EXHIBIT NO. JAP-5T
DOCKET NOS. UE-090704/UG-090705
2009 PSE GENERAL RATE CASE
WITNESS: JON A. PILIARIS

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-090704** **Docket No. UG-090705**

PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF JON A. PILIARIS ON BEHALF OF PUGET SOUND ENERGY, INC.

DECEMBER 17, 2009

PUGET SOUND ENERGY, INC.

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PUGET SOUND ENERGY, INC.

PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF JON A. PILIARIS

I. INTRODUCTION

Q. Are you the same Jon A. Piliaris who provided prefiled direct testimony in this proceeding on May 8, 2009, on behalf of Puget Sound Energy, Inc. ("PSE" or "the Company")?

A. Yes.

Q. Please summarize the purpose of your rebuttal testimony.

A. This rebuttal testimony responds to

1. the Prefiled Direct Testimony of Michael P. Parvinen, Exhibit No. MPP-1T, on behalf of the Washington Utilities and Transportation Commission Staff ("Staff") and

2. the Prefiled Direct Testimony of James R. Dittmer, Exhibit No. JRD-1CT, on behalf of Public Counsel

with respect to the Company's conservation phase-in adjustment proposal. I also address issues raised in the Prefiled Direct Testimony of Donald W. Schoenbeck, Exhibit No. DWS-1T, on behalf of the Industrial Customers of Northwest Utilities ("ICNU") regarding the Company's proposed changes to its classifying of electric production and transmission costs.

II. RESPONSE TO STAFF TESTIMONY REGARDING CONSERVATION PHASE-IN ADJUSTMENT

Q. What is the Company's proposed Conservation Phase-In Adjustment?

A. PSE's proposed Conservation Phase-In Adjustment restates the weather-normalized test year loads of the Company's retail natural gas and electric customers. This adjustment mitigates certain ratemaking consequences of the phase-in of Company-sponsored conservation that occurred during this proceeding's test year. The adjustment increases the Company's revenue deficiency by slightly more than $4 million.

Q. Please describe the testimony of Staff witness Michael Parvinen as it relates to the proposed Conservation Phase-In Adjustment.

A. Staff recommends that the Commission completely reject the Company's Conservation Phase-In Adjustment proposal.

Q. How does Staff justify its recommendation?

A. Staff, through Mr. Parvinen, argues that the Conservation Phase-In Adjustment proposal fails to meet Staff's definition of a proper pro forma adjustment. However, as I will explain below, Staff's interpretation of a proper pro forma adjustment is novel, unsupported by existing statute, the Commission's rules or its prior orders. Mr. Parvinen also asserts that the Conservation Phase-In Adjustment: 1) creates a mismatch between test year expenses and revenues, 2) does not produce a sufficient change to the revenue requirement to warrant its

need, 3) uses energy savings values that are not sufficiently rigorous for ratemaking, 4) does not address the hourly load shape of conservation savings, and 5) is not necessary due to PSE's Electric Conservation Incentive Mechanism ("ECIM"). I will refute each of these assertions in this rebuttal testimony.

A. The Conservation Phase-In Adjustment is a Proper Pro Forma Adjustment

Q. How does Mr. Parvinen support his claim that the Conservation Phase-In Adjustment is not a proper pro forma adjustment?

A. Alluding to his interpretation of WAC 480-07-510(3)(e)(iii), Mr. Parvinen believes that the Conservation Phase-In Adjustment is not a proper pro forma adjustment "because it pro forms changes in *units* during the test period, rather than a change in the rate applied to the test period units."[1]

Q. Do you agree with Mr. Parvinen's interpretation of WAC 480-07-510(3)(e)(iii), that it prohibits changes to units in the test period?

A. No; WAC 480-07-510(3)(e)(iii) makes no distinction between "units" and "rates", and Staff does not explain this new limitation on pro forma adjustments. Such restriction is certainly not supported by past Commission practice, which has accepted changes to test year units (*i.e.,* loads) in many electric and gas rate cases.

[1] Prefiled Direct Testimony of Michael P. Parvinen, Exhibit No. MPP-1T, page 13, lines 20-21.

Q. Please elaborate.

A. Like conservation, the ambient air temperature in PSE's service territory influences the level of electric and natural gas loads it serves. Whether caused by conservation or temperature, the level of loads served affects PSE's revenues, as well as the power supply and natural gas supply costs it incurs. Higher loads result in higher revenues and higher energy supply costs, while lower loads result in lower revenues and lower energy supply costs. Moreover, the effect of a change in loads on the Company's revenues and costs will be the same, regardless of whether the effect on loads is due to conservation or abnormal temperature.

Since its loads in any given test year will be higher or lower than what would be expected under "normal" temperatures, PSE routinely makes restating adjustments to test year loads for the difference between actual and "normal" temperatures in the development of its retail rates. Doing so helps to ensure that the relationship between revenues and costs in the test year is reasonably representative of that relationship in the rate year.

The Commission has approved temperature adjustments to test year loads since at least the 1970's. In fact, in one case, Staff initiated such a temperature adjustment to test year loads. On page 18 of the Second Supplemental Order to Cause No. U-74-4,[2] this Commission noted:

[2] Second Supplemental Order Rejecting Revisions to Tariff WN U-23, But Authorizing Refiling Under Conditions Stated, Cause No. U-74-4.

> Staff proposed an effect on net operating income of $31,000; *said adjustment was made by Staff based upon a study made by company of temperature normalization*. Exhibit No. 31 reflects the data used by Staff to determine the effect on KWH and revenues of the company had the 1973 test year period weather been normal. The company did not oppose this adjustment; the Commission is of the opinion that the Staff adjustment is proper. (emphasis added)

Since, (1) conservation and temperature both affect PSE's revenues and costs in the same manner, (2) the effect of conservation achieved in the test year is not adequately reflected in test year revenues and costs, and (3) the Commission routinely approves temperature adjustments to test year loads to make the relationship between test year revenues and costs more reflective of that relationship expected in the rate year, the Conservation Phase-In Adjustment is an equally appropriate ratemaking adjustment.

B. The Conservation Phase-In Adjustment Properly Matches Test Year Revenues and Costs

Q. Please explain Staff's claim that the Conservation Phase-In Adjustment creates a mismatch in test year revenues and costs.

A. Mr. Parvinen asserts that introducing the Conservation Phase-In Adjustment into the case creates a mismatch between test year loads and test year costs. To alleviate this mismatch, Mr. Parvinen asserts that, in addition to the effects on PSE's power costs, other offsetting factors that would have occurred during the test year as a result of decreased loads must be recognized in concert with the

proposed adjustment.[3] Mr. Parvinen speculates that the Company should have also reduced costs such as labor or maintenance in connection with this adjustment.[4]

Q. Do you agree that offsetting factors related to labor or maintenance costs should be taken into consideration in connection with the Conservation Phase-In Adjustment?

A. No. Aside from power and gas supply costs, which are already reduced through the application of the Conservation Phase-In Adjustment, conservation savings do not affect any of the Company's short-run costs that are used in the development of its base rates. Conservation savings do not reduce the amount of transmission or distribution facilities owned and operated by the Company in the short run or the associated costs. They also have no bearing on the Company's customer-related costs. As a result, there are no other offsetting costs to consider.

Q. Does Commission precedent support Mr. Parvinen's conclusion that offsetting factors, aside from those already reflected in the Company's proposal, should be considered in connection with the Conservation Phase-In Adjustment?

A. No, in fact, quite the opposite. Since at least the 1980's, the Company has incorporated the effects of temperature on test year loads in its ratemaking. To

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[3] *See* Exhibit No. MPP-1T, page 14, lines 20-22.

[4] *See id*. at 15, lines 1-2.

the Company's knowledge, the Commission has never required consideration of any other offsetting factor in connection with adjustments to test year loads for the effects of temperature. Further, to the Company's knowledge, no other electric or gas utility under the Commission's jurisdiction accounts for other offsetting factors in connection with temperature adjustments to their test year loads.

As noted earlier, the effect of a change in loads on the Company's costs will be the same, regardless of whether the effect on loads comes from conservation or abnormal temperature. Therefore, singling out the effects of the Conservation Phase-In Adjustment in a different manner than Commission-approved temperature adjustments would create unequal treatment of like adjustments. Indeed, assuming that Commission-approved temperature adjustments appropriately matches revenues and costs, requiring PSE to account for additional offsetting effects related to the Conservation Phase-In Adjustment would create a mismatch between the Company's revenues and costs.

C. The Conservation Phase-In Adjustment Has a Material Effect on the Company's Finances

Q. Did Mr. Parvinen consider other factors in reaching his conclusion that the Commission should reject the Company's proposed Conservation Phase-In Adjustment?

A. Yes. Pointing to PSE's Response to Staff Data Request No. 190, Mr. Parvinen concludes that, since the Company declined to re-run its cost of service analyses for the effects of the Conservation Phase-In Adjustment in the Company's Supplemental Filing, the adjustment is not material enough to warrant its need by the Company.[5]

Q. Do you agree that the Conservation Phase-In Adjustment is immaterial to the Company's finances?

A. No. The adjustments to gas and electric test year loads add more than $4 million to the Company's revenue deficiency. Such an amount is material to PSE's finances.

Q. Does the fact that the Company decided not to re-run its cost of service studies for the effects of the Conservation Phase-In Adjustment bear on the adjustment's materiality?

A. No. The Company often makes adjustments during the course of a rate proceeding, and rarely does it re-run its cost of service analysis during this time. Only in instances where the relative parity ratios are expected to be materially affected, will the Company choose to re-run its analysis. Therefore, to jump to the conclusion that an item is immaterial because the Company does not re-run its cost of service analyses is invalid.

[5] *See id.*, page 15, lines 14-20.

D. The Conservation Savings Used in the Conservation Phase-In Adjustment Are Sufficiently Rigorous for Ratemaking Purposes

Q. Please summarize Mr. Parvinen's testimony with regard to conservation savings used in the Conservation Phase-In Adjustment?

A. Mr. Parvinen asserts that in order for the conservation savings used in the Conservation Phase-In Adjustment to be rigorous enough for ratemaking, these savings must meet the "known and measurable" standard. According to Mr. Parvinen, to meet this standard, conservation savings must be independently verified and evaluated, and they must go through a post-installation analysis.[6]

Q. Does Mr. Pariven support his conclusion that conservation savings must be independently verified and evaluated through a post-installation analysis to meet the "known and measurable" standard?

Mr. Parvinen provides no support in rule, Commission precedent, or law, for his assertion that conservation savings must be independently verified and analyzed following installation before these savings meet the known and measurable standard for ratemaking purposes. This is an entirely new standard developed post hoc by Staff.

[6] *See id.*, page 16, lines 12-23.

Q. Does Commission precedent support Mr. Pariven's conclusion that PSE's reported conservation savings do not meet known and measurable ratemaking standards?

A. No. The Commission has used the Company's reported conservation savings, which are not independently verified or evaluated with any post-installation analyses, in PSE's performance incentives since 2003. The Commission has used these savings first in the Company's penalty-only performance incentive mechanism in place from 2003 through 2006, then in the reward/penalty performance incentive mechanism that replaced the penalty-only mechanism in 2007. For example, Staff and the Commission reviewed the Company's conservation savings in Docket Nos. UE-090314 and UE-080389. To now argue that conservation savings are not sufficiently rigorous for ratemaking purposes after supporting their use for applying penalties is, at best, inequitable.

Q. Is there any other support for the validity of the Company's reported conservation savings?

A. Yes. The measurement and evaluation of the Company's conservation savings is consistent with industry standards, as defined by the International Performance Measurement and Verification Protocol. Further, the Company's reported conservation savings and the associated process for developing them were reviewed this year by an independent third-party, Blue Ridge Consulting Services, Inc. ("Blue Ridge"), hired jointly by Staff and the Company to evaluate

PSE's ECIM. The final report by Blue Ridge for the time period 2007 through 2008 was issued on October 24, 2009 and sent to Staff.[7] This report, which validated the Company's reported conservation savings, is provided as the First Exhibit to my Prefiled Rebuttal Testimony, Exhibit No. JAP-6.

According to page 29 of the Blue Ridge Report, "[t]he Measure Metrics Management process provides reasonable strength by which energy savings may be calculated. Attention to keeping the system current while ensuring justifiable additions, maintenance of historical record, and ease of access *provide confidence in accurate reporting of savings*." (emphasis added)

Q. Has the Commission used the Company's estimates of future conservation savings for ratemaking purposes?

A. Yes. The Company's rates are developed, in part, using forward-looking load and power cost projections. Embedded within PSE's load forecast, and reflected in the power cost projections, is a forecast of conservation savings, which reduce loads and power projected in the rate year. The conservation savings projected in the rate year include 100% of the conservation savings implemented in the test year, including the savings used to calculate the proposed Conservation Phase-In Adjustment.

Similarly, PSE's Commission-approved gas cost rates are also forward-looking,

[7] Independent Third-Party Evaluation of PSE's Electric Conservation Incentive Mechanism (hereafter, "Blue Ridge Report"), Blue Ridge Consulting Services, Inc., October 24, 2009.

including the effects of forward-looking estimates of conservation savings and actual savings achieved in the test year.

Further, the Commission has reviewed the Company's expected conservation savings and has used them to approve PSE's conservation budgets and rates since at least 2003.

Q. What does this suggest about whether the test year conservation savings data is "rigorous" enough for ratemaking purposes?

A. The fact that the Commission already allows PSE to use projections of conservation through the end of the rate year to develop rates suggests that reported test year conservation savings data, which should be known with greater certainty, are sufficiently rigorous for ratemaking purposes.

E. Applying Hourly Shapes to Conservation Savings Has Little Effect on the Resulting Conservation Phase-In Adjustment

Q. Please explain Mr. Parvinen's concern regarding the hourly load shapes of conservation savings.

A. Mr. Parvinen believes that the adjustment should address the hourly load shape of the Company's test year conservation savings.

Q. Do you agree that the Conservation Phase-In Adjustment should make use of

shaped conservation savings?

A. While this approach has theoretical appeal, it would make little difference to the results in this case.

Q. Can you illustrate what impact shaped conservation savings would have on the results of the Conservation Phase-In Adjustment?

A. Yes. Using the factors used to shape conservation savings in the Company's Integrated Resource Plan, ("IRP"), the Conservation Phase-In Adjustment for the electric system grows from 124 million kWh to 127 million kWh, or an increase of approximately 2.4%. For the Company's gas system, the adjustment increases from 2.086 million therms to 2.106 million therms, or an increase of approximately 0.9%. These figures are derived in the Second Exhibit to my Prefiled Rebuttal Testimony, Exhibit No. JAP-7.

Q. Given what little difference it makes whether conservation savings are shaped or not, do you have an opinion as to whether this is a reasonable improvement to the proposed Conservation Phase-In Adjustment?

A. I do not believe the minimal change in results warrants a more precise accounting of the potential seasonality of conservation savings, particularly in light of the added costs that ratepayers may have to bear to acquire this precision.

F. <u>The Company's Electric Conservation Incentive Mechanism Is Insufficient to Recover Lost Revenue or Lost Margin Due to PSE's</u>

Conservation Programs

Q. Please describe the Company's ECIM?

A. PSE's ECIM, in effect since the beginning of 2007, replaced the penalty-only mechanism that had been in place since 2003. The ECIM provides a financial incentive to the Company for energy savings from conservation programs that meet or exceed annual baseline targets set by PSE in consultation with the Conservation Resources Advisory Group ("CRAG").

Q. How much additional revenue has the Company earned through the ECIM?

A. PSE has earned incentives of $3.45 million for conservation savings achieved in calendar year 2007 and $4.34 million for conservation savings achieved in calendar year 2008.

Q. What does Mr. Parvinen conclude about PSE's earned incentives?

A. He concludes that the level of these incentives "outweighs any estimates of [PSE's] lost revenue."[8]

Q. Why does Mr. Parvinen conclude that the incentive earned through the Company's ECIM outweighs any estimates of PSE's lost revenue?

A. This is unclear. Nowhere in Mr. Parvinen's testimony does he provide estimates

[8] Exhibit No. MPP-1T, page 17, line 12.

of the lost revenue, or lost margin, the Company experiences related solely to its conservation programs. However, Staff should be fully aware of the lost revenue and lost margin estimates provided and validated in the previously-discussed Blue Ridge Report.

Q. What were the estimates of lost revenue and lost margin validated by the Blue Ridge Report?

A. As stated above, PSE earned a total of nearly $8 million in incentive payments under the ECIM in calendar years 2007 and 2008. At the same time, Blue Ridge confirmed that the conservation implemented in these two calendar years were projected to result in over $46 million in lost revenues and $34 million in lost margin to the Company. As a result, "Blue Ridge concluded that the ECIM does not provide full recovery of lost margin…"[9]

Q. Did Staff, or any other party in this proceeding, object to these Blue Ridge findings?

A. No, they did not.

Q. Does the Company have any other concerns with Mr. Parvinen's testimony surrounding PSE's ECIM?

A. Yes. The Company disagrees with Mr. Parvinen's assertion that the ECIM was

[9] Blue Ridge Report, page 9.

established with the purpose of removing the Company's disincentive to invest in conservation.[10] The ECIM was established to provide an incentive to conservation, but there were no illusions that it would remove disincentives. These are apples and oranges. The financial disincentive to Company-sponsored conservation programs occurs as a result of the effects these programs have on the Company's ability to recover its costs.

The independent Blue Ridge Report supports PSE's understanding that the ECIM does not remove disincentives. Page 11 of the Blue Ridge Report states that "PSE has attempted to achieve as much cost-effective conservation as possible *even though the ECIM was not designed as a recovery mechanism for lost margin or foregone earnings*." (emphasis added)

As illustrated above, the ECIM clearly does not remove the disincentive to Company-sponsored conservation. The Company's lost margin due to Company-sponsored conservation far exceeds payments under the incentive mechanism.

Moreover, the ECIM is specific to PSE's electric system. There is no comparable mechanism for the recovery of PSE's lost margin due to Company-sponsored natural gas conservation programs. This only adds to the problem already highlighted in the Blue Ridge Report.

Q. With the RCW 19.285 requirement that utilities invest in conservation, why

[10] Exhibit No. MPP-1T, page 17, lines 4-8.

should the Commission be concerned about removing financial disincentives to utility-sponsored conservation?

A. The simple answer is that it is a critical element of good ratemaking.

Think of a situation where legal or regulatory constraints on the operation of a hydroelectric generating facility result in lower secondary sales and/or higher costs for a utility. Under this situation, assuming that the utility is doing what it is required to do, the Commission would appear obligated to allow the utility to recover the associated foregone secondary sales revenues and/or higher expenses.

The same logic applies to the requirements of RCW 19.285. PSE is now required, by law, to achieve conservation savings targets that reduce its sales and impedes its ability to otherwise recover costs unrelated to conservation (*i.e.,* incur "lost margin"). As a result, in keeping with the fundamental doctrine of setting rates to cover appropriate costs, the Commission should authorize full recovery of the utility's lost margin resulting from the requirements of RCW 19.285.

Q. How could the proposed Conservation Phase-In Adjustment be modified to more effectively remove the financial disincentives to Company-sponsored conservation?

A. The Conservation Phase-In Adjustment could be modified to reflect the projected Company-sponsored conservation savings through the end of the rate year. By doing so, PSE's rate year revenues will not be adversely affected by Company-

sponsored conservation programs.

Q. What would the level of the adjustment be if it reflected PSE's projected Company-sponsored conservation savings through the end of the rate year?

A. If the proposed adjustment were modified to reflect Company-sponsored conservation currently projected to be achieved through the end of the rate year, including conservation savings projected to be achieved through PSE's participation in the Northwest Energy Efficiency Alliance, the adjustment to electric test year loads would be approximately 748 million kWh and the adjustment to natural gas test year loads would be approximately 11.7 million therms. The electric figures are derived in the Third Exhibit to my Prefiled Rebuttal Testimony, Exhibit No. JAP-8. The natural gas figures are derived in the Fourth Exhibit to my Prefiled Rebuttal Testimony, Exhibit No. JAP-9.

Q. Would this completely remove the disincentive to Company-sponsored conservation programs?

A. It would go a long way toward removing the financial disincentives, but it would not remove them completely. Currently, the effects of conservation on the reduction in demand charge revenues are not captured in the Company's revenue calculations.

Q. Is it appropriate to also include the effects of conservation on lost demand charge revenues?

A. Yes. However, the Company believes the impacts of its conservation programs on peak billing demands is not understood well enough to include as part of this adjustment at this time. The understanding of how conservation affects PSE's demand charge revenues continues to evolve and could be sufficiently rigorous to use as part of some future rate filing.

Q. Can you provide a rough estimate of the impact of Company-sponsored conservation on the loss in demand charge revenues assuming the reduction in billed demands were proportional to the reduction in billed energy sales?

A. Yes. Under the filed Conservation Phase-In Adjustment, test year commercial and industrial electric sales are reduced by 0.5%. If test year commercial and industrial customer billed demands were assumed to decrease proportionally, PSE's current electric system revenue deficiency of $113.3 million would increase by $0.9 million under the filed adjustment. The derivation of these figures is provided in the Fifth Exhibit to my Prefiled Rebuttal Testimony, Exhibit No. JAP-10.

Q. Would PSE's power supply costs also need to be further reduced to reflect the impact of Company-sponsored conservation on the Company's peak demands?

A. No. The impact of Company-sponsored conservation is already reflected in the test year power costs through the application of the Production Factor

Adjustment. This further highlights the conservative nature of the Company's proposed adjustment. While PSE's power costs have been reduced to reflect the impact of Company-sponsored conservation on energy sales and peak demands, the projected revenues only reflect lower energy sales, but not lower billed demands.

Q. Do you have any other concerns with Mr. Parvinen's testimony regarding the Company's disincentive to invest in conservation?

A. Yes. The Company is troubled that there continues to be confusion surrounding the issue of disincentives to utility-sponsored conservation. The Company believes that a formal, written Commission policy regarding the removal of disincentives to conservation that applies fairly and consistently to all jurisdictional utilities would go far to alleviate this confusion. It is also noteworthy that, like PSE, no electric or gas utility regulated by the Commission has a permanent mechanism in place to address the issue of lost margin due to conservation. With this backdrop, this case presents a perfect opportunity for this Commission to formulate clear written policy and approve permanent mechanisms that promote conservation investment by removing the rapidly growing disincentives to Company-sponsored conservation programs.

III. RESPONSE TO PUBLIC COUNSEL TESTIMONY REGARDING CONSERVATION PHASE-IN ADJUSTMENT

Q. What is Public Counsel witness James Dittmer's reason that the Conservation Phase-In Adjustment should be removed from this case?

A. Mr. Dittmer claims that it is unreasonable to select only one driver of changing sales volumes while not taking into account other variables that also influence the level of these sales. He goes on to conclude that the adjustment does not meet the "known and measurable" criteria of WAC 480-07-510(3)(e)(iii), since it fails to consider that usage per customer may be increasing due to other factors.[11]

Q. Do you agree with these assertions?

A. No. Unlike Staff's use of the term "offsets" (in Mr. Parvinen's reference to WAC 480-07-510(3)(e)(iii)), Mr. Dittmer's opinion is that the effects of conservation on utility load cannot be used in isolation, without also considering all of the other factors that affect utility sales. In Mr. Dittmer's view, as long as loads are increasing in general, there is no harm to the utility.

Whether or not loads are increasing is irrelevant, because PSE's ability to recover costs has diminished due to conservation, regardless of load. What matters is that the utility would have had greater sales and recovered more costs were it not for the sales-reducing impact of conservation. In other words, the baseline is not

[11] *See* Prefiled Direct Testimony of James R. Dittmer, Exhibit No. JRD-1CT, page 38, lines 3-14.

whether loads are growing. Rather, it is what PSE's loads would have been in the absence of Company-sponsored conservation. In that regard, there are no offsets. Either conservation is reducing the Company's energy sales, and thereby its ability to recover costs, or it is not.

Q. Does Mr. Dittmer attempt to refute the Company's estimates of the conservation savings used in the Conservation Phase-In Adjustment?

A. Mr. Dittmer provides no evidence to refute the validity of the Company's conservation savings used in the Conservation Phase-In Adjustment, only that there are other offsetting factors. Along these lines, Mr. Dittmer also does not refute any of the conclusions reached in the independent Blue Ridge Report related to the validity of PSE's reported conservation savings.

Q. How do you respond to Mr. Dittmer's portrayal of the trajectory of the Company's use per customer?

A. Mr. Dittmer's testimony attempts to show that the Company's use per customer is not declining. Given the five-year economic period Mr. Dittmer presents in his testimony, this is not surprising. However, when a longer period of time is taken into account, it is clear that the Company's use per customer is declining, both for electric and natural gas service. More importantly, as stated earlier, whether use per customer is declining or increasing is irrelevant to determining whether an adjustment for known and measurable changes to test year loads caused by

Company-sponsored conservation is required by fundamental ratemaking principles.

IV. RESPONSE TO ICNU TESTIMONY REGARDING PEAK CREDIT CALCULATIONS

Q. Please describe the testimony of ICNU witness Donald Schoenbeck as it relates to the Company's proposed peak credit calculations.

A. ICNU rejects the Company's proposed peak credit calculation because, in Mr. Schoenbeck's opinion, it

(i) assumes an incorrect capacity factor for the baseload resource;

(ii) eliminates the hours of peaking resource operation; and

(iii) includes carbon emission costs.

A. PSE's Peak Credit Calculation Uses an Appropriate Capacity Factor for the Baseload Resource

Q. What is Mr. Schoenbeck's proposal for the baseload resource capacity factor in the peak credit calculation?

A. Mr. Schoenbeck claims that PSE erred in its peak credit calculations by using a 95% capacity factor for the baseload resource in the calculations. Instead, he proposes that a 55% capacity factor be used, based on PSE's system load factor.

Q. Is Mr. Schoenbeck putting forth a new proposal?

A. No. This proposal is nearly identical to one provided in his direct testimony in PSE's 1992 general rate case. Docket Nos. UE-920433, UE-920499 and UE-921262 (consolidated) ("1992 GRC"). In that case, Mr. Schoenbeck proposed using a 54% baseload resource capacity factor in the peak credit calculation instead of the Company's proposal.[12] Mr. Schoenbeck's figure in the 1992 GRC tied to his estimate of the Company's system load factor at the time.

Q. Is the Company persuaded by Mr. Schoenbeck's arguments in this case regarding the appropriate baseload resource capacity factor to use in the peak credit calculation?

A. The Company does not believe Mr. Schoenbeck's testimony in this case is any more compelling today than it was in the 1992 GRC. The Company's response in the 1992 GRC to Mr. Schoenbeck's proposal was that the assumed capacity factor of the baseload resource used in the peak credit calculation should be consistent with the Company's resource planning and avoided cost criteria. PSE continues to believe this is true today.

Q. Is the baseload resource capacity factor used by the Company in the peak credit calculation in this case consistent with its current resource planning assumptions and avoided cost calculations?

A. Yes, it is. The combined-cycle combustion turbine ("CCCT") is assumed to be

[12] *See* Prepared Direct Testimony of Donald W. Schoenbeck on Behalf of the Washington Industrial Committee for Fair Utility Rates, page 8, lines 2-22.

operated as a baseload resource in the peak credit calculation, where, consistent with the Company's resource planning and avoided cost assumptions, it is assumed to be available 95% of the time.

Q. Is it necessary, as asserted by Mr. Schoenbeck, to assume that the CCCT in the peak credit calculation operates in a manner similar to the way it might actually be operated by the Company?

A. No. To the extent that the Company's CCCTs are operated at less than their full availability in actuality or in its AURORA projections, that is an indication of economic dispatch and not baseload operations. In fact, it is far more likely that the Company's coal-fired generating resources would be called upon for true baseload operations, given their lower operating costs. For instance, in the test year, PSE operated its coal-fired Colstrip Units 1 & 2 at nearly an 80% capacity factor and Colstrip Units 3 & 4 at over a 90% capacity factor. In contrast, the Company operated its Goldendale CCCT at only a 56% capacity factor during the test year. Therefore, at a minimum, if it were imperative to reflect actual baseload operations in the peak credit calculations, using the operations of PSE's Colstrip units as a guide would be more appropriate, since they are actually operated as true baseload resources.

Q. Has the Commission already addressed Mr. Schoenbeck's proposal?

A. Effectively, it has. The Commission addressed Mr. Schoenbeck's nearly identical proposal in PSE's 1992 GRC and found in favor of the Company's proposal regarding the appropriate capacity factor for the baseload resource, citing "the company's consistent use of this factor in its resource planning and avoided cost calculations."[13]

Q. Has Mr. Schoenbeck provided any evidence to suggest that the Commission's reasons for finding in favor of the Company in the 1992 GRC are no longer valid?

A. No. This is simply a duplication of his previous arguments. Since Mr. Schoenbeck's testimony offers no new evidence to support a proposal that is nearly identical to one he made in PSE's 1992 GRC, the Commission should reject it again.

B. The Company's Peak Credit Calculation Properly Excludes The Hours of Operation for Peaking Resource

Q. Does Mr. Schoenbeck take issue with any other part of the Company's peak credit calculation?

A. Yes, Mr. Schoenbeck claims that it is inappropriate to eliminate the 75 hours of peaking resource operation in the peak credit calculation because, in his opinion,

[13] *See* Docket Nos. UE-920433, UE-920499 and UE-921262 (consolidated), Ninth Supplemental Order on Rate Design Issues, at 9 ("1992 Order").

the calculation must recognize the higher fuel cost associated with the peaking resource versus the baseload resource.

Q. Do you agree that the peak credit calculation must recognize the higher fuel cost associated with the peaking resource?

A. No. As mentioned in my direct testimony, it is inappropriate to include energy-related costs associated with the peaking resource, if the assumed purpose of the peak credit calculation is to isolate the cost of capacity. In fact, PSE's avoided capacity cost calculations, used in Schedules 91 and Appendix C of the Company's conservation tariffs, support this concept by assuming no fuel or any other variable operating costs for the proxy peaking resource used in support of those calculations.

Further, Mr. Schoenbeck appears to contradict himself relative to several points he made in his testimony in PSE's 1992 GRC that clearly favor the elimination of the hours of peaking resource operation from the peak credit calculation. In one instance, Mr. Schoenbeck noted that "[t]he foundation of the peak credit theory…is to separate these joint [capacity and energy] uses by determining the cost of supplying *pure* peak capacity."[14] (emphasis added) Mr. Schoenbeck went on to say that the peak credit calculation "derives the appropriate cost of providing capacity *without energy* ("naked capacity") from the cost of resources

[14] Prepared Direct Testimony of Donald W. Schoenbeck on Behalf of the Washington Industrial Committee for Fair Utility Rates, page 7, lines 11-13.

simultaneously providing both capacity and energy."[15] (emphasis added)

Each of these statements support the elimination of peaking resource hours of operation in the peak credit calculation.

Additionally, as stated on page 12 of my direct testimony, Exhibit No. JAP-1T, and acknowledged by Mr. Schoenbeck on page 8 of his direct testimony, Exhibit No. DWS-1T, this issue has minimal effect on the peak credit results and the results of the cost of service analysis. Further, the Commission has not used PSE's electric cost of service analysis, for which the peak credit calculation is one of many inputs, as "the" basis for setting rates. The Commission has simply used it as a guide.

C. The Company's Peak Credit Calculation Properly Includes Carbon Emission Costs

Q. Does Mr. Schoenbeck object to any other portion of the Company's peak credit calculation?

A. Yes. Mr. Schoenbeck states that the cost of carbon emissions are too speculative to include in the peak credit calculation at this time.

Q. Do you agree with Mr. Schoenbeck's assertion?

A. No, I do not. Carbon emissions are estimated, but they are no more speculative

[15] *Id.* at 9, lines 16-20.

than natural gas prices, which are another input to the peak credit calculation. As illustrated in my direct testimony, the range of gas prices used in PSE's current IRP produce peak credit results that range from 15% to 24%.[16] This is greater than the impact of the assumed carbon emission costs, which lowered the peak credit percentage from 27% to 21%.[17]

Further, the U. S. Environmental Protection Agency ("EPA") has finalized the proposed findings refernced in my direct testimony, Exhibit JAP-1T, noting that greenhouse gases "threaten the public health and welfare of current and future generations."[18] According to EPA Administrator, Lisa P. Jackson, "[t]hese long-overdue findings cement 2009's place in history as the year when the United States Government began addressing the challenge of greenhouse-gas pollution and seizing the opportunity of clean-energy reform."[19] The EPA's final rule serves to further erode the basis for arguments by Mr. Schoenbeck that "the possibility of these costs….is highly speculative."[20]

Q. Do you agree that the current prices for carbon emissions reported in Mr. Schoenbeck's testimony are more appropriate than those used in the

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[16] *Id.*

[17] *Id.* at 8, lines 7-9.

[18] http://www.epa.gov/climatechange/endangerment.html. *See also*, Docket No. EPA-HQ-OAR-2009-0171, "*Endangerment and Cause or Contribute Findings for Greenhouse Gases Under Section 202(a) of the Clean Air Act*".

[19] Press release issued by the EPA on December 7, 2009.

[20] Exhibit No. DWS-1T, page 9, lines 4-5.

Company's proposal?

A. No, for two reasons. First, Mr. Schoenbeck provides in his testimony a projection of emissions costs in only one year out of 30 used in the peak credit calculations. I am unaware of any carbon emission price forecast that assumes that prices in 2012 will persist 26 years into the future. To assume that the cost of carbon emissions will be the same in the fourth year as it will be in the 30th year of the projection is clearly unrealistic and inappropriate.

Second, and more importantly, the Company is currently using the carbon price forecast used in the peak credit calculation for resource planning purposes. Put simply, the Company is currently basing resource acquisition decisions, not to mention determining the cost effectiveness of its energy efficiency acquisitions, on a projection of carbon emission costs that is far higher than proposed by Mr. Schoenbeck. Using Mr. Schoenbeck's proposed carbon emission prices in the peak credit calculation would produce results that are internally inconsistent with the Company's resource planning and acquisition strategies. Mr. Schoenbeck's proposal would have the Company's resource acquisition decisions based on one carbon emission cost forecast and the classification of resource costs for ratemaking purposes based on another carbon emission cost forecast.

For these reasons, the Commission should reject Mr. Schoenbeck's proposal and order that the Company's forecast of carbon emission costs be included in the peak credit calculation.

V. CONCLUSION

Q. Please summarize your response to ICNU's proposed modifications to the Company's peak credit calculations.

A. ICNU's proposed modifications to the Company's peak credit calculations are inconsistent with the Company's resource planning and avoided cost assumptions, are unrealistic and, in one case, have already been denied by the Commission. In contrast, consistent with Commission direction in past orders, the Company's calculations are consistent with its resource planning and avoided cost assumptions. As such, the Commission should reject ICNU's proposal and adopt the Company's proposed changes to its peak credit calculations.

Q. Please summarize your response to Staff's and Public Counsel's criticisms of the Company's proposed Conservation Phase-In Adjustment.

A. Staff and Public Counsel base their rejection of the Company's Conservation Phase-In Adjustment on either incorrect assertions or inappropriate conclusions. The Company's proposed adjustment is appropriate and should be approved by the Commission because, in part, it:

- is consistent with current statute, Commission rules and Commission precendent,
- adjusts the Company's test year loads in a manner consistent with Commission-approved temperature adjustments,
- properly considers all appropriate offsetting factors,

- properly matches the Company's test year revenues and costs,
- has a material effect on the Company's finances,
- uses data sufficiently rigorous for ratemaking purposes, and
- helps reduce the disincentives to Company-sponsored conservation programs.

Further, to alleviate ongoing confusion surrounding the issue of lost margins due to utility-sponsored conservation programs, the Company believes that this case presents a perfect opportunity for this Commission to formulate clear written policy and approve permanent mechanisms that promote conservation investment by removing the rapidly growing disincentives to utility-sponsored conservation programs.

Q. Does this conclude your testimony?

A. Yes.