

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.

**DOCKETS UE-121697 and
UG-121705 (*consolidated*)**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.

Respondent.

**DOCKETS UE-130137 and
UG-130138 (*consolidated*)**

TESTIMONY OF

Thomas E. Schooley

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

Testimony on Remand

December 3, 2014

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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

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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?**

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

6

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

9 A. Staff relied on the Order Granting in Part and Denying In Part Petitions for Judicial
10 Review, signed by Judge Murphy, and entered in Thurston County Superior Court in
11 Case Nos. 13-2-01576-2 and 13-2-01582-7 (consolidated) on July 25, 2015 (Order
12 on Review). Staff also reviewed Judge Murphy's letter ruling dated June 4, 2014.
13 Judge Murphy's order and letter ruling were filed in Commission Dockets UE-
14 121697 and UG-121705 (consolidated) and UE-130137 and UG-130138
15 (consolidated) on July 29, 2014. In addition, Staff consulted the transcript of the oral
16 argument on the petitions for judicial review, held May 9, 2014, before Judge
17 Murphy. A copy of the transcript constitutes Exhibit No. ____ (TES-6).

18

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

20 A. The court considered several main issues in its review of the Commission's Order
21 07¹: Whether an expedited rate case was proper procedure or whether a general rate
22 proceeding was required; whether there was substantial evidence supporting the

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.

1 Commission's decision and whether the company was held to its burden of proof
2 with respect to return on equity (ROE), and whether the Commission erred when it
3 established an attrition adjustment.² In the Order on Review,³ the court affirmed the
4 Commission's decision with respect to the expedited rate case treatment and use of
5 an attrition adjustment. The court reversed the Commission's decision setting the
6 rates to be charged during the rate plan because the Commission's findings of fact
7 with respect to the return on equity (ROE) component of cost of capital in the
8 context of a multi-year rate plan was unsupported by substantial evidence and the
9 Commission did not hold the company to its the burden of proof on this issue. To
10 Staff it is quite clear that the only issue, and task, of this remand proceeding is the
11 need for more evidence to support a decision on the ROE. It is also clear to Staff
12 that any potential effect from decoupling on ROE is never mentioned in the Order on
13 Review or Judge Murphy's letter ruling and, therefore, it is not an issue to be
14 considered on remand.

16 III. DISCUSSION

18 A. PSE's Rate of Return

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).

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).

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

3 A. Yes. Mr. David Parcell presents Staff's cost of equity analysis using data from the
4 first quarter of 2013. His analysis shows a reasonable equity return is in the range of
5 9.0 to 10.0 percent.

6
7 **Q. Did Staff address the issue of cost of capital, or return on equity, in its previous**
8 **testimony?**

9 A. Yes, but Staff did not directly testify to a revision to ROE. My testimony in Exhibit
10 No. TES-1T speaks to PSE's shortfall in rate of return over the past several years in
11 spite of regular rate increases. Exhibit No. TES-3 presents this data. In my rebuttal
12 testimony, I explained that the intent of an expedited rate case is to avoid the debate
13 surrounding the rate of return. The Commission expressly acknowledges this
14 approach in Order 07.⁴ In addition, I addressed the issue of the effect of decoupling
15 on the rate of return.

16
17 **Q. What does the latest data from Commission basis reports show for PSE's**
18 **earnings?**

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

22

⁴ Order 07 at ¶ 65.

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

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

4
5 **B. Effect of Decoupling on Cost of Capital**

6
7 **Q. You mentioned earlier that Staff addressed the issue of the effect of decoupling**
8 **on cost of capital, or return on equity, in its previous testimony. What was**
9 **Staff's position?**

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

17
18 **Q. Has your position changed since the testimony of May 2013?**

19 A. No. I still believe the best course of action is the one we are on. The Commission
20 wisely determined that the return on equity should remain the same during the next
21 few years to allow objective data on the effects of decoupling on earnings to
22 accumulate.⁶

⁵ Exhibit No. TES-4T at 5:6-8.

⁶ See Order 07 at ¶¶103-107.

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

2

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

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

9

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

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

21

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

1 A. The first decoupling and the first K-factor rate increase went into effect on July 1,
2 2013. Over the next six months PSE recovered more dollars in customer payments
3 than it earned on a delivery revenue per customer basis by about \$16 million in
4 electricity and \$5 million in gas. This over-collection was returned to customers in
5 the rate revision of May 2014. In the first half of 2014, the electric delivery revenues
6 owed to the company exceed revenues collected from customers by over \$25 million,
7 while the natural gas delivery revenues exceed customer collections by about \$10
8 million.⁷ It appears some customers may see a rate increase in 2015.

9

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

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

16

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

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

22

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

⁷ See Exhibit No. ____ (DAD-6), page 2 and summing just the 2014 data.

1

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

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

13

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

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

20

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

22 A. Mr. Doyle further states, “In other words, utilities may over-earn and under-earn
23 their authorized rates of return and ROEs, but, all things being equal, the average

⁸ Exhibit No. ____ (DAD-4T) at 19:12–13.

1 actual rates of return and ROEs will approximate the authorized rates of return and
2 ROEs over time.”⁹

3

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

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

10

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

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

19

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

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

23

⁹ Exhibit No. ____ (DAD-4T) at 19:18–21.

1 Q. Does this conclude your testimony?

2 A. Yes.

Exhibit No. ____ (TES-8)
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**EXHIBIT TO
TESTIMONY OF**

Thomas E. Schooley

**STAFF OF WASHINGTON UTILITIES
AND TRANSPORTATION COMMISSION**

Update to Exhibit No. TES-3, Rate Changes Versus Earned Returns

December 3, 2014

Update to Exhibit No. ____ (TES-3) in bold and italics
Exhibit No. ____ (TES-8)
UE-121697, et. al.
Remand
December 3, 2014

Comparison of Rate Changes to Earned Returns at PSE
For 2005 through 2013

Docket	Rates effective	Percent Rate Change *1	Calendar Year	PSE Commission Basis Results of Operations				Deviation from Authorized				
				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%	0.38%		-0.10%	
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%	-0.27%		-0.51%	
UE-072300	11/1/2008	7.1%	2008	UE-090674	6.39%	8.25%	5.94%	10.15%	-1.86%		-4.21%	
UE-090704	5/1/2010	3.7%	2009	UE-100719	6.11%	8.25%	5.63%	10.15%	-2.14%		-4.52%	
UE-111048	5/12/2012	3.2%	2010	UE-110764	6.07%	8.10%	5.57%	10.10%	-2.03%		-4.53%	
UE-130137	7/1/2013	2.5%	2011	UE-120608	6.62%	8.14%	6.98%	10.10%	-1.52%		-3.12%	
UE-130617	11/1/2013	-0.5%	2012	UE-130652	7.14%	7.80%	8.11%	9.80%	-0.66%		-1.69%	
			2013	UE-140536	7.56%	7.77%	9.06%	9.80% *2	-0.21%		-0.74%	
			Average Earnings Shortfalls							-1.04%		-2.43%

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

*2 Decoupling and rate plan were in effect for the last six months of 2013.

Comparison of Rate Changes to Earned Returns at PSE
 For 2005 through 2013

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%	-1.19%	-0.10%
UG-060267	1/13/2007	3.10%	2007	UG-080851	7.34%	8.40%	9.89%	10.40%	-1.06%	-0.51%
UG-072301	11/1/2008	4.60%	2008	UG-090675	6.52%	8.25%	5.94%	10.15%	-1.73%	-4.21%
			2009	UG-100720	6.10%	8.25%	5.63%	10.15%	-2.15%	-4.52%
UG-090705	5/1/2010	0.80%	2010	UG-110765	6.24%	8.10%	5.57%	10.10%	-1.86%	-4.53%
			2011	UG-120609	6.78%	8.14%	7.30%	10.10%	-1.36%	-2.80%
UG-111049	5/12/2012	1.3%	2012	UG-130653	7.46%	7.80%	8.78%	9.80%	-0.34%	-1.02%
UG-130138	7/1/2013	0.9%	2013	UG-140537	7.34%	7.77%	8.62%	9.80% *2	-0.43%	-1.18%
				Average Earnings Shortfalls					-1.38%	-2.53%

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

*2 Decoupling and rate plan were in effect for the last six months of 2013.