

**EXHIBIT NO. ___(EMM-13T)
DOCKET NO. UE-072300/UG-072301
2007 PSE GENERAL RATE CASE
WITNESS: ERIC M. MARKELL**

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

**Docket No. UE-072300
Docket No. UG-072301**

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF
ERIC M. MARKELL
ON BEHALF OF PUGET SOUND ENERGY, INC.**

JULY 3, 2008

PUGET SOUND ENERGY, INC.

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF
ERIC M. MARKELL**

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PUGET SOUND ENERGY, INC.

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF
ERIC M. MARKELL**

I. INTRODUCTION

Q. Are you the same Eric M. Markell who provided prefiled direct testimony in this proceeding on December 3, 2007, on behalf of Puget Sound Energy, Inc. (“PSE” or “the Company”)?

A. Yes. On December 3, 2007, I filed direct testimony, Exhibit No. ___(EMM-1T), and eleven exhibits supporting such direct testimony, Exhibit No. ___(EMM-2) through Exhibit No. ___(EMM-12).

Q. Please summarize the purpose of your rebuttal testimony.

A. My testimony responds generally to the testimony submitted by the other parties to this case and presents an overview of the PSE’s rebuttal filing.

Q. What is PSE’s reaction to the response testimonies submitted by the other parties?

A. PSE has both a “big picture” reaction to the response testimony and specific, focused reactions to the other parties’ detailed adjustments and proposals.

1 **Q. Could you describe PSE’s overall reaction?**

2 A. PSE finds, in the testimony of Commission Staff, responsible reactions to the
3 PSE’s proposals that can be accepted as proposed and others that provide some
4 room with which to work productively. Commission Staff’s support for the
5 power cost adjustment (“PCA”) and power cost only rate case (“PCORC”)
6 mechanism is welcome and well reasoned. The return on equity proposal of the
7 Industrial Customer of Northwest Utilities (“ICNU”) is a helpful step in the right
8 direction. However, ICNU’s recommendation to eliminate a well-proven means
9 to recover PSE’s actual power costs over time—the PCORC process—is
10 troubling given the energy environment with which the State of Washington finds
11 itself dealing. The rebuttal testimony of Ms. Kimberly J. Harris explains in detail
12 the origins of these mechanisms, that they have worked fairly and effectively as
13 originally intended, and why they are still necessary.

14 **Q. Does PSE have a general reaction to the testimony of Public Counsel?**

15 A. In contrast to the testimony of many other parties, PSE finds the testimony of
16 Public Counsel to be punitive in effect and unsettling in its approach to setting
17 fair and equitable rates. Public Counsel’s proposed adjustments are a disservice
18 to customers and an attempt to shift current costs of consuming energy to future
19 generations of customers.

20 For example, Public Counsel’s proposal to stretch out the recovery of
21 depreciation of the Colstrip generating facility for 60 years and changing the

1 methodology to determine utility properties' cost of removal is unwise. Similarly,
2 Public Counsel's proposal with respect to flow-through of the taxes related to
3 catastrophic storm damage is shortsighted and unwise. As Mr. John H. Story and
4 Matthew Marcellia describe in their rebuttal testimony, Public Counsel's storm
5 damage proposal to flow-through the taxes related to catastrophic storm damage
6 would provide short-term rate relief in this proceeding only to push recovery of
7 significant storm costs and large revenue requirement increases a year or two
8 ahead. This will introduce even greater year-to-year price volatility to our
9 customers than the wholesale energy markets already do.

10 **Q. Do the other parties seem to recognize the many changes with which PSE is**
11 **trying to cope?**

12 A. If they do, it is not apparent in their testimony. PSE does recognize that the
13 regulatory process is inherently a litigious process. Nevertheless, it is surprising
14 that no party acknowledges the huge, transformative investment and operational
15 demands facing the Company or the changes occurring in the global energy
16 marketplace that drive the costs of providing electric and gas service to PSE's
17 customers. Instead, the other parties propose even greater costs and penalties for
18 PSE.

19 PSE believes that its customers—and the State of Washington—would be better
20 served if all those who participate in the regulatory process looked beyond short-
21 term rate impacts and worked more effectively together to support the evolution

1 of vibrant, modern utility organizations fully capable of addressing the energy
2 needs of the communities served.

3 **Q. What do you mean that the demands upon PSE are “transformative”?**

4 A. PSE is facing great challenges in its provision of electric and natural gas service
5 to its customers in terms of systems, people, emerging compliance regimes, power
6 supply, transmission and distribution systems and customer needs and
7 expectations. Like others in the industry, PSE finds itself competing fiercely in
8 the regional and global market for commodities, resources and skilled employees.
9 PSE is a very different company now than it was five years ago, and PSE will be
10 a very different company in 2013 than it is today.

11 **Q. Could you give some examples?**

12 A. Yes. The following are but a few examples:

13 a) Since the 2003 power blackout in the Northeast,
14 compliance requirements have become far more rigorous,
15 demanding and costly. Over the past two years, PSE has
16 had to document its compliance with over 1,000 NERC and
17 WECC requirements and develop a company-wide program
18 to demonstrate continued, sustainable compliance.
19 Similarly, the compliance activities of PSE’s regulatory
20 affairs group must also expand to educate employees,
21 monitor transactions and report on how the Company’s
22 many operations are complying with emerging federal
23 requirements in the areas of transmission and energy
24 trading.

25 b) Over 1,250 new employees—of a workforce of about
26 2600—have been hired since January 1, 2002. In other
27 words, about 50% of the Company’s employees are new to
28 the business since 2002. Like all employees, individuals

1 need to be recruited, trained, acculturated, educated to the
2 business model and motivated to perform at high levels.
3 This requires constant effort and the ability to offer
4 attractive compensation.

5 c) The composition and cost of PSE's long-term resource
6 outlook has significantly changed, as documented in the
7 Company's resource plans filed at the Commission since
8 2003. Such alterations in PSE's plans are, in large part, in
9 response to significant changes in federal and state energy
10 policy. From 2003 to 2007, the following changes emerged
11 in the Company's Least Cost Plans:

- 12 i) energy efficiency measures increased from
13 270 aMW to 430 aMW;
- 14 ii) elimination of 800 MW of coal-fired generation as
15 too costly and risky, even before adoption of
16 RCW 80.80;
- 17 iii) elimination of 1,000 MW of shared ownership
18 natural gas combined cycle plants because PSE
19 found no partner willing to share the other half of
20 such natural gas combined cycle natural gas plants;
- 21 iv) adoption of a goal to meet 10% of PSE's retail load
22 by renewable resources by 2013;
- 23 v) enactment of the Energy Independence Act,
24 requiring PSE to meet 15% of its retail load with
25 renewable resources as defined; and
- 26 vi) dramatic escalation of costs of new resource.
27 Resource costs increases are illustrated in Exhibit
28 No. __ (EMM-14), which is based on market bids
29 received in PSE's 2003, 2005 and 2008 Request for
30 Proposals. Long-term forecasts of natural gas
31 prices, a key driver for generation fuel and market
32 electric prices, have increased over 100% since
33 2003, as illustrated in Exhibit No. __ (EMM-15).

34 d) Estimates of expected carbon costs have increased
35 significantly, from a range of \$1/ton to \$20/ton in the
36 2003 Least Cost Plan, to as high as \$80/ton in 2008. Even
37 higher carbon costs may well be imposed in the future.

1 The June 6, 2008, edition of the Financial Times¹ reported
2 the International Energy Agency's position that carbon
3 dioxide prices would have to be over \$200/ton in order to
4 avert the threat of global warming. A cost of \$80/ton
5 would *increase* natural gas prices by about \$4/MMBtu. A
6 \$200/ton carbon cost would *add* over \$10/MMBtu to
7 already high natural gas prices.

8 **Q. Do any of the other parties acknowledge the customer benefits that result**
9 **from PSE's investments to expand and rebuild its energy supply system?**

10 A. Other than Commission Staff's support of the new resources being added in this
11 proceeding and the PCA and its PCORC process, no they do not. PSE finds no
12 clear recognition in their testimonies of the benefits accruing to customers from
13 the investments the Company is making to assure access to diverse, economic
14 supply resources, to expand the delivery system or to comply with ever more
15 exacting legal requirements that are meant to ensure system security and
16 reliability.

17 **Q. Do the other parties discuss or acknowledge any of the cost pressures facing**
18 **PSE?**

19 A. Yes. Commission Staff notes that "the cost of all sources of energy has risen at a
20 historically rapid pace." Exhibit No. ___T(APB-1T) at page 6, line 2. This is
21 welcome confirmation from Commission Staff that they recognize the exceptional
22 cost increases in the industry, which are described above as well as in the direct

¹ Jonathan Soble & Ed Crooks, "IEA Proposes Much Higher Carbon Offsets," *The Financial Times*, available at <http://www.ft.com/cms/s/0/ecb92312-339e-11dd-869b-0000779fd2ac.html> (last visited June 26, 2008).

1 testimonies of, among others, Ms. Susan McLain and Mr. David Mills.
2 Commission Staff's observations are echoed in the FERC Staff report, dated June
3 19, 2008, entitled "Increasing Costs in Electric Markets." Please see Exhibit
4 No. ___(EMM-16) for a copy of an article regarding the report and Exhibit
5 No. (EMM-17) for a copy of the FERC report itself. The plain fact is that
6 customers must pay more for their electric and gas service because the cost of
7 energy consumption in the present global energy economy costs much more. The
8 era of cheap, abundant energy is over.

9 **Q. Do you have any comment about cost pressures and pricing in general?**

10 A. Yes. Global and regional energy costs are rising significantly, as are the costs of
11 many other basic commodities. These facts are well documented in numerous
12 publications in the industry press. In an article prepared by The Brattle Group for
13 the Edison Foundation entitled "Rising Utility Construction Costs: Sources and
14 Impacts" the authors conclude,

15 Construction costs for electric utility investments have risen sharply over
16 the past several years, due to factors beyond the industry's control.
17 Increased prices for material and manufactured components, rising wages,
18 and a tighter market for construction project management services have
19 contributed to an across-the-board increase in the costs of investing in
20 utility infrastructure. These higher costs show no immediate signs of
21 abating.

22 Exhibit No. ___(SML-4) at page 33. PSE is not immune from these cost
23 increases. The direct testimony of Ms. Susan McLain discusses some of the

1 specific areas where PSE has seen its material and labor costs dramatically
2 increase over the past several years.

3 **Q. Has PSE acted to mitigate the cost pressures it faces?**

4 A. Yes, it has. Despite the impression that Public Counsel endeavors to create in the
5 record, PSE continually focuses on cost management. For example, PSE's
6 procurement professionals regularly work with internal business partners and
7 external suppliers to obtain the best value for our purchases in terms of price,
8 quality, design criteria, delivery, impact on the environment, future maintenance
9 expenses, exposure to liabilities and risk mitigation.

10 **Q. Could you describe some of these efforts by the procurement team?**

11 A. The procurement team obtains favorable pricing and terms by requesting bids
12 from a large number of suppliers for generic, non-specialized goods and services.
13 PSE also has alliances with certain suppliers for specialized materials and
14 equipment, which results in volume pricing, ongoing supplier knowledge of
15 company standards, production efficiencies, local and emergency stock on hand,
16 increased quality and reliability, and excellent customer service. By virtue of
17 such supplier alliances, PSE has been able to reduce the impact on the Company
18 of recent trends in rising commodity costs (oil, resin, steel, copper, etc.).

19 Other procurement cost management practices include:

- 20 • Making efforts to qualify a sufficient number of suppliers so that
21 PSE has access to materials at competitive prices even during

1 emergencies and to reduce situations where only one supplier can
2 meet the required project timeline,

- 3 • Partnering with PSE's engineering and standards groups so that the
4 costs of purchasing and maintaining equipment is considered along
5 with technical specifications, and
- 6 • Researching procurement best-practices through external
7 professional resources such as the Procurement Strategy Council
8 of the Corporate Executive Board, the Institute for Supply
9 Management (ISM), and the Utility Purchasing Managers Group
10 (UPMG).

11 **Q. Has the Company made efforts to control costs in addition to such**
12 **procurement strategies?**

13 A. Yes, PSE has been diligent in its commercial approach to acquiring new supply
14 resources. PSE's reputation for leadership in the systematic analysis of potential
15 resource options, the acquisition of renewable energy and in implementing cost-
16 effective energy efficiency measures is well established. PSE believes that it has
17 demonstrated exceptional commercial skill with first-mover strategy and
18 opportunistic resource acquisition. For example, just thirty months after PSE
19 completed its first wind farm in December 2005, it would now cost *twice* as much
20 per installed kilowatt to replicate that resource in today's marketplace for delivery
21 by 2010. No party has suggested additional financial rewards to PSE for
22 exercising such expertise. Instead, other parties offer only penalties and
23 disallowances, hardly a fair balancing of interests or a means to incent even better
24 performance.

1 **Q. Have the other parties recognized PSE's efforts in that they do not challenge**
2 **the prudence of any resource acquisitions?**

3 A. Yes. PSE recognizes and appreciates that none of the other Parties has challenged
4 the well-documented prudence of PSE's acquisition of the new resources
5 presented for the Commission's approval in this case. However, as discussed in
6 Mr. John Story's, Mr. Roget Garratt's and Ms. Kimberly Harris's rebuttal
7 testimony, proposals such as those offered by Public Counsel to deny in rates
8 operating costs of the Goldendale Generating Station and the Whitehorn
9 Generating Facility, each of which PSE acquired at a small fraction of their
10 replacement costs, can only be viewed as unguardedly punitive in spirit. Equally
11 remarkable is Public Counsel's proposal to disallow an arbitrary percentage of
12 storm repair expenses without any showing that it was not reasonable for PSE to
13 incur such expenses. Plus Public Counsel offsets the remaining storm repair
14 expenses with an inappropriate proposal to allocate a portion of accumulated
15 depreciation to offset the deferred storm costs.

16 **Q. Are there any other proposals of Public Counsel of particular note?**

17 A. Yes. Public Counsel makes several proposals in this proceeding regarding federal
18 income taxes and depreciation. The effect of such proposals is to reduce revenue
19 requirements and cash flow in the near term, only to require even larger rate
20 increases in the future. In addition to containing numerous errors, these tax
21 proposals would put our customers at risk of losing hundreds of millions of

1 dollars of tax benefits because they violate well-established IRS normalization
2 rules. The depreciation proposals reflect both a lack of understanding of good
3 commercial practice and short-sighted regulatory policy. Mr. Umbaugh, Mr.
4 Stout, Mr. Clarke, Mr. Stranik, Mr. Marcelia and Mr. Story elaborate on these
5 points in each of their respective rebuttal testimony.

6 **Q. What about Public Counsel’s proposal with respect to PSE’s cost of**
7 **managing PSE’s federal relations activities?**

8 A. Public Counsel has proposed that all, or a significant portion of, the compensation
9 of Ms. Harris, Mr. Bussey, Ms. Odell and myself be disallowed from rates based
10 on the assertion that PSE’s federal regulatory activities and those of certain direct
11 reports, “provide no direct benefit to ratepayers.” Exhibit No. ___(MJM-1TC) at
12 page 32, line 15. Public Counsel appears to have developed this proposal based
13 solely on a review of various job titles, without any comprehension of the actual
14 activities certain individuals perform. In fact, these are the very same individuals
15 and staff functions that:

- 16 i) secured for PSE a private letter ruling from the Internal Revenue
17 Service (“IRS”) to allow utilities to utilize the federal wind
18 production tax credit (“PTC”), which benefits flow to customers as
19 an offset to power costs and are estimated to exceed \$20 million
20 per year;
- 21 ii) have worked to protect from ongoing federal legislative, regulatory
22 and legal challenge significant BPA Residential Exchange benefits
23 that flow dollar-for-dollar to PSE’s residential and small farm
24 customers that since 2001 amount to well over \$900 million.

- 1 iii) have obtained notice of an IRS revenue ruling that utilities are
2 entitled to pass through to customers PTC benefits from third-party
3 wind entities in which they are investors (*see* Exhibit
4 No. ___(EMM-18);
- 5 iv) are leading the federal legislative effort in the industry to secure
6 for utility customers the benefit of solar Investment Tax Credits
7 (“ITC”) (*see* Exhibit No. ___(EMM-19), Exhibit No. ___(EMM-
8 20), and Exhibit No. ___(EMM-21));
- 9 v) are providing leadership in the region on the evolution of a
10 workable region-wide transmission grid system (“Columbia
11 Grid”);
- 12 vi) are providing leadership in the region in the dialogue with the
13 Bonneville Power Administration and other transmission
14 customers regarding investments that are needed to improve
15 electric transmission service to the I-5 corridor; and
- 16 vii) are playing a key role in representing PSE as an anchor customer
17 and potential co-investor in the proposed pipelines to access
18 Rockies region natural gas supplies.

19 It is frankly inconceivable that the representative for residential and small
20 commercial customers has submitted testimony in this proceeding claiming that
21 these federal regulatory efforts “provide no direct benefit to ratepayers.”

22 Ms. Harris and Mr. Hunt also address these matters in each of their respective
23 rebuttal testimony.

24 **Q. Could you summarize the effect on PSE’s financial position of the other**
25 **parties’ proposals?**

26 A. Taken as a whole, the positions advocated by the other parties, if adopted, would
27 not allow PSE to recover the costs incurred to provide service to its customers or
28 to have a reasonable opportunity to earn a fair return for its shareholders. In the

1 filings of other parties, PSE finds neither recognition of nor concern for the fact
2 that the Company, under present cost recovery measures and mechanisms
3 including the PCA and PCORC, continues to significantly under earn its
4 authorized return on equity. Indeed, adoption of either Public Counsel's or
5 Commission Staff's recommended rate increases significantly exacerbates PSE's
6 already sizable and perpetual under-earnings. Commission Staff's
7 recommendation would further reduce PSE's earned return on equity by
8 approximately 140 basis points, and Public Counsel's recommendation would
9 reduce PSE's earned return on equity by approximately 300 basis points. *See*
10 Exhibit No. ____ (EMM-22C) for a calculation of these likely effects.

11 Public Counsel and ICNU propose to eliminate the PCORC altogether, which
12 would only increase the delay between the time funds are invested in new
13 resources for customers and the time PSE begins to recover the investment in
14 rates. In the interim, PSE's shareholders would bear the operating and fixed-
15 charge costs associated with these investments made to serve customers. Even
16 though a Public Counsel witness advocates using the general rate case for
17 recovery of resources, another Public Counsel witness proposes to disallow
18 recovery of certain costs during the rate year for the Whitehorn and Goldendale
19 generating facilities, investments in which the Company prudently incurred costs.

20 The other parties also propose to reduce the current level of authorized returns to
21 capital well below the levels recently approved by utility commissions around the
22 country (10.31%), and thus the returns PSE can actually earn. Dr. Morin

1 discusses why these proposals are inappropriate. Mr. Donald Gaines explains in
2 his rebuttal testimony how acceptance of these proposals in concert with others
3 being made in this proceeding that shift additional risk to PSE and eliminate
4 critical cost recovery mechanisms such as the PCA and PCORC, would
5 compromise the progress the Company has made to improve its creditworthiness
6 and could well result in a further diminution of PSE's credit standing.

7 **Q. What is PSE's reaction to criticisms the other parties have made of PSE's**
8 **operational performance in certain areas, such as gas meter malfunctions?**

9 A. PSE agrees that there are areas of the Company's operational performance in need
10 of special attention, and it is entirely appropriate that the other parties express
11 their concerns about these matters. PSE is also very concerned about these
12 technology and business process issues. Although PSE continually strives for
13 high levels of customer service and believes that it is successfully performing at
14 high levels in many areas, the Company acknowledges a need to improve
15 performance in certain operational areas, such as gas meter technology and back
16 billing.

17 Accordingly, in the rebuttal testimony of Ms. Booga Gilbertson, PSE describes its
18 efforts in the area of meter technology and back billing processes and propose a
19 program to measure future performance. In the rebuttal testimony of Ms. Susan
20 McLain, PSE addresses the complexities of current SQIs. In addition, the
21 Company proposes to work collaboratively with interested parties to explore how

1 SQIs might be modified to reflect current customer values, increased costs that
2 may make some current SQIs unreasonably expensive to achieve, and the
3 complexities of design and measurement that are inherent in various SQIs.

4 The adjustments to revenue requirement proposed by Commission Staff for PSE's
5 performance in this area are unduly punitive and unsupportable. Mr. Karl
6 Karzmar addresses this issue in his rebuttal testimony.

7 **Q. Could you comment on the matter of the frequency of regulatory filings?**

8 A. As demonstrated in PSE's multi-year financial plan Business Update and Review
9 dated October 19, 2007 (see Exhibit No. ___(EMM-3C)), the Company is nearer
10 the beginning than the end of its current cycle of investing heavily in its delivery
11 systems and in new electric resources. Consequently, PSE is nearer the beginning
12 than the end of a series of regulatory filings that will be required to recover its
13 actual costs and a fair and reasonable return on the capital invested.

14 Commission Staff and others protest the frequency of filings and related
15 workload. So do my staff and the many PSE employees who contribute their
16 efforts to PSE's regulatory filings. The reality is that there is indeed much work
17 to be done and few experienced hands to do it. Strengthening and expanding a
18 significant infrastructure enterprise such as PSE is a lot of work, but it must be
19 done.

20 No party that has participated in or monitored PSE's rate-related proceedings

1 since 2001 or that has engaged with the Company in its several Integrated
2 Resource Plan processes since 2003 can doubt that many regulatory filings will be
3 needed to address the needs of the delivery system and the need to replace
4 expiring electric resources, meet growing customer needs, and effect new public
5 policy requirements. PSE has been plain spoken about its need in the future to
6 rely heavily on the regulatory process to support these efforts.

7 II. REVISED REQUEST FOR RELIEF

8 **Q. Has the financial relief that is being requested by PSE changed since its**
9 **initial filing of this case on December 3, 2007?**

10 A. Yes. In mid-April 2008, PSE made a supplemental filing in this case to update
11 the amount of the gas and electric revenue increases it is requesting. The
12 supplemental filing incorporated more current information about PSE's
13 anticipated rate year (year ending October 2009) costs than the information that
14 was available to the Company when it prepared its filing of December 3, 2007.
15 That supplemental filing increased PSE's original request for an annual increase
16 in electric revenues from approximately \$174.8 million to approximately
17 \$179.6 million. The supplemental filing also increased PSE's original request for
18 an annual increase in gas revenues from approximately \$56.7 million to
19 approximately \$58.0 million.

1 **Q. Is PSE's request for relief in this rebuttal case the same as its request for**
2 **relief in the April 2008 supplemental filing?**

3 A. No. Although PSE does not agree with many of the positions set forth in the
4 other parties' testimonies, the Company has accepted some of their revenue
5 requirement adjustments in whole or part. PSE is also proposing some additional
6 updates based on information that has become available since it prepared its
7 filings of December 2007 and April 2008.

8 The net result of such adjustments is a reduction in PSE's request for an increase
9 in electric revenues to approximately \$165.2 million. If approved, this adjustment
10 would represent an average 8.99% electric rate increase. PSE's rebuttal case also
11 requests an annual increase in gas revenues of approximately \$55.5 million. This
12 would represent an average 5.20% gas rate increase.

13 **Q. Does PSE agree that forecasted natural gas prices should be updated near**
14 **the end of this proceeding to reflect in rates the most current forecast of rate**
15 **year power costs?**

16 A. Yes. PSE proposes that the Commission's final rate order direct PSE to make a
17 final update to the projected power costs for the rate case as part of its compliance
18 filing in this case by updating the natural gas price forecasts used in the projection
19 methodology. Mr. David Mills discusses this process in his rebuttal testimony.
20 Such an update will ensure that rates are set based on a forecast of natural gas
21 prices that is as close as possible to prices likely to be experienced during the rate

1 year. Such an update would be consistent with past Commission practice (e.g., in
2 Docket No. UE-060267) and is supported by Commission Staff in this
3 proceeding.

4 **Q. Does PSE continue to have an interest in exploring the use of a forward-
5 looking test year to set rates in future cases?**

6 A. Yes. In this proceeding and others, parties have expressed concern about the
7 frequency of the PSE's regulatory filings and the related workload that complex
8 proceedings require. At the same time, PSE has expressed its concern about the
9 growing amount of regulatory lag with respect to cost recovery, especially with
10 respect to the energy delivery system. Although there is no "silver bullet"
11 solution to the concerns of all the parties, the use of an appropriately designed
12 forward-looking test year could possibly mitigate some workload and simplify
13 some considerations.

14 PSE's original case requested that the Commission commence a rulemaking to
15 consider this issue. An alternative approach would be for the Commission to
16 order a technical conference to examine the potential merits of a forward-looking
17 test year. PSE requests that the Commission require some such process to move
18 forward so that the Commission and interested parties begin actively considering
19 the use of forward looking test years in the State of Washington.

1 **III. OVERVIEW OF PSE'S REBUTTAL TO VARIOUS**
2 **SPECIFIC OBJECTIONS RAISED BY OTHER PARTIES**

3 **A. Financial Structure and Rate of Return**

4 **Q. What is PSE's response to the other parties' recommendations regarding**
5 **capital structure and return on equity?**

6 A. PSE's direct filing explained that the Company's approved equity percentage and
7 its authorized return on this equity need to be raised to modestly higher levels to
8 support the Company's gradual financial recovery and its ability to meet the long-
9 term interests of its customers. The requested financial relief will support PSE's
10 investment in its distribution system, new power plants, and its growing
11 maintenance and compliance activities. PSE proposes a weighted cost of equity
12 of 4.86%, comprised of an authorized return on equity of 10.80% on a capital
13 structure that includes 45% equity. This weighted cost of equity is significantly
14 less than the average weighted cost of equity of 5.02% approved recently in
15 numerous other jurisdictions. *See* Exhibit No. ___(DEG-10).

16 No party disputes PSE's need to replace aging components of the Company's
17 electric and gas delivery systems, maintain a reliable and adequate energy supply
18 by acquiring new electric generation resources, and enter into risk management
19 transactions to mitigate energy price volatility. Yet, other parties make proposals
20 that, in my judgment, would serve to weaken the cash flow of PSE, make more
21 marginal its credit standing and compromise the progress the Company has been

1 making since 2002 to improve its financial condition.

2 **Q. Would you please explain?**

3 A. Other parties propose that the Commission authorize much lower returns on
4 equity than exist today or that PSE requests in this proceeding. At the same time,
5 they propose to make shareholders assume significant new power cost risks by
6 elimination of the PCORC and implementing a proposal to filter hydro data.

7 By proposing elimination of the PCORC, they would also increase the delay
8 between the time new resources are placed into service and the time customers
9 start paying for the new resources in their rates. In the interim, it is PSE's
10 shareholders that bear these costs while its customers enjoy the benefits of the
11 investments.

12 In addition to the elimination of the PCORC, which would negatively impact the
13 PSE's cash flow, other parties also propose to reduce cash flow from operations
14 by greatly extending certain plant depreciation lives and underestimating the cost
15 of removal associated with capital investment. In addition to making it more
16 difficult for PSE to fund its investment efforts on behalf of customers with
17 internally generated funds, the extension of plant depreciation lives would push
18 the cash costs of service that is consumed today to future generations of
19 customers. Other parties' testimonies are simply silent as to the intergenerational
20 consequences of their proposals.

1 The prefiled rebuttal testimonies of Mr. Donald Gaines, Dr. Roger Morin, Mr.
2 William Stout, Mr. Richard Clarke, Mr. Mike Stranik, and Mr. Mike Jones
3 address these points in greater detail.

4 **B. The PCA Mechanism and PCORC**

5 **Q. What is PSE's view with respect to continuation of the PCORC and PCA**
6 **mechanisms?**

7 A. The PCORC has been, and remains, critical to PSE's efforts to acquire the
8 resources needed to provide electric customers with reliable service over the long
9 term. The PCA remains a very important buffer between PSE and extreme power
10 market and power cost events that could be financially devastating to the
11 Company, which also shares with customers the benefits of favorable market
12 conditions. Both the PCORC and the PCA also continue to be important, and
13 complementary, mechanisms through which PSE's electric customers' rates stay
14 in sync with the costs of generating or purchasing the power that they consume.

15 **Q. Does Commission Staff express a view on the PCORC and PCA**
16 **mechanisms?**

17 A. Yes. It is encouraging that Commission Staff recognizes the continued
18 importance of the PCORC and the PCA to PSE and its customers. Commission
19 Staff, however, proposes to make a number of changes to the PCORC and PCA.
20 PSE is prepared to accept most of these recommendations, as described in the

1 rebuttal testimony of each of Ms. Kimberly Harris and Mr. John Story.

2 **Q. Why is the PCORC process so critical to PSE's ability to execute on its**
3 **resource acquisition plans?**

4 A. The PCORC process is critical to ensuring that PSE can manage these challenges
5 from a financial perspective. In order to minimize cash flow constraints and
6 adverse earnings impacts, it is important that new resource acquisitions be
7 promptly included in rates and that customers begin paying the costs of these
8 resources at the same time (or very shortly after) the new resources are placed
9 into service. The PCORC is the mechanism PSE relies on to reduce the delay
10 between the time the Company invests in a project and the time the Company
11 begins to recover that investment through rates.

12 The availability of the PCORC process, and the resulting timely inclusion and
13 recovery of new resource investments, also provides current and future investors
14 with confidence that the PSE will be able to compensate capital providers in a
15 timely manner. This is especially important in today's volatile financial markets.

16 **C. Gas Rate Design**

17 **Q. Having reviewed the other parties' response to PSE's proposed gas rate**
18 **design, does PSE continue to advocate a basic charge for gas service of**
19 **\$18.00 per month?**

20 A. Yes. As described in the rebuttal testimony of Mr. David Hoff, PSE continues to

1 believe that its proposed basic charge is appropriate to recover the fixed,
2 customer-related costs of providing gas service and to mitigate the adverse
3 seasonal and weather effects on customers' bills. A monthly charge of \$18.00
4 would provide improved recovery of the costs that are incurred just to provide gas
5 service to a customer, reduce customer bill volatility, be fair and understandable,
6 and send an appropriate price signal, without undue impacts on customers' bills.

7 **Q. Does the Company continue to support its gas cost of service study?**

8 A. Yes. The parties in this case have widely varying views about the appropriate
9 cost of service methodology. As described in the rebuttal testimony of Janet
10 Phelps, the methodology PSE used for its cost of service study is sound and
11 represents a middle ground amongst the parties' varying positions.

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D. Increased Funding for Low Income Electric Energy Efficiency

Q. What is PSE’s response to Public Counsel’s recommendation that the Company increase its funding for low income energy efficiency programs by a minimum of \$1,500,000 per year for the 2008-2009 biennium?

A. PSE is, and will continue to be, a strong advocate for energy efficiency programs. PSE would likely be in favor of increased funding if there were evidence supporting the amount of funds needed and demonstrating the reasonable ability of the implementing agencies to cost-effectively spend additional funds. Public Counsel, however, has not addressed these issues. It is not at all clear that additional residences would be reached if funding were increased. Thus, PSE opposes any order by the Commission in *this* proceeding to increase funding for low-income energy efficiency.

Q. Is PSE aware whether low-income agencies spent the energy efficiency funds that are budgeted under the current level of funding?

A. Yes, low-income agencies have recently failed to spend the funds budgeted to them for energy efficiency. During the 2006-2007 biennium, the participating low-income agencies deployed, on average, only about 85% of the budgeted funds available from PSE.

1 **Q. Where should these issues be addressed if not in this proceeding?**

2 A. As it has historically, PSE believes that this issue is best addressed by the
3 knowledgeable participants in the Conservation Resource Advisory Group
4 (“CRAG”) process. It is within the context of that process that issues not
5 addressed by Public Counsel (such as need, cost trends, additional residences that
6 would be reached, and the cost-effectiveness of the increased funding) could be
7 thoughtfully addressed.

8 **Q. Why do you believe that the CRAG is the appropriate body to consider the**
9 **issue of increased energy efficiency funding?**

10 A. PSE establishes its energy efficiency savings targets and budgets by working
11 collaboratively with a group of stakeholders who participate in the CRAG. One
12 of the primary purposes of the CRAG is to “review issues related to limited
13 income participation in energy efficiency programs.”² PSE believes that the
14 CRAG process is the proper forum for considering low-income energy efficiency
15 issues. PSE is willing to work with the CRAG and the low-income agencies to
16 identify appropriate, cost-effective energy efficiency funding levels based on
17 more thorough analysis of the agencies’ specific needs.

18 **Q. Are Public Counsel and the Energy Project members of the CRAG?**

19 A. Yes.

1 **Q. Have Public Counsel or the Energy Project presented their low-income**
2 **energy efficiency proposal to the CRAG?**

3 A. No. CRAG meetings were held in July and September 2007 to discuss energy
4 efficiency program targets and budgets for the 2008-2009 biennium. Draft tariffs
5 were sent to the CRAG for review in October 2007, prior to filing with the
6 Commission in November 2007. Neither the recommended funding increase
7 proposed by Public Counsel nor any other 2008-2009 low-income energy
8 efficiency budget proposal from Public Counsel or the Energy Project has been
9 presented, reviewed, or endorsed by the CRAG to date.

10 **Q. Is there anything the Commission should do in this case related to the low-**
11 **income energy efficiency issue?**

12 A. PSE asks the Commission to allow the Company to invite the CRAG participants
13 to consider the issues raised Public Counsel and to present a report to the
14 Company on these issues not later than December 1, 2008. This would be an
15 adequate time for PSE to consider such recommendations in advance of filing its
16 next general rate proceeding.

² Settlement Terms for Conservation, Twelfth Supplemental order of Docket Nos. UE-011570 and UG-011571.

1 **IV. EXPANDED BENEFITS FOR LOW-INCOME CUSTOMERS**

2 **Q. Please describe the status of PSE’s proposal to increase bill assistance**
3 **benefits for qualifying low-income customers.**

4 A. PSE has considered the testimony of the participating parties, on-going
5 developments in the global energy market, the June 6, 2008 report entitled, “2008
6 Energy Cost Survey” authored by the Energy Programs Consortium (“EPC”) and
7 the National Energy Assistance Directors’ Association (“NEADA”) and updated
8 projections of all-in delivered natural gas costs for the next several years. As a
9 result of such considerations, PSE proposes that:

- 10 (i) the total aggregate funding cap for its low income customer bill
11 assistance program be increased to approximately \$15 million per
12 year from approximately \$10.25 million per year, and
13 (ii) benefit funds not distributed to qualifying customers in any single
14 program year be able to be carried over to provide supplemental
15 benefit funding to be available in the next program year.

16 PSE also proposes clarification of the program accounting rules to define the
17 program caps to include benefits and administrative costs. Amounts to be set in
18 rates would include a gross-up over and above the program caps sufficient to
19 cover PSE’s revenue sensitive items.

20 **Q. Is there an overarching reason for PSE’s updated bill assistance proposal?**

21 A. Yes. PSE is highly sensitive to energy cost trends and to the special needs of its
22 less fortunate customers. Furthermore, I know, from my engagement as a
23 member of the Board of Directors of King County United Way and its endeavors

1 to end homelessness, that failure to be able to meet energy bills can become a
2 rolling stone on the way to homelessness. As explained throughout PSE's
3 testimony, the forces of global energy markets, federal and state energy policy
4 and general inflationary trends in the Company's value chain have created a
5 significant and continuing need for rate relief over the next several years. PSE
6 knows from dialogue with its twelve low-income service provider partners, the
7 advocates for the interests of low income families, and our the Company's own
8 customer service staff that increases in bill assistance funding made in the past,
9 while helpful, are simply not adequate to serve all those who currently apply for
10 bill assistance.

11 Unlike other private corporations, a regulated utility has unique responsibilities
12 not only to render reliable gas and electric service but to discharge the social
13 responsibilities it implicitly assumes when it accepts the public trust to place its
14 works in the public rights of way.

15 **Q. How would the increased funding benefit low-income customers?**

16 A. The increased funding levels PSE proposes will permit the bill assistance program
17 to increase service to more customers who qualify for bill assistance. PSE
18 estimates that approximately 16,400 low-income electric customers and
19 approximately 8,700 low-income natural gas customers will be able to be served
20 by the program, and that the program will be able to provide increased levels of
21 assistance per customer.

1 **Q. Please describe the impact of PSE's proposal on the monthly bill of a typical,**
2 **or average, residential customer?**

3 A. As discussed in the rebuttal testimony of Mr. David Hoff, PSE currently estimates
4 that PSE's low income proposal would increase the typical residential electric
5 customer's bill by only 19 cents per month and the average residential gas
6 customer's bill by only 18 cents per month.

7 **Q. When would the increased caps for this funding go into effect?**

8 A. PSE will be filing proposed changes to the caps in Schedules 129 to implement
9 this proposal no later than September 2008, with a requested effective date of
10 October 2008. Cost recovery to provide funds for the increased caps would start
11 coincident with the effective date of the tariffs so that the increased funds are
12 available for the upcoming heating season.

13 **V. CONCLUSION**

14 **Q. Please summarize PSE's rebuttal case.**

15 A. PSE's proposals in this proceeding are designed to adequately fund PSE's
16 essential operational and investment activities on behalf of its customers. The
17 Company urges the Commission to consider the effects of global markets upon its
18 business and the long-term value to PSE's customers and the region of having
19 robust electric and gas supply and delivery systems and a financially healthy
20 company to deliver such services.

1 PSE's proposals and programs deal with immediate needs, while positioning the
2 Company for the long-term. They are fair, balanced, and reasonable,
3 notwithstanding the objections raised by the other parties to this proceeding. PSE
4 has carefully considered the positions set forth by other parties and accepted them
5 in whole or with minor modifications whenever possible. The Company,
6 however, simply does not agree that the remaining objections of the other parties
7 are correct, reflect market and operational realities, or would serve the long-term
8 interests of PSE's customers.

9 PSE requests that the Commission support the Company's efforts on behalf of its
10 customers and approve the relief the Company has requested in this proceeding
11 and as modified in this rebuttal filing.

12 **Q. Does that conclude your prefiled rebuttal testimony?**

13 **A. Yes.**