BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, INC. Respondent.	DOCKET NO. UE-060266 DOCKET NO. UG-060267

REPLY BRIEF

OF PUBLIC COUNSEL

NOVEMBER 14, 2006

I. INTRODUCTION: PSE IS A SOUND UTILITY

1. PSE builds its case around the premise that it needs financial relief and its decoupling proposal, PCA modifications, and depreciation tracker are needed to reduce an "unnecessary, artificial and harmful misalignment between the interests of the Company and its customers."[1]

2. Public Counsel concurs with Commission Staff that PSE's utility operations are sound, and viewed in a positive light by the financial community.[2] Staff points out that PSE's test period return on equity (ROE) (for utility operations) is 10.03%, which they characterize as a "healthy return" achieved "despite warmer than normal weather and declining use per customer."[3] The Initial Brief of Commission Staff (Staff Brief) observes that "PSE enjoys 'strong customer growth,' which translates into greater earnings opportunities." [4]

3. Staff challenges PSE's assertions that its Gas Revenue Normalization Adjustment (GRNA) decoupling mechanism and the depreciation tracker are needed to provide the opportunity to earn its authorized rate of return by reducing regulatory lag. Staff accurately points out that "the Company has already benefited from numerous mechanisms to counter regulatory lag solely at ratepayer expense."[5] According to Staff witness Mr. Russell, the PGA insulates 69% of the Company's revenue requirement from the effects of weather.[6] Similarly, the PCA insulates 72% of PSE's electric revenue requirement, according to Staff.[7]

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[1] Initial Brief of Puget Sound Energy, Inc. (PSE Brief), ¶¶ 3, 5.
[2] Initial Brief of Staff (Staff Brief), ¶¶ 12-16).
[3] *Id.*, ¶ 14; (citation omitted).
[4] *Id.*, ¶ 16; (citing Exh. No. 459 at 6 and 18).
[5] *Id.*, ¶ 25.
[6] *Id.*, ¶ 26, (citing Exh. No. 521 at 23:9-11).
[7] *Id.*, ¶ 27.

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4. Like Public Counsel, Staff strongly opposes the depreciation tracker. Specifically, Staff contends that the Depreciation Tracker:

- Represents "inappropriate single issue ratemaking".[8]
- Violates the matching principle[9]
- Reduces management's incentive to pursue cost savings and efficiencies.[10]

These cogent arguments against the tracker can and should be applied with equal force to the decoupling mechanisms proposed by all of the parties in this case. Neither Staff nor any other proponent has explained convincingly why the analysis should be any different for decoupling. Staff points out that "[t]he Commission has diverged from traditional ratemaking, but only upon clear and convincing evidence that a utility will be denied any reasonable opportunity to earn its authorized rate of return without extraordinary relief."[11] As Staff itself has established, no such clear and convincing showing has been made here. To the contrary, the evidence of record shows financial health.

II. DECOUPLING

A. Reply To PSE.

1. PSE's proposal will not promote energy efficiency.

5. PSE's Brief continues the approach of tying decoupling to "the pursuit of energy efficiency and conservation programs."[12] PSE states that decoupling will "promote PSE's pursuit of energy efficiency,"[13] not just remove the asserted disincentive. Other than advocating

[8] *Id.*, ¶ 32.
[9] *Id.*, ¶ 34.
[10] *Id.*, ¶ 40-42.
[11] *Id.*, ¶ 36; n. 81.
[12] PSE Brief, ¶ 87.
[13] PSE Brief, ¶ 88.

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for inclusion of weather, the PSE Brief makes no mention of the fact that it recovers lost margins from a wide range of causes unrelated to PSE-sponsored energy efficiency programs.

6. PSE concedes, as it must, that it offers no incremental energy efficiency measures in return for approval of decoupling. Surprisingly, however, PSE continues to assert that it embodies all the elements the Commission has sought for decoupling proposals,[14] while simultaneously telling the Commission that when it comes to this key element, supposedly the rationale for this entire exercise, "[n]o such condition should be required or used to deny PSE a decoupling mechanism."[15]

2. PSE's claim of CRAG support for decoupling is unfounded.

7. PSE's Brief makes the claim that "The Conservation Resource Advisory Group "CRAG" has supported decoupling in large part because of PSE's history of supporting and promoting gas conservation programs despite the financial disincentive."[16] This assertion is supported by a reference to Ms. Steward's testimony. The cited transcript excerpts, however, are devoid of any reference to CRAG support. Ms. Steward stated only that she is "satisfied with how they [PSE] actively consult with their advisory group right now."[17] PSE has cited no evidence in this case about where the Conservation Resource Advisory Group stands on decoupling. This statement is a clear misrepresentation of the record. Indeed, it should be obvious from the record that several members of the CRAG who are parties to this case (Public Counsel, Staff, and NWEC) have differing views on this issue.

[14] *Id.*, ¶ 90.
[15] *Id.*, ¶ 92.
[16] *Id.*, n. 165, citing Steward Tr. 747:6-748:13; 767:9-768:5.
[17] Steward, Tr. 747:23-25.

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3. Fixed cost recovery is not at issue.

PSE also continues to make the argument that decoupling is necessary to allow it to better recover its fixed costs. While it offers theoretical argument on this point, it has not provided persuasive evidence that Commission ratemaking is denying it the opportunity to recover its costs. As discussed in the Introduction, the Company's utility operations are financially sound. There has been no showing of declining sales in total, only declining use per customer. The evidence shows that overall sales volumes are stable and that PSE conservation has had a very small impact on sales.[18] This case will result in an order setting revenues at a level that will allow PSE to recover its prudently incurred costs and the opportunity to earn a reasonable return.

B. Reply To Staff.

1. Promotion of energy efficiency is not a compelling reason to approve decoupling for PSE.

8. Staff again repeats the standard energy efficiency justification for decoupling as the leading "compelling" reason for the Commission to implement its proposal.[19]

> First, removing the disincentive of the utility to promote conservation will assist customers in coping with gas commodity costs that have increased over 50% since the Fall of 2003. A recent study suggests that accelerated energy efficiency and renewable energy investment in the Pacific Northwest may help reduce gas prices up to 38%. An evaluation of the Northwest Natural decoupling mechanism in Oregon suggests that decoupling encourages a corporate culture that fosters conservation."[20]

9. Staff has made it clear, however, that they do not expect PSE to conduct any incremental conservation efforts as part of the decoupling mechanism.[21] PSE already has a strong corporate

[18] Opening Brief of Public Counsel (Public Counsel Brief), ¶¶ 27-29; Exh. No. 506TC, p. 42:3-22 (Brosch).
[19] Staff Brief, ¶ 87.
[20] *Id*, ¶ 89.
[21] *See* evidence cited in Public Counsel Brief, ¶¶ 51-53.

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culture supporting long-term commitments to conservation. Staff acknowledged this in its Brief[22] and it is not seriously questioned by any party to the docket.

10. It is hard to see how decoupling would have assisted customers with the 50% increase in commodity costs since the Fall of 2003. The simulation of Staff's partial decoupling mechanism showed annual rate increases of about $8 million for residential customers, for a total increase of $24 million had the three-year pilot been in effect.[23] These rate increases would have been in addition to the commodity cost rate increases that Staff refers to above.

11. In addition, PSE is already stretching the limits of available natural gas energy efficiency.[24] PSE's conservation achievements are well in excess of those of Northwest Natural Gas in Oregon, even after Northwest Natural implemented a gas decoupling mechanism.[25]

2. Staff correctly opposes the inclusion of weather by PSE and NWEC.

12. Staff makes a strong case against the PSE and NWEC decoupling proposals on the ground that they include weather. Staff points out that, while this stabilizes revenue for PSE, it imposes an "unfair cost to ratepayers of increased bill volatility,"[26] and that NWEC is "wrong" to argue that volatility is reduced. The fact that 69% of the Company's gas revenues are already protected from the impact of weather under the PGA, and that customer and demand charges are also impacted by weather, further render the PSE and NWEC proposals unfair to ratepayers.[27]

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[22] Staff Brief, ¶ 116.
[23] Public Counsel Brief, ¶ 32.
[24] Public Counsel Brief, ¶¶ 41-43.
[25] Exh. No. 803, p.1 and Attachment A.
[26] Staff Brief, ¶ 96.
[27] *Id.*, ¶ 98.

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3. Staff's proposal does not effectively target the asserted public policy goal of decoupling.

13. Staff also correctly challenges the PSE and NWEC proposals because neither "targets specifically the public policy that underlies decoupling."[28] Public Counsel again agrees. The problem for Staff is that its own mechanism does only a marginally better job of targeting. Staff's Brief concedes that its mechanism also includes a list of factors having nothing to do with PSE-sponsored programs: price elasticity, improved building and appliance codes, and customer-financed conservation.[29] Staff argues that including the effects of weather "is irrelevant to the public policy of decoupling *to remove the disincentive for PSE to promote conservation.*"[30]

14. What Staff does not explain is how the inclusion in its own mechanism of the effects of price elasticity, building codes, appliance standards, or customer-financed conservation is relevant to the public policy of removing "the disincentive for PSE to promote conservation." Its only response to this fundamental flaw common to all the decoupling proposals, is to observe in a footnote that "[t]he Company is not an island."[31] The vague and speculative notion that directing large sums of money at the utility will perhaps lead it to take pro-conservation positions in future unspecified policy debates in unidentified venues is scant justification indeed for exposing ratepayers to a potential for surcharges of $8 million per year or more. Moreover, as we pointed out in our Opening Brief there is no evidence that PSE has been an active opponent of energy efficiency in the public policy arena.[32] On the contrary, Cal Shirley, PSE's Vice

[28] *Id.*, ¶ 93.
[29] *Id.*, ¶ 94.
[30] *Id.*, (emphasis added).
[31] *Id.*, n. 215.
[32] Public Counsel Brief, ¶ 35

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President for Energy Efficiency Services, testified at the hearing that PSE had advocated in support of energy efficiency.[33]

4. Staff's application of ratemaking principles is inconsistent.

15. Staff mischaracterizes Public Counsel witness Brosch's testimony as failing to acknowledge that growth has costs and asserting that shareholders retain all revenue from new growth."[34] Staff misunderstands the testimony and this criticism does not stand up to analysis. Mr. Brosch states clearly that growth creates both costs and revenues. His point is that the GRNA and other decoupling proposals favor shareholders by charging customers higher rates to make up for declining use, while ignoring the fact that margin revenues in total are growing due to customer growth.[35] In any event, the evidence in the case is that PSE has had stable overall sales and margins, indicating that customer growth has tended to offset declining use per customer.[36] In fact, Staff agrees with Mr. Brosch on the effects of growth, stating in the cost of capital portion of its Brief that "PSE enjoys 'strong customer growth' which translates into greater earnings opportunities."[37] Mr. Brosch makes this same point in the context of explaining how the decoupling proposals, contrary to fundamental tenets of balanced ratemaking, isolate only one area of declining revenues.[38]

16. In fact, Staff's Brief has done a good job of pointing out how PSE has failed to justify departure from fundamental ratemaking principles.[39] Staff points out that this Commission has

[33] Public Counsel Brief, ¶ 36.
[34] *Id.*, ¶ 90, n. 208.
[35] Exh. No. 506TC, p. 35:8-39:3 (Brosch).
[36] Public Counsel Brief, ¶¶ 23-26.
[37] Staff Brief, ¶ 16.
[38] Exh. No. 506TC, p. 18:15-19:2 (Brosch).
[39] *Id.*, ¶¶ 36-39; *See also*, Exh. No. 506TC, p. 19:3-13 (Brosch).

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only diverged from traditional ratemaking on convincing evidence that a utility will be denied a reasonable opportunity to earn its authorized rate of return without extraordinary relief. Staff finds no such evidence here. On the contrary, Staff points to PSE's increased retained earnings, healthy earnings, and unimpeded access to debt and equity capital as evidence of its sound financial position. Staff also notes that PSE has not provided adequate attrition studies or reliable financial forecasts. Staff cannot have it both ways. It may not reasonably argue that these criticisms are fatal to the depreciation tracker but not to the decoupling mechanism.

5. The impact on low-income customers is not sufficiently addressed.

17. Like the other parties advocating decoupling, Staff does not adequately respond to the issue of low-income impact, beyond referring to the low-income assistance component of the gas rate spread settlement.[40] First, there is no dispute that low-income assistance programs do not serve all potential eligible customers. Secondly, there is no data analysis in this record of the impact of decoupling on low-income customers. Third, Staff does not respond to the issue raised by Commission Oshie at hearing. In response to the Commissioner's questioning, both PSE and NWEC witnesses acknowledged that because low-income customers cannot afford to pursue conservation measures to the same extent as others, they are disproportionately burdened by a customer class rate increase from decoupling.[41] The reasonable conclusion to draw from this record is that decoupling will have a negative impact on low-income customers.

[40] *Id.*, ¶ 116.

[41] Public Counsel Brief, ¶ 54.

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C. Reply to NWEC.

18. NWEC's primary arguments have already been addressed in Public Counsel's Brief. However, NWEC makes a number of arguments that seem only loosely tethered to ratemaking fundamentals, so some additional response is warranted.

1. NWEC's cost of capital discussion is unclear.

19. NWEC makes much of the cost of capital reduction as a benefit to customers but seems uncertain and somewhat unconcerned about how the reduction really works. The Post-Hearing Brief of NW Energy Coalition (NWEC Brief) seems to be saying, based on Steve Hill's testimony, that $14 million in savings will be realized almost automatically, no matter whose ROE recommendation is approved.[42] Of course, this only happens if Mr. Hill's recommendation is adopted in the case, along with the rest of Staff's case. If Dr. Morin's recommendation is adopted, there will be a cost of capital increase, not a reduction. His recommended "reduction" still keeps ROE significantly above the current authorized level and would increase not decrease current rates.

20. NWEC suggests that the cost of capital "benefit would certainly be passed along to customers over time…or it could immediately be passed through to customers in this proceeding."[43] It is hard to tell what this means. Again, there will no savings passed along to customers unless a reduced ROE is reflected in rates set by the Commission. The Company will not voluntarily pass through ROE reductions it experiences, nor will the savings simply materialize on customer bills "over time."

[42] NWEC Brief, ¶¶ 7-8.
[43] NWEC Brief, ¶ 7.

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21. NWEC also makes the claim that "the $14 million cost of capital savings from the weather adjustment is more than sufficient to cover all of the Company's conservation costs."[44] As written, this seems to imply that $14 million of PSE's funds will be freed to pay for its conservation program costs. An ROE reduction for PSE, however, generates no funds for the Company but instead results in a revenue reduction to the Company. In addition, the costs of PSE's gas conservation programs are recovered from ratepayers through the DSM tariff rider. If this argument is meant as it is written, it reflects an unclear understanding of both cost of capital and of conservation costs recovery.

2. NWEC makes conflicting statements regarding the risk of a "windfall" from decoupling.

22. NWEC makes other claims that are quite untenable. It argues that "decoupling does not provide an unwarranted windfall to the company,"[45] even though the Coalition's own witness testified that both the PSE and NWEC proposals could create a windfall.[46] It is not clear from this statement whether NWEC believes that there is such a thing as a "warranted windfall" that the Company should receive to encourage energy conservation. If that is the position, Public Counsel strongly disagrees that this serves the interest of consumers or public policy. NWEC disputes Mr. Brosch's testimony that PSE would collect positive additional revenues from the GRNA, apparently on the basis that this is in "unproven assumption."[47] NWEC disregards the fact that the burden of proof is on PSE, or other proponents advocating a new mechanism that would increase revenues between rate cases that the financial results would be reasonable. After all, if there are no such revenue effects, there would be no reason for PSE to pursue decoupling.

[44] *Id.*, ¶ 9.
[45] *Id.*, ¶ 15.
[46] Public Counsel Brief, ¶ 30, citing Weiss, Tr. 683:12-23.

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Later in its Brief, NWEC recognizes the risk, warning that "[t]he Commission should not allow the Company to improve its profits due to this factor [recovery of declining margins] without providing customers immediate evidence that this extra cost will result in reduced bills through increased conservation spending by the Company."[48] There is no such evidence in this case.

3. NWEC is incorrect to argue that decoupling does not shift risk.

23. NWEC asserts that "decoupling does not shift utility risks to customers,"[49] which is a strange argument given that the Commission has expressly recognized that decoupling shifts risk.[50] Moreover, earlier in the same Brief, NWEC notes that "decoupling reduces the Company's risk of collecting its approved margins[.]"[51] and thereby generates $14 million in savings for ratepayers.

4. NWEC improperly dismisses the violation of the matching principle by decoupling.

24. Finally, NWEC argues that "decoupling does not significantly break the match between costs and revenues between rate cases."[52] Both Commission Staff and Public Counsel show clearly that decoupling violates the matching principle.[53] Certainly, NWEC may argue if it wishes that the benefits of decoupling outweigh the harm of violating the matching principle, but they do not convincingly argue that the matching principle is not affected. If, as NWEC argues, it is "virtually impossible for any other party to drag the utility in for a rate case,"[54] the last thing

[47] NWEC Brief, ¶ 15.
[48] NWEC Brief, ¶ 26.
[49] NWEC Brief, ¶¶ 17-18.
[50] See, e.g., *WUTC v. PacifiCorp*, Docket No. UE-050684, Order No. 04, ¶¶ 108-109 (PacifiCorp Order).
[51] NWEC Brief, ¶ 7.
[52] NWEC Brief, ¶¶ 19-20.
[53] Public Counsel Brief , ¶¶ 45-46; Staff Brief, ¶ 106. *See also* Staff Brief, ¶¶ 33-35 (matching principle violated by depreciation tracker)
[54] NWEC Brief, ¶ 20.

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this Commission should do is adopt a mechanism to increase revenues between rate cases that could clearly either cause or exacerbate an excess earnings problem.

5. NWEC implicitly acknowledges Staff's concern about multi-million dollar deferrals.

25. NWEC responds to Staff's criticism of including weather by implicitly conceding that problematic "multi-million dollar deferrals" could result but suggesting that this can be fixed by having PSE do monthly adjustments.[55] Notably, PSE itself makes no proposal to do such adjustments, and in fact touts the advantages of its single annual adjustment.[56] Nevertheless, NWEC recommends that the Commission approve the weather mechanism despite the flaws identified by Staff. NWEC hopes that the large deferral problem would be fixed later by encouraging the Company do determine whether its billing system can implement monthly adjustments. NWEC betrays little concern for the fact that it is the customers who will pay the price if this gamble fails.

26. NWEC attempts to find support for its decoupling proposal by providing an incomplete quotation from testimony of Michael Brosch at the hearing to the effect that a stand-alone weather adjustment has merit.[57] This excerpt omits Mr. Brosch's statement that there is no such adjustment before the Commission here and overlooks Mr. Brosch's statement expressly criticizing the decoupling proposals in this case, including those such as NWEC's that incorporate weather. Shortly after this cross-examination, on re-direct, Mr. Brosch discussed this point in significantly greater detail, describing the attributes of a weather normalization adjustment as contrasted with decoupling, pointing out that it is a "narrower scope adjustment

[55] *Id.*, ¶ 12-14.
[56] PSE Brief, ¶ 95
[57] NWEC Brief, ¶ 13; Brosch, Tr. 762:22-25.

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device than decoupling," that it is a revenue stability mechanism which has nothing to do with energy efficiency, and that fluctuations in weather are already taken into account in ratemaking through weather normalized sales volume in the test period.[58]

III. DEPRECIATION TRACKER

A. The Depreciation Tracker Has Not Been Justified.

27. Public Counsel's Brief addresses the main points made in the Company Brief. The proposal is improper single issue ratemaking, it violates the matching principle, and it is unsupported by adequate attrition studies. There is no evidence that PSE is being denied recovery of prudently incurred costs or that it will fail to make any necessary investments in infrastructure in the absence of this mechanism.[59]

B. PSE's Alternative "Known and Measurable" Adjustment Should Be Rejected.

28. Public Counsel agrees with the critique of PSE's alternative proposal in Staff's Brief.[60] The "known and measurable" adjustment is neither equitable nor balanced. It tortures test year matching in the same fashion as the depreciation tracker, but in an even worse fashion in that it also affects return on rate base. In essence, the alternative adjustment trades a one-time tracker-style piecemeal update to plant for the series of piecemeal tracker updates that were initially proposed by PSE. Matching is important because with the passage of time, customer/revenue growth creates new margin income to help "pay for" plant additions. Plant additions may also create operating efficiencies that were not fully reflected in test year O&M – another mismatch.

[58] Brosch, Tr. 675:8-677:21.
[59] Public Counsel Brief, ¶¶ 82-95.
[60] Staff Brief, ¶¶ 43-45.

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The PSE alternative is not what was proposed by FEA witness Smith.[61] Piecemeal updates to selected elements of the revenue requirement represent bad regulatory policy and the WUTC can expect utilities throughout the state to jump on the bandwagon and propose similar distortion of test year cutoffs in future proceedings if this door is opened for PSE.

IV. POWER COST ADJUSTMENT (PCA) MODIFICATIONS

A. The Joint Parties Support For The Current PCA Mechanism Is Based On A Broad Range Of Factors.

29. PSE asserts that the Joint Parties "comfort with the current PCA mechanism is based on outdated information" because of the reliance on credit agencies' favorable reaction in 2002.[62] This is an inaccurate characterization of Joint Parties' position. First, the Joint Parties have pointed not only to 2002 analyst reports, but also to the current analyst reports contained in Mr. Valdman's exhibits.[63] Second, and more important, a reading of the Brief and the joint testimony[64] clearly reflect that the "comfort level" with the current mechanism is based on a range of factors and analysis, including: (1) whether the PCA has worked as expected; (2) an comparison of the risk exposure under the current versus proposed PCA; (3) the current reactions of the financial community; (4) the effect of PSE's piecemeal changes in disturbing the negotiated balance in the original proposal (*e.g.*elimination of Exhibit E); (5) PSE's significantly improved financial position since the original PCA was adopted; and (6) an analysis of PSE's PCA exposure relative to earnings capacity for 2001 compared to 2005.[65]

[61] Staff Brief, ¶ 43, n. 97.
[62] PSE Brief, ¶ 11, n. 12.
[63] Public Counsel Brief, ¶¶ 109-110.
[64] Exh. No. 599 (Lazar, Shoenbeck, Mariam).
[65] Exh. No. 599, p. 27, Figure 7.

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B. The Rate Case Requirement In Paragraph 10 Of The Original Settlement Should Be Retained.

30. PSE's Brief states that "the Company proposes the elimination of paragraph 10 of the PCA mechanism and that no party has expressly objected to such revision.[66] Paragraph 10 essentially requires that a general rate case be filed following a PCORC, if the PCORC causes a rate increase. It provides:

> Further, if at any time after July 1, 2005 the Company shall file for a Power Cost Only review, and such filing shall result in an increase to general rates then in effect, the Company shall, within three (3) months of the effective date of any rate increase resulting from such Power Cost Only review, file a general rate case. Not more than one general rate case filing in any 12 month period shall be required to comply with this requirement.[67]

This appears to be the first express reference in the record of this case to the proposal to eliminate this paragraph, and should be denied on that ground alone. PSE's Brief cites Mr. Story's Exh. No. 428C (without page number) as the source of the proposal.[68] Exh. No. 428C contains the Company's proposed PCA. While it does appear that paragraph 10 is no longer incorporated in this proposed format, there is no reference to its elimination. Other provisions PSE proposes to remove such as Exhibit C and E are clearly marked. A review of Mr. Story's direct testimony under the heading "Proposed Changes to the PCA Mechanism" shows no reference to the removal of paragraph 10.[69] As the party with the burden of proof, PSE has the duty to provide notice to the Commission and other parties by clearly identifying and supporting its proposals in its direct testimony. This allows other parties to respond in testimony and at hearing. PSE has provided no testimony or evidence in support of the elimination of this

[66] PSE Brief, ¶ 13.
[67] Exh. No. 426.
[68] PSE Brief, ¶ 13, n. 16.
[69] Exh. No. 421, pp. 49-53 (Story).

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provision. PSE cannot remedy its failure to do so at this late date and the proposal should be denied for that reason.

31. The proposal should also fail on the merits. The provision is intended to insure that costs are trued up within a reasonable period of time after a PCORC-generated increase takes effect. The PCORC and PCA represent a compromise in which the parties negotiated and the Commission approved a single issue ratemaking mechanism so that PSE could recover certain power costs more quickly. It gets these dollars sooner, without the delay of a full rate case. Paragraph 10 is the quid pro quo. It provides for a general rate case to follow a PCORC so that any true-up of power costs that may be necessary can occur, as well as an earnings review. The PCA was not intended as a full waiver of this right of review.

32. PSE argues Paragraph 10 is not necessary because of the current frequency of rate cases. While it is technically correct that the current spate of PSE rate cases has avoided the need to apply this provision, the point of the provision is to ensure an opportunity to review earnings and true-up cost in times when PSE might otherwise not file. Elimination of paragraph 10 would effectively shift the burden of initiating rate and power cost true-up review to the Commission or other parties.

C. Power Cost Volatility Was Properly Taken Into Account By The Joint Parties.

33. PSE's Brief states that the Joint Parties "fail to acknowledge the extent of the power cost volatility cause by changes in hydroelectric conditions and temperatures."[70] This point is directly addressed and rebutted in Public Counsel's Brief, where Mr. Aladin's testimony is discussed, and the low probability of the catastrophic power cost spikes posited by PSE is explained.[71] Even

[70] PSE Brief, ¶ 18.
[71] Public Counsel Brief, ¶ 102.

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if power costs of $120 million do occur, it must be remembered that under both the current sharing bands and PSE's proposed modifications, 90% of the costs are borne by customers.[72] If costs exceed $120 million, again the current PCA allocates 95% of the costs to customers, just as the PSE proposal does.[73] As the joint testimony illustrates, even in a worst case scenario where power costs might spike by $200 million, PSE would still be making money because only 21 % of its earnings would be at risk.[74] In other words, even in that difficult environment, PSE would still earn almost 80 % of normal profit margins.

34. Although the PCA is designed to recover costs that are out of the Company's control, it bears remembering that the Company is a for-profit firm. Taking risk is a necessary element in inducing efficiency and fairness in the delivery of power. The Company can explore various avenues such as the use of various hedging strategies to reduce or smooth financial risk due to fluctuations in market price and weather. If PSE is not sheltering rate payers from risks that can be managed by efficient management, there is no basis for allowing PSE to earn returns that are much higher that the risk-free rate. It is PSE's willingness to take risk on behalf of ratepayers that justifies a request for a rate of return higher than the risk-free rate.

D. The Deadband Should Not Be Eliminated.

35. While advocating elimination of the current deadband, PSE's Brief makes no mention of the Commission's expression of support for the inclusion of a deadband in a PCA.[75] The Joint Parties oppose elimination. This simply shifts more risk to consumers and removes an incentive for the Company and its management to control power costs.

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[72] *See* Exh. No. 426, p.2 (current PCA) and Exh. No. 428, p. 1.
[73] *Id.*
[74] Exh. No. 599, p. 15, Figure 4.
[75] PacifiCorp Order, ¶ 96.

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E. Exhibit E Should Be Retained.

36. PSE's proposal to eliminate Exhibit E should be rejected as should the alternative suggestion of using actual contract rates.[76] PSE's criticisms miss the point of this provision. The provision intentionally "does not true-up costs."[77] Instead, it holds specific costs constant between general rate cases. Exhibit E is an integral part of the stipulation that resulted in the PCA. It holds some costs constant that the parties know are likely to rise (such as power supply contracts), precisely because there are other costs not tracked that parties know are likely to decline. Examples of the latter are depreciation on Colstrip and Transmission, which tend to decrease relative to revenues in between rate cases. Similarly, the revenue requirement per kWh for Colstrip and Transmission tends to decline over time because the rate base is being depreciated and kWh sales are increasing. Holding these items constant tends to offset the power contract costs that may tend to rise. PSE always has the right to file a general rate case if this balance is not working. Absent this delicate balance, the PCA would be nothing more than a structured rate increase, tracking power contract costs increases.

F. "Retention" Was A Factor For The Joint Parties In the Design of the Current PCA.

37. PSE's Brief challenges the Joint Parties' testimony that the current PCA was designed "so that Puget is at risk for only a portion of its power supply cost variations that result from weather or power market conditions. The amount of risk was designed to be only a fraction of the Company's 'retention' each year."[78] This concept was explained in detail in the joint testimony.[79]

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[76] PSE Brief, ¶ 32.
[77] *Id.*
[78] Exh. No. 599, p. 10:10-13 (Lazar, Schoenbeck, Mariam).
[79] *Id.*, p. 10:2-13:11.

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38. PSE argues that this was never a premise of the mechanism. The Joint Parties acknowledge that PSE did not accept the theory at the time of the original settlement and does not now. There was no need to memorialize the concept in testimony because it was not a part of the mechanics of the PCA. This does not change the fact that it was part of the thinking of the Joint Parties. While PSE says this view is "without support," it is supported by the sworn testimony in this case cited above. Public Counsel witness Jim Lazar was part of the original PCA negotiations and was on the original PCA settlement witness panel, as PSE's Brief points out. In this case, PSE had an opportunity to cross-examine Mr. Lazar on this point, or any aspect of the PCA, and chose not to do so.

V. OTHER ISSUES

39. Public Counsel adopts the Staff Reply Brief regarding the gas rate spread and rate design settlement. Public Counsel adopts the ICNU Reply Brief on power cost issues.

VI. CONCLUSION

40. For the foregoing reasons, and those set forth in our Opening Brief, Public Counsel respectfully requests that the Commission accept its recommendations in this case.

41. DATED this 14th day of November, 2006.

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