

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

v.

PUGET SOUND ENERGY, INC.

DOCKET NOS. UE-111048 AND UG-111049 (*consolidated*)

DIRECT TESTIMONY OF ANDREA C. CRANE (ACC-1T)

ON BEHALF OF

PUBLIC COUNSEL

AND

THE ENERGY PROJECT

DECEMBER 7, 2011

DIRECT TESTIMONY OF ANDREA C. CRANE (ACC-1T)
DOCKET NOS. UE-111048 AND UG-111049

EXHIBIT LIST

- Exhibit No. ACC-2 Summary of Background and Experience of Andrea C. Crane
Exhibit No. ACC-3 Electric Adjustments
Exhibit No. ACC-4 Gas Adjustments

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1 **I. INTRODUCTION**

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

3 A. My name is Andrea C. Crane and my business address is 90 Grove Street, Suite 211,
4 Ridgefield, Connecticut 06877. (Mailing Address: PO Box 810, Georgetown,
5 Connecticut 06829)

6 **Q. By whom are you employed and in what capacity?**

7 A. I am President of The Columbia Group, Inc., a financial consulting firm that specializes
8 in utility regulation. In this capacity, I analyze rate filings, prepare expert testimony, and
9 undertake various studies relating to utility rates and regulatory policy. I have held
10 several positions of increasing responsibility since I joined The Columbia Group, Inc., in
11 January 1989. I became President of the firm in 2008.

12 **Q. Please summarize your professional experience in the utility industry.**

13 A. Prior to my association with The Columbia Group, Inc., I held the position of Economic
14 Policy and Analysis Staff Manager for GTE Service Corporation, from December 1987
15 to January 1989. From June 1982 to September 1987, I was employed by various Bell
16 Atlantic (now Verizon) subsidiaries. While at Bell Atlantic, I held assignments in the
17 Product Management, Treasury, and Regulatory Departments.

18 **Q. On whose behalf are you testifying?**

19 A. I am testifying on behalf of the Public Counsel Section of the Washington Attorney
20 General's Office (Public Counsel). The portion of my testimony addressing the
21 Conservation Savings Adjustment (CSA) is also being sponsored by The Energy Project.
22 Testimony on behalf of The Energy Project is also being filed by John Howatt.
23 Testimony on behalf of Public Counsel is also being filed by Scott Norwood.

1 **Q. Have you previously testified in regulatory proceedings?**

2 A. Yes, since joining The Columbia Group, Inc., I have testified in over 350 regulatory
3 proceedings in the states of Arizona, Arkansas, Connecticut, Delaware, Hawaii, Kansas,
4 Kentucky, Maryland, New Jersey, New Mexico, New York, Oklahoma, Pennsylvania,
5 Rhode Island, South Carolina, Vermont, Washington, West Virginia and the District of
6 Columbia. These proceedings involved electric, gas, water, wastewater, telephone, solid
7 waste, cable television, and navigation utilities. A list of dockets in which I have filed
8 testimony since January 2008 is included in Exhibit No. ACC-2.

9 **Q. What is your educational background?**

10 A. I received a Master of Business Administration degree, with a concentration in Finance,
11 from Temple University in Philadelphia, Pennsylvania. My undergraduate degree is a
12 B.A. in Chemistry from Temple University.

13 **II. PURPOSE OF TESTIMONY**

14 **Q. What is the purpose of your Direct Testimony in this proceeding?**

15 A. The purpose of my Direct Testimony is to address select issues raised in the filings made
16 on June 13, 2011 and September 1, 2011 by Puget Sound Energy, Inc. (PSE or Company)
17 requesting general rate increases for its electric and gas distribution system rates. In its
18 filings, PSE requested a rate increase of \$161,275,557 for its electric distribution system
19 and of \$31,864,884 for its gas distribution system. These increases were based on a test
20 year ending December 31, 2010 and on a proposed rate of return of 8.42 percent.¹ On
21 September 1, 2011, Mr. Story filed Supplemental Testimony, revising the electric rate

¹ Per Exhibit No. JHS-7.02 and Exhibit No. MJS-7.02. The Company is requesting an after-tax return of 7.29 percent.

1 increase request to \$152,928,501. This revision did not impact the quantification of any
2 of the issues discussed in my testimony. On November 9, 2011, Mr. Piliaris also filed
3 Supplemental Testimony, stating the electric revenue requirement would increase by
4 approximately \$70,000 due to the reclassification of one customer to rate Schedule 40.
5 However, Mr. Story has not updated his schedules to reflect that change.

6 Given limited resources, I was engaged by Public Counsel to address only
7 selected issues in this case. I am testifying on the Company's proposed CSA, on the
8 Company's deferral of the Chelan Public Utility District (PUD) reservation payment, and
9 on certain tax issues involving net operating losses (NOLs) and the accounting for repairs
10 and retirements. In addition, I have quantified the revenue requirement impact of an
11 adjustment sponsored by Mr. Norwood regarding the Lower Snake River (LSR) project.

12 **III. SUMMARY OF CONCLUSIONS**

13 **Q. What are your conclusions regarding the issues that you are addressing in this case?**

14 A. Based on my analysis of the Company's filing and other documentation in this case, my
15 conclusions and recommendations are as follows:

- 16 • The Commission should reject the Company's proposed CSA, which is
17 inconsistent with the Commission's policy statement regarding decoupling
18 proposals.
- 19 • The Company has not demonstrated that the benefits provided by its conservation
20 programs to low-income customers are comparable to the benefits provided to
21 other ratepayers.
- 22 • The Commission should reject the Company's request to reduce rate base to

1 reflect the impact of a net operating loss carry-forward (Exhibit No. ACC-3.02
2 and Exhibit No. ACC-4.02).

- 3 • The Commission should revise the Company's revenue requirement claim to
4 reflect an accounting change for repairs and retirements that was utilized by PSE
5 during the test year (Exhibit No. ACC-3.03 and Exhibit No. ACC-4.03).
- 6 • The Commission should adopt Mr. Norwood's recommendation to reduce the
7 Company's revenue requirement based on imprudence with respect to the LSR
8 project.
- 9 • The Commission should examine the appropriate ratemaking treatment of
10 Treasury Grants associated with the Lower Snake River (LSR) wind project once
11 those grants are received.
- 12 • The Commission should revise the interest claimed by the Company relating to
13 the Chelan Public Utility District (PUD) reservation payment to reflect a net-of-
14 tax rate, as authorized in Docket UE-060266 and UG-060267 (Exhibit No. ACC-
15 3.04).
- 16 • The Commission should revise the amortization expense claimed by the Company
17 relating to the Chelan PUD reservation payment, consistent with my
18 recommendation to calculate interest on a net-of-tax basis (No. ACC-3.05).
- 19 • Based on my recommendations, and on the recommendation of Mr. Norwood
20 regarding the return on the LSR project, the Commission should approve a rate
21 increase for the electric utility of no greater than \$ 89,615,425 (Exhibit No. ACC-
22 3.01). The Commission should approve a rate increase for the gas utility of no

1 greater than \$27,529,183 (Exhibit No. ACC-4.01).

2 **IV. DISCUSSION OF THE ISSUES**

3 **A. Conservation Savings Adjustment**

4 **1. Description of the CSA Mechanism**

5 **Q. Please describe the Company's proposed conservation savings adjustment (CSA).**

6 A. As described in the testimony of Jon A. Piliaris (Exhibit No. JAP-1T), the Company is
7 proposing a CSA, which is intended to "recover costs that would otherwise go
8 unrecovered by PSE as a result of the load-reducing impacts of Company-sponsored
9 energy efficiency that have occurred since the beginning of the test year used to derive its
10 retail rates."²

11 **Q. Please describe the mechanism proposed by PSE.**

12 A. The proposed CSA mechanism would result in a surcharge to customers based on the
13 amount of estimated load reduction that results from Company-sponsored conservation
14 programs each year. The Company is proposing that each month, the estimated
15 conservation-related load reduction would be multiplied by the per unit margin in order
16 to determine the Company's estimated monthly lost revenues that it could collect through
17 the CSA.³ In order to estimate conservation-related load reduction for the CSA the
18 Company uses the savings estimates from PSE's energy efficiency programs. The CSA
19 adjustment would be made annually, so twelve months of such losses would constitute
20 the recoverable amount for that year. Seventy-five percent of the recoverable amount
21 would be charged to ratepayers in the following CSA year, and the remaining twenty-five

² Exhibit No. JAP-1T, p. 32, ll. 14-17.

³ Exhibit No. JAP-1T, p. 33, ll. 7-8.

1 percent would be charged to ratepayers in a subsequent CSA year, subject to third party
2 verification of the actual energy savings.

3 The Company is proposing an earnings cap so that lost margins for any given year
4 would only be recoverable to the extent that the Company failed to achieve its authorized
5 rate of return in that year. Mr. Piliaris' testimony suggests at page 33, lines 14-19, that
6 25 percent of the CSA recoverable surcharge would be subject to the earnings test.
7 However, in response to discovery, the Company clarified that the entire CSA surcharge
8 would be subject to such a test.⁴

9 **Q. How does the Company propose to calculate the per unit margin associated with lost**
10 **revenues?**

11 A. The Company proposes that the per unit impact of the electric CSA be derived by
12 dividing pro forma test year revenue from the prior general rate case, less basic charge
13 revenue and allocated power-related costs, by the pro forma test year sales.⁵ The per unit
14 impact of the gas CSA would be derived by dividing pro forma test year margin revenue
15 in the prior rate case, less any associated basic charges and minimum charge revenue, by
16 the corresponding pro forma test years sales.⁶

17 **Q. To which customer classes would the CSA surcharge apply?**

18 A. According to Mr. Piliaris on page 34, lines 1-8 of Exhibit No. JAP-1T, the Company is
19 proposing to apply the surcharge to three groups of electric customers: (1) residential
20 electric customers (Rate Schedule 7), (2) non-residential electric customers that are
21

⁴ PSE Response to Public Counsel Data Request No. 178.

⁵ Exhibit No. JAP-1T, p. 37, ll. 16-20.

⁶ Exhibit No. JAP-1T, p. 38, ll. 2-6.

1 eligible for conservation programs under rate Schedule 258 (Large Power User Self-
2 Directed Programs, which serve Rate Schedules 40, 46, 49, 448, 449, 458, and 459), and
3 (3) remaining non-residential electric customers served under rate Schedules 24, 25, 26,
4 29, 31, 35, 43, and 57.⁷ Table 4 on page 38 of Exhibit No. JAP-1T quantifies the amount
5 of the surcharge by customer group.

6 With regard to gas customers, the Company is proposing to apply the CSA
7 surcharge to residential gas customers, firm non-residential gas sales customers, and
8 interruptible gas sales customers.⁸ The CSA surcharge applicable to each electric and gas
9 group would be separately determined. The Company's proposed CSA rates are based on
10 lost revenues beginning January 1, 2010.⁹

11 **Q. How much is the Company proposing to recover in its initial CSA rates?**

12 A. The Company is proposing to recover \$9.8 million from its electric customers and \$2.0
13 million from its gas customers.¹⁰ These CSA revenues would be in addition to any rate
14 increase approved by the Commission in this general rate case.

15 **2. Commission Policy Statement on Conservation and Decoupling**

16 **Q. Has the Commission issued a Policy Statement that addresses conservation and**
17 **decoupling issues?**

18 A. Yes, it has. On November 4, 2010, in Docket U-100522, the Commission issued its
19 *Report and Policy Statement on Regulatory Mechanisms, Including Decoupling, to*
20

⁷ Exhibit No. JAP-1T, p. 34, ll. 1-8.

⁸ Exhibit No. JAP-IT, p. 34, ll. 10-16.

⁹ Exhibit No. JAP-1T, p. 36, l. 15 – p. 37, l. 2.

¹⁰ Exhibit No. JAP-1T, Tables 4 and 5. 75 percent of these revenues would be collected in the first year of new rates and the additional 25 percent would be collected in year 2.

1 *Encourage Utilities to Meet or Exceed Their Conservation Targets* (Decoupling Policy
2 Statement). In that Policy Statement, the Commission addressed three types of regulatory
3 mechanisms: limited decoupling, full decoupling, and the use of specific incentives to
4 encourage conservation.

5 **Q. How did the Commission define limited decoupling vs. full decoupling?**

6 A. In its Policy Statement, the Commission defined limited decoupling as a “lost margin
7 recovery mechanism” that would permit utilities “to recover lost margin due only to the
8 conservation efforts of the utility including educational and informational efforts.”¹¹ The
9 Commission defined full decoupling as a mechanism “designed to minimize the risk to
10 both the utilities and to ratepayers of volatility in average use per customer by class
11 regardless of cause, including the effects of weather.”¹²

12 **Q. What type of program is PSE proposing in this case?**

13 A. While the program proposed by PSE is most similar to a limited decoupling proposal, in
14 that it is designed to respond solely to reductions in usage caused by conservation
15 measures, the Company’s program is inconsistent with the limited decoupling mechanism
16 outlined in the Commission’s Decoupling Policy Statement, as discussed later in my
17 testimony.

18 **Q. What were the Commission’s conclusions with regard to the various mechanisms?**

19 A. With regard to gas utilities, the Commission noted that in the context of a general rate
20 case, it would “consider a limited decoupling mechanism for natural gas utilities where,
21 over time, existing customer use by class drops from that determined by the Commission

¹¹ Decoupling Policy Statement, ¶ 12.

¹² *Id.*, ¶ 12.

1 when setting rates.”¹³ The Commission limited this option to natural gas utilities. The

2 Commission found that:

3 Because the increased electric load per customer reduces the potential
4 adverse impact of increased conservation efforts on utility revenues, we
5 believe lost and found margins are likely to be in better balance for
6 electric utilities, which argues against using a limited decoupling
7 mechanism for such companies to address the revenue impacts of
8 conservation.¹⁴

9 With regard to full decoupling, the Commission stated that it would “consider a
10 full decoupling mechanism for electric and natural gas utilities, which will allow a utility
11 to either recover revenue declines related to reduced sales volumes or, in the case of sales
12 volume increases, refund such revenues to its customers.”¹⁵ The Commission also noted
13 that it would consider incentive mechanisms, for both electric and gas utilities.¹⁶

14 **Q. Did the Commission provide PSE with the opportunity to file supplemental**
15 **testimony and exhibits on decoupling after the Company’s initial filing?**

16 A. Yes. The Prehearing Conference Order contemplated that PSE would include proposals
17 relating to decoupling in its Supplemental Testimony filing on September 1, 2011.

18 However, PSE declined the opportunity, stating that,

19 PSE does not intend to file optional supplemental testimony on the topic
20 of the effect that PSE sponsored energy efficiency has on its ability to
21 recover its fixed costs, or optional supplemental testimony on decoupling
22

¹³ *Id.*, ¶ 18.

¹⁴ *Id.*, ¶ 22.

¹⁵ *Id.*, ¶ 28.

¹⁶ *Id.*, ¶ 33.

1 as provided for in the Procedural Schedule, Appendix B to the Prehearing
2 Conference Order.¹⁷

3 **Q. Did the Commission subsequently instruct Staff to provide a full decoupling**
4 **proposal for its consideration?**

5 A. Yes, it did. In a bench request issued on October 5, 2011, the Commission stated that
6 “[i]n the interest of having a more complete record concerning the issues raised in PSE’s
7 proposal, the Commission requests that Staff examine full decoupling, as discussed in the
8 Decoupling Policy Statement, as an option for PSE.” The Bench Request required Staff
9 to include such an evaluation when it filed its responsive case on December 7, 2011. The
10 Bench Request also provided PSE and the other interveners with the option of filing full
11 decoupling, or alternative, proposals. PSE objected to the Bench Request and ultimately
12 notified the Commission that it would not file a full decoupling proposal on December 7,
13 2011.

14 **Q. Does the Decoupling Policy Statement address the components of a mechanism that**
15 **should be filed by a natural gas utility seeking approval of a limited decoupling**
16 **proposal?**

17 A. Yes, it does. In paragraph 18 of the Policy Statement, the Commission provided a
18 description of a limited decoupling proposal that it would consider. To be considered by
19 the Commission, a utility’s request for a limited decoupling mechanism should include, at
20 a minimum:

- 21 • A true-up mechanism to recover reduction in sales volumes directly attributable to
22 the utility’s conservation efforts.

¹⁷ Letter, September 1, 2011, Sheree Strom Carson to David Danner (cover letter to supplemental testimony filing of John Story and David Mills).

- 1 • Evidence evaluating the impact of the proposal on risk to investors and ratepayers
2 and its effect on the utility's ROE.
- 3 • A proposed earnings test to be applied at the time of the true-up.
- 4 • Evidence of any source of found margin that could make the adoption of a limited
5 decoupling mechanism unfair to ratepayers. Such found margin could include a
6 growing customer base or any other foreseeable increase in customer use by class.
- 7 • Evidence that evaluates the proposed mechanism's impact on rates.
- 8 • Evidence demonstrating the soundness of the Company's weather normalization
9 methodology, and how the mechanism's design effectively removes weather as a
10 factor influencing the results of its lost margin analysis.¹⁸

11 In addition to these requirements, the Commission also identified certain criteria that
12 should be present in any limited decoupling proposal. These include:

- 13 • Relationship of Found Margin to Lost Margin. The Commission will consider
14 limited decoupling only where found margins are not significant in comparison to
15 lost margins.
- 16 • Conservation measures covered. The utility must demonstrate that lost margins
17 are directly related to company-sponsored conservation programs.
- 18 • Application to all customer classes whose usage drops over time as a result of the
19 conservation programs.
- 20 • Evidence describing the incremental conservation the company may achieve in
21 conjunction with the proposed mechanism.

¹⁸ Decoupling Policy Statement, ¶ 18.

- 1 • A limited duration, such as the period required to achieve a Commission objective
- 2 or until the filing of the utility's next general rate case.
- 3 • A demonstration that the conservation programs provide benefits to low-income
- 4 customers that are comparable to those provided to other ratepayers, as described
- 5 below.
- 6 • Other factors impacting the public interest.¹⁹

7 **Q. What does the Decoupling Policy Statement require with regard to low-income**
8 **customers?**

9 A. The Decoupling Policy Statement provides that,

10 A utility proposing a limited decoupling mechanism must demonstrate
11 whether or not its conservation programs provide benefits to low-income
12 ratepayers that are roughly comparable to other ratepayers and, if not, it
13 must provide low-income ratepayers targeted programs aimed at achieving
14 a level of conservation comparable to that achieved by other ratepayers, so
15 long as such programs are feasible within cost-effectiveness standards.²⁰

16
17 There is a similar requirement for full decoupling proposals.²¹
18

19 **3. Analysis of the Proposed CSA Mechanism**

20 **Q. Is the Company's CSA proposal consistent with the provisions of the Decoupling**
21 **Policy Statement?**

22 A. No, it is not. As discussed by Tom DeBoer in Exhibit No. TAD-1T, page 10, lines 13-19,
23 the Company rejected the decoupling and incentive mechanisms envisioned in the
24 Decoupling Policy Statement, stating that,

25 After carefully considering and analyzing the mechanisms in the Report

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*, ¶ 28.

1 and Policy Statement, the Company concluded that none of the specific
2 mechanisms discussed by the Commission meet PSE's needs because they
3 effectively hold use-per-customer (and, therefore, revenue-per-customer)
4 constant while expenses-per-customer continue to grow.

5 Thus, the Company acknowledges that its proposal is inconsistent with the provisions of
6 the policy statement.

7 In fact, PSE's proposal blatantly disregards many of the basic components laid
8 out in the Commission's policy statement. The CSA surcharge would be based solely on
9 margins lost as a result of conservation programs, without consideration for other usage
10 factors. In quantifying its adjustment, the Company has not considered any found
11 margin, as defined in the Decoupling Policy Statement. Thus, as long as the Company
12 does not exceed its authorized rate of return, the Company's mechanism would always
13 result in a surcharge on ratepayers.

14 **Q. Does the Company's proposal appear to address issues that are broader than**
15 **conservation?**

16 A. Yes, it does. Mr. DeBoer suggests that the Company's proposal is directed more toward
17 overcoming a regulatory lag issue than compensating the utility for a net revenue
18 reduction due to conservation programs. Mr. DeBoer states that PSE's proposed
19 mechanism is necessary because utility costs-per-customer are generally growing faster
20 than usage-per-customer.²² Thus, Mr. DeBoer implies that any limited decoupling
21 mechanism that maintains the relationship between revenues and expenses determined in
22

²² Exhibit No. TAD-1T, p. 11, ll. 9-19.

1 the prior rate case will invariably result in the Company failing to earn its authorized
2 return.

3 However, the mechanisms outlined in the Decoupling Policy Statement were not
4 intended to compensate the Company for increasing operating costs. That is the function
5 of a general rate case. Moreover, this Company already has a history of filing frequent,
6 almost annual, general rate cases and it has stated that it expects to continue to file
7 frequent rate cases in the future. Thus, the Company's limited decoupling proposal is a
8 one-sided attempt to increase shareholder earnings between general rate cases in the guise
9 of implementing good public policy, i.e., conservation programs.

10 **Q. Are the Company's conservation programs responsible for the growth in expenses-**
11 **per-customer relative to usage-per-customer?**

12 A. No, they are not. Rates are established at a point in time, based on the relationship
13 between a utility's costs and its sales. The purpose of using a test year is to establish this
14 relationship. If expenses are growing faster than revenues, then the Company has the
15 option of accepting a lower return or of filing a general rate case. The conservation
16 decoupling mechanism should not be used to address a situation whereby expenses are
17 faster growing than revenues. As mentioned above, that was not the intent of the
18 decoupling and incentive mechanisms outlined in the Decoupling Policy Statement.

19 Moreover, Figure 1 to Mr. DeBoer's testimony indicates that from the 2004
20 general rate case to the 2009 general rate case, electric usage-per-customer did not
21 decline.²³ While increased usage might have been expected in the absence of
22

²³ Exhibit No. TAD-1T, p. 19.

1 conservation, even with conservation, electric usage-per-customer was stable during this
2 period. In the gas utility, the Company experienced a slight decline in usage from the
3 2004 general rate case to the 2009, but the Company estimates that the majority of this
4 decline was caused by factors other than conservation. Therefore, it is likely that the
5 overall decline in gas usage and the flatness of the electric usage are attributable
6 primarily to other factors, such as the economic recession, more efficient appliances, and
7 a growing awareness of energy usage. Thus, the Company's proposal is intended to solve
8 a perceived problem, i.e., a growth in expenses relative to revenues, that is not being
9 driven by conservation efforts.

10 Moreover, PSE's customer base has grown significantly over the past ten years.
11 From 2003 to 2010, residential electric and residential gas customers increased by 11.6
12 percent and 18.9 percent respectively.²⁴ During this period, the number of commercial
13 electric and commercial gas customers increased by 9.3 percent and 14.1 percent
14 respectively. In addition, over this same period, the Company has had frequent rate
15 proceedings, so that any decline in usage-per-customer has been reflected in rates in a
16 timely manner.

17 **Q. Could the Company's proposal reduce its incentive to control costs between general**
18 **rate cases?**

19 A. Yes, it could. Since the Company's proposal does not consider "found" margins, it
20 provides PSE with additional revenues regardless of other business factors. In the
21 absence of CSA surcharge revenues, PSE would have a greater incentive to control costs

²⁴ PSE Response to Public Counsel Data Request No. 106.

1 between general rate cases, especially if revenues declined for any reason. Compensating
2 PSE for lost revenues in the manner proposed will reduce this incentive.

3 **Q. Are the overall electric and gas loads increasing or decreasing?**

4 A. Information provided by the Company in discovery indicated that both the electric and
5 gas loads increased between 2004 and 2009.²⁵ Moreover, the rate of increase at the gas
6 utility has accelerated during this time. The average annual growth rate in the gas load
7 from 2004 to the 2009 general rate case was 1.5 percent, but the annual growth rate from
8 2007 to the 2009 general rate case was 2.7 percent. While the rate of growth on the
9 electric side has been declining, overall electric load still grew at an annual rate of 2.0
10 percent between 2007 and the 2009 general rate case. According to the response to
11 Public Counsel Data Request No. 257, actual sales did decline in 2010 for both electric
12 and gas.²⁶ However, the Company has not indicated if this decline was due to
13 conservation programs or to other factors.

14 **Q. Does PSE's proposal consider whether energy loads are increasing or decreasing?**

15 A. No, it does not. Under PSE's proposal, it would still be permitted to add a CSA
16 surcharge to customers' bills, even if total revenues were higher than those authorized in
17 the most recent general rate case due to increased loads. Therefore, the limited
18 decoupling mechanism as proposed by PSE is not intended to permit the Company to
19 maintain its authorized level of revenues. Instead, the Company's proposal is intended to
20 partially compensate shareholders for increasing costs between general rate cases.

21

²⁵ PSE Response to Public Counsel Data Request No. 249.

²⁶ PSE Response to Public Counsel Data Request No. 257.

1 **4. The Effect of the CSA on Risk and Return**

2 **Q. Has the Company adequately evaluated the impact of its proposal on risk to**
3 **investors and ratepayers and its effect on the utility's ROE?**

4 A. No, it has not. As shown in the response to Public Counsel Data Request No. 240, the
5 majority of companies included in the comparable group used in the Company's cost of
6 capital analysis do not have a mechanism similar to the proposed CSA.²⁷ In fact, only
7 two of the nine companies have a similar mechanism. Although Mr. DeBoer indicates
8 that other companies have other regulatory mechanisms that permit utilities to increase
9 rates between general rate cases, it does not follow that such a mechanism is good
10 regulatory policy for ratepayers in Washington State. In this case, the Company has not
11 proposed any reduction to its cost of equity assuming that its proposed CSA is adopted,
12 although clearly such a mechanism will reduce the Company's risk.

13 **Q: What type of financial risk does the Company face?**

14 A: There are basically two risks faced by utilities: revenue risk and expense risk. The
15 Company has already eliminated the vast majority of its expense risk through
16 implementation of the power cost adjustment clause and purchased gas adjustment
17 mechanisms that provide for a guaranteed dollar-for-dollar recovery from ratepayers. In
18 addition, the Company has other mechanisms that eliminate or reduce expense risk, such
19 as the electricity conservation service rider and the Power Cost Only Rate Case. The
20 Company's CSA proposal is another step in an effort to shift revenue risk from
21 shareholders to ratepayers. If such a proposal is adopted, then there should be a
22

²⁷ PSE Response to Public Counsel Data Request No. 240.

1 commensurate reduction to cost of equity. If the Commission adopts a decoupling
2 mechanism for PSE, then I recommend that the Commission also recognize this reduction
3 in shareholder risk when determining the cost of equity for the Company's shareholders.

4 **5. The Relationship Between the CSA and Conservation**

5 **Q. Has the Company demonstrated that its conservation efforts will increase if the**
6 **proposed mechanism is adopted?**

7 A. No, it has not. PSE has not provided any evidence to suggest that its conservation efforts
8 will increase, or that its conservation programs will become more effective, if its
9 proposed mechanism is adopted. The Decoupling Policy Statement requires a utility
10 requesting a limited decoupling mechanism to provide "evidence describing the
11 incremental conservation the company may achieve in conjunction with the proposed
12 mechanism."²⁸ PSE has not provided any such evidence. Moreover, I understand that
13 the Company is already required to "pursue all available conservation that is cost-
14 effective, reliable, and feasible."²⁹ Utility managers should have the intent and the skills
15 to comply with, and implement, conservation programs ordered by regulators or required
16 through State or Federal legislation, regardless of how popular the directives may be
17 internally. Given that PSE is bound to comply with any such programs, I do not see any
18 reason to jettison traditional regulation in order to obtain compliance with legally
19 mandated conservation directives. If the Commission wants PSE to pursue a more
20 aggressive conservation program, then the Commission is free to order them to do so. I
21 understand that there is already a mechanism in place to guarantee recovery of the

22
²⁸ Decoupling Policy Statement, ¶18.

²⁹ Washington's Energy Independence Act (EIA), RCW 19.285.040(1).

1 conservation program costs in a timely manner. Furthermore, given the frequency with
2 which the Company files general rate cases, I do not believe that the CSA as currently
3 proposed by PSE is appropriate.

4 **Q. Do you believe that PSE's decoupling proposal sends the wrong conservation signal**
5 **to ratepayers?**

6 A. Yes, I do. PSE's proposal to recover lost revenues may remove its alleged disincentive
7 for the Company to promote conservation efforts but it does not provide customers with
8 any additional incentive to conserve. The Company's proposal provides a disincentive to
9 conserve because rates go up the more they conserve, even if overall revenues are
10 increasing due to customer growth or other factors. Therefore ratepayers will see higher
11 rates as their conservation efforts increase.

12 The CSA proposal also has the potential to shift costs among consumers. This is
13 because all customers in an affected group pay the CSA surcharge, regardless of whether
14 or not that customer is actually contributing to any revenue shortfall. Under the
15 Company's proposal, customers will pay CSA surcharges that are based on the
16 conservation results of the overall class, instead of on usage parameters that they can
17 personally control. More importantly, customers will pay surcharges that do not reflect
18 offsetting revenue increases resulting from additional customers, favorable weather, or
19 increased customers usage.

20 **6. The CSA and Low-Income Customers**

21 **Q. Has the Company met the requirement of the Decoupling Policy Statement that it**
22 **take into account the impact on low-income customers?**

23 A. No, it has not. The Company has not demonstrated that its conservation programs

1 provide benefits to low-income customers that are roughly comparable to other
2 ratepayers. Mr. DeBoer stated on page 25 of his testimony, Exhibit No. TAD-1T, that in
3 2011, “PSE’s electric low-income bill assisted customers comprise approximately two
4 percent of PSE’s residential electric customers and are allocated approximately 13
5 percent of the budget for the direct residential conservation programs. PSE’s natural gas
6 low-income bill-assisted customers comprise approximately 1.1 percent of residential
7 natural gas customers and are allocated approximately 10 percent of the budget for direct
8 residential programs.” However, in response to discovery, the Company indicated that it
9 does not track annual revenue-per-customer or usage-per-customer for customers that
10 participate in its conservation programs.³⁰ Thus, while the Company provided some
11 information about its conservation budget, it did not demonstrate that low-income
12 customers are actually receiving comparable benefits from those programs. In fact, it
13 appears that the Company is unable to identify specific benefits for any individual
14 customer. Moreover, in response to Public Counsel Data Request No. 236, the Company
15 indicated that it does not track participation in its residential conservation programs by
16 income levels.³¹ Accordingly, the Company does not have the data necessary to
17 demonstrate the impact of these programs on low-income customers relative to other
18 customers.

19 In addition, while the Company referenced the percentage of low-income bill-
20 assisted customers as 2 percent of electric customers and 1.1 percent of gas customers,
21 these percentages understate the low-income population. In response to discovery, the
22

³⁰ PSE Response to Public Counsel Data Requests Nos. 263 and 264.

³¹ PSE Response to Public Counsel Data Request No. 236.

1 Company used recent Census data to estimate that there are approximately 204,000
2 residential customers below 125 percent of the federal poverty level and 255,000
3 residential customers below 150 percent of the federal poverty level in its service
4 territory.³² This would equate to 15.7 percent and 19.6 percent of all customers.
5 Obviously, the vast majority of low-income customers are not receiving bill assistance
6 from PSE and therefore have not been identified as low-income by the Company. In
7 response to discovery, PSE reported that it provided energy bill assistance to 4 percent of
8 residential electric customers and 2 percent of residential gas customers in 2010.³³

9 According to the Company, the percentage increase resulting from the CSA
10 would be the same for low-income and non-low-income customers.³⁴ However, since the
11 Company does not track participation in its residential conservation programs by income
12 level, except for the Residential Low Income Weatherization Program, it is unable to
13 demonstrate the impact of its conservation programs on low-income customers.
14 Moreover, it has not even identified the vast majority of its low-income customers, since
15 the Company only tracks those that receive bill assistance. Given the fact that in order to
16 take advantage of conservation incentives customers are often required to make an initial
17 investment, one cannot assume that low-income customers are able to take advantage of
18 these programs to the same extent as other utility customers.

19 **Q. How much of the total projected energy savings results from the Residential Low**
20 **Income Weatherization Program?**

³² PSE Response to Public Counsel Data Request No. 224.

³³ PSE Response to Public Counsel Data Request No. 266.

³⁴ PSE Response to Public Counsel Data Request No. 258.

1 A. According to the 2012-2013 Conservation program provided in response to Public
2 Counsel Data Request No. 235, the electric low-income weatherization program
3 comprises just 2.8 percent of the total electric budget and only 0.6 percent of the kwh
4 savings. That response also indicates that the gas low-income weatherization program
5 constitutes just 4.6 percent of the gas budget and only 0.8 percent of the savings. With
6 regard to residential programs, the low-income weatherization program accounts for just
7 1.3 percent of the electric savings and 2.0 percent of the gas savings.

8 **Q. It is possible that low-income customers will be disproportionately harmed by the**
9 **CSA?**

10 A. Yes, it is. Since the Company is not able to identify all of its low-income customers, and
11 since it does not generally track participation in conservation programs by income level,
12 it is impossible to state how the program benefits received by low-income customers
13 compare with the program benefits provided to other customers. The same is true with
14 regard to the CSA. Low-income customers could end up paying a disproportionate share
15 of the CSA surcharge, depending upon the extent to which low-income customers
16 achieve conservation savings relative to other residential customers. PSE has simply not
17 provided enough information about low-income customers to permit the parties to
18 accurately assess the impact of conservation programs, or the CSA, on low-income
19 customers.

20 **7. Other Problems With the CSA**

21 **Q. Does the Company's proposal potentially result in a double-counting of certain**
22 **conservation savings?**

23 A. Yes, it does. The Company is seeking recovery of lost revenues based on conservation

1 efforts since January 2010. Since 2010 is the test year in this case, at least some of these
2 losses may already be reflected in the weather-normalized historic test year sales used to
3 develop pro forma revenue at present rates. Accordingly, if the CSA is approved, I
4 recommend that the Commission limit recovery to only those sales lost after new rates
5 from this case go into effect.

6 **.Q. Do you have any concerns regarding PSE’s proposal for third-party verification of**
7 **conservation savings?**

8 A. Yes, I do. Mr. DeBoer proposes that recovery of costs under the CSA “be conditioned
9 upon third-party verification of the savings used to derive the CSA Rate.” Mr. DeBoer
10 further states that the “verification standards” adopted by the Commission in Docket UE-
11 100177 “should be sufficient.”³⁵ However, it is my understanding that the requirement
12 for verification of electric portfolio savings by an independent third-party is a “one-time
13 only” requirement that applies to the 2010-2011 period.³⁶ In its recently filed Biennial
14 Conservation Plan (BCP) for 2012-2013, in Docket UE-111881, PSE observes that this
15 specific third-party verification requirement “terminates after the final report is delivered
16 in June 2012.”³⁷ Notably, as part of their BCP for 2012-2013, PSE has not recommended
17 that this requirement for independent third-party verification be continued or extended
18 beyond 2011.

19 Moreover, this third-party verification requirement applies only to electric
20 portfolio savings, not natural gas. In response to discovery, PSE proposes that evaluation
21

³⁵ Exhibit No. TAD-1T, p. 22, ll. 3-10.

³⁶ PSE Response to Public Counsel Data Request No. 310.

³⁷ Biennial Conservation Plan, p. 20.

1 standards approved by the Commission in UG-011571 “be used for verification of PSE’s
2 natural gas conservation savings associated with [the CSA] proposal.”³⁸ However, the
3 program evaluation criteria that PSE cites in this data response includes no mention or
4 reference to independent, third-party verification of natural gas portfolio savings.³⁹ Thus,
5 there are issues with regard to the verification process that would be used to determine
6 the amounts charged to ratepayers pursuant to the CSA.

7 **8. Recommendation**

8 **Q. What do you recommend?**

9 A. I recommend that the Company’s proposed CSA mechanism be rejected. The
10 Company’s proposed mechanism is inconsistent with the provisions of the Commission’s
11 Decoupling Policy Statement. The proposed mechanism is one-sided in that it views
12 reduced sales from conservation in isolation. Moreover, the Company’s proposal does
13 not address the reduction in risk to shareholders that would result from adoption of a
14 limited decoupling mechanism. The Company’s proposal could reduce the Company’s
15 incentive to reduce costs between general rate cases and could reduce ratepayers’
16 incentives to conserve.

17 In addition, there has been no showing that the CSA proposal will result in
18 increased conservation or in more effective conservation programs. Nor has the
19 Company demonstrated that low-income customers are receiving benefits from
20 conservation that are commensurate with the benefits being received by other customers.
21

³⁸PSE Response to Public Counsel Data Request No. 310, p. 4.

³⁹ Docket Nos. UE-011570/UG-011571, Twelfth Supp. Order (June 20, 2002), Settlement Stipulation Ex. F. Settlement Terms For Conservation, Section G: Program Evaluation Criteria, p. 6.

1 For all these reasons, I recommend that the Commission reject the Company's
2 proposed CSA. If the Company believes that some decoupling mechanism is required, it
3 should propose a mechanism that is consistent with the Commission's directives as
4 contained in the Decoupling Policy Statement.

5 **B. Tax Issues**

6 **Q. What are the tax issues that you reviewed as part of your engagement in this case?**

7 A. As part of my engagement, I reviewed the Company's request to include a rate base
8 reduction relating to net operating losses (NOLs) and the Company's proposed
9 adjustments relating to repairs and retirements.

10 **Q. Are your adjustments relating to NOLs and repairs and retirements associated with**
11 **specific adjustments to per-book results that the Company identified in its filing?**

12 A. No, my adjustments related to NOLs and repairs and retirements do not correspond with
13 specific adjustment numbers used by Mr. Story or Mr. Stranik in Exhibit Nos. JHS-4 and
14 Exhibit No. MJS-4 respectively. Instead, the Company's adjustments, which I am
15 recommending be reserved, were made by PSE before it reported its per-books actual
16 results. Thus, the per-books amounts shown as the starting point in the Company's
17 revenue requirement calculation have already been adjusted to include NOLs and to
18 modify the accounting treatment for repairs and retirements. Hence, my adjustments do
19 not correspond to specific adjustment numbers included in the testimonies of Mr. Story or
20 Mr. Stranik.

21 **1. Net Operating Losses**

22 **Q. Please describe the Company's adjustment relating to net operating losses.**

1 A. PSE has included a rate base addition of \$23,235,929 in its electric filing and of
2 \$18,506,288 in its gas filing relating to the tax effect of net operating tax loss carry-
3 forwards.⁴⁰ These adjustments are described in the testimony of Mr. Marcellia.⁴¹ PSE
4 claims that these adjustments are necessary because the Company has not been able to
5 take advantage of all of the tax benefits that have been passed through to ratepayers in the
6 deferred tax reserve.

7 The deferred tax reserve reflects the accumulated deferred taxes that have been
8 recorded by the Company to reflect the timing difference between when the benefit of a
9 tax deduction is recorded for tax purposes and when it is recorded for ratemaking
10 purposes. As an example, assume that the Company incurs a cost of \$100 that is
11 amortized over five years in rates. In that situation, the Company will have taken a tax
12 deduction of \$35 in year 1 ($\$100 \times 35\%$), but ratepayers will only receive a tax deduction
13 of \$7 ($\$100/5 \times 35\%$) in that year.⁴² The remaining \$28 in income tax deductions will be
14 received by ratepayers over the subsequent four years, as one-fifth of the underlying
15 expense is recognized in rates each year. The \$28 deferred tax is reflected as a reduction
16 to rate base, on the theory that this tax benefit has been received by the Company but not
17 yet passed through to ratepayers, and will be provided to them in a future period.

18 However, if a company had net losses in year 1, then it would not have been able
19 to actually utilize the \$35 tax deduction that is reflected in the deferred tax reserve. The

⁴⁰ Exhibit Nos. JHS-3.08 and MJS-3.08.

⁴¹ Exhibit No. MRM-1T, pp.27-32.

⁴² In practice, ratepayers do not actually receive any benefit until the expenditure is reflected in rates in a general rate case.

1 Company's position is that the \$28 deferred tax rate base deduction should be offset by
2 the tax effect of the NOLs, since the NOLs resulted in the Company not being able to
3 take advantage of larger tax deductions in the current year. Thus, in my example,
4 assuming that the Company had net operating losses with a tax effect of \$28, the NOL
5 rate base addition would completely offset the deferred tax rate base deduction, resulting
6 in no rate base reduction being passed through to ratepayers.

7 **Q. Do you agree that the Company's rate base should be increased to reflect the tax**
8 **effect of the NOLs that are available to PSE?**

9 A. No, I do not. While the Company's argument has some intuitive appeal, the Commission
10 should bear in mind that the Company has calculated its federal income tax claim on a
11 stand-alone basis at the statutory income tax rate. PSE has included income tax expense
12 of \$144.2 million in its electric revenue requirement claim and of \$47.5 million in its gas
13 claim.⁴³ These are actual dollars that will be collected from ratepayers to fund an income
14 tax expense that the Company will not actually incur. If the Company wants to include
15 the impact of its NOL in regulated rates, then the Commission should make a
16 corresponding adjustment to the income tax expense that the Company is seeking to
17 recover.

18 The current tax methodology used for ratemaking purposes does not consider
19 when taxes are actually paid by the Company. If the Commission decides to accept the
20 Company's adjustment to increase rate base by the tax impact of its NOL, then the
21 Commission should extend this policy to a review of other tax issues, such as whether
22

⁴³ Exhibit No. JHS-4, p. 1 and Exhibit No. MJS-4, p. 1.

1 PSE should be subject to a consolidated income tax adjustment, or other adjustments that
2 could reduce the income tax burden on ratepayers. It is unreasonable for the Company to
3 argue that its deferred tax reserve should be adjusted to consider actual taxes paid, when
4 other components of the revenue requirement calculation are not based on actual tax
5 payments to the IRS. Accordingly, I recommend that the Commission reject the
6 Company's proposed adjustment.

7 **Q. How did you quantify your adjustment?**

8 A. My adjustment is shown in Exhibit No. ACC-3.02 for the electric utility and in Exhibit
9 No. ACC-4.02 for the gas utility. This adjustment is limited to the removal of the NOL
10 tax adjustment, as booked prior to the reallocation of the repairs and retirement accounts
11 adjustment discussed below. The reallocation of the repairs and retirements accounts
12 adjustment also impacts the quantification of the NOL adjustment. That portion of the
13 NOL adjustment related to repairs and retirements is included in the repairs and
14 retirements adjustment.

15 As shown in Exhibit No. ACC-3.02, the adjustment will reduce the Company's
16 electric rate base by \$12,759,093. As shown in Exhibit No. ACC-4.02), this adjustment
17 will reduce PSE's gas rate base by \$10,161,998. These rate base reductions include the
18 impact of my adjustments on the Company's cash working capital calculation. My
19 adjustments will reduce the Company's electric revenue requirement by \$1,498,413 and
20 will reduce the Company's gas revenue requirement by \$1,191,989.

21 **2. Accounting Change for Repairs and Retirements**

22 **Q. Did the Company make an adjustment to restate its per books rate base relating to**
23 **a change in the accounting treatment afforded to repairs and retirements?**

1 A. Yes, it did. As discussed in Mr. Marcellia's testimony, PSE has changed the accounting
2 method used for repairs and retirements.⁴⁴ In both cases, the Company has changed the
3 units of property (UOP) used for tax purposes relative to the UOP used for book
4 purposes. As a result, this change results in a larger immediate tax deduction for repairs
5 and retirements, which in turn results in an increase to deferred income taxes. Since
6 deferred income taxes are deducted from rate base, this change would increase the
7 Company's deferred tax reserve and reduce its rate base.

8 However, PSE made an adjustment to its per books accounts to reverse the
9 impact of this accounting change. As a result, the Company's starting rate base balances
10 have already been adjusted to eliminate the impact of this accounting change.

11 **Q. Why did the Company believe that it was appropriate to eliminate the impact of this**
12 **accounting change?**

13 A. The Company eliminated the impact of this accounting change because the Commission
14 accepted a similar adjustment in the Company's 2009 general rate case, as noted in
15 Exhibit No. MRM-1T, page 19. In that case, the issue was limited to an accounting
16 change for retirements. The Company argued that the IRS approved the change after the
17 close of the test year and that it would be one-sided to reflect this change, since
18 significant expenditures occurring after the close of the test year were not reflected by the
19 Commission.⁴⁵ The Company also argued that the IRS had not yet audited the
20 Company's implementation of this change and therefore it was possible that revisions

⁴⁴ Exhibit No. MRM-1T, p. 18, beginning at l. 10.

⁴⁵ *Washington Utilities and Transportation Commission v. Puget Sound Energy, Inc.*, Docket UE-090704 and UG-090705 (*PSE 2009 GRC*), Order 11, ¶ 194.

1 could be made by the IRS.⁴⁶ The Commission accepted the Company's argument,
2 finding that,

3 The final disposition with the IRS is not known and the tax impact is in any event
4 subsequent to the test year. Having made this determination for purposes of this
5 proceeding, we note that the Company should implement an increase to ADIT in a
6 future case if the IRS approves its methodology for treatment of repair costs
7 following an audit.⁴⁷
8

9 **Q. When did the Company first reflect the accounting change for repairs?**

10 A. The Company first reflected this method in its 2008 tax return, which was filed in
11 September 2009.⁴⁸

12 **Q. When did the Company make a similar change for retirements?**

13 A. PSE filed the method change in March 2010, to be included in PSE's 2010 federal
14 income tax return.⁴⁹

15 **Q. Do you believe that it is appropriate to continue to ignore this accounting change for
16 ratemaking purposes?**

17 A. No, I do not. While I can understand the reluctance of the Commission to reflect this
18 change in the Company's last case, given the fact that the accounting change was
19 relatively new and was approved by the IRS subsequent to the test year, the fact is that
20 PSE has now used the new method for repairs for three tax filings (2008-2010), and used
21 a similar method for retirements in its most recently filed return. Moreover, in a recent
22 case involving PacifiCorp, the Commission found that a similar accounting change that
23 had been adopted by PacifiCorp should be reflected in rates. In the PacifiCorp case, the

⁴⁶ *Id.*

⁴⁷ *Id.*, ¶197.

⁴⁸ Exhibit No. MRM-1T, p. 19, ll. 3-5.

⁴⁹ Exhibit No. MRM-1T, p. 21, ll. 3-5.

1 Commission referred to the PSE proceeding, stating that “[i]n the PSE case, we rejected
2 the proposed adjustment because ‘[T]he final disposition with the IRS is not known and
3 the tax impact is in any event subsequent to the test year.’”⁵⁰

4 In this case, the accounting change has been used for several years with regard to
5 repairs, and was filed for retirements during the test year. Moreover, the accounting
6 change has been authorized by the IRS, although the IRS has not yet completed its audit
7 of the years in question.

8 **Q. Had the IRS completed its audit of PacifiCorp when the Commission ruled that
9 Pacificorp should reflect the new accounting method in rates?**

10 A. No, it had not. In that case, PacifiCorp requested approval to establish a regulatory asset
11 or liability to account for interest paid to or recovered from the IRS for any audit
12 adjustments relating to the repairs deduction.⁵¹ The Commission rejected this request,
13 finding that “...the Company’s request is premature because...the Company does not
14 have a definitive ruling from the IRS...PacifiCorp may request an accounting order when
15 the results of any IRS audit are known and measurable.”⁵²

16 **Q. What do you recommend?**

17 A. Consistent with the recent order in the PacifiCorp case just discussed, I recommend that
18 the Commission reflect the impact of the accounting change for repairs and retirements in
19 the Company’s rate base calculation. My electric utility adjustment is shown in Exhibit
20

⁵⁰ *PSE 2009 GRC*, Order 11 ¶ 197, cited in *WUTC v. PacifiCorp*, Docket UE-100749 (*PacificCorp 2010 GRC*) Order 06, n.378.

⁵¹ *PacificCorp 2010 GRC*, Order 06, ¶ 262.

⁵² *Id.*, ¶ 264.

1 No. ACC-3.05. My gas utility adjustment is shown in Exhibit No. ACC-4.03.

2 **Q. How did you quantify your adjustment?**

3 A. In Exhibit No. JHS-3.08, Mr. Story quantified the impact on the Company's electric rate
4 base of the repairs and retirements adjustment, including the impact associated with the
5 NOL. Mr. Stranik quantified a similar adjustment for the gas utility in Exhibit No. MJS-
6 3.08. I have reversed these adjustments to develop my recommendations relating to
7 repairs and retirements.

8 **Q. What is the revenue requirement impact of your adjustments relating to the**
9 **accounting change for repairs and retirements?**

10 A. My adjustment decreases the Company's electric revenue requirement by \$4,055,959, as
11 shown in Exhibit No. ACC-3.03. My adjustment decreases the Company's gas revenue
12 requirement by \$3,143,712, as shown in Exhibit No. ACC-4.03.

13 **C. Lower Snake River Project**

14 **Q. Please provide a brief summary of the Company's claims relating to the Lower**
15 **Snake River ("LSR") Project.**

16 A. PSE has included an adjustment relating to Phase 1 of the Lower Snake River Project.
17 As described in Mr. Story's testimony, this project involves the construction of 149 wind
18 turbines with a total capacity of 343 MWs. This project is expected to be completed by
19 February 2012 and the power from LSR has been included in the AURORA power model
20 for the rate year filed by PSE.⁵³

21 The LSR Project is eligible for a Treasury Grant, pursuant to Section 1603 of the
22

⁵³ Exhibit No. JHS-1T, pp.17-18.

1 American Recovery and Reinvestment Act of 2009. The Treasury Grant is an alternative
2 to Production Tax Credits (“PTCs”). The Treasury Grant is equal to 30 percent of the
3 qualifying investment and reduces the tax basis for accelerated tax depreciation by one-
4 half of the grant claimed.⁵⁴

5 **Q. How did the Company reflect the LSR project in its revenue requirement claim?**

6 A. The Company utilized projected total costs of the project through July 2012 to calculate
7 monthly plant investment. It then used the average of the monthly averages plant balance
8 for the rate period to determine its rate base claim in this case. PSE included
9 corresponding rate base adjustments relating to deferred income taxes and accumulated
10 depreciation, as well as associated depreciation and operating expenses. In addition, PSE
11 included rate base and operating expenses associated with transmission upgrades required
12 by the LSR project. The LSR project is discussed in more detail in the testimony of
13 Public Counsel witness Scott Norwood.

14 **Q. Did the Company propose any ratemaking treatment for the Treasury Grants in**
15 **this case?**

16 A. No, it did not. According to Mr. Story, “For PSE, Treasury Grants are passed back to
17 customers outside of general rates and the general rate case process, in Tariff Schedule
18 95A. Accordingly, the rate impact of the Treasury Grant is not included in this
19 adjustment other than to include the impact of the tax basis reduction in the determination
20 of tax depreciation.”⁵⁵

⁵⁴ Exhibit No. JHS-1T, pp. 20, ll.18-20.

⁵⁵ Exhibit No. JHS-1T, p. 21, ll.1-5.

1 **Q. Is Public Counsel recommending any adjustments relating to the LSR project?**

2 A. As discussed in Mr. Norwood's testimony, Exhibit No. SN-1TC, Public Counsel is
3 recommending that the Commission adopt a revenue requirement adjustment associated
4 with the LSR project. Mr. Norwood is recommending that the Company's revenues be
5 reduced by \$55.0 million. I have reflected Mr. Norwood's recommendation in my electric
6 summary schedule, Exhibit No. ACC-3.01.

7 **Q. Are you recommending any adjustment to the Company's proposal to flow-back the**
8 **benefits of the Treasury Grants through Tariff Schedule 95A?**

9 A. No, I am not recommending any adjustments to the Company's proposal that the
10 Treasury Grants be returned to ratepayers through Tariff Schedule 95A. However, I am
11 recommending that the Commission examine the issue of an appropriate amortization
12 period for the Treasury Grants, and other ratemaking issues, when the Company makes
13 its Schedule 95A filing relating to these grants.

14 **Q. Did PSE propose an amortization period for the Treasury Grants in this case?**

15 A. No, it did not. As stated in the response to discovery, PSE "does not specifically propose
16 ratemaking treatment of the U.S. Treasury Grant...in this proceeding because the cash
17 grant is not part of general rates. The cash grant flows through to customers under
18 Schedule 95A."⁵⁶

19 **Q. What amortization period did the Company utilize to evaluate the LSR project?**

20 A. PSE assumed a ten-year amortization period in the workpapers supporting the underlying
21 LSR project.

22

⁵⁶ PSE Response to Public Counsel Data Request No. 272

1 **Q. What do you recommend?**

2 A. Since PSE did not propose a specific ratemaking treatment in this case, Public Counsel
3 did not address the issue of the appropriate ratemaking treatment for the Treasury Grants.
4 However, the ultimate disposition of the Treasury Grants will have a significant impact
5 on ratepayers. It is my understanding that once the initial Treasury Grant is received,
6 PSE will have 60 days to include it in Schedule 95A.⁵⁷ I recommend that the Company
7 be required as part of its Schedule 95A filing to provide support for the proposed
8 amortization period reflected in that filing. Moreover, as a result of that filing, other
9 parties should have the opportunity to review the Company's support and to recommend
10 alternative amortization periods. In addition, other parties should have the opportunity to
11 recommend other ratemaking adjustments related to the Treasury Grants, either in the
12 Schedule 95A proceeding or in a subsequent rate case proceeding, if appropriate.

13 **D. Chelan Public Utility District ("PUD") Reservation Fee**

14 **Q. Please summarize the Company's proposal relating to the Chelan PUD reservation**
15 **fee payment.**

16 A. In April 2006, PSE entered into an agreement with the Chelan PUD whereby PSE agreed
17 to purchase 25 percent of the output of Chelan PUD's Rock Island and Rocky Beach
18 dams on the Columbia River. Pursuant to the agreement, PSE made a reservation
19 payment of \$89 million on April 27, 2006. Purchases under this agreement began
20 November 1, 2011, for the Rocky Reach hydroelectric facility and are scheduled to begin
21 on July 1, 2012, for the Rock Island hydroelectric facility.

22

⁵⁷ PSE Response to ICNU Data Request No. 2.33.

1 In Docket No. UE-060539, PSE requested an accounting order seeking
2 authorization to defer the \$89 million reservation fee as a prepayment, together with
3 interest at PSE’s net-of-tax rate of return. In PSE’s then-pending 2006 general rate case,
4 the Company requested that amortization of the deferred amounts, including interest,
5 begin when power was received pursuant to the agreements. In its Order in that case, the
6 Commission approved recovery of the costs associated with the 20-year purchased power
7 agreement and related transmission agreement, “including recovery of interest at the net
8 of tax rate of return.”⁵⁸

9 **Q. How did the Company quantify its adjustment in this case?**

10 A. PSE’s adjustment is shown in Adjustment 5.09 to Mr. Story’s testimony. As shown in
11 that schedule, the Company has included a rate base adjustment of \$117,130,302 relating
12 to the original Chelan PUD reservation fee payment. This rate base adjustment includes
13 deferrals of \$141,761,312, offset by accumulated amortization of \$7,088,066 and
14 deferred taxes of \$17,542,944. PSE also included an amortization expense adjustment of
15 \$7,088,066.

16 **Q. How did the Company calculate the total deferral of \$141,761,312?**

17 A. The calculation of the Company’s deferral is shown in the response to Public Counsel
18 Data Request No. 266. This amount represents the total deferred balance at November 1,
19 2011, including interest from April 2006. In Adjustment 5.09, the Company also
20 included an amortization expense of \$7,088,066, based on a 20 year amortization of this
21

⁵⁸ *Washington Utilities and Transportation Commission v. Puget Sound Energy, Inc.*, Dockets UE-060266\ UG-060267 (PSE 2006 GRC), Order 08, ¶ 170.

1 deferral.

2 **Q. How did the Company calculate the monthly interest on the deferral?**

3 A. As shown in the response to Public Counsel Data Request No. 266, the Company
4 calculated interest at an after-tax (or net-of-tax) rate of return. However, PSE then
5 grossed-up this interest for federal income taxes and added this pre-tax monthly interest
6 to its deferred balance. Thus, PSE's claim includes interest calculated at a pre-tax rate of
7 return, instead of at the net-of-tax rate approved by the Commission in its 2006 general
8 rate case Order.

9 **Q. What is the impact of using the pre-tax rate to calculate the Company's monthly**
10 **interest cost?**

11 A. The Company's methodology results in a double recovery of federal income taxes, and
12 results in rates to customers that are higher than necessary. The Commission's Order,
13 authorizing deferral of this prepayment, with interest, already provided a benefit to
14 investors by providing for a return on this prepayment during the deferral period.
15 However, the Commission recognized in its Order that this return was itself being
16 deferred, and therefore the Company was not incurring any federal income taxes during
17 the deferral period. By including the deferral in rate base in this case, PSE will begin to
18 collect a return from ratepayers. The prospective return charged to ratepayers will be
19 grossed-up for federal income taxes through the normal ratemaking mechanism. By
20 using a pre-tax interest rate for the deferral, PSE has overstated the actual carrying costs
21 incurred during the deferral period. In addition, the Company's methodology is
22 inconsistent with the Commission's Order authorizing deferral of the \$89 million
23 prepayment, plus interest at the net-of tax-rate.

1 **Q. How much of the Company’s proposed deferral relates to interest expense?**

2 A As mentioned above, the total deferred balance as of November 1, 2011 is \$141,761,312.
3 Of that amount, \$77,238,688 represents interest. Even if a net-of-tax interest rate is
4 applied to the deferral, the carrying costs being borne by ratepayers will still be
5 significant.

6 **Q. What do you recommend?**

7 A. I have made an adjustment to reduce the Company’s claim to reflect interest at the net-of-
8 tax rate. My adjustment is consistent with the Commission’s Order in the 2006 rate case
9 and it reflects the fact that PSE did not incur any federal income tax expense on its
10 carrying costs during the deferral period.

11 **Q. How did you quantify your adjustment?**

12 A. My adjustment impacts both the Company’s rate base claim and its operating income
13 claim. With regard to rate base, I have recalculated the deferred balance at November 1,
14 2011, based on the net-of-tax rate approved in the last case. This adjustment resulted in a
15 total deferred balance of \$123,294,853 instead of the \$141,761,312 utilized by PSE. This
16 rate base, together with the corresponding adjustments to accumulated amortization and
17 the deferred income tax reserve, will reduce the Company’s revenue requirement by
18 \$1,791,872, as shown in Exhibit No. ACC-3.04. In addition, in Exhibit No. ACC-3.05, I
19 made a corresponding adjustment to the annual amortization expense, to reflect a 20-year
20 amortization of the revised deferred balance. This amortization expense adjustment
21 reduces the Company’s revenue requirement by \$966,832.

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V. CONCLUSION

Q. What is the overall impact of the revenue requirement adjustments discussed in your testimony?

A. As shown in Exhibit No. ACC-3.01, the adjustments that Public Counsel is recommending relating to the LSR project, the Chelan PUD reservation payments, the tax effect of the NOLs, and the accounting changes for repairs and retirements will reduce the Company's electric revenue requirement claim by \$63,313,076, from \$161,275,557 to \$ 89,615,425. A comparison of my recommendation relative to the Company' electric claim, starting with its per-books filed position, is shown in Exhibit No. ACC-3.06.

The NOL adjustment and repairs and retirements adjustment will decrease the Company's gas revenue requirement claim by \$4,335,701, from \$31,864,884 to \$27,529,183, as shown in Exhibit No. 4.01. A comparison of my recommendation relative to the Company' gas claim, starting with its per-books filed position, is shown in Exhibit No. ACC-4.04.

Q. Do you have a position on other aspects of the PSE revenue request?

A. My recommendations represent a maximum revenue amount for PSE. Public Counsel did not have the resources to retain me to conduct a full evaluation of the Company's revenue requirement claims in this case and I therefore do not take a position on other aspects of the PSE filing. However, there may be additional accounting and cost of capital adjustments proposed by other parties that Public Counsel would support and which should be adopted by the Commission.

1 **Q. Does this complete your testimony?**

2 **A. Yes, it does.**