Agenda Date: April 26, 2018
Item Number: A1

Docket: UE-180280
Company Name: Puget Sound Energy

Staff: Jing Liu, Regulatory Analyst
Kristen Hillstead, Regulatory Analyst

Recommendation

Staff recommends that the commission issue an order (1) accepting the tariff sheets filed by Puget Sound Energy (PSE or company) in Docket UE-180280 on March 30, 2018, and (2) directing the company to recalculate the 2017 fixed production deferral based on staff's methodology for allocating allowed fixed production revenue, and incorporate the deferral difference in the company's decoupling filing next year, with accrued interest.

Summary of Decision Point

At issue is the methodology that PSE used to prorate the partial-year allowed revenue for January 1, 2017, through December 18, 2017, for fixed production costs.

PSE prorated the January 1, 2017, through December 18, 2017, allowed revenue using a straight-line method it believes is consistent with the company's accounting petition in Docket UE-161112. Staff recommends prorating the January 1, 2017, through December 18, 2017, allowed revenue using normalized monthly loads, consistent with Order 01 of Docket UE-161112. The difference in proration methodology results in a discrepancy of approximately $4.9 million.

Staff is asking the commission to re-affirm its intention that PSE follow the direction of the commission in Order 01 of Docket UE-161112 which states: "The deferral account will track the monthly difference in actual revenue collected compared to the amount of revenue estimated using forecasted loads."[1]

Background

On March 30, 2018, PSE filed proposed revisions to Schedule 142, Revenue Decoupling Adjustment Mechanism, of its electric tariff. The filing reflects the revenue true-up under the decoupling mechanism established in 2013 with the implementation of changes the commission authorized in PSE's 2017 general rate case (2017 GRC), Dockets UE-170033 and UG-170034.

As filed, the company's electric decoupling filing represents a revenue decrease of $22.7 million, or 1.0 percent, of the total electric revenue. A typical residential electric customer using 900 kWh per month would experience a decrease of $2.10 per month, or -2.2 percent.

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[1] *In the Matter of the Petition of Puget Sound Energy For an Accounting Order Authorizing the Deferral of Fixed Production Costs Previously Recovered in PSE's Power Cost Adjustment Mechanism and To Modify Final Order 11 in Docket No. UE-130617*, Docket UE-161112, Order 01, ¶ 5 (Nov. 10, 2017)

In June 2013, the commission approved a multi-party settlement agreement establishing electric and natural gas decoupling mechanisms for PSE.[2] PSE's decoupling mechanism functions as a deferred accounting mechanism, whereby the difference between actual revenues and allowed revenues for the most recently completed calendar year is reconciled in an annual true-up filing.

Of particular note here is the fact that rates established in PSE's 2017 GRC became effective December 19, 2017. Given that the annual decoupling true-up filings cover full calendar years, this 2017 annual true up filing captures two distinct rate periods: January 1, 2017, through December 18, 2017, and December 19 through December 31, 2017. This presents a unique challenge with respect to deferrals for fixed production costs, which the company calculates using one allocation methodology prior to December 19, 2017, and another methodology after. The issue at hand is how to properly prorate allowed fixed production revenue for the partial year January 1, 2017 through December 18, 2017. Staff estimates that the methodology the company used to prorate the partial year inaccurately results in approximately $4.9 million more revenue to the company.

Discussion

I. Fixed Production Revenue

PSE's filing implemented changes to the established Revenue Decoupling Adjustment Mechanism, as provided in the Commission's Order 08 (Final Order) in PSE's 2017 GRC. One important change involves a true-up of an accounting deferral that tracked variances associated with the recovery of fixed production costs for most, but not all, of 2017. This one-time true-up is necessary to complete the transition of the recovery of fixed production costs from PSE's Power Cost Adjustment (PCA) mechanism to its new decoupling mechanism.

At issue is the methodology that PSE used to prorate the partial-year allowed revenue for January 1, 2017 through December 18, 2017. Staff believes the company's monthly allocation of allowed revenue (1) is not consistent with the commission order in UE-161112, and (2) is not consistent with the way the company allocates annual allowed revenue in the new decoupling mechanism for the second rate period in 2017 (December 19 through December 31, 2017). This methodological glitch resulted in approximately $4.9 million more revenue recovery in the company's favor.

Some background on the accounting deferral is helpful to understand the issue at hand. Originally, PSE recovered both its fixed production costs and variable power costs through the PCA. In 2015, however, the commission approved a settlement agreement that moved the recovery of fixed production costs out of the PCA and allowed the company to propose

[2] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-121697 and UG-121705, Order 07, UE-130137 and UG-130138, Order 07 (Jun. 25, 2013).

collecting fixed production costs through the decoupling mechanism, if it continued.[3] The settlement agreement also allowed PSE to file an accounting petition to request deferral of the revenue variances associated with the recovery of fixed production costs to bridge the timing difference between implementation of the changes to the PCA on January 1, 2017, and the start of the rate year for PSE's next general rate case, by which time the continuation of the decoupling mechanism would be decided.[4]

On September 30, 2016, PSE filed its accounting petition.[5] The accounting petition included a detailed explanation of its proposed accounting treatment[6] and included an attachment that provided an example of how it would calculate the deferral *over a full calendar year*.[7] Of note, the petition's prayer for relief also implied that the deferral would last a full calendar year:

> PSE respectfully requests that the Commission issue an accounting order authorizing the accounting treatment proposed in this Petition to defer the revenue variances associated with the fixed production costs once they are removed from the PCA mechanism on *January 1, 2017 through December 31, 2017*, until rates for PSE's next general rate case become effective.[8]

On November 10, 2016, the commission granted PSE's petition, allowing the company to defer the revenue variances associated with the collection of fixed production related costs *beginning January 1, 2017, until the commission establishes new rates for the Company in PSE's next general rate case*.[9] Importantly, the commission's order explicitly stated: "The deferral account will track the *monthly difference in actual revenue collected compared to the amount of revenue estimated using forecasted loads*."[10] The commission determined: "The deferral of these variances protects both the Company and its ratepayers from possible over- or under- collection of the authorized amount of fixed production related costs currently in rates and is therefore in the public interest."[11] The commission's order also explicitly retained jurisdiction over the deferral in order to ensure proper ratemaking treatment.[12]

Due to the mid-December start date of the new rates from PSE's 2017 GRC, the allowed revenue associated with fixed power costs must be prorated to calculate the deferred revenue in the first

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[3] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-130583, Order 07, UE-130617, Order 11, UE-131099, Order 07, and UE-131230, Order 07 (Aug. 7, 2015). Settlement Stipulation pages 4-5 specify costs that are classified as "Fixed Production Costs" and are carved out of the PCA imbalance calculation.
[4] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-130583, UE-130617, UE-131099, and UE-131230, Settlement Stipulation, 7, ¶ 4 (Mar. 27, 2015).
[5] *In the Matter of the Petition of Puget Sound Energy For an Accounting Order Authorizing the Deferral of Fixed Production Costs Previously Recovered in PSE's Power Cost Adjustment Mechanism and To Modify Final Order 11 in Docket No. UE-130617*, Docket-161112 (Sept. 30, 2016).
[6] *Id*. at ¶ 9.
[7] *Id*. at Exhibit A-1.
[8] *Id*. at ¶ 11 (emphasis added).
[9] *In the Matter of the Petition of Puget Sound Energy For an Accounting Order Authorizing the Deferral of Fixed Production Costs Previously Recovered in PSE's Power Cost Adjustment Mechanism and To Modify Final Order 11 in Docket No. UE-130617*, Docket UE-161112, Order 01, ¶ 5 (Nov. 10, 2017) (*emphasis added*).
[10] *Id. (emphasis added).*
[11] *Id.*
[12] *Id.* at ¶¶ 15-16.

rate period. Specifically, the deferral for fixed power cost recovery in 2017 consists of two parts: (1) the deferral from the transition period of January 1 through December 18, 2017, authorized by the approved accounting petition in UE-161112, allocated to each decoupled group based on peak credit allocation factors; and (2) the deferral from December 19 through December 31, 2017, based on the allowed revenue for each decoupled group based on the new rates authorized in the 2017 GRC.

Table 1 below shows the amounts for fixed production revenue deferrals proposed by the company and proposed by staff. Based on the company's calculation, the total calendar year 2017 deferral is a $3.5 million *undercollection* before adjusting for revenue sensitive items. Under staff's proposal, the total calendar year 2017 deferral is a $1.2 million *overcollection* before adjusting for revenue sensitive items. The difference is $4.7 million in net deferral ($4.9 million revenue after adjusting for revenue sensitive items). Please see Attachment 1 to this memo for detailed calculation.

Table 1. Fixed Production Deferral for 2017 Calendar Year[13]

	Company Proposal	Staff Proposal	Difference
Jan 1 – Dec 18, 2017	$ 4,969,863	$ 269,783	$4,700,080
Dec 19 – Dec 31, 2017	($1,445,948)	($1,445,948)	$ -
Total 2017 CY	$ 3,523,915	$(1,176,165)	$4,700,080

The difference between the company's and staff's approach stems from the method for prorating the deferral period of January 1 through December 18, 2017. The two methodologies would have produced the same result over a full twelve-month period. However, they produced a $4.9 million revenue divergence in a year with two prorated periods.

The company used the 1/12 monthly allocation method, the way it tracked deferrals in the PCA mechanism. Based on the 2014 Power Cost Only Rate Case, PSE's authorized revenue requirement for fixed production cost on an annual basis is $525,885,095. The company uses 1/12th of the annual revenue requirement, or $43,823,758, as the "allowed revenue" for each month. In other words, the company uses the same average monthly allowed revenue for all twelve months. PSE allocates December 2017, like all other months in 2017, 8.33 percent of the annual allowed revenue. PSE then calculates the monthly deferral by taking the difference between the average monthly allowed revenue and the actual revenue collected for that month.

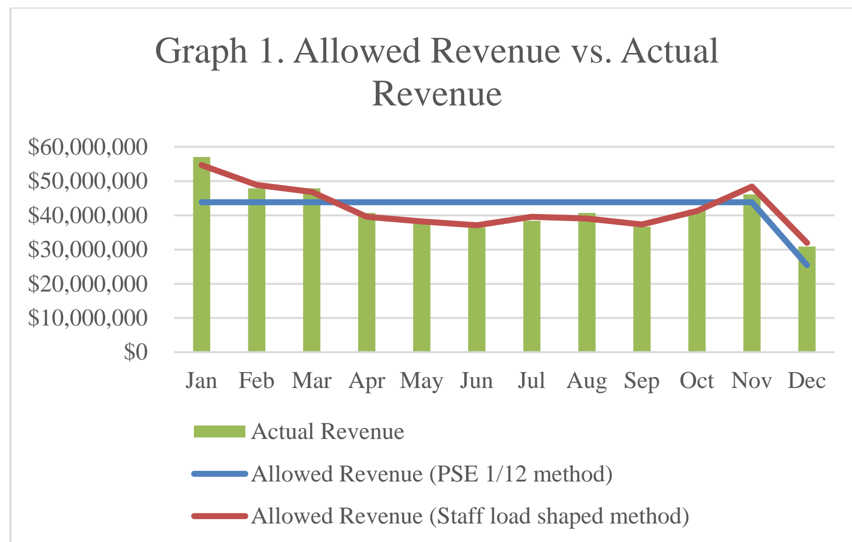
While the company's methodology would have accurately calculated the annual deferral if it had been in place for a full calendar year, this methodology is inappropriate for a partial year. It appeared that's what the company envisioned in its accounting petition in UE-161112. However, it overlooked the plain language in the commission order approving the accounting petition, which provided instructions that deviate from the 1/12 monthly allocation method: that the actual

[13] The numbers in the table do not include revenue sensitive items.

revenue collected will need to be compared to "*the amount of revenue estimated using forecasted loads*."[14]

Staff calculates the deferral period consistent with the commission's order allowing deferred accounting by using the weather-normalized sales for all decoupled groups to develop a monthly allocation factor.[15] Staff then shapes the monthly allowed fixed production revenue by the monthly sales percentage. This serves to reflect more accurately the expected recovery of the annual allowed fixed production revenue following the monthly load curve. Importantly, this is also the same method for how the company allocates the annual allowed fixed production revenue to each decoupled group in the new decoupling mechanism after December 19, 2017. Following staff's approach, December 2017 is allocated 10.46 percent of the annual allowed revenue.[16]

The following graphs depict the difference in PSE's and staff's approaches. Graph 1 depicts how PSE and staff allocate monthly allowed revenue associated with fixed production cost recovery. Because the actual monthly revenue collected follows the monthly load curve, which tends to be significantly higher in winter months and significantly lower in summer and shoulder months, staff's monthly allowed revenue is more closely aligned with the collection of revenue.



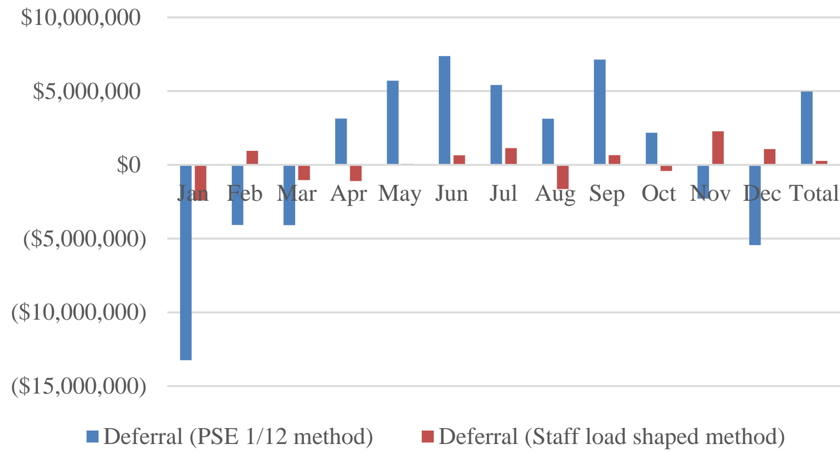
The following two graphs show the difference between PSE's and staff's calculation of fixed production related deferrals. Graph 2 shows the difference in deferrals in each individual months. Staff's load-shaped approach minimizes the swings in monthly deferrals. Graph 3 shows the

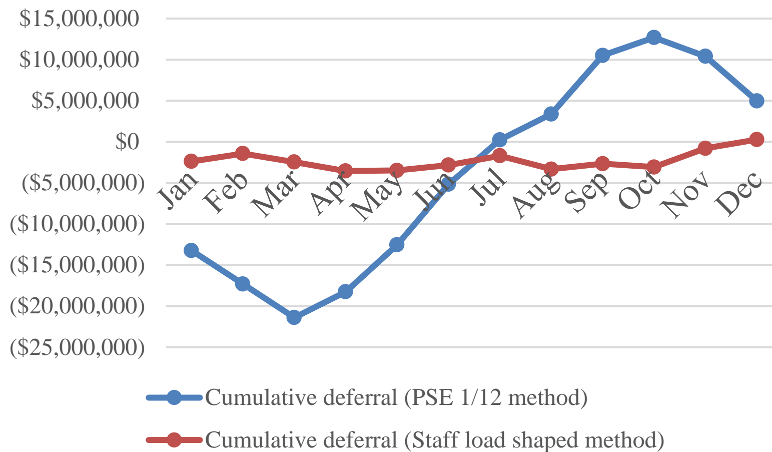
[14] *In the Matter of the Petition of Puget Sound Energy For an Accounting Order Authorizing the Deferral of Fixed Production Costs Previously Recovered in PSE's Power Cost Adjustment Mechanism and To Modify Final Order 11 in Docket No. UE-130617*, Docket UE-161112, Order 01, ¶ 5 (Nov. 10, 2017) (*emphasis added*).

[15] Staff used the weather normalized sales approved in the 2017 GRC, the same source the company used to calculate monthly allocation factors for allowed fixed production revenue in the compliance filing in the 2017 GRC.

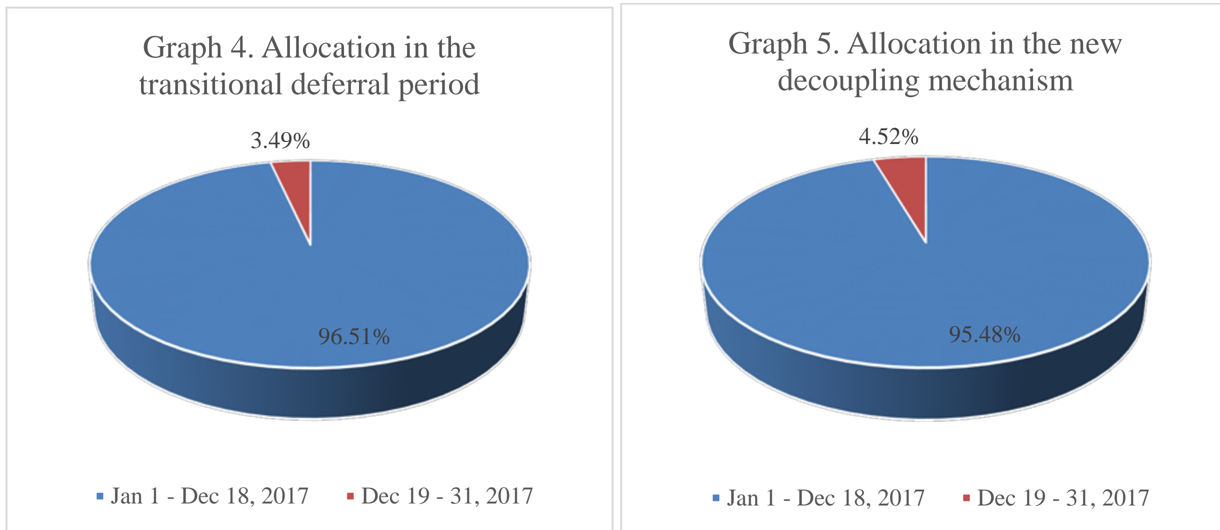
[16] As a reference, based on the 2017 GRC result, the company will allocate 10.77% of the annual allowed fixed production revenue to December. The specific monthly allocation factors vary among decoupled groups.

difference on a cumulative basis. PSE's approach results in a higher allowed revenue for the time period of January 1 to December 18, 2017.





Again, the two allocation methods would have produced the same deferral amount if we evaluate the difference between the revenue requirement and the actual revenue in a full 12-month cycle. But when the deferral is evaluated in a partial year and when the deferral calculation in the remaining part of the year is based on a load-shaped allowed revenue, it results in a glitch that would cause the company to recover more than 100 percent of its allowed revenue, as illustrated in the following graphs.



As shown in the above two graphs, in calculating the allowed revenue for the transitional period of January 1 to December 18, 2017, the company carved out 3.49 percent of the annual allowed revenue for the last 13 days of 2017.[17] However, in calculating the allowed revenue for the period of December 19 through December 31, 2017, the company allocated 4.52 percent of its new annual allowed revenue to the last 13 days of 2017.[18]

Although staff believes the company does not intentionally create this revenue gain, the result is such that ratepayers would pay approximately $4.9 million more than they should due to the application of two inconsistent allocation methods in two prorated periods.[19] The issue needs to be addressed to derive a fair, just, and reasonable allowed revenue for the company and the ratepayers.

2. Delivery Revenue Decoupling

This filing reflects the true-up between the allowed decoupled delivery revenue and actual volumetric revenue, including the true-up of the amortization balance from prior years. The table in Attachment 2 of this memo shows the components of delivery decoupling deferral balances for each customer group. The total balance to be amortized is $4.7 million which will be refunded to all customers under the decoupling mechanism.

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[17] For the carved-out triangle wedge in Graph 4, the calculation is 1/12*13/31 = 3.49%.

[18] Staff notes that the allowed annual revenues in two rate periods of 2017 are different and Schedule 46 and 49 are excluded from the new decoupling mechanism starting December 19, 2017. But the illustrations in Graph 4 and Graph 5 remain relevant. For the wedge in Graph 5, the calculation is based on the percentage of allowed revenue for December in the compliance filing in UE-170033, 10.7716057271601%*13/31 = 4.52 percent.

[19] Also consider the scenario where the December 19 – 31, 2017 deferral were to be calculated based on 1/12th allocation of the annual allowed revenue approved in the 2017 GRC. The company's allowed revenue for the last 13 days in December 2017 would be reduced from $25,703,815 to $19,885,472. The deferral would be reduced by $5,818,344 accordingly, in par with the $4.7 million reduction I outlined above. While Staff is not advocating for revising the monthly allocation of allowed revenue in the new decoupling mechanism, this comparison provides a cross-check of what would happen if the company were to use consistent methods to allocate the December revenue for both the two rate periods. Staff's recommendation above passes this cross-check, PSE's does not.

In Calendar year 2017, for residential customers, the bill payments collected $5.8 million more than the allowed delivery revenue, primarily driven by the higher customer usage in colder winter months. The deferral will be returned to customers as a credit in the upcoming rate year. Non-residential customer groups, however, underpaid by $12.6 million, which will be assessed as a customer surcharge in the rate year.[20] The deferrals for Schedules 12 & 26 and Schedules 10 & 31 were under-collected by $0.33 million and $0.26 million, respectively. The total 2017 deferral of all decoupled groups to be amortized is a surcharge of approximately $6.8 million.[21]

The Earnings Test shows the company's actual rate of return in 2017 to be 8.06 percent, which exceeded the authorized rate of return of 7.76 percent. Accordingly, the company's filing incorporates $12,417,431 that will be shared with customers, representing 50 percent of the excess earnings in 2017. Approximately $7.5 million will be returned to residential customers.[22]

Staff reviewed the company's work papers underlying the delivery revenue decoupling and determined that the delivery decoupling rates were properly calculated.

Conclusion

Staff believes that the company incorrectly calculated the fixed production deferral in 2017. Staff recommends the commission direct the company to use the same method and information the company used and the commission approved in the 2017 GRC to allocate the allowed fixed production revenue in 2017 and calculate decoupling rates accordingly. Because the decoupling mechanism will continue next year, staff believes this correction can be rolled into next year's decoupling filing. The company should record the difference in fixed production deferral and earnings sharing using staff's proposed methodology, and pass back the revenue to customers in decoupled groups, with accrued interest.

Recommendation

Staff recommends the commission issue an order (1) accepting the tariff sheets filed by Puget Sound Energy in Docket UE-180280 on March 30, 2018, and (2) directing the company to recalculate the 2017 fixed production deferral based on staff's methodology for allocating the allowed fixed production revenue, and incorporate the deferral difference in company's decoupling filing next year, with accrued interest.

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[20] For January 1 – December 18, 2017, the non-residential deferral is calculated based on Revenue per Customer for the entire non-residential group authorized in the 2013 decoupling proceeding. The total non-residential deferral for the period is then allocated to the new subgroups to determine their responsibility of the deferral. Schedules 46 and 49 are still decoupled through most of 2017 but are excluded from the decoupling mechanism starting December 19, 2017.

[21] The number includes revenue sensitive items, but not interest.

[22] If the commission adopts staff's recommendation for allocating fixed production revenue, the company will reduce its booked revenue and reflect lower earnings in its Commission Basis Report. Staff estimates that the company will have less excess earnings to share with customers in the decoupled groups.