

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Petition of)	
)	
PUGET SOUND ENERGY, INC., and)	
NW ENERGY COALITION)	DOCKET NOS. UE-121697/UG-121705
)	(Consolidated)
For an Order Authorizing PSE to Implement)	
Electric and Natural Gas Decoupling)	and
Mechanisms and to Record Accounting)	
Entries Associated with the Mechanisms)	
)	
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WASHINGTON UTILITIES AND)	DOCKET NOS. UE-130137/UG-130138
TRANSPORTATION COMMISSION,)	(Consolidated)
)	
Complainant,)	
)	
v.)	INDUSTRIAL CUSTOMERS OF
)	NORTHWEST UTILITIES' PROPOSAL
PUGET SOUND ENERGY, INC.)	FOR PROCEDURE ON REMAND
)	
Respondent.)	
)	
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I. INTRODUCTION

1 Pursuant to the Washington Utilities and Transportation Commission's ("Commission") Notice Suspending Response Deadlines and Providing Opportunity to File Proposals ("Notice"), issued on August 5, 2014 in the above-referenced dockets, the Industrial Customers of Northwest Utilities ("ICNU") files this proposal, as set forth below, for how the Commission should proceed following remand of Order 07 in these dockets.

II. BACKGROUND

2 On July 25, 2014, the Thurston County Superior Court ("Court") entered an order reversing, in part, the Commission's findings in Order 07, which authorized an expedited rate filing ("ERF"), decoupling mechanism, and rate plan for Puget Sound Energy, Inc. ("PSE" or the

“Company”).^{1/} Although a full cost of capital study performed by ICNU’s witness, Michael Gorman, established a reasonable return on equity (“ROE”) for PSE of 9.30 percent, the Commission maintained PSE’s ROE at 9.8 percent, the level it previously authorized in PSE’s most recent general rate case.^{2/} No other complete cost of capital study was entered into the record. In its remand order, the Court found that “the Commission’s findings of fact with respect to the return on equity component of Puget Sound Energy, Inc.’s cost of capital in the context of a multi-year rate plan are unsupported by substantial evidence and the Commission improperly shifted the burden of proof on this issue”^{3/} The Court ordered the Commission to “establish fair, just, reasonable and sufficient rates to be charged under the rate plan, and to order any other appropriate relief.”^{4/}

3

Pursuant to the Thurston Superior Court Order, ICNU, on July 30, 2014, filed a Petition for Accounting Order (“Petition”) and a Motion to Modify Order 07 (“Motion”).^{5/} ICNU’s Petition requested that the Commission order PSE to refund to customers amounts it has collected under its rate plan that represent the difference between its currently authorized 9.8 percent ROE and the 9.3 percent ROE supported by the record.^{6/} ICNU further requested that PSE establish a deferred account to track this difference going forward.^{7/} ICNU’s Motion requests that the Commission modify Order 07 to find that there is sufficient evidence in the record to set PSE’s ROE at 9.3 percent.^{8/}

^{1/} WUTC Docket Nos. UE-121697/UG-121705 and UE-130137/UG-130138, “Letter re: Order of Judge Carol Murphy” (July 25, 2014).

^{2/} Order 07 ¶ 220.

^{3/} Id.; Super. Ct. Order at 2.

^{4/} Super. Ct. Order at 3.

^{5/} WUTC Docket Nos. UE-121697/UG-121705 and UE-130137/UG-130138, ICNU Petition for Accounting Order and ICNU Motion to Modify Order 07 (July 30, 2014).

^{6/} Petition ¶ 8.

^{7/} Id. ¶ 9.

^{8/} Motion ¶ 8.

4 Subsequent to the filing of ICNU’s Petition and Motion, the Commission served its Notice on the parties to this proceeding. The Notice indicated that ICNU’s Petition and Motion “represent ICNU’s view of how the Commission should comply with the Court’s order.”^{9/} While ICNU advocates for the relief requested in its Petition and Motion, it also appreciates the ability to address the benefits and limitations of other possible options the Commission could pursue in this remand proceeding.

III. ICNU’S PROPOSAL

5 The Court’s remand order requires the Commission to “establish fair, just, reasonable and sufficient rates” for PSE.^{10/} Accordingly, it would be within the Commission’s discretion to hold a general rate case for PSE so that a full picture of its rates can be developed. ICNU would support this process.

6 ICNU also recognizes, however, that a driving factor behind the expedited rate filing and rate plan Order 07 granted PSE was to avoid holding such a rate case.^{11/} Thus, if the Commission does not hold a general rate case, ICNU proposes that the Commission determine PSE’s ROE based on the current record.

A. Determining a reasonable ROE from the current record evidence is the simplest, fastest, and most legally sound procedure.

7 As discussed in ICNU’s Petition and Motion, the record in these dockets is already sufficiently developed to determine a reasonable ROE for PSE.^{12/} It contains a complete cost of capital analysis performed by Mr. Gorman, which includes three versions of a discounted cash flow analysis, a risk premium analysis, and a capital asset pricing model analysis.^{13/} This

^{9/} Commission Notice at 2.
^{10/} Super. Ct. Order at 3.
^{11/} Order 07 ¶ 21.
^{12/} Motion ¶¶ 6-8; Petition ¶ 7.
^{13/} ICNU Ex. No. __ (MPG-3).

was sufficient evidence for Commissioner Jones to find that PSE's ROE should be reduced at the time Order 07 was issued.^{14/} The Commission has previously determined a utility's ROE based on a single cost of capital analysis.^{15/} Furthermore, determining PSE's ROE based on the current record evidence would not create the legal and procedural difficulties the other options would, discussed below, including the absence of necessary evidence and the potential for a contentious and lengthy proceeding.

8 Moreover, determining PSE's ROE based on the record as it existed at the time Order 07 was issued would be consistent with the Commission's intentions when it authorized the ERF and rate plan for PSE, which was to establish baseline rates at this time to be in effect for the duration of the plan. Accordingly, determining an ROE for PSE based on the current record would be a legally sound procedure that would also support the Commission's intentions when it authorized PSE's rate plan and ERF.

B. Calculating a past ROE is procedurally and legally problematic.

9 As opposed to determining a reasonable ROE for PSE based on the record when Order 07 was issued, an after-the-fact calculation of a reasonable ROE raises a host of evidentiary problems that would make any order based on such a procedure suspect. Much of the data necessary to calculate PSE's ROE when Order 07 was issued, on June 25, 2013, is likely no longer available.^{16/} Growth rate estimates used in a discounted cash flow analysis ("DCF") are not retained for long periods because they only provide the current consensus analysts' growth projections.^{17/} Thus, it is very difficult to accurately estimate a DCF cost of equity for a

^{14/} Order 07, Separate Statement of Commissioner Jones ¶ 4.

^{15/} WUTC v. American Water Res., Inc., Docket Nos. UW-980072, UW-980258, UW-980265, UW-980076, 1999 Wash. UTC LEXIS 63, 6th Supp. Order at *12-*17 (Jan. 21, 1999).

^{16/} Attachment A (Affidavit of Michael P. Gorman) ¶ 7.

^{17/} Id. ¶ 8.

utility in a period after the rate case.^{18/} Certain *Value Line* information necessary for a capital asset pricing model analysis may also not be available to all parties.^{19/} The absence of such information would lead to results of questionable validity. It would also inhibit other parties' ability to evaluate and challenge these results.^{20/}

10 Further complicating an after-the-fact ROE calculation is whether one uses the information even if it is available. Such information consists largely of projections about how markets will perform in the future.^{21/} As such, some of these projections almost certainly deviate from how markets have actually performed in the past year. Do the parties use the projections – as they would have done to calculate the ROE at the time – or do they use actual data from the past year? While the former is likely to be based, at least in part, on information known to be inaccurate, the latter would require calculating an ROE that deviates from accepted modeling principles. Either way, to the extent parties differ in fundamental assumptions as to what information to use, this is likely to lead to extended debate on the validity of the various modeling results.^{22/} While the Commission often determines a reasonable ROE based on the range of reasonableness established by the parties' respective results, this task would be made more complex in this case due to the potential incompatibility of such results.^{23/} Thus, reopening the record to receive additional evidence of what PSE's ROE should have been when Order 07 was issued (or some other past date) is likely to raise significant evidentiary and legal problems, which make this option difficult.^{24/}

^{18/}

Id.

^{19/}

Id. ¶ 9.

^{20/}

Id. ¶¶ 9, 11.

^{21/}

Id. ¶ 10.

^{22/}

Id.

^{23/}

Id. ¶ 11.

^{24/}

Nevertheless, if the Commission determines to undertake a retrospective examination of PSE's ROE, ICNU plans to fully participate in this process.

C. Reopening the record to receive additional evidence of PSE’s ROE would be a complex and time-consuming process.

11 While reopening the record to determine an after-the-fact ROE for PSE would be fraught with evidentiary issues, reopening the record to receive additional evidence of PSE’s ROE, even limited to a going-forward basis, would frustrate the purposes behind the ERF filing and rate plan. The Commission intended for PSE’s rates to be in effect for the duration of the rate plan.^{25/} It would be incompatible with this intention to determine an ROE for PSE for the portion of the rate plan that has already occurred (based on the current record), and a potentially different ROE for the portion that has yet to occur (based on new evidence of current market forecasts).

12 Moreover, one of the Commission’s principal reasons for granting PSE an ERF and rate plan in the first place was “to relieve all stakeholders and the Commission from the burdens of almost continuous general rate case proceedings that have characterized our utility regulation during recent periods.”^{26/} As another state utility commission has recognized, “to reevaluate the return on equity ... would make it necessary to open the record for a broad range of issues, all of which could lead to a protracted process not substantially different from an entirely new rate case.”^{27/}

13 Procedurally, there would likely need to be at least two rounds of testimony, briefing, and a hearing – substantially the same process the Commission would follow in a general rate case. Moreover, this would not be a simple, straightforward process. Determining an appropriate ROE is often one of the most contentious and time-consuming aspects of a rate case. It most certainly would be in this remand proceeding. Such a determination is no mere

^{25/} Order 07 ¶ 15.

^{26/} *Id.* ¶ 21.

^{27/} *In re Applications of Westar Energy, Inc.*, Kan. Corp. Comm’n Docket No. 05-WSEE-981-RTS, 2007 Kan. PUC LEXIS 187, *22 (Feb. 8, 2007).

ministerial calculation. It involves an overarching and comprehensive evaluation of PSE's investment risk. This is likely to implicate numerous aspects of PSE's business, which, in turn, is likely to turn this remand process into precisely the type of proceeding the Commission was attempting to avoid in the first place when it issued Order 07.

14 Simply put, there would be no quick resolution to this case if the Commission reopened the record on PSE's ROE in this proceeding. Accordingly, if the Commission wishes to adhere to its "important policy objective" of relieving the Commission and stakeholders of the burdens of such proceedings, it should not reopen the record in this case.^{28/} Otherwise, it might as well hold a general rate case for PSE.

IV. CONCLUSION

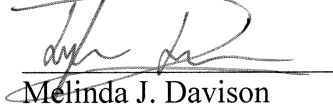
15 For the foregoing reasons, ICNU proposes that the Commission either hold a general rate case for PSE to determine the Company's "fair, just, reasonable and sufficient rates" or, alternatively, determine a reasonable ROE for PSE based on the evidence as it currently exists in the record. Further, ICNU requests that its Petition for Accounting Order and Motion to Modify Order 07 be granted.

^{28/} Order 07 ¶ 21.

Dated in Portland, Oregon, this 26th day of August, 2014.

Respectfully submitted,

DAVISON VAN CLEVE, P.C.

A handwritten signature in black ink, appearing to read "Melinda J. Davison", is written over a horizontal line.

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Of Attorneys for Industrial Customers
of Northwest Utilities

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WASHINGTON UTILITIES AND) DOCKET NOS. UE-130137/UG-130138
TRANSPORTATION COMMISSION,) (Consolidated)
)
Complainant,)
)
v.) AFFIDAVIT OF MICHAEL P.
) GORMAN
PUGET SOUND ENERGY, INC.)
)
Respondent.)

STATE OF MISSOURI)
) ss.
County of ST. LOUIS)

I, Michael P. Gorman, being first duly sworn, do say:

1. My name is Michael Gorman. I am over the age of 18, a citizen of the United States, and competent to be a witness.
2. I am employed by the firm of Brubaker & Associates, Inc. (“BAI”). My business address is: 16690 Swingley Ridge Road, Suite 140, Chesterfield, MO 63017.
3. Since 1990, I have performed various analyses and sponsored testimony on cost of capital and various other issues before the Federal Energy Regulatory Commission and

numerous state regulatory commissions including: Arkansas, Arizona, California, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Michigan, Missouri, Montana, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming, and before the provincial regulatory boards in Alberta and Nova Scotia, Canada.

4. I hold the designation of Chartered Financial Analyst (“CFA”) from the CFA Institute. The CFA charter was awarded after successfully completing three examinations which covered the subject areas of financial accounting, economics, fixed income and equity valuation and professional and ethical conduct. I am a member of the CFA Institute’s Financial Analyst Society.

5. After Puget Sound Energy, Inc. (“PSE”) initiated these proceedings, in February and March of 2013, I performed cost of capital analyses to determine a reasonable return on equity (“ROE”) for PSE. I sponsored testimony on this issue on April 26, 2013. My recommended ROE for PSE of 9.30% was based on the results of my cost of capital analyses, which relied on the most up-to-date information at that time.

6. I have been made aware that the Washington Utilities and Transportation Commission (“Commission”) is considering how to proceed following remand of its final order (“Order 07”) in this proceeding based on the Thurston County Superior Court’s findings that the Commission set PSE’s ROE without substantial evidence and by unlawfully shifting the burden of proof away from PSE. One option the Commission may be considering is to reopen the administrative record to determine what PSE’s ROE should have been at the time Order 07 was issued (or some other past date).

7. There are significant difficulties associated with attempting to calculate a utility's ROE in retrospect. Measuring the utility's cost of equity for setting rates should provide the utility an opportunity to recover its cost of equity capital during the period the rates will be in effect. As such, measuring this cost of equity requires the use of market information that is available in the rate case, which generally precedes the rate-effective period. Unfortunately, not all data needed to measure the utility's cost of equity in the rate case, is available in periods after the rate case is completed.

8. Discounted cash flow ("DCF") analyses, which are a commonly used method of determining a reasonable ROE, require the use of growth rate estimates. The consensus analysts' growth rate estimates are not retained for long periods of time, and therefore, are generally not available after the rate case (unless they are included in the rate case file). An important element of DCF investigations is to use consensus analysts' growth rate projections. These consensus analysts' growth rate projections are available at online sources such as *Yahoo! Finance*, *Zacks Investment Survey*, and *Reuters Thomson Financial*. These data sources only provide current consensus analysts' growth projections. Consensus analysts' projections that were published in prior periods are not retained on these resource websites and are not available to construct a DCF study based on information that was available in prior periods. As such, it is not possible to accurately estimate a DCF cost of equity for a utility company in a period after the rate case.

9. Capital asset pricing model ("CAPM") analyses are also commonly used to estimate a reasonable utility ROE. These analyses make use of *Value Line* information. *Value Line* information may be difficult to obtain for past time periods. Beta estimates for utility companies must be based on the published *Value Line* company report at the time of the rate case. Historical *Value Line* company reports are only available to subscribers that purchase the

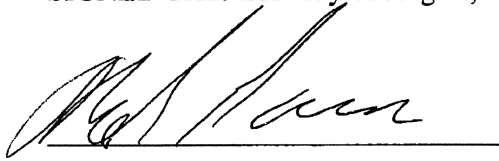
rights in a broader subscription service from *The Value Line Investment Survey*. Not all parties to the case may be able to collect and/or verify the accuracy of the historical *Value Line* beta estimates.

10. There are likely to be discrepancies between market projections at the time Order 07 was issued and how markets actually performed since that time. Because the ROE models use projections rather than historical actuals, the Commission would want to look to these projections. However, there is no certainty that all parties will use the same information and assumptions.

11. The potential lack of necessary information, coupled with the significant possibility that parties will use incompatible data and assumptions in their models, is likely to make it difficult, if not impossible, for parties to evaluate and challenge the validity of other parties' results, and for the Commission to compare these results on an apples-to-apples basis.

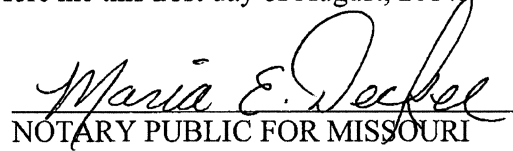
12. Due to these factors, if the Commission accepted additional evidence of PSE's ROE at the time Order 07 was issued, on June 25, 2013 (or some other past date), it may create a process in which parties provide the Commission with information that is neither accurate nor useful for establishing a reasonable ROE for PSE.

SIGNED THIS 21st day of August, 2014, at Chesterfield, MO.

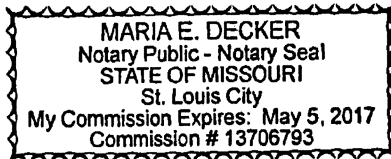


Michael P. Gorman
State of Missouri
County of St. Louis

SUBSCRIBED AND SWORN to before me this 21st day of August, 2014,



NOTARY PUBLIC FOR MISSOURI



My Commission Expires: May 5, 2017