

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 COMMISSION STAFF

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I. INTRODUCTION

1 Commission Staff and Puget Sound Energy, Inc. (“PSE” or “the Company”) agree that the ultimate legal issue in this case is whether the rates and charges it proposes are “just, fair, reasonable and sufficient.”¹ The Company alone bears the burden to prove that its proposals meet that standard.² PSE’s burden is not one of merely coming forward with the evidence. It is a burden of persuasion that extends to each element by which the Company seeks to justify an increase in rates.³

2 Through an exhaustive examination of the evidence, underlying public policy, and ratemaking implications, Staff’s Initial Brief demonstrates that PSE violates its burden of proof through proposals that sharply favor the interests of investors over the interests of ratepayers.⁴ For example, the Company uses the returns of other utilities to increase its authorized rate of return above current investor expectations, rather than reducing that return in order to give ratepayers the benefit of historically low capital costs.

3 The Company seeks to require ratepayers to further guarantee cost recovery through additional mechanisms such as a Depreciation Tracker, even though utility earnings are healthy and the PSE’s access to equity and debt capital on reasonable terms is unimpeded.

4 The Company asks to revise a Power Cost Adjustment mechanism that already stabilizes earnings for shareholders, where such revisions would shift the risk of power cost variations onto ratepayers without providing corresponding benefits of lower capital costs.

¹ Staff Initial Br. at ¶4 and PSE Initial Br. at ¶¶6-7.

² RCW 80.04.130(4).

³ Tegland, Karl B., Washington Practice, Vol. 3, §301.2 (4th Ed. 1999).

⁴ Staff’s Initial Brief addressed the vast majority of arguments raised by PSE and other parties on contested issues. Thus, lack of repetition here should not be construed as agreement with another party on those issues.

5 While the Company is correct to oppose Public Counsel by seeking to align
ratemaking with public policy that supports natural gas conservation, PSE proposes a
decoupling mechanism that includes the impacts of weather, which will stabilize revenue for
PSE, but increase bill volatility for ratepayers.

6 The proposals of Commission Staff correct all of the deficiencies inherent to the
Company's requested relief. Staff's proposals balance properly the interests of ratepayers
and investors as required by law and are fully supported by the evidence.

II. ARGUMENT

A. The Company Improperly Places Shareholder Interests Above Ratepayer Interests

7 In its Initial Brief, Staff dealt head-on with the Company's fundamental allegation at
hearing that the rate of return and new regulatory mechanisms it seeks will "likely" improve
PSE's corporate credit rating and "better enable" the Company to invest in utility
infrastructure, acquire new generation resources, and engage in energy risk management
activities.⁵ That discussion shows that PSE already maintains favorable access to financial
markets to support its utility operations.⁶ Indeed, the Company admits that its corporate
credit matrices improve both without rate relief of any kind and under the Staff case.⁷ PSE
did not quantify benefits for ratepayers from the cost of capital and new regulatory
mechanisms it proposes.⁸

8 The Company's Initial Brief is silent on these matters. Rather, PSE argues that the
traditional methods employed by the Commission have resulted in a "harmful
misalignment" of Company and ratepayer interests through the "chronic under-recovery of

⁵ Exhibit No. 131C at 2:15 (Gaines) and Exhibit No. 171 at 7:5 (Harris).

⁶ Staff Initial Br. at ¶¶12-24.

⁷ Staff Initial Br. at ¶8, citing, Exhibit No. 10 and Exhibit No. 131C at 15-17 (Gaines).

⁸ Staff Initial Br. at ¶9, citing, Tr. 425:7-426:25 (Gaines).

the levels of revenues and rates of return on equity that the Commission has authorized.”⁹

The argument ignores Staff’s gas decoupling mechanism, which will restore revenues to authorized levels that PSE loses to customer conservation.

9 The Company also overlooks the fact that its earned return on equity for its utility operations during the test period was a healthy 10.03% despite warmer than normal weather and declining gas sales.¹⁰ Any reduction in that return is the result of unregulated operations and regulatory disallowances. It is not the responsibility of ratepayers to compensate PSE for those items. That responsibility lies solely with the Company and its shareholders.

10 The Company is correct that it is entitled to the opportunity to earn a rate of return sufficient to maintain its financial integrity, attract capital on reasonable terms, and receive a return commensurate with other enterprises of comparable risk.¹¹ However, PSE ignores that fact that that opportunity is not a guarantee of profitability. Rather, it presumes an “efficient and economical management” that will control operating expenses and effectively allocate resources between capital investments in order to maximize earnings between rate cases.¹²

11 The Company’s proposals for a Depreciation Tracker, revised PCA and decoupling mechanism guarantee cost recovery for PSE and eliminate PSE’s incentive under existing ratemaking approaches to operate the utility under efficient and prudent management. Thus,

⁹ PSE Initial Br. at ¶¶5 and 7.

¹⁰ Exhibit No. 5, Staff Response to Bench Request No. 1.

¹¹ PSE Initial Br. at ¶52, citing, *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Bluefield Water Works Improvement Co. v. Public Serv. Comm’n of West Virginia*, 262 U.S. 679 (1923).

¹² *Bluefield Water Works Improvement Co. v. Public Serv. Comm’n of West Virginia*, 262 U.S. at 692 (1923).

the Company's proposals overwhelmingly favor investors over ratepayers in violation of all legal requirements.¹³

B. The Commission Should Reject The Cost of Capital Proposed By PSE

1. The Company failed to prove that a capital structure with 45% equity balances properly safety and economy

12 Staff recommends a capital structure that contains 43% common equity. Its Initial Brief demonstrated that its proposal properly balances safety and economy because it is the mid-point of PSE's actual capitalization over the recent past and its projected capital structure for the 2007 rate year. The 45% equity ratio requested by PSE is much higher than the combination gas and electric utility industry in general (42%) and combination utilities with a similar bond rating as the Company in particular (38%).¹⁴

13 PSE claims that no party argued that its proposed capital structure fails to strike an appropriate balance between safety and economy.¹⁵ The burden of proof, however, does not obligate Staff to make that demonstration. The burden of proof obligates only PSE to show that its proposed capital structure appropriately strikes that balance. The Company did not satisfy that burden. Its proposed capital structure would unnecessarily cost ratepayers an additional \$22 million per year with no showing of offsetting benefits.¹⁶

¹³ The Company's failure to understand fully the existing ratemaking framework is evidenced by its reliance on *People's Org. for Wash. Energy Res. v. WUTC*, 104 Wn. 2d 798 (1985). (See, PSE Initial Br. at ¶7.) Contrary to PSE's argument, Commission disallowance of an operating expense from an historical test period has no impact on the Company's actual earned rate of return for the test period. Nor does it mean that PSE's future rate of return will be lower than its authorized rate of return. Rather, disallowance of an operating expense places the Company on notice to eliminate or control that expense going forward in order to preserve its ability to earn its authorized rate of return.

¹⁴ Staff Initial Br. at ¶84.

¹⁵ PSE Initial Br. at ¶47.

¹⁶ Staff Initial Br. at ¶83.

14 PSE argues that Staff failed to recognize equity infused by Puget Energy during the past year.¹⁷ The Company, however, fails to acknowledge that its equity ratio languished at 40% through most of the test year in this case even though, in the 2004 general rate case, PSE projected that it would be capitalized with 45% equity during the same time period.¹⁸ The Company also fails to acknowledge that it expects its equity ratio to decline at the beginning of the rate year below the 45% level it requests in this case.¹⁹

15 Simply stated, the Commission should not require ratepayers to compensate PSE for equity the Company has not demonstrated it will achieve during the rate year and for which the Company has not quantified benefits for ratepayers. The Commission should, instead, adopt a capital structure around which PSE's actual capitalization will likely fluctuate. That capital structure includes 43% common equity, as proposed by Staff.

2. The Company failed to prove that an 11.25% cost of equity capital reflects current investor return expectations and PSE's lower risk profile

16 Staff recommends a rate of return on equity capital of 9.375%. Its Initial Brief demonstrated that this cost rate meets all legal requirements by improving the Company's financial soundness and by allowing PSE to attract necessary capital on reasonable terms.²⁰ A 9.375% equity cost is supported not only by a Discounted Cash Flow analysis that the Commission has held to be the most reliable and accurate measure of the cost of equity.²¹ Staff's recommendation is also supported by substantial market evidence not based on the subjective opinion of experts.²² These demonstrations also prove that PSE's 11.25% cost of

¹⁷ PSE Initial Br. at ¶48.

¹⁸ Exhibit No. 531C at 34:3-11 (Hill). *See also, WUTC v. Puget Sound Energy, Inc.*, Order No. 06 at ¶33, Docket Nos. UG-040640, *et al.*, (February 18, 2005).

¹⁹ Exhibit No. 136C at 2, column (B). (Gaines).

²⁰ Staff Initial Br. at ¶¶49-51.

²¹ Staff Initial Br. at ¶55.

²² Staff Initial Br. at ¶¶55-58.

equity capital is grossly overstated.²³

17 Indeed, the Company admits that capital costs are at “near all time lows” with “market conditions [that] have been attractive.”²⁴ It also admits that the new regulatory mechanisms it proposes would lower risk and lower the cost of capital.²⁵ Yet, PSE inexplicably requests a return on equity more than 200 basis points higher than the return it expects to earn on its own equity investments.²⁶

18 Rather than acknowledging these inconsistencies, the Company only challenges technical aspects of Mr. Hill’s DCF analysis and corroborating CAPM study. Each of these challenges mischaracterizes Mr. Hill’s testimony and should be rejected by the Commission.

a. The Company’s challenges to Mr. Hill’s DCF analysis lack merit.

19 First, PSE alleges that Mr. Hill “exclusively relies on the sustainable growth method” to determine the growth component of his DCF analysis.²⁷ PSE is wrong. Mr. Hill explained that he analyzed published data regarding growth rates in dividends, earnings and book value, in addition to sustainable growth rates.²⁸ His analysis was fully documented and demonstrated that his growth rate estimates are reasonable.²⁹

20 Second, PSE argues that Mr. Hill’s DCF result is understated because he relied on end-of-period Value Line forecasts.³⁰ However, Mr. Hill explained that only his internal (“b x r”) growth rates are based on end-of-period data published by Value Line.³¹ He relied on many other growth rate indicators besides that one measure.

²³ Staff Initial Br. at ¶¶59-69.

²⁴ Exhibit No. 457C at 7:6 (Valdman) and Tr. 283:11-12 (Valdman).

²⁵ PSE Initial Br. at ¶57.

²⁶ Exhibit No. 221 at 2 and 75 and Exhibit No. 531C at 49:11-50:19 (Hill).

²⁷ PSE Initial Br. at ¶61.

²⁸ Exhibit No. 531C at 40:7-18 (Hill).

²⁹ Exhibit No. 531C at 46:13-47:19 (Hill) and Exhibit No. 534 (Hill).

³⁰ PSE Initial Br. at ¶62.

³¹ Exhibit No. 531C at 45:9-46:11 (Hill) and Exhibit Nos. 534 and 541 at 1 and 3 (Hill).

21 Moreover, a review of Mr. Hill's recommended growth rates reveals that they are based primarily on projected information.³² In that regard, the Value Line data are based on a three- to five-year projection and, therefore, are not tied to any particular period and do not suffer the infirmities attributed by the Company. Mr. Hill's DCF growth rates compare favorably with other published projected growth rates available to investors and, therefore, provide a reasonable basis for determining an appropriate DCF cost of equity.

22 Finally, PSE argues that Mr. Hill "assumes" that his DCF sample companies will actually earn a return on equity above their cost of capital.³³ Mr. Hill made no such assumption. Rather, Mr. Hill merely acknowledged the undisputed reality that the current market price of utility stocks is well above book value.³⁴ Thus, utilities are, *in fact*, earning returns above the return required by investors, which is a utility's cost of capital.

b. The Company's challenges to Mr. Hill's CAPM analysis lack merit.

23 PSE's challenges to Mr. Hill's CAPM analysis are also misplaced. The Company accuses Mr. Hill of using the yield on 90-day Treasury Bills as a proxy for the risk free rate.³⁵ Again, PSE is wrong. Mr. Hill acknowledged the problems with using Treasury Bills for that purpose. Thus, he relied upon long-term Treasury bonds instead.³⁶

24 PSE challenges Mr. Hill's selection of beta for his CAPM analysis.³⁷ However, beta coefficients are quite volatile and they change from time to time. Absent recasting the entire cost of capital study, it is improper to single out any component of one particular method in order to draw any conclusions. Betas may have increased slightly since Staff filed its

³² Exhibit No. 531C at 46:13-47:19 (Hill) and Exhibit Nos. 534 and 541 at 2 and 4 (Hill).

³³ PSE Initial Br. at ¶63.

³⁴ Exhibit No. 531C at 53:13-20 (Hill).

³⁵ PSE Initial Br. at ¶66.

³⁶ Exhibit No. 535 at 4-5 (Hill).

³⁷ PSE Initial Br. at ¶68.

testimony, but interest rates have recently declined. Therefore, it is not clear that that one factor has any impact on the cost of capital. Besides, as Staff has demonstrated, CAPM suffers many flaws and should not provide a primary indication of the return to be allowed in this proceeding.³⁸

25 The Company states that a long-term arithmetic mean market risk premium of 7.5% is appropriate rather than the 6.5% used by Mr. Hill and published by Ibbotson Associates.³⁹ This position illustrates clearly PSE's bias to overstate its cost of equity results. A 7.5% arithmetic mean market risk premium is at the upper end of a range (5-8%) that Dr. Morin himself believes is reasonable based on his own published review of recent relevant research.⁴⁰ In contrast, Staff's 6.5% market risk premium is the mid-point of that range.

26 PSE challenges Mr. Hill's use of the geometric average market risk premium of 4.9% published by Ibbotson Associates.⁴¹ The geometric means, however, are equally available to investors, are published by the same source (Ibbotson) as the arithmetic means, and, therefore, should be considered since they are reflected in market prices. Moreover, a 4.9% geometric market risk premium is virtually identical to the 5% lower end of historical arithmetic market risk premiums that Dr. Morin finds reasonable, but ignored in his testimony. In fact, a 4.9% market risk premium may overstate a CAPM result because: 1) it is at the upper end of the range of market risk premiums found in the research cited by Dr. Morin,⁴² and 2) is taken from the Ibbotson data set which the same research has been found to have upward survivor bias.⁴³

³⁸ Staff Initial Br. at ¶¶63-66.

³⁹ PSE Initial Br. at ¶71.

⁴⁰ Exhibit No. 327 at 11.

⁴¹ PSE Initial Br. at ¶¶74-75.

⁴² Exhibit Nos. 329-335, which are discussed at length in Staff's Initial Brief at ¶65, n152.

⁴³ Exhibit No. 329 at 51.

27 The Company claims that Mr. Hill has “cherry-picked” only the research showing that forward-looking risk premiums are substantially below the Ibbotson historical averages used by Dr. Morin.⁴⁴ The argument is absurd. One of the studies is by Ibbotson himself who now finds that the arithmetic market risk premium is only 5.9%.⁴⁵ Moreover, all but one of the studies cited by Mr. Hill was either provided by Dr. Morin in discovery or was referenced in his own published work. The one study that was either not provided by Dr. Morin or cited in his textbook finds that the market risk premium is near zero.⁴⁶

28 Rather than acknowledging the research that clearly undermines its case, the Company, instead, attempts to obfuscate what the research actually concludes. For example, PSE states that one study found that a market risk premium for all countries is 5%, but 7% for the United States.⁴⁷ Examination of the study, however, reveals that the 7% risk premium for U.S. companies was not offered for its veracity, but rather only to illustrate the extreme variability of the historical results and why reliance upon such results leads to inaccurate conclusions.⁴⁸ Indeed, the data relied upon by Dr. Morin show that historical risk premiums are extremely volatile as even he defines it and, if anything, are on the decline.⁴⁹

29 Finally, the Company states that Mr. Hill did not explain why he uses the Ibbotson historical market risk premium in his own CAPM analysis, when he criticizes that data as overstating the expected market risk premium.⁵⁰ This criticism ignores Mr. Hill’s testimony on that exact issue:

⁴⁴ PSE Initial Br. at ¶79.

⁴⁵ Exhibit No. 333 at 10.

⁴⁶ Exhibit No. 333 at 2.

⁴⁷ PSE Initial Br. at ¶79.

⁴⁸ Exhibit No. 329 at 53-54.

⁴⁹ Staff Initial Br. at ¶¶68-69.

⁵⁰ PSE Initial Br. at ¶79.

I continue to utilize the historical Ibbotson data in my CAPM analysis in order to be consistent with the manner in which I have traditionally used those data. I have been testifying on the subject of the cost of equity capital for more than twenty years and have consistently used the Ibbotson historical data in my CAPM analyses, and choose not to deviate from that practice at this time. *However, the new research on the market risk premium (including a paper from Ibbotson, himself) indicates that the market risk premium expected by investors is considerably lower than the risk premium contained in the historical data.* While that information does not cause me to change my long-standing CAPM methodology using the Ibbotson historical risk premium data, the current research on the topic of the market risk premium is important, deserves consideration and *causes me to put considerably less weight on the higher end of the CAPM estimates.*⁵¹

(Emphasis added.) PSE ignores this sound advice through its heavy reliance on risk premium approaches, which skew its equity cost results sharply upward.⁵²

c. The Company's analysis of market risk premiums implied in returns on equity authorized by other commissions is both irrelevant and inaccurate

30 PSE analyzed risk premiums implied in returns on equity allowed for electric utilities by other commissions relative to recent long-term Treasury bond yields. It asserts that this analysis provides an average return on equity for PSE of 10.85%.⁵³

31 Staff has previously warned against estimating the current cost of capital for PSE by using allowed returns that are based on settlement or market data from periods before a commission order was rendered.⁵⁴ Moreover, the allowed returns used in PSE's analysis are simply averaged over all available rate case decisions during a calendar year. Thus, the relative risk of a utility for which the equity return was determined is simply, but improperly, not a factor in the analysis.⁵⁵ The use of average allowed returns has also

⁵¹ Exhibit No. 535 at 6 (Hill).

⁵² Staff Initial Br. at ¶59.

⁵³ PSE Initial Br. at ¶81.

⁵⁴ Staff Initial Br. at ¶54. *See also*, Exhibit No. 531C at 97:17-98:4 (Hill).

⁵⁵ Exhibit No. 531C at 98:5-8 (Hill).

become less reliable as the number of rate case decisions has declined, according to the source of the data used by PSE.⁵⁶

32 Finally, the Company's analysis assumes that risk premiums increase as interest rates decrease. A recent study published by Graham and Harvey of Duke University directly contradicts that assumption. That study is challenged by PSE because it addressed the market risk premium for the broad equity market, rather than the utility industry.⁵⁷ The Company concludes, therefore, that the study is irrelevant.

33 That argument is untenable. The operative assumption of all cost of equity estimation techniques is that all stocks trade in the same manner. Thus, a risk premium relationship for the market as a whole is also appropriate for any sub-sector of the market, such as utilities. Therefore, calculating the DCF or CAPM cost of equity for, say, General Dynamics is no different, methodologically, than doing the same calculation for PSE.

d. The Company failed to prove that an upward risk adjustment of 25 basis points is warranted.

34 The Company argues that an upward adjustment to the cost of equity of 25 basis points is necessary to account for PSE's "higher relative construction, power cost, regulatory and financial risks."⁵⁸ It bases this risk increment on: 1) the return difference between A-rated bonds and Baa-rated bonds; and 2) the difference between PSE's debt ratio adjusted for purchased power and that of the electric utility industry.

35 The 25 basis point adjustment, however, is nothing more than blind guess-work. The Company made no showing that the difference between A-rated bonds and Baa-rated bonds is related to construction or purchased power risk, and not a myriad of other factors that may

⁵⁶ Exhibit No. 531C at 98:8-16 (Hill).

⁵⁷ PSE Initial Br. at ¶82.

⁵⁸ PSE Initial Br. at ¶83.

be involved. PSE also did not tie the risk adjustment to any particular operating parameter of its own or any other utility.

36 Moreover, differences in PSE's debt ratio adjusted for purchase power imply that there is some measured difference between PSE's adjusted debt ratio and the debt ratio of other companies. However, Dr. Morin did not make such a comparison because, as he admitted, it would be difficult if not impossible to perform.⁵⁹ The Company did estimate the amount of additional debt S&P might attribute for its purchased power obligations, but it did not perform a similar analysis for Dr. Morin's sample companies.⁶⁰

37 In short, the Company's 25 basis point risk increment to the cost of equity "adds insult to injury" without any evidentiary support. The Commission should reject the Company's 11.25% proposed cost of equity and, instead, adopt Staff's cost rate of 9.375%. Staff's proposal *is* fully supported by a record of expert and non-expert evidence, and complies fully with all legal requirements.

C. The Commission Should Reject The Depreciation Tracker and Alternative Known and Measurable Adjustment Proposed By PSE

38 The Company asks for a Depreciation Tracker that would raise electric and gas rates immediately and annually thereafter without review of PSE's earnings and without limitation on the PSE's ability to seek general rate relief. Staff's Initial Brief demonstrated that the Depreciation Tracker should be rejected because it departs from the matching principle of historical test year ratemaking without any showing of extraordinary circumstances required by Commission precedent.⁶¹

⁵⁹ Exhibit No. 344 at 2.

⁶⁰ Exhibit No. 144HC at 2 (Gaines). *See also*, Staff Initial Br. at ¶85.

⁶¹ Staff Initial Br. at ¶¶31-39. Such Commission precedent requires a clear and convincing showing that the Company will be denied any reasonable opportunity to earn its authorized rate of return without extraordinary relief. The Company's is wrong to argue that it meets this test. (PSE Initial Br. at ¶45.) As noted, PSE's

39 PSE's alternative known and measurable adjustment should be rejected for similar reasons.⁶² Moreover, the Commission cannot verify whether the projects included by PSE qualify as non-revenue producing and non-expense reducing. A plain review of the projects indicates that many may not meet that standard.⁶³ The Company's response to this concern is nothing more than a "trust us" attitude.⁶⁴

40 The Company's response also ignores the fact that it is currently the beneficiary of:

- A Purchased Gas Adjustment mechanism that assures the Company 100% recovery of fixed and variable gas supply costs.
- A Power Cost Adjustment mechanism that insulates PSE from energy price volatility and under-recovery of fixed production costs.
- A Power Cost Only Rate Case process that allows expedited recovery of significant production and transmission assets and changes in power supply.
- Deferral and tracker mechanisms, tariff riders and regulatory assets that address the timing and recovery of a host of other costs.⁶⁵

In addition, Staff now recommends a \$21 million increase in gas revenue requirement to account for increased operating expenses and a gas decoupling mechanism to restore revenues lost to declining gas consumption. Staff also recommends recovery through the PGA and PCA of the costs of a separate credit facility to support the Company's electric and gas portfolio hedging transactions.

41 PSE argues that without either the Depreciation Tracker or alternative known and measurable adjustment, customers receive the benefit of new plant that is placed in service,

utility earnings are healthy despite warmer than normal weather and declining gas consumption. Its access to equity and debt capital on reasonable terms is unobstructed. Its retained earnings have grown consistently. Its plant under construction is a small percentage of post-test period plant. (Staff Initial Br. at ¶37.) Contrary to PSE's position (PSE Initial Br. at ¶46, n71), its "attrition studies" and internal financial forecasts do not demonstrate that extraordinary relief is warranted. (Staff Initial Br. at ¶¶38-39.)

⁶² Staff Initial Br. at ¶44.

⁶³ Staff Initial Br. at ¶44, n103.

⁶⁴ PSE Initial Br. at ¶44.

⁶⁵ Staff Initial Br. at ¶¶26-29.

but do not begin to pay for that plant until the next rate case when the plant is added to rate base.⁶⁶ The Company's argument, however, overlooks the fact that ratemaking establishes baseline rates upon which the utility is given an opportunity to earn its allowed rate of return going forward. Once a project is transferred to "plant in service" it is included in rate base and the utility subsequently earns a return on that plant at whatever return is actually achieved. To state that any particular post-test-period plant addition is not included in rate base, and therefore, not in rates, misstates this fundamental concept of ratemaking.⁶⁷

42 The Company's argument is also unbalanced. Gas and electric utilities continually add plant to rate base. Some of that plant is revenue producing, while other plant is not revenue producing. Some plant reduces expenses, while other plant increases expenses.

43 Washington utilities are also continually adding new customers and seeking to maximize efficiencies through plant additions and replacements. Therefore, until the next rate case, shareholders receive the benefit of revenues associated with new customers, and they receive the benefit of cost savings and federal income tax benefits associated with efficiency improvements.⁶⁸

44 Finally, the Company argues that other states have authorized infrastructure recovery mechanisms and adjustments to rate base to reflect known and measurable pro forma changes.⁶⁹ The argument ignores Staff's proposal to, in fact, increase rate base by \$530

⁶⁶ PSE Initial Br. at ¶¶38 and 40-41.

⁶⁷ Once a project is transferred to "plant in service" it is included in rate base and the utility subsequently earns a return on that plant at whatever return is actually achieved.

⁶⁸ This concept is embodied in WAC 480-07-510(3)(b)(ii), which defines a proper "pro forma" adjustment as an adjustment that gives effect to the test period for all known and measurable changes that are not offset by other factors.

The Company argues that the Depreciation Tracker considers growth in revenues associated with new customers because the surcharge is calculated by dividing projected depreciation expense by new load. (PSE Initial Br. at ¶40.) However, Public Counsel rightly points out that that calculation does not fully account for new margin revenues earned from new customers. (Exhibit No. 506C at 26:10-18 (Brosch).)

⁶⁹ PSE Initial Br. at ¶46.

million in order to reflect known and measurable pro forma changes and all offsetting factors, as required by WAC 480-07-510.⁷⁰

45 Moreover, none of the infrastructure recovery mechanisms from other states are similar to PSE's Depreciation Tracker proposal in this case.⁷¹ Nor did PSE demonstrate analogous facts and circumstances, including the breadth of anti-regulatory lag mechanisms already available to PSE, that would justify any deference to the decisions of other commissions.

D. The Commission Should Adopt A Gas Decoupling Mechanism In The Form Proposed By Staff

1. Public Counsel's Plea For The Status Quo Should Be Rejected

46 Staff, the Company, and the NW Energy Coalition ("NWEC") recommend gas decoupling mechanisms. Staff's Initial Brief explained that its decoupling mechanism will: 1) help customers cope with sharply increasing gas costs; 2) strike an appropriate balance between PSE, which will recover margin costs authorized in a general rate case despite declining customer use, and ratepayers, who will retain the benefits of conservation through volumetric pricing; 3) align ratemaking with public policy supporting conservation; and 4) benefit society in general through reduced pollution and greenhouse gases.⁷²

47 Public Counsel is opposed to gas decoupling, but supports an electric conservation incentive mechanism. Its position to oppose compensating the Company for its efforts in gas conservation is clearly inconsistent with its support for compensating PSE for its efforts in electricity conservation. Perhaps recognizing this inconsistency, Public Counsel recommends that the Company develop a gas incentive mechanism for its next general rate

⁷⁰ Exhibit No. 4C, Attachment A at 1:12 (Baker Hydro Re-Licensing), 18 (Hopkins Ridge Wind Plant) and 34 (Wild Horse Wind Plant).

⁷¹ Tr. 147:17-25 (Harris).

⁷² Staff Initial Br. at ¶¶89-92.

case.⁷³ This is a new proposal offered on brief and possessed with deficiencies that are addressed below.

48 It is also apparent that Public Counsel is satisfied with the status quo. It would prefer that companies pass through volatile gas costs that have recently increased over 50% even though recent research suggests that accelerated energy efficiency may help to substantially reduce gas costs.⁷⁴ It would rather ignore examining how current ratemaking policies conflict with policies that support conservation. It would rather punish companies for declines in customer use caused by the conservation those very same companies are encouraged to promote. Staff, the Company and NWECA agree that such an approach is unacceptable.

49 Public Counsel is correct that gas usage has been declining for several years and for multiple reasons that are not always within the control of the utility.⁷⁵ However, the need for decoupling is driven primarily by changes in gas commodity markets that have become highly volatile with skyrocketing prices. We also have a better understanding of the environmental and societal costs of energy consumption. Business as usual, as Public Counsel would have it, is not the answer.

50 Public Counsel also fails to acknowledge that current ratemaking policies recover a large portion of fixed costs through volumetric pricing. In fact, Public Counsel ignores the cost side of the equation altogether. Its sole focus is on PSE's gas margin revenues⁷⁶ even

⁷³ Public Counsel Initial Br. at ¶69.

⁷⁴ Staff Initial Br. at ¶89.

⁷⁵ Public Counsel Initial Br. at ¶¶21-26.

⁷⁶ Public Counsel Initial Br. at ¶¶23-25.

though the Company operates in a largely fixed cost industry.⁷⁷ Staff's decoupling proposal allows PSE to recover only the fixed costs authorized in a rate case and nothing more.

51 Public Counsel argues that the Company's margin losses from conservation are quite small and that decoupling would generate revenues for PSE far exceeding the problem it seeks to fix.⁷⁸ However, Public Counsel addresses only savings from program measures and does not address savings from behavioral changes due to PSE-sponsored educational activities or otherwise. Admittedly, these other savings are controversial and difficult to measure. However, they are influenced by the Company and they are valuable. They should not be ignored if the Commission intends to create a positive environment for PSE to continue its conservation efforts.⁷⁹

52 Public Counsel argues that decoupling is unnecessary because the Company has a long-standing commitment to conservation that has stretched the limits of available natural gas energy efficiency.⁸⁰ The evidence does show that PSE is committed to conservation, which is a record for which the Company should not be punished.

53 However, the record does not support Public Counsel's allegation that PSE has "maxed out" available gas energy efficiency. To the contrary, the evidence is clear that the natural gas energy efficiency market is not as mature as the electric energy efficiency market.⁸¹ This is precisely why decoupling is an appropriate response that will assist in development of the gas energy efficiency market.

54 It is also why a gas incentive mechanism is an insufficient response. The more limited experience with gas energy efficiency will increase regulatory burdens associated

⁷⁷ In fact, 98.4% of PSE's margin is fixed costs. (Tr. 495:2-4 (Amen).)

⁷⁸ Public Counsel Initial Br. at ¶¶27-32.

⁷⁹ Tr. 763:3-9 (Steward).

⁸⁰ Public Counsel Initial Br. at ¶¶34-43.

⁸¹ Tr. 621:25-622:6 (Shirley) and Tr. 625:4-20 (Shirley).

with savings verification and target setting. Public Counsel is simply incorrect to state otherwise.⁸² The experience of the Company and the CRAG with respect to electric energy efficiency cannot be easily applied to the gas business without serious controversy, complications, and the threat of unintended consequences.

55 Finally, Public Counsel states that decoupling may be an idea whose time has passed.⁸³ It is true that environmental issues and energy efficiency have moved more to the forefront for utilities, regulators and customers. That is precisely why it is important for the Commission's ratemaking policies to be aligned properly with the values that we endorse. Only Staff's decoupling proposal accomplishes that goal and nothing more.

2. Other Parties Criticisms Of Staff's Decoupling Mechanism Should Be Rejected

56 In its Initial Brief, Staff demonstrated that the decoupling mechanism it proposes is far superior to the proposals of PSE and NWECC. Staff demonstrated that decoupling should be a three-year pilot designed to avoid increased bill volatility for ratepayers by excluding weather-related changes to gas consumption. Staff also supported a new customer adjustment, which will ensure that decoupling restores only margin that is actually lost from reduced sales, and a surcharge cap, which will allow PSE to fully recover lost margins from changes in gas use, while also giving customers certainty that the maximum rate impacts of decoupling will not reduce the benefits of pursuing conservation. Finally, Staff discussed all of the PacifiCorp Order factors and supported its proposal to limit decoupling to residential and commercial classes since those are the classes that have shown declining gas use.⁸⁴

⁸² Public Counsel Initial Br. at ¶¶67-69.

⁸³ Public Counsel Initial Br. at ¶63.

⁸⁴ Staff Initial Br. at ¶¶94-121.

57 Public Counsel argues that disagreement among the proponents of decoupling over the mechanism's details indicates that decoupling will introduce unnecessary complexity and administrative burdens.⁸⁵ Our disagreement, however, does not make the mechanism complex and burdensome, just as disagreement among proponents of an electric conservation incentive mechanism does not make that mechanism complex and burdensome. Rather, our disagreement over the components of a decoupling mechanism shows that the parties have scrutinized the mechanism in light of the exact questions Public Counsel insists should be examined.⁸⁶

58 The Company argues that it is inappropriate to reduce the amount of margin recovery for new customers because the fact that new customers use less gas than existing customers contributes to PSE's lost margins.⁸⁷ However, PSE does not account for the cost to serve new customers. Therefore, for *current* customers, Staff's decoupling mechanism provides recovery of the margin authorized in a rate case, but, for *new* customers, Staff uses the actual margin revenue, rather than assuming a level of margin revenue. This provides a reasonable balance between decoupling and traditional regulation.

59 Like the Company, NWECC supports a decoupling mechanism that includes the impact of weather. It argues that such a mechanism will result in cost of capital savings of

⁸⁵ Public Counsel Initial Br. at ¶55.

⁸⁶ Public Counsel Initial Br. at ¶12. Public Counsel notes that the weather normalization methodology adopted in this case will be used for the decoupling mechanism, but is not without controversy. (Public Counsel Initial Br. at ¶58.) That controversy, however, is not an insurmountable barrier to adopting decoupling in this case. Staff agrees that that weather normalization methodology is a step in the right direction. (Exhibit No. 552 at 6:19-7:2 (Mariam).) Staff also recommends a series of data collection to further improve the methodology in the future. Thus, the decoupling mechanism will be modified to reflect any new weather normalization process adopted subsequently by the Commission. (Tr. 772:10-773:5 (Steward).)

⁸⁷ PSE Initial Br. at ¶96.

\$14 million, which is sufficient to offset most surcharges and fund the Company's conservation program.⁸⁸

60 NWEC misinterprets the \$14 million amount calculated by Mr. Hill. That amount represents savings from a 50 basis point reduction in the cost of equity for the Company's combined gas and electric operation.⁸⁹ The same 50 basis point reduction for gas operations converts only to a \$4 million reduction in revenue requirement,⁹⁰ which neither offsets surcharges under the Company's mechanism nor covers PSE's conservation program costs.

61 Moreover, the interest of all parties offering a decoupling mechanism is to remove the disincentive for the Company to promote conservation. That interest is not addressed in a mechanism that includes the impacts of weather, as proposed by PSE and NWEC. That interest is addressed, however, by Staff's proposal to exclude the effects of weather.

E. The Commission Should Adopt An Electric Efficiency Incentive Mechanism In The Form Proposed By Staff

1. None Of The Federal Executive Agencies Concerns Warrant Rejection Of A Conservation Incentive Mechanism

62 Staff, the Company, Public Counsel and NWEC recommend electric conservation incentive mechanisms. Staff's Initial Brief demonstrated an incentive mechanism reflects sound public policy.⁹¹ Staff also demonstrated that its proposal is the most balanced and reasonable approach because it: 1) sets a dead band that will convey to PSE a straight-forward message to achieve an aggressive savings target; 2) establishes incentives that will remove any temptation for the Company to seek a lower target in order to maximize the

⁸⁸ NWEC Initial Br. at ¶¶8-10. NWEC also argues that weather adjustments in a decoupling mechanism over time will tend to zero. (NWEC Initial Br. at ¶8, last sentence.) That result is no different than base rates. Setting base rates on normalized weather will make the Company whole over a multi-year period.

⁸⁹ Exhibit No. 548 at 3 (Hill).

⁹⁰ A 50 basis point reduction in equity reduces Staff's overall after tax cost of capital by 21 basis points, which, multiplied by gas rate base of \$1.18 billion divided by a conversion factor of .6216, equals \$4.0 million.

⁹¹ Staff Initial Br. at ¶¶127-130.

incentive payment; and 3) sets a baseline target for 2007 that does not undermine PSE's current commitment for 2007.⁹²

63 The Federal Executive Agencies ("FEA") is the only party that opposes an incentive mechanism of any kind. It argues that PSE has an obligation to serve customers at least cost. Thus, the costs of energy efficiency should be treated no differently than the costs of acquiring supply-side resources.⁹³

64 FEA ignores fundamental differences between supply-side expenditures and energy efficiency expenditures that the Commission has already recognized. On the one hand, supply-side investments take place on a considerably larger and "lumpier" scale. They are also the result of a single decision by the Company. Thus, supply-side investments are not recovered in rates until they have passed "used and useful" and "prudence" tests.

65 On the other hand, investments in energy efficiency are made continuously and are relatively small. They are also highly responsive to customer participation and may vary annually. Thus, the Commission allows the costs of energy efficiency to be annually recovered through a tariff rider subject to a test of cost effectiveness, which is, in essence, a prudence test.⁹⁴ This treatment recognizes that energy efficiency benefits customers and society in general and, therefore, should be encouraged above and beyond supply-side investments. An incentive mechanism assists in that endeavor.

66 FEA expresses concerns over the Company's influence in setting a target and recommends that the Commission reject any incentive mechanism until it is assured that the

⁹² Staff Initial Br. at ¶¶132-139. Staff also supported its list of program requirements for implementation of the mechanism. These requirements are jointly sponsored with Public Counsel and supported by NWEC. (Staff Initial Br. at ¶¶140-144.)

⁹³ FEA Initial Br. at ¶¶26-27.

⁹⁴ Exhibit No. 561 at 35:13-21 (Steward).

target is realistic.⁹⁵ However, Staff's incentive mechanism is designed specifically to counter any undue influence that PSE may exercise over the process by facilitating Staff's role in setting the target, verifying savings, and recommending penalty or incentive amounts. Thus, Staff shares FEA's concerns, but does not believe they are insurmountable.

2. All Criticisms Of Staff's Incentive Mechanism Should Be Rejected

67 The Company argues that Staff's multi-tiered incentive levels will be complicated to calculate.⁹⁶ Staff's proposal does require additional calculations because each incentive level applies only to incremental savings.⁹⁷ However, the result is more equitable than any other proposal because it produces a constant and consistent increase in the incentive for all savings that exceed the target, which will minimize PSE's incentive to "game" the process.

68 The Company argues that Staff's 2007 baseline target is nearly the same as the accelerated target from its integrated resource plan and departs from the baseline established by the Conservation Resource Advisory Group ("CRAG").⁹⁸ However, PSE currently faces a penalty-related target of 16.5 aMW, which was developed in collaboration with the CRAG. Staff's dead band and target respect this effort by the CRAG to develop a penalty-related target for 2007, and results in a baseline target of 18.3 aMW.⁹⁹

69 In contrast, the Company's 16.5 aMW baseline target for 2007 reduces its current commitment because it would not incur penalties unless savings fall below 15.7 aMW.¹⁰⁰ No justification exists for undermining this commitment. Staff is the only party that does not weaken PSE's current risk of incurring penalties.

⁹⁵ FEA Initial Br. at ¶¶28-29.

⁹⁶ PSE Initial Br. at ¶103.

⁹⁷ Exhibit No. 567 (Steward).

⁹⁸ PSE Initial Br. at ¶103.

⁹⁹ Exhibit No. 561 at 31:10-32:3 (Steward) and Exhibit No. 569 at 6:8-7:13 (Steward).

¹⁰⁰ Exhibit No. 381 (Shirley).

70 Finally, while Public Counsel supports an aggressive target of 20 aMW for 2007, it would provide an incentive payment even if PSE fails to achieve that target.¹⁰¹ This undermines the very purpose of setting an aggressive target in the first place and, therefore, a 20 aMW target for 2007 should be rejected by the Commission.

F. The Commission Should Reject The Gas Rate Spread And Rate Design Proposed By PSE And Supported By Seattle Steam

1. Gas rate spread

71 The Initial Brief of Staff demonstrated that the gas rate spread it proposes jointly with Public Counsel and the Northwest Industrial Gas Users (“NWIGU”) minimizes severe customer impacts, but moves all classes toward parity given the results of both cost of service studies that were presented in this case.¹⁰² Thus, our rate spread is a fair and balanced compromise that results in just and reasonable rates, while avoiding contentious litigation of how a proper cost of service study should be conducted.

72 The Company seeks to unnecessarily mire the Commission in litigation over cost of service methodology. It states that its use of system design day as a peak demand allocator is superior to the accepted Commission Basis approach that uses the five highest load days during a recent three-year period.¹⁰³ PSE seeks to justify its peak demand allocator because: 1) its system design day was reviewed extensively in its 2005 Least Cost Plan; 2) it designs its system to meet a design day peak demand; and 3) design day peak is a more stable allocator.

¹⁰¹ Exhibit No. 512 (Klumpp).

¹⁰² Staff Initial Br. at ¶147-148.

¹⁰³ PSE Initial Br. at ¶130-132.

Each of the Company's arguments, however, has already been rejected by the

Commission:

The Commission rejects design day as a basis for calculating peak usage. The arguments against it are persuasive: actual use on a design day is unknown and speculative, and design day fails to consider actual use by all classes on real peak days and thus the classes' actual responsibility for the fixed costs of providing service.

Design day would offer stability – but part of our concern in requiring periodic studies is that they reflect actual usage patterns as they change over time. The design day fails to reflect those changing patterns. The peak usage calculated from design day changes, too, as the number of customers grows and as installed technology affects gas use on the HDD. It may be prudent for the Company to oversize some of its facilities to accommodate reliability and reasonable growth expectations. The design day analysis is less likely to consider future use and growth patterns than alternative measures of peak. Finally, the record fails to show a sufficient relationship between design day usage and embedded costs to support its use as a cost allocator.

The Commission believes that the appropriateness of the design day for planning purposes has no necessary bearing on its appropriateness for cost allocation purposes. The purposes are indeed very different and the selection of an appropriate measure is made in each instance for widely different reasons and policy considerations. The design day should be rejected as a criterion for cost allocation.¹⁰⁴

The Company provides no evidence in this case why the Commission should diverge from this precedent, especially when further examination of the issue is not necessary.

PSE complains that the Joint Parties rate spread is a “black box” with no evidentiary support.¹⁰⁵ Similarly, Seattle Steam argues that we have presented no justification for imposing a larger increase on the interruptible classes than the increase proposed by PSE.¹⁰⁶

¹⁰⁴ *WUTC v. Washington Natural Gas Co.*, 5th Suppl. Order at 7, Docket Nos. UG-940034, *et al.*, (April 11, 1995).

¹⁰⁵ PSE Initial Br. at ¶128.

¹⁰⁶ Seattle Steam Initial Br. at ¶¶10-14. Seattle Steam also complains that the parity ratios shown by the Joint Parties in Exhibit No. 586 at 1 do not match those presented by PSE. (Seattle Steam Initial Br. at ¶11, n4.) Seattle Steam misunderstands our exhibit. Exhibit No. 586 only restates the total revenue to cost ratio to show the parity in proportion to current rates rather than proposed revenues. This restatement of revenues is commonly employed (Exhibit No. 194 at 1:46 (Hoff)) and in no way affects the class parity relationships.

75 The Company's criticism is surprising given its own presentation. Despite considerable testimony devoted to cost of service, PSE devoted only two pages of its direct testimony to explaining its entire rate spread and rate design proposals.¹⁰⁷

76 It is also simply wrong to suggest that the Joint Parties did not justify their proposed rate spread with sufficient evidence and sound ratemaking principles. The Joint Parties stated explicitly that fairness and impacts on all customer classes were a primary consideration of their proposal.¹⁰⁸

77 Our rate spread also takes into account that the interruptible classes are above parity under both cost of service studies. Therefore, the interruptible classes receive a below average increase under our rate spread. This is an equitable outcome no matter which cost of service study is given more weight.

78 Finally, Seattle Steam argues that there is no reason to fix the rate increase for the interruptible classes at \$576,000, with any reduction in from the proposed revenue requirement allocated only to the firm classes.¹⁰⁹ This ignores that under the Joint Parties rate spread the vast majority of any increase will fall onto the firm classes regardless of the revenue requirement allowed by the Commission. At the same time, our proposal "achieves very significant movement toward eliminating current rate disparities among all classes of customers and does so recognizing cost disparities within the industrial schedules."¹¹⁰

2. Gas rate design

79 The Initial Brief of Staff demonstrated that the gas rate design it proposes jointly with Public Counsel and the NWIGU balances several important principles such as cost

¹⁰⁷ Exhibit No. 38 at 27-28 (Amen).

¹⁰⁸ Exhibit No. 581 at 3:16-22 and 8:15-18 (Joint Parties).

¹⁰⁹ Seattle Steam Initial Br. at ¶¶15-16.

¹¹⁰ NWIGU Initial Br. at 8.

causation, sending appropriate price signals to customers, minimizing rate shock, providing PSE a reasonable opportunity to recover its revenue requirement, and setting rates that consumers can understand.¹¹¹ Our proposed residential customer charge of \$7.00 per month is no exception. It fully recovers the costs of metering, meter reading, and billing.¹¹² It also maintains the benefit of lower bills for customers that conserve, and does not place a higher burden on small use customers.¹¹³ Our proposal is a 12% increase in the context of a proposed 4% increase in base rates.

80 In contrast, PSE's proposal to increase the residential customer charge 172% from \$6.25 to \$17.00 is unacceptable rate shock under any definition. It also undermines the conservation price signal by recovering considerably less (80% rather than 92%) of a customer's bill through volumetric charges.¹¹⁴

81 In fact, a \$17 customer charge will require a corresponding decrease in the delivery charge, which may encourage additional gas consumption in an era when prices are soaring due to high levels of use and constrained supply. The decrease in the delivery rate is significant. Under the Company's proposal, the delivery rate would decline 35% from \$.287/therm to \$.187/therm.¹¹⁵

82 The Company challenges the magnitude of the Joint Parties residential customer charge.¹¹⁶ However, the \$7 customer charge that we propose is more than double the class average increase. It is also more proportionate to the lower revenue requirement that has been justified in this proceeding.

¹¹¹ Staff Initial Br. at ¶153.

¹¹² Exhibit No. 587.

¹¹³ Staff Initial Br. at ¶154.

¹¹⁴ Staff Initial Br. at ¶¶158-159.

¹¹⁵ Exhibit No. 68 at 2 (Schedule 23 Present Delivery Charge v. Proposed Delivery Charge).

¹¹⁶ PSE Initial Br. at ¶¶135-136.

83 PSE attempts to support its \$17 customer charge by citing rate design principles identified by Staff.¹¹⁷ By any definition, however, a near tripling of the customer charge violates the principle of rate stability for customers since it is such an abrupt and significant change from the current customer charge and overall residential rate design. A \$17 customer charge will also be a significant increase for small use customers. It will be particularly difficult for small use customers to understand why their bills have a considerably higher percentage increase than large use customers.¹¹⁸

84 Finally, the Company presents arguments on the rate design it proposes for its other customer classes.¹¹⁹ Each of these arguments is already rebutted in Staff's Initial Brief.¹²⁰

G. Staff's D&O Insurance Adjustment And Weather Normalization Recommendation Should Be Adopted By The Commission

1. The Company Did Not Justify The Amount Of D&O Insurance Premiums It Seeks To Recover From Ratepayers

85 The issue concerns the amount of Director and Officer ("D&O") Insurance for Puget Energy that should be allocated to the regulated operations of PSE. Staff's Initial Brief demonstrated that insurance premiums should be allocated between PSE and other subsidiaries based on plant, number of employees, and number of officers and directors. Staff also demonstrated that the Company failed to reassess its need for insurance after the sale of InfrastruX. PSE merely applies precedent from 1992 without any further justification for the amount of premiums it seeks to recover in rates.¹²¹

¹¹⁷ PSE Initial Br. at ¶139.

¹¹⁸ Exhibit No 68 at 3.

¹¹⁹ PSE Initial Br. at ¶¶145-148.

¹²⁰ Staff Initial Br. at ¶¶160-166.

¹²¹ Staff Initial Br. at ¶¶169-173.

86 The Company argues that Staff's adjustment is faulty because there is no relationship between the number of employees and D&O insurance.¹²² This argument ignores the fact that there is a relationship between directors and officers and the number of employees for which the directors and officers are ultimately responsible. Staff's adjustment properly captures that relationship.

87 The Company also fails to explain any relationship between assets and D&O insurance that would support its allocation. Again, PSE simply applies a prior methodology without explaining why that approach remains valid for ratemaking purposes. As advocated in Staff's Initial Brief, the Company should be required in the next general rate case to justify both the level of D&O insurance and the appropriate amount to be allocated to PSE's regulated operations.

2. The Company Did Not Justify Its Opposition To The Load Research Study Recommended By Staff

88 The issue is whether PSE should be directed to collect detailed data on energy consumption by its customers in order to use multiple balance point temperatures in a weather normalization adjustment in future rate cases. Staff's Initial Brief demonstrated that such data collection need not be cost prohibitive and is necessary to insure that rates are just and reasonable.¹²³

89 PSE argues that its proposal is based on a "robust methodology" that addresses Staff's concerns and has been subject to expensive and exhaustive investigation by Staff.¹²⁴

¹²² PSE Initial Br. at ¶123.

¹²³ Staff Initial Br. at ¶¶176-182.

¹²⁴ PSE Initial Br. at ¶107.

The use of multiple balance point temperatures, however, is a new proposal that was never presented to Staff before this proceeding.¹²⁵

90 Moreover, the Company agrees that energy consumption varies by customer class and by time of day.¹²⁶ Customer usage also varies widely across the counties served by PSE perhaps because of differences in average temperature and socio-economic conditions.¹²⁷ Yet, PSE's "robust methodology" relies only upon aggregated system-wide daily usage from all customers and counties, and daily temperature data collected only from Sea-Tac International Airport.¹²⁸ Thus, PSE's methodology does not address Staff's concerns.¹²⁹

91 PSE's also relies upon a 1985 thermal engineering model, but PSE admits that that study cannot be used either to model customer behavior or set rates.¹³⁰ The only other evidence presented by the Company is a one-time survey from 2004 that was limited to residential customers. No evidence was presented to prove that the survey results represent any other class or time period. The survey also did not even collect empirical data on the consumption by customers that were included in the survey.¹³¹

92 Finally, the Company argues that the cost of the data collection recommended by Staff is \$3.5 million. That cost estimate is grossly overstated because it assumes too large of a sample group and too high of a per customer cost.¹³² The Company also ignores the fact that the results of the data collection can be used for other valuable analyses.

¹²⁵ Tr. 449:1-13 (Dubin).

¹²⁶ Tr. 442:25-443:7 (Dubin).

¹²⁷ Exhibit No. 552 at 8, n5 (Mariam), Exhibit Nos. 553 and 554 (Mariam), and Exhibit No. 204.

¹²⁸ Exhibit No. 81 at 14:16-17 (Dubin).

¹²⁹ Aggregation, as proposed by PSE, also smoothes out any variations in the underlying data. Thus, PSE's argument that its weather normalization proposal explains 97% of the variation in the data is immaterial.

¹³⁰ Exhibit Nos. 92 and 93.

¹³¹ Exhibit Nos. 88 at 4 and 89 at 2 (Dubin), Exhibit Nos. 93 and 94, and Tr. 443:22-444:3 (Dubin).

¹³² Staff Initial Br. at ¶¶180-182.

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The Commission should order the Company to collect the data recommended by Staff. Staff is available to assist PSE in developing a study plan that will keep costs to a minimum, but also provide the necessary information.

III. CONCLUSION

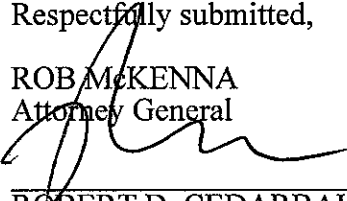
94

For the reasons set forth above and in its Initial Brief, Staff asks the Commission to issue an order rejecting the rate relief requested by Puget Sound Energy, Inc. and approving the recommendations of Staff. Staff's recommendations are supported fully by the record and meet all applicable legal requirements.

DATED this 14th day of November, 2006.

Respectfully submitted,

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