Exhibit No. ___(DWS-1T)
Docket No. UE-072300/UG-072301 (*Consolidated*)
Witness: Donald W. Schoenbeck

BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	)	
Complainant,	)	
v.	)	**Docket Nos. UE-072300/ UG-072301 *(Consolidated)***
PUGET SOUND ENERGY, INC.	)	
Respondent.	)	

DIRECT TESTIMONY OF DONALD W. SCHOENBECK

ON BEHALF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

May 30, 2008

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Donald W. Schoenbeck. I am a member of Regulatory & Cogeneration Services, Inc. ("RCS"), a utility rate and economic consulting firm. My business address is 900 Washington Street, Suite 780, Vancouver, WA 98660.

Q. PLEASE DESCRIBE YOUR BACKGROUND AND EXPERIENCE.

A. I've been involved in the electric and gas utility industries for over 35 years. For the majority of this time, I have provided consulting services for large industrial customers addressing regulatory and contractual matters. I have appeared before the Washington Utilities and Transportation Commission (the "Commission" or "WUTC") on many occasions, including several proceedings regarding the establishment of charges for customers of Puget Sound Energy (the "Company" or "PSE"). A further description of my educational background and work experience can be found in Exhibit No. ___ (DWS-2) in this proceeding.

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A. I am testifying on behalf of the Industrial Customers of Northwest Utilities ("ICNU"). ICNU is a non-profit trade association whose members are large industrial customers served by electric utilities throughout the Pacific Northwest, including PSE.

Q. WHAT TOPICS WILL YOUR TESTIMONY ADDRESS?

A. I will discuss PSE's "Power Cost Only Rate Case" mechanism ("PCORC"), the allocation of costs to Schedule 449 and 459 customers ("Transportation Customers"), and Transportation Customer rate design. My testimony will not address revenue requirement issues at this time. This silence should not be construed as acceptance by ICNU of the amount of the Company's proposed increase. ICNU also is submitting testimony from Michael Gorman regarding cost of capital. ICNU reserves the right to address revenue requirement matters in its briefs.

Q. PLEASE BRIEFLY SUMMARIZE YOUR FINDINGS AND RECOMMENDATIONS ADDRESSED IN THIS TESTIMONY.

A. Since 2002, PSE has had the ability to submit a PCORC filing seeking power cost increases on an expedited basis. As the Company has made three PCORC filings, parties have gained much experience under this Commission-approved mechanism. Pursuant to a recent Commission order, a collaborative was held to see if parties could resolve their differences and issues with the PCORC process. No agreement or settlement resulted from this collaborative. ICNU recommends the Commission terminate PSE's PCORC. PSE can submit a general rate case filing and seek cost deferrals for the timely recovery of its resource acquisition costs.

The Company's cost-of-service study should be corrected to more accurately determine the cost of serving Transportation Customers. In particular, these customers should not be assigned power supply costs associated with account 557, and Montana taxes related to the Colstrip units. In addition, the Washington utility tax should be allocated based upon class revenue instead of plant investment. Making these corrections substantially increases the revenue to cost ratio for the Transportation Customers under PSE's supplemental case.

The Company has proposed the Transportation Customer rate charges be increased to provide $840,000 of additional revenue. ICNU recommends the High Voltage Transportation Customer rate charges should not be changed and the Primary Voltage Transportation Customer demand charge be reduced from $3.999/kVa to

$2.95/kVa. This would provide these customers with a rate decrease of $220,000 or 26%.

II. PSE'S PCORC MECHANISM

Q. PLEASE PROVIDE THE HISTORY BEHIND THE PCORC MECHANISM.

A. The PCORC mechanism was part of a multiparty settlement that was adopted by the Commission on June 20, 2002, in docket number UE-011570. While ICNU was a signatory party to certain elements of the settlement stipulation, ICNU was not a party to the Settlement Terms for the Power Cost Adjustment Mechanism ("PCA Stipulation"), which is the specific agreement that created the PCORC. Under the PCA Stipulation, PSE was authorized to submit a PCORC to update the base power cost level and/or to recognize and incorporate into rates the costs of new resource acquisitions. The PCA Stipulation contemplated that such reviews would occur on an expedited basis with the Commission issuing an order five months from the filing date. Finally, after July 1, 2005, the PCA Stipulation required that, in the event the PCORC results in an upward adjustment to rates, the Company must file a general rate case within three months of the Commission order.

The PCA Stipulation also instituted a PCA mechanism for PSE, which set forth the manner in which annual deviations in actual power costs from a base power cost level would be shared between the Company and its customers. The PCA sharing mechanism consists of four bands or levels for power cost deviations with a corresponding sharing percentage. For the first $20 million deviation (either plus or minus), the Company absorbs 100% of the cost or benefit. The second band is for deviations of $20 to $40 million. These amounts are shared equally between the Company and its customers

(50%-50%). The third band is for deviations from $40 to $120 million with the Company being responsible for 10% and customers for the remaining 90%. Finally, the fourth band is for deviations in excess of $120 million. In these cases, the Company is responsible for 5% and customers are responsible for the remaining 95%.

The settlement also contained a cumulative sharing mechanism for the initial period of July 1, 2002, through June 30, 2006. During this term, the customers are responsible for 99% of any deviation should the Company's share of the power costs exceed $40 million. This value did limit the Company's share of power cost for several months during this four year period, but by July 1, 2006, the Company's cumulative responsibility was only $27.2 million out of almost $3.8 billion of power costs (0.7%). Since June 2006, the Company's responsibility under the PCA mechanism has been a credit of $23.3 million through December 2007, as the Company's actual power costs have been below the baseline projections. The PCA mechanism has never impacted rates.

Q. PLEASE SUMMARIZE THE FILINGS PSE HAS MADE UNDER THE PCORC MECHANISM.

A. To date, PSE has submitted three PCORCs. In each filing, the utility had acquired a portion of, or all of, a new generating resource. The first PCORC filing was Docket No. UE-031725, filed on October 24, 2003. In addition to updating all power costs, PSE proposed the acquisition of Frederickson 1 (about 135 MW for PSE's 50% share), with an associated capital cost of $80 million.[1/] In the second docket, UE-050870 filed on June 7, 2005, PSE proposed the acquisition of the Hopkins Ridge wind project (150

[1/] WUTC v. PSE, Docket No. UE-031725, Exhibit No. 221 (JHS-11) at 5.

MW), with a capital cost of $190 million.[2] Most recently, in docket UE-070565 filed on March 20, 2007, the utility proposed the acquisition of the Goldendale Generating Station (277 MW), with a capital cost of $131 million.[3] Thus, with each and every PCORC filing, PSE sought Commission authority for the acquisition of a major new generating resource at a substantial capital cost.

Significantly, however, the majority of the increases sought by PSE in these filings were the results of cost pressures in all other production-related accounts. For example, in Docket UE-050870, PSE noted that the net impact of Hopkins Ridge was only $5.7 million out of a proposed net increase of about $42 million ($55.6 million less production tax credits of about $13 million). Similarly, in Docket UE-070565, PSE noted the net impact of Goldendale was $30.4 million out of a proposed initial increase of $64.7 million. In a supplemental filing, PSE sought $77.8 million in this proceeding. While PSE did not provide similar testimony in Docket UE-031725, in that proceeding, I estimated the Frederickson related increase was $18.3 million out of a request increase of $64.4 million. In my view, the main objective of the PCORC was to provide a timely inclusion of the costs of new resource in rates. But in actuality, the vast majority of each PCORC rate increase to date has not been attributable to new resource costs.

Q. WHAT HAVE THE PARTIES LEARNED FROM THESE FILINGS?

A. I believe most parties have been able to identify several serious shortcomings with the PCORC. One very troubling concern is the abbreviated time frame for PSE's PCORC proceedings. It simply does not allow sufficient time to analyze and judge the prudence of the proposed costs. Under the existing mechanism, all production costs and most

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[2] <u>WUTC v. PSE</u>, Docket No. UE-050870, Exhibit No. 16 (JHS-4) at 5.

[3] <u>WUTC v. PSE</u>, Docket No. UE-070565, Exhibit No. 95 (JHS-5) at 6.

transmission costs may be updated. Consequently, an extensive analysis is required in order to determine the reasonableness of all the forecasted values the utility is seeking in each account for the projected test year. In fact, with regard to power supply costs, the analysis that should be done for a PCORC is precisely the same as what is undertaken for a general rate case. This was pointed out by ICNU in the last PCORC proceeding. In that proceeding, ICNU recommended the Commission order a collaborative so that parties could have a frank and open dialog of the many issues that had been identified from all the parties that have gone through three PCORC proceedings.

Q. WAS THE COLLABORATIVE PROCESS SUCCESSFUL?

A. Unfortunately, it was not. As was indicated in the Facilitator's Report on PCORC Collaborative filed with the Commission on December 12, 2007, the parties met on several occasions but not a single issue was resolved. As a consequence, parties now have the opportunity to seek Commission resolution of their concerns.

Q. WHAT ARE ICNU'S CHIEF CONCERNS WITH THE PCORC MECHANISM?

A. ICNU has several serious objections with regard to PSE's PCORC filings. First, ICNU believes a PCORC filing should only be allowed if PSE is acquiring a major resource. While this has been the case in each of the three filings to date, it is not a requirement. As noted previously, PSE has a PCA mechanism. This mechanism allows for the recovery of power cost changes. The Company should not be allowed to circumvent this process by submitting PCORC filings. The fact that a rate change has never occurred as a result of the PCA, makes it clear that PSE does not need both a PCA and a PCORC.

Second, the very limited time frame in which to analyze a very complex number of cost projections and perform the necessary computer model simulations (each of which takes about 20 hours to run) is woefully inadequate. As I have pointed out in testimony in each of the PSE PCORC filings, the majority of each revenue increase being sought by PSE was related to projected cost increases not directly related to the resource acquisition. This requires an initial review of supporting documents (some of which are not provided until the Commission has issued a confidentiality agreement in the proceeding), submittal of several rounds of data requests (to which PSE almost always takes the full 10 days to respond), and clarifying discussions with utility personnel. Accordingly, an analyst must attempt to undertake the eight month review typically done in a general rate case in about two months. This is simply an impossible task given the extensive documentation, including workpapers, EXCEL spreadsheets, and the extremely large AURORA data base provided to support the filing.

Third, PSE has filed supplemental updates to the initial cost projections that can be impossible to analyze within the remaining time before intervenor testimony is due. For example, the third PCORC filing was made on March 20, 2007. The prehearing conference order, which was issued on April 12, 2007, noticed an intervenor testimony due date of June 15, 2007. However, PSE provided a supplemental update filing on May 23, 2007. It was simply impossible to meaningfully investigate portions of this update as the necessary discovery process could not be done in the allowed time frame.

Fourth, there are the administrative delays in getting the necessary confidential information from the utility to just start the analysis, and data responses are not provided until due. In a general rate case proceeding, these delays can be tolerated (although not appreciated), but under the existing PCORC schedule, these circumstance are intolerable as every day's delay becomes quite critical.

Q. CAN PSE'S PCORC MECHANISM BE MODIFIED TO TAKE INTO ACCOUNT ALL OF ICNU'S CONCERNS AND ISSUES?

A. No. It is simply impossible to compress the necessary and needed analytical time period to provide a meaningful difference between the current general rate case schedule and a reasonable PCORC schedule. In my view the difference would be just one or two months so at that point, it would be of little value.

ICNU also questions the need for a PCORC; PSE has shown it can file general rate cases very quickly and has not demonstrated why it needs a PCORC to pass on regular, projected cost increases. In addition, allowing PSE to choose between a general rate case and a PCORC allows PSE to choose the option best for it and worst for ratepayers. For example, in a declining capital cost market, PSE would likely choose a PCORC, because cost of capital is only updated in a general rate case.

Finally, PSE has sought and been granted deferred accounting of costs even with regard to a resource acquisition that was part of a PCORC filing. PSE submitted a PCORC filing with regard to the Goldendale plant on March 20, 2007. However, prior to this date, PSE had filed an accounting petition seeking deferred accounting treatment for Goldendale's fixed costs on March 15, 2007 in Docket UE-070533. The Commission approved this application on April 11, 2007, allowing the costs to be deferred commencing on March 15, 2007. It is impossible for PSE to argue that a PCORC filing is the only way to receive timely recovery of the costs of new resources. The protections afforded all parties under the general rate case procedures are absolutely necessary for equitable due process. In the months while these filings are being examined, PSE's PCA mechanism will allow for cost recovery. For all these reasons, ICNU recommends that the PSE PCORC mechanism be terminated at this time.

III. COST OF SERVING TRANSPORTATION CUSTOMERS

Q. HAS THE COMPANY PREPARED AN ELECTRIC COST-OF-SERVICE STUDY FOR THIS PROCEEDING?

A. Yes. As it has done in the last several rate cases, PSE submitted the results of a cost study in Exhibit No. ___(DWH-4).

Q. HAVE YOU REVIEWED THE MANNER IN WHICH THE COMPANY CLASSIFIED AND ALLOCATED COSTS IN PERFORMING THIS STUDY?

A. Yes, with particular emphasis on the manner in which the Company has assigned costs to its Transportation Customers. These customers are rather unique in that they are responsible for obtaining their needed power supply from third parties and they pay PSE's applicable wholesale Open Access Transmission Tariff ("OATT") charges. The OATT charges recover the costs associated with having the third party power supply delivered over PSE's high voltage transmission system and the associated ancillary service costs. Consequently, the only costs recovered from the retail rate charges these customers pay under Schedules 449 and 459 are for local sub-transmission delivery-related services.

Q. HAS THE COMPANY'S COST STUDY ACCURATELY DETERMINED THE COST OF PROVIDING THIS SERVICE TO THE TRANSPORTATION CUSTOMERS?

A. No. The Company states in its prefiled testimony that generation costs, including the costs of remote resources should not be assigned to Transportation Customers.[4/] However, my review found two production-related accounts - Account 557 Other Production Expense and Montana Electric Energy Tax - whose costs were allocated to

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[4/] See Exhibit No. ___ (DWH-1T) at 4 and 12.

the Transportation Customers. Since both costs were allocated based upon an energy factor, these inappropriate assignments make a substantial difference in the resulting cost-of-service. In addition, my review found the Washington utility tax was allocated based upon plant investment. As this tax is assessed based upon utility revenue, a revenue based allocation factor should be used.

Q. PLEASE EXPLAIN WHY IT WAS INAPPROPRIATE TO ASSIGN ACCOUNT 557 COSTS TO TRANSPORTATION CUSTOMERS.

A. Account 557 is the “catch-all” account for production-related costs. A partial description of the account as contained in the Federal Energy Regulatory Commission guidelines is:

> This account shall be charged with any production expenses including expenses incurred directly in connection with the purchase of electricity, which are not specifically provided for in other production expense accounts. Charges to this account shall be supported so that a description of each type of charge will be readily available.

For the test period, PSE has included over $15 million of costs in this account. A review of the Company’s workpapers indicates the costs included in this account include payroll taxes on production wages, property insurance, workmen’s compensation expense, hedging costs, BPA related contract and rate case expenses, competitive bid costs, and many other miscellaneous items.

It appears that the Company believed this account had been related to providing ancillary services but that is simply not the case. Transportation Customers are directly assigned costs (and revenues) related to ancillary services. Any additional allocation of production related costs such as account 557 is inappropriate. This account should be allocated in the same manner as other production accounts that exclude Transportation Customers from any cost assignment.

Q. WHY IS IT INAPPROPRIATE TO ALLOCATE THE MONTANA ELECTRIC ENERGY TAX TO TRANSPORTATION CUSTOMERS?

A. This cost is directly related to the energy produced from the Colstrip units and it is assessed on the generated energy. As the Company's testimony has noted, output from PSE's remote plants is not used at all to serve Transportation Customers as these customers must procure their own supply.[5/] Consequently, none of this cost should be assigned to the Transportation Customers.

Q. PLEASE EXPLAIN YOUR DISAGREEMENT WITH THE MANNER IN WHICH THE COMPANY HAS ALLOCATED THE WASHINGTON UTILITY TAX.

A. The Company's cost-of-service study allocates this tax based upon the investment in production, transmission and distribution plant assigned to each class. This type of allocation would be appropriate if the tax was assessed on property value. However, the Washington utility tax is assessed on revenue at a rate of 3.873%. To more accurately assign this cost, the Company should use a revenue based or total cost allocation factor that takes into account both investment and expense components of utility costs.

Q. HOW DO YOUR RECOMMENDATIONS CHANGE THE COSTS ASSIGNED TO THE TRANSPORTATION CUSTOMERS?

A. The ICNU cost allocation recommendations are compared with the Company's assignment in the following table.

Transportation Customer Cost Comparison

Cost Category	PSE Study	ICNU Study	Difference
Other Production Exp	$1,318,042	$0	-$1,318,042
Montana Elec Eng Tax	$137,908	$0	-$137,908
Washington Utility Tax	$630,545	$282,862	-$347,683
Total:	$2,086,495	$282,862	-$1,803,633

[5/] See Exhibit No. ___ (DWH-1T) at 12.

As indicated in the table, the ICNU recommendations lower the direct costs assigned these customers by $1.8 million.

Q. HAVE YOU INCORPORATED THESE CHANGES INTO THE COMPANY'S COST-OF-SERVICE MODEL?

A. Yes. Attached as Exhibit No. ___(DWS-3) is a summary showing the results of the ICNU cost study for the Transportation Customers. The ICNU recommendations make a substantial difference in the revenue to cost or parity ratio of the Transportation Customers while not materially changing the parity ratio of the other customer classes (see line 35). The parity ratio is the most appropriate yardstick for determining whether the rate schedule charges are equitable to each customer class. A ratio less than 1.0 or 100% indicates a class is not paying its fair share of costs. Conversely, a ratio greater than 100% indicates the class is paying charges in excess of its cost responsibility. As the following table indicates, under the Company cost study, the overall Transportation parity ratio was just 96%. However, under the ICNU recommendations, the parity ratio is substantially greater at 145% indicating these customers are paying rate charges substantially above a cost-based level.

Parity Ratio Comparison Of Transportation Customers

Customer Sub-Class	PSE Study	ICNU Study
Primary	2.46	5.19
High Voltage	0.90	1.34
Transportation Total:	0.96	1.45

IV. TRANSPORTATION RATE DESIGN

Q. WHAT HAS PSE PROPOSED WITH REGARD TO THE DESIGN OF THE TRANSPORTATION RATE CHARGES IN THIS PROCEEDING?

A. The Company is proposing an overall rate increase to the Transportation Customers of almost $840,000 or 9.7%. The Company's supplemental filing did not contain specific rate charges on how this amount would be recovered. In the Company's initial prefiled testimony, the Company noted a two-step rate design method. The first step increased the customer charge for both Primary and High Voltage customers from $709 to $1,300 per month (a $591 increase). The second step derived essentially the same demand charge increase in recognition of the large disparity in the revenue to cost ratio of the two sub-classes. The proposed distribution charges are shown in the following table along with the current rate.

Comparison of Distribution Charges Transportation Customers ($/kVa)

Sub-Class	Current	Proposed	Difference
Primary	$3.999	$4.174	$0.175
High Voltage	$1.532	$1.713	$0.181

For the Company's initial rate spread proposal, this method increased the High Voltage distribution charge by 11.8% while the Primary distribution charge increase was 4.4%.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSED INCREASES FOR THESE CUSTOMERS?

A. No. Properly assigning costs to the Transportation Customers, as ICNU recommends, would result in extraordinarily high revenue to cost ratio for the Primary transportation customers. The Company's proposed increase to this sub-class cannot be justified. The delivery charges for these customers should be substantially decreased in this proceeding. The revenue to cost ratio of the High Voltage customers is very high as well. While it may not be high enough to have their rates reduced at this time, these customers should not receive any increase as the Company has proposed. ICNU recommends simply maintaining the current rate charges for the High Voltage Transportation Customers as they are currently paying.

Q. HOW SHOULD THE RATE CHARGES FOR THE PRIMARY TRANSPORTATION CUSTOMERS BE DETERMINED IN THIS PROCEEDING?

A. ICNU recommends these customers receive a rate decrease based upon moving one-third of the way toward a cost-based rate level. As the ICNU cost study indicates, the existing rate charges are almost $666,000 too high; therefore, the Commission should authorize a decrease of $220,000 (25.7%) for these customers. This should be achieved by maintaining the existing customer charge and reducing the distribution delivery charge from $3.999/kVa to $2.95/kVa.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.