

Agenda Date: April 28, 2016
Item Numbers: A2 and A3

Dockets: UE-160367 and UG-160368
Company Name: Puget Sound Energy

Staff: Chris McGuire, Energy Policy Strategist

Recommendation

Take no action, thereby allowing the tariff sheets filed by Puget Sound Energy in Dockets UE-160367 and UG-160368 to become effective May 1, 2016, by operation of law.

Background

On March 31, 2016, Puget Sound Energy (PSE or company) filed proposed revisions to Schedule 142, Revenue Decoupling Adjustment Mechanism of its electric and natural gas tariffs. The filing is continued implementation of the decoupling mechanism established in 2013.

Overall, this proposal represents an average increase in overall bills of 1.0 percent for decoupled electric customers and 2.8 percent for decoupled natural gas customers. The typical residential electric customer using 1,000 kWh per month will experience an increase of \$1.65 per month. The typical residential natural gas customer using 68 therms per month will experience an increase of \$2.19 per month.

In June 2013, Washington Utilities and Transportation Commission (commission) approved a multi-party settlement agreement establishing electric and natural gas decoupling mechanisms for PSE.¹ PSE's decoupling mechanism consists of two parts: (1) deferred accounting mechanism (deferral); (2) an embedded rate plan (K-factor). To determine the deferral, the company first establishes an annual per customer revenue requirement, also known as "Allowed Revenue," which is based on the fixed costs of delivering energy to end users and forecasted customer counts. Allowed revenue essentially creates an accounts receivable from the customers. Throughout the course of the ensuing year, customers are billed on a price per unit to pay off the receivable. Bill payments are also known as "Actual Revenue." The difference between the Allowed Revenue and the Actual Revenues is deferred on a monthly basis and then summed over the twelve month period. If, during the course of a year, energy sales are relatively low because of a warmer than normal winter or other factors, actual revenue will be less than allowed revenue and the deferred balance will reflect a shortfall in payments. The deferred balances are then trued up annually by a surcharge (in the case of deferral shortfall) captured in the next 12-month period.

The K-factor refers to the escalation factor set in the rate plan and is separate from the mechanics of the deferral process. The commission allows for an annual escalation of 3.0 percent for electric delivery costs, and 2.2 percent for natural gas delivery costs.

¹ Consolidated Dockets UE-121697 and UG-121705, UE-130137 and UG-130138, Order 07 (Decoupling Order). June 25, 2013.

The settlement agreement also holds PSE to the following additional requirements:

- To protect customers from significant rate increases, the decoupling adjustments are limited to no more than three percent increase annually for each customer group three percent soft cap).²
- Share with customers on an equal basis any earnings that exceed its authorized rate of return (earnings test).³

In accordance of the decoupling order, PSE's current filing contains two-part adjustments: (1) Deferral: true-up of the difference between allowed and actual decoupling revenue during calendar year 2015 and (2) the K-factor: the revenue increase allowance for the upcoming rate year from May 1, 2016, through April 30, 2017. New decoupling rates are the sum of the two components.

Discussion

Snowballing Deferral Balance

In its review of this filing, staff uncovered no serious infirmities with the operation of the decoupling mechanism. However, staff wishes to bring to the commission's attention a snowballing balance in the natural gas deferral account. Although staff does not believe immediate remediation is warranted, it does believe the size of the deferral warrants discussion and possible consideration of the need for future adjustments to the decoupling mechanism.

Over the past two years, unusually warm weather has led to unusually low natural gas sales volumes. As a result, PSE has been unable to fully collect its "allowed revenue." Although the decoupling mechanism is constructed so as to create a deferral for the uncollected allowed revenue, and that deferral is to be amortized and collected over the following year, the deferrals over the past two years have exceeded the three percent soft cap. When the three percent soft cap is reached, the uncollected revenue in excess of the three percent cap remains in the deferral account and is not amortized over the next 12 months. When the three percent cap is not reached, the deferral account is fully cleared (i.e. the deferral balance is zero). When the three percent cap is reached, the deferral balance is positive. The expectation is that these costs will be amortized at a later date when sales volumes rebound. However, when consecutive low-volume years are encountered, very large deferrals are generated and the uncollected revenue above the three percent soft cap begins to create compounding pressure on future years.

As a case in point, take PSE's deferral balance for residential customers over the past two years:

² Decoupling Order, at ¶ 27.

³ Decoupling Order, at ¶ 165 and 245.

Table 1. Effect of Snowballing Unamortized Balances in the Natural Gas Deferral Account

	Dec 2014	Dec 2015
Calendar year Balance	\$23,504,773	\$45,798,495
<u>Prior year unamortized balance</u>	-	<u>5,791,772</u>
Total Balance	23,504,773	51,590,267
<u>Amortized (under 3% cap)</u>	<u>(17,713,002)</u>	<u>(24,039,360)</u>
Unamortized (over 3% cap)	5,791,772	27,550,907

Table 1 demonstrates that unrecovered revenues above the three percent soft cap can lead to compounding balances in the deferral account. The effect is that in each successive year it becomes more and more difficult to clear the deferral balance. The \$27,550,907 balance shown above at December 2016 is the balance carried over from 2015 (i.e. that could not be collected through amortization due to the three percent cap). That \$27,550,907 represents the unrecovered balance even before 2016 began. Interest continues to accrue on this balance.

It is important to note that this is the effect of successive warm heating seasons. It is also important to note that “normal” temperatures are unlikely to prevail over short time horizons. Imbalance should be expected unless we can become comfortable allowing deferral mechanisms to persist over long enough time horizons that they have an opportunity to correct themselves.

Electric Rates

Deferral

For residential customers, the bill payments in the last rate year collected \$16.5 million less than the allowed level of revenue, which will be assessed as a customer surcharge in the upcoming rate year. Similarly, non-residential and industrial customers underpaid, as well. The primary driver behind the under-collections were warmer-than-normal temperatures during the early part of 2015. The total deferral balance of all schedules as of year end 2015 is approximately \$27 million. Table 2 shows the detailed components of deferral balances for each customer group.

Table 2. Decoupling Deferral Balances As of Year End 2015 (Electric)

	Residential	Non-Residential	Schedules 12 & 26	Schedules 10 & 31	Total
2014 Deferral	(\$159,177)	\$38,863	\$78,800	\$1,126	(\$40,388)
2015 Deferral	16,466,832	6,602,021	636,868	1,883,997	25,589,717
Interest	784,698	327,466	34,184	80,218	1,226,566
Total	\$17,092,353	\$6,968,349	\$749,853	\$1,869,576	\$26,775,895

K-factor

PSE's allowed electric delivery revenue per customer increases each year by 3.0 percent. The k-factor increases PSE's forecasted allowed volumetric delivery revenue for the 2016 rate year by approximately \$18.7 million, of which the increase for residential customer is approximately \$12.5 million.

Earnings Sharing

The Earnings Test resulted in a normalized rate of return that exceeded the authorized rate of return. Accordingly, this filing incorporates a reduction of \$11.9 million that will be returned to customers, representing 50 percent of the normalized, over-collected revenue in 2015. Approximately \$7.2 million will be returned to residential customers.

Total Revenue Impact Summary

	<u>Revenue Impact</u>
K-factor:	\$ 18,659,493
+ Deferral:	\$ 26,775,895
- Shared Earnings	\$ 11,927,123
= Total:	\$ 33,508,265

Natural Gas

Deferral

For residential customers, bill payments collected in 2015 were \$45.8 million less than the allowed revenue. Including the additional deferred balance from 2014,⁴ the total residential deferral balance for 2015 was \$54.0 million.⁵ For non-residential customers, the total deferral balance for 2015 was \$10.9 million. The total deferral balance for 2015 is \$69.2 million. This amount is subject to the three percent soft cap, and so the total deferral cannot be amortized over the next year. The unamortized 2015 balance will be deferred to 2016. Table 3 shows components of deferral balances for these two customer groups.

⁴ In 2014, the three percent soft cap was reached so the complete calendar year 2014 deferral balance could not be amortized. Approximately \$5.8 million of the 2014 deferral for residential customers was deferred to 2015. Approximately \$5.6 million of the 2014 deferral for non-residential customers was deferred to 2015.

⁵ This amount also includes revenue sensitive items.

Table 3. Decoupling Deferral Balances As of Year End 2015 (Natural Gas)

	Residential	Non-Residential	Total
2014 Deferral	\$1,275,520	\$992,994	\$2,268,515
2015 Deferral	53,970,360	10,936,714	64,907,074
Interest	1,592,833	416,516	2,009,349
Total	\$56,838,713	\$12,346,225	\$69,184,939

K-factor

PSE's allowed delivery revenue per customer increases each year by 2.2 percent for natural gas. The k-factor adjustment increases PSE's forecasted allowed volumetric delivery revenue for the 2016 rate year by approximately \$9.9 million, of which the increase for residential customer is approximately \$7.3 million.

Earnings sharing

The Earnings Test resulted in a normalized rate of return that exceeded the authorized rate of return. Accordingly, this filing incorporates a reduction of \$5,505,334 that will be returned to customers, representing 50 percent of the normalized, over-collected revenue in 2015. Approximately \$4.1 million will be returned to residential customers.

Total Revenue Impact Summary

	<u>Revenue Impact</u>
K-factor:	\$ 9,900,146
+ Deferral:	\$ 69,184,939
- 3% cap excess ⁶	\$ 45,145,579
- Shared Earnings	\$ 5,505,334
= Total:	\$ 28,434,172

Conclusion

Staff determined that the 2016 rate is properly calculated and has uncovered no issues that warrant immediate remediation. However, due to the snowballing nature of the natural gas deferral account balance, staff recommends discussing this item at the April 28, 2016, Open Meeting.

Recommendation

⁶ This amount will be deferred for later recovery.

Staff recommends the commission take no action, thereby allowing the tariff sheets filed by Puget Sound Energy in Dockets UE-160367 and UG-160368 to become effective May 1, 2016, by operation of law.