

**BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND)	DOCKET UG-101644
TRANSPORTATION COMMISSION,)	
)	
Complainant,)	ORDER 04
)	
v.)	
)	FINAL ORDER APPROVING AND
PUGET SOUND ENERGY, INC.,)	ADOPTING SETTLEMENT
)	AGREEMENT
Respondent.)	
)	
.....)	

Synopsis: The Washington Utilities and Transportation Commission (Commission) rejects revised tariff sheets Puget Sound Energy, Inc. (PSE or the Company) filed on October 1, 2010, by which the Company proposed to increase natural gas rates by approximately \$24 million. In lieu of the Company’s proposed increase in rates, the Commission approves and adopts a Settlement Agreement entered into by all parties to this proceeding that results in an increase of \$19 million. Additional settlement terms provide for an adjustment to water heater rental depreciation rates, maintenance of the status quo in terms of rate spread and rate design, support for increased funding for low-income program support, and ongoing study and discussion concerning cost of service study methodology.

SUMMARY

1 **PROCEEDING.** On October 1, 2010, PSE filed revisions to its natural gas tariffs proposing an increase of \$24,384,451 – a 2.3 percent increase in *overall* revenues¹ – reflecting increased costs over the test year ending June 30, 2010. The Commission suspended the filing on October 28, 2010, and conducted a prehearing conference on November 19, 2010. The parties initiated settlement discussions on January 14, 2011,

¹ We note that this proceeding involves only PSE’s non-gas costs. Gas costs are a pass-through item in rates regulated via Purchase Gas Adjustment proceedings conducted each fall. Relative to the Company’s non-gas costs, PSE’s as-filed increase in this case amounts to 4.9 percent. This is the so-called marginal increase in rates.

and reached a mutually agreed upon Settlement Agreement, which they filed on January 27, 2011. The Commission held a settlement hearing and a public comment hearing on March 1, 2011. The date for receipt of written comments from the public was extended to March 4, 2011, upon which date the record was closed.

2 **PARTY REPRESENTATIVES.** Sheree Strom Carson, Perkins Coie, Bellevue, Washington, represent PSE. Simon ffitch, Assistant Attorney General, Seattle, Washington, represents the Public Counsel Section of the Washington Office of Attorney General (Public Counsel). Robert D. Cedarbaum, Senior Assistant Attorney General, Assistant Attorney General, Olympia, Washington, represents the Commission's regulatory staff (Commission Staff or Staff).²

3 Chad M. Stokes, Cable Huston Benedict Haagensen & Lloyd LLP, Portland, Oregon, represents Northwest Industrial Gas Users (NWIGU). Elaine L. Spencer, Graham & Dunn PC, Seattle, Washington, represents Seattle Steam Company (Seattle Steam). Ronald L. Roseman, Attorney, Seattle, Washington, represents the Energy Project. Damon E. Xenopoulos, Brickfield, Burchette, Ritts & Stone, PC, Washington, DC, represents Nucor Steel Seattle, Inc. (Nucor Steel).

4 **COMMISSION DETERMINATIONS:** PSE presented its request as being limited in scope. The parties nevertheless carefully scrutinized the filing, conducted discovery, and analyzed pertinent data. They negotiated and resolved the issues to their mutual satisfaction without specifically resolving individual points of dispute concerning the Company's revenue requirement, but at a level that satisfied each of them on an overall basis considering what appears to have been a thorough review of relevant books and records. The Commission determines it should approve and adopt the parties' Settlement Agreement as a reasonable compromise of the issues in this proceeding.

5 Based on our review of the record, discussed below, we determine that PSE should be authorized to file revised tariff sheets that provide for the recovery of an additional \$19 million in revenue, as provided in the parties' Settlement Agreement. We also determine that it is appropriate to maintain the status quo with respect to rate spread

² In formal proceedings, such as this, the Commission's regulatory staff participates like any other party, while the Commissioners make the decision. To assure fairness, the Commissioners, the presiding administrative law judge, and the Commissioners' policy and accounting advisors do not discuss the merits of this proceeding with the regulatory staff, or any other party, without giving notice and opportunity for all parties to participate. *See* RCW 34.05.455.

and rate design while allowing an opportunity for continuing analysis and dialogue concerning these mechanisms for allocating and recovering costs. Further, it is reasonable to allow PSE to adjust its depreciation rates for water heater rentals, as provided in the settlement. Finally, we express our general support for the Company's continuing commitment to provide a level of support for low-income customers that recognizes the impact of increased rates.

MEMORANDUM

I. Background and Procedural History

- 6 On October 1, 2010, PSE filed revisions to its natural gas tariffs proposing an increase of \$24,384,451 – a 2.3 percent increase in overall revenues³ – reflecting increased costs over the test year ending June 30, 2010. PSE submitted prefiled testimony and exhibits in support of its tariff filing. The Commission suspended the filing on October 28, 2010, and conducted a prehearing conference on November 19, 2010. The parties, in addition to PSE, are Staff, Public Counsel, Northwest Industrial Gas Users, Seattle Steam Company, The Energy Project, and Nucor Steel Seattle, Inc. The Commission established a procedural schedule setting February 7, 2011, as the date for response testimony from the parties other than PSE.
- 7 The parties engaged in discovery, analyzed PSE's request and initiated settlement discussions on January 14, 2011. They reached a mutually agreed upon settlement prior to the date scheduled for response testimony. The Settlement Agreement, filed on January 27, 2011, was presented as a full settlement pursuant to WAC 480-07-730(1) (*i.e.*, all parties and all issues). The parties filed joint testimony in support of the Settlement Agreement on February 11, 2011.
- 8 The Commission held a settlement hearing and a public comment hearing on March 1, 2011, in Olympia, Washington. The date for receipt of written comments from the public was extended to March 4, 2011.

³ See *supra* footnote 1.

II. Settlement Agreement

- 9 The Settlement Agreement recommends an increase in natural gas revenue requirements of \$19 million, which constitutes a 1.8 percent increase in *overall* revenues and represents about 78 percent of what PSE asked for in its initial filing. The marginal increase (*i.e.*, relative to the non-gas costs) is 4.76 percent. On an average annual basis, residential customers will experience an increase of about 2.0 percent in the amount they pay PSE for natural gas service.⁴
- 10 The parties do not associate their recommended increase in PSE's revenue requirement to specific ratemaking adjustments, but agree that the overall increase of \$19 million will result in rates for natural gas service that are fair, just, reasonable and sufficient, considering the evidence filed, the discovery undertaken by Staff and others, and the rate spread and design agreed to by the Parties.⁵ The parties propose that the revised rates become effective April 1, 2011.
- 11 The Settlement Agreement also includes the parties' agreement to lower the depreciation rates for gas water heaters to avoid having the projected net balance of these assets become negative during 2011.⁶ Staff states this is a reasonable interim step until a full depreciation study can be performed. The parties request that the Commission approve these new depreciation rates and propose that they remain in effect until the Company's next depreciation study results are presented and accepted by the Commission. Mr. Story explained the background and rationale for this adjustment in his initial testimony and during the hearing. It is largely a matter of correcting for past practices, including over-depreciation of some long-lived infrastructure, to avoid having negative values appear on the asset side of PSE's balance sheet.

⁴ Exhibit B-2 (update of Exhibit JKP-12 showing residential customer bill impacts under the Settlement Agreement).

⁵ By way of background, Staff identifies five issues on which it disagreed with PSE in terms of specific adjustments: cost of debt; investor supplied working capital; treatment of accumulated deferred income tax benefits; staffing levels, wages, benefits and incentives; miscellaneous expenses and items included in rate base. Exhibit Joint-1T (Joint Testimony) at 10:10-18. Public Counsel also mentions a number of specific adjustments to which it objected, including "certain operations and maintenance expense" such as advertising costs; sponsorships; Board of Directors expenses; and use of corporate aircraft. *Id.* at 13:14-18.

⁶ The new depreciation rates were developed in a limited scope study performed by Gannett Fleming, Inc., which is the same company that sponsored PSE's 2006 Depreciation Study. *See* Exhibit JHS-1T (Story) at 16:19 – 18:18.

- 12 Attachment A to the Settlement Agreement shows the revenue requirement allocation among rate schedules and the rate design. The rate spread to which the parties agreed is the same rate spread for natural gas customers that was agreed to and approved by the Commission in PSE's 2009 general rate case, Docket UG-090705. The rate design is the same rate design PSE proposed in this case, except that the monthly residential customer charge will remain at \$10, rather than being increased as PSE originally proposed. Thus, the settlement rate design will not change from that approved in Docket UG-090705.
- 13 The agreed rate spread results in a 4.76 percent increase on margin⁷ with various classes receiving higher or lower proportions of that increase. Residential (Schedules 16, 23, and 53), Commercial and Industrial (Schedules 31 and 61), and Rental customers will see 100 percent of a uniform increase. Large Volume (Schedule 41 and 41T) will see 75 percent of a uniform increase. Interruptible (Schedules 85, 85T, 87 and 87T) and Limited Interruptible (Schedule 86) will see 50 percent of a uniform increase.
- 14 PSE agrees to continue its ongoing review of its natural gas tariffs as they relate to recovery of costs from firm and interruptible customers on Schedules 85, 86, 87, 85T, 86T and 87T. PSE will meet with Staff, Seattle Steam, NWIGU, Nucor Steel and other interested parties to inform them of the progress and preliminary findings of its review of these natural gas rate schedules prior to filing its next general rate case. However, PSE is not required to complete its review prior to making that filing.
- 15 Furthermore, PSE has agreed to modify its transportation tariff provisions to mirror Northwest Pipeline's monthly balancing and related penalty provisions. The parties propose that this modification will take place in a separate filing, which PSE has agreed to make within thirty days of a Commission order adopting and approving the Settlement Agreement in this docket.⁸
- 16 The parties also agree to support an increase in the annual level of low-income natural gas bill assistance funding when PSE files its low-income tariff (Schedule 129) for the next program year. The parties will support an increase that corresponds to the

⁷ See *supra* footnotes 1 and 3, and associated text.

⁸ The parties confirmed at the settlement hearing that this will be a separate filing in its own docket, subject to Commission review upon its presentation at an open meeting. The filing may appear on the Commission's no action, consent, or discussion agenda, as appropriate.

percentage total revenue increase the Commission approves in this proceeding for the residential class of natural gas customers.

17 Finally, as a standard settlement term, the parties agree that the Settlement Agreement and its underlying facts, principles, methods or theories will have no binding or precedential effect in any later proceeding. In this connection, the Settlement Agreement provides that PSE's next gas rate increase filing will be presented as a general rate case.⁹

III. Discussion and Determinations

18 The parties' witnesses, in their jointly filed testimony, state individually their reasons for supporting the Settlement Agreement. All parties describe it as a reasonable compromise considering the issues presented—one that results in rates that are fair, just, reasonable and sufficient, as required by law.

19 In terms of the proposed increase of \$19 million to its revenue requirement, PSE states that such an increase "supports the work the Company has been doing to strengthen its infrastructure and benefit its customers."¹⁰ PSE states more generally that "the Settlement Agreement is good for the Company, its customers, and its shareholders."¹¹

20 Staff's witness, Mr. Schooley, testifies that following a thorough investigation¹² Staff concluded that "many drivers of PSE's natural gas revenue deficiency represent prudently incurred expenses and investment, including PSE's significant investment in its gas distribution network to expand the system's capacity."¹³ In Staff's view, the

⁹ Exhibit J-2 (Settlement Agreement ¶ 13 (Provision VI. G.)).

¹⁰ Exhibit Joint-1T at 8:16-17; *see also* Exhibit SML-1T, *passim*.

¹¹ Exhibit Joint-1T at 9:11-13.

¹² Staff relates through Mr. Schooley's testimony that its investigation included submission of numerous data requests to PSE on a wide range of topics and analysis of the Company's responses to those requests, as well as analysis of PSE's responses to data requests submitted by other parties; several telephone conference calls with the Company and other parties; and time spent in the Company's Bellevue offices to review documents and to directly question Company personnel about the filing. "In essence, Staff conducted and completed a thorough investigation of the Company's filing in anticipation of submitting its own response case had the Parties not reached a full settlement." Exhibit Joint-1T at 9:15—10:4.

¹³ Exhibit Joint-1T at 10:6-9.

1.8 percent increase in overall revenues represents an appropriate increase in compensation to the Company.¹⁴ Staff testifies that since PSE's most recent general rate case, filed in May of 2009, the Company has invested significantly in its distribution network and has experienced operations cost increases that reflect modest national inflation over the past two years. This is consistent with the initial testimony and exhibits filed by PSE's witnesses.¹⁵ Staff believes that these heightened expenditures have resulted in benefits to customers and the public in the form of safe and reliable natural gas distribution service.

21 Staff testifies further that although the parties did not reach agreement on the proper treatment for each of the particular issues Staff might have raised in response to PSE's filing,¹⁶ "Staff is confident that our Settlement Agreement to increase the Company's natural gas revenues by \$19 million is a fair compromise that reserves all parties' rights to contest these issues in a subsequent rate proceeding."¹⁷ In this connection, we find it significant that the Settlement Agreement provides that "PSE's next natural gas rate case will be a 'general rate proceeding' that meets at least one of the criteria set forth in WAC 480-07-505(1)."¹⁸ This implies, at least, that the Commission will have an opportunity in the next case to review in detail the Company's full financial picture, including evaluation of its revenue requirement in the light of response testimony from Staff and others.¹⁹

¹⁴ We note again that the marginal increase in rates resulting from the settlement is 4.76 percent, a point Staff makes in its individual portion of the joint testimony. Exhibit Joint-1T at 11:6-9. It is particularly appropriate to take this perspective on the magnitude of the proposed change given that the proposed increase in revenue requirement, and the parties' stated rationale for supporting it, turns on increases only in the non-gas components of the rates. Our concern is more than academic. Though those involved in the regulatory process can easily distinguish between a PGA proceeding and a rate case involving non-gas costs, we suspect that the average ratepayer may not. A 1.8 percent increase may not seem like much, but, if it is coupled a few months later with a rate case through the PGA mechanism, it may seem more significant. It may be difficult to explain the separate avenues for gas rate adjustments, but we should err on the side of communicating more information rather than less in the hope that confusion will be minimized.

¹⁵ See generally Exhibits JHS-1T (Story) and SML-1T (McLain).

¹⁶ See *supra* footnote 4.

¹⁷ Exhibit Joint-1T at 10:20 – 11.3..

¹⁸ Exhibit Joint-2 (Settlement Agreement ¶ 13 (Provision VI. G.)).

¹⁹ We note in this regard that the Commission increasingly finds so-called black-box settlements a problematic outcome in rate proceedings for our larger jurisdictional utilities. While we are generally satisfied in this proceeding with Staff's representations concerning the rigor of its review, we nevertheless observe that without the benefit of response testimony our ability to review of the Company's financial circumstances vis-à-vis the proposed settlement, and therefore

- 22 Public Counsel’s witness, Ms. Kimball, testifies similarly to Mr. Schooley that following detailed review of the Company’s as-filed case and via discovery and discussions with other parties, Public Counsel concluded:

The revenue requirement increase of \$19,000,000, which is more than \$5 million lower than PSE’s original request, appropriately incorporates a compromise with respect to the disputed expenses identified by Public Counsel, as well as the issues identified by other Parties.²⁰

- 23 NWIGU, Seattle Steam and Nucor Steel all support the proposed revenue requirement as being a reasonable compromise of the contested issues. These parties, who individually and collectively represent the interests of PSE’s larger industrial gas customers, focus more specifically, however, on the issues of rate spread and rate design. NWIGU’s witness, Mr. Schoenbeck, for example, testifies that it is important to the organization that all schedules move toward parity and that relative cost relationships among schedules are maintained in the utility’s rate design. NWIGU states that it finds the spread of the gas rate increase in this instance consistent with various cost of service analyses it has undertaken in the past.²¹ Nevertheless, NWIGU also finds important the provisions of the Settlement Agreement that preserve parties’ rights to pursue cost of service issues in PSE’s next gas rate case, which will be a general rate case under the terms of the settlement.

- 24 Also focusing on rate spread and rate design, Nucor Steel’s witness, Mr. Higgins, testifies that the Settlement Agreement provides a reasonable apportionment of revenue responsibility among customer classes. Mr. Higgins states the result “is consistent with the apportionment determined in the previous PSE general rate case, which took into consideration a range of results produced by various cost of service studies.”²² Mr. Higgins testifies further that:

The rate design for large customers is also reasonable in that it provides for a proportionate increase in all rate components for Schedules 85,

fulfill our statutory duty to ensure that rates are fair, just, reasonable, and sufficient, may be more limited than is ideal.

²⁰ Exhibit Joint-1T at 13:18-22.

²¹ *Id.* at 15:10-14.

²² *Id.* at 17:10-13.

86, and 87, which produces consistent rate impacts across all customers on these rate schedules. Further, the demand charge for large customers will continue to be equalized. This consistency will provide for rational transitions between rate schedules, which is a characteristic of sound rate design.²³

- 25 Seattle Steam's witness, Mr. Gent, also finds paragraph 11 of the Settlement Agreement significant in connection with the issues addressed by Nucor Steel.²⁴ Paragraph 11 states:

PSE is in the process of reviewing, and agrees to continue its review of, its natural gas tariffs as they relate to recovery of costs from firm and interruptible customers on Schedule 85, 86, 87, 85T, 86T and 87T. Prior to filing its next general rate case, PSE agrees to meet with Staff, Seattle Steam, NWIGU, Nucor Steel, and other interested Parties to inform them of the progress of its review of these natural gas rate schedules and preliminary findings.²⁵

- 26 According to Mr. Gent, this provision relates to the rate spread and rate design settlement the Commission approved in PSE's 2007 general rate proceeding (Dockets UE-072300 and UG-072301). The settlement in that proceeding provided that the parties would conduct a facilitated collaborative concerning rate spread and rate design with an eye to possible changes in cost of service methodologies and results. Mr. Gent testifies that the parties conducted the collaborative but did not reach agreement on many of the issues. However, they did agree that separation of firm and interruptible service in Schedules 85, 86 and 87 for purposes of developing a cost of service study has conceptual merit. While this feature has not been a part of PSE's subsequent cost of service studies in any filed case, Mr. Gent testifies that:

PSE's agreement to inform the Parties of its progress on meeting the intent of the 2008 collaboration is a small step in the right direction. Seattle Steam believes the process started in the 2008 collaborative should make substantive progress.²⁶

²³ *Id.* at 17:13-19.

²⁴ Exhibit Joint-2 (Settlement Agreement ¶ 11 (Provision VI. E.)).

²⁵ *Id.*

²⁶ Exhibit Joint-1T at 17:2-5.

- 27 With respect to rate spread and rate design, the Energy Project finds it significant for low income customers that the status quo is being maintained. According to Mr. Eberdt's testimony, this means more is not being demanded of low-income households because of alterations that might otherwise have adverse effects for these customers. The Energy Project also testifies that maintaining the current monthly customer charge at \$10 is in low-income customers' best interest.
- 28 The Energy Project also supports the settlement because it is consistent with the organization's longstanding advocacy in support of adjusting the Company's programs to assist low-income customers to compensate for rate increases.²⁷ Mr. Eberdt testifies that by indexing HELP (*i.e.*, PSE's bill assistance program) funding to the residential rate increase approved by the Commission, the impact of the increase is mitigated to a degree for those families who are able to qualify for the program.²⁸
- 29 It appears from the parties' individual testimonies in support of the Settlement Agreement that it satisfies the parties' diverse interests. The intervenors' interests range from those of the Company's low-income residential customers to some of PSE's largest industrial customers. Public Counsel represents the interests of residential and smaller commercial customers, while the Commission Staff presents the public interest perspective. In addition, we have the Company's initial testimony providing some detail regarding the factors driving its request, and the assurances from Staff, Public Counsel and other parties that they carefully vetted this evidence in the light of discovery. We conclude on the basis of the full record that we should approve and adopt the Settlement Agreement as a reasonable compromise of the issues raised.
- 30 We reach this conclusion cognizant, too, of the public comment testimony that is largely in opposition to any rate increase.²⁹ The Commission understands, particularly in these harsh economic times, that many customers find any rate increase difficult to bear. Our responsibility, however, is not only to protect all customers' interests in keeping rates reasonable, but also to ensure the Company has sufficient resources to continue providing safe, reliable service. Based on the evidence presented, what we authorize here strikes the appropriate balance of these interests.

²⁷ Exhibit Joint-2 (Settlement Agreement ¶ 12 (Provision VI. F.)).

²⁸ Exhibit Joint-1T at 18:23 – 19:2.

²⁹ Exhibit B-1.

FINDINGS OF FACT

31 Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated findings and conclusions upon issues in dispute among the parties and the reasons therefore, the Commission now makes and enters the following summary of those facts, incorporating by reference pertinent portions of the preceding detailed findings:

32 (1) The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate rates, rules, regulations, practices, and accounts of public service companies, including electrical and gas companies.

33 (2) PSE is engaged in Washington State in the business of supplying utility services and commodities to the public for compensation.

34 (3) PSE's existing rates for natural gas service provided in Washington State are insufficient to yield reasonable compensation for the service rendered.

35 (4) PSE requires relief with respect to the rates it charges for natural gas service provided in Washington State. The Company should be authorized to recover in rates an additional \$19 million in revenue.

CONCLUSIONS OF LAW

36 Having discussed above all matters material to this decision, and having stated detailed findings, conclusions, and the reasons therefore, the Commission now makes the following summary conclusions of law, incorporating by reference pertinent portions of the preceding detailed conclusions:

37 (1) The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of, and parties to, these proceedings.

38 (2) Puget Sound Energy, Inc., (PSE) is a "public service company" and a "gas company," as those terms are defined in RCW 80.04.010 and as those terms otherwise are used in Title 80 RCW.

- 39 (3) The rates proposed by tariff revisions filed by PSE on October 1, 2010, and
suspended by prior Commission order, were not shown to be fair, just or
reasonable and should be rejected.
- 40 (4) The Commission must determine the fair, just, reasonable, and sufficient rates
to be observed and in force under PSE's tariffs that govern its rates, terms, and
conditions of service for providing natural gas to customers in Washington
State.
- 41 (5) The Settlement Agreement attached to this Order as an Appendix, and
incorporated by this reference, should be approved and adopted.
- 42 (6) The rates, terms, and conditions of service that will result from this Order are
fair, just, reasonable, and sufficient.
- 43 (7) The rates, terms, and conditions of service that will result from this Order are
neither unduly preferential nor discriminatory.
- 44 (8) The Commission Secretary should be authorized to accept by letter, with
copies to all parties to this proceeding, a filing that complies with the
requirements of this Order.
- 45 (9) The Commission should retain jurisdiction over the subject matters and the
parties to this proceeding to effectuate the terms of this Order.

ORDER

THE COMMISSION ORDERS THAT:

- 46 (1) The proposed tariff revisions PSE filed on October 1, 2010, which were
suspended by prior Commission order, are rejected.
- 47 (2) The Settlement Agreement attached to this Order as an Appendix, and
incorporated by prior reference, is approved and adopted.
- 48 (3) PSE is authorized and required to file tariff sheets following the effective date
of this Order that are necessary and sufficient to effectuate its terms. The

required tariff sheets must be filed at least three business days prior to their stated effective date, which shall be no sooner than April 1, 2011.

- 49 (4) The Commission Secretary is authorized to accept by letter, with copies to all parties to this proceeding, a filing that complies with the requirements of this Order.
- 50 (5) The Commission retains jurisdiction to effectuate the terms of this Order.

Dated at Olympia, Washington, and effective March 15, 2011.

WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

JEFFREY D. GOLTZ, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner

NOTICE TO PARTIES: This is a Commission Final Order. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 and WAC 480-07-870.

APPENDIX

Settlement Agreement