BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant,

v.

PUGET SOUND ENERGY, Respondent.

In the Matter of the Petition of

PUGET SOUND ENERGY

For an Order Authorizing Deferred Accounting Treatment for Puget Sound Energy’s Share of Costs Associated with the Tacoma LNG Facility

TESTIMONY OF

JASON L. BALL

STAFF OF
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Multiyear Rate Plan Policy;
Electric Reliability Reporting

July 28, 2022
# TABLE OF CONTENTS

I. INTRODUCTION .................................................................................................................. 1

II. SCOPE AND SUMMARY OF TESTIMONY ...................................................................... 2

III. STAFF OBJECTIVES WITH THE MYRP ................................................................. 5

IV. GENERAL POLICY FOR MYRPs .................................................................................. 8
   A. Legal Requirements of MYRPs ................................................................................. 10
   B. Principles And Standards for Reviewing MYRP ................................................... 11
      1. Commission history with MYRPs ...................................................................... 12
      2. Applying Commission historical standards to the MYRP ............................... 16
   C. Prudence During the MYRP ................................................................................. 17

V. MAP COMPONENT #1 - BASELINE & PROJECTIONS OF COSTS ......................... 23

VI. MAP COMPONENT #2 - REVIEW PROCESS FOR PROFORMA AND
    PROVISIONAL RATE BASE ......................................................................................... 29
    A. Review Process Proposed by PSE .......................................................................... 29
    B. Staff Proposed Review Process ........................................................................... 32

VII. MAP COMPONENT #3 - PERFORMANCE MEASUREMENT .............................. 39
    A. Need for Performance Measurement ................................................................... 39
    B. Policy Objectives, Performance Areas, and Performance Measures ............... 43
       1. Background ........................................................................................................ 44
       2. Staff-proposed Policy Objectives, Performance Areas, and Performance
          Measures ........................................................................................................... 45
    C. Performance Incentive Mechanisms .................................................................... 47
       1. Background ........................................................................................................ 49
       2. PSE’s Proposed Portfolio Refund Threshold ..................................................... 50

VIII. ELECTRIC DISTRIBUTION SYSTEM RELIABILITY REPORTING .................. 52
LIST OF EXHIBITS


Exh. JLB-3    Next-Generation Performance-Based Regulation: Primer-Essential Elements of Design and Implementation
Q. Please state your name and business address.
A. My name is Jason L. Ball, and my business address is 621 Woodland Square Loop SE, Lacey, Washington, 98503. My business mailing address is P.O. Box 47250, Olympia, Washington, 98504-7250. My business email address is jason.ball@utc.wa.gov.

Q. By whom are you employed and in what capacity?
A. I am employed by the Washington Utilities and Transportation Commission (Commission) as the Assistant Director in the Energy Regulation Section of the Regulatory Services Division.

Q. Please provide your educational background.
A. I earned a degree from New Mexico State University in 2010 with a dual major in Economics and Government. In 2013, I graduated with honors from New Mexico State University with a Master of Economics degree specializing in Public Utility Policy and Regulation.

Q. Have you testified previously before the Commission?
A. Yes. I have testified in a number of Commission proceedings including the following: PacifiCorp d/b/a/ Pacific Power & Light Company (PacifiCorp) general rate cases (GRCs) in Dockets UE-191024, UE-152253, and UE-140762; the
PacifiCorp PCAM review proceeding in Docket UE-170717; Puget Sound Energy (PSE) GRCs in Dockets UE-190529/UG-190530 and UE-170033/UG-170034; PSE’s power cost only rate case in Docket UE-141141; Avista Corporation d/b/a Avista Utilities in Dockets UE-200900/UG-200901 and UE-200894 (Consolidated), UE-190334/UG-190335, UE-160228/UG-160229, and UE-150204/UG-150205; and the Northwest Natural Gas Company, d/b/a NW Natural 2020 GRC UG-200994.

Q. Have you worked on any major projects at the Commission for which you have not provided testimony?

A. Yes. I was the lead staff for inquiries into reliability reporting and the lead negotiator for Washington in the PacifiCorp’s multi-state process. I was a co-lead for developing cost-of-service rules through the ongoing rulemakings in Dockets UE-170002 and UG-170003.

II. SCOPE AND SUMMARY OF TESTIMONY

Q. What is the scope and purpose of your testimony?

A. I provide Staff’s response to PSE’s proposed Multiyear Rate Plan (MYRP) filed under the new statute RCW 80.28.425 (MYRP Law). I explain staff’s general approach to a MYRP, the required components of a MYRP, and the treatment of performance measures within PSE’s proposed MYRP. Finally, I address improving Electric Distribution System Reliability Reporting.
Q. Please summarize your recommendations.

A. Staff recommends the Commission not implement a Performance-Based Regulation (PBR) approach for this case and instead use Staff’s more limited MYRP Assessment Prototype (MAP) for approval of this MYRP. Staff’s proposed MAP incorporates several recommendations related to the standards applied to MYRPs as well as each of the three major components of an MYRP. Importantly, the use performance measures in Staff’s MAP ensures that PSE will continue to make progress towards key policy objectives and, when combined with the portfolio review threshold, engage in cost-saving efforts at the same time.

I also recommend the Commission require PSE to propose a revised electric service monitoring and reporting plan before filing its next general rate case, improve the reporting of reliability, and require PSE to participate in a multi-party collaborative to address the general treatment of electric distribution system reliability.

Q. Why is Staff proposing a MAP?

A. Staff’s proposed MAP satisfies the legal requirements for approving a MYRP, replaces the incentive for cost controls formerly created by regulatory lag, and creates a process for reviewing the prudence of provisional plant subject to review in each year of the MYRP. The word “prototype” is meant to indicate the limited applicability of this framework. Staff designed the MAP with specific focus on PSE’s current case. At the end of the MYRP proposed by PSE, we believe a new
framework that incorporates the lesson’s learned from this case is the best course forward.

Q. Is the Company’s MYRP consistent with the legal requirements of the MYRP Law and existing Commission standards?

A. No. Although the Company’s presentation does a good job of technically satisfying the requirements of the MYRP law, it notably lacks a link between performance measures and actual operations required by statute. This missing link is a critical component of any practical implementation for MYRPs and should be considered necessary for their approval.

Q. Have you prepared any exhibits in support of your testimony?

A. Yes. I prepared Exhibits JLB-2 through JLB-3:

- Exh. JLB-2 is a handbook for regulators developing Performance Based Regulation (PBR) by Synapse Energy Economics, Inc.
- Exh. JLB-3 is a primer on design and implementation elements for PBR.

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1 RCW 80.28.425 (“The commission must, in approving a multiyear rate plan, determine a set of performance measures that will be used to assess a gas or electrical company operating under a multiyear rate plan.”).
III. STAFF OBJECTIVES WITH THE MYRP

Q. Please summarize Staff’s objectives for the current MYRP

A. This case represents the first fully adjudicated general rate case subject to the MYRP Law.\(^2\) Staff balanced the immediate rate case requirements with the long-term use of MYRPs. In particular, Staff focused several criteria in evaluating PSE’s proposed MYRP while at the same time developing its proposed MAP as an appropriate substitute for regulatory lag.

Q. Why does the MAP need to provide a substitute for regulatory lag?

A. Regulatory lag, or the delay in recovery of investment for the utility, is generally a way to encourage the utility to engage in cost discipline.\(^3\) As discussed later in my testimony, the effects of the MYRP on regulatory lag almost entirely negates the existing cost discipline incentive. However, as a replacement for the lack of cost control incentives, Staff used performance measures within our proposed MAP to transparently evaluate the effects of utility decisions on customers, utility service quality, the environment, and the utility’s operations. Staff also recommends the Commission approved PSE’s proposed portfolio review threshold which creates a strong incentive for PSE to engage in cost controls. Whenever Staff witnesses discuss or propose performance measures, our focus is on ensuring fair and equitable outcomes for the MYRP.

\(^2\) Id. ("Beginning January 1, 2022, every general rate case filing of a gas or electrical company must include a proposal for a multiyear rate plan as provided in this chapter.").

\(^3\) Ball, Exh. JLB-2 at 11.
Based on Staff’s objectives in this case, we recommend a MAP to generate rates over the course of the MYRP that are equitable, fair, just, reasonable, and sufficient. However, this MAP is limited and should only be used for the present case.

Q. **How does Staff incorporate the Commission’s existing standards?**

A. Staff applied existing Commission principles and standards in a manner consistent with the new law. Moreover, the legislature explicitly bound MYRPs to existing regulatory practices:

> The commission's consideration of a proposal for a multiyear rate plan is subject to the same standards applicable to other rate filings made under this title, including the public interest and fair, just, reasonable, and sufficient rates. In determining the public interest, the commission may consider such factors including, but not limited to, environmental health and greenhouse gas emissions reductions, health and safety concerns, economic development, and equity, to the extent such factors affect the rates, services, and practices of a gas or electrical company regulated by the commission.\(^4\)

Staff followed this guidance carefully to ensure our MAP complies with the new MYRP Law while focusing on the outcomes of the MYRP itself. Importantly, Staff focused on the concept of equity in examining the proposed MYRP, as described by Staff witness Deborah Reynolds.\(^5\) Staff also identified areas where streamlining can occur through the reduction in duplicative or unnecessary reporting.\(^6\)

Finally, Staff focused on following existing processes wherever possible.

Within the policy directive, the Legislature specifically stated:

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\(^4\) RCW 80.28.425(1).

\(^5\) See Reynolds, Exh. DJR-1T at 8:8 – 13:19.

\(^6\) See Reynolds, Exh. DJR-1T at 14:5 – 16:5.
To provide clarity and certainty to stakeholders on the details of performance-based regulation, the utilities and transportation commission is directed to conduct a proceeding to develop a policy statement addressing alternatives to traditional cost of service rate making, including performance measures or goals, targets, performance incentives, and penalty mechanisms.\(^7\)

Since this policy statement is not yet complete, Staff is operating without direct guidance from the Commission. Wherever possible, Staff witnesses applied existing Commission guidance articulated through prior Commission orders and policy statements. This was critical step in Staff’s case as we identified the impact from the new MYRP Law on regulatory lag.

Q. **How does the MYRP Law influence Staff’s presentation?**

A. Staff’s analysis and proposed MAP within this case is designed to align with the MYRP Law. In particular, the MYRP Law lays out specific requirements for the approval of MYRPs, including the use of performance measures as well as aligning the MYRPs with clean energy legislation.\(^8\) Staff strongly believes that these requirements represent a minimum threshold and must align with broader regulatory reform. For example, the Commission is engaged in a policy proceeding with a 5-year expected time frame to evaluate alternatives to cost of service regulation.\(^9\) To the extent practical, Staff’s proposed MAP is designed to support and uplift that investigation while ensuring the immediate requirements are met.

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\(^7\) **Laws of 2021**, ch. 188, § 1.
\(^8\) See generally **RCW 80.28.425**.
\(^9\) **In re the Comm’n’s Proceeding to Develop a Policy Statement Addressing Alternatives to Traditional Cost of Serv. Ratemaking**, Docket U-210590, UTC Legislative Report – Performance Based Regulation Final Appendix, 2 (Jan. 27, 2022).
IV. GENERAL POLICY FOR MYRPs

Q. What is a Multiyear rate plan (MYRP)?

A. A MYRP is a fixed period during which adjustments to rates are limited and not
determined through general rate cases. The Commission has a long history with
MYRPs, and RCW 80.28.425 establishes the procedures, broadly, that a MYRP must
follow.

Q. What are the components of a MYRP that must be addressed in a MYRP
Assessment Prototype (MAP)?

A. In alignment with the MYRP Law, Staff has identified three specific components of
MYRPs that are required by the Commission’s current processes. In combination,
these three components constitute Staff’s proposed MAP. These are:

1. Baseline O&M and rate base, including projections of these elements for
each rate year.
2. Review process for proforma and provisional rate base additions.
3. Performance measures, including:
   o Performance goals and areas.
   o Performance measures.
   o Performance incentive mechanisms.

I discuss each of these components below and whether PSE’s proposal meets the
minimum requirements of the MYRP law. I also present Staff’s proposed MAP as an
alternative to the PSE presentation.
Q. **What is Performance Based Regulation (PBR)?**

A. PBR is the use of incentives, measures, and other regulatory tools to influence utility actions and behaviors to achieve certain policy objectives. There are many different descriptions and aspects of PBR, including titles like “alternative form of regulation” and “alternative ratemaking.” Sometimes even MYRPs are considered a form of PBR. For the purposes of Staff’s testimony, we consider PBR to be the general restructuring of revenue recovery to change general utility behaviors, actions, and practices. Staff is not recommending the Commission take a PBR approach for this case but instead the Commission should use Staff’s more limited MAP.

Q. **What are the differences between PBR and Staff’s proposed MAP?**

A. Staff’s MAP constitutes the minimum requirements necessary to satisfy the MYRP Law. PBR, on the other hand, requires broad examination and restructuring of existing incentives throughout the utility’s rate schedules (including individual tariffs, riders, and cost recovery mechanisms), reports, and its operations. The broad scope of PBR makes it extremely challenging to implement in a single proceeding.

Q. **How does PBR relate to performance incentives?**

A. Performance incentives are specific tools to address or change specific behaviors, actions, or practices. In this way they are only a component of PBR and are hyper-focused on singular objectives. Incentives take many forms and are already a key

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10 Ball, Exh. JLB-2 at 13.
11 Id.
12 See generally RCW 80.28.425.
element of the regulatory framework. \textsuperscript{13} Staff is recommending the Commission adopt its proposed MAP that incorporates limited performance incentives consistent with the legal requirements of RCW 80.28.425.

A. Legal Requirements of MYRPs

Q. Please describe the statutory foundations for the Company’s GRC.

A. RCW 80.28.425 establishes the procedures, broadly, that a MYRP must follow. This creates a minimum legal threshold, which includes performance measures, that must be present for the Commission to approve a MYRP. These requirements are:\textsuperscript{14}

1. The MYRP must be subjected to the same standards applicable to GRCs;
2. Low-income bill assistance must increase by twice as much as general rates;
3. The calculation of rates separately for each year of a MYRP. This includes:
   a. A fair value estimate, for rate making purposes, of used and useful property during each rate year, including the initial effective date.
   b. Revenues and operating expenses for each year of the MYRP;
4. A proposal to update power costs in the third year of a MYRP, if present;
5. A deferral mechanism for revenue exceeding 0.5\% of the authorized rate of return as determined by the Commission Basis Reports; and
6. Performance measures that assess utility operations during a MYRP.

Q. How did PSE apply these requirements to its case?

A. PSE provided comprehensive testimony that is, on a technical basis, consistent with the overall legal threshold discussed above. However, as described by Staff witnesses, there are areas of the Company’s case that lack sufficient detail, evidence, or connection with Commission standards. The sections below address PSE’s

\textsuperscript{13} Ball, Exh. JLB-3 at 2.
\textsuperscript{14} See generally RCW 80.28.425.
approach for each of the MYRP requirements just listed and, where applicable, Staff’s response.

B. Principles and Standards for Reviewing MYRP

Q. Are MYRPs subject to the same standards applicable to GRCs?
A. Yes. Since the Commission sets rates on a prospective basis, as prescribed in statute, Staff’s analysis of the MYRP starts with the projections used to formulate the rates in each year of the plan. All staff witnesses also rely on the existing standards relevant to their analysis (e.g., known & measurable, used & useful, etc.). Each standard, where necessary, is referenced by each witness.

Q. Do you have specific recommendations on how the Commission should apply its principles and standards to MYRPs?
A. Yes. The Commission should rely on its historical experience with MYRPs and incentive regulation. Staff has compiled four recommendations based on Commission precedent to apply in evaluating MYRPs.

1. Apply the Used & Useful policy statement in a manner consistent with the new MYRP law. In particular, Staff recommends the Commission continue

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15 RCW 80.28.425(1).
16 See McGuire, Exh. CRM-1T at 9:17-20.
17 In the Matter of the Commission Inquiry into the Valuation of Public Service Company Property that Becomes Used and Useful after Rate Effective Date, Docket U-190531, Policy Statement on Property that Becomes Used and Useful, (Jan. 31, 2020) (hereinafter “Used and Useful Policy Statement”). The Commission has stated that the Used and Useful Policy Statement provides relevant guidance pertaining to the recovery of provisional capital within the context of a multi-year rate plan. See Wash. Utilis. & Transp. Comm’n v. Nw. Nat. Gas, d/b/a NW Nat., Dockets UG-200994, et al., Order 05, n.5 (Oct. 21, 2021) (“RCW 80.04.250, which forms the basis for the Policy Statement, is neither superseded nor displaced by RCW 80.28.425, which governs multiyear rate plans. Rather, the requirements set out in RCW 80.28.425 are consistent and compatible with RCW 80.04.250.”).
to apply the same standards of prudence to investment on an ongoing basis, consistent with the Commission’s historical practices.\(^{18}\)

2. Examine the outcomes of the MYRP for operational efficiency that, in the long-run, benefits ratepayers.\(^{19}\)

3. Examine MYRPs, and especially performance measures, with a focus on the end result, not the means of getting to it, to determine whether proposed rates are fair, just, reasonable, and sufficient.\(^{20}\) This includes designing incentive mechanisms to be measurable, simple to administer, and simple to explain to customers.\(^{21}\)

4. Ensure the overall MYRP is an improvement, on balance, over current methods of regulation.\(^{22}\)

1. Commission history with MYRPs

Q. Please describe generally the Commission’s history with MYRPs

A. The Commission has a long history with MYRPs going back at least to the 1990s. Staff has not undertaken an exhaustive review of all Commission precedents related to MYRPs, but several key cases stand out:

- **2022** - The Commission approved a two-year MYRP for Northwest Natural Gas which included capital expenditures spread over two-years and a portfolio-based review of projects that were included in rates on a provisional basis and subject to refund.\(^{23}\)
- **2019** - The Commission approved a three-year MYRP for PacifiCorp that created a separate process for evaluating the prudence of plant that was provisionally included in revenue requirement and subject to refund.\(^{24}\)

\(^{18}\) Used and Useful Policy Statement at ¶ 39.


\(^{20}\) Id. at ¶ 150.


\(^{22}\) Id.


PacifiCorp limited issue filing was reviewed by the Commission less than a year later. As a part of a full settlement, the limited issue filing provided for a partial refund to ratepayers and a revenue decrease based on the parties review.

- **2013** - The Commission approved a three-year MYRP for PSE which included annualized rate increases, an expedited rate filing, and a full decoupling mechanism. This included an incentive mechanism attached to the overall MYRP along with significant reporting requirements:

  We approve the rate plan in part because it is an innovative approach that will provide incentives to PSE to cut costs in order to earn its authorized rate of return. It is important that the Commission monitor how, and how well these incentives operate to improve efficiency and reduce costs that ultimately will mean rates to customers that are lower than they would be absent these gains in efficiency. As Mr. Schooley testified, the key to additional reporting is that it provides helpful information to the Commission. Again, we expect PSE and Staff to work together to develop reporting protocols that will keep the Commission informed about PSE’s cost cutting and efficiency initiatives during the term of the rate plan.

- **2000** - The Commission approved a five-year MYRP for PacifiCorp which created predictable rate changes to reduce rate shock and allow the utility time to reduce costs and improve service in Washington. This plan included an evaluation of PacifiCorp’s performance over the full five-years as well as reasonableness check of the company’s existing rates.

- **1991** - The Commission authorized a Periodic Rate Adjustment Mechanism (PRAM) for PSE which operated similarly to a three-year MYRP. The PRAM was ultimately eliminated five years later with the Commission noting that:

  The issues which originally lead to the invention of the PRAM have not evaporated. Power costs and hydro conditions can be expected to continue to vary. This variability presents risks which must be managed by Puget and balanced between shareholders and ratepayers. Aligning company motivations

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26 Id. at 20.
28 Id. at ¶ 214-215.
30 Id. at ¶ 38.
with state and regional policy objectives remains an important public interest goal.\(^{32}\)

Q. Has the Commission provided any relevant policy statements about MYRPs and their operation?

A. Yes. We have identified at least three policy statements which are uniquely relevant to the present case.

- **Used & Useful Policy Statement**\(^{33}\) - The Commission’s 2020 Used & Useful Policy Statement was required by RCW 80.04.250(3) and was written before the new MYRP Law. In the policy statement, the Commission lists several evidentiary requirements for plant placed in service after the rate-effective date. This includes:

  1. Identify rate-effective period investment separately from traditional pro forma rate-base adjustments;
  2. State whether they are seeking recovery through base rates or a separate tariff schedule;
  3. Include the estimated or projected costs;
  4. Include a description of the investment, as well as other existing documentation;
  5. Provide the expected in-service date (during the rate effective period);
  6. Show that the property will be used and useful;
  7. Show that proposed adjustments involve known and measurable events;
  8. Show that the proposed adjustments adhere to the matching principle;
  9. Separately demonstrate, and account for, all offsetting factors; and
  10. Provide information regarding level of spending, cost controls, and the specific need for the projected investment.

- **Decoupling Policy Statement**\(^{34}\) - In 2010, the Commission focused on ways to encourage broad adoption of cost-effective conservation. A key aspect of this concern was related to the incentives imbedded in the historic regulatory practices:

  …[W]ith full decoupling comes a concern that, by eliminating the risk of recovery of declines in revenue, combined with an

\(^{32}\)\textit{Id.}  
\(^{33}\)\textit{See Generally Used and Useful Policy Statement.}  
energy cost recovery mechanism that reduces an electric utility’s financial risk due to changes in power costs, the utility could lose some of its incentive to manage the company in a manner that constantly looks to reduce costs. Indeed, some experts in the theory and practice of regulation caution commissions to engage in regulation that constantly provides incentives for a utility to cut costs. Such prudent actions on the part of the utility serve to benefit the utility as well as, in the long run, the ratepayers.35

**PGA Incentives Policy Statement**36 – In 1997, the Commission laid out 15 guidelines for purchased gas adjustments. This includes:37

1. Incentive mechanisms should utilize a benchmark;
2. The benchmark should be based on total costs;
3. Incentive mechanisms should be simple to avoid gaming;
4. Benchmarks should rely on market prices, not utility historic costs;
5. Revenue and risk sharing should be symmetric;
6. Deadbands are useful to dampen market effects;
7. Incentive mechanisms should have a limited duration with explicit evaluation protocols;
8. Proposals for new mechanisms should include a three-year back cast;
9. Benchmarks that include index market prices should include the liquidity of such index to avoid a utility exercising too much market power;
10. The Commission should avoid one-size-fits-all mechanisms;
11. The Commission may consider mechanisms that don’t fit these guidelines in special circumstances;
12. The Commission should not consider narrowly tailored mechanisms;
13. Incentive mechanisms should be clear in how they affect rates;
14. All gas utilities should adopt clear procedures for updating rates based on gas costs; and
15. Incentive mechanisms should not replace the Commissions’ ability to review utility actions for prudence.

35 Id. at ¶ 26 (internal citations omitted).
37 Id. at 2-4.
Q. Are these policy statements relevant to the present case?

A. Yes. The Used & Useful Policy Statement articulates the Commission’s historic and current standards and policies for evaluating plant. The Decoupling Policy Statement and PGA Incentives Policy Statement reinforce the four historical standards articulated above. In combination, these three policy statements support the need for Staff’s proposed MAP.

2. Applying Commission historical standards to the MYRP

Q. How does Staff recommend the Commission apply to this case the six statutory foundations of a MYRP cited above?

A. Each principle is relevant to specific aspects of the MYRP. Staff recommends applying the following standards:

1. **Determine property to be used & useful** – To aid in the Commission’s evaluation of the MYRP Components, Staff has grouped several key standards into two buckets. Each of these buckets is referenced by Staff members as they evaluate different elements of PSE’s case.

   - Forward-Looking Standards – These are applied on a forward-looking basis to determine the appropriate way rates should be set and cost-recovery should be allowed. This includes materiality, known & measurable, indirect offsets, and the matching principle. These standards are generally applied within the MYRP Component #1 - Baseline & Projections of Costs

   - Backward-Looking Standards – These are applied in a backward-looking manner to examine utility decisions, their context, and their outcomes. This includes showing need, basing decisions on the best information available, and retaining records of decisions. As discussed in the next section of my testimony, Staff recommends the Commission use these standards on an ongoing basis consistent with the Commission’s historical practices. This
is a key aspect of the Commission’s evaluation through the MYRP Component #2, the Review Process.

2. **Examine outcomes** – This standard is applied through the MYRP Component #2, Review Process, which provides an opportunity to review multiple aspects of the utility’s operations, including rate base expenditures and prudence of its decisions.

3. **Evaluate end result** – This standard is applied through the MYRP Component #3, Performance Measurement, which will allow the Commission to adopt simple, straight-forward incentive mechanisms and focus on the outcomes (i.e., the end result) of PSE’s MYRP.

4. **Improve current methods** – Staff’s overall case and proposed MAP including the application of standards to the revenue requirement models and updates to capital planning yield a complete package for the Commission to consider. Consistent with Staff’s objectives, these pieces work together to support changes that will improve the overall regulatory framework.

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**C. Prudence During the MYRP**

**Q. What is prudence?**

**A.** Prudence examines the decisions and expenditures made by a utility. This is derived from the requirement that the Company requesting an increase to rates carry “the burden of proof to show that such increase is just and reasonable.”[^38] In examining the request, the Commission has stated that:

The Commission relies upon a reasonableness standard. The company must establish that it adequately studied the question of whether to purchase these resources and made a reasonable decision, using the data and methods that a reasonable management would have used at the time the decisions were made. Prior Commission rulings established that this standard applied to both abandoned

[^38]: [RCW 80.04.130(4)](https://apps.leg.wa.gov/rcw/default.aspx?cite=80.04.130)
projects and successfully completed projects.

... 

The Commission's more flexible approach gives a company more management discretion in making its decisions, and the capability to seize unplanned opportunities, should the market develop in unexpected ways. Those specific resource decisions are then reviewed in an after-the-fact prudence review. 39

Q. Why is prudence important?

A. Prudence is critical to ensuring cost-controls are implemented by the utility. The Commission has specifically stated this:

In our view, the prudence review remains important to assure that the company is not indifferent to cost. Utility managers are faced with an increasingly competitive future. They must learn skills that their counterparts in the unregulated sector have always observed and succeeded or failed by soon. 40

The application of prudence, through an appropriate process, is necessary to ensure utilities engage in behavior that results in cost controls.

Q. Please describe the Prudency Process.

A. The Prudency Process applies the Backward-Looking Standards to specific investments included in rates for cost recovery after project completion. Specifically:

The Commission has consistently applied a reasonableness standard when reviewing the prudence of decisions relating to power costs, including those arising from power generation asset acquisitions.

The test the Commission applies to measure prudence is what would a reasonable board of directors and company management have decided given what they knew or reasonably should have known to be true at the time they made a decision. This test applies both to the question of need and the appropriateness of the expenditures. The company must establish that it adequately studied the question of


40 Id. at 37.
whether to purchase these resources and made a reasonable decision, using the data and methods that a reasonable management would have used at the time the decisions were made.\(^{41}\)

By examining Company decisions for consistency with the Backward-Looking Standards, the Commission determines what level of cost recovery is necessary to satisfy the public interest. For both expenditures and capital costs,\(^{42}\) this test examines three factors “(1) Was the initiation of the project prudent? (2) Was the continued construction of the project prudent? and (3) Were the construction expenses prudently incurred?”\(^{43}\)

Q. Should regulated investor-owned utilities be required to provide contemporaneous evidence to demonstrate prudence of provisional capital?

A. Yes. The Commission has stated: “Documentation and evidence of prudent decision making must be kept contemporaneously with a company’s decision making or the Commission’s ability to evaluate prudence is thwarted. Regulated companies bear the burden of proving their decisions were prudent.”\(^{44}\)


Q. Is prudence evaluated throughout the planning process and life of a capital investment?

A. Yes. Along with the statutory requirements related to performance measures, the Commission has stated: “Prudence is always part of the investment threshold question and is continuously evaluated during the life of an investment.”

Q. How is the Prudency Process conducted during a MYRP?

A. Due in part to the new MYRP Law, but also other legislation such as the Clean Energy Transformation Act, the backwards looking review conducted by the Commission for investments must be conducted at multiple points in time. First, the review and approval of need can now occur concretely in planning elements, like the CEIP. Second, rate recovery for projects in the traditional pro forma and provisional periods can begin before the review process for pro forma plant within the rate year (in situations like this, the Commission utilizes rates subject to refund). Third, the Commission will need to examine the continued prudence of company investments and operations based on actual utility performance. Staff recommends the Commission implement the third piece by tying performance measures to prudence throughout the MYRP.

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45 RCW 80.28.425(7).
46 Used and Useful Policy Statement at n.39.
47 See generally WAC 194-40-200.
48 Used & Useful Policy Statement at ¶ 46 (“[T]his Policy Statement establishes a two-step approval process. The first step involves provisional approval for the inclusion in rates of identified rate-effective period investment. The second step involves final approval after the investments are reviewed and confirmed to be used and useful and prudent.”); see also id. at ¶ 20 (“Under this process, we make our final decision on rate recovery in a future period after sufficient information about the property in question has become available.”).
Q. Regarding the first point in time, which includes planning elements like the CEIP, how do you recommend the Commission apply its prudence standards?

A. There is functionally very little difference between the prudence and determination of need within a CEIP and the same aspect or review conducted in a GRC. Other than the need for continuously updating assumptions, Staff recommends the Commission conduct its review of plant identified in the CEIP using the same reasonableness test as applied in general rate cases.

Q. Regarding the second point in time, regarding pro forma plant placed in service, how do you recommend the Commission conduct its prudence review?

A. At a high level, I recommend the Commission continue to use the rates subject to refund procedure from the Used & Useful Policy Statement. This is consistent with the Staff objectives to use existing processes while meeting the minimum requirements of the MYRP Law. However, as discussed later in my testimony, the use of refunds during a MYRP has the potential to undermine any cost-saving incentives the utility faces. Rather than tie refunds to specific investments, I recommend the Commission take a portfolio level view of company actions before calculating any refunds. This simplifies both the rate setting and prudence review process. Staff’s proposal also ensures flexibility for the Company and Commission to determine the best course of action for specific investments.
Q. Regarding the third point in time, the continued prudence of operations and investments, how do you recommend the Commission conduct its prudency reviews?

A. The Prudency Process must now incorporate Performance Measures to replace the cost discipline incentive that was created by regulatory lag. For the purposes of this MYRP, Staff recommend multiple performance measures in addition to PSE’s proposed metrics. These measures are grouped through policy objectives and performance areas. The combination of the policy objectives, performance areas, performance measures, and performance incentives in Staff’s proposed MAP is critical to ensuring fair & equitable, just, and reasonable outcomes in each year of the rate plan.

Q. How is the prudency process impacted by Staff’s proposed MAP?

A. Based on the reporting of performance measures identified in Staff’s MAP, the Commission will have a good indication of whether the policy objective or performance area is at risk. Since the Company is the owner of these metrics, they are the ones best situated to achieve the policy objectives and performance areas. Failure to achieve progress by the Company would be evaluated in the Prudency Process for relevant investments and could result in changes to the structure of their cost recovery. The mechanics of how this process would work are discussed in-depth in my section on MYRP Component #2 - Review Process for Proforma and Provisional Rate Base.
Q. Why should the Company be responsible for achieving these performance measures?

A. First, PSE is the owner and operator of the assets used to provide utility services. Therefore, the Company is the best situated to see that each of these policy objectives are achieved. Second, by significantly reducing regulatory lag the Company is receiving a substantial reduction in the amount of revenue it places at risk with every investment. In exchange for this reduction, the Company is required by statute to include performance measures. For performance measures to be effective, they must carry some form of incentive or penalty. Staff is recommending the Commission ensure this incentive or penalty exists by relying on the current standards and prudence process, much as it has done since the 1990s.

V. MAP COMPONENT #1 - BASELINE & PROJECTIONS OF COSTS

Q. What are the elements of MAP Component #1 – Baseline & Projections of Costs?

A. The MYRP presented by PSE starts with a modified historical test year from which it begins to build its proposal. This includes pro forma and provisional adjustments to the revenue requirements.
Q. What are traditional pro forma adjustments?
A. Traditional pro forma adjustments update the restated results of operations for known and measurable changes that are not offset by other factors.\(^{49}\) For purposes of MYRP, these adjustments generally include the test-period through the rate effective date.

Q. What are provisional pro forma adjustments?
A. Provisional pro forma adjustments reflect investments placed into service after the rate effective date and during the rate-effective period.\(^{50}\) However, the Used and Useful Policy Statement, which addresses provisional adjustments, does not generally apply to operating revenues or expenses. Provisional pro forma adjustments are also subject to a future review process and refund.\(^{51}\) In particular, the Commission has stated that any “rate-effective period investment amounts found during the review process not to be used and useful, known and measurable, adequately matched to offsetting factors, and prudently incurred, will be refunded to customers.”\(^{52}\)

Q. Should the Commission make a final prudence determination on provisional pro forma adjustments when issuing its final order in this docket?

\(^{49}\) WAC 480-07-510 (3)(F)(ii).
\(^{50}\) Used and Useful Policy Statement at ¶ 34.
\(^{51}\) Used and Useful Policy Statement at ¶¶ 38-42.
\(^{52}\) Used and Useful Policy Statement at ¶45.
A. No. The Commission should not issue a final prudence determination on any provisional investments until the conclusion of any future review process. The Commission will then need to examine the continued prudence of company investments and operations based on actual utility performance.

Q. **How are forecasted revenues and expenses incorporated into the MYRP?**

A. As Staff witness Chris McGuire explains, the MYRP Law requires that both revenues and operating expense for are determined for each rate year. However, these revenues and expenses are not subject to treatment as provisional adjustments to revenue requirement (i.e. like certain capital that is subject to refund). As I discuss later in my testimony, Staff’s proposed MAP provides adequate incentive for the utility to engage in cost controls with respect to investments as well as revenues and expenses.

Q. **What impact makes up the baseline portion of the MYRP?**

A. Staff witness Chris McGuire summarizes revenue requirement throughout the MYRP. In addition, several Staff witnesses address topics which specifically impact this calculation for baseline rates for electric service. These include:

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53 Used and Useful Policy Statement at ¶ 46 (“[T]his Policy Statement establishes a two-step approval process. The first step involves provisional approval for the inclusion in rates of identified rate-effective period investment. The second step involves final approval after the investments are reviewed and confirmed to be used and useful and prudent.”); see also id. at ¶ 20 (“Under this process, we make our final decision on rate recovery in a future period after sufficient information about the property in question has become available.”).


55 See generally McGuire, Exh. CRM-3; McGuire, Exh. CRM-6.
<table>
<thead>
<tr>
<th>Test Year O&amp;M Expenses</th>
<th>Staff witness Chris McGuire discusses generally PSE’s test year O&amp;M revenue requirements. Staff witness Roxie McCullar recommends specific depreciation rates for the duration of the MYRP.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Capital</td>
<td>Staff witness David Parcell discusses Staff’s proposed capital structure which includes recommendations for each year of the MYRP and is a key element of determining revenue requirement.</td>
</tr>
<tr>
<td>Capital Investments</td>
<td>Staff witness Jennifer Snyder recommends the Commission allow return of Advanced Metering Infrastructure (AMI) investment but continue to defer return on. Staff witness Chris McGuire discusses pro forma plant during the initial test-period.</td>
</tr>
<tr>
<td>Other Expenses</td>
<td>Staff witness Andrew Rector recommends the Commission approve PSE’s existing transportation electrification pilot.</td>
</tr>
</tbody>
</table>

1 Several Staff witnesses address topics which specifically impact this calculation for baseline rates for natural gas service. These include:

2 Staff witness Chris McGuire discusses generally PSE’s test year O&M revenue requirements. Staff witness Roxie McCullar recommends specific depreciation rates for the duration of the MYRP. |

| Cost of Capital         | Staff witness David Parcell discusses Staff’s proposed capital structure which includes recommendations for each year of the MYRP and is a key element of determining revenue requirement. |
| Capital Investments     | Staff witness Jennifer Snyder recommends the Commission allow return of AMI investment but continue to defer return on. Staff witness Chris McGuire recommends the Commission allow recovery of a portion of the Tacoma Liquified Natural Gas (LNG). |
Q. What makes up the projected portion of the MYRP?

A. Again, Staff witness Chris McGuire summarizes revenue requirement throughout the MYRP. In addition, several Staff witnesses address topics which specifically impact this calculation for provisional adjustments and rates for electric service. These include:

- **Forecasted O&M Expenses**: Staff witness Chris McGuire discusses PSE’s projections of O&M expenses for each year of the MYRP along with proposed adjustments. Staff witness Roxie McCullar recommends specific depreciation rates for the duration of the MYRP. Staff witness Hanna Navarro recommends the Commission adopt a mechanism to update power costs annually.

- **Cost of Capital**: Staff witness David Parcell discusses Staff’s proposed capital structure which includes recommendations for each year of the MYRP and is a key element of determining revenue requirement.

- **Capital Investments**: Staff witness Joel Nightingale recommends the Commission allow the Energize Eastside investment into rates on a provisional basis subject to the ongoing prudency review process. Staff witnesses Molly Brewer and Hanna Navarro recommend numerous changes to PSE’s capital planning and investment process which may have a financial impact on decision making by the Company.

- **Other Expenses**: Staff witness Andrew Rector recommends the Commission remove the distributed energy resource and energy storage demonstration projects from forecasted rates.

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56 McGuire, Exh. CRM-3; McGuire, Exh. CRM-6.
Q. How did Staff determine what projected plant is appropriate to include in rates on a provisional basis within the MYRP?

A. The Used and Useful Policy Statement notes that the “threshold for including provisional pro forma adjustment will be determined on a case-by-case basis. . . .”

Staff focused on five key elements identified within this policy statement in considering whether it was appropriate to include PSE’s forecasted plant costs into rates on a provisional basis. In particular, Staff considered the following five key elements discussed by the Commission in the policy statement:

1. Degree of certainty as to the budget;
2. Degree of certainty that project will be built;
3. Demonstration of the need for the project;
4. Consideration of all offsetting factors; and
5. Reasonable expectations of cost controls.

In the responsive testimonies of Joel Nightingale and Andrew Rector, both Staff witnesses apply these five factors in recommending whether or not to include certain provisional plant in base rates.

57 Used and Useful Policy Statement at ¶ 35 (“In sum, this Policy Statement establishes a two-step approval process. The first step involves provisional approval for the inclusion in rates of identified rate-effective period investment.”).

58 The Commission has stated that the Used and Useful Policy Statement provides relevant guidance pertaining to the recovery of provisional capital within the context of a multi-year rate plan. See Wash. Util. & Transp. Comm’n v. NW Nat’l Gas, d/b/a NW Nat., Dockets UG-200994, et al., Order 05, at n.5 (“RCW 80.04.250, which forms the basis for the Policy Statement, is neither superseded nor displaced by RCW 80.28.425, which governs multiyear rate plans. Rather, the requirements set out in RCW 80.28.425 are consistent and compatible with RCW 80.04.250. Accordingly, the Policy Statement continues to provide relevant guidance for regulated utilities and non-company parties that propose recovery of rate effective period property in a multiyear rate plan where rates approved for years two through four are provisional and subject to refund.”) (emphasis added).

59 See generally Nightingale, Exh. JBN-1T; Rector, Exh. ASR-1T.
VI. MAP COMPONENT #2 - REVIEW PROCESS FOR PROFORMA AND PROVISIONAL RATE BASE

A. Review Process Proposed by PSE

Q. Please describe the review process PSE has proposed for reviewing plant during the MYRP.

A. PSE’s proposed review process specifies the timing and type of information that PSE would provide during each year of the MYRP. This information would be used to check the veracity of rates that are subject to refund.\(^{60}\) The filing would include:\(^{61}\)

- a. Plant closing amounts, for each categorization of investments: specific, programmatic, and projected;
- b. In service dates for specific investments;
- c. Narrative explanations for differences between forecasted and actuals;
- d. Recalculation of revenue requirement using compliance workpapers; and
- e. Proposed tariff revisions.

Q. What is the timeline that PSE proposes for this review process?

A. PSE’s proposal provides the following information by March 31st of each year, beginning in 2023.\(^{62}\) The parties would then have 90 days to review the information provided by PSE and, if refunds are necessary, PSE would provide replacement tariff schedules.\(^{63}\)

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\(^{60}\) Piliaris, Exh. JAP-1T at 41:7-9.


\(^{62}\) Piliaris, Exh. JAP-1T at 41:12-15.

\(^{63}\) Id. at 41:15-42:11.
PSE also contemplates that the effective dates for these schedules would occur no later than July 1. At that point, revenues no longer subject to refund are transferred to the non-refundable schedule. All other adjustments to going forward rates would be effective January 1, including adjustments to low-income rates.

Q. Does PSE’s proposal follow the guidance issued in the Used & Useful Policy Statement?

A. Yes. However, PSE proposes that parties use a portfolio-based approach to reviewing electric plant in-service. According to PSE, this approach is needed to address regulatory lag and because “rate recovery should evolve to take into consideration the way utilities must manage their business during the multiyear rate plan.” Rather than tie refunds to specific investments, PSE proposes to use a portfolio approach for revenues exceeding 0.5% of their requested return. As I discuss later in my testimony, PSE’s refund threshold serves as a performance incentive mechanism for the entire MYRP.

Q. Is PSE’s proposed review process consistent with the prudence process you discuss above?

A. Yes.

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64 Free, Exh. SEF-1T at 48:2-7.
65 Id. at 48:7-12.
66 Id. at 36:11-13.
Q. **Is PSE’s proposed review process consistent with Staff’s proposed MAP?**

A. Partially. First, PSE’s process fails to incorporate performance measures in a meaningful fashion. While the Company proposes to track a multitude of performance measures, as well as create three unique performance incentive mechanisms, the Company’s approach lacks real practical effects on its operations, and correspondingly its behavior in achieving regulatory goals. This is discussed by multiple staff witness that examined multiple aspects of the utilities filing from a performance perspective.

Second, PSE’s proposal is not sufficiently detailed to provide adequate review by the parties. In particular, PSE’s proposal misses key information that is necessary to determine the veracity of the information used to set rates. More importantly, PSE’s proposal inappropriately burdens parties by forcing them to uncover evidence of imprudent actions rather than PSE making a positive showing of prudence at the outset.

Q. **Please describe the procedures that PSE recommends the parties undertake to review the Company’s actual capital spending.**

A. PSE advocates for a “process, control, and substantive testing” approach, similar to their external auditors.\(^67\) PSE also makes the claim that a portfolio review would be similar in practice to a Cost Recovery Mechanism and should be handled in a like manner.\(^68\)

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\(^{67}\) *Id.* at 38:3-5.  
\(^{68}\) *Id.* at 39:5-40:4.
Q. **Do you agree with PSE’s proposal for reviewing plant during the MYRP?**

A. Yes, but only as a concept. The details of PSE’s recommendations do not align with the Commission’s ratemaking standards, identified above. For example, the prudence standards require the utility to demonstrate the property is used & useful for ratemaking in Washington. An audit style examination, as contemplated by PSE, requires interested parties to find and demonstrate any action of imprudence by the Company. Such a process would create a presumption of prudence, and therefore inappropriately shift the burden of proof away from the company to make the prima facie case that their actions are indeed prudent. In short, PSE should bear the burden for providing sufficient evidence demonstrating prudency at the outset of its review process filing.

B. **Staff Proposed Review Process**

Q. **Please describe Staff proposed review process.**

A. Staff’s proposed process corrects the flaws in PSE’s proposal. Staff is particularly focused on addressing the lack of performance measures included in PSE’s annual review process. As described above, Staff’s proposed MAP is specifically designed to address the needs of this case while replacing the cost control incentives provided by regulatory lag.

69 Used and Useful Policy Statement at ¶ 39 (“Regulated companies bear the burden of proving that their investment decisions are prudent, just as they are required to demonstrate that their proposed rates are just, reasonable, and reflect capital expenditures that are used and useful to ratepayers. The general framework for review of provisional pro forma adjustments requires that: Companies will provide sufficient information to facilitate the review, including a prudence review, by Staff or other parties.”) (emphasis added).
Q. What information does Staff propose the Company provide in its annual review process?

A. Staff recommends expanding the information provided by PSE on an annual basis.

For clarity, I have provided the full list below:

a. **Plant Closing Amounts** - for each categorization of investments:
   specific, programmatic, and projected. *(PSE Proposed)*
   i. Totals must be based on Net Plant inclusive of accumulated depreciation, accumulated deferred income taxes, and offsetting factors.
   ii. Actual in-service dates for each project

b. **Narrative Explanations** - for differences between forecasted and actuals *(PSE Proposed)*
   i. Changes which occur within the capital planning process
      1. Updates or changes to a project within the Project Lifecycle Model.*70*
      2. Demonstration of how equity was/is incorporated into project.*71*
   ii. Sampling of projects *(PSE Proposed)*
   iii. Direct narrative explanation and demonstration of prudence for individual projects if any of the following occurs:
      1. Cost exceeding a threshold,
         a. Discussion of any decision to continue with investment.*72*
      2. Projects originally identified in the forecast but replaced with separate or new projects.
      3. Additional projects or new projects that required new Corporate Spending Authorizations.*73*

c. **Portfolio Level Prudency** – for reviewing all plant additions over the course of the review period
   i. Narrative discussion supporting the prudence of the overall portfolio.
   ii. Scorecard – reporting of performance measures.

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*70 See Brewer, Exh. MAB-1T at 7:4-9.*

*71 See generally Brewer, Exh. MAB-1T; Navarro, Exh. HEN-1T.*

*72 Staff does not have a specific recommendation for what this threshold should be. We suggest that PSE provide such a threshold and defend its use in the annual report rather than determining a bright-line cutoff here. This allows the utility to identify the appropriate balance between reporting necessary demonstrations of prudence and overburdening the parties with additional unneeded information.*

*73 See Brewer, Exh. MAB-1T at 30:7-12.*
1. Narrative explanation of overall scorecard results.
2. For each performance measure with significant variations from previous year, provide a narrative explanation.

iii. Decision or anticipated need to defer costs under CETA Compliance process.\(^{74}\)

iv. Process Review – review of \((PSE \text{ Proposed})\)
   1. Any updates or changes to any component of the capital planning processes.\(^{75}\)
   2. Summary of changes made in pursuing proposals by Staff witnesses Brewer and Navarro.\(^{76}\)

v. Controls Examination \((PSE \text{ Proposed})\)
   1. Identification and narrative explanation supporting prudence for any projects that failed to comply with any component of the capital planning processes.

vi. Substantive Review
   1. Review of projects for closing within a reasonable amount of budget and categorization that is consistent with the approved forecast.
   2. For projects which do not meet this threshold, detailed investigation and summary of causes, description of effects, recommendation on the need for a refund, and actions taken to improve processes going forward

d. \textbf{Revenue Requirement} – calculation should be based on compliance workpapers \((PSE \text{ Proposed})\)

e. \textbf{Proposed Tariff Revisions} \((PSE \text{ Proposed})\)

Q. \textbf{Does Staff agree with PSE’s proposed timeline?}

A. No. The July 1 date should be pushed to August 1 to allow a full 120 days for interested persons to review the information provided by PSE. Staff recommends the last open meeting of July include the proposed tariff revisions. If parties choose, they should be allowed to request adjudication or extension of the 120-day review period

\(^{74}\) RCW 80.28.410.
\(^{75}\) See generally Brewer, Exh. MAB-1T.
\(^{76}\) See generally Navarro, Exh. HEN-1T.
at that time based on their review beginning in April. Staff would also provide at the open meeting a summary of its findings and recommendations moving forward.

Q. How does Staff intend to conduct a review of this information?
A. Staff intends to review the information provided by PSE using the Forward-Looking and Backward-Looking Standards as well as the outcomes of the performance measures. While Staff agrees that an arbitrary materiality threshold for PSE to provide evidence is burdensome, interested persons should be free to examine any plant included in provisional rates. Staff’s proposed process would allow all interested persons to conduct a more discrete review of plant included in provisional rates than PSE has proposed.

Q. How do performance measures impact the review process?
A. As discussed above, the Company is responsible for achieving results for each of the policy objectives and performance areas established during the MYRP. Progress in these objectives and areas are tracked by performance measures. This is critical to ensuring fair and equitable, just, and reasonable outcomes each year of the rate plan. If PSE fails to make progress towards the policy objectives, then the Commission should evaluate their actions and determine an appropriate course of action, including reevaluating the recovery of the related rate base, when necessary. The

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77 Used and Useful Policy Statement at n.39.
78 Used and Useful Policy Statement at ¶ 40 (“Each party should have the flexibility to propose the structure of its own review, including preferred audit protocols where appropriate.”).
building, tracking, and reporting of these metrics is discussed more in the next
section.

Q. What options are available to the Commission if the Company fails to make
progress with a policy objective?

A. The Commission has a range of forward-looking options to consider if PSE is failing
to achieve performance in a specific objective or performance area. The Commission
has historically used several ratemaking tools to ensure ratepayers benefit from the
Company’s investments including scrutinizing future investments,\textsuperscript{79} denying interest
or return-on,\textsuperscript{80} imputing the revenue requirement,\textsuperscript{81} and disallowing cost recovery in
its entirety.\textsuperscript{82}

Consideration of these options should be based on PSE’s presentation as well
as the investigations conducted by the parties. In particular, the Commission should
continue to rely on its existing standards. For example, if a project included large
reliability net benefits that then fail to materialize, it should be subject to additional
scrutiny. Where company actions, or lack thereof, contributed to, or created the
problem that resulted in lost benefits, the Commission should apply its standards and
take consistent action. This is a key element of Staff’s proposed MAP that ensures
any performance measures have a real-world impact on utility behavior.

\textsuperscript{79} \textit{Wash. Utils. \\ & Transp. Comm’n v. Avista Corp. et. al.}, Dockets UE-090134, et. al., Order 10 at ¶ 51-52
(March 20, 2020).
\textsuperscript{82} In the Matter of the Petition of Puget Sound Energy, Inc. For an Order Regarding the Accounting Treatment
for the Purchase of a Gas Sales Contract, Docket UE-971619, Order at ¶ 5 (December 10, 1997).
Q. Please provide an example of how this could work.

A. Certainly. Assume a utility makes a large investment in demand response infrastructure to achieve a reduction in its peak load. This investment carries a performance measure related to the use of the infrastructure and the corresponding reductions. The utility receives provisional cost recovery beginning in year 1 of the MYRP. In the beginning the program is moderately successful. However, in year 3 of the MYRP, the company fails to achieve its performance measure.

During the annual review process, the utility discloses that it reduced staff devoted to the program and cut a planned advanced dashboard to facilitate interactions with the customers. The Company’s actions have directly contributed to the failure of the demand response program, but the utility would continue to receive 100% cost recovery. The Commission can, and should, exercise its authority to examine the Company’s failure to achieve the specific performance measures. The root cause for why the performance measure is not being achieved should be considered a prevailing factor, consistent with the Backward-Looking Standards.

Q. Is Staff’s proposal a punitive action that will discourage investment from the Utility?

A. Absolutely not. The Company should not be explicitly penalized when the root cause of any failure to achieve a performance measure is beyond a utility’s control. The above example identifies the specific actions taken by the utility which resulted in the project benefits failing to materialize. The utility would undoubtedly provide evidence as to why these actions should be considered prudent. Regardless of the
circumstances, Staff would investigate the situations, apply the same standards cited
previously, and craft a recommendation for Commission consideration that is
reasonable and consistent with the public interest.

Q. Does Staff’s proposal result in retroactive ratemaking?

A. No. Retroactive ratemaking involves:

surcharges or ordered refunds applied to rates which had been
previously paid, constituting an additional charge applied after the
service was provided or consumed. The evil in retroactive rate
making as thus understood is that the consumer has no opportunity
prior to receiving or consuming the service to learn what the rate is
or to participate in a proceeding by which the rate is set. The
Commission agrees that retroactive rate making, as thus understood,
is extremely poor public policy and is illegal under the statutes of
Washington State as a rate applied to a service without prior notice
and review.\(^{83}\)

Staff’s proposal does not retroactively undo any rates or create a charge for services
after the fact. Indeed, the entire concept outlined in Staff’s MAP is that PSE is
responsible for forward momentum in achieving specific policy objectives. Where
plant and investment are specifically tied to those objectives, the utility is in the best
position, as the owner and operator, to ensure the expected outcomes occur. If the
Commission takes any action as described above, then it would be applied on a
forward-looking basis using the decisions examined up to that point-in-time. Indeed,
the Commission has specifically stated that utilities are responsible for the ongoing
prudence of investments, as cited previously.

Order at 10 (Nov. 7, 1997).
VII. MAP COMPONENT #3 - PERFORMANCE MEASUREMENT

Q. Please describe Staff’s proposal for Performance Measurement.

A. Staff’s proposal meets the legal requirements of the MYRP Law, creates an adequate incentive basis for PSE to engage in cost control, incorporates Staff’s objectives listed previously, and provides the first step towards a comprehensive review of utility operations and performance. This proposal incorporates three distinct components: performance goals and areas, performance measures, and limited performance incentive mechanisms. Each of these components are linked and cannot be separated or made distinct. Importantly, Staff’s proposal builds from the Company’s more limited set of performance tools and measures that do not adequately address the need for performance management within the MYRP.

Q. How is this section of your testimony organized?

A. I first discuss the need for performance measurement as a replacement for regulatory lag. I next discuss the three components of Staff’s proposal: performance goals and areas, performance measures, and limited performance incentive mechanisms.

A. Need for Performance Measurement

Q. Why is Performance Measurement necessary?

A. The MYRP Law explicitly requires performance measures for approval of an MYRP, and the practical implementation of any performance plan necessitates some
level of structure and consistency. Aligned with Staff’s objectives, performance measurement include the elements necessary for effective tracking of utility performance and monitoring of outcomes within a MYRP. While additional requirements and more comprehensive policies could certainly be used, Staff has focused only on those pieces necessary for this MYRP. Additionally, Staff is cognizant of the ongoing policy investigation by the Commission and its goal to develop comprehensive strategies for creating performance measures and incentive mechanisms.84

Q. Does PSE’s case provide an adequate framework for meeting the legal requirements of the MYRP Law as well as Staff’s objectives?

A. No. While the Company has met the minimum legal requirements, as described above, its case lacks elements necessary for achieving the desired outcomes of MYRPs. Specifically, the Company points out that “the only strict requirement is the Commission ‘must in approving a multiyear rate plan, determine a set of performance measures that will be used to assess a gas or electrical company operating under a multiyear rate plan.’”85 While the Company’s assertion is technically correct it misses the practical requirements for performance measures to be useful. Moreover, PSE’s case makes very little connection between the actual performance it achieves regarding its proposed measures and the requested revenue requirement increase of $1.1 billion over three years.

84 That investigation is assigned Docket U-210590.
85 Piliaris, Exh. JAP-1T at 22:16-18 (internal citations omitted).
Q. How are performance measures and the requested revenue requirement increase related?

A. The MYRP Law establishes a fixed period between rate cases and requires the inclusion of performance measures but does not dictate how these measures are used. The fixed period between cases creates incentives for the utility to reduce operating costs and boost earnings. Cost discipline, a form of managerial efficiency, is a key opportunity available to both investors and customers through a MYRP.\(^{86}\) In the past, regulators and the Commission have relied on regulatory lag to provide this improved efficiency.\(^{87}\) However, with the MYRP Law, regulatory lag will no longer provide the cost discipline incentive to the utility. Therefore, performance measures, and the framework in which they operate, are a necessary component of any MYRP.

Q. What is regulatory lag?

A. Regulatory lag is the bounded timeframe that begins with a utility incurring an expense, or placing an asset in service, and the collection of additional revenue to recover the cost of the investment. Generally speaking, regulatory lag lasts from 11 to 36 months though it can be interrupted using cost deferrals, tracking mechanisms, and other regulatory mechanisms. Staff witness Chris McGuire also discusses the impacts of regulatory lag.\(^{88}\)
Q. How is regulatory lag affected by the new MYRP statute?

A. The MYRP Law effectively eliminates the majority of foreseeable lag that occurs between rate cases, since the Company can incorporate these events into the approval of the MYRP itself and begin the regulatory processes before the investment occurs. 89 Indeed, the law even contains a provision to allow utilities to modify a MYRP after just 2 years. 90 In total, the MYRP Law has removed regulatory lag as an effective means to encourage cost control at a utility.

Q. Can you explain if PSE’s case is affected by regulatory lag and the MYRP Law?

A. Yes. PSE has presented a full capital plan for three years in this rate case. Assuming all these projects are prudent, the effect on PSE’s income statement from each of these non-revenue generating assets is almost real-time for each year of the MYRP. This is due to the near perfectly timed revenue recovery. From a cashflow perspective, the Company has almost no incentive to find alternatives, reevaluate its decisions, or negotiate lower costs. Without the effects of regulatory lag, the utilities have a significantly reduced interest in the ultimate outcomes of the investment. 91

Q. Does the Company propose a substitute for the loss of regulatory lag?

A. Yes. PSE’s proposed portfolio-based review process will operate a substitute for the cost disciplining incentive that regulatory lag provided. Under Staff’s proposed MAP, the portfolio-based approach with performance measures will allow the

89 See also id. at 13:3-9.
90 RCW 80.28.430 (5).
91 Prudence disallowances can still happen, but are rare. See above at 34:6-11.
Commission to focus more on the outcomes of PSE’s investments during the MYRP, enable the Commission to evaluate the end-result of the Company’s decision making, and improve the existing regulatory process (i.e. replace regulatory lag).

Q. How do performance measures increase the focus of the utility on the outcomes of its investments?

A. Since rates are set on a prospective basis, the continued prudence of investments should be questioned if the performance is not being achieved. Performance Measures forge a link between shareholder risk of cost recovery and cost discipline by giving the Company an interest in the outcome through the performance measure. This is critical because, as the operator and owner of services, the Company is best situated to achieve the underlying policy objectives.

B. Policy Objectives, Performance Areas, and Performance Measures

Q. Does PSE discuss policy objectives, performance areas, and performance measures for the MYRP?

A. Partially. PSE witness Mark Lowry provides significant testimony on the use of performance measures in a MYRP. However, PSE does not provide a clear and comprehensive proposal that connects these performance measures to their actual impacts and outcomes.
Q. **How does Staff propose to fill this gap?**

A. As discussed previously, Staff’s proposed MAP creates a unified structure for tracking, measuring, and ensuring performance within the MYRP. Specifically, Staff proposes using policy objectives and performance areas to ensure performance measures are linked to clear objectives. The performance measures themselves are reported using a scorecard, to ensure adequate transparency in the overall process.

1. **Background**

Q. **What is a policy objective?**

A. A policy objective is an informed and prioritized policy position that captures the basic reason for creating and tracking performance measures. Overall, policy objectives need to be a balance of generalization (since they can encompass large portions of a utility’s business) while avoiding too much ambiguity. Since policy objectives can overlap multiple aspects of utility service, Staff proposes grouping performance measures using a second category called performance areas.

Q. **What is a performance area?**

A. A performance area is an aspect of utility service that is being measured.

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92 Ball, Exh. JLB-3 at 8.
93 Id. at 9.
94 Ball, Exh. JLB-2 at 16, 18.
Q. **What is a performance measure?**

A. Performance measures are either qualitative or quantitative metrics for tracking certain objectives. These can range from company-wide service quality indexes to specific categories of O&M expenditures.

Q. **Why is it important to have performance measures that are linked to policy objectives and performance areas?**

A. The cross-over between policy objectives and performance areas allows stakeholders, customers, and interested persons to sort and examine performance measures based on what they are most interested in. For example, clean energy could encompass measures from a wide range of utility services such as demand side response programs or low-income weatherization. Cross-referencing the policy objectives with the different aspects of utility services enables more meaningful tracking of utility progress towards achieving preferred outcomes.

2. **Staff-proposed Policy Objectives, Performance Areas, and Performance Measures**

Q. **Please summarize Staff’s proposed policy objectives.**

A. Staff’s proposed policy objectives are:

<table>
<thead>
<tr>
<th>Source</th>
<th>Policy Objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policy Objective</td>
<td>Clean Energy</td>
</tr>
<tr>
<td>Policy Objective</td>
<td>Equity</td>
</tr>
</tbody>
</table>
This list incorporates both policy objectives arising from regulatory goals and those identified in the CEIP. The reason for including both is to ensure easy access of the data for all interested persons.

Q. Please summarize Staff’s proposed performance areas.

A. Staff’s proposed performance areas are:

<table>
<thead>
<tr>
<th>Performance Area</th>
</tr>
</thead>
<tbody>
<tr>
<td>Affordability</td>
</tr>
<tr>
<td>Electric Vehicles</td>
</tr>
<tr>
<td>Emissions</td>
</tr>
<tr>
<td>Customer Engagement</td>
</tr>
<tr>
<td>Public health</td>
</tr>
<tr>
<td>Resilience</td>
</tr>
</tbody>
</table>

This list is not meant to be comprehensive and should serve as a starting point. Staff focused on the components of the MYRP as proposed by PSE. Where necessary and
to the extent other parties propose additional measures, Staff recommends expanding
the above list to include additional performance areas.

Q. Please summarize Staff’s proposal to track these policy objectives, performance
areas, and performance measures.

A. Staff recommends using a scorecard. To develop this reporting tool, Staff
recommends interested parties work with PSE during the first few months of the rate
year. The Commission could then review the scorecard proposed by PSE during the
first portfolio review process. This proposal has the added advantage of being able to
incorporate any guidance from the Commission’s generic PBR investigation.95

C. Performance Incentive Mechanisms

Q. Did PSE propose any Performance Incentive Mechanisms for this case?

A. Yes. Various Staff witnesses discuss PSEs proposed incentive mechanisms
including:

1. Staff witness Andrew Rector recommends the Commission reject PSE’s
   proposed managed charging and time-of-use electric vehicle PIM.96

2. Staff witness Jennifer Snyder recommends the Commission reject proposed
   peak load management PIM, though witness Snyder offers an alternative
   version for the Commission to consider.97

3. I recommend the Commission accept, with modifications, PSE’s proposed
   portfolio review process as described above which includes a threshold
   before issuing any refunds.

95 Again, that investigation is docketed at U-210590.
96 Rector, Exh. ASR-1T at 34:16-35:2.
97 Snyder, Exh. JES-1T at 20:2-13.
I discuss below why PSE’s proposed portfolio refund threshold, and the use of
performance measures in Staff’s proposed MAP, operates as a PIM.

Q. Please describe PSE’s proposed portfolio refund threshold
A. The portfolio refund threshold examines the actual earnings in the Commission Basis
Report (CBR). If the Company over earns, regardless of whether it is related to
reduced capital expenditures or operational savings, PSE would keep the first 0.5
percent of savings before issuing any refunds to ratepayers through the portfolio
review process, as described above.

Q. Why is the portfolio refund threshold a PIM?
A. This refund threshold creates a direct incentive for PSE to control costs throughout
the MYRP so they may keep the additional revenue. This is no different than
creating a separate, stand-alone incentive structure that encourages PSE to reduce
costs and achieve managerial efficiencies. Indeed, PSE’s proposal is identical to their
existing PIM in the current decoupling mechanism. Relying on this existing
mechanism, albeit in a modified and more generalized format, reduces regulatory
administration. Importantly, the use performance measures throughout the MYRP as
described in Staff’s proposed MAP ensures that PSE will continue to make progress
towards key policy objectives. Combined with the portfolio refund threshold, PSE
will simultaneously have a strong incentive to engage in cost-saving efforts.
1. Background

Q. What are Performance Incentive Mechanisms?
A. Performance Incentive Mechanisms (PIMs) are regulatory tools designed to achieve a specific policy objective by changing utility cost recovery. As discussed below, the Commission has a significant amount of experience with PIMs.

Q. Please briefly describe the Commission’s history with Performance Incentive Mechanisms.
A. The Commission has an extensive history with performance incentive mechanisms. Staff has not undertaken an exhaustive review of all Commission precedents, but a few notable examples include:

- **Power Cost Mechanisms** – Each power cost mechanism approved for Avista, PSE, and PacifiCorp includes cost sharing directly designed to encourage managing power expenses.\(^98\)

- **Decoupling** – The Commission identified in the Decoupling Policy Statement that a key rationale for implementing these mechanisms is to incentivize conservation beyond a utility’s statutory requirements.\(^99\)

- **Customer Service Guarantees** – Both Avista and PSE have service quality guarantees in Washington, requiring them to pay penalties or provide bill credits related to multiple customer service agreements.\(^100\)


\(^{99}\) Decoupling Policy Statement at ¶ 4.

• **Energy Efficiency Programs** – The Commission has implemented policies specifically to address the management and success of energy efficiency programs.\(^{101}\)

Q. **Does PSE have any explicit PIMs currently in operation?**

A. Yes. PSE has both a Decoupling Mechanism and a Power Cost Mechanism. Both function as directional PIMs which make specific adjustments to utility revenue and income outside of a general rate case.

2. **PSE’s Proposed Portfolio Refund Threshold**

Q. **Is PSE portfolio-based approach and proposed 0.5% refund threshold appropriate for an MRYP?**

A. Yes. Using the portfolio-based approach and threshold encourages PSE to engage in cost control across the board to maximize its opportunity to earn a profit. The alternative use of refunds tied to specific investments would undermine the incentives Staff recommends for this MYRP. Specifically, if each investment were subject to potential refund throughout the MYRP (rather than a portfolio-based approach), the effects of any cost control incentive described previously would be significantly reduced.

Q. Why would refunds tied to specific plant mute PSE’s incentive to control costs?
A. If the Commission were to authorize a narrow refund process, such as an investment-by-investment refund, PSE would have no reason to engage in cost controls related to capital planning since any savings would be near-instantly returned to ratepayers. As discussed above and by Staff witness Chris McGuire, this incentive used to be created through regulatory lag. However, the MYRP Law effectively eliminates the incentives to control costs created by regulatory lag. It is critical that the MYRP incorporates an alternative means to disciplining spending that also gives the utility an adequate opportunity to earn its rate of return.

Q. Does relying on a narrow refund process have any other effects?
A. Yes. The narrow refund process undermines the historical standards identified above by focusing on investment budgeting instead of outcomes, creating process without evaluating the end-result, and failing to improve on the current methods of regulation. Moreover, Staff’s proposed MAP with numerous performance measures tied to policy objectives relies on the portfolio-based approach and will not function correctly without it.

Q. Is PSE’s proposed review process consistent with the concept of rates subject to refund discussed in the Used and Useful Policy Statement?
A. Yes. If a company operates imprudently provisional rates would still be subject to refund. This can also include refunds if PSE fails to make progress towards specific

102 McGuire, CRM-1T at 15:17-16-8.
policy objectives, as described previously. PSE’s proposal could also result in
refunds if actual plant expenditures differ from the forecasted—but on a forward-
looking portfolio basis rather than an individual investment basis.

Q. **Are any changes needed to the existing PIM’s for the PSE MYRP to function?**
A. No, except for a minor change to the decoupling mechanism. Following the current
MYRP, it will be important to review the efficacy of these tools. In particular, each
PIM should be directly connected to specific goals and performance areas with clear
and transparent reporting of their results. However, Staff is cognizant of the
Commission Investigation into PBR which has specifically identified this as a topic
for future review.\(^{103}\) Therefore, Staff agrees with PSE on only slightly modifying the
existing earning mechanism to fit within the broader MYRP structure. In practice the
earnings test, is the same as what was included in the MYRP Law albeit with a
separate timeline and scope of consideration.

**VIII. ELECTRIC DISTRIBUTION SYSTEM RELIABILITY REPORTING**

Q. **What is Electric Distribution System Reliability?**
A. Electric Distribution System Reliability, also referred to as Electric Service
Reliability, is the “continuity of electric service experienced by retail customers.”\(^{104}\)
Reporting refers to the monitoring of certain reliability metrics, as well as additional

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\(^{103}\) *In re the Comm’ns Proceeding to Develop a Policy Statement Addressing Alternatives to Traditional Cost
of Serv. Ratemaking*, Docket U-210590, UTC Legislative Report – Performance Based Regulation Final
Appendix at 2 (Jan. 27, 2022).

\(^{104}\) WAC 480-100-388.
information, on an annual basis. To be clear, this definition is specifically targeted at
identifying and reporting sustained outages. However, the Commission has
considerable flexibility to examine reporting of electric reliability by utilities.

Q. How does Electric Distribution System Reliability differ from the general term
electric reliability?

A. Electric Distribution System Reliability, or Electric Service Reliability, is
specifically defined by WAC 480-100-388. This term is narrow and refers only to
the specific metrics that are tracked through applicable Electric Service Reliability
Monitoring and Reporting Plans (M&R Plans). Specifically, this term is only focused
on sustained outages during normal operating days for the entire distribution system
of a local utility.

On the other hand, electric reliability is a generic term that occurs frequently
in statutes and documents throughout the industry. Electric reliability is a “catch-
all” that can refer to anything from sustained outages to generation dispatch to power
quality. Electric reliability is often a flexible, fluid term that depends on the context
where it is used. My testimony in this section is limited to updates of reporting for
Electric Distribution System Reliability, and not the generic electric reliability term.

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105 In the Matter of Adopting WAC 480-100-388; 480-100-393, and 480-100-398 Relating to Electric Service Reliability, Docket UE-991168, Open Meeting Memo, 4 (Mar 14, 2001) (“The rules primarily address interruptions to service as opposed to fluctuations in power quality, though customer complaints about power quality problems made to the utility must be reported to the Commission. The rules do not address reliability of supply.”).

Q. Please describe PSE proposed updates to Electric Distribution System
   Reliability Reporting.

A. PSE proposes two changes. First, PSE proposes to remove four measures which date
   back to 2003, due to changes in IEEE standards.\textsuperscript{107} Second, PSE proposed to update
   SQI-3 and SQI-4 to the IEEE Standard 2012 and move the baselines to 2014.\textsuperscript{108}

Q. Does Staff support PSE’s proposed updates to Electric Distribution System
   Reliability reporting?

A. Yes. In general, the changes bring the Company’s measurement and calculation
   methodologies up to date with current industry-wide standards. Essentially, PSE is
   updating its reporting to the latest industry standard. In addition, relying on a 2014
   baseline would more accurately represent the actual Electric Distribution System
   Reliability following PSE’s investment in both its Outage Management System and
   Customer Information System. Since these systems are significantly tied to the types
   of metrics tracked by Electric Distribution System Reliability, their impact on the
   baseline and subsequent performance by the Company cannot be ignored.

Q. Does Staff have any additional recommendations to improve Electric
   Distribution System Reliability Reporting?

A. Yes. Staff also recommends PSE implement additional updates to streamline Electric
   Distribution System Reliability Reporting including:

   a. Propose a revised electric service monitoring and reporting plan (per WAC
      480-100-393) before filing its next general rate case.

\textsuperscript{107} Koch, CAK-1Tr2 at 50:1-51:14.
b. Disaggregate the filing of “Service Quality and Electric Service Reliability Report” and file each subsequent annual report as a new and separate docket. The current process requires PSE to include these reports as documents within UE-170033/170034.

1. File the Natural Gas Emergency Response Plans for Outlying Areas and the Critical Infrastructure Security Annual Report in conjunction with the Electric Service Reliability Report as a separate document.

c. Participate in any multi-party collaborative to establish common reliability measurements, streamlined reporting formats, and revised M&R Plans among all three Washington IOUs for Electric Distribution System Reliability.

Q. Why does Staff recommend revising PSE’s M&R Plan?

A. The M&R Plan was last updated in 2011. Since then, numerous changes as directed by Commission orders have occurred to the Company’s reporting of reliability, and Staff also conducted an in-depth inquiry into reliability reporting.\(^\text{109}\) Revising the M&R Plan codifies all the changes and allows interested parties and the Commission to find opportunities for streamlining.

Q. Does this conclude your testimony?

A. Yes.

\(^{109}\) In re Reliability Reporting Inquiry, Docket U-151958, Staff Findings and Recommendations (Jan. 1, 2019).