BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMSSION, Complainant, v. Puget Sound Energy, Inc., Respondent.	DOCKET NO. UE-090704 and DOCKET NO. UG-090705 (consolidated)

OPENING BRIEF OF PUBLIC COUNSEL

FEBRUARY 19, 2010

REDACTED VERSION

TABLE OF CONTENTS

I. INTRODUCTION 1

II. COST OF CAPITAL 2

A. Capital Structure: PSE's Proposed Common Equity Ratio Is Excessive. 2

B. Cost of Equity (ROE) 6

1. Public Counsel recommends a reduction in PSE's authorized ROE 6

2. Dr. Morin's estimates are unreliable. 8

C. Post-Sale Considerations. 10

III. POWER COSTS – MINT FARM 13

A. Prudence Issues. 13

1. The Commission's prudence standard. 13

2. PSE admits Mint Farm was surplus capacity. 14

3. Alternative resources offered benefits superior to Mint Farm. 15

a. Phase I analysis. 15

b. Phase II analysis. 16

4. Other risks of ownership. 17

5. The Company testimony and rebuttal on prudence is not persuasive. 18

a. The "levelized cost" metric does not mean Mint Farm costs less for customers. 18

b. Qualitative factors. 20

c. "Earnings" effects. 21

d. Future availability of the alternative PPA. 21

e. Public Counsel recommendation. 22

B. The Mint Farm Deferral Requests Should Be Denied. 23

1. PSE's deferral request. 23

2. Mint Farm does not meet the requirements of the greenhouse gas statute...........23

a. The facility is not needed or appropriate. 24

b. Mint Farm does not meet capacity factor requirements...............................24

(1) PSE evidence confirms the insufficient capacity factor. 25

(2) Staff does not rebut Public Counsel evidence. 27

(3) The terms "designed and intended" are incorrectly interpreted by PSE. 28

(a) Statutory provisions...28

(b) The Department of Ecology decision does not determine the outcome of this proceeding. 29

3. There are no cost savings for customers during the deferral period....................30

IV. POWER COSTS – BASELINE POWER COST FORECAST..31

A. PSE's Projections For Off-System Sales Are Seriously Understated.........................31

B. A Mark to Market (MTM) Adjustment Is Appropriate To Allow Customers The Benefit Of Falling Natural Gas Prices. 33

C. A New Trigger Mechanism Should Be Adopted...33

V. REVENUE REQUIREMENT...34

A. Public Counsel Revenue Recommendations. 34

B. Pro Forma Issue. 34

1. General principles...34

2. Certain PSE adjustments violate Washington ratemaking rules and principles. 35

a. PSE has improperly based adjustments on estimates and projections..........35

b. Offsetting factors the PSE has not considered include efficiency and productivity gains, deflation in cost inputs, and the economic environment. 35

(1) Efficiency and productivity gains..35

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

(2) Deflation of input prices. 37

(3) The current economy. 37

3. Specific proforma adjustments contested by Public Counsel. 40

a. Wage increases. 40

b. Flex credit increases. 41

c. Property insurance premiums. 41

d. Transmission and distribution contractor expenses. 41

C. Other Income Statement Adjustments Proposed by Public Counsel. 42

1. Injuries and damages. 42

2. Qualified Pension Cost: The Commission should normalize pensions by calculating a four-year average of actuarially-based defined pension benefit costs. 42

a. Public Counsel's *contribution*-based adjustment. 42

b. Alternative recommendation for use of *actuarial basis* pension costs. 43

3. Supplemental Executive Retirement Plan (SERP). 44

4. Directors' and Officers' (D&O) Liability Insurance. 46

5. Incentive Compensation. 46

6. PSE's Corporate Aircraft. 47

7. Production Operations and Maintenance Expense – Electric. 50

a. Non-fuel production operations and maintenance expense should not consider budgeted or forecasted amounts. 50

b. The "Deferral Method" in the form endorsed by Staff and Public Counsel is acceptable to account for planned major production plant maintenance that does not require Commission authorization. 50

8. Proposed amortization of over-recovered production maintenance expense and Colstrip settlement costs. 51

a. Over-recovered production maintenance – "regulatory liability". 51

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

b. Colstrip litigation – "regulatory asset". 52

D. Rate Base Items 53

1. Tax adjustment related to White River Asset Sale – Electric. 53

2. Jackson Prairie adjustment. 53

3. Other rate base adjustments. 54

E. PSE's Requested Gas Revenue Requirement Exceeds Its Tariffed Request. 54

VI. CONSERVATION PHASE-IN 55

A. The Conservation Phase-In Adjustment Is Not Appropriate Because It Is Not "Known and Measurable." 55

B. PSE's Conservation Estimates Are Not Reliable 57

C. The Conservation Phase-In Is A Decoupling Proposal Barred By The Terms Of The PSE Sale Agreement And Order 58

VII. RATE SPREAD/RATE DESIGN 59

VIII. CONCLUSION 60

TABLE OF AUTHORITIES

Statutes

RCW 80.04.130 13

RCW 80.80 23

RCW 80.80.010(16) 28

RCW 80.80.010(4) 24, 28, 29

RCW 80.80.060 30

RCW 80.80.060(3) 29, 30

RCW 80.80.060(5) 24

RCW 80.80.060(6) 30

Other Authorities

Black's Law Dictionary, 8th Edition, 2004, West Publishing 29

Rules

WAC 173-407-110 29

WAC 480-07-510(3)(e)(iii) 35

WAC 480-100-405 to -435 30

Treatises

Leonard Goodman, *The Process of Ratemaking*, Public Utility Reports, Inc. 1998, p. 601 38

Sutherland Statutes and Statutory Construction, Seventh Edition, ¶ 46:6 28

UTC Cases

In the Matter of the Joint Application of Puget Holdings LLC and Puget Sound Energy, Docket U-072375, Order 08 (December 30, 2008)(*Puget Sale Order*)................. 10, 11, 13, 58

In the Matter of the Petition of PSE For An Accounting Order Authorizing Deferral of Colstrip Lawsuit Settlement Payment, Docket No. UE-080900 (May 22, 2008)..................... 52

WUTC v. Avista Corp, Docket Nos. UE-090134, UG-090135... 35, 47, 59

WUTC v. PSE, Docket Nos. UE-060266 & UG-060267.. 59

WUTC v. Puget Sound Power & Light, Docket Nos. UE-920433, UE-920499, UE-921262 (consolidated)(*Puget Prudence Case)* 13, 14, 22

Other Administrative Cases

In the Matter of the Application of Hawaiian Electric Co., Inc., For Approval of Rate Increases, Hawaii Public Utility Commission, Docket No. 2008-0083, Interim Decision and Order (July 2, 2009), p. 11 39

In the Matter of the Application of Idaho Power Co. To Increase Its Rates And Charges, Idaho Public Utility Commission, Case No. IPC-E-08-10, Order No. 30722 (January 30, 2009), pp. 3-4 39

Proceeding On Motion of the Commission As To Rates, Charges, Rules, and Regulations of Consol. Edison Co. of NY, Inc., for Electric Service, New York Public Service Commission, Case 08-E-0539, Order Setting Electric Rates (April 24, 2009), pp. 342-333 38

Re Application of Connecticut Natural Gas Corp. for a Rate Increase, Docket No. 08-12-06, Decision (June 30, 2009), at 144 (Section entitled "Current Economic Conditions"), 274 PUR 4th 345 (*Connecticut Gas)* 39, 45

TABLES

Table 1 Public Counsel Equity Cost Estimates 7

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

I. INTRODUCTION

1. This case, which includes PSE's tenth request for an electric revenue increase since 2002, comes before the Commission at a time when the impact of current economic conditions is a harsh reality for Washington residential and business customers at all levels. In the context of these economic challenges, this case poses a number of important issues for Commission resolution.

2. PSE's cost of capital requests are excessive, both as to capital structure and return on equity, and far out of line with industry averages, PSE's own past levels, the results of expert technical analysis, and representations made during the recent PSE sale proceeding. In the area of power costs, the Company continues to under-forecast the volume of off-system sales by huge margins, creating significant upward pressure on customer rates. In addition, PSE seeks millions in cost recovery for the Mint Farm facility which it knew created surplus capacity when acquired and for several years, and which rated poorly in comparison with available alternatives.

3. The Company's revenue requirement case improperly distorts the meaning of the proforma adjustment based on "known and measurable" changes. Finally, PSE asks for a poorly supported and designed "conservation phase-in adjustment" to increase its revenues as customers struggle to make ends meet by turning down thermostats and weatherizing homes. The net effect of the Company case, the first since the sale of PSE to the Macquarie/Canadian Investor Consortium, is to present a picture of a utility company that, while it may pay lip service to cost-cutting, is badly out of step with the Washington economy and the situation faced by its customers.

4. The Commission held three public comment hearings during December and January in Bremerton, Kirkland and Olympia. Monica Hoover, testifying at the Olympia hearing, was representative of the customer sentiment expressed:

> I am speaking in opposition to the rate increase and thank you for this opportunity to comment. As we watch the continued unraveling of our economy and continued job loss, it is galling to me that you are considering a rate of return at or near double digit levels for such a secure investment.[1]

Customers submitted a total of six hundred ninety three public comments to the Commission and to Public Counsel, the overwhelming majority in opposition to the rate request.[2] One commenter summed up well the reaction of many customers to the PSE request:

> "I would like to give a thumbs down on this rate increase. My family is currently on unemployment, and trying to pay the bills we have now is gut wrenching. With the loss of two full time salaries, it is a day to day struggle to maintain our normal every day living at the current rates. Adding an increase at this time only puts further burden on our plate. I'm sure we are not the only family struggling to stay afloat in this economy. Please refuse this rate increase until our city, county and states families economical forecast are in the black."[3]

II. COST OF CAPITAL

A. Capital Structure: PSE's Proposed Common Equity Ratio Is Excessive.

5. In this case PSE is requesting that rates be set using a capital structure which incorporates a 48 percent common equity ratio. The Commission should reject this effort by PSE to use such an expensive, unwarranted and hypothetical level of equity for ratemaking purposes.

6. PSE's request has little relation to its actual needs or its historical levels of equity. PSE's actual equity ratio during the test year, according to its own witness Mr. Gaines, was 44.67

[1] TR. 258:3-13.
[2] Exh. No. B-1 (Public Comment Exhibit).
[3] Exh. No. B-1, Sharon Hinshaw-Payne, PDF File "Comments Received by Public Counsel," p. 57.

percent, well below the requested level. The Company's average common equity ratio for the four years prior to the acquisition by the Macquarie consortium in 2008 was just under 42 percent (41.71 percent). During that time period, PSE was able to maintain a BBB bond rating with a substantially less expensive capital structure than that requested in this case.[4]

7. Increasing the amount of common equity in the capital structure is expensive for ratepayers. Common equity capital is substantially more expensive than debt because, in addition to a higher opportunity cost, ratepayers must provide the funds necessary to pay the income tax associated with the common equity return allowed by the Commission. Setting rates at PSE's requested 48 percent equity ratio rather than maintaining the Company's recent historical level of 42 percent would cost Washington ratepayers approximately $29 million per year.[5]

8. PSE's requested capital structure contains significantly more common equity than the utility industry on average. The average common equity ratio of combination electric and gas utilities is 44 percent.[6] For companies that are BBB-rated, the average equity ratio is only 40 percent. PSE has not shown in this case that there is an increase in operational risk since its acquisition that would warrant a risk-related increase in common equity ratio. These data also indicate that the additional common equity requested is not necessary for Puget to maintain its credit rating. Increasing the equity ratio would merely serve to increase cash flow to PSE and its parent companies.

---

[4] Exh. No. SGH-1HCT, p. 8; Exh. No. SGH-5C, p. 1. During the past few years PSE has had a pattern of increasing its equity ratio during rate proceedings, but on average, capitalizing its operations with more debt and less than its authorized equity. This is shown in graphical form in Exh. No. SGH-5C, p. 2.

[5] Exh. No. SGH-1HCT, pp. 10-11; Exh. No. SGH-5C, p. 3 (based on original PSE filing).

[6] Exh. No. SGH-5C, p. 4 (Combination Gas-Electric Utility Equity Ratios, source: AUS Utility Reports, October 2009).

9. PSE faces pressure to increase cash flow to its parent companies for two reasons: (1) due to substantial amounts of additional debt residing at Puget Energy and Puget Holdings corporate entities above PSE, and (2) due to substantial expenses incurred by Puget Energy's parent companies. The only monies available to provide the necessary cash flow to pay these expenses come from the ratepayers of PSE. Raising the common equity ratio is a very direct means of increasing this cash flow.

10. In conjunction with the sale of Puget, the Investor Consortium required Puget Energy, Inc., (PSE's immediate parent) to use its borrowing capacity to borrow $1.2 billion to help fund the purchase. Puget Energy also issued $1 billion in debt to fund construction. That debt now resides at the Puget Energy level. In addition, Puget Intermediate has issued debt in the amount of **[Begin Confidential]** XXXXXXX **[End Confidential].** During cross-examination, a review of the financial statements of the various Puget entities confirmed that the interest obligations for the debt at the Puget Intermediate level are **[Begin Confidential]** XXXXXX **[End Confidential]**[7]. This debt at Puget Intermediate represents loans from the Investor Consortium at an interest rate of **[Begin Confidential]** XXXXXXX **[End Confidential].**[8]

11. Evidence in the record shows that the cash flow requirements imposed on PSE have increased since the acquisition. Immediately following the sale, in the first quarter of 2009, Puget Energy paid more than twice the dividend paid the year before. In part the dividend was used for interest payments on the debt residing at Puget Intermediate.[9] Puget Holdings also faces significant costs other than debt expense in connection with the sale transaction. A copy of the "2009 Budget for Puget Holdings Non-Utility Subsidiaries" was introduced at the hearing during

[7] Exh. No. MJS-22C, p. 5.
[8] Stranik, TR. 349:10-19; Exh. No. DEG-25HC.
[9] Markell, TR. 316:8-317:11; Exh. No. EMM-9.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

examination of Mr. Markell showing that the annual "overhead" costs associated with the additional corporate layers above PSE are substantial, totaling approximately [**Begin Highly Confidential**] XXXXXX[**End Highly Confidential**] even after subtraction of the very large one-time cost of [**Begin Highly Confidential**] XXXXXXX [**End Highly Confidential**]related to the sale transaction.[10]

12. As noted above, the only source of funds for the payment of these obligations is Puget Sound Energy, as PSE witnesses Stranik and Markell acknowledged at the hearing.[11] A review of the income statements of the Puget Holdings corporate entities shows that the total operating revenue is the same at each level,[12] all generated solely by PSE from its ratepayers. It is not credible for PSE to argue that these financial demands from its parent entities do not impose pressure to produce greater cash flows at the operating company level. It is Public Counsel's position that these increased cash flow requirements --- not an increase in operational risk --- are the impetus for PSE's request to increase its common equity ratio. Therefore, these costs should not be passed on to ratepayers.

13. Since the Commission imposed "ring fencing" as a condition of sale approval, "double leveraging" concerns are moot and are not argued here. Public Counsel is not requesting the Commission use a consolidated capital structure analysis to set cost of capital. However, the Commission must decide in this case whether it is necessary to substantially increase PSE's equity ratio (and its ROE, discussed below) for ratemaking purposes. In that regard, the Puget Holdings corporate structure, cash flows, debt obligations and capitalization are realities which affect PSE and which should be given consideration in evaluating PSE's request in this docket.

[10] Exh. No. EMM-15HC, p 3.
[11] Stranik, TR. 345:14-21; Markell, TR. 313:1-10.
[12] *See,* Exh. No. MJS-22C, pp. 3-6.

14. Because PSE maintained a triple-B bond rating with a common equity ratio of 42 percent prior to its acquisition, because the average equity ratio in the electric industry is 44 percent, and because for triple-B rated electric utilities the average is 40 percent, Mr. Hill recommends that the Commission adopt an equity ratio of 43 percent for ratemaking purposes. While this is a reduction from the 46 percent level approved in the last rate case settlement, this is actually higher than the average level employed by PSE over the last four years and therefore supports the Company's financial position, while at the same time offering ratepayers some benefit from the Company's lower cost debt capital.

B. Cost of Equity (ROE).

1. Public Counsel recommends a reduction in PSE's authorized ROE.

15. Mr. Hill conducted his cost of equity analysis using four methodologies. The Discounted Cash Flow (DCF) model, which relies on the equivalence of the market price of the stock with the present value of the cash flows investors expect from the stock, assumes that the discount rate equals the cost of capital. The total investor return, which equals the required return or cost of equity, is the sum of the dividend yield and the expected growth rate in the dividend. [13]

16. The Capital Asset Pricing Model (CAPM) states that the expected rate of return is determined by a risk-free rate of return plus a risk-adjusted market premium.[14] The Modified Earnings-Price Ratio (MEPR) is the expected earnings per share divided by the current market price used in combination with the expected return on common equity. This methodology is used as a corroborative tool.[15] The fourth methodology Mr. Hill employs is the Market-to-Book (MTB) ratio analysis. While based on DCF, which "smooths" data to determine investors' long-

---

[13] Exh. No. SGH-1HCT, pp. 27-41 (DCF analysis).
[14] *Id.*, pp. 41- 47 (CAPM analysis).
[15] *Id.*, pp. 48-53 (MEPR analysis).

term sustainable expectations, MTB relies instead on point-in-time data projected one year and five years into the future.[16] This offers another corroborative check on the traditional DCF.

17. Mr. Hill's equity cost estimates using these four methods are shown below:

Table 1
Public Counsel
Equity Cost Estimates[17]

Method	**ROE Results**
DCF	9.87%
CAPM	7.79% /8.49%
MEPR	9.19%/9.33%
MTB	9.6%/9.71%

18. As this table shows, the corroborative analyses indicate that the DCF is overstated. Mr. Hill also notes that the Congressional Budget Office projected growth in GDP indicates a lower cost of equity for similar risk utilities. Based on these factors, Mr. Hill concludes that a reasonable range for PSE's cost of equity capital is 9.25 percent to 9.75 percent, with a mid-point of 9.5. As independent corroboration, Mr. Hill notes that this 9.5 percent ROE estimate is higher than the equity cost estimates provided to the Puget Board of Directors in connection with the valuation of the Company during the sale negotiations.[18] In addition, this is above the long-term equity return expectation for common stocks in Puget's own pension fund, projected by the fund administrator be in the range of 8 to 9 percent.[19]

[16] *Id.*, pp. 53-55 (MTB analysis).
[17] Exh. No. SGH-1HCT, p. 55 (Table III).
[18] *Id.*, p. 56.
[19] Exh. No. SGH-1HCT, pp. 57-58.

2. Dr. Morin's estimates are unreliable.

19. PSE witness Dr. Morin's initial ROE estimates in this case found a range of 11.0 to 11.5 percent, although PSE's filing requests 10.8 percent.[20] In rebuttal, Dr. Morin's request was reduced to 10.95 percent, although the Company's request of 10.8 percent was not changed. In developing his recommendation to the Commission in this case, PSE witness Dr. Morin generally uses the same primary methods that he used in prior testimony before the Commission (DCF, CAPM, Risk Premium).[21] Interestingly, however, he has changed the manner in which he calculates the results of the methods and has omitted one previously used methodology altogether. Dr. Morin's changed approach causes his results to be higher than they would have been if he had remained true to his earlier methodology. The changes Dr. Morin made to his analytic methodology are reviewed in detail in Mr. Hill's testimony[22] and summarized here.

20. Historical Risk Premium (Direct Testimony): In prior cases, Dr. Morin has used long-term U.S. Treasury bonds as the fundamental yield measure. In this case, although he continued to use Treasury bonds for his CAPM and ECAPM analysis, he instead used utility bonds (single-A rated) for the Historical Risk Premium method. Continuing to use U.S. Treasury bonds as he did previously would have reduced his ROE result from 11.1 percent to 9.7 percent, which Dr. Morin concedes.[23] In addition, his previous approach used the Moody's Electric Utility Index, which contains only electric utilities, for historical returns, while in this case Dr. Morin used the Standard & Poor's Utility Index, which contains other types of utilities. If he had continued to

---

[20] Exh. No. EMM-1CT, p. 9.
[21] Dr. Morin testified for PSE in its 2007 general rate case, Dockets UE-0702300/UG-0702301.
[22] Exh. No. SGH-1HCT, pp. 63-75; Exh. No. RAM-24 (detailed response acknowledging specific changes).
[23] Exh. No. RAM-24, p. 3 (response c).

use Moody's Electric Utility Index, his Historical Risk Premium ROE result would have been reduced an additional 40 basis points from 9.7 percent to 9.3 percent.[24]

21. Historical Risk Premium (Rebuttal Testimony): In his rebuttal, Dr. Morin again changed his method, as he acknowledged on cross-examination, [25] deciding to use triple-B (also known as Baa) rated bonds instead of single-A bonds. The results of this analysis are an ROE of 10.64 percent according to Dr. Morin, or 10.34 percent when flotation costs are removed. [26] His stated rationale for the change was that triple-B is the average bond rating for electric utilities. Since this was also true when his direct testimony was filed, the rationale for the change is weak.

22. "Allowed Return" Risk Premium analysis: Dr. Morin used this method in the last PSE rate case, but not in this one. If he had done so, his ROE result from this method would have been 9.2 percent, which Dr. Morin acknowledges.[27] By omitting this analysis, Dr. Morin increased the average of his remaining cost of equity estimates. Mr. Hill's testimony explains the flawed logic of Dr. Morin's rationale for omitting the "Allowed Return" Risk Premium, a method he has used for many years.[28]

23. Averaging Results of Methodologies: In PSE's prior rate case, Dr. Morin averaged the results of his CAPM, Risk Premium and DCF analyses, but did not do so in this case. Averaging those results in this case would have resulted in an ROE average of 10.7 percent, which Dr. Morin admits.[29]

24. Flotation costs: Dr. Morin's testimony at the hearing regarding his use of flotation costs was confusing at best. In discussing his historical risk premium analysis, he indicated that 30

[24] Exh. No. SGH-1HCT, p. 64.
[25] Exh. No. RAM-27; Morin, TR. 651:7-16.
[26] Exh. No. RAM-28 (response a, b, c).
[27] Exh. No. RAM-24, p. 3 (responses d and e).
[28] Exh. No. SGH-1HCT, pp. 66-67.
[29] Exh. No. RAM-24, p. 5 (response g)(calculation based on Morin Direct ROE estimates).

basis points of flotation costs should be removed to reduce the ROE result to 10.34 percent. He also admitted on further examination that he had included 25 or 30 basis points of flotation costs in other ROE estimates, stating that this was done for consistency with his prior testimony.[30] He stated at the hearing that "there's a pretty good reason why one should exclude [flotation costs] in this case in view of the nature of the private ownership of the company[.]"[31] Ultimately, Dr. Morin agreed to provide a restatement of his ROE results with flotation costs removed in response to Bench Request No. 7. Based on that response, Dr. Morin's average CAPM, Risk Premium and DCF results, without flotation costs, are 9.5 percent, 10.34 percent, and 10.8 percent, for an overall average of 10.21 percent. As noted above, if these results included the "Allowed Return" Risk Premium which Dr. Morin has used previously, the overall average would be still lower.

25. While Dr. Morin's results as corrected yield an ROE of 10.21 percent, considerably below PSE's 10.8 percent request, doubts remain even as to this 10.21 figure. By changing or omitting methodologies without an adequate rationale, in a way that uniformly increases his results, Dr. Morin calls into question the overall reliability of his cost of equity estimates. As Dr. Morin stated in response to a discovery request: "Methodological consistency is important for reasons of professional credibility and robustness to varying economic circumstances."[32]

C. Post-Sale Considerations.

26. A major focus of the recent PSE sale proceeding was an analysis of the transaction's impact on PSE's access to affordable capital.[33] Puget and the Investor Consortium argued that

---

[30] TR. 657:20-24.

[31] TR. 654:4-6.

[32] Exh. No. RAM-24, p. 2 (response a).

[33] *In the Matter of the Joint Application of Puget Holdings LLC and Puget Sound Energy*, Docket U-072375, Order 08 (December 30, 2008)(*Puget Sale Order*), The Commission's final order approving the sale reviews this issues of access to capital and capital cost and the related evidence and arguments in detail. ¶¶ 128-164.

the transaction offered it the opportunity to meet its capital expenditure requirements, very large relative to its size, through access to a significant pool of "patient capital,"[34] providing PSE a "more reliable method of obtaining needed capital now and in the future on reasonable terms without being subject to the vagaries of quarterly and annual earnings forecasts and short-term market reactions."[35]

27. Citing the evidence and commitments provided by the Joint Applicants, the Commission concluded:

> [T]he evidence shows PSE would have improved access to capital on terms as favorable, or more favorable, than might be achieved absent the transaction....Moreover, Commitment 24 protects ratepayers from any risk that the transaction might result in higher capital costs relative to the *status quo* by providing that PSE will not seek recovery of any such costs in rates.[36]
> Another important consideration is that the transaction means that under PSE's current business plan there is certainty with respect to a significant part of PSE's capital needs being met through 2013.[37]

28. The Commission concluded:

> In the final analysis, PSE is trading uncertainty for certainty in terms of its ability to access on reasonable terms very significant amounts of capital it requires over the next five years. These assured sources of capital through 2013 will fund new and improved infrastructure that is necessary to ensure PSE's provision of safe, reliable, electricity and natural gas to customers[.][38]

29. Less than six months later, PSE filed this case, requesting an increase in its overall cost of capital, based on a higher common equity ratio and return on equity than it had agreed to in the rate case settlement during the pendency of the merger. In support of the Company's request for

[34] *Puget Sale Order,* ¶ 19.
[35] *Puget Sale Order*, Exh. No. 71T (Markell) at 10:9-11:3 (quoted in final order at ¶ 142).
[36] *Puget Sale Order*, ¶ 145.
[37] *Puget Sale Order*, ¶ 146 ("PSE's existing business plan calls for funding the balance of its capital expenditure needs with debt and retained earnings [over and above the $1 billion credit facility available under Commitment 3]." *Id.,* n. 121.
[38] *Puget Sale Order*, ¶ 155.

a higher overall rate of return in this case, PSE Chief Financial Officer Eric Markell filed testimony on PSE's financial condition listing the "need for additional capital"[39] and the need to improve PSE's financial strength.[40] In marked contrast to earlier testimony about the benefits of access to patient capital offered by the sale, Mr. Markell testifies that "[t]he Company's financial strength is its ability to raise capital and secure credit in the financial markets on reasonable terms....To access debt and hybrid capital PSE must compete with other entities for this capital --- both within and outside the utility sector--- and must offer investors and counterparties a risk adjusted return opportunity consistent with prevailing market requirements."[41] He discusses "post-merger financial challenges" such as "turbulent credit markets" and expresses concern about the PSE's "significant capital expenditures" relative to PSE's size.[42] Similarly, Dr. Morin applies a 25 basis point increase to his ROE recommendation "to allow for PSE's greater investment risk relative to the industry, mainly due to PSE's large capital spending program for the next several years."[43]

30. The testimony of Mr. Markell and Dr. Morin are striking in the degree to which they echo statements made in support of the sale, asserting the continued existence of the very financial challenges that the sale was supposed to protect against. At the hearing Mr. Markell agreed that it was not his position that PSE had any concern about funding its capital budget plans.[44] Nonetheless he continued to argue that while there was no concern about access to capital per se,

---

[39] Exh. No. EMM-1CT, p. 15.
[40] *Id.*, p. 22.
[41] *Id.*, pp. 22-23.
[42] *Id.*, p. 24. At the hearing, Mr. Markell confirmed that Puget had presented the same regulatory lag and under-earning information it presented in this case to Standard & Poors in August 2009. He admitted that S&P reacted not by putting Puget on ratings watch, but by subsequently upgrading the Company to BBB from BBB-. TR. 311:3-312:10 (discussing Exh. No. DEG-22).
[43] Exh. No. RAM-19T, p. 57.
[44] TR. 305:7-307:3.

there was "a question of accessing those markets in the best terms possible." This is virtually identical to the argument made by PSE in the sale case, when Public Counsel questioned whether PSE faced actual difficulties with access to capital.[45] The PSE and Investor Consortium response, and the Commission's conclusion in approving the sale was that "PSE is trading uncertainty for certainty in terms of its ability to access on reasonable terms very significant amounts of capital it requires over the next five years." PSE's apparent change of position regarding the effects of the sale should be taken into account in evaluating the merits of PSE's cost of capital request.

III. POWER COSTS – MINT FARM

A. Prudence Issues.

1. The Commission's prudence standard.

31. The leading decisions in which the Commission articulates its standard for determining prudence are the Eleventh and Nineteenth Supplemental Orders in Puget Sound Power & Light's 1992 general rate case and other consolidated dockets.[46] The Commission held, pursuant to RCW 80.04.130, that the utility had the burden of proof on prudence, and "must make an affirmative showing of the reasonableness and prudence of the expenses under review."[47]

32. Under the Commission's standard for prudence review: (1) the utility must determine whether new resources are necessary; (2) the utility must determine how to fill any need determined in a cost-effective manner, evaluating that resource against the standards of what other purchases are available, and against the standard of what it would cost to build the resource itself; (3) the utility should inform its board of directors about the purchase decision and its costs and involve the board in the decision process; and (4) the utility must keep adequate

[45] *Puget Sale Order*, ¶ 134.

[46] *WUTC v. Puget Sound Power & Light,* Docket Nos. UE-920433, UE-920499, UE-921262 (consolidated)(*Puget Prudence Case)*; Eleventh Supplemental Order, Nineteenth Supplemental Order.

[47] *Puget Prudence Case,* Eleventh Supplemental Order, p. 19.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

contemporaneous records that will allow the Commission to evaluate its actions with respect to the decision process. [48]

2. PSE admits Mint Farm was surplus capacity.

33. The first element of the prudence standard requires a determination by the utility of whether new resources are necessary. The evidence in this case shows that it was not necessary for PSE to acquire Mint Farm in December 2008 in order to meet PSE's native system capacity and energy requirements. Indeed, PSE's own presentation to its Board of Directors in August 2008 indicated that the plant would create **[Begin Highly Confidential]** XXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXX**[End Highly Confidential]** [49]

34. While PSE witness Roger Garratt agreed that Mint Farm created surplus capacity, he suggested it did not do so from an "operational" perspective.[50] However, PSE's decision to acquire Mint Farm before it was needed to meet capacity requirements cannot have been motivated by an expectation that anticipated energy savings would justify the fixed capital and operating costs of the plant. PSE estimated that the fixed costs of ownership of Mint Farm would be approximately $42 million per year,[51] dramatically higher than the estimated variable production cost savings, forecasted to range from only $1.2 – 2.9 million per year.[52] In fact, when fixed gas transportation and wheeling charges are considered there are no expected production cost savings from the Mint Farm plant. This is because the cost of energy supplied from the plant it is approximately **[Begin Confidential]** XXXXXXXXX **[End Confidential]**

---

[48] *Puget Prudence Case,* Nineteenth Supplemental Order, pp. 5-11.

[49] Exh. No. RG-1HCT, pp. 9 and 19; PSE Response to Public Counsel Data Request No. 209, discussed at Exh. No. SN-1HCT, p. 9.

[50] TR. 216:1-16.

[51] Exh. No. WJE-18, p. 1.

[52] Exh. No. SN-1HCT, p. 19 (citing PSE Response to Public Counsel Data Request No. 222).

than PSE's forecasted price of on-peak market purchases which Mint Farm is expected to displace.[53]

3. Alternative resources offered benefits superior to Mint Farm.

35. The prudence test also requires the utility to determine how to fill its need in a cost-effective manner. Following its 2007 IRP, PSE issued a Request for Proposals (RFP) in early 2008 for new generating capacity. PSE conducted an evaluation of the bids received in two phases.[54]

a. Phase I analysis.

36. During this phase, PSE ranked the proposals based on portfolio benefits, the portfolio "benefit ratio" and on the levelized cost of each proposal.

37. "Portfolio benefits" are measured by calculating the difference between the present value of system production costs as reflected in the 2007 IRP and the present value with the proposed resource added. In other words, the portfolio benefit measures the total system cost impact on customers of a given generating resource alternative in comparison to PSE's IRP. A portfolio benefit of $100 million means that a given portfolio is forecasted to cost $100 million less on a total system present value basis than forecasted system costs from the IRP.[55]

38. The portfolio "benefit ratio" measures how much benefit a given resource alternative produces divided by the cost of that resource. For example, a benefit ratio of 5 means that the benefits are 5 times the total cost of owning and operating the resource.[56]

39. "Levelized cost" is measured by dividing the forecasted total capital and operating costs

[53] Exh. No. SN-7C.
[54] Exh. No. SN-1HCT, pp. 5-6.
[55] Elsea, TR. 286:24-288:7.
[56] Elsea, TR. 288:11-289:6.

of a generating resource option by the forecasted megawatt-hours. Because this metric captures only the cost of a single generating unit, it does not measure the overall system benefits provided by the resource. [57]

40. The evidence in the record is undisputed that **[Begin Highly Confidential]** XXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. **[End Highly Confidential]**. This information is depicted in PSE-prepared graphs and charts, attached to Mr. Norwood's testimony.[58] PSE does not contest the accuracy of these results. Both Mint Farm and the alternative PPA made the short list for Phase II analysis.

b. Phase II analysis.

41. The Phase II analysis was a more in-depth evaluation of the short-listed projects, conducted in late July 2008 and formed the basis for the final decision to acquire Mint Farm. **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

[57] Elsea, TR. 290:12-22.

[58] Exh. No. SN-3HC (discussed at Exh. No. SN-1HCT, p. 10).

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXX. **[End Highly Confidential]** These data are depicted in graphic form in Exh. No. SN-4HC.

42. The Phase II analysis also looked at the economic benefits of the short listed bids when grouped with other new resources. The results showed **[Begin Highly Confidential]** XXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXX **[End Highly Confidential]** Again, PSE does not dispute the accuracy of this information.[59]

4. Other risks of ownership.

43. At the time it acquired Mint Farm, PSE was aware that it did not have adequate firm gas transportation capacity to supply the full requirements of the facility, nor sufficient firm transmission rights to deliver the full output of Mint Farm to its system.[60] PSE also knew that Mint Farm had no back-up fuel capability. This increased the risk that the output of the plant could be restricted if the natural gas supply were to be curtailed for any reason.[61]

/ /

/ / /

/ / / /

[59] Exh. No. RG-60; Garratt, TR. 225:25-230:7 (reviewing Exh. No. RG-3, p. 119 *et seq*. showing results of the three metrics (portfolio benefit, benefit ratio, levelized cost) under different scenarios.

[60] Exh. No. RG-1HCT, pp. 30-31 (293 MW of transmission. Mint Farm produces 260 "nominal," 297 with duct firing, and 311 MW when duct firing and steam augmentation are included. *Id.*, p. 28).

[61] Exh. No. RG-1HCT, p. 31-32; Exh. No. SN-1HCT, p. 16.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

5. The Company testimony and rebuttal on prudence is not persuasive.

a. The "levelized cost" metric does not mean Mint Farm costs less for customers.

44. PSE justifies the Mint Farm acquisition on the basis that the alternative PPA had a higher levelized cost than Mint Farm.[62] The Company argues in rebuttal that Public Counsel has given undue emphasis to portfolio benefit and benefit ratio and improperly disregarded the levelized cost factor.[63] This is an unpersuasive argument. First, it is inaccurate to view levelized cost, as completely separate and distinct from portfolio benefit, as PSE implies. In fact, the record is clear that the same costs are used in determining both measures. Mr. Garratt confirmed on cross that each component of cost listed in his rebuttal testimony as a component of levelized cost is also included in the calculation of portfolio benefit.[64] The portfolio benefit analysis incorporates the same factors as levelized cost but is a broader and more comprehensive metric.

45. Staff's witness, David Nightingale, supports a finding of prudence for Mint Farm by essentially restating the arguments made by PSE. When asked to provide support for his statements and recommendations, however, he responded that he had not performed any independent analysis or review other than a review of PSE's testimony in the case.[65] His testimony simply accepts PSE's recommendations and does not add anything to the evidence already provided by PSE.

---

[62] Exh. No. RG-60.

[63] Exh. No. RG-53HCT (Garratt), p. 9; Exh. No. KJH-8CT, pp. 6-7 (Harris). Notably, the witnesses who made this assertion could not actually define benefit ratio or portfolio benefit when asked to do so at the hearing. Harris, TR. 194:18-195:18; Garratt, TR. 223:2-13, 229:20-23.

[64] TR. 224:9-225:24; Exh. No. RG-62.

[65] *See* Exh. No. DN-5 (re support for testimony that additional projected costs of purchasing Mint Farm before 2012 are outweighed by longer term benefits, other than review of PSE testimony "no further analysis or review was performed by Mr. Nightingale"); Exh. No. DN-6 (re uniqueness of Mint Farm opportunity, same response); Exh. No. DN-8 (requesting analysis to support testimony that Mint Farm is a cheaper source of energy when alternative PPA showed lower economic costs under PSE's studies, same response); Exh. Nos. DN-9 and DN-10 (request for independent analysis of reasonableness of PSE quantitative or qualitative evaluations, "no additional analysis" beyond that shown in testimony).

46. The levelized cost comparison relied on by PSE and Staff simply reflects the fact that Mint Farm is expected to operate more (more MWh) than the alternative PPA and, therefore, has a lower levelized $/MWh since fixed costs of the plant are divided by greater volume of MWh. This metric makes sense when comparing two like resources – intermediate to intermediate, or peaker to peaker. Levelized cost is not a useful comparison, however, when the options being evaluated are dispatched in a different manner, as is the case here. The alternative PPA essentially fills a peaking capacity need, and under the scenario where it is evaluated, the energy not supplied by the PPA is purchased from the market or generated by other PSE resources at a lower cost than Mint Farm.

47. By relying on levelized cost arguments, PSE and Staff create the misleading impression they are recommending the "cheaper" option for customers. The important "bottom line" question, however, is "which resource addition results in the lowest total system production cost?" PSE's studies show that the alternative PPA provided by far the lowest system production costs in all scenarios evaluated.[66] Ultimately, the value of individual resource metrics (such as levelized cost) or qualitative risk factors must be measured in terms of their impact on total system production cost. It is PSE, not Public Counsel, that places undue emphasis on an isolated factor – levelized cost -- in effect, arguing it trumps the other two key quantitative analyses (portfolio benefit, benefit ratio), even though it is a narrower, less informative metric than total system cost.

48. In this case, PSE did an appropriate comprehensive analysis but then failed to follow the results of that analysis. The portfolio benefit method evaluates the net present value (NPV) of revenue requirements of the entire system. This is what customers pay, not levelized cost. As

[66] Exh. No. RG-3, p. 119 *et seq.*; Garratt, TR. 225:25-230:7.

PSE witness Mr. Garratt confirms, the project with the best portfolio benefit "result[s] in the lowest impact on PSE's revenue requirements and rates when included in PSE's existing generation resource portfolio."[67]

49. Here, after a comprehensive analysis, results showed a significant customer benefit (portfolio benefit and benefit ratio) for one resource (the alternative PPA) over a wide range of scenarios. The burden is on the Company to provide an explanation for not selecting the resource with the lower portfolio benefit, since customers ultimately pay the higher cost resulting from this decision. In the end, PSE has not done so. Nothing in the Board Presentation specifically explained the decision to select a more costly resource when all the qualitative risks were essentially the same.

b. Qualitative factors.

50. PSE witness Roger Garratt criticized the Public Counsel analysis for failing to take into account the qualitative factors considered by PSE in its PSE's Phase II evaluation.[68] The first page of the Board Presentation on "Phase II Qualitative Evaluation" lists "Key Risks," specifically transmission risk, price risk, development/siting risk, and execution risk. The Key Risk information presented in Mr. Garratt's exhibit shows that in fact Mint Farm's level of risk is essentially identical to other alternatives including the alternative PPA on three of the four factors, and that for execution risk, Mint Farm actually was higher risk than the alternative PPA.[69] PSE cannot rely on the qualitative factors to support its choice of Mint Farm.

---

[67] Exh. No. RG-53HCT, p. 13.

[68] Exh. No. RG-53HCT, pp. 9-10.

[69] Exh. No. RG-3HC, p. 110. *See,* Exh. No. RG-57HC (risk factors are a conceptual representation of management judgment and perception of relative difference, not numerically based)

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

c. "Earnings" effects.

51. One explanation for the choice of Mint Farm does suggest itself. By acquiring Mint Farm instead of the alternative PPA, PSE increases its rate base by approximately $230 million per year. This provides an opportunity for PSE's shareholders to earn additional return in the range of $25 million per year.[70] In contrast, there was no opportunity for PSE's investors to earn a return on the alternative PPA since costs of purchased power are recovered without a return.[71]

52. In its rebuttal, PSE presented three witnesses to assure the Commission that it did not consider the availability of higher shareholder returns in making the decision to acquire Mint Farm.[72] On cross-examination at the hearing, however, PSE witness Roger Garratt acknowledged that PSE's August 2008 presentation to the Board did in fact include an analysis of the financial impact of the acquisition – a "Financial Pro Forma."[73] **[Begin Confidential]** X XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX **[End Confidential]**

d. Future availability of the alternative PPA.

53. PSE also argues that the alternative PPA is still under evaluation and hasn't truly been rejected as an option. The relevance of this point is not clear. The Commission must decide in

---

[70] Exh. No. SN-1HCT, p. 18.

[71] Harris, TR. 201:8-25.

[72] Exh. No. KJH-8CT, p. 11; Exh. No. RG-53HCT, pp. 28-29; Exh. No. WJE-21HCT, p. 15.

[73] TR. 230:19-22 (referring to Exh. No. RG-7C, August 2008 Board Presentation, Financial ProForma, p. 74, *et seq*. Ms. Harris was also less categorical in her denial during cross-examination. TR. 197:24-201:25.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

this GRC docket whether Mint Farm was a prudent acquisition and its costs should be recovered from customers, even during a period when it is not needed. The fact that the alternative PPA may or may not be available to also meet PSE's needs later does not resolve that issue. Indeed, it is a reminder that the alternative PPA met PSE's timing and cost-effectiveness needs more closely than Mint Farm, and would have avoided the millions in costs which PSE seeks to recover for Mint Farm during the period it is surplus capacity. Moreover, the fact that PSE is continuing to consider the alternative PPA undermines the argument that the PPA was found lacking on other criteria.

54. Another problem with this argument is that the same PPA bid price may no longer be available should PSE decide to pursue the PPA at later date. The alternative PPA project may decide to sell power to other parties or to charge a higher rate than the bid PSE rejected in favor of Mint Farm. Meanwhile, a $50 million economic benefit has been lost as a result of PSE's decision to acquire Mint Farm.

e. Public Counsel recommendation.

55. The Commission's prudence standard requires that the Commission should be able to follow the utility's decision process; understand the elements that the utility used; and determine the manner in which the utility valued these elements. [74] In this case there is simply a "gap" in the reasoning. PSE has not provided an adequate justification for selecting an option that is at least $50 million more expensive for customers.

56. Public Counsel recommends that PSE should not be allowed to recover a return on equity for the plant in its revenue requirement at this time. PSE's Investor Consortium should not be rewarded for the Mint Farm investment. Because PSE could have opted for the alternative PPA

[74] *Puget Prudence Case,* Nineteenth Supplemental Order, pp. 2, 37, 46.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

without imposing these return costs on consumers, a fair result is to eliminate the shareholder return component of the Mint Farm revenue requirement, at least during the period of excess capacity. PSE would be allowed to recover all other capital and operating costs and to request a return on the plant in its next rate case if it could show the investment was necessary and proper at that time. This is a moderate recommendation as compared to a full prudence disallowance, recognizing that Mint Farm may offer some benefits to consumers in the long-term.

B. The Mint Farm Deferral Requests Should Be Denied.

1. PSE's deferral request.

57. PSE is requesting approval to defer fixed and variable costs of ownership of the Mint Farm facility dating from December 2008 when the plant was acquired, through the effective date of rates in this case. The fixed cost component of the request, estimated at approximately $60.7 million, includes operation and maintenance expense, depreciation, insurance, taxes, and cost of capital invested in rate base, plus accrued interest. The amount would be amortized over three years, with the company requesting approximately $20.99 million each year.[75]

58. PSE requests deferred accounting for these costs under RCW 80.80 (governing greenhouse gas emissions standards), or alternatively under a traditional accounting order. Public Counsel recommends that the request for deferral be denied on either ground.[76]

2. Mint Farm does not meet the requirements of the greenhouse gas statute.

59. In order to qualify for deferred accounting for Mint Farm under the greenhouse gas statutes, PSE must show that : (1) it has a "need for the resource" and the resource is

[75] Exh. No. SN-1HCT, p. 23, PSE is also requesting deferral of variable costs, but assumes they will be fully offset by a proposed credit for market power purchases and for over-recovery of power costs in the PCA true-up.

[76] Public Counsel also takes the position that the deferral request is not consistent with the terms of the PCA. Exh. No. SN-1HCT, pp. 25-27.

"appropriate"[77] and (2) the Mint Farm facility meets the definition of "baseload electric generation."[78] PSE does not meet these statutory requirements.

a. The facility is not needed or appropriate.

60. As shown above, the Mint Farm plant is not needed to meet system capacity requirements **[Begin Highly Confidential]** XXXX **[End Highly Confidential]**. This is conceded by PSE. The plant is not appropriate because, as discussed in the prior section of the brief, other alternatives, in particular the alternative PPA offered more than double the economic benefits forecast for Mint Farm. In addition, in the context of a deferral request, the "long-term benefit" argument does not apply. In a deferred accounting request, the focus is on the deferral period, and on whether any benefit is conferred on customers during that period. Under the facts in the record, PSE cannot argue that there is an energy need met or a financial benefit provided to customers during the deferral period. Accordingly, the plant is not needed or appropriate as required by RCW 80.80.060(5).

b. Mint Farm does not meet capacity factor requirements.

61. Even if the Commission concludes that the plant was necessary and appropriate, however, PSE has not established that the plant meets the definition of "baseload electric generation" under RCW 80.80.010(4), which states:

> (4) "Baseload electric generation" means electric generation from a power plant that is designed and intended to provide electricity at an annualized plant capacity factor of at least sixty percent.

[77] RCW 80.80.060(5).
[78] RCW 80.80.010(4).

PSE's forecasts of the Mint Farm annual capacity factor have been consistently lower than the required minimum of 60 percent both before and after the plant's acquisition.

- PSE's Phase II analysis of the Mint Farm bid projected a 20-year average capacity factor of 25% for the plant; [79]
- PSE's August 4, 2008, presentation to the Board of Directors which supported the decision to acquire the plant forecasted a 31% average capacity factor for Mint Farm;[80]
- PSE's original Aurora rate year power forecast for this case indicated an annualized average capacity factor of 40% for Mint Farm;[81]
- PSE's updated Aurora rate year power forecast for this case indicated an annualized average capacity factor of approximately 45% for Mint Farm.[82]

(1) PSE evidence confirms the insufficient capacity factor.

62. At the evidentiary hearing, Chairman Goltz asked PSE witness Mr. Henderson to identify the support for PSE's assertion that Mint Farm was designed and intended to operate as a baseload generation plant. Mr. Henderson pointed to one page of his testimony and to a letter from the Department of Ecology.[83] PSE and Staff counsel both directed the Commissioners to additional evidence on the baseload generation issue in the testimony of Odom, Elsea, Mills, and Staff witness Nightingale. A review of that evidence does not reveal support for the Company's position.

63. In his direct testimony, Mr. Mills says that Mint Farm has been "dispatched" 61 percent and 58 percent of on-peak and off-peak hours since its maintenance outage was concluded in January 2009. [84] However, the term "dispatched" simply indicates the plant was operated during

---

[79] Exh. No. WJE-1HCT, p. 29.
[80] *Id.*, p. 29.
[81] *Id.*, p. 29.
[82] Exh. No. DEM-11C.
[83] Exh. Nos. JMH-4 and JMH-5.
[84] Exh. No. DEM-1CT, p. 31.

that percentage of the hours, not that it produced at a 61percent capacity factor, which would mean that it produced, on average, 61 percent of its rated output during those hours. Moreover, the rate year forecast by Mr. Mills projects Mint Farm's capacity factor at 40-45 percent.[85] Mr. Mills does not respond to Mr. Norwood's testimony on this issue in his rebuttal.

64. PSE witness Mr. Odom addresses the capacity factor issue in his direct testimony,[86] essentially making two arguments. First, he states Mint Farm is *designed* to operate at a 90 percent capacity factor. While this may be true, it is not unlikely for a plant to be designed to operate at that level in theory. Mr. Odom goes on to argue, however, that PSE *intends* to operate Mint Farm as a baseload unit "to the extent it is economical" to do so. This is a key admission. PSE's long-term dispatch studies and its rate year forecasts both show that PSE does not expect it to be economical to operate Mint Farm at a 60 percent annual average capacity factor.[87] There is thus no evidence of intent to operate at or above that capacity factor. Mr. Odom did not file rebuttal testimony to respond to Mr. Norwood on this point.

65. Like the other witnesses listed above, Mr. Elsea did not respond to Mr. Norwood's testimony on Mint Farm's capacity factor in his rebuttal. In his direct testimony,[88] Mr. Elsea presents testimony showing that, under all PSE forecasts, Mint Farm is expected to operate below 40 percent capacity factor at the rated capacity of 296 MW. He includes an exhibit showing that in over 85 percent of the scenarios the annual capacity factor was lower than 60 percent.[89] Again, it is key that PSE's own production cost studies forecast that Mint Farm will not be economically dispatched at a 60 percent annual capacity factor level. As Mr. Norwood

---

[85] Based on forecasted rate year, Exh. No. DEM-11C, and Mint Farm net capacity Exh. No. RG-1HCT, p. 28.

[86] Exh. No. LEO-1CT, pp. 28-29.

[87] Exh. No. SN-1HCT, p. 28 (citing PSE studies).

[88] Exh. No. WJE-1CT, p. 29.

[89] Exh. No. WJE-12.

explains, this is because market energy prices are expected to be significantly lower than Mint Farm energy costs in most hours.[90]

(2) Staff does not rebut Public Counsel evidence.

66. Staff witness David Nightingale does not respond to Mr. Norwood's testimony on this issue in his rebuttal except to reference his earlier direct testimony. Mr. Nightingale's direct testimony, however, does not present any evidence of the actual capacity factor performance of Mint Farm to date or of PSE's forecasted performance for the plant.[91] Mr. Nightingale admits that combined cycle units such as Mint Farm often do not run at a 60 percent capacity factor and that PSE's studies supporting its decision to buy the plant predicted a 28 percent average annual capacity factor.[92]

67. Mr. Nightingale's testimony also contains an error. He asserts that PSE's analysis[93] shows that the Mint Farm capacity factor exceeded 60 percent in nearly half of the runs evaluated, which is not accurate.[94] He appears to be mistakenly referencing only the Mint Farm runs with primary firing. This does not accurately measure the Mint Farm operations in full. Mr. Nightingale also argues that PSE's expectation of a 90 percent availability factor for Mint Farm supports the 60 percent annual CF determination.[95] This makes no sense and confuses availability with capacity, assuming the two are correlated.[96]

---

[90] Exh. No. SN-1HCT, p. 29.
[91] Exh. No. DN-1T, pp. 38-42.
[92] *Id.*, p. 41.
[93] Exh. No. WJE-12.
[94] Exh. No. DN-1T, p. 41.
[95] Exh. No. DN-1T, p. 42.
[96] A peaking unit that rarely runs will have a very low capacity factor but could have an availability factor over 90 percent, for example.

(3) The terms "designed and intended" are incorrectly interpreted by PSE.

(a) Statutory provisions.

68. A key issue in ruling on the Mint Farm capacity factor question is the meaning of the terms "designed and intended" in RCW 80.80.010(4). There is no real dispute about the underlying facts. Public Counsel does not dispute that Mint Farm is designed, as a technical matter, as a plant with a capacity factor exceeding 90 percent. The plant has been issued a permit.[97] There is also no serious dispute that for forecasted operations, the plant has a capacity factor well below the 60 percent required by the statute.

69. The fact that the plant may have been *designed* with a sufficient capacity factor does not end the inquiry. The legislature used two terms in the statute -- *designed* and *intended.* In interpreting and applying the statute both must be given effect.[98] The Commission must decide the *designed* and the *intended* capacity factor of the plant. The first item is not in dispute. The second requires a determination of the meaning of the term *intended* in this context.

70. The greenhouse gas statutes provides a definition of capacity factor which provides key guidance on the question of intent. RCW 80.80.010(16) states:

> (16) "Plant capacity factor" means the ratio of the *electricity produced* during a given time period, measured in kilowatt-hours, to the *electricity the unit could have produced if it had been operated at its rated capacity* during that period, expressed in kilowatt-hours. [emphasis added].

The reference to "electricity produced" versus "electricity the unit could have produced if it had been operated at its rated capacity" indicates that the agency must look to the actual or expected energy production of the plant in determining whether the *intended* minimum capacity factor

[97] Exh. No. JMH-1T, p. 2; Exh. No. JMH-5.
[98] *Sutherland Statutes and Statutory Construction,* Seventh Edition, ¶ 46:6.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

standard has been met. It is not sufficient to look simply at the plant's designed capacity factor, or the permit specifications (discussed below).

71. When given its plain meaning, the term "intend" is defined as "to have in mind a fixed purpose to reach a desired objective; to have as one's purpose."[99] As reviewed above, the record is clear that at the time it purchased Mint Farm, PSE projected economic operations below 60 percent capacity factor over the long term.[100] Knowing this, PSE went forward with the purchase. Subsequent projections of operations confirm that Mint Farm will operate at most at a 45 percent capacity factor. This evidence of PSE's actual operational plans for Mint Farm shows that PSE intends , and has always intended, to operate below a 60 percent annual capacity factor.

(b) The Department of Ecology decision does not determine the outcome of this proceeding.

72. The fact that a permit has been issued for the plant is not determinative of intent. RCW 80.80.060(3) states that "[i]n determining whether a long term financial commitment is for baseload electric generation, the commission shall consider the design of the power plant and its intended use, based upon the electric purchase contract, if any, permits necessary for the operation of the power plant, and any other matter the commission determines is relevant under the circumstances." As in RCW 80.80.010(4), design and intent are separate factors. The statute does not equate intent with the issuance of a permit. Contracts, permits, and any other relevant matter are to be considered as they bear on both design and intent.[101] It would make sense for a utility to obtain a permit to allow it to operate at a 60 percent capacity factor, even if it did not

[99] Black's Law Dictionary, 8th Edition, 2004, West Publishing.

[100] *See e.g.,* Exh. No. RG-7HC, pp. 82-83 (August 2008 Board Presentation, Income Statement, listing "Annual Capacity Factor" for each year through 2027).

[101] Mr. Nightingale reads RCW 80.80.060(3) incorrectly to mean that the "operators intent for operating the plant is relevant, but it is not the primary focus" in determining whether a plant meets the 60 percent annual capacity factor standard, citing WAC 173-407-110, a Department of Ecology rule that states, in part, that "intent" means allowed by permit.

expect to do so, to eliminate the risk of emissions limits restricting the output of the plant in the event future conditions changed for some reason. This would not necessarily reflect the intent to operate at any particular capacity factor.

73. Both PSE and Staff place undue reliance on the determination of the Department of Ecology, as reflected in its letter.[102] The letter does not indicate that the Department conducted any evaluation of the plant capacity factor, of which no mention is made. The letter focuses primarily on emissions issues, which is reasonable given the Department's role. The letter's only statements with respect to intent appear to simply repeat PSE's representations that it intends to operate the plant as a baseload power plant similar to Goldendale.

74. The express language of the statutory scheme makes it clear that it is this Commission, not the Department of Ecology, that has the authority to decide whether a plant is designed and intended for baseload electric generation[103] and whether a company can defer and recover costs for a baseload generation facility.[104] The Commission is authorized and required to adopt rules to enforce the provisions of RCW 80.80.060, which it has done.[105] The Commission rules do not contain a provision defining intent in terms of permit issuance. Nothing in RCW 80.80.060 takes away the Commission's authority to make a separate determination on the statutory issues within its purview, or provides that the Commission must treat the Department's determination as binding.

3. There are no cost savings for customers during the deferral period.

75. In addition to the statutory issues discussed above, the Mint Farm deferral should be

[102] Exh. No. JMH-5.
[103] RCW 80.80.060(3).
[104] RCW 80.80.060(6).
[105] WAC 480-100-405 to -435.

disallowed because Mint Farm is not presently needed for capacity purposes and **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. **[End Confidential].** This is because Mint Farm energy costs include over $14 million in combined gas transportation and wheeling charges, resulting in a total cost of energy **[Begin Confidential]** XXXXXXXX **[End Confidential]** than PSE's forecasted average price of on-peak market energy purchases during the rate year. Indeed, Mint Farm **[Begin Confidential]** XXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXX. **[End Confidential].**[106]

IV. POWER COSTS – BASELINE POWER COST FORECAST

A. PSE's Projections For Off-System Sales Are Seriously Understated.

76. PSE's projections of off-system sales for ratemaking purposes raise an issue of serious concern in the calculation of PSE's baseline power costs. Data obtained in discovery shows that the average level of off-system sales made by PSE over the last five years is **[Begin Confidential]** XXXXXX **[End Confidential]** of the level forecast by PSE to occur in the rate year. This data is shown on Table 1 of Mr. Norwood's testimony.[107] Moreover, a look back at prior proceedings reveals that PSE has consistently under-forecast the volume of off-system sales by very significant margins, as shown in Mr. Norwood's Table 2.[108] **[Begin Confidential]** XX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

[106] Exh. No. SN-1HCT, p. 29.
[107] Exh. No. SN-1HCT, p. 37.
[108] *Id.*, p. 38.

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX **[End Confidential].**

77. The fact that these forecasts are developed using the Aurora model raises concerns that Aurora is not accurately forecasting these costs or simulating the operations of the PSE system and regional market prices. To the extent that PSE's off-system sales forecasts are understated, the Company's baseline power rate will be overstated and will tend to over-recover actual power costs during the rate year period.

78. In rebuttal, PSE witness Mr. Mills provided Table 6 showing the Company's actual versus projected market transactions.[109] He acknowledged on cross-examination that his chart showed actual off-systems sales were more than 10 times Puget's forecasted level used to set power costs,[110] and that if baseline rates were adjusted to include a higher level of sale, customers would pay less for baseline power charges.[111] Table 6 also shows that the actual level of market purchases was more than double the forecasted level of purchases used to set power costs.[112] Mr. Mills agreed on cross-examination that if the rate year forecast was adjusted to include a higher level of market purchases, the baseline power charges to retail customers would be expected to be lower.[113]

79. To remedy this, Public Counsel recommends that the power cost forecast in this case reflect averages sales over the past five years as presented in Table 1, as well as a credit of $5.1 million against PSE's updated power cost forecast.[114] PSE takes issue with the profit margin

---

[109] Exh. No. DEM-12CT, p. 47.
[110] TR. 764:7-13.
[111] TR. 765:18-766:14 ("arithmetically correct" but arguing that the Aurora model is working).
[112] TR. 767:1-12.
[113] TR. 768:11-21 (because market purchases occur when it is more economical than producing energy from PSE's own units).
[114] The complete recommendation and calculation of the credit is presented at Exh. No. SN-1CT, pp. 39-40.

assumptions used by Mr. Norwood in developing this credit. When asked to provide the actual profits recorded from off-system sales, PSE responded that it "does not track, and therefore is unable to provide, an estimate of the margin for off-system sales[.]"[115]

B. A Mark to Market (MTM) Adjustment Is Appropriate To Allow Customers The Benefit Of Falling Natural Gas Prices.

80. PSE is proposing to embed a $46.2 million gas contract MTM adjustment in its baseline power cost rate in this case. This represents an increase of approximately 10 percent over the Company's current forecast of market gas prices during the rate year. During a period when gas prices have been falling significantly, this "locks in" relatively higher gas costs into rates, preventing consumers from benefitting from declining prices. If market gas prices are indeed lower than forecast, the result is significant over-charges to customers for power costs. Under PSE's existing PCA "deadband," 100 percent of the first $20 million per year of any over-recovery would be retained by the company, as well as a percentage of higher amounts.

81. Public Counsel recommends that the MTM amount reflected in the baseline be eliminated after the first 12 months rates are in effect. After April 1, 2011, an MTM credit factor of $0.00201 per kwh would implement the change. This would not apply if PSE modifies its baseline power rate before that date.

C. A New Trigger Mechanism Should Be Adopted.

82. PSE has seen a 350 percent growth in the volume of gas-fired generation on its system. This makes PSE's fuel costs more volatile. The PCA mechanism creates a financial disincentive for PSE to adjust its power cost rates downward when there are significant reductions in the market price for natural gas. For this reason, Public Counsel recommends that the Commission

[115] Exh. No. DEM-19.

consider establishing a trigger mechanism that would require PSE to petition the Commission to reduce its power cost rate at any time that natural gas costs drop by 15 percent or more below the forecasted price used in setting its approved power cost rate. PSE's response about administrative burden is not persuasive, given that PSE was willing to adjust its baseline power cost in this case to reflect a change of only 1 percent in gas prices.[116]

V. REVENUE REQUIREMENT

A. Public Counsel Revenue Recommendations.

83. Public Counsel recommends that the Commission approve a revenue requirement of $7,900,879 for PSE's electric operations and $2,105,652 for gas operations.[117]

B. Pro Forma Issue.

1. General principles.

84. In its recent decision in the Avista 2009 General Rate Case, the Commission clarified the proper interpretation of the rules governing known and measurable changes. The Commission stated, in pertinent part:

> First, the adjustment must be known and measurable.... This means the amount cannot be an estimate, a projection, the product of a budget forecast, or some similar exercise of judgment—even informed judgment—concerning future revenue, expense or rate base. Costs that are documented by actual expenditure, invoice, contract, or other specific obligation usually meet this test. Costs that are the product of forecasts, projections, or budgets generally will not qualify. There are exceptions, and we will discuss those below.
>
> Second, for rate base, and for expense or revenue items, pro forma adjustments must be matched with offsetting factors.... A mismatch would be created if offsetting factors are not taken into account.

[116] Exh. No. SN-1HCT, p. 42.

[117] Public Counsel Response to Bench Request No. 3. Accounting and rate treatment of REC proceeds will be addressed in Docket No. UE-070725, pursuant to Order 10 in this docket.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

> The less certainty with which actual utility costs and offsetting factors are known and measurable, the greater is the risk that an adjustment would disturb test year relationships and the less appropriate is the pro forma adjustment.[118]

2. Certain PSE adjustments violate Washington ratemaking rules and principles.

a. PSE has improperly based adjustments on estimates and projections.

85. In this case, PSE has adopted an inappropriate interpretation of the "known and measurable" standard. For some expenses, the proforma adjustment is merely an estimate, sometimes based on "cost trends," which does not meet even the most liberal definition of a known and measurable change. While some of the estimates have been updated to reflect costs now said to be actual, for a number of expenses, PSE seeks to justify recovery of "price changes" all the way through the end of the rate year (twelve months ending March 2011), and to recover for some allegedly known and measurable costs without regard to offsets to those costs. PSE's application of the known and measurable standard violates Washington ratemaking principles.

b. Offsetting factors the PSE has not considered include efficiency and productivity gains, deflation in cost inputs, and the economic environment.

(1) Efficiency and productivity gains.

86. A key shortcoming in PSE's approach is its disregard of offsets to its claimed costs. For example, changes in the unit price paid by a firm (the utility) for goods and services can be offset in whole or in part by productivity increases. Mr. Dittmer discusses this factor in detail in his

[118] *WUTC v. Avista Corp,* Docket Nos. UE-090134, UG-090135, Order 10, ¶¶ 45-47 (footnotes omitted). WAC 480-07-510(3)(e)(iii).

testimony.[119] Efficiency or productivity gains can be achieved through technology advances, better use of existing technology, substitution of capital for labor, or better business practices.

87. For example, in April 2008, PSE installed new state-of-the-art bill processing equipment that doubled the rate of processing. In rebuttal testimony, PSE witness Valdman disagrees that that the new equipment created any offsetting efficiencies or savings but merely replaced old equipment.[120] During cross-examination, however, when the feasibility study for the project was reviewed with him,[121] Mr. Valdman agreed that the study showed that specific reductions in historical costs were expected from the purchase, of a sufficient level to provide PSE with a return on its investment of 35 percent.[122] Labor savings were also expected.

88. In 2007 and 2008, PSE introduced its Mobile Workforce Project which put laptop computers in company vehicles to improve employee efficiency. Mr. Valdman argues again in rebuttal that these efficiencies simply offset ongoing cost growth and so should not be considered as offsetting the post-test year costs for which PSE presents proforma adjustments in this case. The business case for the project[123] reviewed on cross-examination, however, clearly reflects PSE's expectation that it will receive "hard cost reductions" of $1.9 million per year and an internal rate of return of 31 percent.[124] These examples illustrate PSE's inappropriate disregard of offsetting productivity factors.

---

[119] Exh. No. JRD-1CT, p. 20. As detailed in Mr. Dittmer's testimony, PSE has pursued new software and software upgrades to improve efficiency including a Human Resources/Payroll Enhancement, a Generation Work Management System at Goldendale, and new systems to ensure compliance with reliability standards of the North American Electric Reliability Cxxxx and WECC.

[120] Exh. No. BAV-10 CT, pp. 4-5.

[121] Exh. No. 12C.

[122] TR. 178:6-11. Exh. No. 12C, p.

[123] Exh. No. BAV-11.

[124] Exh. No. BAV-11, p. 15; TR. 183:3-18.

(2) Deflation of input prices.

89. Price increases in some goods and services can also be offset by a decline in price of other goods and services. The year 2009 has seen a significant and widespread decline in a number of commodity prices, a unique event in the recent historical period, as well as finished goods, intermediate materials and crude material inputs.[125] Bureau of Labor Standards data in Table 1 in Mr. Dittmer's testimony reflect commodity price deflation ranging from 2.2 percent for copper and brass mill shapes to 32.8 percent for steel mill products from September 2008 through September 2009. It is therefore reasonable to expect that certain materials and supplies expensed during the 2008 test year will cost less in 2009, as well as within the rate year. Mr. Valdman argues in response to the deflation argument that 85 percent of material purchases go to capital.[126] Even accepting this for purposes of argument, the remaining 15 percent going to O&M for which there is no adjustment or offset recognized. These types of cost declines are not taken into account as potential offsets by PSE.

(3) The current economy.

90. As Mr. Dittmer discusses in his direct testimony in this area, an additional factor to be considered in analyzing PSE's proposed proforma adjustments is the depressed economic environment. In this case, as a reflection of that environment, PSE has projected a reduction in sales, a development which for a firm in a competitive market would be expected to result in the firm cutting costs through efficiencies, economies and cost containment. Public Counsel does not argue economic factors alone would warrant disallowance of proforma costs. As a surrogate

---

[125] The full Bureau of Labor Statistics release of Producer Price Indexes – September 2009 is in the record as Exh. No.JRD-7.

[126] Exh. No. BAV-10CT, pp. 8-9. Mr. Valdman lists a small number of commodities that have experienced price increases, but does not address items such as gasoline and diesel that have become less costly since the 2008 test year. Exh. No. JRD-1CT, p. 29.

for the competitive market place, however, it is appropriate for the utility regulator to put reasonable pressure on the utility to similarly control costs.[127] Cost reductions and cost containment by the utility should act to offset expenses which PSE seeks to proform into its current revenue requirement.

91. As part of the task to regulate in the public interest, regulators in recent decisions have exercised their discretion in a variety of ways to consider economic conditions in the rate setting process. In its recent rate decision for Consolidated Edison, the New York Public Service Commission found:

> Expenditures that are reasonable during average or good economic times are not necessarily reasonable when economic conditions are extremely poor. When consumers are experiencing the extraordinarily harsh economic realities we see today, a certain measure of frugality is properly expected from utilities and a reprioritizing of expenditures may be needed.
>
> * * *
>
> In these extraordinary times, we recognize the need for utilities to implement austerity programs to constrain costs and tighten belts to limit discretionary spending. We will require a meaningful further downward adjustment to the Company's revenue requirement amounting to $60 million, half of which is subject to further review and potential deferral based on a review of the Company's ability and best efforts to implement the required measures effectively.[128]

92. In its early 2009 rate case order for Idaho Power, the Idaho Public Utility Commission stated:

> Rate increases are not the only means to increase earned return on equity. We expect Idaho Power to demonstrate its ongoing efforts to reduce operating costs and increase efficiencies. We caution the

[127] Leonard Goodman, *The Process of Ratemaking*, Public Utility Reports, Inc. 1998, p. 601 ("regulated companies in periods of economic downturn bear an especial burden of proving efficient performance")

[128] *Proceeding On Motion of the Commission As To Rates, Charges, Rules, and Regulations of Consol. Edison Co. of NY, Inc., for Electric Service,* New York Public Service Commission, Case 08-E-0539, Order Setting Electric Rates (April 24, 2009), pp. 342-333.

Company that in the current economic climate, Idaho Power's fiscal responsibility will be reviewed extensively and continually.[129]

93. In July 2009, the Hawaii Public Utilities Commission issued an Interim Decision and Order regarding the rate increases requested by Hawaiian Electric Company. The Commission rejected a request to reflect 2009 merit employee wage increases, finding that "the record insufficiently addresses the accuracy, reasonableness, and fairness of the proposed wage increases…given current economic conditions."[130]

94. The Connecticut Department of Public Utility Control, when reducing rates for Connecticut Natural Gas, in a section of its order entitled "Current Economic Conditions" stated:

> [T]he Company failed to aggressively manage its rate year expectations, expenses, cash flows, collection efforts and investment activities. The Company's rate increase request does not reflect current economic conditions.
>
> References to the "recent economy" and the "current economic situation" litter the record. Citations Omitted. [sic]. Apparently, what does not appear in the record is how the Company, its shareholders and labor force have shared the experiences of many of Connecticut's citizens. There were no Company proposals to reduce wages, increase unpaid time off, or make staff reductions. The Company also proposed net growth in capital investment; therefore, increasing overall rate base. The Department will direct the Company to prepare and present a plan to manage further its operational expenses and capital investments that genuinely reflect current economic conditions. The Department, State of Connecticut and the Company's ratepayers simply cannot afford anything less. [131]

Consistent with this statement, the CPUC set ROE at 9.31 percent, and disallowed some expenses on the

---

[129] *In the Matter of the Application of Idaho Power Co. To Increase Its Rates And Charges,* Idaho Public Utility Commission, Case No. IPC-E-08-10, Order No. 30722 (January 30, 2009), pp. 3-4.

[130] *In the Matter of the Application of Hawaiian Electric Co., Inc., For Approval of Rate Increases,* Hawaii Public Utility Commission, Docket No. 2008-0083, Interim Decision and Order (July 2, 2009), p. 11.

[131] *Re Application of Connecticut Natural Gas Corp. for a Rate Increase,* Docket No. 08-12-06, Decision (June 30, 2009), at 144 (Section entitled "Current Economic Conditions"), 274 PUR 4th 345 (*Connecticut Gas).*

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

basis that it was unreasonable to impose the charges on consumers given the state of the economy.

3. Specific proforma adjustments contested by Public Counsel.[132]

a. Wage increases.

95. Public Counsel's wage increase adjustment rejects all estimated wage increases included by PSE, since estimates are not "known and measurable" changes.[133] In addition, Public Counsel recommends the Commission reject the UA 3 percent increase that became effective October 2009. This increase took effect nine months after the test year and fifteen months beyond the test year's mid-point. The increase does not take into account offsets for productivity increases, deflationary trends in materials, or an expectation the PSE should strive to cut costs in this economic environment.

96. PSE witness Hunt took issue with the recognition of productivity offsets to wage increases, testifying that as worker productivity increases, the Employment Cost Index also increases, citing his own Exh. No. TMH-19. This is an incorrect analysis. As Public Counsel showed during cross examination of Mr. Hunt, the Employment Cost Index does not correlate to productivity. In fact, the BLS actually produces a specific analysis of how productivity relates to labor cost. This analysis of "unit labor costs" shows that for the non-farm business sector, notwithstanding an overall nationwide increase in compensation per hour, unit labor costs (output per dollar of wages) actually declined in the third quarter of 2009.[134] PSE's proforma wage adjustment only measures projected wage increase costs but makes no attempt to consider the productivity offset described in the BLS publication.

[132] In addition to the four adjustments listed here, Public Counsel testimony also challenged, on a conceptual basis, PSE production O&M costs for many of its generating units which are based on budgeted and forecasted amounts. Exh. No. JRD-1CT, pp. 95-96. The amounts of these items were small.

[133] Exh. No. JRD-1CT, pp. 45-46 (listing PSE proforma adjustments from testimony of John Story, and describing those rejected by Public Counsel).

[134] Exh. No. TMH-22.

b. **Flex credit increases.**

97. PSE originally sought recovery for an estimated 8 percent increase in its 2010 Flex Credit plan contribution. Discovery later established that the actual increase would only be 4.75 percent. Although PSE now argues that this change is known, Public Counsel recommends rejection of this 2010 amount in its entirety because it occurs a full twelve months after the end of the test year and 18 months after the test year mid-point, and does not reflect any offsets for productivity, for deflation in other cost of service components, or for reasonable cost containment by PSE due to the economy.[135]

c. **Property insurance premiums.**

98. PSE's original filing included estimates of property insurance premiums expected to take effect in 2010 and 2011. While PSE subsequently updated its filing to reflect actual changes, Public Counsel recommends that these amounts nevertheless be rejected because they occur far beyond the test year and disregard the probability of offsets.[136]

d. **Transmission and distribution contractor expenses.**

99. PSE's expected price changes for this expense should be rejected for the same reasons as the prior items --- the failure to recognize offsets. In addition, the contract was being renegotiated during the pendency of the rate case with the result that the ultimate price as well as the level of services were not known and measurable.[137]

//

///

////

---

[135] Exh. No. JRD-1CT pp. 47-48.
[136] *Id.*, p. 45.
[137] *Id.*, pp. 49-50.

C. Other Income Statement Adjustments Proposed by Public Counsel.

1. Injuries and damages.

100. Public Counsel recommends an adjustment to normalize Injuries and Damage expense. The calculation is based on a three-year historical average of accruals plus payments in excess of accruals recorded. Public Counsel's review and discovery identified a spike in the level of expense for accruals and payments for Injuries and Damages in the test year as compared with 2006 and 2007. Mr. Dittmer's testimony proposes normalizing this expense through the use of a three-year average.[138]

101. In rebuttal, PSE witness Mr. Stranik challenges Mr. Dittmer's basis for using a three-year average, but offers no testimony as to why the high test year amount is to be considered normal. PSE itself uses multi-year averages for its bad debt expense and pension costs. Mr. Stranik does not explain why the same approach cannot be applied here.

2. Qualified Pension Cost: The Commission should normalize pensions by calculating a four-year average of actuarially-based defined pension benefit costs.

a. Public Counsel's *contribution*-based adjustment.

102. Mr. Dittmer proposed an adjustment to reflect a four-year average of *contributions* made by PSE to the external trust established for PSE's defined pension benefit plan. The adjustment differs slightly from that calculated by PSE and Staff in that he used a four-year average considering pension contributions made within calendar years 2005 through 2008. This is consistent with the methodology employed in PSE's last two rate cases,[139] which included four years of contributions, the last year of which coincided with the end of the then-utilized historic

[138] Exh. No. JRD-1CT, pp. 50-51.
[139] Exh. No. JRD-1CT, p. 55.

test year.

103. In this docket PSE departed from its past approach by "reaching" forward to pick up actual/anticipated contributions to be made some nine months following the end of the historic test year being used in this docket. By "reaching" to pick up contributions for the four twelve-month periods ending September 30, 2006, September 30, 2007, September 30, 2008 and September 30, 2009, PSE was effectively able to include in its four-year average one additional "heavy" year of contributions. This is not appropriate. If an average of "contributions" is to be employed to calculate "normalized" pension costs, as in previous PSE rate cases, the methodology and cut-off periods used in the calculation should be applied consistently. PSE should not be allowed to pick and choose the most beneficial annual periods that it desires to include in the normalization calculation.

b. Alternative recommendation for use of *actuarial basis* pension costs.

104. While Mr. Dittmer based his adjustment upon an average of historic *contributions*, he indicated that he had seldom observed jurisdictions establishing utility rates on pension contributions.[140] Public Counsel recommends that the Commission adopt as a preferable alternative the use of a four-year average of *actuarially determined* (or *actuarial basis)* pension cost as recommended by Federal Executive Agencies (FEA) witness Mr. Ralph Smith in this case.

105. In his testimony, [141] Mr. Dittmer explained the reasons why there is less subjectivity in determining *actuarial based* pension cost than there is in determining the pension *contribution* to be made in any given year. In addition, historically, use of pension *contributions* to set rates has

[140] Exh. No. JRD-1CT, p. 56.
[141] *Id.*

worked to the benefit of PSE's shareholders. While *actuarially-determined* pension costs can be *negative* (i.e., creating pension income for financial reporting purposes), pension *contributions* can only be positive or "zero."[142] Over the past four years, pension cost reported for financial statement reporting purposes has often been negative.[143] In fact, for the years 2005 through 2008 total pension *income* for financial statement reporting purposes was cumulatively $7,115,409 while total pension *contributions* were $24,500,000. Thus, the amount of pension costs collected in rates has undoubtedly been significantly more than the amount of pension cost recorded for financial statement reporting purposes. According to PSE's most recent projection of pension costs and contributions, this trend is likely to continue. [144]

106. Company rebuttal provides no answers to the important questions raised in the testimony of Mr. Dittmer and Mr. Smith. PSE's relies primarily on precedent when the precedent demonstrably produces inequitable results. Public Counsel agrees with FEA that it is timely and appropriate for the Commission to revisit this issue and adopt a four-year average of *actuarially determined* Net Periodic Pension Costs for purposes of normalizing pension expense in this docket.

3. Supplemental Executive Retirement Plan (SERP).

107. Public Counsel recommends the removal of all Supplemental Executive Retirement Plan (SERP) expenses from PSE's revenue requirement[145] for three reasons: (1) PSE's highly paid executive employees are already entitled to standard Company retirement benefits pursuant to the "qualified plan" that is offered; (2) SERP is expensive to offer because it is not a "qualified"

---

[142] TR. 437:22-438:19.

[143] Exh. No. JRD-1CT, Table IV, p. 54.

[144] Exh. No. TMH-12C, p. 2, TR. 446:6-19.

[145] PSE's proposed rate base includes components related to SERP. SERP rate base impacts are discussed in Mr. Dittmer's testimony, Exh. No. JRD-1CT, pp. 64-65, and he provides a recommended treatment if Public Counsel's adjustment is accepted.

plan for IRS purposes, and does not receive the tax benefits of PSE's qualified plan; (3) other Washington regulated utilities either do not offer SERP or do not seek recovery of SERP expenses in rates.

108. SERP expenses represent a very significant proportion of PSE's total retirement plan costs – fully 36 percent, as shown in Table VII of Mr. Dittmer's testimony.[146] These substantial costs cover only PSE's most senior employees.[147] Public Counsel is aware of no other Washington regulated utility that asks customers to pay for SERP costs. Pacific Power & Light closed its SERP plan to new participants in 2007. Cascade Natural Gas has prohibited new participants since 2003 and has restricted new benefits to existing participants. Avista provides SERP to its senior executives but records the cost below the line and does not seek recovery from ratepayers.[148]

109. Beyond boilerplate recruitment and retention arguments, PSE has not offered a persuasive justification for requiring its customers to pay SERP costs. Ratepayers should not have to provide for generous and expensive retirement benefits to executives in addition to those which they already provide for these executives together with all employees. If the Board believes the expense is justified, it should be absorbed by the shareholders/owners of PSE. This expense is particularly unjust and unreasonable at a time when many PSE customers face severe economic challenges and many are losing jobs and potentially retirement benefits of their own.[149]

---

[146] Exh. No. JRD-1CT, p. 62.

[147] *Id.*, p. 63 (The specific numbers of employees covered by both the general qualified plan and SERP is stated in Public Counsel's testimony. It has been designated by PSE as confidential).

[148] Exh. No. JRD-1CT, p. 64 (Regarding Avista, citing Docket Nos. UE-090134/UG 090135, TR. 597:10-11.)

[149] In the decision cited above, the Connecticut Dept. of PUC rejected SERP recovery as inappropriate and excessive given the current economic climate. *Connecticut Gas*, p. 49.

4. Directors' and Officers' (D&O) Liability Insurance.

110. Public Counsel objects to PSE's proposal in this case to impose 100 percent of D&O liability insurance costs on ratepayers. As discussed in Mr. Dittmer's testimony, this insurance clearly provides benefits to shareholders as well as to ratepayers. Payouts under the insurance policy are generally the result of shareholders suits, and the financial benefits accrue to the plaintiff shareholders or shareholder class. The insurance reduces the level of risk faced by investors arising from poor or improper management decisions. Since such decisions are also likely to fail the prudence standard, costs of the imprudent decision would not be imposed on ratepayers in any event. In this sense, the insurance primarily benefits shareholders.

111. The Commission's decision in the most recent Avista rate case recognized that shareholders benefit from D&O insurance and it is therefore inappropriate to charge customers the full cost. In the Avista case, the Commission found that a 90/10 sharing between customers and shareholders was appropriate, based on an Avista concession, and data about officer time allocations. In the instant case, a different sharing level should be considered. PSE has not acknowledged any obligation or proposed any sharing level. Moreover, because the ultimate "shareholders" of PSE now consist of a small number of private equity investor entities, the function of the liability insurance is unclear, and would appear to be different than for publicly traded company shareholders. Accordingly, Public Counsel recommends that in the case of PSE there be an equal sharing of the cost of D&O insurance between customers and ratepayers.

5. Incentive Compensation.

112. Public Counsel has not recommended an adjustment for this item. However, based on a preliminary review, Mr. Dittmer expressed some concerns that the program is unduly weighted toward shareholder benefit. Mediocre service quality achievement can still result in substantial

incentive payments if earnings per share are high enough.[150] In the recent Avista rate case decision, the Commission noted that a review of that company's incentive program had not occurred for a number of years, and found that review should be conducted in the next general rate case.[151] Public Counsel recommends a similar approach for PSE. It is appropriate to revisit the issue, given the frequency and magnitude of rate filings and the need to ensure that PSE bonus and incentive costs are only recovered from customers if clearly justified.

6. PSE's Corporate Aircraft.

113. Business travelers in the United States, whether government or corporate, commonly use commercial airlines and car rentals to reach their destinations, rather than aircraft owned by their corporate or governmental employer. In this case, PSE seeks to recover from customers the costs to own, operate and maintain its own aircraft for board member, officer and employee travel, even though PSE's service territory is entirely within Washington state, primarily on the west side of the Cascades in the I-5 corridor, and at most a few hours drive from company headquarters in Bellevue. Public Counsel's analysis of data provided by PSE shows that the approximate average cost *per PSE passenger* is $945 per flight leg or $1,890 per round trip.[152] Given the high cost per passenger trip – which in most cases are of relatively short duration – it is certainly reasonable to examine whether PSE's aircraft expenses are excessive.

---

[150] Exh. No. JRD-1CT, pp. 68-69. Public Counsel raised similar issues in the last PSE rate case, Docket No. UE-072300/UG-073201, Exh. No. MJM-1T, p. 38

[151] *WUTC v. Avista Corp.,* Docket Nos. UE-090135/UG-090135, Order 10, ¶ 129.

[152] James Dittmer Workpapers. The $1,890 estimate for the cost per passenger for round trips was developed by dividing the total company corporate aircraft ownership and operation costs included in the development of the test year cost of service (found in Exh. No. JRD-2 and Exh. No. JRD-3C) and dividing this total by the number of one-way trips taken by all PSE employees, counsel , agents and other representatives during the test year (found in Dittmer workpaper titled "Aircraft Cost Adjustment") to arrive at an average cost for each "one-way" trip of $945. This amount was doubled based on an assumption that most "one-way trips" during the test year represented one leg of a round trip.

114. Public Counsel's analysis has concluded that PSE's *excess* costs from its aircraft are approximately $550,000.[153] It should be emphasized that Public Counsel's adjustment calculation assumes a conservatively high level of expense for alternative forms of transportation. Public Counsel's adjustment only eliminates what it believes to be the truly excessive cost of utilizing the Company's corporate aircraft for business travel.

115. Public Counsel developed its recommendation by calculating alternative pricing for all trips reported by PSE, with the exception of the Montana Governor's Cup charity golf tournament, CEO Steve Reynold's trip to a newspaper meeting in Port Townsend, and a trip to pick up Eric Markell in Palm Springs related to a merger announcement. Public Counsel's alternative costs assumed travelers would use a car for trips within a 3-4 hour drive of Bellevue. For trips more than four hours drive away, commercial air travel was priced, assuming it was available to the location, together with car rental and additional costs (airport parking extra meals, hotel stay). A significant number of the PSE flights are from Renton to Portland, Oregon, which is an approximate three-hour drive by car from PSE headquarters.

116. Public Counsel acknowledges that some PSE trips involve destinations that are harder to reach and may be outside the service territory. For instances where the location was over four hours away by car, there were no reasonable commercial flight alternatives, and there were several passengers on the flight, round trip charter flight costs were used.

117. As noted, conservative assumptions were employed. For car travel, IRS personal vehicle mileage reimbursement was used, although less expensive fleet cars would likely be used on many occasions. Commercial air fares were priced at *the highest last minute fare from Sea-Tac,* although cheaper fares would likely be arranged or available for some trips. An allowance of

---

[153] Exh. No. JRD-1CT, p. 74. Public Counsel recommended an adjustment for this expense in PSE's last

$100 per passenger per trip was conservatively added to consider incidental costs that may be incurred when alternative forms of transportation are employed. Costs were added for car rentals, meals and hotel stays that might not have been incurred on corporate aircraft trips.[154]

118. PSE offered no alternative study in rebuttal this case, and does little to rebut the reasonableness of Public Counsel's alternative cost assumptions.[155] PSE has in fact never performed a study to justify the aircraft investment.[156] Instead, the Company places much reliance on asserted productivity gains to justify charging corporate aircraft use to customers. Importantly, PSE provides no study to demonstrate its claim of productivity gains,[157] and in at least one instance such "productivity" benefits that have been suggested are significantly overstated. For example, PSE's comparison between flying and driving to Portland fails to take into account aircraft preparation, pilot readiness, required employee ground travel from Bellevue to the Renton airfield, and required ground transportation needs after arrival in Portland. Moreover, Public Counsel's analysis conservatively allows for some use of charter flights for hard to reach locations. For charter flights there are no time or productivity savings as compared with the corporate aircraft.

119. In the final analysis, PSE provides no empirical data to show that use of the corporate aircraft is more economical than ordinary commercial travel. While it argues productivity benefits, no study has ever been performed to quantify this factor. Public Counsel's alternative cost calculations, with many significant conservative assumptions incorporated, have not been rebutted by the Company. PSE officers and senior employees may find it convenient to travel by

---

rate case. Exh. No. MJM-1T, p. 43. Since the case was settled, the issue was not reviewed by the Commission.

[154] Exh. No. JRD-1CT, p. 75.

[155] PSE initially contested that IRS mileage covered all costs (i.e. both fixed and variable), but ultimately conceded the point. Exh. No. MJS-23, p. 2 (response d).

[156] Stranik, TR. 376:21-24; Exh. No. MJS-24, p. 1 (response d).

[157] Stranik, TR. 376:16-20; Exh. No. MJS-23, p. 2 (response a).

corporate aircraft, but that is not sufficient justification for asking customers to pay the excess costs of that convenience. This is type of economizing that customers can reasonably expect from PSE in the current economic climate.

7. Production Operations and Maintenance Expense – Electric.

a. Non-fuel production operations and maintenance expense should not consider budgeted or forecasted amounts.

120. PSE's original direct testimony and exhibits supported proforma non-fuel production operations and maintenance expense levels that were, in many instances, developed by considering forecasts or budgets.[158] Staff witness Kathryn Breda and Public Counsel witness Dittmer both rejected the Company's proposed development of proforma production O&M expense that consisted of budgets or forecasts. In its rebuttal filing PSE significantly revised its proforma levels of non-fuel production O&M expense to an amount slightly less than the proforma level calculated by Mr. Dittmer for the various production facilities he had addressed. Public Counsel has accepted PSE's proforma level of non-fuel production O&M expense for these facilities.[159]

b. The "Deferral Method" in the form endorsed by Staff and Public Counsel is acceptable to account for planned major production plant maintenance that does not require Commission authorization.

121. PSE initially recommended a method of accounting for "major production maintenance" that was similar in some respects to the "deferral method" of recently issued accounting guidelines permitted for planned major maintenance for the airline industry.[160] In response

[158] Exh. No. JRD-1CT, p. 87.

[159] Public Counsel's analysis did not address each and every production facility as did Staff. Public Counsel supports adoption of Staff adjustments that were calculated in the same manner as Public Counsel's by rejecting budgeted/forecasted expenses and considering available "actual" expense levels at those remaining facilities.

[160] Exh. No. JHS-1T, pp. 14-15.

testimony, Staff and Public Counsel both endorsed this "deferral method" of accounting for major maintenance, but only as specifically delineated within the recently issued airline industry guidelines, noting that PSE had departed from those guidelines in its proposal in some regards.[161] Ms. Breda and Mr. Dittmer testified that a properly implemented "deferral method" for accounting for planned major maintenance should result in a better matching of costs and benefits, and should also result in the "normalization" of such activities for accounting and ratemaking purposes.[162] In rebuttal PSE agrees with the "deferral method" advocated to be implemented by Staff and Public Counsel.[163]

122. The Commission's order in this docket should not address the recoverability of production maintenance expenses being deferred. That issue would be considered in developing retail rates in PSE's "next" general rate case or PCORC.

8. Proposed amortization of over-recovered production maintenance expense and Colstrip settlement costs.

a. Over-recovered production maintenance – "regulatory liability".

123. PSE states that it has been over collecting for production maintenance expense since 2002. PSE is recommending creation of a "regulatory liability" for the over collection, to be returned to ratepayers via a credit amortization over three years. The liability has not been currently established on PSE's financial statements. This request is linked to PSE's proposed adoption of the deferral method of accounting discussed above.

[161] Exh. No. KHB-1CT, pp. 15 -16; Exh. No. JRD-1CT, pp. 90 – 94).
[162] Exh. No. KHB-1CT, p. 14, Exh. No. JRD-1CT, p. 94.
[163] Exh. No. LEO-13CT, p. 2.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

b. Colstrip litigation – "regulatory asset".

124. PSE proposes to defer and amortize over a five year period the cost incurred from certain Colstrip litigation settled in the 2008 test year. The Company has not reflected the settlement payments on its balance sheet.

125. The Commission should deny PSE's proposal to recover Colstrip litigation expenses from customers. The purpose of test year rate making is to develop a normal level of expenses that will match the company's expenses in the rate year. This litigation expense is an unusual and non-recurring item. Thus far PSE has not deferred any of the settlement costs or recorded any of the costs on the balance sheet as a regulatory asset.[164] The company filed an accounting petition regarding the expense in 2008, but it has not been acted upon.[165] If the Commission grants the request to defer and amortize the expense at this time, 2010 reported earnings before tax would increase by about $8 million.[166]

126. Public Counsel recommends that neither of these out of the ordinary rate treatment requests be granted. In a general sense, the under-recovery for Colstrip and the over-recovery for production maintenance are offsetting.[167] It would be inequitable to allow PSE to recover for this abnormal non-recurring litigation expense which arose during the same time that it was over-recovering production maintenance expense. The litigation expense should be borne by shareholders.

---

[164] Story, TR. 593:17-594:24.

[165] *In the Matter of the Petition of PSE For An Accounting Order Authorizing Deferral of Colstrip Lawsuit Settlement Payment,* Docket No. UE-080900 (May 22, 2008).

[166] Story, TR. 595:21-25.

[167] The related recommendation for rate base treatment of these items is set forth in Exh. No. JRD-1CT, p. 102:19-103:4.

D. Rate Base Items.

1. Tax adjustment related to White River Asset Sale – Electric.

127. This Public Counsel adjustment reflects a net reduction in the tax ramifications of the sale of the White River assets and water rights to the Cascade Water Alliance. Contrary to the Company's assumption that all of the sales proceeds would be taxable, Mr. Dittmer's testimony showed that there would be an expected tax loss on the transaction which would act as an offset to other taxable income generated by electric operations.[168] PSE has removed the tax amounts associated with the White River sale.[169]

128. However, PSE has not agreed with Public Counsel's position that there should be an incremental rate base reduction adjustment to recognize the probable tax loss, which would translate to a tax receivable not yet recognized by the Company. Although the record clearly reflects that the sale will result in a tax loss and attendant tax receivable, PSE argues in rebuttal that it is inappropriate to consider such tax losses in this proceeding until all of the transactions have occurred.[170] This newly developed Company argument is not persuasive. If it was appropriate for PSE to reflect taxes payable as an offset to proceeds of the sale and an increase in rate base, as originally proposed, it is likewise appropriate to recognize the rate base reduction reflecting the tax receivable now expected to result from the sale.

2. Jackson Prairie adjustment.

129. Public Counsel recommended an adjustment to reflect a reduction in plant cost related to PSE's receipt of a tax refund.[171] On rebuttal, Mr. Marcelia testified that PSE was only a one-third owner of the plant, but did not otherwise rebut Mr. Dittmer's recommendation, or

---

[168] Exh. No. JRD-1CT, p. 15.
[169] Exh. No. MRM-4T, p. 3
[170] Exh. No. MRM-4, p. 3.
[171] Exh. No. JRD-1CT, p 17.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

incorporate an adjustment in the Company's rebuttal revenue requirement on this issue.[172] In Public Counsel's response to Bench Request No. 3, Mr. Dittmer has revised his adjustment to reflect PSE's one-third ownership interest. This addresses the only objection raised by PSE in rebuttal to this Public Counsel adjustment.

3. Other rate base adjustments.

130. Public Counsel has recommended a number of other rate base adjustments, for the most part related to expense adjustments. These are not separately discussed in the brief.[173] They include:

- Elimination of investment in corporate aircraft[174]
- Elimination of Colstrip regulatory asset[175]
- Elimination of regulatory liability for over-collection of production maintenance[176]
- Removal of Mint Farm deferrals[177]
- Rate base adjustment resulted from elimination of conservation phase-in[178]
- Production rate base adjustment.[179]

E. PSE's Requested Gas Revenue Requirement Exceeds Its Tariffed Request.

131. PSE's proposed tariffs on file in this case request approval of a gas revenue requirement

[172] Exh. No. MRM- 4T, pp. 4-5.

[173] Federal Executive Agencies' witness Mr. Ralph Smith proposed an adjustment to rate base to reflect additional Accumulated Deferred Income Taxes that PSE will realize as a result of adopting a new method for accounting for repairs. As a result of the change the Company will be allowed to take a much larger tax deduction for "repairs" which, for financial statement reporting/ratemaking purposes, will continue to be recognized as a "unit of property" and therefore capitalized to plant and depreciated. This book and tax timing difference is expected to generate a significant amount of additional Accumulated Deferred Income Taxes related to filing an amended 2008 federal income tax return. Public Counsel agrees with FEA that this should be used as a rate base offset.

[174] Exh. No. JRD-1CT, p. 13.

[175] *Id.*

[176] *Id.*, p. 14.

[177] *Id.*, p. 15.

[178] *Id.*, p. 16.

[179] *Id.*

of $27.1 million. PSE subsequently increased its gas revenue requirement in testimony. To date, however, it has not filed new tariffs to reflect the increased request. PSE's intentions regarding recovery of the higher amount in rates were uncertain at the time of supplementation. The Company has now affirmatively stated that it seeks approval of $28.2 million in rates.[180] It is Public Counsel's position that the maximum revenue PSE can receive in this case is limited by Washington law to the amount requested in its proposed tariffs -- $27.1 million. In support of position, Public Counsel incorporates by reference the legal arguments and authorities contained in its August 10 and October 5, 2009, Answers to PSE's motions to file supplemental and revised testimony.

VI. CONSERVATION PHASE-IN

A. The Conservation Phase-In Adjustment Is Not Appropriate Because It Is Not "Known and Measurable."

132. Testimony from Staff and Public Counsel witnesses establishes that the conservation phase-in violates the Commission's requirements for a proforma adjustment because it is not "known and measurable." Mr. Parvinen points out the adjustment is unnecessary and that its lack of precision fails to account for offsetting factors.[181]

133. Testimony of Mr. Dittmer for Public Counsel demonstrates the existence of offsets not considered in the Company calculation of the reduction in usage per customer alleged to result from its DSM/conservation measures. Overall electric usage on a total company basis has increased. Overall electric usage per customer is essentially flat, notwithstanding PSE's conservation programs. This in itself shows that offsets are occurring. New patterns in

[180] PSE Response to Bench Request No. 3.
[181] Exh. No. MPP-1T, pp. 12-18.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

residential customer usage such as energy-intensive High Definition television, expanded use of air conditioning, and proliferation of "always on" computers are not taken into account.[182] On the gas side as well, overall sales of gas on a company-wide basis continue to rise. Even long term trends in declining use per customer were actually reversed in between 2007 and 2008.[183]

134. In rebuttal, Mr. Piliaris disputes Mr. Dittmer's five year analysis of usage per customer, suggesting the time period is too short. However, Mr. Piliaris does not disagree with Mr. Dittmer's conclusion that per-customer usage is flat over that period, nor does he provide alternative data or recommend an different time period.[184]

135. Questioning by the Commissioners at the hearing further highlighted the offset issue. Chairman Goltz asked whether a "reverse adjustment" would be appropriate at some point to reflect increased charging of electric cars. PSE disagreed that it would.[185] Commission Oshie posed a hypothetical about a customer who received a PSE rebate for a more efficient gas hot water heater, but also acquired a new gas oven, dryer and cooktop at the same time to take advantage of the gas re-plumbing. Mr. Piliaris admitted that this increase in load would not be reflected under the PSE proposal, only the estimated reduced usage for the hot water heater.[186]

---

[182] Exh. No. JRD-1CT, pp. 35-43.
[183] *Id.*, pp. 43-44.
[184] Exh. No. JAP-5T, pp. 23-24.
[185] TR. 546:14-548:3.
[186] TR. 560:6-561:12. In response to Bench Request No. 5, PSE clarified that fuel switching effects are not included in the Conservation Phase-In because the fuel switching pilot does not begin until after the test year. In the future, however, this issue could re-emerge if the "phase in" were approved and PSE did not reflect the offsetting effect of increased gas usage.

B. PSE's Conservation Estimates Are Not Reliable.

136. Mr. Piliaris states in his rebuttal that the Blue Ridge report "reviewed" and "validated" PSE's conservation savings estimates.[187] What is clear from the Blue Ridge report, however, is that Blue Ridge performed no "verification" whatever of the estimates or of the data provided by PSE, as acknowledged at hearing in response to questions from Chairman Goltz.[188] The Blue Ridge report is an interim not a final report, covering only the first two years of the mechanism. It was not requested or required by the Commission. Furthermore, as Staff points out, there has been no post-installation measurement and verification of PSE's conservation savings claims.[189] While Mr. Piliaris asserts in his rebuttal testimony that PSE's conservation savings estimates are consistent with the International Performance Measurement and Verification Protocol (IPMVP), he was unable, at hearing, to provide even a brief explanation of IPMVP.[190]

137. As Staff correctly points out, PSE's proposal for the Phase-In "is a third level of recovery."[191] The first level of recovery is provided by ratepayers through the electric and gas conservation program tariff riders (Electric and Gas Schedules 120). In 2009, PSE's gas and electric conservation programs, funded by the riders, cost over $86M.[192] The second level of recovery is PSE's electric incentive pilot. Although PSE has now decided to terminate this program, in 2008 PSE received $4 million under the mechanism in addition to tariff rider

---

[187] Mr. Pilaris claim in testimony that no party had questioned the Blue Ridge report was shown at the hearing to be a clear misstatement of fact. TR. 553:3-536:8; Exh. No. JAP 12.

[188] TR 550:6-551:13 (discussing lost margin data calculated by PSE but not confirmed by Blue Ridge); *see also* Exh. No. JAP-6, p. 3.

[189] Exh. No. MPP-1T, p. 16; Exh. No. JAP-11.

[190] Exh. No. JAP-5T, p. 10; TR 540:19-542:9.

[191] Exh. No. JAP-11, p. 2.

[192] Docket No. UE-970686, PSE Energy Efficiency Services Program Results: January – December 2009, compliance filing February 16, 2010, at Exhibit 1. PSE has recently estimated annual conservation program expenditures of approximately $100M per year for the two-year period 2010-2011. Docket Nos. UE-091859 & UG-091860, PSE's November 30, 2009 filing, Appendix B.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

recoveries.[193] Since the Conservation Phase-In would adjust the test-year (2008) billing determinants for customer usage, it represents a third and duplicative level of recovery for PSE.

C. The Conservation Phase-In Is A Decoupling Proposal Barred By The Terms Of The PSE Sale Agreement And Order.

138. In the PSE Sale agreement, the Joint Applicants agreed that "PSE will not make any proposals regarding decoupling for electric [and gas] industrial customers during the two-year period commencing as of the date of closing of the Proposed Transaction."[194] The settlement also stated that PSE had "no current plans" to make a decoupling proposal for any class of customers for a two year period.

139. While PSE witness Piliaris asserts that the Conservation Phase-In is not decoupling,[195] the claim lacks credibility. Mr. Piliaris argues this is the case because the Phase-In would not "break the link" between the Company's revenues and loads or with the disincentive to invest in conservation measures.[196] The argument is a tortured one, given that the Phase-In adjustment is expressly designed to replace revenue which would be lost from estimated sales declines (i.e. to "delink" revenue and sales).[197] Indeed Mr. Piliaris stated "[w]e believe that the mechanism should be more reflective of what we're trying to address, which is disincentives, not incentives"[198] further explaining that "[w]hat we're trying to address is our disincentives to conservation."[199] This is identical to the rationale offered for all decoupling proposals.

[193] Exh. No. MPP-1T, p. 17:9-10.

[194] *Puget Sale Case,* Multiparty Settlement Stipulation, Conditions 62 and 63.

[195] TR. 565:8-10.

[196] TR. 565:14-566:1.

[197]TR 545:18 – 546:13. When asked by Chairman Goltz if other state commissions had approved an adjustment comparable to the Phase-In, Mr. Piliaris stated that decoupling and lost margin mechanisms have been approved, adding that "they're all different, I believe they all mean to address the same thing, which is to address the disincentives to conservation" and stating that the Phase In more narrowly addresses the issue.

[198] TR 557:23-25.

[199] TR 559:5-6.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

140. It is worth recalling that the Commission rejected PSE's 2006 request for gas decoupling (the "GRNA mechanism") because PSE opposed inclusion of both an earnings cap as well as conservation performance measures. The Commission found that "without performance measures, neither the Commission nor the public can evaluate whether or to what extent decoupling is actually promoting incremental amounts of conservation. Yet, PSE opposes any sort of earnings cap or performance measure."[200] In this case, PSE asserts that the Conservation Phase-In addresses its disincentive to promote conservation, yet the mechanism contains neither of these elements.[201]

141. Seen as a decoupling proposal, PSE's Conservation Phase-In is, therefore, flawed in several respects. If PSE wishes to implement decoupling, it should forthrightly identify its proposal as such, and make a filing that is consistent with the guidance provided by the Commission in its PSE[202] and Avista decoupling orders, after the expiration of the sale commitments.

VII. RATE SPREAD/RATE DESIGN

142. Public Counsel joined with the Company and other parties in presenting a settlement to the Commission intended to resolve all electric and gas rate spread and rate design issues.[203] Public Counsel supports the settlement because it provides for a fair allocation of revenue responsibility, with residential customers receiving the uniform percentage increase common to most schedules.[204] Beneficial aspects of the settlement include the avoidance of any increase in the residential gas monthly charge, which saw a sizeable increase in the last GRC, and a limited

---

[200] *WUTC v. PSE*, Docket Nos. UE-060266 & UG-060267, Order 08, ¶ 68.

[201] The Avista decoupling mechanism includes both components. *WUTC v. Avista Corp.*, UE-090134/UG-090135, Order 10, ¶¶ 248-252.

[202] *WUTC v. PSE*, Docket Nos. UE-060266 & UG-060267, Order 08, ¶¶ 52-69.

[203] Exh. No. JT-1 (electric), JT-3 (gas).

[204] Exh. No. JT-2, p. 5, JT-4, p. 5.

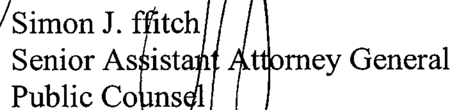
increase of 25 cents to the electric charge. Public Counsel recommends that the Commission adopt the compromise agreement as a fair result for customers.

VIII. CONCLUSION

143. For the foregoing reasons, Public Counsel recommends that the Commission reject the electric and gas revenue increases proposed by Puget Sound Energy. Public Counsel respectfully requests that the Commission adopt Public Counsel's recommendations herein and establish fair, just, and reasonable rates for PSE's residential and small business customers, consistent with its authority to regulate in the public interest.

144. DATED this 19th day of February, 2010.

ROBERT M. McKENNA
Attorney General



Simon J. ffitch
Senior Assistant Attorney General
Public Counsel