Exhibit No. ___ (TES-7)
Dockets UE-121697, et al.
Witness: Thomas E. Schooley

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY,** **Respondent.**	**DOCKETS UE-121697 and UG-121705 (*consolidated*)**
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.** **Respondent.**	**DOCKETS UE-130137 and UG-130138 (*consolidated*)**

EXHIBIT TO TESTIMONY OF

Thomas E. Schooley

STAFF OF WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Thurston County Superior Court Transcript of Oral Argument on Petitions for Judicial Review of Order 07

December 3, 2014

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON
IN AND FOR THE COUNTY OF THURSTON

WASHINGTON STATE ATTORNEY GENERAL'S OFFICE, PUBLIC COUNSEL DIVISION, Petitioner, vs. WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Respondent.	)	SUPERIOR COURT NO. 13-2-01576-2 (Consolidated)
INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES, Petitioner, vs. WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Respondent.	)	

THE HONORABLE CAROL MURPHY PRESIDING

May 9, 2014
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Olympia, Washington

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THE COURT: Please be seated.

Good afternoon. My apologies for having to get a little organized here.

I'll begin this hearing with appearances on the record by all counsel, and then we'll proceed to hear argument in this case.

MS. DAVISON: Start with me?

THE COURT: Please.

MS. DAVISON: Your Honor, I am Melinda Davison and I am counsel for the Industrial Customers of Northwest Utilities.

MR. FFITCH: Good afternoon, Your Honor. Simon ffitch with the Washington State Attorney General's Office appearing on behalf of the Office of Public Counsel.

MS. GOODIN: Good afternoon, Your Honor. Amanda Goodin appearing on behalf of the Northwest Energy Coalition.

MS. CARSON: Good afternoon, Your Honor. Sheree Strom Carson with Perkins Coie representing Puget Sound Energy.

MS. CAMERON-RULKOWSKI: Good afternoon, Your Honor. Jennifer Cameron-Rulkowski, assistant attorney general representing the Washington Utilities and Transportation Commission.

THE COURT: Thank you.

Prior to this hearing I received a joint request for oral argument times. I suspect that it was probably submitted at the encouragement of my judicial assistant with regard to the parties' request to have additional time for oral argument. I very much appreciate that the parties are in agreement, and the court agrees that this case does require some additional argument, and the court is granting that request to have the oral argument time that was requested by the parties.

So it appears that the parties have agreed as to the splitting of time, and so without any further direction from me, I'm assuming that the parties have planned order of argument?

MS. DAVISON: We have, Your Honor.

THE COURT: So you may proceed.

MS. DAVISON: Thank you.

THE COURT: And as you're coming up, I will tell the parties, which you've probably guessed, is I have read all the materials that have been submitted. I very much appreciate the materials that were submitted in this case. I didn't bring to the bench today the record in the case. It is in chambers. But I have read all of the documents that were referenced and all of the briefs that have been submitted as well as others that I thought were of interest.

MS. DAVISON: Thank you, Your Honor. Good

afternoon. At issue in ICNU's petition, which is distinct from Public Counsel's, is whether commissions -- the commission's Order 07 should be remanded for failure to meet the requirements of the APA. It's a very narrow issue. The Washington Utilities and Transportation Commission is tired of nearly annual rate cases. This is abundantly clear throughout Order 07. To solve this perceived problem, the commission invented the concept of expedited rate filing, or as you saw in the briefs, shorthand ERF. The problem with the commission's declared solution is that it doesn't get rid of annual rate increases for ratepayers. Instead, we will see up to three percent per year, and that's not counting power cost adjustments and other issues I don't want to bring into this argument, for up to three years. Order 07 doesn't stop annual rate increases; instead, it limits the ability to review and challenge PSE's underlying costs on an annual basis.

For example, we have declining cost of capital. The ERF as applied by the commission only looked at increasing costs. They did not look at costs that were declining, such as costs of capital, which is the issue that we bring before you.

So another issue, just as an aside, is why does this expedited rate filing uniquely apply to PSE? Avista and

PacifiCorp file rate cases almost every year. Both of these utilities currently have general rate cases pending, but the ERF proceedings or process is not applied to either of those general rate cases. Traditional general ratemaking is applied in those two cases. Despite the many flaws in Order 07, as I said earlier, our challenge is narrow.

I will note that the respondents refer to us as petitioners in many instances in the briefs that really should just have said "Public Counsel." We had a ten-page reply brief so we really didn't have enough time to correct all of those mis-references so I just want to be very clear about that.

Our narrow challenge is the commission's decision to use an ROE in this case that is based on evidence from a previous case. That is strictly prohibited by the APA. But even the commission brief states that (indiscernible) just merely referenced information from that previous case. The commission didn't reserve the issue for another day.

Excuse me. I'm having voice problems with --

THE COURT: That's okay. Can I ask a question while you take a drink there?

MS. DAVISON: Sure.

THE COURT: Would you agree that the process involved essentially starting after the last general rate

case and then sort of determining whether there should be any differences based on that instead of starting the process all over again?

MS. DAVISON: Your Honor, I think I understand your question. So you're referring to workshops and things that occurred between the general rate case and then the filing by PSE of a rate case that turned into the expedited rate filing?

THE COURT: Right.

MS. DAVISON: Respectfully, no, Your Honor. We do not agree to that. There were some informal workshops and ideas thrown around, but there was never a concept developed, what's in, what's out, what's the timing. That was never done through that process.

THE COURT: Well, I'm not sure we're communicating very well. I guess what I'm saying is that there was a process of getting information in order to develop the rate in the 07 order, right?

MS. DAVISON: Yes, Your Honor. Just like any rate case, you have the ability to file for, you know, they're called data requests.

THE COURT: So information was collected in order to formulate the rate in that order.

MS. DAVISON: Yes, Your Honor.

THE COURT: Okay. So we know that some information

was collected. It wasn't like they didn't collect any information at all.

MS. DAVISON: That's correct. They did collect some information, but as it relates to our issue, we -- we had no idea that cost of capital was excluded from an expedited rate filing. We'd never been through an expedited rate filing. So we do what we always do, which is we hire an expert witness whose views were adopted in the previous rate case of PSE's, and he did a full-blown cost of capital analysis. He's the only expert who did that. And so PSE and staff say, "Well, that is not appropriate for an expedited rate filing." Well, how do we know that?

THE COURT: But whether it's appropriate or not, that is not required. Wouldn't that be accurate?

MS. DAVISON: Your Honor, I don't agree with that. I think that when you look at a utility's rates, there are some very basic components that you always have to decide when you're resetting rates.

THE COURT: In a general rate case.

MS. DAVISON: Or any rate case where you're putting rates in effect for four years. Basically you need to look at the cost of capital because that is the profit component that the commission is providing to PSE. That is the essential piece of setting rates.

THE COURT: So is there a citation to authority that

requires under the APA for an expedited rate filing process to require the same information as in a general rate case?

MS. DAVISON: No, Your Honor. Because this is the first time we've ever had an expedited rate filing, we don't have any rules that were developed by the commission. We don't have any policies that were developed by the commission. It was just kind of made up as it went along.

THE COURT: Thank you.

MS. DAVISON: So as I said, you've got this commission brief that says that they merely reference information in a different order. That's their argument. But how can that be? The commission didn't reserve the issue for another day. If you look at paragraph 220 of Order 07, it established an ROE of 9.8 percent. But there was no evidence in the 07 record to support 9.8 percent. Nobody brought forward evidence that says that was the correct ROE. The evidence brought forward by ICNU's expert witness and supported by the dissent said that number should be 9.3 because we have a declining market. That case may have concluded a year earlier, but that data that was relied upon in the previous PSE rate order was at least two years old, and given today's financial markets, that's stale data, particularly if you apply it four years out. So either we have a situation in which the commission established an ROE based on this stale data from PSE's

previous rate case or it based it on evidence on -- based it on no evidence in the record from Order 07. Either approach violates the APA. You cannot rely on evidence outside the record, and if you're going to establish something as important as an ROE, you have to do that based on substantial evidence.

Respondents argue that we should have known cost of capital was excluded from the expedited rate filing. As I said, no one told us this rule. We didn't learn of this until the order came out. Which is interesting is that if this cost of capital issue was outside of the ERF proceeding, then Mr. Gorman, who was our witness for cost of capital, his evidence was admitted to the record. There was no motion to strike. There were no objections. The commission on its own didn't say, "Well, that's inappropriate evidence for an ERF filing." But instead, it got admitted to the record, and it was unrebutted.

The commission's most important job is to establish fair, just and reasonable rates. If you do not have evidence to support a 9.8 ROE for 2013, '14, '15 and '16, how can the commission reach a finding that the rates established in Order 07 are fair, just and reasonable? As I said earlier, cost of capital is a major issue. If Mr. Gorman's uncontested testimony was adopted, PSE's rate increase would be approximately $10 million less per year.

This is an important case, Your Honor. It will establish whether the APA still applies to the WTC or whether they can decide complicated issues in a rate case based on, quote, end result approach. Of course, the end result approach in this case also fails to meet the APA standards. Given the high rate increases facing PSE's customers, we deserve a thoughtful, well-considered decision based on record in that case.

In conclusion, ICNU respectfully requests that Your Honor remand this case back to the commission with instructions to conduct a complete analysis of PSE's cost of capital and issue a decision based on the evidence in that record. Thank you, Your Honor.

THE COURT: Thank you.

MR. FFITCH: Good afternoon, Your Honor. Simon ffitch again appearing on behalf of the Office of Public Counsel for the state attorney general. Appearing also today on behalf of over one million Puget Sound Energy company ratepayers, particularly with an emphasis on the interests of residential and small business customers, who have been directly and negatively impacted by this rate plan, beginning with a rate increase for electric customers of over $50 million in 2013, in cumulative increases extending to the end of the rate plan of over $350 million.

What I'd like to do first of all is just respond to your

question about process if I may also do that, perhaps hopefully clarify a little bit of the procedural complexity here. It is a new, complex experimental plan that the commission has approved in this order, and there are three components, the expedited rate filing piece, the decoupling piece, and the K factor piece.

The expedited rate filing piece actually, Your Honor, I don't believe is at issue in this case. You had asked about the process for that. I would agree with Ms. Davison's answer that we were not satisfied with the process; however, the key thing to -- a couple of key things about the ERF piece of this. It -- as originally presented and conceived by commission staff, it's a one-time increase. It's not a multiple annual recurring increase. That's an important piece.

Second factor is that --

THE COURT: Is that required? Is there an authority that requires that that be only a one-time --

MR. FFITCH: All we have, Your Honor, is a recommendation by a commission staff witness in the 2011 rate case, and the commission's sort of general discussion of how they would like to see that proposal brought forward by parties. So this is the first time that it's been sort of fleshed out and presented. Again, we don't oppose it. And the reason we don't oppose it is because it is based on

actual cost, not projections. It's a one-time increase, which helps the company stay caught up with costs. And it's less than three percent. That's a very key factor. It's less than three percent.

In terms of the information gathering, just a couple of points there. The commission essentially gathers no information itself, or in general it can issue bench requests and sometimes does do that. But in general, the burden of proof under Title 80 is on the company to come forward and prove its need for rates under 80.04.130(4).

So the company had the burden of proving the need for its rate increases in the case. There are two key failures on that score. Ms. Davison's mentioned one. That's the failure of the company to actually file expert testimony on its cost of capital. And the second piece is its failure to file supporting attrition study quality projections to support the K factor, and I'll come back to both of those points. But so we would say that the information that was presented in the record was not adequate.

And finally, just on a procedural point, the total amount of time allowed to parties to conduct discovery on the company filing was 19 days in this case, Your Honor, which we don't believe is sufficient. We argued that point to the commission. So just on that point we -- you know, the sort of information gathering component of this case we

think is -- has been problematic.

But in any event, you know, to sort of return to the main points of our argument if I may.

THE COURT: I just have a couple of questions if you don't mind. Is there a requirement that the company provide expert testimony or is it okay to say "In the last rate case, we had this expert testimony, and there is no reason that that has changed"? Are both methods permissible?

MR. FFITCH: That is not permissible. We address that in our brief, as does ICNU. The reason it's not permissible is that as the commission has itself said I believe in the 2011 rate case order that you have in the appendixes, as recently as that, the cost of capital is dynamic. It is not static. It is constantly changing. So in every case the burden of proof is on the utility to prove what their cost of capital is at that time. And so even if they wish to -- through expert testimony. And that's normally how it's done. It's always done that way until this case. That's why we provided you with copies of the 2011 rate case order and the 2009 rate case order, both of which display in great detail the normal process of setting cost of capital through expert testimony.

THE COURT: So I understand that this is not the normal process, but does it actually violate a rule to not

have that expert testimony?

MR. FFITCH: Well, the commission's general rate case rule, which is one of our issues that ICNU is not addressing, does require as part of the company's presentation that it present evidence in support of its rate of return. And the fact that the company believes that its rate of return is still the same in 2013 as it was two years earlier in 2011, that's not a irrebuttable presumption. They need to once again come forward and carry their burden of proof on that through expert testimony.

THE COURT: But isn't the rule that you're citing applicable to a general rate case and not necessarily an expedited rate filing?

MR. FFITCH: That is correct. But we believe that that is one of the major defects in the commission order, that -- its failure to conduct this as a general rate case.

I want to say, by the way, that the Public Counsel Office does not frequently challenge orders of the UTC. We do not do so lightly. In this case though we believe that there are three significant defects in the order. The first one, which you've sort of introduced the topic of, is the question of whether this should have been conducted as a general rate case under the commission rules. As we've said in our briefs, the rules clearly define any rate

increase that increases rates by three percent or more for a customer class as a general rate case. And coupled with that there is a detailed set of evidentiary requirements for the company to meet in proving its need for a rate increase of that magnitude. There's no dispute in this case that the rates that were approved increased rates in excess of three percent in the first year alone, in July 2013, and over the life of the plan, the customer rates will increase in the range of nine percent, in excess of nine percent. There's no dispute about that in the record.

It's not a ministerial or procedural requirement solely. It's actually sort of a manifestation of the burden of proof requirement under the commission statutes. It's a roadmap for the company to come in and provide adequate evidence to support its request for rates, and the reason it's there is so that there's not a lot of time wasted at the beginning of the case in asking for each little piece of the broad, detailed evidence that's required, you know, to conduct a general rate case. So we think it has some real substantive importance. It is the basis on which the commission can ultimately decide that rates are fair, just and reasonable as the statute requires.

Now, the commission for the first time to our knowledge -- and the commission has not cited any other instances of it -- issued a blanket waiver of the general rate case rule

in a case that raises rates by over three percent, and nine percent over the life of the plan. This is the first time we're aware of this ever happening. The rationale provided is the issue of frequent rate cases. The standard that applies is stated in the waiver rule that the commission cites, and it's essentially a two-prong standard. It has to be in the public interest, and it has to further the purpose of the rule. We think this falls far short, Your Honor.

Let's turn to the primary justification. Ms. Davison's already addressed this. The primary justification is frequent rate cases, but the cure is worse than the disease here. What this does instead of providing a moratorium or a pause or a timeout is it actually institutionalizes rate increases for customers through 2016 and possibly 2017 at the sole option of Puget Sound Energy. The only relief is really afforded to institutional participants, folks in this room, the commission, the staff, the counsel who don't have to actually process the rate cases. But from the customer perspective, there will be now annual rate increases out through at least 2016. And in addition, they will be more frequent than under the admittedly harsh rate case frequency regime that we've been seeing because as we provided in Appendix A of our reply brief, the frequency of rate cases has been about 18 to 24 months. Under the rate

plan we go to every twelve months there's a rate increase. Those rate increases under the rate plan are bigger than the increases over the last four years, which added up to 6.9 percent. Rate cases since 2009 up to this point added up to 6.9 percent. Going forward again, we have the larger size of 9 percent increases that customers will experience under the plan. So the rationale doesn't fit.

If there ever were a case, we would submit, where a general rate case was appropriate, this is it. We have three -- by the commission's own admission we have three new experimental alternative methods that have never been used before. We have the outstanding questions about attrition analysis and methodology that the commission has yet to address. We have outstanding cost of capital issues. We have a very significant economic impact on residential and business customers in the state. This is simply not a case that you start off with this kind of expedited unsupported case procedural structure.

THE COURT: Mr. ffitch, you are then asking this court to overturn the commission's decision to waive its own procedures, correct?

MR. FFITCH: That's correct, Your Honor. On the general rate case rule issue, that's correct.

THE COURT: And that's an extraordinary thing to ask the commission, whose expertise is in that area, and who

issued its own waiver, would be second-guessed by a court. What do you understand the standard to be for the court to overturn an agency's decision on waiver?

MR. FFITCH: Well, Your Honor, the -- we rely upon the APA first of all. We've argued that the waiver didn't meet the standards of the rule itself, which I've just addressed in terms of public interest and purpose of the rule. In addition, the arbitrary and capricious standard under the APA, you know, we've argued that the rationale that's offered by the commission actually doesn't make sense, that the rationale that you're providing relief doesn't match the facts. There is no relief except for institutional participants. That's not a public interest. So that's what we would argue, Your Honor. And we would argue that yes, it is a significant thing for a court to do, but this was -- this is an unprecedented action with the commission with significant impacts on Western Washington utility customers.

Let me turn to the next issue that we've raised, and that's the K factor. The --

I guess just one more answer as I'm looking at my notes to your question about the general rate case rule. Obviously, the APA also has a component in which a commission -- an agency has to follow its own rules under 570(3)(h), and if it departs from those rules, it has to

provide an adequate explanation. So that would be an additional ground for reversal.

The K factor is our second main point. There's no dispute in this case that the K factor is a form of attrition. Of course, we'd love Your Honor to discuss these arcane matters of utility ratemaking, and what I'd like to do is just sort of provide a brief explanation of how this works and why it's important. Essentially, attrition is earnings erosion. It's earnings erosion that's usually created by some external factors. Most typically cited are very high rates of inflation, double-digit inflation or very high capital expenditures by the company. And the result of those kinds of factors is that even if you set rates today in a rate case based on normal actual cost type of analysis, the attrition argument goes I can collect those rates next year when they go into effect, but by then I'll already be behind. I'll be so far behind that I have no reasonable opportunity to earn my rate of return. And that is what an attrition case is about.

It's an extraordinary form of relief, however, because costs are constantly changing. And every rate case is something of an estimate of where costs will be down the line when the rates go into effect. It is described by the commission in all its precedents as an extraordinary form of relief, and there's a reason for that, and that is

because attrition is based on projections. Ordinarily, ratemaking is not based on projected costs. And again, we've provided the last two Puget rate cases so that's clearly demonstrated in the commission's early discussions in those orders of the principles that it applies.

But the key thing is that ratemaking is based on auditable actual expenditures by the utility company in a very recent time period coupled with what's called known and measurable costs. So if they know that they're going to -- they've already got contracts to build a plant within six months, they know they've got a labor contract that's going to kick in in six months after the rate case is over, but they know exactly what that's going to cost, they're allowed to do that.

But projections are severely disfavored. The commission has said repeatedly that they're inherently suspect, and that's the problem with attrition. That's why it's an extraordinary relief because it's based on projections. The company comes in and says, "We project that we're going to need -- we're going to be this far behind. We're going to have these kinds of expenses down the road." The commission has allowed that, but because it's so much of a departure from the reliable database that it usually uses that it has required attrition studies in the past which are the sort of most reliable form of projection

development that the company can provide. And that provides a sense of assurance that at least even if you're using projections, they're the best you can do.

We don't have attrition studies in this case for the first time in the history of the commission as far as we know. The commission has allowed attrition adjustments here with no attrition studies by the company, and there's no dispute that there are there are no attrition studies in the record. The other thing that's interesting that's missing here is the commission's own staff didn't do any attrition studies, pretty much just accepted the company numbers. Particularly interesting because in the Avista 2012 case that's discussed in the record only a few months before the commission did its own attrition studies submitted through one of its witnesses, and of course in that case Avista itself did a full-blown attrition study and a sort of corroborating attrition study. So there were essentially three attrition studies in the Avista case.

Coming back to this case, we have none. So our argument, Your Honor, is that A, this is a departure from precedent with no explanation, B, it's a failure to carry a burden of proof, C, it's a failure to provide substantial evidence. The commission doesn't have substantial evidence to grant attrition adjustment. In our view that's because after 30 years of precedent of requiring attrition

adjustments, that has essentially denominated the attrition study as what you need to have substantial evidence to order an attrition adjustment.

Now, the commission has I think a final critical factor on this issue, on the K factor issue, is that the commission's position on attrition is now extremely uncertain. The Avista order approved a settlement by parties who expressly said that they were not creating an attrition adjustment. The commission did discuss attrition in the Avista case, but it said we're not commenting on the analysis. We're not commenting on the evidence. We're not announcing any attrition policy. We're going to hold a separate proceeding to adopt attrition policy. That proceeding has never happened. Subsequently, we now have a multiple-year $350 million attrition adjustment in the form of the K factor imposed on Washington ratepayers. So we believe that's arbitrary and capricious. The court needs to have a determined policy articulated by the commission in order to be able to evaluate whether this is a reasonable attrition adjustment, whether the K factor is a reasonable attrition adjustment in our view.

I will say that I don't think the commission disputes that the commission's brief says that there is no settled methodology. The commission's own briefing in the case, and even its own order, is sort of leaving the ball up in

the air, and that's just not a tenable situation for a reasoned decision-making, especially with the rate outcome for customers.

The final issue, Your Honor, that we've raised is the cost of capital issue. Ms. Davison has already addressed that. We share those concerns. We also share the concerns that were raised by Commissioner Jones in his separate statement in the order. He actually essentially is raising the arguments that we're raising, and they are essentially these: Number one, the company didn't carry its burden of proof. It did not file a cost of capital analysis through an expert witness. And number two, there is evidence in the record of declining cost of capital. Sort of back to your question of, you know, why can't they just use the 2011 number because there is competent, clear evidence in the record from Mr. Gorman corroborated by other intervener witnesses that the company's cost of capital is declining for two reasons. ICNU is focusing on the first reason, which we agree with, which is that in general capital costs were coming down at that time. And we are emphasizing the second reason, which is that the adoption of decoupling in this case by definition reduces the company financial risk, and for that reason as well the cost of capital needs to be reevaluated.

THE COURT: Mr. ffitch, the commission did not have

to find Mr. Gorman's testimony credible though, correct? I mean, it didn't have to go along with that testimony.

MR. FFITCH: Your Honor, I don't believe that they found it not credible. I don't think there's a finding that Mr. Gorman's testimony was not credible. The commission essentially made sort of a general statement that the record was too spare, but they did not specifically find that his testimony was not credible.

THE COURT: Well, they could have rejected it for any reason, but I think what you're saying is that would require a competing expert's testimony in order to reject his testimony? Is that what you're saying?

MR. FFITCH: I'm not saying that, but I guess a couple of thoughts. First of all, the burden of proof is on Puget Sound Energy to prove, as Ms. Davison argued, an essential element of its cost structure for setting rates, and that is their cost of capital. It's a big piece. It's $10 million a year in this case alone, $40 million at least over the life of the rate plan. It's a significant part of the cost structure of the company. And again, the rate orders that we've supplied show that. It's not sort of a theoretical incidental issue, and the company chose not to go forward with it.

The other sort of volitional thing that happened here is the commission could have required the company to provide a

study in the record. The record is clear that -- I think in response to questioning from Commissioner Jones at the hearing the company could have in about a week generated a expert analysis of its costs of capital. It affirmatively chose not to do that in this case. The company chose -- the commission chose not to request it.

And it's created a catch-22 because the commission at the same time in this order says there's -- cost of capital's definitely an issue here. In multiple orders it has said that the adoption of decoupling reduces risk, reduces cost of capital. That should be passed through in lower rates to customers, but we're not going to look at it here because we don't have a record. It's a catch-22. The commission had completely adequate authority to remedy the defects in the record in this case by issuing a bench request and ordering the company to file a cost of capital study, and it could have had a less spare record.

And in terms of Mr. Gorman's credibility, Mr. Gorman was relied on heavily in the 2011 general rate case as the most credible rate of return witness in the case. So it -- it's not a strong argument we think in the order that to sort of disregard his evidence.

We do not oppose decoupling. We are comfortable with the decoupling, in fact support the form of decoupling that's been adopted in this case under the relief that we

request, the ERF piece of the -- sort of the tripartite alternative mechanism would remain in place. The decoupling piece would remain in place.

What we're asking, Your Honor, is that the commission -- excuse me -- that the court remand to the commission to have the commission set the correct -- or current cost of capital effectively in 2013 when the rate plan began, and that would -- that would result in an adjustment of the rates under -- that are ongoing under the ERF and decoupling proposals downward in our view if the commission finds that those declining trends that are reflected in the evidence are in fact the case after its proceeding.

So in terms of additional relief, we're asking that the order with respect to the K factor be vacated so that essentially what would happen is that the K factor would stop. The future annual rate increases under the K factor would stop and customers would be refunded the amounts of money that have been collected under the K factor up to that point in time. Puget Sound Energy then would have an opportunity to file a new general rate case and fully establish its 2014 or 2015 cost of capital, fully put on an attrition study to prove that it had attrition and in general prove that it would need a rate increase in 2015 or thereafter.

I think just in conclusion, Your Honor --

THE COURT: I'm sorry. I need to interrupt here with regard to the requested remedy because I am a little confused, and I apologize if I'm not using the right terms here. You indicated your first request for relief was to remand back to the commission?

MR. FFITCH: Yes.

THE COURT: And presumably that would be not under an ERF process. The court would have to dictate a process by which the commission would determine a rate; is that correct?

MR. FFITCH: I don't think the court would have to dictate, Your Honor. The commission knows how to conduct an adjudication of cost of capital. So the ERF piece of it really is secondary. Essentially what we are asking is that the court remand to the commission to set correct cost of capital by giving all parties an -- by looking at what's already in the record, and at the commission's option, offering parties an opportunity to submit additional evidence.

THE COURT: But didn't you also ask this court to reverse the commission's waiver?

MR. FFITCH: Correct. But that essentially as a practical matter overlaps with the K factor because the K factor is what kicks this up over three percent, Your Honor. So it is confusing. The ERF itself is under the

three percent, and the decoupling program by itself also doesn't trigger the general rate case rule. So you sort of end up at the same place if you require the general rate case or if you vacate the K factor. And then the third prong of relief is recalculate the correct cost of capital, and then adjust the rates accordingly.

THE COURT: Thank you.

MR. FFITCH: I would just conclude by saying that the commission has the duty to protect the interests of Washington citizens who depend on monopoly utility companies to provide them with electric and natural gas service which is essential to their lives and their livelihoods. And to adequately protect customers and to establish fair, just, and reasonable rates, the commission must base its decisions on law, its own rules and precedents, and on substantial evidence in the record as well as a reasonable exercise of its discretion. We recognize the commission has discretion, but it's not unfettered. It's bounded by Title 80 and the enabling act, by the Administrative Procedures Act, by the commission's rules, by its own precedents, and by the evidence in the record.

In this case to the extent the commission is relying on its discretionary powers, it's significant that there is no statutory prescription or framework that expressly

authorizes any of the three prongs of the alternative ratemaking framework that's been adopted here. So this is not a case of the commission making familiar discretionary judgments within a long-established and accepted framework. In this context with no clear legislative guidance, the commission's exercise of discretion and adherence to statutes and rules and evaluation of the evidence requires a higher standard of scrutiny, and we believe less deference. The order fails to withstand the scrutiny for the reasons we've addressed, and we would request that the court grant relief to Puget Sound Energy's customers. Thank you, Your Honor.

THE COURT: Thank you.

MS. CAMERON-RULKOWSKI: May it please the court, my name's Jennifer Cameron-Rulkowski, assistant attorney general, and as I indicated before, I represent the Washington Utilities and Transportation Commission. I will address the commission's authority and the standard of review, the context of the commission's decision in Order 7, and then I'll discuss three of the main issues of this appeal, which are the applicability of the general rate case filing rule, return on equity and the attrition adjustment or K factor.

To start with, I want to emphasize that this case concerns ratemaking policy. The legislature tasked the

commission with regulating public service companies like PSE in the public interest, and specifically mandated that the commission set rates that are fair, just, reasonable and sufficient. However, there is no statute which prescribes exactly how the commission is to go about this. The substantial evidence and arbitrary and capricious standards are applicable to this case and are discussed in my brief.

What is important in this case is that courts accord substantial deference to the commission's findings on matters within the commission's authority, and the commission has broad authority in rate-setting matters. Courts recognize that the commission exercises substantial discretion in selecting appropriate ratemaking methodologies. Our state supreme court made it clear in the *US West* case that courts are not at liberty to substitute their judgment for that of the commission in rate cases. Absent a clear showing of abuse, the courts will not set aside a discretionary decision of a commission.

Turning to the context of the decision in Order 7, the context is the commission's order in PSE's last general rate case, which came out in 2012. In this order the commission expressed its concern with serial back-to-back general rate case filings stating that they were overtaxing the resources of all participants and were wearying to

ratepayers. In the 2012 order the commission recognized that these serial general rate cases were fueled by a cycle of high capital expenditures which were necessary to replace aging infrastructure and also maintain that infrastructure. In the 2012 general rate case order, the commission discussed a proposal by staff to file a simplified rate case. And in this proposal that staff presented in the last general rate case, staff specifically excluded consideration of return on equity. In the 2012 general rate case order, the commission invited the parties to come forward with alternatives to a general rate case.

And I would note that Public Counsel and Industrial Customers were parties in the -- in the 2011 PSE general rate case and were certainly familiar with staff's proposal.

PSE ultimately did come forward with their expedited rate filing, and this filing did not contain -- did not contain testimony on return on equity which should not have been a surprise at that point to the other parties given their participation in the last general rate case.

THE COURT: Why is that?

MS. CAMERON-RULKOWSKI: They -- because they had also heard staff's proposal for the simplified rate case, and in the 2012 order, the commission discussed it and specifically mentioned its components, and one of its

components was that there was no return on equity. And I would mention here that there are other proceedings regularly before the commission where return on equity is not an issue and is not considered.

THE COURT: So are you saying that in the 2011 rate case these other parties and the public were put on notice that the next potential rate case would be expedited and would not include that information?

MS. CAMERON-RULKOWSKI: To some extent, yes. However, it is up to the utility to make the filing. So other parties wouldn't know whether the utility was actually going to take up that challenge and put forward a simplified rate case. In this case, PSE did work with staff, and the expedited rate filing was based on the framework that staff had proposed in the -- in the 2011 general rate case.

THE COURT: Presumably the commission has many ways that it could address this policy issue that arose with regard to serial general rate cases. It just chose to address it this particular way. Would that be accurate?

MS. CAMERON-RULKOWSKI: I think that's accurate, Your Honor. And also the commission is responsive to proposals by the parties, and the expedited rate filing and the rate plan in the decoupling proposal, those were proposals by PSE who had worked with other -- with other

parties and stakeholders to bring forward these alternatives to the general rate case.

THE COURT: So presumably the commission could have instead of addressing the problem in a rate request could have modified its procedures generally for all companies.

MS. CAMERON-RULKOWSKI: That's true, Your Honor.

THE COURT: And it chose not to do that.

MS. CAMERON-RULKOWSKI: It may still choose to do that in the future, but at this point, no, it has not chosen to promulgate a rule specifically applicable to this type of situation of high capital expenditures.

THE COURT: So it sought to address this problem that it was having on a large-scale basis and address it specifically with regard to one company's request.

MS. CAMERON-RULKOWSKI: In this order, in Order 7, yes. However, I would mention that it is also addressed in the *Avista* case which came right before Order 7. In the *Avista* case there was also a multi-year rate plan and also an attrition adjustment. So I think what we're seeing is a trend of ratemaking alternatives to address this issue. And the commission's decisions in Order 7 are the result of the commission's evaluations of various proposals in these proceedings.

Moving now to the main issues in the appeal, I'll discuss the applicability of general rate case rules, and

I'll be brief. The commission was not required to treat the expedited rate filing and the decoupling proposal as a general rate case. Both of these cases are separate and distinct filings. They came into the door at the commission at different times, and they also address different purposes.

Turning to the cost of capital, Order 7 addresses cost of capital in two contexts, in the expedited rate filing and in the decoupling proposal. In the 2012 general rate case order, the commission had just reduced PSE's return on equity to 9.8 percent. The commission stated in the 2012 order -- I'm sorry. The commission stated in the -- in Order 7 that at least with respect to the majority commissioners, they had not anticipated addressing return on equity in the context of the expedited rate filing. Nevertheless, the commission duly considered all of the evidence and the arguments put forth by the parties on this issue, and this evidence included analysis that the most recent average return on equity for utilities similar to PSE was 9.88 percent. This is just above PSE's current return on equity which is 9.8 percent. The commission also considered analyses by Industrial Customer's expert which showed that the -- which showed under different models that the returns on equity for comparable companies could be as high as 11.37 percent. On the basis of this evidence as

well as other evidence, the commission reasonably concluded that 9.8 percent was within a range of reasonable returns for PSE.

THE COURT: But what information was it considering that was specific to PSE?

MS. CAMERON-RULKOWSKI: That would have been what the -- what the range had been in the last general rate case, and that is -- that's stated in the order.

THE COURT: Right. So I read that. So it considered what was provided at the last rate case, the historical information, but nothing more recent than that with regard to PSE, only information regarding trends and the industry in general. Would that be accurate?

MS. CAMERON-RULKOWSKI: Well, the -- to some extent, yes. The commission essentially decided that it was not going to reset the return on equity in this case, and I think you could say that it took a quick look to make sure that this was still a reasonable return on equity. So for example -- or for instance this is not a case where anyone came into the commission and said, "Commission, the returns on equity are currently down at five percent. There's no way that PSE could still have an accurate return on equity at 9.8." This was a case where the commission decided that it should take up return on equity in the next general rate case where it could look at all offsetting factors, and it

took a quick look and considered the parties' evidence, which showed that the return still -- still was within a reasonable range of returns.

THE COURT: But not based on any information from PSE, specific to PSE.

MS. CAMERON-RULKOWSKI: That's correct, Your Honor. And I think I'll mention here too that under some of the -- some other types of proceedings that do involve rates, the commission relies on whatever -- whatever authorized rate of return was set in the last general rate case, for example, some of the power cost adjustment cases. So there is precedent for a rate up -- for a type of rate update like happened here in the expedited rate filing. And I'll reiterate that the evidence that was before the commission did not support resetting the return on equity for the purpose of setting rates in the expedited rate filing.

The commission also considered cost of capital in the context of the decoupling proceeding, and the issue there was whether cost of capital should be reduced due to a perceived reduction in risk due to decoupling. And the commission there considered all of the available evidence, including the energy coalition's expert on decoupling, Mr. Cavanagh. Mr. Cavanagh testified that there is no evidence to date in any jurisdiction that correlates decoupling with the utility's cost of capital. He also presented a

national study showing that the vast majority of decoupling decisions did not include an adjustment to the utility's return on equity. In short, the commission's decision not to reduce PSE's return on equity is supported by ample evidence.

Turning finally to the K factor, in Order 7, as we've heard, the commission implemented use of a rate escalator or K factor to increase rates modestly each year until after PSE files its next general rate case in 2015 or '16. And I'd like to emphasize "modest." We've heard some numbers from Public Counsel and from Industrial Customers, and the rates under the rate plan will be -- will be increased for electric customers three percent, but the three percent is three percent only of a certain category of revenues, and it's approximately a third of the rate that will be increased by three percent, and therefore, the three percent is not an increase to the total rate.

On top of that, we have decoupling, but there's a soft cap so that we can be sure that rates will not increase above three percent. The K factor is a type of rate mechanism. It was not an inappropriate or unexplained departure from past commission practice. In the 2012 order the commission specifically discussed attrition adjustments and suggested that an attrition adjustment was one possible resolution to the problem of the cycle of extensive capital

investments.

THE COURT: So you would disagree that that's an unusual process?

MS. CAMERON-RULKOWSKI: There was a period in the '80s where attrition adjustments were used. They have not been used for some time. In this case the commission is looking at them. We can see that from the discussion in the 2012 order. We can see that from the *Avista* case that came about half a year after the 2012 order where the -- where there was an attrition adjustment and a rate planned, and now we have Order 7 where the commission has approved implementation of an attrition adjustment. So at this point I would say that there was a trend to implement attrition adjustments to resolve this problem of high capital expenditures. Essentially implementing the K factor was a continuation of rather than a departure from a trend, and the commission's decision not to require an attrition study was reasonable given that the commission had not found them to be dispositive in the *Avista* case.

In conclusion, petitioners have met their burden -- sorry -- have not met their burden to demonstrate error under the APA. The commission was not required to treat these proceedings as a general rate case because they were separate proceedings that did not meet the definition of a general rate case. The commission's decision not to reset

or reduce the return on equity was based on substantial evidence and was not willful or unreasoning. Finally, the commission's approval of the K factor was not error as it was supported by substantial evidence and recent commission decisions. Because these issues all involve rate-setting approaches or methodologies, the commission's -- and because the commission's decisions on them are reasonable in light of the evidence, the court should accord deference to the commission and should affirm Order 7. Thank you.

THE COURT: Thank you.

MS. CARSON: May it please the court, I'm Sheree Strom Carson with Perkins Coie representing Puget Sound Energy.

In addition to answering any questions that you have today, I want to focus my argument on the following three issues: First, the 2012 general rate case, why is that important, second, the return on equity, it remains within a zone of reasonableness, and third, the rate plan K factor, escalation factor. It goes by many names. It's part of the decoupling. It's supported by substantial evidence.

First I want to take a quick look at the 2012 order in the general rate case. There's two reasons why it's important. First, it's important because the commission set PSE's cost of capital in May 2012, just a few months

before these proceedings were filed. Second, in two separate sections of this order, the commission considered proposals that ended up being the follow-on proposals that you're hearing today, the expedited rate filing, or ERF, and the decoupling. These have different purposes. The expedited rate filing addressed a specific problem that was called out by PSE in that 2011 general rate case and that had been brought to the commission's attention by other utilities as well as there was an inability for the utilities to earn their authorized rate of return over a period of many years because of the historical ratemaking model that the commission uses. And the -- for example, the rates in the 2012 case are based on a test year 2010. So by the time those rates go into effect in May of 2012, they're stale already. And this was the concern, and there was evidence before the commission that PSE had not been earning its authorized return since 2007. So the commission looked at this and commission staff had made a proposal in that case to have a refresher between rate cases, this expedited rate filing, that would address the issue with utilities not being able to earn their authorized rate of return despite rate case after rate case. So the commission's concern was not just with we're having too many rate cases. It was a combination of parties are constantly in these rate cases, and we're

failing to achieve one of our stated purposes which is to make sure there's a fair opportunity to earn an authorized rate of return.

THE COURT: Because of the lag time.

MS. CARSON: Because of the lag time.

THE COURT: And so couldn't it in response to that change its procedures?

MS. CARSON: It could. And it's talked about it, and it continues to talk about it. But certainly the commission has a long history of trying different approaches in different rate cases, and the fact that it's available to one utility as was discussed before doesn't mean it's not available to other utilities. Utilities certainly watch the orders that come out in other general rate cases and they see the opportunities that are available, and they avail themselves of that. So one approach is to establish a rule, and it's my understanding that the commission has been looking at that and is looking at that. But it also has the opportunity to do this sort of refresher.

And it's not completely as the commission said in its order. It's certainly not unprecedented to have this type of refresher. In 2010 PSE filed what we call the gas tariff increase filing which was very similar to this where PSE updated its rate base, its plant and service for

natural gas, its expenses, and filed an expedited case. It requested a $24 million increase, and I think the increase was $19 million. So that -- that's a very similar proceeding. It didn't have any fancy name as this did, but it updated rates in between general rate cases, and of note, there was no cost of capital testimony in that case. Nobody brought it forward, and the commission did not consider cost of capital or updating cost of capital in that case.

So certainly these things occur, have occurred in the past. This was not completely unprecedented, and of course, it's not in violation of any statute, any commission rule. There is not a set rule that says how the commission must adjust rates. One of the key points about what the commission said about the expedited rate filing and what was proposed by staff in the 2012 case was that it would not include an update to cost of capital unless -- except to potentially update debt costs, but there would be no return on equity update. In fact, the language in the order in paragraph 496 is PSE would not be allowed to request a change in return on equity. So that was what was -- was put forth as a possibility for this expedited rate filing in the last case.

The other separate recommendation that was before the commission in the last rate case was the decoupling, and

that had been put before a specific proposal was put before the commission by the energy coalition. And the commission liked what it saw. It said this seems consistent with our policy statement that we put out in 2010, but PSE had some concerns about it about the ability to be able to recover its fixed costs under that program, and the commission said, you know, we don't want to impose something on a utility that they don't want so we encourage you to work together and see if you can work out your differences and bring a proposal back to us. And so two different -- two different mechanisms were addressed in that order addressing two different issues. The commission encouraged parties to go forth and see if they could reach agreement on this and bring these back to the commission, and that's exactly what happened. In October of 2012 jointly PSE and the Northwest Energy Coalition filed a petition for decoupling, and in February of 2013 the expedited rate filing took place. These are two separate filings made at two separate times for two separate purposes. The commission looked at them together because of -- for expediency, but they were separate filings. They addressed separate issues.

Next I want to turn specifically to return on equity. Again, there's no requirement in statute or rule that every time a rate is adjusted there is analysis of return on

equity. That just absolutely isn't true. And I've mentioned this gas tariff. Increased filing in 2010, but another prime example is the power-cost-only rate cases that PSE files on a regular basis. In 2005 there was a power-cost-only rate case that increased rates by 55 million. In 2007 a power-cost-only rate case that increased rates in excess of 60 million when a new power plant was brought into PSE's fleet. No cost of capital analysis takes place in these power-cost-only rate cases. There also --

THE COURT: Ms. Carson, I'm sorry to interrupt, but the APA does require that the rate that is set be supported by substantial evidence.

MS. CARSON: Yes.

THE COURT: In that regard.

MS. CARSON: Yes.

THE COURT: And so that doesn't necessarily allow for relying on things in a prior case or other cases or outside the record. Would you agree?

MS. CARSON: I would agree that the commission does not -- yes, does not typically rely on evidence outside of a record, but they do not always require a cost of capital study to adjust rates in every rate proceeding.

THE COURT: I think I understand that position that a specific study or document isn't necessarily required,

but there does have to be substantial evidence to support the rate.

MS. CARSON: There must be substantial evidence to support the rate.

THE COURT: And so without the return on equity, what is it that's in this record that supported it besides the policy arguments that have been made?

MS. CARSON: Well, there -- PSE did certainly rebut the expert study that the industrial customers put forward on return on equity, and there's -- and I can get into the detail of how they rebutted it. I think it's important to recognize how a return on equity analysis is done. It's done by looking at proxy companies or similarly situated companies and looking at what their return on equity is and doing various studies to determine what their return on equity would be. And so that's what was done by Mr. Gorman, despite the fact that the commission said we don't expect to have that done in this case. And PSE offered -- well, first of all, Mr. Gorman's own study, as Ms. Cameron-Rulkowski said, showed a wide range of actual return on equity in its constant growth DCF study that ranged all way up to 11.37. So there is evidence in the record showing that a 9.8 percent return on equity is within a range of reasonableness.

THE COURT: In the industry, but there's nothing in

the record about PSE.

MS. CARSON: Well, but you have to understand that that's how you determine PSE's return on equity is you look at similarly situated companies and you do discounted cash flow studies and other studies, and you have your cost of capital expert say looking at these other similarly situated companies as proxies, this is what your return on equity would be. So it's -- it tends not to be a lot of company-specific information. It's financial information based on similarly situated companies. So you can go back and look at other records as well. There's not a lot of PSE-specific factual information in the cost of capital study.

THE COURT: And when you say that PSE rebutted the expert that was offered, you don't mean there was another expert that was offered by PSE.

MS. CARSON: No. Mr. Doyle, who's the chief financial officer at PSE, rebutted it. And there's not a requirement that PSE offer a cost of capital study.

But I guess the point I was making is that there are routinely rate increases where you don't have cost of capital studies. The commission accepts that the cost of capital will remain the same as it was in the past case. And PSE was not making any kind of proposal to change return on equity. In fact, was prohibited based on the

language that was in the order.

So I think it's important to recognize the two different points of intersection where return on equity is discussed in the order before the court, and one is in the decoupling and one is in the expedited rate filing, and we've talked a little bit about the expedited rate filing and how there was no expectations set forth in the 2012 order that PSE would submit a new cost of capital study. In fact, it was said PSE would not do that. But the commission had expressed interest in the context of decoupling to consider wether decoupling reduces risk to a utility such that its cost of capital is actually lowered because of reduced risk. And the commission -- that's not in statute or rule, but the commission in a policy statement in 2010 had said that it was the commission's preference to hear that. And so jointly the petitioners, energy coalition and Puget Sound Energy submitted expert testimony from Mr. Cavanagh as well as exhaustive report that was referenced earlier that showed there is no empirical evidence demonstrating that decoupling reduces risk such that the capital costs are lowered. And in fact, the one study that really looked at it said looks like the risk actually may go up a little bit for utilities who implemented a decoupling program.

So as to the commission's preference for a review of cost of capital in the decoupling setting, that was done.

The commission looked at it. The other parties, the petitioners here, had nothing more than really kind of a gut reaction as to well, seems like decoupling should reduce risk, but did not really analyze that. And the commission found there was no empirical evidence supporting a prospective decrease in return on equity. Now, the commission said that doesn't -- that doesn't end the issue. We will monitor this. It's over a relatively short period of time. We're going to do a thorough evaluation at the end of this decoupling, and if in fact this lowers the return on equity, we will adjust it at that point in time, but to prospectively adjust it when there's no evidence in the record to suggest that decoupling actually reduces the return on equity would not be appropriate.

It's important to make the two distinctions. The industrial customers are not challenging -- based on their reply brief are not challenging the decoupling and the return on equity determination in decoupling. And when we look at the other point, it's the expedited rate filing where the commission specifically said we didn't expect a return on equity study. We said in our last order that PSE would not provide that. And so we can't say they didn't meet their burden of proof on that issue when it was never expected that they would provide that.

So I've mentioned briefly -- and I have record cites if

it's helpful for you, but there is evidence in the record showing that a 9.8 percent return on equity is reasonable, and I think it's cited in the brief, but some of Mr. Gorman's own studies -- for example AR 6132 shows -- the constant growth DCF study shows higher returns on equity. When PSE -- Mr. Doyle actually looked at the similarly situated companies and looked at what authorized -- what their authorized return on equity was, not just the study based on the discounted cash flow. That's where he -- the average of those was 10.08. So it was above PSE's current authorized return on equity. And then there was a refresher, and that's at AR 1871 to 1872. There was a refresher look at more recent commission decisions around the country on what return on equity they authorized, and that remained above the 9.8. That was at 9.88.

Finally, I want to turn to the rate plan and the escalation factors, or K factors contained in the rate plan. It's important for the court to recognize that the commission has -- has approved multi-year rate plans in the past. In the 1997 Puget Sound Energy merger -- that's where Washington Natural Gas and Puget Sound Power and Light merged to form PSE -- the commission approved a five-year rate plan with rate increases over this five-year period.

THE COURT: Was that in a general rate filing or was

it a general rate case or was that an expedited rate filing?

MS. CARSON: That was neither. That was a merger proceeding.

In 2000, PacifiCorp, a five-year rate plan was approved, again, with rate increases over that five-year period, and most recently in 2012 the *Avista* case, there was a two-year rate plan with rate increases. So it's important to recognize that the commission has great discretion to adjust rates, and at different points in time it has chosen to adjust rates in different ways, and there is no statute, rule or commission policy that prohibits the commission from approving a rate plan, a multi-year rate plan.

THE COURT: But this expedited rate filing is unusual or different I guess. I shouldn't say unusual. That's the wrong word. But different than a general rate case.

MS. CARSON: It is different from a general rate case. And but as I said, it's similar things called by different names have happened in the past. For example, the gas increase filing in 2010 which was a refresher of new plant in service and updated expenses and updated revenues, but not the cost of capital.

The rate plan was supported by substantial evidence. The K factor. It involves a historical look back at what the commission has approved for delivery costs, and this is

again what Ms. Cameron-Rulkowski was trying to make the point of. What we're looking at in decoupling is delivery costs. It's not PSE's full -- all of its costs. It's not its power costs. It's not costs for power or operating costs relating to production of power. It's delivery costs which in the record says it's about a third, a quarter to a third of PSE's costs. So in the record there's some excellent testimony and exhibits, AR 1733 to 36, Cathy Barnard's testimony and then follow-on exhibits where she does an analysis of historically what has the commission allowed for delivery costs based on rate cases. She looks at what has the consumer price index been for operating expenses historically as well as looking forward, and then she does a double check on plant, not just what the commission has historically approved in rate cases, but what's projected in the future. And so based on all of this she shows that an annual increase for the rate plan for electric, this supports four percent increase on delivery costs and a three percent increase on natural gas delivery costs, but that's not what PSE asked for. It asked for a three percent rather than a four percent increase on delivery costs and a 2.2 percent increase on natural gas delivery costs.

And this is where we see the discussion in the order that PSE, if it is going to earn its authorized rate of

return, it's going to have to operate efficiently. It's not going to be an automatic that because of these rate increases it will earn its authorized rate of return. PSE has given up the opportunity to go in and seek its full delivery costs as it has in past cases, and it's limited to these amounts, and it's going to have to live within these means and it can't come in and seek more. And so it's a tradeoff.

Just a few words on attrition. Again, there's testimony in this record as well as in the past record about PSE's inability to earn its authorized rate of return in Cathy Barnard's testimony showing the years through 2007 and rate cases and rate increases are happening, and even so, the company is falling short of earning its authorized rate of return by quite a bit. When the commission looked at this in the 2012 final order, it did a pretty thorough review of attrition, and really attrition mechanisms, attrition adjustments haven't been used very frequently at all, and I think Public Counsel said it best in his brief when he said the last one that was approved was 25 years ago. This is not -- attrition analyses are not something that's routinely done in general rate cases, and I think because there's a lot of confusion about what is attrition and what do you have to show. So the commission in its 2012 order talked about this, talked about one way to show attrition

is a failure to earn your authorized return over a period of time, which PSE had shown, and then the commission said, you know, based on all the different -- everything we've reviewed, we are at all reluctant -- we're reluctant to be at all prescriptive about how to address this. So the commission said we are open to consider reasonable approaches to dealing with attrition and inability to earn authorized rate of return. So there's not a hard and fast rule there regarding attrition.

In conclusion, the court must give substantial deference to the commission's judgment about how best to serve the public interest. The court's not at liberty to substitute its judgment for the well-reasoned and supported decision by the commission, and PSE respectfully requests that the court deny the petitioners' petition. Thank you.

THE COURT: Thank you.

MS. GOODIN: Good afternoon, Your Honor. Amanda Goodin on behalf of the Northwest Energy Coalition.

I'm aware the court has heard from a number of parties already so I would just like to ask if you have any questions for me.

THE COURT: I do not.

MS. GOODIN: Thank you.

THE COURT: Thank you.

MS. DAVISON: Your Honor, may I request a few

minutes for rebuttal?

THE COURT: I will allow the petitioners an opportunity for rebuttal argument. We are, of course, well past our time that we had anticipated. Frankly, that doesn't surprise me, but I had anticipated that the petitioner would require a few minutes of rebuttal.

MS. DAVISON: Thank you, Your Honor. I will be very quick if my voice holds out.

You asked Mr. ffitch a very good question about how the ratemaking process goes, and is PSE obligated to file rebuttal testimony on the cost of capital issue for example. And the way the process works is that PSE files its case and puts in all its evidence of requesting a rate increase. The petitioner -- I mean the interveners and then staff come in as parties, and we raise what are known as adjustments. So we're not going to raise all the issues that have been posed by the utility. We're going to raise the ones that we think they got wrong. And then PSE has ability to file rebuttal testimony on those issues.

Now, you are correct, Your Honor. They don't have an obligation to do that. But they do carry the burden of proof all the way through. And so if you have an issue as important as cost of capital, and they choose not to do a cost of capital study, then they are taking a huge risk because they carry the burden of proof all the way through

the case. The --

THE COURT: But in this case -- sorry to interrupt -- the direction they got from the commission was that it wasn't necessary or even wanted.

MS. DAVISON: No, Your Honor. Actually, they did not get that. What everyone is relying on is a proposal from staff in the last rate case. Staff is just like any other party. I could have through ICNU made a proposal about an expedited rate filing. That doesn't mean that it's going to be adopted. It doesn't mean that it has any merit. It just is an idea that staff threw out, which I will point to you, I think it's very important to look at Administrative Record 978, paragraph 34, where the commission explains that it is not adopting many of the recommendations by staff's proposal. So at the end of the day though, the commission has to make a decision based on substantial evidence. If one major party chooses not to put evidence on, then they're doing so at their own risk.

The -- quickly, the mention to the *Avista* case is a red herring. That was not an expedited rate filing case. It was a case that resulted in an all-party settlement. It has -- it has nothing to do with this case in my opinion.

Let's see. Ms. Carson stated repeatedly that this was a refresher case, what staff proposed in the previous general rate case was in fact a refresher case, and if that was

adopted, we wouldn't be here before you today because staff actually had a process where you just take a commission basis report, and here are, you know, temperature normalization. There was a whole lot of things that they said you would do, but nothing else. It was really limited. That's not what happened in this case, and that record cite supports that.

I guess I'm sort of at a loss that somehow or another Mr. Gorman's testimony supports 9.8 ROE. That's just baffling to me. When you do a cost of capital analysis, you use different models and then you make adjustments to the results of those models. So you have a big range. You may have eleven percent over here with one model. You may have eight percent over here with another model, which was the case here. And then as an expert, someone who knows the field, that person makes a judgment of what number you pick, and he picked 9.3 percent ROE. He did not in any way support 9.8 percent ROE. That's just a misstatement.

The long discussion about rate plans, you've got a merger, PSE -- that resulted in PSE, PacifiCorp rate plan. Actually, that turned out to be two years instead of five, and *Avista* was a settlement. So there's a lot of information that in my opinion is irrelevant to the case. What's relevant is that we have a very important issue. We have a long period of time in which rates will be in

effect, and no evidence to support the 9.8 percent ROE. Thank you.

THE COURT: Thank you.

MR. FFITCH: Thank you, Your Honor. I just have a few points to respond to. I'm afraid it may be a bit disjointed, but I will try to bring things together.

First of all, Ms. Cameron-Rulkowski for the commission said that there's no statute that requires the commission to set rates in a certain way. That is literally true. However, what there is is essentially a century of commission ratemaking that establishes precedents and procedure for how rates are set in Washington State. And I would refer you to cases that have been cited in the record, particularly the power case, and the *US West* case. The power case is cited by the commission itself in almost every general rate case as explaining this centurylong framework, well-settled framework for how rates are set. And so the commission, if it's going to depart from that and announce a new direction for Washington, it really needs to do that in a careful, thoughtful way, and we submit that didn't happen here.

The *US West* case is also a good example of this framework in action. Both of them are general rate cases applying all of the traditional actual cost-based ratemaking analysis that we submit should have been applied

here.

There's also been a tremendous amount of sort of confusing and misleading focus on ERF. And Ms. Davison took the words right out of my mouth. If this -- if all we were talking about was the expedited rate filing piece of this, we wouldn't be here. So just a brief recap. The expedited rate filing proposal is a one-time proposal. And the idea of it is, as proposed by commission staff, and this is what was discussed in the 2011 rate case, you take -- you let the company come in within a few months if it needs to after its last rate case and update some of its costs based on known actual cost increases. And in that context it was understood that that one-time small cost update would not require a full general rate case.

But that's not what we have here. We have a much larger, more complicated, long-term, more expensive rate plan that, you know, as we discussed and pointed out, has a much larger impact on customers. The ERF component of this case does not trigger a three percent rate increase. It is small by itself. It is a one-time piece by itself. But when you add the K factor rate plan, you have the full -- you know, the full mechanism that's actually before the court and was approved in the commission. So this constant referral to -- reference back to the ERF proceeding has really -- it really is irrelevant. And in fact, the

parties kind of repeatedly say that that's why there was no need to do a cost of capital study here.

Well, that specific argument was rejected twice in this case already. It was rejected at the outset of the hearing by the administrative law judge, and I apologize I don't have the transcript reference. But Puget Sound Energy argued at the beginning of the case when we requested to put on some additional cost of capital evidence, they argued it was not an issue, and the ALJ overruled that and said it is certainly an issue in this case. That can be found in the transcript at the outset of the hearing.

In addition, if you look at paragraph 57 of the order, the -- this argument is again just squarely rejected by the commission. It says in paragraph 57, "If this was a standalone ERF proceeding, the commission is inclined to agree with Puget and staff that it would be inappropriate to consider any part of the cost of capital other than demonstrable changes in debt. The ERF here, however, is joined with related proposals, decoupling and the rate plan, that make broader consideration of this issue appropriate."

So what we're hearing here from Puget Sound Energy is just reassertion of an argument that's already been rejected twice by this commission. The commission says in the -- earlier in that same paragraph, "cost of capital is

definitely an issue in this case." So it's just -- it's just a red herring. The question is did they meet their burden of proving that the cost of capital that was used to set rates in this case was current and valid and accurate.

THE COURT: And do you agree with the argument that the testimony doesn't have to be specific as to a particular company, that industrywide testimony is adequate?

MR. FFITCH: No. It is true that cost of capital experts as a subpart of their analysis use what's called a proxy group of companies, and they put together a group of a dozen or so companies around the country and they look at -- you know, they analyze those and see what the rate of return is for those folks. But that's not how -- that's not how the cost of capital is set. If that's how it was done, we wouldn't need experts. You know, I could do it or you know, anybody could do it. You just look up some numbers and run an average and that's the cost of capital. That's only a small subpart of the analysis, and again, I hate to sound like a broken record, but the commission's last two rate orders show how that is just one piece that fits in. It's essentially sort of a, you know, piece of contextual information that is then built upon by far more complex types of financial analysis that the experts conduct, including the discounted cash flow model, capital asset pricing model and the risk premium model. Those are

the three primary ones that are applied. So the suggestion that we can look at some averages in some other states and that's how we set rates here, that's actually just incorrect. The commission has never set rates just looking at averages around the country, and the commission is aware of that. That is not how cost of capital is set in Washington State. They're grasping at straws because there is no cost of capital case in the record by the commission -- excuse me -- by the company by its own volition.

The -- one of my colleagues from the respondent's side indicated there are no decoupling cases where there's been a specific cost of capital reduction. The commission's policy statement, which is in the record in this case -- in fact, the company submitted it and we submitted it -- cites three specific orders from other states that adopt a specific percentage reduction in return on equity to reflect the -- the risk reductive effect of decoupling. The commission itself before this order had no doubt that there was a risk reduction -- reductive effect on decoupling, and it cited it as a major issue that needed to be addressed.

There's a newly discovered theory in the case that suddenly it's all very theoretical and unknown and we can't deal with it until later. That's a new theory that we have not seen before, the notion that there -- we need to wait

and see. And I want to address that wait-and-see argument because it sort of has a commonsense appeal. The cost of capital is a real, present cost of the company, and the consideration of the issue in connection with the decoupling is important because decoupling provides revenues stabilization and risk reduction to the company starting now. Starting in July 1st, 2013, Puget Sound Energy under the decoupling procedure and the K factor rate plan began to receive new rates, $50 million of new rates on July 1st, 2013. That began to reduce their financial risk immediately. It began to immediately stabilize their revenues. Argument that we are making, and that the commission's own orders previously also enunciated, is that in order to be fair in your adoption of decoupling, you need to also reflect the risk reduction and pass that benefit or share that benefit with customers in order to have a balanced approach to decoupling.

What's happened here is that the company's received the benefit beginning July 1st, 2013, and those revenues will continue to flow to the company throughout the rate plan until 2016 or 2017, and the customers have received nothing and will receive nothing. Ms. Carson referred to the monitoring process. That is of no value to customers because the commission is legally barred from -- in 2016 saying, "You know, you were right. The cost of capital is

lower. It should have been lower. You were right all along." But they cannot go back by law and refund the excessive rates that were paid by customers starting in 2013. So there is a false promise that's offered to customers. So Puget gets its benefit. It gets its financial stability, and the customers don't receive anything under this order.

Just one or two additional points. We had the reassertion of form over substance in the argument that the two subparts of the mechanism don't add up to three percent so therefore the general rate case rule doesn't apply. The commission's own order in paragraph 188 and in footnote ten acknowledges that the increase is over three percent. Appendix B to our reply brief, which is a copy of the Puget notice to customers specifically tells customers their increase on July 1st is over three percent. There's just no validity to that argument that the increase is too small. And the notion that there were two unrelated pieces is completely at odds with the fact that essentially this adjudication was the -- an adjudication of a combined multiparty settlement that brought together all these disparate pieces into the mechanism that the commission had before it and that you have before you. Those working together created a 3.4 percent increase in 2013 alone, and a nine percent increase over the life of the plan. That

was filed together. It was litigated together. It was scheduled together. It was heard together by the commission and consolidated proceedings and resolved in a combined final order by the commission. So to say that they're separate matters that do not trigger the rule is just, you know, sort of a technical argument that completely ignores the factual reality of the case.

And I guess that's also in response to Ms. Cameron-Rulkowski's inaccurate statement that the three percent only applies to a subpart of the rate. So it's not really three percent. That's just factually inaccurate, and again, paragraph 188 of the order, the company's own notice are, you know, not consistent with that statement. It's just a mistake. Commission certainly feels that even though it's three percent, they don't have to hold a rate case. I understand that. But definitely no dispute that the increase is big enough to trigger the rule.

I'll just wrap up here. Yeah. I guess just on this notion that the commission is always doing multiyear rate plans, the examples cited, first of all, are pretty few and far between. None of them are attrition-based. There is no previous example of this sort of multiyear attrition increase going out many years. Every -- I believe I heard Ms. Carson say that attrition was not done in rate cases. It's exactly the opposite, and we've provided you a binder

full of attrition cases. Every attrition order in the past has been done in a general rate case, and in fact, the *Avista* order that we all keep citing actually says that. It says that we look at attrition in the context of a general rate case so that we can have a full record upon which to decide those complicated issues.

This is the first time we have ever had an attrition adjustment without a rate case. It's the first time we've ever had an attrition adjustment without an attrition study. It's the first time we've ever had not one attrition adjustment as in every case in the past, but automatic future attrition adjustments based on projected costs going out to what may be 2017. It's unprecedented. It all could have been resolved if this had been converted into a general rate case in early 2013. The record could have been completely filled out with attrition studies from the company, could have had cost of capital studies. The commission could have resolved the cost of capital issues around decoupling. The commission could have announced some policy around attrition. The commission could have done a careful construction of some alternative rate methodologies that could provide some guidance to other companies and to the stakeholders in the state. And instead we had a rush to judgment, poorly reasoned and poorly supported decision that is tremendously impactful on

Washington residential and small business customers.

That concludes my argument.

THE COURT: Thank you.

The parties have concluded their argument on this case, and I once again just want to say how much I appreciated the briefing that was provided in this case. While it certainly was not brief, it was very helpful to the court in understanding these issues.

I am not prepared to issue a ruling at this time. Your argument has been very helpful to me, and I need to do some additional work in looking at the record and comparing some of the arguments made today. So I don't think it would be fair for me to issue my ruling today from the bench.

As I've been listening to the arguments, I had anticipated indicating to the parties that I would announce an oral ruling in a future hearing. I'm re-thinking that, and I think it might be helpful for the court to simply issue a written ruling in this case, and so that would be my preference unless any of the parties object.

Hearing no objection, I am going to issue a written ruling in this case. I anticipate being able to issue that within the next two weeks, but because I know my schedule, I'm going to give myself three weeks, and hopefully that will be plenty of time for a decision to be issued in this case, and it will be sent to you by mail.

Do the parties have any questions regarding that procedure?

MS. DAVISON: No, Your Honor.

MS. CAMERON-RULKOWSKI: No, Your Honor.

THE COURT: Again, I very much appreciate the work in this case. This hearing is concluded.

(A recess was taken.)

CERTIFICATE OF REPORTER

STATE OF WASHINGTON)
) ss.
COUNTY OF THURSTON)

I, RALPH H. BESWICK, CCR, Official Reporter of the Superior Court of the State of Washington in and for the County of Thurston do hereby certify:

That I was authorized to and did stenographically report the foregoing proceedings held in the above-entitled matter as designated by Counsel to be included in the transcript and that the transcript is a true and complete record of my stenographic notes.

Dated this 23rd day of May, 2014.

RALPH H. BESWICK, CCR
Official Court Reporter
Certificate No. 2023