

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

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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*)

INITIAL BRIEF OF  
COMMISSION STAFF

March 6, 2015

ROBERT W. FERGUSON  
Attorney General

JENNIFER CAMERON-RULKOWSKI  
Assistant Attorney General  
Office of the Attorney General  
Utilities & Transportation Division  
1400 S Evergreen Park Drive S.W.  
P.O. Box 40128  
Olympia, WA 98504-0128  
(360) 664-1186

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## I. INTRODUCTION

1 This phase of the proceeding involves rewriting one issue in the decision of the Washington Utilities and Transportation Commission (Commission) in this docket. Following judicial review of the final order, the Superior Court upheld the Commission's decision on the majority of issues but remanded to the Commission the determination of Puget Sound Energy's (PSE's) authorized return on equity (ROE). In the initial proceeding, the Commission considered (1) whether to set a new cost of equity and (2) whether to adjust PSE's cost of equity for the effects of decoupling. The Commission decided not to update PSE's cost of equity and decided that the evidence did not support an adjustment of PSE's cost of equity due to decoupling. The Public Counsel Division of the Washington State Attorney General's Office petitioned for judicial review of both of these decisions (as well as others), whereas Industrial Customer of Northwest Utilities' (ICNU's) appealed the cost of equity but did not address the issue of whether PSE's cost of equity should be reduced for the effects of decoupling. Judge Murphy does not discuss the decoupling effects issue in her letter ruling. Accordingly, the Commission's decision that the evidence did not support an adjustment of PSE's cost of equity due to decoupling was not disturbed on appeal. It follows that the issue was not remanded. In the event that the Commission wishes to consider this issue, Commission Staff (Staff) relies on its position and testimony in the initial proceeding.

2 It is awkward and of limited usefulness to go back in time, and yet, that is what we must do given that the rate plan will continue for at least another year. Staff has evaluated market conditions at the time of the initial proceeding. Had Staff made a cost of equity recommendation at that time, in early 2013, Staff would have recommended authorizing

PSE's cost of equity at 9.50 percent. It is important to note, however, that the range of reasonable equity returns from this time period includes the 9.80 percent return that the Commission approved in its final order.

## II. BACKGROUND

3 On June 25, 2013, the Commission entered its final order in the initial proceeding ("Order 07"). Order 07 granted the decoupling petition of PSE and Northwest Energy Coalition (NVEC) in two sets of dockets<sup>1</sup> and authorized rates in the expedited rate filing (ERF) dockets.<sup>2</sup> The decision implementing decoupling for PSE also approved a multi-year rate plan, which is to remain in effect through March 2016 and possibly through March 2017.<sup>3</sup> The Commission accepted PSE's commitment to refrain from filing a general rate case until April 1, 2015, and to file a general rate case no later than April 1, 2016.<sup>4</sup> The ERF proceeding set updated "base" rates that served as the starting point for the rate plan.

4 In Order 07, the Commission decided not to set a new return on equity for PSE and decided not to adjust the ROE for effects of decoupling. These two decisions regarding ROE were made, however, on very different bases. This is reflected in the location in Order 07 of the Commission's discussions of each issue; ROE with respect to capital market conditions is discussed in conjunction with the ERF issues,<sup>5</sup> while the effect of decoupling on ROE is discussed in the portion of the order that addresses decoupling issues.<sup>6</sup>

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<sup>1</sup> *In the Matter of the Petition of Puget Sound Energy, Inc., and Northwest Energy Coalition for an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated With the Mechanisms*, Dockets UE-121697 and UG-121705 (consolidated) ("Decoupling Dockets").

<sup>2</sup> *Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-130137 and UG-130138.

<sup>3</sup> Order 07 at ¶ 137, ¶ 173.

<sup>4</sup> ¶ 137.

<sup>5</sup> ¶¶ 21–25.

<sup>6</sup> ¶¶ 44–49.

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In the decision not to set a new ROE, the Commission acknowledged that, consistent with the concept of the ERF, PSE had not put on a cost of capital case,<sup>7</sup> and it observed that “the evidence in this case is simply too sparse to support a reduction in PSE’s current authorized ROE to reflect current financial market conditions.”<sup>8</sup> In contrast, based on testimony from some half dozen witnesses, the Commission decided that the record did not support an adjustment to ROE for the effect of decoupling on risk.<sup>9</sup> In other words, the parties that advocated for reducing PSE’s ROE due to the implementation of decoupling provided a sufficient record for a decision; they simply were unsuccessful in making their cases. The Commission did note, however, that its decision did not “necessarily lay the matter to rest” and that the Commission “may yet, on an adequate record in a future proceeding, find that such an adjustment is warranted.”<sup>10</sup>

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Public Counsel and ICNU each petitioned for judicial review of Order 07. While both challenged the Commission’s decision to leave PSE’s ROE at 9.80 percent, only Public Counsel challenged the Commission’s decision not to reduce the ROE for the effects of decoupling. The Commission as well as Public Counsel briefed and presented oral argument on the Commission’s decision regarding the effect of decoupling on the cost of capital. Judge Murphy of Thurston County Superior Court filed a letter ruling dated June 4, 2014 (Letter Ruling).<sup>11</sup> On July 25, 2014, Judge Murphy signed an order reflecting her Letter Ruling.<sup>12</sup> In the order, Judge Murphy reversed and remanded the rates to be charged

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<sup>7</sup> Note 72.

<sup>8</sup> Order 07 at ¶ 58.

<sup>9</sup> Order 07 at ¶ 107.

<sup>10</sup> Order 07 at ¶ 107.

<sup>11</sup> *Indus. Customers of Nw. Utils. v. Utils. & Transp. Comm’n and Wash. State Attorney General’s Office, Public Counsel Div. v. Utils. & Transp. Comm’n*, Thurston County Cause Nos.: 13-2-01576-2, 13-2-01582-7 (Consolidated), on file in the ERF and Decoupling dockets.

<sup>12</sup> *Indus. Customers of Nw. Utils. v. Utils. & Transp. Comm’n and Wash. State Attorney General’s Office*,

during the rate plan because “the Commission’s findings of fact with respect to the return on equity component of Puget Sound Energy, Inc.’s cost of capital in the context of a multi-year rate plan are unsupported by substantial evidence and the Commission improperly shifted the burden of proof on this issue from Puget Sound Energy, Inc. to the other parties in the proceeding below.”

7 Neither the order nor the letter ruling contain any explicit or implicit discussion of the issue of the effect of decoupling on ROE. Judge Murphy discussed the Commission’s decision on ROE in Section 2 of her letter ruling. She found error with the decision on ROE in the market conditions context only; that is, that the Commission did not put PSE to its burden of making its case for the appropriate return on equity reflecting current market conditions. The citations in Judge Murphy’s letter ruling to the administrative record that are relevant to return on equity are to the Commission’s discussion of the effect of market conditions on return on equity.<sup>13</sup> There are no citations to the portion of the Commission’s decision discussing the effect of decoupling on return on equity.<sup>14</sup> After citing to the market conditions discussion in the ERF portion of Order 07, Judge Murphy notes, without opining on, the “dissenting opinion on this issue” of Commissioner Jones. She cites to the whole of Commissioner Jones’s separate statement, but the words “on this issue” indicate that the Judge is referring to Commissioner Jones’ discussion of his opinion that “current market

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*Public Counsel Div. v. Utils. & Transp. Comm’n*, Thurston County Cause Nos.: 13-2-01576-2, 13-2-01582-7 (Consolidated), Order Granting in Part and Denying in Part Petitions for Judicial Review, on file in the ERF and Decoupling dockets.

<sup>13</sup> Order 07 begins at Administrative Record (AR) page 944 and concludes at AR page 1059. Commissioner Jones’ Separate Statement begins on AR 1060 and concludes on AR page 1063. Section 2 of the Letter Ruling includes a citation to Commissioner Jones’ Separate Statement; to AR 989, which corresponds to page 25 of Order 07; and to AR 987, which corresponds to page 23 of Order 07.

<sup>14</sup> The discussion of the effects of decoupling on risk are contained in pages 42 to 49 of Order 07. This portion of the order corresponds with pages AR 1008 to 1013.

conditions warrant an adjustment of PSE's return on equity"<sup>15</sup> rather than any effects of decoupling. Judge Murphy's ruling does not contain any apparent discussion on the issue of the effects of decoupling on return on equity.

8           Mr. Schooley of Commission Staff filed testimony in the initial proceeding recommending that the Commission consider the effect of decoupling in PSE's next general rate case, at which time direct empirical evidence of decoupling's effects on PSE can be developed and the analysis can encompass a broader range of factors that add to or reduce PSE's risk.<sup>16</sup> Staff's position has not changed. Mr. Schooley testified in the remand phase, "I still believe the best course of action is the one we are on."<sup>17</sup> The decision in Order 07 will "allow objective data on the effects of decoupling on earnings to accumulate."<sup>18</sup> When Staff reviews the effect of decoupling in PSE's next general rate case, Staff expects to look at "not just decoupling as a mitigating factor to revenue stabilization, but also all the other types of regulatory risk mitigation and risk-inducing elements in the Company's rates."<sup>19</sup>

9           Mr. David Parcell, on behalf of Staff, testifies to a reasonable range for PSE's cost of equity of 9.0 to 10.0 percent in the first quarter of 2013,<sup>20</sup> the time when Staff was scheduled to prepare and file testimony in the ERF proceeding.<sup>21</sup> Mr. Parcell advocates the midpoint of this range, 9.50 percent, as a specific cost of equity recommendation.<sup>22</sup>

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<sup>15</sup> Order 07 at p. 97 (Separate Statement of Commissioner Jones).

<sup>16</sup> Schooley, Exh. No. TES-4T.

<sup>17</sup> Schooley, Exh. No. TES-6T 5:18-19.

<sup>18</sup> *Id.* at 5:21-22.

<sup>19</sup> Schooley, TR. 763:23-764:7.

<sup>20</sup> Parcell, Exh. No. DCP-1T 4:1-2.

<sup>21</sup> Staff was scheduled to file testimony March 27, 2013, in the ERF. Dockets UE-130137 and UG-130138 (*consolidated*), Order 02, Consolidation Order, Prehearing Conference Order; Notice of Hearing (March 22, 2013).

<sup>22</sup> Parcell, Exh. No. DCP-1T 4:3-4.



### III. ARGUMENT

10 To correct the error identified by Judge Murphy, the Commission must gather and consider sufficient evidence to support a decision setting PSE's cost of equity as of early 2013. Staff's evidence shows that, as of the first quarter of 2013, a range of 9.0 to 10.0 percent is reasonable for PSE's equity return, with the midpoint of 9.5 percent as a specific recommended target return. The Commission need not consider the effect of decoupling on risk, as Judge Murphy did not find error with the Commission's decision on this issue.

**A. The Commission Should Authorize a Cost of Equity That Would Have Been Applicable in the First Quarter of 2013 Because That Time Period Is Contemporaneous With the Other Evidence Presented in Support of the Base Rates Set in the ERF.**

11 PSE's multiyear rate plan went into effect July 1, 2013, and will remain in effect for at least another year from now. The foundational rates of the rate plan are the rates that resulted from the ERF portion of the Commission's decision in Order 07. Judge Murphy's order explicitly reverses the Commission's determination of the rates in the rate plan. In order to correct the error, it is necessary to correct the base rates that flow through into the rate plan. The base rates went into effect in 2013 based on updated material and testimony as of the first quarter of 2013 at the latest. All evidence that the Commission considers to re-set the base rates that flow through into the rate plan should be contemporaneous with the other testimony and evidence presented in support of the ERF rates. The time period in which this evidence was presented or would have been presented is early 2013. Accordingly, it is appropriate to authorize a return on equity that would have been applicable in the first quarter of 2013.

**B. PSE's Cost of Equity As of the First Quarter of 2013 May Be Set At 9.5 Percent Or At Least Within the Range of 9.0 to 10.0 Percent.**

12 In order to determine the appropriate cost of equity, the Commission considers the parties' evidence and, on that basis, establishes a reasonable range for the allowed equity return vis-à-vis what would be expected for businesses of comparable risk.<sup>23</sup> To establish this "zone of reasonableness," the Commission weighs the evidence presented and, considering the highest and lowest data points, may narrow that range to a zone of results best supported by the evidence.<sup>24</sup> Typically, the Commission considers the results from a variety of methods and has reiterated "in more than one order that it appreciates and values a variety of perspectives and analytic results because these serve to better inform the judgment it must exercise than would a single model, or a single expert's opinion."<sup>25</sup>

13 Staff's cost of equity witness, Mr. Parcell, used three different methodologies to determine PSE's cost of equity as of "early 2013." Mr. Parcell specifically defines "early 2013" as "the three-month period January–March 2013"; that is, the first quarter of 2013.<sup>26</sup> This period is appropriate because Staff was scheduled to file testimony during this time period in the ERF proceeding, in which the Commission set PSE's base rates.

14 Mr. Parcell applied the Discounted Cash Flow (DCF), Capital Asset Pricing Model (CAPM), and the Comparable Earnings (CE) methodologies in his cost of equity study. In

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<sup>23</sup> *Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Docket UE-111048 and UG-111049 (consolidated), Order 08 Rejecting Tariff Sheets; Authorizing and Requiring Compliance Filing, ¶ 37 (May 7, 2012). This is consistent with the long-standing precedent established in *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 692, 43 S. Ct. 675, 67 L. Ed. 1176 (1923) ("A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding, risks and uncertainties.").

<sup>24</sup> See Docket UE-111048, Order 08 at ¶ 87.

<sup>25</sup> *Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-090704 and UG-090705 (consolidated), Order 11 Rejecting Tariff Sheets; Authorizing and Requiring Compliance Filing, ¶ 292 (April 2, 2010).

<sup>26</sup> Parcell, DCP-1T 2:11–12.

carrying out his study, Mr. Parcell applied each methodology to three groups of proxy utilities: (1) the proxy group that he selected, comprised of publicly traded electric utilities (or holding companies) with operating and risk characteristics that were similar to PSE as of early 2013; (2) ICNU witness Mr. Gorman's proxy group from his April 26, 2013, prefiled testimony; and (3) PSE witness Dr. Morin's sample group.<sup>27</sup>

15           Mr. Parcell's DCF results are 9.1 percent to 9.7 percent.<sup>28</sup> His analysis applying the CAPM methodology results in a CAPM cost of equity of 6.8 percent.<sup>29</sup> Mr. Parcell's CE analysis considers historic returns on equity over the past two business cycles as well as projected returns on equity for 2013, 2014, and 2016 to 2018 and concludes that returns were in a range of 8.7 to 10.4 percent.<sup>30</sup> Given recent earnings and market-to-book ratios of the proxy group firms, as well as the S&P 500 Composite Group, Mr. Parcell finds that the CE cost of equity for the proxy utilities as of early 2013 falls within the narrower range of 9.0 to 10.0 percent.<sup>31</sup> Finally, Mr. Parcell notes that average authorized equity awards were generally in the 9.5 to 10 percent range in 2012 and 2013.<sup>32</sup> In Mr. Parcell's judgment, taking into account his analysis using the various methodologies, 9.0 to 10.0 percent is a reasonable range as of early 2013 for PSE's cost of equity.<sup>33</sup>

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<sup>27</sup> *Id.* at 3:4–21.

<sup>28</sup> *Id.* at 18:6–10.

<sup>29</sup> *Id.* at 22:12–14.

<sup>30</sup> *Id.* at 25:17–18.

<sup>31</sup> *Id.* at 25:21–27:9.

<sup>32</sup> *Id.* at 28:16–20.

<sup>33</sup> Parcell, DCP-1T 27:21–22.

**C. The Issue of Whether PSE's ROE Should Be Adjusted Due to the Effects of Decoupling Is Not Within the Scope of the Remand.**

16           Once a decision on an issue has been appealed, the appellate body's decision on that issue is the settled law of the case and the parties may not continue to litigate that issue in the case.<sup>34</sup> This law of the case affects not only those issues that are settled on appeal but also those issues that could have been put to rest on appeal.<sup>35</sup> The purpose of this rule is judicial economy. That is, an issue that has been appealed already should not be relitigated and made eligible for another appeal.<sup>36</sup> In addition, the findings of an administrative body that are left undisturbed following judicial review are final and binding.<sup>37</sup> In a case where a court remands a matter to an administrative agency for the taking of additional evidence, the agency's original decision stands but the agency can consider new evidence and modify its decision as necessary.<sup>38</sup> The remand, however, does not allow the parties to relitigate the case; rather the remand represents a continuation of the original agency proceeding.<sup>39</sup> In carrying out a remand, it is incumbent upon the body carrying out the remand to examine the appellate opinion and to proceed in conformity with the opinion.<sup>40</sup> As a practical matter, the Commission has a great degree of latitude in carrying out the remand so long as the proceedings are not inconsistent with the Court's decision.<sup>41</sup>

17           In support of its petition for judicial review, Public Counsel specifically addressed the Commission's decision not to reduce PSE's cost of equity due to decoupling. This issue, therefore, was before Judge Murphy and should not be relitigated. Out of respect for judicial

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<sup>34</sup> 4 C.J.S. Appeal and Error § 1131.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> 73A C.J.S. Public Administrative Law and Procedure § 558.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> 5 C.J.S. Appeal and Error § 1137.

<sup>41</sup> *See* 5 C.J.S. Appeal and Error § 1136.

economy, the Commission should not take up this issue in the remand proceeding in a way that would allow the same issue to be appealed again. Judge Murphy's letter ruling makes no mention of any error in the Commission's decision to not reduce PSE's ROE for the effects of decoupling and to wait until PSE's next general rate case to evaluate this issue on a more robust record. This portion of the Commission's decision still stands and need not be revisited.

18 In the event the Commission decides to discuss the issue of the effect of decoupling on risk in this remand phase, Staff recommends that the Commission confirm its prior decision and wait until PSE's next general rate case to conduct a full review of this issue. At that time, the Commission will have two to three years of earnings evidence and will be able to concurrently evaluate other mechanisms that may reduce or add to PSE's risk. This empirical evidence and this breadth of evidence can provide greater confidence in identifying the need for and quantifying any adjustment that the Commission may decide to make to PSE's rate of return.

#### IV. CONCLUSION

19 In this phase of the proceeding, Staff views its main task as contributing to the creation of a record containing the "depth and breadth of data analysis, and the diversity of expert evaluation and opinion on which the Commission customarily relies in setting return on equity."<sup>42</sup> For this purpose, Staff conducted the analysis it could have carried out in early 2013 had it believed cost of equity to be part of the case. Staff's analysis, which results in a recommended cost of equity of 9.5 percent with a range of reasonable equity returns from

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<sup>42</sup> Letter Ruling at Section 2, *quoting* Order 07, at ¶ 58.

9.0 to 10.0 percent, indicates that the Commission could reduce PSE's authorized cost of equity, raise it, or maintain the Company's existing equity return at 9.80 percent.

DATED this 6th day of March, 2015.

Respectfully submitted,

ROBERT W. FERGUSON  
Attorney General



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JENNIFER CAMERON-RULKOWSKI  
Assistant Attorney General  
Counsel for Washington Utilities and  
Transportation Commission Staff