

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

**Docket No. UE-090704
Docket No. UG-090705
(consolidated)**

**REPLY BRIEF OF
PUGET SOUND ENERGY, INC.**

MARCH 2, 2010

PUGET SOUND ENERGY, INC.

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I. INTRODUCTION

Puget Sound Energy, Inc. ("PSE" or the "Company") provides this reply brief in response to arguments made in the initial briefs of other parties to this case.¹

II. POWER COST

A. The Mark-To-Market Adjustment Should Be Included In Setting Rates

1. For the first time, on brief, ICNU proposes that gas hedging costs should be excluded from base rates and flowed through the PCA.² This position contradicts the Joint Parties' proposal in the recent *Avista* case.³ In that case, the Joint Parties successfully prodded Avista to *include* forward market transactions in the power cost update for setting rates.⁴ There is no consistent ratemaking principle behind the Joint Parties' treatment of these mark-to-market contracts other than to advocate for whatever treatment will cause the utility to absorb the greatest cost. Moreover, ICNU is flat wrong in asserting that "once the PCA deadband is exceeded, all costs of the gas hedges will be flowed through to customers."⁵ In none of the four levels of PCA bands do customers absorb 100% of the cost over-runs.⁶ The Commission should reject this arbitrary approach to setting power costs and should further reject on procedural grounds ICNU's new argument, raised for the first time on brief.
2. ICNU wrongly concludes that PSE's gas hedges exceed the Company's gas for power

¹ Many of the issues raised by other parties in their initial briefs have already been addressed by PSE in its Initial Brief. PSE hereby incorporates those arguments by reference.

² See ICNU Initial Brief at ¶20.

³ The "Joint Parties" refers to ICNU and Commission Staff, who jointly filed testimony on power costs in this case and in the recent *Avista* general rate case, Docket No. UE-090135. In this case, ICNU addressed these issues on brief, apparently on behalf of the Joint Parties. References in PSE's Reply Brief to arguments on power costs will cite to ICNU's brief and argument.

⁴ See *WUTC v. Avista Corp.*, Docket Nos. UE-090134, *et al.*, Order 10 (Dec. 22, 2009) ¶27, Multi-Party Partial Settlement Stipulation at p. 4 (Sep. 4, 2009), Exh. No. JT-1T 8:8-18. ICNU and other parties also acknowledged the appropriateness of including hedging costs in base rates in the settlement of PSE's 2005 PCORC. See *WUTC v. Puget Sound Energy, Inc.*, Docket No. UE-050870, Settlement Agreement, including Attachment A (Aug. 29, 2005).

needs. ICNU's own cross exam exhibit⁷ belies this claim and demonstrates that the Company's actual transacted gas hedges are below its forecast gas needs, as modeled by PSE's risk management system. PSE hedged in excess of the *AURORA-projected* gas for power needs, but its actual hedging was not in excess of its forecast needs.⁸ Short-term fixed-price gas for power and power contracts incurred at the price cut-off date for the rate year represent prudent, known and measurable transactions PSE has entered into and is obligated to pay; they are supported by PSE's hedging program, and have been historically included in rates.

3. Further, the Joint Parties and Public Counsel misunderstand the relationship between gas hedges, AURORA, and wholesale power sales. As Mr. Mills testified, having more gas does not mean it is used to make more off system sales.⁹ Over the last six rate periods, purchases net of sales were actually \$83 million higher than the AURORA modeled costs included in rates.¹⁰

4. Although ICNU decries the volume and mark-to-market of PSE's hedges, PSE has seen a sizeable growth in the volume of gas-fired generation on its system.¹¹ PSE extended the tenor of its hedging program in 2007 to remove additional volatility from commodity prices,¹² and market prices have dropped materially over the last two years.¹³ Customers have benefited from

⁵ ICNU Initial Brief at p. 12 (unnumbered paragraph).

⁶ See Story, Exh. No. JHS-8 1-2.

⁷ See Mills, Exh. No. DEM-23C.

⁸ These differences are caused by different input assumptions due to regulatory modeling limitations which, in this case, have caused lower heat rates in AURORA. See Mills, Exh. No. DEM-12CT 19:8-14.

⁹ See Mills, TR. 751:11-753:21.

¹⁰ See Mills, Exh. No. DEM-12CT 48:12, Table 6.

¹¹ See Public Counsel Initial Brief at ¶82; see also Harris, Exh. No. KJH 1CT 9:11-20 and 2:6-12 (discussing increase in gas fired generation capacity); see also Exh. No. JT-1 20:9-11 (recognizing PSE's increased volume of hedges "may make sense and be reasonable" due to the extended tenor of the hedging program and the acquisition of additional baseload gas-fired generation with the acquisition of Goldendale and Mint Farm).

¹² See Mills, Exh. No. DEM-12CT 20:8-11.

¹³ See Mills, Exh. No. DEM-1CT 43; see also Mills, Exh. No. DEM-12CT 58:3 (average gas price of \$8.51/MMBtu in 2007 general rate case as compared to the current proceeding's \$5.97/MMBtu average gas price).

the mark-to-market transactions included in rates over the past several cases.¹⁴ ICNU's new argument on brief that the Tenaska and Encogen buyouts "dwarf" this benefit is a complete red herring. PSE has had regulatory determinations on these buyouts; these have no bearing on the calculation of benefits from including these mark-to-market contracts in setting rates.

5. The Joint Parties' argument to cap mark-to-market transaction at 80% of the AURORA forecast ignores the fact that AURORA is a static modeling tool that provides a snapshot in time.¹⁵ The Joint Parties are well aware that PSE utilizes a comprehensive risk management system—not AURORA—for daily management of the energy portfolio. It makes no sense for PSE to base its hedging on a fixed regulatory model and ignore the actual service requirements of its customers. Furthermore, Joint Parties overlook the fact that because gas prices were dropping over the period of time the hedges were put in place, the average price of the hedges in excess of their proposed 80% cap would be lower than the average price of the total hedges used by the Joint Parties in calculating their adjustment.¹⁶ Removing the actual hedges above the 80% threshold would greatly reduce the Joint Parties' \$18.6 million adjustment.

B. Jackson Prairie

6. ICNU's argument for a \$0.3 million reduction to power costs based on a phantom seasonal cost benefit associated with Jackson Prairie storage misrepresents evidence demonstrating that the assignment was for the purpose of system reliability and renewable resource integration management, not a seasonal optimization of natural gas prices. The EMC minutes referenced by ICNU state that PSE will utilize the capacity for operational reliability

¹⁴ See Mills, Exh. No. DEM-12CT 19:4-15.

¹⁵ See Mills, TR. 750:7 – 751:10.

¹⁶ See Mills, Exh. No. DEM-25C (lower average price for later hedges as compared to earlier hedges).

purposes (balancing/peak-day response).¹⁷

C. Hydro Filtering

7. In its brief, ICNU mischaracterizes the state of the law on hydro filtering. Although the Commission has approved settlements among parties that contain hydro filtering adjustments,¹⁸ and has endorsed *in theory* the use of hydro filtering if there is a PCAM in place,¹⁹ it has never considered a hydro filtering adjustment in a case with a functioning PCA mechanism, as is present here. Moreover, the Joint Parties' hydro filtering proposal fails to comply with the Commission's directives, which requires a hydro filter to "reflect whether the distribution of variability in power costs is symmetrical or skewed as well as how the deadband and sharing bands are designed to reflect asymmetry in the risks and benefits that may accrue to both customers and the Company."²⁰ The Joint Parties' proposal sidesteps these mandates, opting instead for a "simple,"²¹ non-scientific²² approach of eliminating 40% of the data to "normalize" it.²³ The mechanical removal of a large percentage of data does not "normalize" the data.²⁴ Moreover, the 40% of hydro data that the Joint Parties would discard as "extreme" includes three of the past seven years and likely the current year.²⁵ PSE has borne 90% (\$44.9

¹⁷ See Exh. No. JT-7C, (March 19, 2009 EMC Minutes). The EMC presentation included the results of a traditional storage valuation analysis determining the *market value* of the storage capacity in order to ascertain whether the selling price offered by Cabot was reasonable (what price the seller could reasonably expect to receive if sold to a gas marketer). The EMC presentation depicts the measure by which others (not PSE) value the capacity and ultimately set the selling price so that PSE would not pay more than the expected capacity's market value.

¹⁸ See *WUTC v. Avista Corp.*, Docket Nos. UE-090134, *et al.*, Order 10 (Dec. 22, 2009); *WUTC v. Avista Corp.*, Docket Nos. UE-070804, *et al.*, Order 05 (Dec. 19, 2007). As the Commission has previously advised ICNU, "the use of filtered water-years in the settlement of a prior . . . case is not precedent for resolution of the water-year issue in this case" *WUTC v. PacifiCorp*, Docket Nos. UE-061546, *et al.*, Order 08 (June 21, 2007) ¶90.

¹⁹ *WUTC v. PacifiCorp*, Docket Nos. UE-061546, *et al.*, Order 08 (June 21, 2007) ¶89.

²⁰ *WUTC v. PacifiCorp*, Docket Nos. UE-061546, *et al.*, Order 08 (June 21, 2007) ¶101.

²¹ ICNU Initial Brief at ¶24.

²² See ICNU Initial Brief at ¶30.

²³ ICNU Initial Brief at ¶24.

²⁴ See Dubin, Exh. No. JAD-1T 14:3-6.

²⁵ See Mills, DEM-12CT 31:21-32:2; Dubin, Exh. No. JAD-1T 13:16-18.

million) of the under-recovery of costs during these years,²⁶ as PSE bears the full cost of the first \$20 million of annual PCA under-recovery.²⁷ In the context of PSE's PCA, which the Commission has recognized is working as intended²⁸ without such an adjustment, the Joint Parties have not demonstrated the merit of their adjustment.

8. ICNU's pricing argument also lacks merit. As Mr. Mills testified, not all the pricing variables in the AURORA model change because of a change in hydro. For instance, the gas prices remain the same under all hydro variations²⁹ despite the fact that when hydro generation is low, the demand for other sources of power increases, which would put increased pressure on the cost of gas.³⁰ In essence, it is the varying hydro generation that drives the variability in the AURORA generated market heat rates. Other than ICNU's unsupported assertion, there is no evidence that the AURORA generated heat rate distribution causes a pricing concern. The actual PCA history of over and under collections shows that ICNU's assertion lacks merit.³¹

9. ICNU dismisses as irrelevant the fact that its proposed hydro filter included *all* Mid-C hydro rather than just PSE's share of generation. To disregard PSE's hydro generation when determining PSE's power costs to service PSE's load is ludicrous, given that PSE's power costs are highly correlated to its hydro generation.³²

D. Production Operations and Maintenance

10. The Joint Parties agree that it is appropriate to use project budgets associated with Chelan

²⁶ See Mills, Exh. No. DEM-12CT 34:9 – 35:1.

²⁷ See Mills, Exh. No. DEM-12CT 35:7-9.

²⁸ See *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UG-040640, *et al.*, Order 06 (Feb. 18, 2005) ¶¶106-108.

²⁹ See Mills, Exh. No. DEM-12CT 40:17-20.

³⁰ See *e.g.*, Mills, Exh. No. DEM-12CT 31:21 – 32:2.

³¹ See Mills, Exh. No. DEM-12CT 35, Table 5.

³² See Mills, Exh. No. DEM-14C.

PUD and Grant PUD Mid-C projects for "Out-of-AURORA" assumptions for power costs;³³ yet a different Commission Staff member rejects a similar third-party budget for the Colstrip project, despite the showing that the budgeted costs have closely tracked actual costs.³⁴ Similarly, Commission Staff argues that obligations required by the Snoqualmie and Baker FERC licenses should not be included as pro forma adjustments, even though there are no offsets and PSE must undertake this work or be in violation of its licenses.³⁵ It is proper to allow these pro forma adjustments that are related to power resources and rely in part on forecasts for contractual and license obligations that must be undertaken during the rate year.³⁶

11. As demonstrated in this case, PSE needs an adjustment mechanism for accounting and ratemaking treatment of major maintenance for turbines. The parties agree that turbines with major maintenance contracts are deferrable. Similarly, the Commission should allow PSE to defer and amortize the major maintenance costs for turbines without maintenance contracts.

III. MINT FARM IS PRUDENT AND IS BASELOAD GENERATION

12. PSE fully addressed the prudence of Mint Farm in the evidence presented in this case and in its Initial Brief. Public Counsel's Initial Brief has added no new arguments in this regard. Accordingly, the Commission should determine that the acquisition of Mint Farm was prudent.
13. Contrary to Public Counsel's argument, RCW 80.80.060(3) specifically instructs the Commission to consider operating permits to determine whether Mint Farm is baseload electric

³³ See Initial Brief of ICNU at ¶48.

³⁴ See Jones, Exh. No. MLJ-5CT 6:10-20: see also Jones, Exh. No. MLJ-7.

³⁵ See Lane, Exh. No. KWL-1T 10:3-11 and 12:2-5 regarding Baker. See Lane, Exh. No. KWL-1T 15:5-6 and 15:19 regarding Snoqualmie.

³⁶ See *WUTC v. Avista Corp.*, Docket Nos. UE-090134, *et al.*, Order 10 (Dec. 22, 2009) ¶49.

generation,³⁷ and the Commission has acknowledged the importance of operating permits for this purpose.³⁸ Mint Farm's operating permits provide for baseload generation.³⁹

IV. CAPITAL STRUCTURE AND COST OF CAPITAL

A. The Commission Should Adopt PSE's Proposed Capital Structure

14. The ratemaking capital structures proposed by Commission Staff and Public Counsel fail to meet the goal set by the Commission in PSE's 2004 general rate proceeding to set the Company's equity ratio for ratemaking purposes at the level that the evidence shows is most likely to prevail, on average over the course of the rate year.⁴⁰
15. PSE's proposed ratemaking capital structure contains an equity ratio that is at the mid-point of the range of ratemaking capital structures currently authorized by this Commission for electric and natural gas utilities.⁴¹ Any implication that PSE's proposed ratemaking capital structure is unreasonable or fails to balance safety and economy ignores the evidence that a 48% equity ratio is reasonable and average within the industry.
16. Commission Staff and Public Counsel disregard evidence that PSE's proposed ratemaking capital structure will reflect the average actual capital structure that will support utility operations during the rate year, and they cite to prior proceedings in which PSE's actual

³⁷ "In 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 electricity 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." RCW 80.80.060(3).

³⁸ See *WUTC v. PacifiCorp*, Docket No. UE-090205, Order 09 (Dec. 16, 2009) ¶68 (primary focus for baseload generation is on plant design and necessary operating permits).

³⁹ See Henderson, Exh. No. JMH-3; Nightingale, Exh. No. DN-1HCT 43:21 - 44:7.

⁴⁰ *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UG-040640, *et al.*, Order 06 (Feb. 18, 2005) ¶40.

⁴¹ PSE's current ratemaking capital structure contains a 46% equity component. *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-072300 & UG-072301 Order 12 (Oct. 8, 2008) ¶116. Avista Corporation's current ratemaking capital structure contains a 46.5% equity component. *WUTC v. Avista Corp.*, Docket Nos. UE-090134, *et al.*, Order 10 (Dec. 22, 2009) ¶¶24-25. NW Natural Gas Company's current ratemaking capital structure contains a 50.74% equity component. *WUTC v. NW Natural Gas Co.*, Docket No. UG-080546, Order 04 (Dec. 26, 2008) ¶59. PacifiCorp's and Cascade Natural Gas Corporation's rates are the products of "black box" settlements that do not specify a ratemaking capital structure. *WUTC v. PacifiCorp*, Docket No. UE-090205 Order 09 (2009) ¶24;

rate year equity ratio were lower than PSE's proposed ratemaking equity ratio.⁴² These arguments miss the mark. PSE's proposed ratemaking capital structure contains a *lower* equity ratio than PSE's current actual equity ratio, which is in excess of 50%.

17. Finally, the Commission should reject arguments to disregard PSE's actual ratemaking capital structure as evidence in the proceeding because the actual capital structures of some of PSE's parent companies contain equity ratios lower than PSE's actual equity ratio.⁴³ Contrary to Public Counsel's protests otherwise,⁴⁴ these are double leverage arguments that ignore the robust ring fencing provisions approved by the Commission. This Commission has consistently dismissed similar double leverage arguments in other proceedings,⁴⁵ and neither Commission Staff nor Public Counsel provides compelling rationale for deviating from this precedent.

18. PSE was clear during the merger proceeding that the transaction would strengthen its balance sheet with an equity ratio in excess of 50%, and would protect PSE from the risks of leverage within the new ownership structure through ring fencing.⁴⁶ Neither PSE nor any entity in its ownership structure has deviated from this plan.⁴⁷ Now, parties propose to penalize PSE for fulfilling one of the agreed upon outcomes of the transaction.

B. The Commission Should Adopt PSE's Proposed Cost of Capital

19. If the Commission were to correct for the errors in the growth forecasts of the discounted

WUTC v. Cascade Natural Gas Corp., Docket No. UG-060256, Order 05 (Jan. 12, 2007) ¶¶59-66.

⁴² See Commission Staff Initial Brief at ¶¶7-8; Public Counsel Opening Brief at ¶¶5-8.

⁴³ See Commission Staff Initial Brief at ¶¶9-10; Public Counsel Opening Brief at ¶¶9-13.

⁴⁴ Public Counsel Opening Brief at ¶13.

⁴⁵ *WUTC v. PacifiCorp*, Docket Nos. UE-061546, *et al.*, Order 08 (2007); *WUTC v. PacifiCorp*, Docket Nos. UE-050684, *et al.*, Order 04 (April 17, 2006).

⁴⁶ See *In the Matter of the Joint Application of Puget Holdings LLC and Puget Sound Energy, Inc., For an Order Authorizing Proposed Transaction*, Docket No. U-072375, Order 08 (Dec. 30, 2008) ¶¶68 and 197 and Merger Commitment No. 35.

⁴⁷ Contrary to argument in NWIGU's brief, Merger Commitment 24 (precluding PSE from advocating for a higher cost of debt or equity capital as a result of the merger) was never intended to prevent PSE from strengthening its equity level. As discussed above, an increased equity ratio was anticipated.

cash flow (“DCF”) analyses of Mr. Parcell and Mr. Hill that result in a downward bias in their respective DCF cost of equity estimates,⁴⁸ the Commission would arrive at the range of reasonableness of 10.30% - 11.30% suggested by Dr. Morin’s analyses. PSE’s proposed ROE of 10.8% falls at the midpoint of this range, and the proposed ROEs of Commission Staff and Public Counsel fall completely outside of this range of reasonableness.⁴⁹

20. Although Public Counsel's brief focuses on what it describes as a change in “the manner in which [Dr. Morin] calculates the results of [his] methods,”⁵⁰ these changes are neither surprising nor nefarious. Dr. Morin detailed the extremely volatile, unpredictable, and unusual behavior displayed by domestic and international financial markets since early fall of 2008.⁵¹ Any change made by Dr. Morin to the manner in which he may have traditionally conducted his ROE analyses was in response to the turmoil in the capital markets. Blind adherence to orthodoxy without regard to circumstance would have likely resulted in unreliable results, and Dr. Morin’s direct and rebuttal testimonies discuss his rationale for any such changes.

21. As addressed by Mr. Gaines in his rebuttal testimony, and discussed in PSE's Initial Brief, Commission Staff's proposal to price PSE's March and September debt issuances, plus the change related to moving equity to debt, at 5.757%, should be rejected.⁵² The compliance filing in the case can incorporate the actual rate for the March 2010 debt issuance, as it will be known.

⁴⁸ See Morin, Exh. No. RAM-19T 43:12 – 44:8.

⁴⁹ Public Counsel’s comparison of its proposed ROE of 9.50% to expected stock market returns in the range of 8% - 9% that are implied in utility pension fund actuarial data is irrelevant. The California Public Utilities Commission correctly rejected such comparisons and noted that “[t]he objectives of a pension fund are fundamentally different from that of an equity investor in a single utility and the risk profiles are not comparable” and “[m]ore importantly, pension fund returns are related to market value of assets held in the pension fund while a utility’s ROE is applied to a book value rate base.” *In re S. Cal. Edison Co.*, 262 P.U.R. 4th 53, 72 (Ca. Pub. Utils. Comm’n. 2007). The California Public Utilities Commission concluded that “[p]ension return assumptions are not comparable to the ROE used in utility ratemaking.” *Id.* This Commission should similarly reject any such comparison.

⁵⁰ Public Counsel Opening Brief at ¶19.

⁵¹ See Morin, Exh. No. RAM-1T 6:7 – 10:9.

As the Commission has done historically, it should use the embedded cost of long term debt for any other cost of long-term debt adjustments.

V. OTHER CONTESTED ADJUSTMENTS

A. The Conservation Phase-In Adjustment Is Not Decoupling

22. Public Counsel, NWIGU and ICNU each raise a new issue on brief that PSE's conservation phase-in adjustment is a decoupling mechanism.⁵³ Unlike decoupling mechanisms, which break the link between revenues and kWh sales, PSE's proposal merely isolates the amount of under-recovery of margin revenues from reduced test year kWh sales resulting solely from Company-sponsored conservation.⁵⁴
23. Commission Staff claims that PSE's proposal pro forms changes in units rather than changes in rate applied to the units, creating a mismatch with other test year components.⁵⁵ As PSE has shown, however, there are no such offsetting factors related to its conservation phase-in adjustment.⁵⁶ Further, Commission Staff's theory is not supported by past Commission practice, which has accepted changes to test year units (*i.e.*, loads) in many electric and gas rate cases, such as for weather normalization.⁵⁷ Commission Staff argues that weather normalization is different than PSE's proposed adjustment because temperature is symmetrical, meaning load is increased or decreased when the temperature changes.⁵⁸ This is no different than the conservation phase-in adjustment. Load (and therefore revenue) decreases when conservation

⁵² See Gaines, DEG-11HCT 18:19-23.

⁵³ See Public Counsel Opening Brief at ¶¶138-141, ICNU Initial Brief at ¶¶51-57, and NWIGU Initial Brief at ¶¶27-28.

⁵⁴ See Piliaris, Exh. No. JAP-1T 18:9-10; *see also* Piliaris, TR. 565: 180-24 and 546:10-13.

⁵⁵ See Commission Staff Initial Brief at ¶57.

⁵⁶ See Piliaris, Exhibit No. JAP-5T 6:7-13.

⁵⁷ See Piliaris, Exhibit No. JAP-5T 3:16-18.

⁵⁸ See Commission Staff Initial Brief at ¶59.

increases,⁵⁹ and load increases when conservation decreases.

B. Property Taxes

24. Commission Staff's rigid property tax adjustment ignores property valuations and system ratio that have become available in 2009 for plant put into service after January 1, 2008, and thus are known and measurable. In the recent *Avista* case, the Commission recognized that it is appropriate to pro form in new property valuations as they become available.⁶⁰ Excluding these known and measurable property tax updates is inequitable, particularly when Commission Staff's proposal omits the property valuations for all plant put in service during the 2008 test year.⁶¹

C. Simplified Service Cost Methodology

25. Commission Staff muddles the history of the simplified service cost methodology and the benefits it provided to customers. The evidence demonstrates that it was customers who benefited as a result of deferred taxes recorded above the line.⁶² Commission Staff and PSE do agree on one point—that the Commission directed PSE to file an accounting petition seeking "appropriate treatment of any back taxes *and interest assessed*"⁶³ relating to this tax methodology. The accounting petition PSE filed in 2008 to address the appropriate treatment of interest assessed, as instructed, has never been brought before the Commission.⁶⁴ It is ironic that Commission Staff now characterizes PSE's request for recovery as "unique" and a "departure

⁵⁹ See Piliaris, Exh. No. JAP-1T 24:17-19.

⁶⁰ *WUTC v. Avista Corp.*, Docket Nos. UE-090134, *et al.*, Order 10 (Dec. 22, 2009) ¶154 ("[T]he exact amount of these taxes remains unmeasurable until the taxing authorities announce rates and property valuations for any given tax year. It is wholly appropriate to pro form new tax rates and assessments once they become measurable.").

⁶¹ See Breda, Exh. No. KHB-1TC; *see also* Commission Staff Initial Brief at ¶111.

⁶² See Marcellia, Exh. No. MRM-4T 37:10-38:3 (deferred taxes offset other costs customers should rightly bear such as capital expenditures and allow the company to operate for longer periods of time between rate cases); TR. 463:12 ("Taxes such as this are recorded above the line.").

⁶³ See Commission Staff Initial Brief at ¶92 (quoting *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UG-040640, *et al.*, Order 06 (Feb. 18, 2005) ¶159 (emphasis added)).

from traditional ratemaking treatment" when PSE was instructed by the Commission to proceed in this manner.⁶⁵

D. Employee Insurance

26. Contrary to Commission Staff's assertions, PSE's revised count of employees did not add employees from beyond the test year, but corrected the count of employees to reflect those who actually received flex credits each month during the test year.⁶⁶

E. Production Adjustment

27. Commission Staff misstates PSE's position on the production adjustment. This is not an attrition adjustment.⁶⁷ The production factor is applied so that power and production costs are built into rates at the same unit cost when spread over test year loads as they would be using rate year costs spread over rate year load.⁶⁸ A decreased load from the test year to the rate year does not justify the abandonment of this long-standing methodology that PSE has used for the past several decades.⁶⁹ The Commission has affirmed the production adjustment, describing it as a "well established mechanism" used for the purpose of "adjusting rate year costs to match rate year loads."⁷⁰ Commission Staff has cited no authority, other than a false claim of attrition, for its theory that the adjustment is only appropriate when rate year loads are greater than test year loads. Contrary to Commission Staff's argument, PSE is not simply compensating itself for the financial consequences of projected reduced load"⁷¹ PSE's approach allows for the

⁶⁴ See *In re Puget Sound Energy, Inc. For an Accounting Order Seeking Deferral and Recovery of Interest Due the Internal Revenue Service*, Docket No. U-082012 (Nov. 5, 2008).

⁶⁵ Also ironic is the claim that PSE departs from traditional ratemaking by looking at a single item when Commission Staff focuses myopically on a single item and fails to recognize other items offsetting the deferred tax.

⁶⁶ See Stranik, Exh. No. MJS-12T 27:11 - 28:3.

⁶⁷ See Story, Exh. No. JHS-14T 16:1-9.

⁶⁸ See Story, Exh. No. JHS-14T 14:20-15:7.

⁶⁹ See Story, Exh. No. JHS-14T 14:1-16:9.

⁷⁰ *WUTC v. Avista Corp.*, Docket Nos. UE-090134, *et al.*, Order 10 (Dec. 22, 2009) ¶50.

⁷¹ See Commission Staff Initial Brief at ¶ 158.

recovery of the production-related costs the Commission will approve for rate year recovery.

F. Wage Increase

28. Public Counsel's unsubstantiated claim that a quarterly drop in "unit labor costs" represents a productivity offset that should reduce PSE's revenue requirements from a negotiated UA wage increase is misguided. The referenced BLS survey⁷² shows that unit labor costs declined primarily due to a drop in hours worked⁷³ even while hourly compensation rose 5.4%.⁷⁴ Thus, the average cost per worker on an hourly basis increased.⁷⁵

29. PSE has reversed its plan to increase wages for non-union employees for 2010, and therefore agrees with Commission Staff on the Wage Increase and Investment Plan adjustments.

G. Retirement Pensions and SERP

30. The Commission has directed that rate recovery of pension should be an average of cash contributions.⁷⁶ Public Counsel's claim that future contributions will be higher than pension expense is incorrect.⁷⁷ Likewise, FEA uses a faulty analogy in comparing PSE's pension to the 1992 Other Post Retirement Benefits. The increase in pension cost is not due to pension benefits being unknown, as pension regulations have provided clear visibility into PSE's pension obligations, and the temporarily higher cost in pensions is due to dramatic market losses suffered by all investors during 2008. FEA offers no evidence to support its inference of manipulation of

⁷² See Hunt, Exh. No. TMH-22.

⁷³ See Hunt, Exh. No. TMH-22 at 3, Table A Nonfarm Business Hours Q to Q -4.8%, Hours Y to Y -7.4%; Durable Manufacturing Hours Q to Q -6.0%, Hours Y to Y -15.9%.

⁷⁴ See Hunt, Exh. No. TMH-22 at 3; *see also* Hunt, TR. 436:16.

⁷⁵ See Hunt, TR. 436:17-19.

⁷⁶ See Stranik, Exh. No. MJS-12T 23:14 - 24:12.

⁷⁷ See Hunt, Exh. No. TMH-9CT 8:16-17; *see also* Hunt, Exh. No. TMH-12C.

contributions by PSE, and in fact PSE offers evidence to the contrary⁷⁸ and has proposed, and is following, a policy for reasonable pension funding.⁷⁹

31. In its Initial Brief, PSE responded to the FEA and Public Counsel proposals to remove all Supplemental Executive Retirement Plan expense from PSE's revenue requirement.⁸⁰

H. Aircraft

32. The evidence in the record does not support Public Counsel's \$945 cost per PSE passenger per flight leg on PSE's corporate aircraft.⁸¹

VI. PRODUCTIVITY, COST, AND AUSTERITY ISSUES

33. Public Counsel grossly mischaracterizes Mr. Valdman's testimony regarding the new bill processing equipment. Mr. Valdman testified that PSE has not realized the 35% return on this bill processing equipment that was projected in the feasibility study⁸² because the ARC conversion has not taken place.⁸³

34. Likewise, Public Counsel misrepresents the testimony and evidence regarding Mobile Workforce Project. PSE implemented the gas portion of the project in August 2007,⁸⁴ and the efficiencies PSE realized were reflected in the test year. PSE did not implement all elements of the project however, nor did it realize all projected efficiencies.⁸⁵

35. Public Counsel's argument regarding commodity price deflation paints an incomplete picture. While some commodities have decreased in price, PSE does not necessarily purchase

⁷⁸ See Hunt, Exh. No. TMH-9CT 12:1-19.

⁷⁹ See Hunt, Exh. No. TMH-9CT 9:10-15.

⁸⁰ See PSE Initial Brief at ¶114.

⁸¹ Using the same evidence Public Counsel points to in footnote 152 of its opening brief, PSE calculates a cost of \$1008 *per round trip*. See PSE Initial Brief at ¶135 for a further response to Public Counsel's challenge to PSE's aircraft. This calculation still ignores the use of the aircraft for non-passenger trips such as snow survey.

⁸² See Valdman, TR. 188:3-189:13.

⁸³ See Valdman, TR. 187:23 – 189:7.

⁸⁴ See Valdman, Exh. No. BAV-11.

⁸⁵ See Valdman, TR. 189:15 - 191:11.

these commodities in their raw form. Instead, PSE purchases highly specialized equipment and components, like transformers, as finished goods, which have not seen a decrease in price.⁸⁶

Furthermore, the cost of replacing decades old equipment with new equipment clearly shows that the new equipment is more expensive than the old.⁸⁷

36. Public Counsel's austerity adjustment is a departure from long standing Commission practice to set rates based upon substantial evidence in the record and is not supported by Washington law.

DATED this 2nd day of March 2010.

Respectfully submitted

PERKINS COIE LLP

By 

Sheree Strom Carson, WSBA # 25349

Jason Kuzma, WSBA #31830

Attorneys for Puget Sound Energy, Inc.

⁸⁶ See Valdman, Exh. No. BAV-10CT 8:9-19.

⁸⁷ See Valdman, Exh. No. BAV-10CT 9:7-19.