Exhibit No. ___ T (TES-4T)
DOCKET UE-121373
DOCKETS UE-121697/UG-121705
DOCKETS UE-130137/UG-130138
Witness: Thomas E. Schooley

**BEFORE THE WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION**

| | |
|---|---|
| WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,<br><br>Complainant,<br><br>v.<br><br>PUGET SOUND ENERGY, INC.,<br><br>Respondent. | DOCKET UE-121373<br>DOCKETS UE-121697/UG-121705<br>DOCKETS UE-130137/UG-130138 |

**REBUTTAL TESTIMONY OF**

**THOMAS E. SCHOOLEY**

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

***In Support of Multiparty Settlement Re:
Coal Transition Power Purchase Agreement and Other Pending Dockets***

**May 8, 2013**

## I. INTRODUCTION

**Q. Please state your name and business address.**

A. My name is Thomas E. Schooley. My business address is The Richard Hemstad Building, 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA 98504. My email address is tschoole@utc.wa.gov.

**Q. Are you the same Thomas E. Schooley that submitted testimony on March 27, 2013?**

A. Yes.

## II. SCOPE AND SUMMARY OF TESTIMONY

**Q. What is the purpose of your rebuttal testimony in this proceeding?**

A. I reiterate Staff's support for the global settlement of five dockets[1] covering three major issues and rebut various claims of Public Counsel, and intervenors.[2]

**Q. Have any other parties joined the Global Settlement since Staff filed testimony on March 27, 2013?**

A. Yes. NWIGU and The Energy Project have joined the Settling Parties.

---

[1] Those five dockets are: Docket UE-121373, Coal Transition Power Purchase Agreement; Dockets UE-121697/UG-121705 (*consolidated*), Decoupling Plan; and Dockets UE-130137/UG-130138 (*consolidated*), Expedited Rate Filing (collective dockets, or Global Settlement).

[2] The intervenors filing testimony include the Industrial Customers of Northwest Utilities (ICNU), Northwest Industrial Gas Users (NWIGU), Nucor Steel, Kroger, and The Energy Project.

NWIGU accepts the Global Settlement as fair and reasonable with one condition. It requested that Schedules 85, 85T, 87 and 87T be removed from the decoupling mechanism and instead, be treated consistently with "rate plan customers." The demand charges in these schedules will be exempt from the annual K-factor rate plan increases of 2.2 percent. The dollar impact is about $300,000 over the term of the plan, and will be absorbed by PSE. This condition is acceptable to PSE and Staff.

The Energy Project joins the Global Settlement with the conditions: (1) The funding for HELP program is increased by $1.5 million to a total of $21.7 million; and (2) PSE's shareholders will contribute an additional $100,000 per year to low-income energy efficiency programs for a total of up to $400,000 in additional non-recurring shareholder funding. These conditions are acceptable to PSE and Staff.

**Q. Have you prepared any exhibits in support of your rebuttal testimony?**

A. Yes, I revised my Exhibit No. ___ (TES-3) to include the most recent information on PSE's results of operations in 2012.

## III. DISCUSSION

### A. Summary of Contested Issues

**Q. Please give a brief description of the issues presented by intervenors and Public Counsel in opposition to the Global Settlement.**

A. Public Counsel and the intervenors contest the Global Settlement with the following claims:

(a) They claim the rate of return is too high;

(b) They claim the use of end-of-period rate base is unfair;

(c) They claim decoupling and the K-factor is unacceptable in whole, or at least not without a decrease in the rate of return;

(d) They claim the rate plan is overly generous;

(e) They largely ignore the merits of the public benefits of the PSE/TransAlta Centralia Power Purchase Agreement.

**B. Rate of Return**

**Q. Please summarize your reply to concerns about the rate of return.**

A. The parties raise two distinct issues about the rate of return. One is the return in the expedited rate case (ERF); the other is adjusting the return for a decoupling program. Taking the ERF issue first; I must point out one basic premise of the ERF. The whole point of this filing receiving "expedited" processing is to keep certain ratemaking variables constant. Principal among those variables is the rate of return. The Commission determined that 7.8 percent was fair and sufficient in Dockets UE-111048/UG-111049 in Order 08 dated May 7, 2012. Subsequently, parties reached a settlement in the Avista general rate case.[3] The Commission accepted and adopted that settlement in December 2012, which authorized a 7.8 percent rate of return. Given that the Avista settlement is less than five months old, the rate of return of 7.8

[3] *WUTC v. Avista*, Dockets UE-120436/UG-120437.

percent remains within the range of reasonableness. Although the record will now have some testimony on equity returns and capital structure, the Commission does not have before it sufficient or balanced presentations to enable it to arrive at a rate of return other than 7.8 percent. Moreover, the concept of an expedited rate filing does not contemplate that such a determination be made in this context. Finally PSE continues to earn significantly less than their authorized rate of return as I discuss below.

**Q. What is your response to the issue of reducing returns in the context of a decoupling program?**

A. To that point, one must consider the fact that the rates in place today are not producing revenues sufficient to provide PSE its target rate of return of 7.8 percent. Nor have rates over the past several years been sufficient to keep up with the Company's increases in costs or investments. I presented Exhibit No. ___ (TES-3) as evidence of this trend and now update my exhibit to reflect the rate increase instituted in May 2012, and the earnings results for 2012.[4] Revised Exhibit No. ___ (TES-3) shows PSE's electric earnings were about 70 basis points less and gas earnings were 30 basis points less than the rate of return granted in 2012. The other parties' push to reduce returns for any reason seem overstated since PSE's earnings are lower than its authorized rates of return and PSE has not achieved its authorized return for electric operations since 2006, and for gas operations since at least 2004.

[4] Dockets UE-130652 and UG-130653.

**Q. The Commission's policy statement advocates a reduction to a company's rate of return in a decoupling setting. What do you make of that?**

A. The Decoupling Policy Statement sets forth principles for a decoupling plan, but the Commission clarifies its intent stating, "[The Policy Statement] was not intended to set forth immutable doctrine on [decoupling] or to negatively imply that we would be receptive to nothing else."[5] The claim that decoupling reduces risk for regulated utilities has theoretical appeal, but is at best hypothetical and unsupported by empirical evidence. Here we have the opportunity to test that hypothesis. This full decoupling program will compare the financial revenues determined by multiplying the number of customers by the delivery revenues per customer versus the cash collected through volumetric rates intended to generate the same level of dollars. The magnitude of the refunds and surcharges will be direct evidence of the volatility dampened by the decoupling program. Given that this program addresses only delivery costs it cannot be extrapolated to the full impact on the utility's rate of return. However, it will be a good measure of decoupling's impact on the one-half to one-third of the revenues represented by the delivery of gas or electricity. It is important to understand these impacts on real world operations before establishing an "adjustment" to rates of return.

## C. Expedited Rate Filing and End-of-Period Rate Base

**Q. Do the non-settling parties lodge complaints against the expedited rate filings?**

[5] *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049, consolidated, Order 08 (May 7, 2012) ("Order 08"), page 167, fn 617.

A. Yes. Mr. Deen for ICNU raises issues concerning: (1) the rate of return; (2) a "hybrid" test year;[6] and (3) "the novel use of end of period (EOP) rate base".[7] Mr. Dittmer for Public Counsel supports "the ERF in concept," but chafes at the EOP rate base and rate of return, and proposes a "test-year-end revenue adjustment."[8] [9]

**Q. How do you respond?**

A. I address the following points: (1) the test year; (2) EOP rate base; and (3) the year-end revenue adjustment. I addressed the rate of return in Section B above.

The so-called "hybrid" test year is a curious argument. The gas and electric ERFs are based on a test period for the 12 months ending June 30, 2012. There is nothing whatsoever unusual about that. The use of test years ending at dates other than the calendar year end is a common practice. Note that the current PacifiCorp general rate case is based on the same test year ending June 30, 2012.[10] This is a non-issue.

**Q. Please discuss rate base at the end-of-period values.**

A. PSE used rate base values as of the end of the test period, June 30, 2012. The Commission squarely addressed the possibility of using EOP rate base in Order 08.[11]

[6] Exhibit No. ___ (MCD-1T) at 10:23.
[7] Id., at 11:16.
[8] Exhibit No. ___ (JRD-1T) at 4:12-16.
[9] Mr. Higgins for Kroger and Nucor states "Kroger (and Nucor) neither supports nor opposes the revenue requirement provisions proposed by PSE in the ERF." Exhibit No. ___ (KCH-1T) at 3:19-20 and Exhibit No. ___ (KCH-5T) at 3:18-19
[10] *WUTC v. PacifiCorp*, Docket UE-130043.
[11] Order 08, pages 180-181 ¶ 491. The Commission in addressing periods of time when "new plant is more costly than plant being replaced, or more costly than the average cost of plant included in rates" states, it is

This approach is hardly "novel." End-of-period rate base was accepted by the Commission in a 2001-02 Olympic Pipeline[12] case and in a 1980-81 Washington Natural Gas case which references cases in 1972-73 and 1973-74.[13] In short, the issue of valuing rate base at the end of a period is neither new nor novel.

**Q. Is the use of EOP rate base necessary and useful today?**

A. Yes. In Cause No. U-80-111 the Commission identified a number of circumstances where the use of EOP is prescribed. We have at least two of those circumstances here: regulatory lag and persistent under earnings. With respect to the issue of regulatory lag, the Commission stated;

> "We must also recognize that regulatory lag (the interim period elapsing between the filing of a rate case and its ultimate disposition) has long been a concern of both the utilities and their regulators, and regulatory lag may tend to erode the earnings of a utility. If regulatory lag has a deleterious effect, it is difficult to compensate for its overall adverse effect. However, as regulators we have the responsibility to mitigate that effect to the extent possible."[14]

In the early 1980s inflation was a serious economic concern. Today we are faced with replacing old infrastructure with new. The cost impacts are quite similar with regulatory lag causing the same "deleterious effect" on earnings. Therefore,

---

open to remedies which include "use of plant accounts (rate base) measured at the end, or subsequent to the end of the test-year rather than the test-year average."

[12] *WUTC v. Olympic Pipe Line Company*, Docket TO-011472, Twentieth Sup. Order, at page 44 ¶ 160. Stating, "This (EOP) adjustment to the traditional rate base calculation is warranted and appropriate. It contributes to the Company's ability to serve its customers and contributes to rates that are fair, just, reasonable, and sufficient."

[13] *WUTC v. Washington Natural Gas*, Cause No. U-80-111, Third Supp. Order at pages 5-7. Here the Commission addresses the phenomenon that new plant and new customers are occurring, but new revenues produced by those additions are not parallel with the costs. The Commission notes that delivered new therms from the new customers were less that the therms delivered during previous years. A cause of this decline is cited as "serious and conscientious efforts of the public to conserve energy." The Commission concludes that "year-end rate base will be adopted for ratemaking purposes in this proceeding."

[14] Id., at page 6.

measuring rate base at EOP values is a viable, simple way to mitigate regulatory lag in today's filings.

In addition, the Commission stated in Cause No. U-80-111 that the use of EOP rate base is "an appropriate regulatory tool" where there is a "failure of [the] utility to earn its authorized rate of return over a historical period."[15] That is precisely the situation faced by PSE today, as shown in Exhibit No. ___ (TES-3 revised).

**Q. Does EOP rate base violate the matching principle as argued by Mr. Dittmer[16]?**

A. No. While it is true that the Commission has stated that average rate base is a preferred option,[17] it also has regularly opined on the validity of end-of-period valuations. Moreover, in financial reporting the balance sheet is a report of assets and liabilities valued at the end of the fiscal year while the accompanying income statement represents transactions over the course of the year. These account balances are used in developing various financial metrics without regard to averaging the year-end balance sheet. The regulatory goal is to reach a representation of the ratios of the rate base, revenues and expenses to establish rates for a future period. If the end of period rate base fairly presents the going forward values that rates are intended to capture, then progress on reducing regulatory lag is achieved.

---

[15] Id.
[16] Exhibit No. ___ (JRD-1T) at 3:9
[17] *WUTC v. Washington Natural Gas*, Cause No. U-80-111, Third Supp. Order, at page 6

Comparison of Rate Changes to Earned Returns at PSE
For 2005 through *2012*

| Electric Rate Increases | | | PSE Commission Basis Results of Operations | | | | | | Deviation from Authorized | |
|---|---|---|---|---|---|---|---|---|---|---|
| Docket | Rates effective | Percent Rate Change *1 | Calendar Year | Subsequent Commission Basis Report | Achieved Return | Granted Rate Of Return | Achieved Equity Return | Granted Equity Return | Overall | Equity |
| UE-040641/ UE-032043 | 3/4/2005 | 3.9% | | | | | | | | |
| UE-050870 | 11/1/2005 | 3.7% | | | | | | | | |
| UE-060783 | 7/1/2006 | 6.0% | 2006 | UE-070825 | 8.78% | 8.40% | 10.30% | 10.40% | 0.4% | -0.1% |
| UE-060266 | 1/13/2007 | -1.3% | | | | | | | | |
| UE-070565 | 8/9/2007 | 3.7% | 2007 | UE-080850 | 8.13% | 8.40% | 9.89% | 10.40% | -0.3% | -0.5% |
| UE-072300 | 11/1/2008 | 7.1% | 2008 | UE-090674 | 6.39% | 8.25% | 5.94% | 10.15% | -1.9% | -4.2% |
| | | | 2009 | UE-100719 | 6.11% | 8.25% | 5.63% | 10.15% | -2.1% | -4.5% |
| UE-090704 | 5/1/2010 | 3.7% | 2010 | UE-110764 | 6.07% | 8.10% | 5.57% | 10.10% | -2.0% | -4.5% |
| | | | 2011 | UE-120608 | 6.62% | 8.14% | 6.98% | 10.10% | -1.5% | -3.1% |
| *UE-111048* | *5/12/2012* | *3.2%* | *2012* | *UE-130652* | *7.14%* | *7.80%* | *8.11%* | *9.80%* | *-0.7%* | *-1.7%* |
| | | | Average Earnings Shortfalls | | | | | | *-1.2%* | *-2.7%* |

| Natural Gas Rate Increases | | | PSE Commission Basis Results of Operations | | | | | | Deviation from Authorized | |
|---|---|---|---|---|---|---|---|---|---|---|
| Docket | Rates effective | Percent Rate Change *1 | Calendar Year | Subsequent Commission Basis Report | Achieved Return | Granted Rate Of Return | Achieved Equity Return | Granted Equity Return | Overall | Equity |
| UG-040640 | 3/4/2005 | 3.20% | 2006 | UG-070826 | 7.21% | 8.40% | 10.30% | 10.40% | -1.2% | -0.1% |
| UG-060267 | 1/13/2007 | 3.10% | 2007 | UG-080851 | 7.34% | 8.40% | 9.89% | 10.40% | -1.1% | -0.5% |
| UG-072301 | 11/1/2008 | 4.60% | 2008 | UG-090675 | 6.52% | 8.25% | 5.94% | 10.15% | -1.7% | -4.2% |
| | | | 2009 | UG-100720 | 6.10% | 8.25% | 5.63% | 10.15% | -2.2% | -4.5% |
| UG-090705 | 5/1/2010 | 0.80% | 2010 | UG-110765 | 6.24% | 8.10% | 5.57% | 10.10% | -1.9% | -4.5% |
| | | | 2011 | UG-120609 | 6.78% | 8.14% | 7.30% | 10.10% | -1.4% | -2.8% |
| *UG-111049* | *5/12/2012* | *1.3%* | *2012* | *UG-130653* | *7.46%* | *7.80%* | *8.78%* | *9.80%* | *-0.3%* | *-1.0%* |
| | | | Average Earnings Shortfalls | | | | | | *-1.4%* | *-2.5%* |

*1 Percent rate changes are at annual rates and not cumulative.
Some increases were in effect less than one year.