony. I will not repeat the discussion in my Direct Testimony of the many problems associated with usage per customer decoupling/tracking, but will instead focus upon the details of the alternative proposals now being advocated by Mr. Weiss and Ms. Steward.

Q. At page 5 of his testimony, Mr. Weiss refers to "decoupling, or revenue cap regulation" which he characterizes as "Breaking the link between the utility's commodity sales and the disincentive to run effective energy efficiency programs or invest in or encourage other activities that may reduce load." Does the form of decoupling Mr. Weiss advocates impose any "revenue cap" or fully "break the link" as his testimony implies?

A. No. There is no revenue cap established or any "break in the link" accomplished by the form of decoupling he recommends. Mr. Weiss has focused solely upon gas usage per customer, ignoring the fact that total gas demand volume is a function of both the number of customers being served and the average usage per customer. PSE gas margin revenues are not subject to any "revenue cap" under an approach that protects the utility against any continuing declines in usage per customer, while allowing the utility to retain for shareholders all of the margin revenue growth associated with customer growth. His proposal can actually be expected to amplify future PSE margin revenue growth, by ensuring that customers added after the test year produce revenue growth that is no longer offset by the gradually declining usage per customer trend that has existed for many years. This problem with tracking only usage per customer, rather than total usage volumes, was explained in my Direct Testimony at pages 33-36.

Q. Can the problem arising from a limited focus upon only usage per customer be observed in the usage data summarized in Mr. Weiss' testimony?

A. Yes. At pages 12 and 13, residential sales volume graphs are presented by Mr. Weiss on a "Therms/customer" basis, which imply that PSE gas sales volumes are trending downward. In truth, PSE gas sales volumes are relatively stable and there is no such downward trend, as I explained at page 34 of my Direct Testimony.

Q. With respect to declining usage per customer that has been experienced historically, if we ignore offsetting customer growth, do you agree with Mr. Weiss regarding the causes for declining usage per customer?

A. At page 13, Mr. Weiss states, "This reduction in residential usage is probably due to a combination of factors: higher bills, more efficient appliances, and utility- and customer-financed conservation investments. There are good reasons to believe this trend will continue." I agree that these are all factors impacting declining weather normalized usage levels when evaluated on a per customer basis. Additional factors include the improved building codes mentioned by Mr. Weiss at page 16 and resulting trends in tightened building envelopes that contribute to declining usage per customer.

An important distinction should be drawn at this point – most of these drivers of declining usage per customer are beyond the control of the utility and are therefore not influenced by the "incentives and disincentives embedded in traditional utility regulation" that Mr. Weiss criticizes at pages 3 and 4 of his testimony. For example, customer price elasticity effects flowing through the PGA will occur without regard to the disincentives associated with traditional ratemaking.[1] Similarly, the replacement of old appliances and furnaces with modern and more efficient units will occur without regard to the scheme of utility regulation that exists.[2] Unfortunately, Mr. Weiss recommends rate tracking for all of this usage per customer variation from all of these causes (including weather) in his decoupling recommendation. This causes his recommended regulatory remedy, sales decoupling on a "usage per customer basis", to be overly broad in relation to the conservation disincentive problem he claims to be concerned about.

Q. Does Mr. Weiss' recommendation differ from the recommendation of Commission Staff witness Ms. Steward with respect to how weather departures from normal are treated?

A. Yes. Mr. Weiss would allow rate recovery through decoupling for differences in usage per customer caused by weather fluctuations above and below normal conditions, where Staff's proposal would not track weather fluctuations.[3] There are also differences between Mr. Weiss and Ms. Steward regarding other details of their proposals involving the specific rate schedules to become subject to decoupling and various incentives, capping and decoupling pilot program constraints.[4]

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[1] In fact, price elasticity effects may be amplified somewhat by decoupling, if gas commodity price increases passed through the PGA cause customer demand reductions through thermostat dial-back or other conservation measures, which in turn contribute to decoupling price increases intended to "make up" for the margin losses from the price-driven lower sales.

[2] Federal appliance efficiency standards are mandated in 10 C.F. R. § 30.432. These standards have been increased in the past, such that older appliances being replaced today usually cannot be replaced without improving efficiency.

[3] Exhibit No.__(SDW-1T), p. 7. Exhibit No.___(JRS-1T), p. 8. Notably, at page 21, Mr. Weiss states that NWEC would "support a more limited pilot" decoupling mechanism that does not include an adjustment for weather variability.

[4] See generally Exhibit No.__(SDW-1T), at pp. 8-14 and Exhibit No.__(JRS-1T), at pp. 17-19.

Q. Please summarize the individual drivers of changing PSE gas sales volumes and explain whether each party's decoupling proposal would provide rate recovery for those drivers.

A. The following table sets forth the individually significant drivers of gas sales volume changes and indicates whether gas usage changes caused by that variable would be subject to rate recovery through the decoupling tariff proposal of each of the parties:

Table 1: Rate Recovery of Sales Volume Drivers

SALES VOLUME DRIVER	GENERAL ONGOING SALES VOLUME IMPACT	PSE Decoupling Proposal	NWEC Decoupling Proposal	Staff Decoupling Proposal
Number of Customers	Increasing	No	No	No
Weather Abnormality	Variable	Yes	Yes	No
Price Elasticity	Decreasing	Yes	Yes	Yes
Replacement of Inefficient Old Appliances / Furnaces	Decreasing	Yes	Yes	Yes
Construction of Buildings – Improved Building Codes	Decreasing	Yes	Yes	Yes
Customer Financed Conservation Investments	Decreasing	Yes	Yes	Yes
Utility Sponsored Conservation Investments	Decreasing	Yes	Yes	Yes

This summary illustrates several important points. First, it shows (in the Number of Customers line) that all of the decoupling proposals before the Commission in this docket are imbalanced in favor of shareholders, because they would ignore continuing growth in the number of customers being served. This customer growth can be expected to continue to offset much or all of the last five listed sales volume drivers that have had a negative impact upon sales volume trends.

Beyond this fundamental imbalance caused by excluding customer growth, the summary table shows that most of the causes of sales declines that would be tracked through decoupling have nothing to do with utility-sponsored conservation programs that are thought to be subject to disincentives under traditional regulation. For example, the summary shows that the decoupling recommendations of PSE, Staff and NWEC would allow decoupling rate increases when customers adjust thermostats or otherwise react to commodity price increases experienced through the PGA. Additionally, the table shows that PSE would be allowed decoupling rate increases between rate cases for sales volume declines caused by normal replacement of old and inefficient appliances, furnaces and housing/buildings. Further, if customers elect to invest in conservation retrofits at their own expense, the decoupling proposals would allow PSE to increase rates to account for any resulting sales declines caused by such customer-financed conservation. I believe this table shows that decoupling, as proposed by PSE, Staff and NWEC, is an unreasonably broad response to concerns about regulatory disincentives to utility-sponsored conservation programs. Most of the drivers of sales volumes are not sensitive to regulatory incentives to utility management.[5]

Q. At page 9 of his testimony, Mr. Weiss states, "At a time of unprecedented increases in gas and other energy costs, it is imperative that the Company be allowed, and encouraged, to promote reduced energy usage." How do you respond?

A. The table presented above is helpful in responding. First, it shows on the "Price Elasticity" row that usage per customer declines caused by "unprecedented increases in gas" prices would be tracked through the proposed decoupling mechanisms. Utility management would probably claim that it has little or no control over commodity prices, such that PGA recovery of price changes is appropriate and necessary. Clearly, when faced by dramatically higher prices, ratepayers can be expected to be motivated on their own to respond to those higher prices, and management need not "be allowed, and encouraged" through a decoupling mechanism to permit or allow ratepayers to respond to high prices. In some respects, incentives to promote utility-sponsored conservation may be needed less at times when consumers are painfully aware of high natural gas prices and can be expected to dial back thermostats and independently employ conservation measures. Notably, whenever ratepayers actually do respond to higher gas prices, decoupling would effectively shift all risk of price elasticity demand response from

[5] As discussed in my Direct Testimony, if PSE achieves its "stretch" conservation goal of 4.2 million therms for 2006-2007, the resulting 2.1 million annual therms of conservation demand reduction is only about 0.2 percent of PSE's annual sales that exceed 1 billion therms. Exhibit No. ____ MLB-1TC at p.42.

shareholders to ratepayers between rate cases.

Q. At page 10 of his testimony, Mr. Weiss states that "ambitious conservation targets are a critical component of an effective conservation mechanism". How do conservation targets relate to usage per customer declines associated with improved appliance efficiency or improved building codes?

A. Much of the decline in average usage per customer is not related to company conservation targets. Customers replace defective or obsolete appliances and furnaces with modern, higher efficiency models for various reasons, not just company programs or targets.[6] Similarly, when building a new residence or commercial building, improved construction standards and materials will be employed and will cause more efficient energy consumption even if no conservation targets have been imposed. The persistent gradual turnover of housing/building stock and routine appliance replacement cycles explain much of the declining trend in usage per customer that has occurred historically. There is no need to adopt extraordinary regulatory measures such as decoupling rate trackers to continue these historical conservation trends.

Q. NWEC witness Mr. Weiss at page 16 and Staff witness Ms. Steward at page 14 propose adjustments to the PSE-proposed decoupling calculations for "new customers". Do these changes correct the problem associated with how decoupling treats customer growth that you addressed in direct testimony?

[6] See footnote 2 regarding federal appliance efficiency standards.

A. No. Modifications in the treatment of new customers that are proposed by NWEC and Staff represent only refinement of details about average per customer usage assumptions[7], while doing nothing to remedy the fundamental piecemeal ratemaking problem that results from carving out revenue increases created by future customer growth for retention by shareholders. As I mentioned in my Direct Testimony, all elements of the revenue requirement calculation are dynamic through time and changes that are favorable tend to offset other changes that are unfavorable. For example, adding customers and the related revenue growth can help "pay for" increases in operating expenses, or declines in usage per customer. The decoupling proposals of Staff, NWEC and PSE do nothing to recognize that new gas sales and margins produced by connecting new customers are available to help offset declining usage trends associated with existing customers.

Q. Does Staff witness Ms. Steward acknowledge the importance of matching all elements of the revenue requirement calculation as well as the inconsistency of piecemeal accounting for usage per customer declines between test years in her testimony?

A. Yes. At page 17, she states that decoupling should be allowed only as a pilot limited to three years and explains that, "…decoupling addresses the level of revenue the Company is recovering each year, based on what was authorized in a rate case. Decoupling does not address the costs the Company is incurring each

[7] NWEC witness Weiss (page 17) and Staff witness Steward (pages 15-16) recommend that new customer average usage levels be recalculated each year based upon actual data, rather than assuming that new customers' average demand levels are the same as the average demand of all existing customers.

year. In a rate case, the Commission examines what costs are incurred to serve customers, overall and at the customer class level. While decoupling provides the utility with the variances between actual and authorized revenues, it does not provide for any variances between actual and authorized costs." This reference to balanced review of overall costs and revenues that are examined in a rate case is what I referred to in my Direct Testimony as the matching principle. In apparent recognition that decoupling violates the matching principle, Ms. Steward then states, "If a decoupling mechanism is allowed to go on too long without a rate case, we risk violating the cost-based principle of regulation by creating a potential mismatch between current costs and rates."

In my opinion, Staff's proposed decoupling based upon changes in usage per customer will immediately and directly violate the matching principle. It is not a question of "risk" of violating the matching principle or concern about "potential mismatch" problems that should be tolerable for only a few years. Any decoupling tariff that tracks changes in usage per customer in isolation is improper piecemeal ratemaking that should be avoided.

Q. Referring again to the testimony by Ms. Steward at page 17, what is your understanding of her statement, "…decoupling addresses the level of revenue the Company is recovering each year, based on what was authorized in a rate case"?

A. I understand that Staff's recommended decoupling would ensure that future margin revenues would be recoverable by PSE from existing customers on rate schedules subject to decoupling, at the dollar levels authorized in the rate case, except for variances caused by weather. The mechanics of the decoupling would "take into account the new customers" that are added, using the approach described at pages 13-14 of Ms. Steward's Direct Testimony, essentially allowing customer-driven margin revenue growth to be retained for shareholders outside of the decoupling tracker. Customer growth was <u>not</u> mentioned by Ms. Steward in her discussion of changing costs and "authorized revenues", but there is no denying that ongoing PSE customer growth will add new margin revenues above "authorized revenues" that should <u>not</u> be ignored in the design of a decoupling mechanism.

Q. At page 21 of his testimony, Mr. Weiss concludes that, "The main goal of the Coalition in this proceeding is to align the interests of consumers and shareholders in order to encourage and empower consumers to participate in both utility and non-utility measures that cost-effectively reduce gas usage." Similarly, at page 8, Ms. Steward states, "Further, I recommend that the Commission adopt, as a pilot, a partial decoupling mechanism that will remove PSE's disincentive to promote energy conservation by restoring lost margin due to customers' non-weather related changes in usage." Is decoupling necessary to "align interests" or to promote energy conservation?

A. No. The decoupling proposals being advanced by PSE, Staff and NWEC are over-reaching, unbalanced and unnecessary. These proposals would shift most or all of the risks of declining usage per customer between rate cases from shareholders to customers, whether such usage declines are caused indirectly through price elasticity, ongoing appliance replacements and building upgrades, or are caused more directly through explicit company-sponsored conservation efforts. There has been no showing that customers are better off after absorbing the expected decoupling rate increases from such shifts. On the other hand, every decoupling proposal being advanced in this docket is fundamentally flawed in not properly offsetting future declines in sales per customer with the expected increasing sales volumes and margin revenues from serving new customers. Historically, overall PSE gas sales volumes are not declining because new customer sales growth has offset declining usage per customer.

With respect to the alleged need for decoupling, it should be noted that PSE has not failed in its efforts to deliver energy efficiency programs historically, in spite of the alleged disincentive under traditional regulation to do so. Ms. Steward states at page 10, "PSE has set reasonably aggressive targets for energy efficiency programs, which it has met or exceeded for the last several years." This is not surprising because PSE, like any gas LDC, will need to continue to promote the efficient use of its service to retain existing customers, attract new customers and be able to succeed financially in the future. To the extent it is established that there is a need for additional incentives for energy efficiency, decoupling is not a desirable mechanism for the reasons explained in this testimony.

It is my conclusion that traditional test year ratemaking, through which all changes in revenues, investment, expenses and cost of capital are measured at a consistent and "matched" point in time, has been effective in aligning and reasonably balancing the interests of PSE gas customers and PSE shareholders. Declining gas usage per customer has existed for many years for PSE and other LDC's and has been adequately addressed through traditional ratemaking and without decoupling. No changed circumstances exist today that are sufficient to justify adoption of extraordinary and complex piecemeal tariff tracking of changes in usage per customer for PSE's gas utility.

Q. Does this conclude your Cross-answering testimony?

A. Yes.