

Exhibit No. ____ T (TES-1T)
Dockets UE-111048/UG-111049
Witness: Thomas E. Schooley

BEFORE THE WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

DOCKET UE-111048
DOCKET UG-111049
(Consolidated)

TESTIMONY OF

THOMAS E. SCHOOLEY

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Introduction and General Policy

December 7, 2011

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Exhibit No. ____ (TES-2) Company Response to Staff Data Request 11, Docket UG-110723

1 I. INTRODUCTION

2

3 Q. Please state your name and business address.

4 A. My name is Thomas E. Schooley. My business address is The Richard Hemstad
5 Building, 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA
6 98504. My email address is tschoole@utc.wa.gov.

7

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

9 A. I am employed by the Washington Utilities and Transportation Commission
10 (“Commission”) as the Interim Assistant Director in the Energy Section of the
11 Regulatory Services Division. My responsibilities include direct supervision of the
12 Commission’s Regulatory Analysts who review tariff filings and other applications
13 of regulated electricity and natural gas companies, and make recommendations for
14 Commission decision on those filings and applications.

15

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

17 A. I have been employed with the Commission since September 1991.

18

19 Q. Please state your educational and professional background.

20 A. I received a Bachelor of Science degree from Central Washington University in
21 1986. I met the requirements for a double major in Accounting and Business
22 Administration-Finance. I also have a Bachelor of Science degree in geology from
23 the University of Michigan. I passed the Certified Public Accountant exam in May

1 1989. Since joining the Commission, I have attended several regulatory accounting
2 courses, including the summer session of the Institute of Public Utilities.

3 Before obtaining my current position, I held several other positions including
4 Accounting Manager of the Energy Section and Regulatory Analyst. I testified in
5 Docket UE-960195 involving the merger between Washington Natural Gas
6 Company and Puget Sound Power & Light Company ("Puget"). I was the lead Staff
7 analyst in several applications for accounting treatment, including Puget Sound
8 Energy, Inc. Dockets UE-971619 and UE-991918. I testified in the Avista general
9 rate case, Docket UE-991606, and Avista's energy recovery mechanism, Dockets
10 UE-000972, UE-010395, UE-011595, and UE-030751. I also assisted in the
11 development of Staff testimony in Puget's "PRAM 2" case, Docket UE-920630, and
12 I presented the Staff recommendation on environmental remediation in Puget Docket
13 UE-911476.

14 I analyzed PacifiCorp's proposed accounting treatment of Clean Air Act
15 allowances in Docket UE-940947, and participated in meetings of PacifiCorp's inter-
16 jurisdictional task force on allocations. I testified in PSE's power cost only rate case,
17 Docket UE-031725; PSE's general rate cases, Dockets UE-072300/UG-072301 and
18 UE-090704/UG-090705; and PacifiCorp's general rate cases, Dockets UE-032065,
19 UE-050684, UE-061546, *et al.*, and UE-100749.

20 I have prepared detailed statistical studies for use by commissioners and other
21 Commission employees, and have interpreted utility company reports to determine
22 their compliance with Commission regulations. I have also presented Staff
23 recommendations to the Commission in numerous open public meetings.

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II. SCOPE AND SUMMARY OF TESTIMONY

Q. What is the purpose of your testimony in this proceeding?

A. I summarize the Staff recommended revenue requirement increases for the electricity and natural gas operations of Puget Sound Energy, Inc. (“PSE” or the “Company”). I also describe the general policy direction of Staff’s case and introduce Staff’s other witnesses that support that policy direction and Staff’s specific recommendations on revenue requirements, including cost of capital, revenue allocation and rate design.

Q. Have you prepared any exhibits in support of your testimony?

A. Yes, I prepared the following exhibit in support of my testimony:

- Exhibit No. ____ (TES-2), Company Response to Staff Data Request 11, Docket UG-110723

III. DISCUSSION

Q. Please summarize the revenue requirement increases recommended by Staff for the Company’s electricity and natural gas operations.

A. Staff recommends that the Commission allow the Company to increase its annual revenues for electricity service by \$38.919 million (2.0 percent). Staff also recommends that the Commission allow PSE to increase its annual revenues for natural gas service by \$1.526 million (0.14 percent). These recommendations are based on an historical test year ending December 31, 2010, with appropriate restating

1 and pro forma adjustments that satisfy the “matching principle” of historical test
2 period ratemaking.¹

3 On the electricity side, Staff’s recommendation includes the addition of the
4 Lower Snake River Wind Project (“LSR Phase 1”), adjusted to reflect the rate base
5 level as known at October 31, 2011, and the Klamath Purchased Power Agreement.
6 Staff’s recommendation also includes costs deferred for LSR Phase 1 under RCW
7 80.80.060(6).

8 Staff’s recommended revenue requirement increases compare to the
9 Company’s proposals of approximately \$152.4 million for its electricity operations
10 and \$31.9 million for its natural gas operations.

11
12 **Q. What are the primary reasons for the difference between the proposals?**

13 A. The primary reasons for the difference between Staff and PSE revenue requirement
14 increase proposals are cost of capital (Staff recommends an overall cost of capital of
15 7.59 percent compared to the 8.42 percent that PSE requests) and power supply.
16 There are also significant differences related to the ratemaking treatment of:
17 1) federal income taxes; 2) storm damage; 3) rate case expense; 4) property taxes;
18 5) wages and benefits; 6) working capital; 7) power costs; 8) LSR Phase 1; and
19 9) regulatory assets and liabilities.

20

¹ "Restating actual adjustments" adjust the booked operating results for any defects or infirmities in actual recorded results that can distort test period earnings. Restating actual adjustments are also used to adjust from an as-recorded basis to a basis that is acceptable for rate making. WAC 480-07-510(3)(e)(ii) "Pro forma adjustments" give effect for the test period to all known and measurable changes that are not offset by other factors. WAC 480-07-510(3)(e)(iii).

1 **Q. Please describe the crux of PSE's presentation**

2 A. The Company's case for its electric operations is driven primarily by PSE's
3 investment in LSR Phase 1 plus the associated transmission. As a result, PSE is
4 seeking more than \$170 million in additional revenues using the overall cost of
5 capital PSE proposes for ratemaking purposes.² This amount is offset by reductions
6 in net power cost, but, none the less, LSR Phase 1 is the single largest factor driving
7 PSE's proposal for greater revenues.

8 The Company's case includes increases in other electric rate base.³ The
9 natural gas business also includes costs of new investments.⁴

10 Finally, it should be noted that PSE requests an increase in profits for its
11 entire rate base through a 10.80 percent return on equity compared to the 10.1
12 percent the Commission determined fair in the Company's last contested rate case.

13

14 **Q. Does PSE claim an inability to earn a sufficient return on its growing utility**
15 **investments?**

16 A. Yes. PSE raises this issue of attrition in the direct testimony of Mr. Gaines and Dr.
17 Olson who present and comment on comparisons of actual (per books) returns on
18 equity with "authorized" returns on equity.⁵

19

² The rate base increases for Adjustments 5.02 and 5.03 total \$798,249,674, and the decrease to net operating income is \$39,877,591. Exhibit No. ___ (JHS-4), page 4.02. Given the requested rate of return of 8.42 percent and the conversion factor, we derive the Company proposed increase in revenues of \$172,517,738 for LSR Phase 1.

³ Exhibit No. ___ (JHS-3), page 3.01.

⁴ Mr. Stranik's Exhibit No. ___ (MJS-3) compares the rate base total in the present case to that in the 2009 rate case, Docket UG-090705. He should more appropriately compare the present period to Docket UG-101644 which was based on a test year ending June 30, 2010 where the total rate base was \$1,593,833,326. The gas rate base increase since June 2010 is \$66,901,785.

⁵ Exhibit No. ___ (DEG-1T) at 23, Chart 1 and Exhibit No. ___ (CEO-1T) at 8:10-12 and 15-17.

1 **Q. What is Staff's view of PSE's claim of attrition caused by continued investments**
2 **in rate base?**

3 A. Staff recognizes that Washington regulated utilities are entitled to an opportunity to
4 earn a fair return on their prudent investments. Balanced with that interest is the
5 Commission's obligation to set rates, or prices, to be paid by customers that are fair,
6 just, and reasonable.

7 PSE and other utilities assert persistent under-earning and present ever more
8 creative ways to address claims of declining sales and regulatory lag. Staff is open
9 to new approaches, provided the utility adequately proves its claim of persistent
10 under-earning.

11

12 **Q. Has PSE adequately proven its claim of persistent under-earning?**

13 A. No. Mr. Elgin details this area of the Staff case. But, in general, the Company in its
14 direct case could have, but did not, provide an attrition study to determine whether,
15 and by how much, PSE is experiencing attrition due to its need to invest in new rate
16 base thereby denying it the opportunity to earn a fair rate of return during the rate
17 year. If an attrition study had been presented and had confirmed that situation,
18 additional revenues could have been proposed. PSE's presentation of actual versus
19 authorized returns on equity, however, is insufficient to support a claim of attrition.

20

21 **Q. Are there other means Staff would consider to address attrition, if adequately**
22 **proven?**

1 A. Yes. Again assuming adequate proof of attrition, Staff would consider proposals
2 using end-of-period rate base and/or including construction work in progress in rate
3 base. These methods are within the authority and precedent of the Commission.
4

5 **Q. Does the Company attribute its claim of under-earning to factors other than its**
6 **growing rate base?**

7 A. Yes. PSE also asserts that the Commission's current historical test-year ratemaking
8 practices, and resulting regulatory lag, cause its returns on equity to be consistently
9 less than what the Commission grants.⁶
10

11 **Q. Does Staff propose a way to address this complaint?**

12 A. Yes. Staff proposes expedited rate filings as a step toward addressing regulatory lag.
13 Once PSE receives a general rate order, it may file its next case based on the latest
14 Commission-basis Report and Staff will support a schedule that implements new
15 rates before the next heating season, if rate relief is warranted.⁷

16 The details of this proposal are presented by Mr. Elgin. However, I would
17 add that for the Commission-basis report to be useful for ratemaking purposes in the
18 expedited process Staff supports, the report will need certain limited modifications.
19 Examples include annualizing any rate increases instituted during or just after the
20 reporting period and including any new directives from the Commission. Staff also

⁶ Exhibit No. __ (CEO-1T) at 7:20-8:4.

⁷ The Commission-basis Report is an annual filing by each utility required by WAC 480-90-257 for natural gas companies and WAC 480-100-257 for electric companies. It depicts a utility's operations for the prior year with sales based on normal temperatures and power costs based on average hydroelectric conditions, but without annualized expenses or revenues. The results of operations must also include adjustments required by the Commission by order. The report must be filed by April 30 each year.

1 proposes holding certain expenses constant, such as the power cost adjustment
2 baseline, wages, and overall administrative and general expenses, to hold the
3 Company accountable for cost effective management decisions.

4
5 **Q. Will this expedited ratemaking process have any other benefits besides**
6 **alleviating regulatory lag, as Mr. Elgin describes?**

7 A. The expedited rate case process will also have the positive benefit of streamlining
8 rate making procedures for the Commission and all parties. Our recent experience of
9 repeated rate case filings by all regulated companies warrants a streamlined
10 approach, as I explain next.

11
12 **Q. What is PSE's recent history of general rate case filings?**

13 A. PSE has had a history of regular general rate cases for several years. General rate
14 cases were filed in 2004, 2006, 2007, 2009, 2010 (gas only), and now 2011. There
15 have also been power cost only rate cases in 2003, 2005, 2006, and 2007. A similar
16 general rate case pattern has been experienced with Avista and PacifiCorp. Staff
17 expects that all three companies will continue this pattern of regularly seeking rate
18 relief via general rate cases.

19
20 **Q. Does Staff have concerns about this situation that would be assisted through the**
21 **expedited rate case process?**

22 A. Yes. For Staff to effectively process almost annual rate cases from PSE, Avista and
23 PacifiCorp, along with all of the other types of filings and applications submitted by

1 all companies, we must find a more consistent, efficient approach to processing rate
2 cases. While each utility presents different challenges, it is, after all, the same
3 industry under the same regulatory and statutory environment. The public deserves a
4 less complex, more streamlined process.

5 The complexities of PSE's rate cases are particularly perplexing. PSE's
6 Power Cost Adjustment ("PCA") is a burdensome mechanism giving PSE a full
7 return of and on certain regulatory assets; recovery of the cost of lines-of-credit,
8 taxes, insurance, payroll; and a guaranteed rate of return on \$2 billion of rate base.
9 One-half of PSE's total rate base now receives a guaranteed return. PSE recovers all
10 PCA costs by updating the base line through frequent rate filings. The purpose of
11 the PCA -- to share the risk of power cost variation between ratepayers and the
12 Company -- is thwarted by this situation.

13 PSE's rate cases present other complications such as determining revenues
14 after removing many different tariff riders or offsets;⁸ multiple averaging methods
15 for administrative and general expenses; and projections of expenses into future
16 years.

17 On top of the constant rate case pressure, PSE continues to demand greater
18 attention by regularly filing petitions for approval of deferred accounting treatment,
19 which establish a voluminous range of regulatory assets and liabilities that must
20 eventually be addressed in rate cases. Exhibit No. ____ (TES-2) includes a data
21 request response from PSE in Docket UE-110723 listing all of the deferred
22 accounting treatments currently in effect for PSE.

⁸ These riders and offsets include Production Tax Credits, Merger Rate Credit, Tenaska Regulatory Asset Tracker, conservation program riders, low-income riders, municipal taxes, residential exchange, green power, and renewable energy credits.

1 Taken as a whole, PSE alone could occupy Staff's full attention. Add in the
2 requests from the other regulated energy companies and Staff is stretched thin to
3 make sure that each company filing gets the full review it deserves. I believe Staff is
4 successful in fulfilling its responsibilities for all companies and their customers, but
5 it is an increasingly difficult and challenging task.

6

7 **Q. Is there anything else that is noteworthy about PSE's operations?**

8 A. Yes. In spite of PSE's history of seeking greater revenues almost each year, the
9 Company continues to have difficulty collecting all monies due from its customers
10 under filed tariffs. Mr. Kouchi testifies to ongoing meter failures at PSE and its
11 continuing need to back bill customers for many months of energy use. While PSE
12 is meeting the requirements of a meter and billing performance plan from the 2007
13 general rate case, more must be done to make sure that PSE finds and fixes problem
14 meters with the goal of reducing the unacceptable number of excessively long back
15 bills. Mr. Kouchi provides a recommendation for this ongoing issue.

16

17 **Q. Does Staff propose any changes in processing the present general rate case?**

18 A. No. We have processed this rate case as we have in the past.

19

20 **Q. What does Staff expect in PSE's future rate filings?**

21 A. In its next general rate case, Staff expects PSE to present an attrition study if it
22 wishes to back up the claim that it does not have the opportunity to earn a sufficient

1 return. However, if PSE follows the path of an expedited rate case, Staff expects
2 PSE will see a direct positive impact on its earnings.

3 Staff also requests the Commission commence a separate proceeding to
4 review PSE's Power Cost Adjustment and Power Cost Only Rate Case mechanisms
5 for potential revisions. Company witness Aladin addresses the PCA and does not
6 recommend any specific changes to the mechanism. A separate proceeding, in
7 Staff's view, is the best way to address the subject, rather than this proceeding which
8 already has many complicated and probably contentious issues.

9

10 **Q. Please introduce Staff's other witnesses and the subjects each addresses.**

11 A. The following witnesses present testimony and exhibits for Staff:

- 12 • Roland Martin presents the electric revenue requirement based on his own
13 analysis of several ratemaking adjustments and the analysis of other Staff
14 witnesses. Mr. Martin also presents Staff's proposal for recovery of LSR Phase 1
15 costs deferred under RCW 80.80.060(6).
- 16 • Chris Mickelson presents the gas revenue requirement based on his own analysis
17 of several ratemaking adjustments and the analysis of other Staff witnesses. He
18 also presents Staff's recommended revenue allocation and rate design for the
19 Company's natural gas services.
- 20 • Deborah Reynolds presents the electric rate spread and rate design
21 recommendation of Staff. She also recommends that the Commission reject
22 PSE's proposed Conservation Savings Adjustment. Ms. Reynolds is responsible

1 for Staff's response to the Commission's Bench Request pertaining to full
2 decoupling.

- 3 • Ken Elgin presents Staff's cost of capital recommendation. He recommends an
4 overall rate of return of 7.59 percent based on an equity return of 9.5 percent and
5 a capital structure with 46 percent equity. Mr. Elgin also addresses PSE's claim
6 of attrition in the overall context of Commission practice and policy. He
7 sponsors Staff's recommendation for an optional, expedited form of rate making
8 to address Company concerns with regulatory lag.
- 9 • David Nightingale conducted a prudence review of PSE investments in LSR
10 Phase 1 and the Klamath Power Purchase Agreement. He finds the acquisitions
11 prudent under standards set by the Commission, which, for LSR Phase 1, also
12 take into account the Commission's recent Renewable Resources Policy
13 Statement in Docket UE-100849.
- 14 • Ralph Smith of Larkin & Associates provides testimony supporting Staff's
15 treatment of federal tax-related items, including tax accounting changes for
16 repairs deductions and retirements, bonus tax depreciation and net operating loss
17 carry-forwards, a debit balance for accrued federal income taxes payable, and the
18 Company's proposal to normalize the federal income tax treatment for
19 capitalized property taxes, injuries and damages, and bad debts.
- 20 • Alan Buckley presents Staff's adjustments for pro forma power costs during the
21 rate year. His adjustments, taken together, reduce the Company's rate year
22 power costs an estimated \$24 million. He expects a further reduction as rate year

1 forward gas prices continue to fall. He recommends that the Commission order
2 that update as part of the Company's compliance filing.

- 3 • Betty Erdahl proposes electricity and natural gas ratemaking adjustments for
4 expenses related to insurance, wages, and incentive plan.
- 5 • Rick Applegate proposes ratemaking adjustments for property tax expense, rate
6 case expense, Lower Snake River rate base, and electric storm damage expense.
- 7 • Roger Kouchi recommends that the Commission approve the Company's request
8 to eliminate permanently SQI 9: Disconnection Ratio. He also shows that the
9 Company's electric and natural gas back billing frequency and duration is
10 unacceptable. He proposes to address that deficiency by asking the Commission
11 to amend a meter and billing performance plan established in Docket UE-072300
12 by requiring the Company both to identify and repair problem meters within a
13 specific period of time.

14
15 **Q. Does this conclude your testimony?**

16 **A. Yes.**