Sent Via Email and Federal Express

December 23, 2014

Simon ffitch
Senior Assistant Attorney General
Attorney General's Office
Public Counsel Division
800 5th Avenue, Suite 2000
Seattle, WA 98104-3188

RE: *In the Matter of the Petition of PUGET SOUND ENERGY, INC. and NW 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); and
WUTC v. Puget Sound Energy, Inc.
Dockets UE-130137 and UG-130138 (consolidated)
UTC Staff Supplemental Responses to Public Counsel Data Request Nos. 2 and 6

Dear Mr. ffitch:

Enclosed are Commission Staff's Supplemental Response and Attachment to Public Counsel Data Request No. 6. Also enclosed are supplemental attachments to Staff's prior Response to Public Counsel Data Request No. 2. Per your request, these supplemental attachments comprise the full testimonies containing the excerpts provided initially.

Sincerely,

JENNIFER CAMERON-RULKOWSKI
Assistant Attorney General

JCR/emd

Enclosures
cc: Melinda J. Davison, ICNU w/enc.
Tyler C. Pepple, ICNU w/enc.
Sheree S. Carson, PSE w/enc.
Stephen G. Hill w/enc. via Federal Express and Email

Please include Betsy DeMarco (bdemarco@utc.wa.gov) and Krista Gross (kgross@utc.wa.gov) on all data request and response email lists. Thank you.

CA-T-4
DOCKET NO. 2009-0163

DIRECT TESTIMONY AND EXHIBITS

OF

DAVID C. PARCELL

ON BEHALF OF
THE DIVISION OF CONSUMER ADVOCACY

SUBJECT: RATE OF RETURN

CA-T-4
DOCKET NO. 2009-0163

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1 prices. It would not be proper to disregard the lower CAPM results while not
2 discounting the higher DCF results.
3
4 XII. **IMPACT OF DECOUPLING MECHANISMS.**
5 Q. MECO IS PROPOSING A DECOUPLING MECHANISM. DOES THE
6 POTENTIAL APPROVAL OF THIS REGULATORY MECHANISM AFFECT
7 HECO'S RISK?
8 A. Yes, it does.
9
10 Q. PLEASE SUMMARIZE YOUR UNDERSTANDING OF THE NEW
11 REGULATORY MECHANISM THAT MECO IS PROPOSING IN A
12 PROCEEDING.
13 A. In Docket No. 2008-0274, HECO and the Consumer Advocate are jointly
14 proposed a decoupling mechanism for the Company. On March 30, 2009,
15 HECO and the Consumer Advocate issued a "Joint Proposal on Decoupling
16 and Statement of Position of the HECO Companies and Consumer Advocate."
17 According to this proposal, HECO will institute a sales decoupling mechanism,
18 which will be implemented through a Revenue Balancing Account ("RBA") and
19 Revenue Adjustment Mechanism ("RAM"). This proposal, according to the
20 March 30, 2009 joint statement, is intended to be consistent with the HCEI.
21 According to the Joint Decoupling Proposal, the purpose of the sales
22 decoupling mechanism is to remove the linkage between utility sales and

1 revenues, in order to encourage energy efficiency. In turn, the purpose of the
2 RAM is the "adjust revenues decoupled from sales to reflect changes in
3 revenue requirements between rate case[s], which should help maintain the
4 utility's financial integrity and ability to invest in infrastructure necessary to
5 meet Hawaii's 70% clean energy objective, while maintaining reliable service
6 to customers."[14]
7
8 Q. HAS THIS DECOUPLING MECHANISM BEEN APPROVED FOR HECO?
9 A. Yes, it has. In its Order filed on February 19, 2010, the Commission approved
10 the proposed decoupling mechanism set forth in the Joint Final Statement of
11 Position of the HECO Companies and the Consumer Advocate, filed on
12 May 11, 2009 (as amended).
13
14 Q. WHAT WILL BE THE EFFECT ON MECO'S PERCEIVED RISKS IF THIS
15 REGULATORY MECHANISM IS ALSO ADOPTED BY THIS COMPANY?
16 A. Due to the proposed decoupling mechanism that, not only decouples sales
17 from revenues, but also provides a rate adjustment mechanism that also
18 addresses other factors such as attrition, the effect will be to transfer a
19 significant portion of MECO's business risks from its stockholders to its
20 ratepayers. This will, in turn, reduce the cost of equity capital of MECO. In

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14 Joint Final Statement of Position filed by the HECO Companies and the Consumer Advocate filed on May 11, 2009 in Docket No. 2008-0274, at 2-3.

1 fact, it is conceivable that ultimately a combination of new regulatory
2 mechanisms, including the RBA, RAM, Clean Energy Infrastructure
3 Surcharges and a new Purchased Power Adjustment Clause could have the
4 effects of virtually guaranteeing that MECO would earn at or above its
5 authorized rate of return. This would have the effect of reducing the common
6 equity risk to approximately that of the cost of debt.
7
8 Q. HOW IS THE PROPOSED DECOUPLING RISK-REDUCING TO THE
9 COMPANY?
10 A. These rate design and deferral accounting proposals, and the resulting rate
11 adjustments if approved, are risk-reducing to MECO since the Company's
12 revenues and income will be essentially insulated from variations due to
13 usage, whether these variations are caused by conservation, economic
14 conditions, the weather or any other reasons. The net effect of this proposal is
15 to transfer a significant portion of the Company's operating risk from its
16 shareholders to its ratepayers. Yet, it does not appear that the Company
17 acknowledged this risk transfer in terms of its requested rate of return. I
18 understand that the other new cost tracking mechanisms under consideration
19 by the Commission that provide for Clean Energy Infrastructure Surcharges,
20 formulistic annual general rate increases pursuant to the RAM, and to pass
21 through Purchased Power costs will also serve to further shift operational risks
22 to customers.

1 Q. WHAT IS S&P'S ASSESSMENT OF THOSE DECOUPLING MECHANISMS?

2 A. This was expressed in a May, 2009 report on HECO by S&P, wherein it was
3 stated:

4-8 While our outlook reflects the concerns that consolidated operations face in the next two years, **the company may receive HPUC authorization to implement several regulatory mechanisms that could support credit quality as early as 2010.**

10-22 In October 2008, HEI's utilities signed an agreement to support the objectives of the state's Clean Energy Initiative (CEI). The agreement contemplates fundamental changes that would essentially move HECO and its subsidiary utilities away from a fully integrated electric utility dependent on petroleum to fuel 77% of its generation to a transmission and distribution company that would purchase future power requirements from third-party renewable developers and from its customers through distributed generation projects such as solar photovoltaics. **As part of the agreement, the utility would be permitted to introduce several key regulatory enhancements including:**

24-27
- **Decoupling revenues from electric sales**, which would result in HEI's utilities being able to recover in the following year any lost revenues due to lower than forecast sales;

29-38
- **Providing HECO and eventually HELCO and MECO with an annual revenue adjustment mechanism that would allow the company to annually reconcile actual to forecast O&M expenses and capital additions and would also look forward, resetting retail electric rates to reflect** expected expenses for the coming year. This would greatly reduce regulatory lag, which has resulted in the company earning poor, single-digit returns on equity since 2003;

40-41
- **Establishing a separate surcharge to allow the three utilities to pass through all reasonably**

1 **incurred purchases power costs**, including capacity
2 payments through its fuel and purchased power
3 adjustment mechanism that is already in place (This
4 change would result in a lower debt imputation for the
5 company's off-balance-sheet (OBS) obligations under
6 our power purchase criteria); and,
7
8 • **Creating surcharges to automatically collect the**
9 **costs of funding sizable planned energy efficiency**
10 **and renewable investment programs.**
11
12 A HECO decoupling mechanism is pending before the
13 HPUC as part of its settlement agreement. While the utility
14 may be allowed to track in a balancing account sales
15 declines for the last six months of 2009, it will not recover
16 any cash under collections until 2010. As a result, it does
17 not mitigate our near-term flow concerns from 2009. MECO
18 and HELCO are expected to seek decoupling mechanisms
19 in rate case applications that have not been filed. The
20 design of the revenue adjustment mechanism has yet to be
21 pending and at best are not likely to be implemented to
22 provide full year cash flow benefits to HEI's utilities until
23 2010 at the earliest, we view these proposed changes as
24 more long-run enhancements that short-term features that
25 will assist company in the next two years. **[Emphasis**
26 **added]**
27
28

29 Q. HOW CAN THIS REDUCTION IN COST OF CAPITAL BE MEASURED?

30 A. One method to measure the impact of the reduction in cost of equity resulting
31 from the potential adoption of these regulatory mechanisms is to quantify the
32 difference between the yields on bonds and preferred stock for alternative
33 bond ratings. I have made such a calculation on CA-415, which shows the
34 differential over the 2001 to 2010 period in yields between: (1) bonds with a
35 Baa and A rating; and, (2) preferred stocks with a Baa and an A rating. For
36 both series of securities, the average differential is about 0.3 percent,

1 or 30 basis points. It stands to reason that the differential in cost of equity
2 would be greater than 30 basis points, since common equity has a higher cost
3 rate.
4
5 Q. WHAT DIFFERENTIAL DO YOU BELIEVE IS PROPER TO REFLECT THE
6 IMPACT OF THE POTENTIAL APPROVAL OF THIS REGULATORY
7 MECHANISM FOR MECO?
8 A. I believe the mechanisms, if approved, would have the impact of lowering
9 MECO's cost of common equity to the low end of my cost of equity range.
10 This amounts to a 50 basis point reduction, which is justified by the above
11 analysis. Therefore, I specifically recommend a 50 basis point reduction in
12 MECO's cost of equity if the mechanisms are adopted and be included in the
13 Consumer Advocate's revenue requirement.
14
15 **XIII. <u>TOTAL COST OF CAPITAL</u>.**
16 Q. WHAT IS THE TOTAL COST OF CAPITAL FOR MECO?
17 A. CA-401 reflects the total cost of capital for the Company using the 2010 capital
18 structure and costs of long-term debt, short-term debt, hybrid securities,
19 preferred stock, and my common equity cost recommendations. The resulting
20 total cost of capital is a range of 7.86 percent to 8.43 percent. As I indicated in
21 the previous section of my testimony, I believe a 9.5 percent cost of equity,
22 rather than the 10.0 percent mid-point, should be used in connection with

1 MECO's decoupling mechanisms. A 9.5 percent cost of equity equates to
2 a 7.86 percent total cost of capital. I recommend that this 7.86 percent total
3 cost of capital be established for MECO.
4
5 Q. DOES YOUR COST OF CAPITAL RECOMMENDATION PROVIDE THE
6 COMPANY WITH A SUFFICIENT LEVEL OF EARNINGS TO MAINTAIN ITS
7 FINANCIAL INTEGRITY?
8 A. Yes, it does. CA-414 shows the pre-tax coverage that would result if MECO
9 earned my cost of capital recommendation. As the results indicate, my
10 recommended range would produce a coverage level within the benchmark
11 range for a BBB rated utility. In addition, the debt ratio (which reflects the
12 capital structure as proposed by the Company) is within that benchmark for a
13 BBB rated utility.
14
15 **XIV. <u>COMMENTS ON COMPANY TESTIMONY.</u>**
16 Q. HAVE YOU REVIEWED THE TESTIMONY OF MECO WITNESS ROGER
17 MORIN?
18 A. Yes, I have.
19

CA-T-4
DOCKET NO. 2009-0164

DIRECT TESTIMONY AND EXHIBITS

OF

DAVID C. PARCELL

ON BEHALF OF
THE DIVISION OF CONSUMER ADVOCACY

SUBJECT: RATE OF RETURN

CA-T-4
DOCKET NO. 2009-0164

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1 prices. It would not be proper to disregard the lower CAPM results while not
2 discounting the higher DCF results.
3
4 **XII. <u>IMPACT OF DECOUPLING MECHANISMS.</u>**

5 Q. HELCO IS PROPOSING A DECOUPLING MECHANISM. DOES THE
6 POTENTIAL APPROVAL OF THIS REGULATORY MECHANISM AFFECT
7 HELCO'S RISK?
8 A. Yes, it does.
9
10 Q. PLEASE SUMMARIZE YOUR UNDERSTANDING OF THE NEW
11 REGULATORY MECHANISM THAT HELCO IS PROPOSING IN A
12 PROCEEDING.
13 A. In Docket No. 2008-0274, the HECO Companies and the Consumer Advocate
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21 be consistent with the HCEI.

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3 revenues, in order to encourage energy efficiency. In turn, the purpose of the
4 RAM is the "adjust revenues decoupled from sales to reflect changes in
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11 COMPANIES?
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13 the proposed decoupling mechanism set forth in the Joint Final Statement of
14 Position of the HECO Companies and the Consumer Advocate, filed
15 on May 11, 2009 (as amended).
16
17 Q. WHAT WILL BE THE EFFECT ON HELCO'S PERCEIVED RISKS IF THIS
18 REGULATORY MECHANISM IS ALSO ADOPTED BY THIS COMPANY?
19 A. The proposed decoupling mechanism not only decouples sales from
20 revenues, but also provides a rate adjustment mechanism that also addresses

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1 other factors such as attrition. The effect will be to transfer a significant
2 portion of HELCO's business risks from its stockholders to its ratepayers. This
3 will, in turn, reduce the cost of equity capital of HELCO. In fact, it is
4 conceivable that ultimately a combination of new regulatory mechanisms,
5 including the RBA, RAM, Clean Energy Infrastructure Surcharges and a new
6 Purchased Power Adjustment Clause could have the effects of virtually
7 guaranteeing that HELCO would earn at or above its authorized rate of return.
8 This would have the effect of reducing the common equity risk to
9 approximately that of the cost of debt.
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11 Q. HOW DOES THE PROPOSED DECOUPLING MECHANISM REDUCE THE
12 COMPANY'S RISK?
13 A. These rate design and deferral accounting proposals, and the resulting rate
14 adjustments if approved, are risk-reducing to HELCO since the Company's
15 revenues and income will be essentially insulated from variations due to
16 usage, whether these variations are caused by conservation, economic
17 conditions, the weather or any other reasons. The net effect of this proposal is
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19 shareholders to its ratepayers. Yet, it does not appear that the Company
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11 **regulatory mechanisms that could support credit quality as**
12 **early as 2010**.
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14 In October 2008, HEI's utilities signed an agreement to support
15 the objectives of the state's Clean Energy Initiative (CEI). The
16 agreement contemplates fundamental changes that would
17 essentially move HECO and its subsidiary utilities away from a
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19 fuel 77% of its generation to a transmission and distribution
20 company that would purchase future power requirements from
21 third-party renewable developers and from its customers
22 through distributed generation projects such as solar
23 photovoltaics. **As part of the agreement, the utility would be**
24 **permitted to introduce several key regulatory**
25 **enhancements including:**
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27 • **Decoupling revenues from electric sales**, which would
28 result in HEI's utilities being able to recover in the
29 following year any lost revenues due to lower than
30 forecast sales;
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32 • **Providing HECO and eventually HELCO and MECO**
33 **with an annual revenue adjustment mechanism that**
34 **would allow the company to annually reconcile**
35 **actual to forecast O&M expenses and capital**
36 **additions and would also look forward, resetting**
37 **retail electric rates to reflect** expected expenses for the

1 coming year. This would greatly reduce regulatory lag,
2 which has resulted in the company earning poor,
3 single-digit returns on equity since 2003;
4
5 • **Establishing a separate surcharge to allow the three**
6 **utilities to pass through all reasonably incurred**
7 **purchases power costs**, including capacity payments
8 through its fuel and purchased power adjustment
9 mechanism that is already in place (This change would
10 result in a lower debt imputation for the company's
11 off-balance-sheet (OBS) obligations under our power
12 purchase criteria); and,
13
14 • **Creating surcharges to automatically collect the**
15 **costs of funding sizable planned energy efficiency**
16 **and renewable investment programs.**
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18 A HECO decoupling mechanism is pending before the HPUC as
19 part of its settlement agreement. While the utility may be
20 allowed to track in a balancing account sales declines for the
21 last six months of 2009, it will not recover any cash under
22 collections until 2010. As a result, it does not mitigate our
23 near-term flow concerns from 2009. MECO and HELCO are
24 expected to seek decoupling mechanisms in rate case
25 applications that have not been filed. The design of the revenue
26 adjustment mechanism has yet to be pending and at best are
27 not likely to be implemented to provide full year cash flow
28 benefits to HEI's utilities until 2010 at the earliest, we view these
29 proposed changes as more long-run enhancements that
30 short-term features that will assist company in the next two
31 years. (Emphasis added)
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33

34 Q. HOW CAN THIS REDUCTION IN COST OF CAPITAL BE MEASURED?

35 A. One method to measure the impact of the reduction in cost of equity resulting
36 from the potential adoption of these regulatory mechanisms is to quantify the
37 difference between the yields on bonds and preferred stock for alternative
38 bond ratings. I have made such a calculation on CA-415, which shows the

1 differential over the 2001 to 2010 period in yields between: (1) bonds with a
2 Baa and A rating; and (2) preferred stocks with a Baa and an A rating. For
3 both series of securities, the average differential is about 0.4 percent,
4 or 40 basis points. It stands to reason that the differential in cost of equity
5 would be greater than 30 basis points, since common equity has a higher cost
6 rate.
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8 Q. WHAT DIFFERENTIAL DO YOU BELIEVE IS PROPER TO REFLECT THE
9 IMPACT OF THE POTENTIAL APPROVAL OF THIS REGULATORY
10 MECHANISM FOR HELCO?
11 A. I believe the mechanisms, if approved, would have the impact of lowering
12 MECO's cost of common equity to the low end of my cost of equity range.
13 This amounts to a 50 basis point reduction, which is justified by the above
14 analysis. Therefore, I specifically recommend a 50 basis point reduction in
15 HELCO's cost of equity if the mechanisms are adopted and be included in the
16 Consumer Advocate's revenue requirement.
17
18 **XIII. <u>TOTAL COST OF CAPITAL</u>.**
19 Q. WHAT IS THE TOTAL COST OF CAPITAL FOR HELCO?
20 A. CA-401 reflects the total cost of capital for the Company using the 2010 capital
21 structure and costs of long-term debt, short-term debt, hybrid securities,
22 preferred stock, and my common equity cost recommendations. The resulting

1 total cost of capital is a range of 8.03 percent to 8.87 percent. As I indicated in
2 the previous section of my testimony, I believe a 9.5 percent cost of equity,
3 rather than the 10.0 percent mid-point, should be used in connection with
4 HELCO's decoupling mechanisms. A 9.5 percent cost of equity equates to
5 a 7.86 percent total cost of capital. I recommend that this 8.03 percent total
6 cost of capital be established for HELCO.
7
8 Q. DOES YOUR COST OF CAPITAL RECOMMENDATION PROVIDE THE
9 COMPANY WITH A SUFFICIENT LEVEL OF EARNINGS TO MAINTAIN ITS
10 FINANCIAL INTEGRITY?
11 A. Yes, it does. CA-414 shows the pre-tax coverage that would result if HELCO
12 earned my cost of capital recommendation. As the results indicate, my
13 recommended range would produce a coverage level within the benchmark
14 range for a BBB rated utility. In addition, the debt ratio (which reflects the
15 capital structure as proposed by the Company) is within that benchmark for a
16 BBB rated utility.
17
18 **XIV. COMMENTS ON COMPANY TESTIMONY.**
19 Q. HAVE YOU REVIEWED THE TESTIMONY OF HELCO WITNESS ROGER
20 MORIN?
21 A. Yes, I have.