BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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| 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*)  REPLY BRIEF OF COMMISSION STAFF |
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**I. INTRODUCTION**

1. In this remand phase of the proceeding, Staff of the Washington Utilities and Transportation Commission (Commission) has done what it set out to do: supplement the record so that the Commission can set Puget Sound Energy’s (PSE’s) cost of equity as of spring 2013. Commission Staff has provided the same kind of rigorous analysis and informed judgment, tailored to the circumstances of the case, that it customarily presents. As is generally the case, the cost of equity experts presenting testimony in this proceeding disagree with respect to results and methodologies. Staff has elected not to attack the cost of equity analyses that result in a higher or lower recommendation than Staff’s, as they have been prepared by credible experts and establish a more complete record. Instead, Staff has focused on presenting its independent expert opinion on the reasonable range of PSE’s cost of equity during the relevant time period. Staff’s cost of equity analysis does not consider decoupling, as Staff believes decoupling should not be considered without concurrently considering other mechanisms and data that can provide a more complete picture of PSE’s risk.

**II. ARGUMENT**

1. **The Selection of the Midpoint of the Range Is Reasonable Given That PSE Has Average Risk.**
2. Industrial Customers of Northwest Utilities (ICNU) compares Mr. Parcell’s recommendation in the recent PacifiCorp general rate case with his recommendation in this proceeding and criticizes his selection of the midpoint of his range as his recommended cost of equity for PSE.[[1]](#footnote-1) There is a distinction between the two companies, however, that ICNU simply glosses over: PSE has average risk in the industry, while PacifiCorp enjoys significantly less risk.
3. In his testimony, Mr. Parcell states, “PSE’s ratings were at or above the most common rating categories of most electric utilities in early 2013.”[[2]](#footnote-2) In contrast, Mr. Parcell testified in the recent PacifiCorp general rate case that PacifiCorp’s ratings “are *above* the common rating categories of most electric utilities.”[[3]](#footnote-3) Mr. Parcell also points out that PSE’s common equity ratio is similar to those of electric utilities in general, which indicates similar financial risk.[[4]](#footnote-4) Selecting the midpoint of the range in the PSE remand proceeding is justified, given Mr. Parcell’s conclusion that PSE has average risk.
4. **Staff’s Analysis Is Appropriately Tailored to the Case.**
5. Staff’s testimony is tailored to this proceeding, which is a remand of one particular issue, the determination of PSE’s cost of equity. Public Counsel criticizes Mr. Parcell’s testimony on the grounds that it is not “consistent” with his testimony in the PacifiCorp general rate case.[[5]](#footnote-5) Specifically, Public Counsel takes issue with Mr. Parcell’s range because it differs from the scope of the range Mr. Parcell recommended in the PacifiCorp general rate case.[[6]](#footnote-6) Public Counsel essentially argues that Mr. Parcell’s testimony should be discounted because Mr. Parcell adapted his testimony to this particular proceeding. Finally, Public Counsel implies that Mr. Parcell’s testimony is not objective.[[7]](#footnote-7)
6. Public Counsel’s argument is specious given that counsel for ICNU cross examined Mr. Parcell at hearing exactly on the topic of his range of reasonableness in the two proceedings, and Mr. Parcell fully addressed that issue on the stand. At hearing, Mr. Parcell testified that he carefully considered the remand directions provided in Order 10, and he expounded on how he applied his considerations from the order to his analysis.[[8]](#footnote-8) Accordingly, Mr. Parcell explained, “I also believe that I have an obligation as a Staff witness, almost in a policy context, to tell the commission what their options would be at that point in time. . . [a]nd. . .that’s why I acknowledged that I’m not recommending 9.8, but it did fall within my zone of reasonableness.”[[9]](#footnote-9) It is empty rhetoric on Public Counsel’s part to claim that, because, in Public Counsel’s view, Mr. Parcell did something different from Public Counsel and different from the PacifiCorp case, the Commission should not rely on it. Public Counsel would have the Commission elevate a “foolish consistency” above analysis tailored thoughtfully to the circumstances of this particular proceeding.
7. **The Commission Can Have Confidence in Staff’s Range.**
8. Mr. Parcell’s results represent an independent determination of the reasonable range of equity returns for PSE at the relevant time. In his expert judgment, the range of reasonable equity returns for PSE in early 2013 extended from 9.0 to 10.0 percent. Public Counsel criticizes Mr. Parcell’s exclusion of his Capital Asset Pricing Model (CAPM) results from his range.[[10]](#footnote-10) As Mr. Parcell explained, however, in answer to questioning from Commissioner Jones regarding the weight to be accorded to the various methodologies, specifically CAPM and Risk Premium, the analyst can accord weight to the results he considers to be reasonable:

I have for a long, long time used three methodologies. And in some cases, I've used all three for my recommendation. […] But if this is an outlier, like I have right now, I use two. And that's the beauty of having three, to see if there is an outlier. So that's why I think it's useful to have more than two, but you don't have to give equal weight to all of them.[[11]](#footnote-11)

1. Mr. Parcell’s three methodologies are DCF, CAPM, and CE. His analysis under these methodologies produces results of 9.1 to 9.7 percent for DCF; 6.5 to 6.8 percent for CAPM; and 9.0 to 10.0 for CE.[[12]](#footnote-12) In his results, CAPM is an outlier, and accordingly his recommendation focuses on his DCF and CE results.
2. Public Counsel and ICNU take issue with Mr. Parcell’s focus on the highest DCF rates to develop his Discounted Cash Flow (DCF) results.[[13]](#footnote-13) As Mr. Parcell testified, however, he believes that it is appropriate to focus on the highest DCF results.[[14]](#footnote-14) This is a situation in which various experts review the same or similar data and derive different conclusions. In Mr. Parcell’s recent PacifiCorp testimony, he also focusses on the highest DCF results, but neither Public Counsel nor ICNU mentions this in their briefing.[[15]](#footnote-15) This indicates that, essentially, Public Counsel and ICNU disagree with Mr. Parcell’s DCF numbers, which happen to be higher than those of Public Counsel and ICNU in this proceeding.
3. Public Counsel and ICNU also criticize Mr. Parcell’s Comparable Earnings (CE) analysis. As Mr. Parcell explains, the CE method is derived from the corresponding risk concept discussed in the *Hope* and *Bluefield* cases.[[16]](#footnote-16) Mr. Parcell’s analysis under this method considers the experienced equity returns, the prospective returns, and the market-to-book ratio of the utilities in the proxy groups to derive the opportunity cost of investing in alternative investments of similar risk.[[17]](#footnote-17) Considering each of these elements, Mr. Parcell’s results under the CE methodology range from 8.3 percent to 10.3 percent applying historic returns, and from 8.7 to 10.4 percent applying prospective returns.[[18]](#footnote-18) From these results, Mr. Parcell estimates a reasonable CE range for PSE to be 9.0 to 10.0 percent.[[19]](#footnote-19)
4. Public Counsel opines that Mr. Parcell’s CE results are too high because Mr. Parcell uses the highest CE results and he uses CE results from proxy groups other than his own.[[20]](#footnote-20) ICNU contends that Mr. Parcell’s CE range is arbitrary and asserts that the Commission should reject Mr. Parcell’s CE analysis entirely and use it only as a cross-check of other methodologies.[[21]](#footnote-21) It is worth noting, at the outset, that ICNU’s cost of equity witness, Mr. Gorman, generally disfavors the CE methodology;[[22]](#footnote-22) accordingly ICNU’s position is unsurprising. ICNU posits that there is no ceiling to CE results, and that Mr. Parcell’s floor could be lower given that returns below the low end of Mr. Parcell’s range still could produce market-to-book ratios above 100 percent.[[23]](#footnote-23) ICNU’s criticism does not consider, however, that Mr. Parcell’s CE methodology also considers prospective returns. Mr. Parcell considered Value Line’s projected returns on equity for proxy group firms, which is information that is available to investors as indicators of prospective utility earnings.[[24]](#footnote-24) These projected returns in concert with market-to-book ratios provide market information that informs the analyst’s selection of a reasonable CE range. The analyst’s results are guided by this market information and are, thus, not arbitrary. Mr. Parcell analyzed this data to develop a CE range that, in his informed judgment, he believes is reasonable for PSE.

**D. The Issue of the Effect of Decoupling on Cost of Equity Was Not Remanded and Need Not Be Considered At This Time.**

1. Public Counsel contends that the Commission must consider the issue of the effect of decoupling on PSE’s cost of equity on remand.[[25]](#footnote-25) As Staff explained in its initial brief, the remand does not encompass this issue. Moreover, the Commission can evaluate and decide this issue, as originally planned in Order 07, once more data is in and all factors affecting risk are available for examination. This can all happen in PSE’s next general rate case.
2. Public Counsel argues that the Commission cannot legally set a return on equity unless that return includes a reduction associated with decoupling.[[26]](#footnote-26) Public Counsel, however, does not have credible authority for this position. The Commission’s policy statement on decoupling is not binding on the Commission, and Public Counsel has cited no litigated Commission decisions in which the Commission reduced a utility’s return on equity due to decoupling. In contrast, Mr. Cavanagh’s testimony showed that, in the majority of cases, public service commissions that considered the issue did not reduce the utility’s return on equity due to decoupling.[[27]](#footnote-27) The Commission has the authority to decide how to assess any effects of decoupling. Its legislative mandate to fix just, reasonable, and sufficient rates,[[28]](#footnote-28) affords the Commission a “fairly broad range . . . in selecting the appropriate ratemaking methodology.”[[29]](#footnote-29) Consistent with the Washington State Supreme Court’s favorable view of the “end results” test from the *Hope* case, the Commission must ensure under RCW 80.28.010 that a utility charges just, fair, reasonable and sufficient rates; but the Commission is not bound to approve or disapprove of a particular operating expense or approve or disapprove of a particular adjustment to a utility’s rate of return.[[30]](#footnote-30)
3. Public Counsel asserts that “[d]etermining a utility’s cost of capital as part of rate setting without consideration of a major change in its risk profile is a violation of . . . fundamental legal and economic principles.”[[31]](#footnote-31) Staff does not entirely disagree. The question is whether decoupling represents a “major change” or even a significant change in PSE’s risk profile. Stated another way, it is not clear that applying decoupling to the portion of PSE’s revenues subject to decoupling[[32]](#footnote-32) has any significant effect on PSE’s risk or that any effect is not offset by other factors. Decoupling smoothes revenue volatility for both customers and the utility, but this does not translate into a windfall for PSE’s owners. PSE does not receive more revenue or less revenue under decoupling than it otherwise would over time. Rather, PSE must continue its cost control efforts to actually earn its authorized return.
4. Given the history of this case, the testimony on file from Mr. Cavanagh, the emerging nature of this issue, and the Commission’s earlier decision to examine the effects of decoupling at a later date, it makes sense to fully examine decoupling effects in PSE’s next general rate case. It is not fair, at this juncture, to simply trim a few basis points from the return on equity, based on speculation that decoupling reduces risk in any sort of a numerically significant fashion. Finally, decoupling is perhaps best viewed as a rate design tool, a tool designed to provide the utility with an opportunity to achieve revenues from its authorized rates. Now that the Commission has granted PSE this tool, among other supportive regulatory mechanisms, it does not make sense to thwart the mechanism by reducing the utility’s equity return and thereby impairing the company’s opportunity to actually earn its authorized return.

**IV. CONCLUSION**

1. Staff takes umbrage at Public Counsel’s insinuations that Mr. Parcell did not conduct an independent analysis. In this remand, Staff has done what it always does: provide an expert and independent opinion. According to Staff’s analysis, prepared by Mr. Parcell, PSE’s cost of equity as of early 2013 lies at the midpoint of a range of reasonable equity returns from 9.0 to 10.0 percent. Fairness would be best served by reserving a review of the effects of decoupling on cost of capital until PSE’s next general rate case. Simply hacking off a few basis points from PSE’s return on equity now is not the deliberate and reasoned approach that Staff advocates and is not required by the remand or by law.

DATED this 20th day of March, 2015.

Respectfully submitted,

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1. Initial Brief of ICNU, p. 27. [↑](#footnote-ref-1)
2. Parcell, Exh. No. DCP-1T 10:1–3. [↑](#footnote-ref-2)
3. Parcell, Exh. No. DCP-17CX 17:11–13 (emphasis added). [↑](#footnote-ref-3)
4. Parcell, Exh. No. DCP-1T 11:17–12:13. [↑](#footnote-ref-4)
5. Initial Brief of Public Counsel, p. 27. [↑](#footnote-ref-5)
6. *Id.* at 28. [↑](#footnote-ref-6)
7. *Id.* at 28. [↑](#footnote-ref-7)
8. Parcell, TR. 601:15–604:3. [↑](#footnote-ref-8)
9. Parcell, TR. 603:9–14. [↑](#footnote-ref-9)
10. Initial Brief of Public Counsel at 25. [↑](#footnote-ref-10)
11. Parcell, TR. 659:10-12, 14–18. [↑](#footnote-ref-11)
12. Parcell, Exh. No. DCP-1T 27:14–17. [↑](#footnote-ref-12)
13. Initial brief of Public Counsel at 22–24; Initial Brief of ICNU at 25–26. [↑](#footnote-ref-13)
14. Parcell, Exh. No. DCP-1T 18:8–14. [↑](#footnote-ref-14)
15. Parcell, Exh. No. DCP-17CX 32:4–12. [↑](#footnote-ref-15)
16. Parcell, Exh. No. DCP-1T 22:18–20. [↑](#footnote-ref-16)
17. *Id.* at 22:20–23:4; 23:13–24:7. [↑](#footnote-ref-17)
18. *Id.* at 25:5–13. [↑](#footnote-ref-18)
19. *Id.* at 26:17–19. [↑](#footnote-ref-19)
20. Initial Brief of Public Counsel at 25. [↑](#footnote-ref-20)
21. Initial Brief of ICNU at 23–25. [↑](#footnote-ref-21)
22. Gorman, TR. 647:13–15. [↑](#footnote-ref-22)
23. Initial Brief of ICNU at 24. [↑](#footnote-ref-23)
24. *See* Parcell, Exh. No. DCP-10, p. 1. [↑](#footnote-ref-24)
25. Initial Brief of Public Counsel at 8. [↑](#footnote-ref-25)
26. *Id.* at 44. [↑](#footnote-ref-26)
27. Cavanagh, Exh. No. RCC-5, p. 14 (“As the table demonstrates, the large majority of decisions adopting decoupling make no ROE reduction”). [↑](#footnote-ref-27)
28. RCW 80.28.020. [↑](#footnote-ref-28)
29. *People’s Org. for Wash. Energy Res. v. Utils. & Transp. Comm’n*, 104 Wn.2d 798, 812 (1985). [↑](#footnote-ref-29)
30. *See id.* at 811–12, *citing Fed. Power Comm’n v. Hope Natural Gas Co.,* 320 U.S. 591, 605, 64 S. Ct. 281, 88 L. Ed. 333 (1944). [↑](#footnote-ref-30)
31. Initial Brief of Public Counsel at 44. [↑](#footnote-ref-31)
32. Decoupling applies only to delivery revenues. Schooley, Exh. No. TES-1T 16:18 (“The [revenue per customer] revenues are only for electric delivery revenues”); Exh. No. TES-1T 7:4-7 (“Power costs are excluded and . . . [p]roperty taxes are also removed”). [↑](#footnote-ref-32)