**Exhibit No. \_\_\_ (TES-6T)**

**Dockets UE-121697, et al.**

**Witness: Thomas E. Schooley**

**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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

**TESTIMONY OF**

**Thomas E. Schooley**

**STAFF OF**

**WASHINGTON UTILITIES AND**

**TRANSPORTATION COMMISSION**

***Testimony on Remand***

**December 3, 2014**

**TABLE OF CONTENTS**

I. INTRODUCTION 1

II. SCOPE OF TESTIMONY 1

III. DISCUSSION 3

1. PSE’s Rate of Return 3
2. Effect of Decoupling on Cost of Capital 5
3. Review of Decoupling and K-Factor Mechanisms and  
   Customer Impact to Date 6
4. Concerns Related to PSE’s Testimony Regarding Earnings Sharing 8

**List of Exhibits**

Exhibit No. \_\_­\_ (TES-7) Thurston County Superior Court Transcript of Oral Argument on Petitions for Judicial Review of Order 07.

Exhibit No. \_\_­\_ (TES-8) Update to Exhibit No. TES-3, Rate Changes Versus Earned Returns

**I. INTRODUCTION**

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

A. I am Thomas E. Schooley. My business address is 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA 98504.

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

A. I am employed by the Washington Utilities and Transportation Commission (Commission) as the Assistant Director, Energy Regulation.

**Q. How long have you been employed by the Commission?**

A. Since September 1991.

**Q Are you the same Thomas E. Schooley who filed testimony in earlier phases of this proceeding?**

A. Yes. I filed Exhibit No. TES-1T on March 27, 2013, along with Exhibits Nos. TES-2 and TES-3. I also filed Exhibit No. TES-4T on May 8, 2013.

**II. SCOPE OF TESTIMONY**

**Q. What is the purpose of your testimony for the remand portion of this proceeding?**

A. I present Staff’s opinion of the directive from the Thurston County Superior Court and how Staff meets that directive. I also present Staff’s comments on the role of decoupling in this remand phase. I review the rate plan and decoupling mechanisms and discuss the impact of the rate plan and decoupling thus far. Finally, I discuss PSE’s testimony regarding sharing earnings.

**Q. What is the basis for Staff’s opinion on the requirements of the remand from Thurston County Superior Court?**

**A.** Staff relied on the Order Granting in Part and Denying In Part Petitions for Judicial Review, signed by Judge Murphy, and entered in Thurston County Superior Court in Case Nos. 13-2-01576-2 and 13-2-01582-7 (consolidated) on July 25, 2015 (Order on Review). Staff also reviewed Judge Murphy’s letter ruling dated June 4, 2014. Judge Murphy’s order and letter ruling were filed in Commission Dockets UE-121697 and UG-121705 (consolidated) and UE-130137 and UG-130138 (consolidated) on July 29, 2014. In addition, Staff consulted the transcript of the oral argument on the petitions for judicial review, held May 9, 2014, before Judge Murphy. A copy of the transcript constitutes Exhibit No. \_\_­\_ (TES-6).

**Q. Please explain Staff’s interpretation of Judge Murphy’s decision.**

A. The court considered several main issues in its review of the Commission’s Order 07[[1]](#footnote-1): Whether an expedited rate case was proper procedure or whether a general rate proceeding was required; whether there was substantial evidence supporting the Commission’s decision and whether the company was held to its burden of proof with respect to return on equity (ROE), and whether the Commission erred when it established an attrition adjustment.[[2]](#footnote-2) In the Order on Review,[[3]](#footnote-3) the court affirmed the Commission’s decision with respect to the expedited rate case treatment and use of an attrition adjustment. The court reversed the Commission’s decision setting the rates to be charged during the rate plan because the Commission’s findings of fact with respect to the return on equity (ROE) component of cost of capital in the context of a multi-year rate plan was unsupported by substantial evidence and the Commission did not hold the company to its the burden of proof on this issue. To Staff it is quite clear that the only issue, and task, of this remand proceeding is the need for more evidence to support a decision on the ROE. It is also clear to Staff that any potential effect from decoupling on ROE is never mentioned in the Order on Review or Judge Murphy’s letter ruling and, therefore, it is not an issue to be considered on remand.

**III. DISCUSSION**

**A. PSE’s Rate of Return**

**Q. Does Staff present evidence of PSE’s cost of equity for the Commission’s consideration on remand?**

A. Yes. Mr. David Parcell presents Staff’s cost of equity analysis using data from the first quarter of 2013. His analysis shows a reasonable equity return is in the range of 9.0 to 10.0 percent.

**Q. Did Staff address the issue of cost of capital, or return on equity, in its previous testimony?**

A. Yes, but Staff did not directly testify to a revision to ROE. My testimony in Exhibit No. TES-1T speaks to PSE’s shortfall in rate of return over the past several years in spite of regular rate increases. Exhibit No. TES-3 presents this data. In my rebuttal testimony, I explained that the intent of an expedited rate case is to avoid the debate surrounding the rate of return. The Commission expressly acknowledges this approach in Order 07.[[4]](#footnote-4) In addition, I addressed the issue of the effect of decoupling on the rate of return.

**Q. What does the latest data from Commission basis reports show for PSE’s earnings?**

A. I have updated my Exhibit No. TES-3 to reflect data through June 2014. The updates are contained in my Exhibit No. \_\_\_ (TES-7). PSE continues to earn less than its authorized rate of return of 7.77%, but it is getting closer.

**Q. Of what importance is this data?**

A. This data implies that, since PSE is not achieving its authorized return of 7.77 percent, it is unnecessary to reduce the authorized return.

**B. Effect of Decoupling on Cost of Capital**

**Q. You mentioned earlier that Staff addressed the issue of the effect of decoupling on cost of capital, or return on equity, in its previous testimony. What was Staff’s position?**

A. In Exhibit No. TES-4T, I replied to the testimony of other parties who advocated for a reduction in the cost of capital due to the proposed decoupling program. I testified that it was premature to reduce the rate of return absent any data that the rate of return will improve due to decoupling. My testimony is best summed up by my statement: “The claim that decoupling reduces risk for regulated utilities has theoretical appeal, but is at best hypothetical and unsupported by empirical evidence.”[[5]](#footnote-5)

**Q. Has your position changed since the testimony of May 2013?**

A. No. I still believe the best course of action is the one we are on. The Commission wisely determined that the return on equity should remain the same during the next few years to allow objective data on the effects of decoupling on earnings to accumulate.[[6]](#footnote-6)

**C. Review of Decoupling and K-Factor Mechanisms and Customer Impact to Date**

**Q. Please give a brief description of the decoupling mechanism.**

A.In a nutshell, PSE’s revenues will be determined on a delivery dollars per customer basis, but collected from customers on a cents per kilowatt-hour, or cents per therm basis. It is important to note the decoupling mechanism only applies to the delivery portion of total revenues. The production costs of electricity and the purchases of natural gas are not subject to the decoupling mechanism at PSE.

**Q. Please give a brief description of the K-factor, or rate plan.**

A. The “K-factor” is the term given the planned revenue increases during the next few years. It is essentially the mechanism of the so-called multi-year rate plan that results in annual increases to rates. For electricity, a one percent increase for delivery revenue was implemented on July 1, 2013, with annual one percent increases for delivery revenue each subsequent January 1. For natural gas, a 2.2 percent increase for gas delivery was implemented on July 1, 2013, with annual 2.2 percent increases for delivery revenue each subsequent January 1. Customer rate increases also went into effect on July 1, 2013, but subsequent rate revisions will be made each May 1 to recover the K-factor increase plus or minus any decoupling variance from the prior calendar year.

**Q. How have the decoupling mechanism and K-factor affected customer rates since implementation?**

A. The first decoupling and the first K-factor rate increase went into effect on July 1, 2013. Over the next six months PSE recovered more dollars in customer payments than it earned on a delivery revenue per customer basis by about $16 million in electricity and $5 million in gas. This over-collection was returned to customers in the rate revision of May 2014. In the first half of 2014, the electric delivery revenues owed to the company exceed revenues collected from customers by over $25 million, while the natural gas delivery revenues exceed customer collections by about $10 million.[[7]](#footnote-7) It appears some customers may see a rate increase in 2015.

**Q. How should the information on decoupling for 2014 be interpreted?**

A. This is simply a consequence of decoupling mechanisms. For the six months of 2013, customers received a refund. But for the full 12 months of 2014, customers will need to pay more in order for PSE to collect the amount of the revenue requirement approved under the rate plan. These refunds or charges will be passed on to customers on a volumetric, or cents per kilowatt-hour, basis.

**Q. Will this be easy to explain to the customers?**

A. No. I suggest an education campaign be instituted soon. Explanations from PSE and the Northwest Energy Coalition about the rate increases due to decoupling may help to alleviate the high volume of calls the Commission’s Consumer Protection section may expect next spring.

**D. Concerns Related to PSE’s Testimony Regarding Earnings Sharing**

**Q. Could you please briefly explain the earnings sharing aspect of the decoupling mechanism?**

A. The Commission approved decoupling and the rate plan on the condition that any earnings over the authorized rate of return, 7.77 percent, would be shared with customers 50/50. The measure of the achieved return is the Commission basis report (CBR) filed annually per WAC 480-100-257. The concept is to give PSE the incentive and opportunity to earn more than its authorized return, but not substantially more. To achieve such earnings, PSE must work to streamline its operations. If it is successful over the term of the rate plan, PSE will profit from its efforts. Customers will benefit when the test year of the next rate case reflects those reduced expenses.

**Q. PSE witness Mr. Doyle claims the sharing method approved by the Commission “alters the traditional balance that should exist in a utility’s opportunity to earn its allowed rate of return.”[[8]](#footnote-8) What do you think he means by this?**

A. I am not sure. He seems to equate the opportunity to earn an allowed return with a guarantee that the utility’s rates will not be challenged when earnings are greater than the return established in a rate case.

**Q. What else does Mr. Doyle claim in his testimony?**

A. Mr. Doyle further states, “In other words, utilities may over-earn and under-earn their authorized rates of return and ROEs, but, all things being equal, the average actual rates of return and ROEs will approximate the authorized rates of return and ROEs over time.”[[9]](#footnote-9)

**Q. Do you accept this premise?**

A. No, not for the returns determined in a CBR. One primary intent of the CBR is to depict the utility’s operations on a normal basis. This means the utility must remove the variations of temperatures on sales and power costs, and the variations of higher or lower river flows on hydro-generation to determine its achieved return on rate base under normal conditions.

**Q. Is there another view of the achieved rate of return that fits Mr. Doyle’s viewpoint?**

A. Yes, if Mr. Doyle means the over- and under-earnings due to the exogenous factors of temperature and rainfall, then yes, over time the actual rate of return should average out to the Commission’s authorized return. But those highly variable factors are taken into account in determining the rate of return in a CBR. The returns to be shared are based on exceeding this norm. There is no “traditional balance” to be maintained for normalized rates of return.

**Q. Should the Commission revise its method of sharing over-earnings during the rate plan?**

A. No. The Commission’s order is sound and needs no revisions.

**Q. Does this conclude your testimony?**

A. Yes.

1. Final Order Granting Petition (consolidated Dockets UE-121697 and UG-121705) and Final Order Authorizing Rates (consolidated Dockets UE-130137 and UG-130138), served June 25, 2013. [↑](#footnote-ref-1)
2. *Industrial Customers of NW Utilities v. Washington Utilities and Transportation Commission*, Thurston County Cause Nos. 13-2-01576-2 and 13-2-01582-7 (consolidated), Letter Ruling of Judge Murphy (June 4, 2014). [↑](#footnote-ref-2)
3. *Industrial Customers of NW Utilities v. Washington Utilities and Transportation Commission*, Thurston County Cause Nos. 13-2-01576-2 and 13-2-01582-7 (consolidated), Order Granting in Part and Denying in Part Petitions for Judicial Review (July 25, 2014). [↑](#footnote-ref-3)
4. Order 07 at ¶ 65. [↑](#footnote-ref-4)
5. Exhibit No. TES-4T at 5:6–8. [↑](#footnote-ref-5)
6. *See* Order 07 at ¶¶103–107. [↑](#footnote-ref-6)
7. See Exhibit No. \_\_\_ (DAD-6), page 2 and summing just the 2014 data. [↑](#footnote-ref-7)
8. Exhibit No. \_\_\_ (DAD-4T) at 19:12–13. [↑](#footnote-ref-8)
9. Exhibit No. \_\_\_ (DAD-4T) at 19:18–21. [↑](#footnote-ref-9)