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0000133495

1 Laura E. Sanchez
2 NATURAL RESOURCES
3 DEFENSE COUNCIL
4 PO Box 65623
5 Albuquerque, NM 87193
6 (505) 352-7408
7 lsanchez@nrdc.org

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BEFORE THE ARIZONA CORPORATION COMMISSION

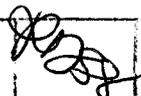
Arizona Corporation Commission

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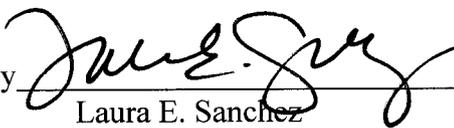
13 IN THE MATTER OF THE APPLICATION OF
14 ARIZONA PUBLIC SERVICE COMPANY FOR A
15 HEARING TO DETERMINE THE FAIR VALUE OF
16 THE UTILITY PROPERTY OF THE COMPANY
17 FOR RATEMAKING PURPOSES, TO FIX A JUST
18 AND REASONABLE RATE OF RETURN
19 THEREON, TO APPROVE RATE SCHEDULES
20 DESIGNED TO DEVELOP SUCH RETURN.

Docket No. E-01345A-11-0224

**NRDC's NOTICE OF TESTIMONY
IN PARTIAL OPPOSITION
TO THE PROPOSED SETTLEMENT**

21 Natural Resources Defense Council ("NRDC") by and through its attorney hereby files
22 the attached Testimony of its Witness Ralph Cavanagh in Partial Opposition to the Proposed
23 Settlement Agreement in the above-referenced matter.

24 RESPECTFULLY SUBMITTED this 17th day of January, 2012.

25 By 

26 Laura E. Sanchez
27 NRDC
28 PO Box 65623
Albuquerque, NM 87193

29 ORIGINAL and 13 COPIES of the
30 foregoing filed this 17th day of
31 January, 2012 to:

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Docketing Supervisor
Docket Control
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

COPIES of the foregoing
electronically mailed this
17th day of January, 2012 to:

All Parties of Record

By: 

TABLE OF CONTENTS

		page
SECTION I	INTRODUCTION	1
SECTION II	SUMMARY OF TESTIMONY	1
SECTION III	THE PROPOSED SETTLEMENT AGREEMENT	4
SECTION IV	RUCO'S TESTIMONY	8
SECTION V	AARP'S TESTIMONY	10
SECTION VI	RECOMMENDATION	12

BEFORE THE ARIZONA CORPORATION COMMISSION

TESTIMONY OF RALPH CAVANAGH
IN PARTIAL OPPOSITION TO THE
PROPOSED SETTLEMENT AGREEMENT

1 **I. INTRODUCTION**

2 Q. Please state your name, business address, and
3 occupation.

4 A. My name is Ralph Cavanagh. My business address
5 is c/o NRDC, 111 Sutter Street, San Francisco, CA 94014. I
6 am the Energy Program Co-Director for NRDC.

7 Q. Did you submit direct testimony in this
8 proceeding?

9 A. Yes, I filed testimony on behalf of the Natural
10 Resources Defense Council in support of the Arizona Public
11 Service Company's proposal for full revenue decoupling.

12 Q. Have there been any changes in your
13 qualifications?

14 A. No.

15 **II. SUMMARY OF TESTIMONY**

16 Q. Please summarize your testimony in partial
17 opposition to the proposed Settlement Agreement.

18 A. Barely a month after its decision in the
19 Southwest Gas rate case, the Commission faces a virtually
20 identical choice on the issue of whether to decouple a
21 utility's financial health from increases in its retail
22 energy sales. My direct testimony urged the Commission to
23 approve the Arizona Public Service Company's (APS) proposal
24 for an Efficiency and Infrastructure Account ("EIA"), which

1 represented a straightforward decoupling mechanism of the
2 very type endorsed in the Final Policy Statement adopted
3 unanimously by the Commission less than a year earlier.¹
4 After the filing of my testimony, the Commission approved
5 (on December 13, 2011) full revenue decoupling for the
6 Southwest Gas Company, based on a settlement proposal that
7 left the Commission a clear choice between full decoupling
8 and a lost revenue recovery mechanism. The Commission's
9 decision in favor of decoupling included a thorough review
10 of policy and legal issues, and signaled no retreat from
11 the Final Policy Statement. That same document is cited
12 repeatedly in my direct testimony as the primary basis for
13 NRDC's support of APS's revenue decoupling proposal in this
14 proceeding.

15 In this proceeding, as in the Southwest Gas case, NRDC
16 and SWEEP are urging the Commission to adopt full
17 decoupling, while Staff and others are contending that the
18 Commission should adopt a clearly inferior alternative in
19 the form of a lost fixed-cost recovery mechanism. The only
20 relevant difference between the two proceedings is that the
21 Southwest Gas case framed the choice as part of a proposed
22 Settlement Agreement (which NRDC joined), whereas in this

¹ Arizona Corporation Commission, Final Policy Statement Regarding Utility Disincentives to Energy Efficiency and Decoupled Rate Structures, Docket Nos. E-00000J-08-0314 and G-00000C-08-0314 (December 29, 2010) ("Final Policy Statement").

1 case the proposed Settlement Agreement attempts to prevent
2 the Commission from making the same choice, by including
3 only the inferior alternative in the body of the Agreement.
4 For that reason, NRDC did not join the proposed Settlement
5 Agreement. I recommend that the Commission decide this
6 case in the same way it resolved the Southwest Gas case:
7 approve the Settlement Agreement, but substitute decoupling
8 (in the form of the original APS proposal) for lost fixed-
9 cost recovery. My testimony primarily addresses that
10 issue, although I support also the additional
11 recommendations in Jeff Schlegel's testimony for SWEEP.

12 Prior to the filing of the Settlement Agreement, the
13 principal opposition to the APS proposal for revenue
14 decoupling came in testimony by Staff, AARP and RUCO.
15 Staff championed the lost fixed cost recovery mechanism
16 that became part of the proposed Settlement Agreement.
17 AARP's witness, Nancy Brockway, essentially ignored the
18 Commission's Final Policy Statement and (like the RUCO
19 witness) tried to relitigate issues that the Statement
20 addressed fully. This might be relevant if the Commission
21 had acted to reopen these issues, but it has not done so.
22 RUCO's witness said that he is "not unalterably opposed to

1 decoupling,"² although he went on to oppose it on terms
2 strikingly similar to those used unsuccessfully by RUCO in
3 contesting the Commission's recent adoption of decoupling
4 for Southwest Gas, including advocacy for a straight fixed
5 variable rate design policy that would reduce customers'
6 rewards for saving energy (Walmart Stores expressed a
7 similar preference in the Testimony of Steve W. Chriss).

8 The testimony of these witnesses has an almost generic
9 quality; the arguments could be and no doubt have been used
10 in many other states to oppose revenue decoupling and
11 support straight fixed-variable rate design. But as an
12 invited and active participant in the 2010 workshops that
13 preceded the Commission's Final Policy Statement, I believe
14 that in Arizona, witnesses need at minimum to acknowledge
15 and accommodate the Commission's analysis and conclusions.
16 Opponents of decoupling in this case have conspicuously
17 failed to do so.

18 **III. THE PROPOSED SETTLEMENT AGREEMENT**

19 Q. The proposed Settlement Agreement essentially
20 substitutes Staff's proposal for lost fixed-cost recovery
21 (LFCR) for the APS decoupling proposal. Why isn't lost

² Additional Direct Testimony of Frank W. Radigan (Nov. 23, 2011), p. 12: 18-19.

1 fixed-cost recovery a reasonable alternative to full
2 decoupling?

3 A. Without repeating the list of reasons in my
4 direct testimony (see pp. 12-13), I emphasize here that the
5 Commission itself has on two recent occasions rejected this
6 very argument. The first such occasion is the Final Policy
7 Statement, which states a clear preference for "full
8 decoupling" compared to "lost margin recovery mechanisms"
9 (pp 28-29). Moreover, in contesting the lost fixed-cost
10 recovery provision here, NRDC and other parties are giving
11 the Commission the opportunity to make exactly the same
12 choice that it faced in the recent Southwest Gas case,
13 where a stipulation joined by both Staff and NRDC asked the
14 Commission to select either a lost fixed-cost recovery
15 mechanism (Alternative A, favored by Staff) or full revenue
16 decoupling (Alternative B, favored by NRDC and SWEEP). The
17 Commission chose Alternative B, reaffirming the preference
18 stated in its Final Policy Statement:

19 [A] partial decoupling mechanism such as is included
20 in Alternative A could create conflicting incentives
21 for the Company by, on the one hand, imposing
22 significant energy efficiency goals that must be
23 achieved while, on the other hand, leaving in place a
24 structure that would concurrently provide an incentive
25 for SWG to sell higher volumes of gas in order to
26 improve its bottom line, thereby undermining the
27 Policy Statement's goal of encouraging conservation.
28 Another concern raised by Alternative A is the nature
29 of the annual proceedings that would be required to

1 review the performance of the LFCR mechanism, and the
2 likelihood that those proceedings would be extremely
3 adversarial as parties were forced to litigate on a
4 yearly basis whether SWG had achieved the required
5 energy efficiency goals. Further, as Mr. Cavanagh
6 pointed out, adoption of Alternative A may cause SWG
7 to pursue energy efficiency programs that look good on
8 paper but deliver much less in actual savings.³

9
10 In its lost fixed-cost recovery provision, the Settlement
11 Agreement is really just trying to resurrect Alternative A
12 from the Southwest Gas case, in an attempt to displace
13 another clearly preferable full decoupling mechanism.

14 Q. But doesn't the Settlement Agreement include an
15 opt-out provision for its lost fixed cost recovery
16 mechanism?

17 A. Yes, but the "opt-out" option requires customers
18 to accept higher fixed charges and reductions in the
19 rewards that they would otherwise receive in their APS
20 bills for saving electricity. The Commission's Policy
21 Statement considered this rate design option and noted that
22 it would adversely affect low-income customers and
23 discourage efficient energy use.⁴ The Commission went on to
24 reject a very similar proposal from RUCO in the recent
25 Southwest Gas case, on the ground that it would not "be
26 consistent with the stated goals of the Policy Statement."⁵

³ Decision No. 72723, Docket No. G-01551A-10-0458 (January 6, 2012), pp. 39-40.

⁴ Final Policy Statement, note 1 above, p. 28.

⁵ Decision No. 72723, note 3 above, pp. 40-41.

1 Section 9.7 of the Proposed Settlement proposes the same
2 kind of rate design change for large customers as a
3 rationale for excusing them from contributing to the lost
4 fixed-cost recovery mechanism. Again, in the Commission's
5 own words, this move toward "fixed cost/variable pricing"
6 and larger customer charges would mean "reduced variable
7 charges, which discourages efficient energy use."⁶

8 Q. But, from a consumer perspective, wouldn't the
9 one percent rate cap in the Settlement Agreement's LFCR
10 mechanism be preferable to the three percent rate cap in
11 the original APS decoupling proposal?

12 A. No, because the LFCR represents an automatic rate
13 increase, whereas decoupling can either raise or reduce
14 rates. Also, from a customer perspective, an even more
15 invidious element of the Settlement Agreement is the ways
16 in which it undercuts APS's incentive to achieve or exceed
17 Arizona's energy efficiency targets and accompanying
18 utility bill savings "on the order of \$4.6 billion between
19 2011 and 2030."⁷

20 Q. Why would the Settlement Agreement impair those
21 incentives?

⁶ Final Policy Statement, note 1 above, p. 28.

⁷ Id., p. 20 (comparing "high efficiency scenario" to "the business as usual case" for APS).

1 A. The Settlement Agreement does not make APS whole
2 for lost fixed costs even from those sales that APS is
3 judged to have lost as a result of its programs. The
4 proposed LFCR affects only "a portion of distribution and
5 transmission costs," and entirely omits fixed costs of
6 generation.⁸ This means that even for savings potentially
7 eligible for fixed cost recovery under the Settlement
8 Agreement, APS would be better off financially if it gave
9 up the savings and received instead equivalent increases in
10 retail sales. And of course, in the words of the Final
11 Policy Statement, all other electricity savings would
12 automatically "impact recovery of fixed costs and
13 investment returns," even as "sales growth . . . offers the
14 opportunity to recovery fixed costs and earn profit;" this
15 is precisely the dilemma that the Commission aimed to
16 eliminate in its Statement and its subsequent Southwest Gas
17 decision.⁹ The Proposed Settlement Agreement leaves the
18 dilemma largely unaddressed.

19 **IV. RUCO'S TESTIMONY**

20 Q. How do you respond to RUCO's legal objections to
21 revenue decoupling (Additional Direct Testimony of Frank W.
22 Radigan, p. 14)?

⁸ Proposed Settlement Agreement, p. 10, section 9.3.

⁹ See Final Policy Statement, note 1 above, p. 2 and Decision No. 72723, note 3 above.

1 A. RUCO raised the same concerns in the recent
2 Southwest Gas case, and a full rebuttal appears in the
3 Commission's decision.¹⁰

4 Q. What is your response to RUCO's review of
5 decoupling in other states?

6 A. It is an episodic and incomplete account (citing
7 only nine states and the Southern Company, which has no
8 experience whatever with decoupling), and it is no
9 substitute for the comprehensive assessment of results from
10 every adopted decoupling mechanism prepared by Pamela Lesh
11 Morgan and published in the Electricity Journal, which is
12 summarized in my direct testimony (see pp. 9-10).
13 Moreover, as regards the only western state covered by the
14 RUCO assessment (Washington), I note RUCO's wholly
15 equivocal conclusion about the Commission's decision to
16 terminate a complex rate adjustment mechanism that included
17 a decoupling element among many other features:

18 [T]he rate impacts of the resource-cost
19 adjustment overwhelmed the rate impacts of the
20 decoupling adjustment, making a fair comparison
21 of decoupling with
22 traditional ratemaking difficult.¹¹

23 Finally, virtually everything in RUCO's skewed summary
24 predates this Commission's Final Policy Statement and the

¹⁰ Decision No. 72723, note 3 above, pp. 31-37.

¹¹ Additional Direct Testimony of Frank Radigan, p. 17: 3-5.

1 very complete record on which it relied; there is no new
2 evidence here that might suggest a need to reopen the
3 inquiry.

4 Q. How do you respond to RUCO's contention that
5 Arizonans can't afford revenue decoupling at a time of
6 severe economic distress?

7 A. Here, and in his characterization of decoupling
8 as a "surcharge,"¹² RUCO's witness is acting under the
9 apparent misapprehension that revenue decoupling somehow
10 adds dollars to a utility's cost of service. Yet of course
11 revenue decoupling adds no costs to customers' bills; it is
12 a mechanism designed to ensure that utilities recover only
13 the fixed costs of service that the Commission has reviewed
14 and authorized in the previous rate case. That strikes me
15 as sound policy in good and hard times alike, particularly
16 since - as the Commission's Final Policy Statement attests
17 - revenue decoupling is essential to achieving the multi-
18 billion dollar economic benefits that cost-effective energy
19 efficiency can bring to all Arizonans.

20 **V. AARP'S TESTIMONY**

21 Q. How do you respond to AARP's negative response to

¹² Id., p. 10:8.

1 moves in the direction of straight fixed-variable rate
2 design?¹³

3 A. I agree with her entirely, and note that her
4 succinct assessment is starkly at odds with the lost fixed
5 cost recovery provision of the proposed Settlement
6 Agreement. Ms. Brockway is entirely right to say that
7 reducing variable charges and raising fixed charges would
8 mean that "the cost and effort of making usage more
9 efficient would be rewarded with lower bill reductions."¹⁴

10 Q. What about AARP's critique of the company's
11 decoupling proposal, including its treatment of weather?

12 A. Here the AARP testimony is wholly unpersuasive,
13 in part because the author apparently is unaware of the
14 Commission's Final Policy Statement (or at least she does
15 not cite it). For example, her lengthy assessment of
16 "weather risk" (pp. 26-28) is flatly inconsistent with the
17 Statement's conclusion that "[w]eather normalization in the
18 application of decoupling is discouraged because such
19 normalization would reduce the size of decoupling
20 surcredits to customers following an extreme weather
21 event."¹⁵ AARP's witness also invokes constitutional
22 issues raised by ALJ Dwight Nodes during the review of

¹³ Direct Testimony of Nancy Brockway, p. 23:1-13.

¹⁴ Id., p. 23:11-12.

¹⁵ Final Policy Statement, note 1 above, p. 31, no. 9.

1 Southwest Gas Corporation's revenue decoupling proposal,¹⁶
2 but Judge Nodes ultimately concluded that the
3 constitutional arguments against revenue decoupling were
4 without merit, and the Commission decided as much in its
5 final order.¹⁷

6 **VI. RECOMMENDATION**

7 Q. If the Commission agrees with your testimony,
8 what action should it take on the Settlement Agreement?

9 A. I recommend that the Commission resolve the
10 decoupling issue as it did in the Southwest Gas case, by
11 approving the Settlement Agreement except for section IX,
12 which describes the Lost Fixed Cost Recovery option. The
13 Commission should substitute for that option the original
14 APS decoupling proposal, as described and supported in my
15 Direct Testimony.

16 Q. Does this conclude your testimony?

17 A. Yes.

18

19

¹⁶ Direct Testimony of Nancy Brockway, p. 21: 14-22.

¹⁷ Decision No. 72723, note 3 above, pp. 31-37.