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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the In the Matter of the Application of Rocky Mountain Power for Authority to Increase its Retail Electric Utility Service Rates in Utah and for Approval of its Proposed Electric Service Schedules and Electric Service Regulations	Docket No. 09-035-23

REBUTTAL TESTIMONY OF RALPH CAVANAGH

ON BEHALF OF UTAH CLEAN ENERGY (UCE) and SOUTHWEST ENERGY EFFICIENCY PROJECT (SWEEP)

UCE and SWEEP submit the Rebuttal Testimony of Ralph Cavanagh in this docket.

DATED this 23th day of March, 2010.

/s/ Sarah Wright
Representing UCE

/s/ Howard Geller
Representing SWEEP

I. Background and Qualifications

Q. Please state your name, address, and employment.

A. My name is Ralph Cavanagh. I am the Energy Program Co-Director for the Natural Resources Defense Council, 111 Sutter Street, 20th Floor, San Francisco, CA 94104.

Q. Please outline your educational background and professional experience.

A. I am a graduate of Yale College and Yale Law School, and I joined NRDC in 1979. I am a member of the faculty of the University of Idaho's Utility Executive Course, and I have been a Visiting Professor of Law at Stanford and UC Berkeley (Boalt Hall). From 1993-2003 I served as a member of the U.S. Secretary of Energy's Advisory Board, and in March of 2008 I was appointed to serve on the U.S. Department of Energy's Electricity Advisory Committee. My current board memberships include the Bonneville Environmental Foundation, the Center for Energy Efficiency and Renewable Technologies, the Northwest Energy Coalition, the Renewable Northwest Project, and the University of Wyoming's Ruckelshaus Institute. I have received the Heinz Award for Public Policy (1996) and the Bonneville Power Administration's Award for Exceptional Public Service (1986). I published my first article on ways to break the link between utilities' financial health and their retail energy sales more than twenty years ago.[1]

Q. On whose behalf are you testifying?

A. I am testifying as a witness for the Southwest Energy Efficiency Project (SWEEP) and Utah Clean Energy (UCE) as an expert on mechanisms for "decoupling" utilities' recovery of authorized fixed-cost revenue requirements from their retail energy sales. SWEEP promotes greater energy efficiency in a six-state region that includes Utah; the organization

[1] R. Cavanagh, Responsible Power Marketing in an Increasingly Competitive Era, 5 Yale Journal on Regulation (1988).

works with consumers, businesses, utilities, and state and local governments. UCE is a state-based non-profit public interest group working to advance energy efficiency and renewable energy, and the economic and environmental benefits those resources provide, in public policy and utility regulatory arenas in Utah.

Q. Have you testified on analogous issues previously before this Commission?

A. Yes, I was a witness for Questar Gas in support of the decoupling mechanism that the Commission approved in 2006.[2]

Q. What is the purpose of your testimony in this proceeding?

A. My testimony reviews the proposal for a decoupling tariff that the Utah Division of Public Utilities has advanced in this proceeding and recommends that the Commission adopt the proposal.

II. Summary of Conclusions and Recommendations

Q. Summarize your conclusions and recommendations.

A. On behalf of the Division of Public Utilities, Dr. William A. Powell and Dr. Abdinasir Abdulle have proposed a residential rate design and revenue decoupling pilot that would advance both customer and environmental interests. It avoids inequitable increases in fixed charges, increases customers' rewards for saving energy, and reduces barriers to energy efficiency progress on the Rocky Mountain Power (RMP) system. The proposal also builds appropriately on the successful implementation of an analogous decoupling mechanism at Questar Gas. And it helps align RMP shareholder interests with customer interests in minimizing the cost of reliable electricity service.

One of RMP's most important responsibilities involves assembling a diversified mix of demand- and supply-side resources designed to minimize the societal costs of reliable

[2] Order Approving Settlement Stipulation, Docket No. 05-057-TO1 (Oct 5, 2006).

electricity supplies. The company is effectively a resource portfolio manager for its customers, and in the twenty-first century's volatile financial markets, the stakes and challenges have never been more daunting. Yet the regulatory status quo undercuts sound portfolio management by penalizing utility shareholders for reductions in electricity throughput over distribution systems, regardless of the cost-effectiveness of any contributing energy-efficiency, distributed-generation or fuel substitution measures. From customers' perspective, increases in throughput (above those contemplated when rates were established) result inappropriately in an uncompensated over-recovery of fixed costs by their utility. And a grave if unintended pathology of such ratemaking practices is the linkage of utilities' financial health to retail electricity throughput. Increased retail electricity sales produce higher fixed cost recovery and reduced sales have the opposite effect. To address all of these problems, I recommend that the Commission accept the Powell/Abdulle proposal for a simple system of periodic true-ups in electric rates, designed to correct for disparities between the company's actual fixed cost recovery and the fixed-cost distribution revenue requirement approved by the Commission for the residential sector in this proceeding. The true-ups would either restore to RMP or give back to residential customers the authorized fixed costs per customer that RMP under- or over-recovered as a result of fluctuations in retail electricity sales.

III. Evaluation of the Proposed Decoupling Mechanism and Alternatives

Q. Why not remove the linkage between RMP's financial health and retail sales by having the utility recover its fixed costs in higher fixed charges to customers?

A. This would significantly cut customers' rewards for saving energy at the very time they should be encouraged to do more. If you raise the portion of the bill that is independent of

energy consumption, you necessarily reduce the incentive to use less energy, while shifting costs from the heaviest users to the most sparing. Moreover, the rationale for utility investment in cost-effective energy efficiency rests in part on the conclusion that extensive market failures continue to block energy savings that are much cheaper than additional energy production at today's electricity prices. We would make a bad situation worse by reducing customers' rewards for conserving electricity, which is precisely what would happen if the Commission shifted costs from volumetric to fixed charges.

Q. Does revenue decoupling guarantee utility profits and reduce utilities' incentive to operate efficiently and minimize costs?

A. Decoupling would not guarantee any particular level of "profit," or in any way insulate RMP against the risk that internal inefficiencies will prevent management from achieving profitability objectives. With or without decoupling, the company keeps any operating savings that it achieves between rate cases and absorbs any cost overruns. Decoupling merely assures that RMP's opportunity to recover the overall fixed cost revenue requirement *previously authorized by the Commission* will not be affected by fluctuations in electricity use that the Commission did not anticipate when it set the company's rates. It is hard to see a pro-shareholder or anti-consumer bias in that common sense proposition.

Q. What is your response to concerns that decoupling insulates utilities from the effect of an economic downturn, but raises customers' rates at a time when customers can least afford it?

A. I disagree. First, recognize that a mechanism tied to revenues per customer leaves utilities fully exposed to reductions in customer growth associated with economic downturns. As the Washington Commission found in similar circumstances:

> [T]he revenue per customer mechanism does not insulate the company from fluctuations in economic conditions, because a robust economy would create additional customers and hence, additional revenue. Furthermore, the Commission believes that a mechanism that attempts to identify and correct only for sales reductions associated with company-sponsored conservation programs may be unduly difficult to implement and monitor. The company would have an incentive to artificially inflate estimates of sales reductions while actually achieving little conservation.[3]

Moreover, in or out of recessions, decoupling will only raise rates at a time when bills are declining as consumption drops; it is of course utility bills, not rates, that matter to customers. And the best way to protect customers from unaffordable bills is to maximize cost-effective energy efficiency investment, which decoupling promotes and its absence discourages. The potential economic benefits to customers from cost-effective energy efficiency measures dwarf the very modest maximum annual rate increases that the Powell/Abdulle proposal could produce.

Q. Doesn't revenue decoupling create its own disincentive for customers to improve their energy efficiency, by increasing rates and reducing savings in the aftermath of conservation efforts?

A. On the contrary, as the Oregon PUC pointed out in its January 2009 order approving a decoupling mechanism for Portland General Electric: "We believe the opposite is true: an individual customer's action to reduce usage will have no perceptible effect on the decoupling adjustment, and the prospect of a higher rate because of actions by others may actually provide *more* incentive for an individual customer to become more energy efficient."[4]

Q. Does revenue decoupling introduce painful or unsettling rate volatility?

[3] Docket No. UE-901183-T, Third Supplemental Order (April 10, 1991), p. 10.
[4] Oregon PUC, Order No. 09-020, p. 28 (January 2009).

A. No. Other witnesses have cited Pamela Lesh's comprehensive assessment of rate impacts of revenue decoupling, for which I was a reviewer.[5] It is worth emphasizing her conclusion, based on a review of decoupling mechanisms over a decade for 28 natural gas and 17 electric utilities: rate adjustments moved bills down as well as up, and were uniformly modest, amounting to "less than $1.50 per month in higher or lower charges for residential gas customers and less than $2.00 per month in higher or lower charges for residential electric customers (p. 67)." In terms of rate volatility for residential electricity customers, then, the nation's experience with revenue decoupling comes down to adjusting utility bills by less than seven cents per day, in both directions.

Q. Isn't it inequitable to test decoupling only for RMP's residential customers?

A. I think decoupling makes sense for all customer classes, but many initial tests of the mechanism in other states have focused on the residential class because its variable energy charges typically include a much larger share of system wide fixed costs than other customer classes. I see nothing inequitable in ensuring that the residential class pays no less *and no more* than the RMP fixed costs assigned to it by the Utah Commission. I take no position on appropriate inter-class allocation of RMP revenue requirements in this proceeding, an issue that is wholly independent of the merits of the decoupling test proposed by witnesses Powell and Abdulle.

Q. Would you prefer a broader application of revenue decoupling to all authorized RMP fixed costs and all customer classes?

[5] Pamela Lesh, Rate Impacts and Key Design Elements of Gas and Electric Utility Decoupling: A Comprehensive Review, Electricity Journal (October 2009).

A. Since Utah has no experience with electric revenue decoupling, I think that the proposed test is reasonable in scope, although I hope that a successful outcome will indeed persuade all parties and the Commission to support broader applications.

Q. Do you recommend any changes in the pilot test of revenue decoupling proposed by the Utah Division of Public Utilities?

A. My recommendations are more in the nature of clarifications than changes. The proposed mechanism is based on an allowed level of fixed-cost revenue per customer, like its Questar Gas counterpart (Powell testimony, p. 4); like the Questar mechanism, the RMP version should be adjusted regularly to reflect changes in the overall customer count (so that total authorized distribution fixed costs for the residential sector rise or fall between rate cases in proportion to changes in the number of residential customers). I think that this is the intent of the proposal (see, e.g., Abdulle testimony at p. 3 regarding changes in the customer count). Also, I recommend that any rate adjustments associated with revenue decoupling be timed to coincide with pre-existing seasonal or annual adjustments, to minimize administrative costs, and I do not think that rates need to be adjusted more often than annually to reflect under- or over-recovered balances in RMP's authorized fixed costs.

Q. What effect should the introduction of revenue decoupling have on RMP's authorized rate of return?

A. There are arguments on both sides, but I agree with what I take to be witness Powell's conclusion (pp. 18-22) that for purposes of the pilot test the right answer is no adjustment. The test affects only the recovery of authorized fixed costs of distribution to residential customers. RMP will be giving up some ability to gain from rising electricity sales and avoiding some future losses associated with unanticipated downward sales fluctuations, and

it is impossible without experience to predict how that will affect the company's overall risk profile, capital structure, and cost of capital. Across the nation, electric utility managements typically have preferred to keep shareholders' fortunes tied directly to upward sales trends, as attested by my and other energy-efficiency advocates' struggles over two decades to persuade more electric utilities to embrace revenue decoupling. That may itself be strong evidence that the balance of customer/shareholder interests is not likely to change to customers' disadvantage if Utah and other states adopt electric revenue decoupling.

Q. Absent a downward adjustment in rate of return, what's the customer benefit from revenue decoupling?

A. First, as I noted earlier, decoupling is a far superior alternative to raising fixed charges, which is the other way (still preferred by many utilities) to make recovery of authorized fixed costs independent of fluctuations in electricity sales. Such fixed-charge increases represent disruptive rate design changes that shift costs appreciably within customer classes, to the detriment of those who use the least electricity. Moreover, coupled as proposed in this proceeding with inverted rates, revenue decoupling will allow the Commission to send price signals that reward efficient use and deter wasteful consumption, to the ultimate benefit of all customers as the need for costly new generation resources is reduced. Additional benefits from revenue decoupling involve its contribution to sustained utility engagement in all aspects of cost-effective energy efficiency, from direct financial incentives to RMP support for enhanced efficiency standards for buildings and equipment. These are the fastest and cleanest ways available to reduce the nation's $350 billion electricity bill. I have seen repeatedly, over thirty years of engagement with the industry, the formidable difference that motivated utilities can make in driving or frustrating energy efficiency progress. Utah has

rightly set some of the nation's most ambitious energy efficiency targets, with an eye to reducing customers' bills, improving environmental quality and enhancing statewide energy security. RMP is a crucial partner in that effort.

Q. Are you suggesting that RMP is not already making significant energy efficiency efforts?

A. No. Both SWEEP and Utah Clean Energy appreciate the success of RMP's current DSM efforts, which include dedication of more than four percent of revenues to cost-effective energy efficiency and load management programs and achievement of annual energy savings in excess of one percent of system wide consumption in 2009. This is a strong record by any measure. The expansion of RMP's energy efficiency programs and resulting energy savings in recent years makes it all the more important to align shareholder and customer interests through decoupling of energy sales and recovery of fixed distribution costs. In more than thirty years of work with utilities on energy efficiency initiatives, I have seen too many impressive efforts fade over time when regulators left unaddressed fundamental conflicts between shareholder and customer welfare.

Q. What is the nationwide status of revenue decoupling for electric and natural gas utilities?

A. As of this filing, I count eighteen states that have adopted decoupling for one or more natural gas utilities and ten for electric utilities (Dr. Powell's list of eight states (p. 18) omits the two most recent adopters, Hawaii and Michigan).[6]

Q. How do you account for the disparity between natural gas and electric utilities, in terms of revenue decoupling adoption?

[6] See Michigan Public Service Commission, Orders in Case Nos U15751& U15768 (Detroit Edison Co.) (Jan. 11, 2010); and Case No. 15645 (CMS) (Nov. 2, 2009); Public Utilities Commission of the State of Hawaii (Hawaaian Electric Company) (Feb. 19, 2010).

A. I am a strong advocate for revenue decoupling across both industries, of course, but I think the disparity is easily explained by shareholder interests and associated management enthusiasm for advocating regulatory changes. Electric utilities have generally fared better than their natural gas counterparts under policies tying financial health directly to increases in retail sales; after all, comparing 1973 to 2009, U.S. natural gas consumption was essentially flat while electricity use more than doubled.[7]

Q. Does this conclude your testimony?

A. Yes.

[7] See data compiled in U.S. Energy Information Administration, Monthly Energy Reports (2010).

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was sent by United States mail, postage prepaid, or by email this 23 day of, March 2010, to the following:

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