BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-111048** **Docket No. UG-111049** **(*consolidated*)**

REPLY BRIEF OF PUGET SOUND ENERGY, INC.

MARCH 26, 2012

PUGET SOUND ENERGY, INC.

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1. Puget Sound Energy, Inc. ("PSE") faces increasing capital investment requirements and costs as it strives to both meet state policy objectives and continue to provide safe and reliable service to its customers. In response, the parties to this case have proposed deep cuts to PSE's cost recovery request, many of which stray from long-standing Commission precedent and seek to impose unreasoned and previously rejected adjustments on PSE in order to achieve their desired outcome.[1] PSE's requested relief balances customers' needs with PSE's need to provide safe and reliable service. It is consistent with the law and policies of this state and should be approved by the Commission.

I. LOWER SNAKE RIVER PHASE 1 IS PRUDENT, USED AND USEFUL

A. The Public Counsel and ICNU Brief is Replete With Half-Truths and Innuendo

2. The Public Counsel and ICNU Brief is replete with half-truths and innuendo that seeks only to obfuscate the record.[2] They insinuate that PSE has not challenged the accuracy of Mr. Norwood's key analyses, which is simply untrue.[3] Additionally, they misrepresent the evidence when they claim that PSE filed this case only because of its investment in the Lower Snake River Project Phase 1 ("LSR Phase 1") and to increase investor returns.[4] They ignore the approximately $400 million in transmission and distribution investments and $41 million in depreciation, among other expenses, that caused PSE to file this case.[5] Moreover, they provide no concrete evidence to refute the extensive, detailed evidence presented by PSE that

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[1] *See, e.g.,* ICNU Br. ¶ 114. (admonishing PSE for reflecting only "required" changes in its power costs).

[2] For example, Public Counsel and ICNU cite to a California Public Utilities Commission order for the proposition that a "self-build strategy . . . has the effect of shifting the risk of lower than estimated wind energy production from project owners and their shareholders to ratepayers." Public Counsel Br. ¶ 57. The cited order, however, is critical of a project with significant qualitative issues, such as interconnection, environmental, real property rights, and procurement concerns. Moreover, the project did not rank competitively with similar projects from a quantitative perspective. *See generally In re Pac. Gas & Power Elec. Co.*, 488 P.U.R.4th 299 (2011). No party has—or could—raise similar concerns with respect to LSR Phase 1.

[3] Public Counsel Br. fn 61. PSE's Portfolio Screening Model III ("PSM III") optimization model was not designed to perform portfolio benefit analyses and calculations of portfolio benefit comparing two optimized portfolios do not isolate wind benefits. *See* Seelig, TR. 263:2–264:7.

[4] Public Counsel Br. ¶ 2.

[5] *See* Story TR. 1040:17-1041:20; Exh. No. JHS-24. Moreover, if PSE had not built LSR, it would need to acquire $30 million of replacement power. *See* Exh. No. JHS-39CX 20:17.

demonstrates by the preponderance of the evidence that the construction of LSR Phase 1 was cost-justified. For example:

(i) Contrary to the assertions by Public Counsel and ICNU, PSE never "de-emphasized" earlier need analyses, such as the 2009 Integrated Resource Plan ("2009 IRP"), the 2009 IRP Re-run, and the Discounted Cash Flow analyses.[6]

(ii) Public Counsel and ICNU argue a novel but flawed theory that compares the net estimated benefits of LSR Phase 1 to PSE's total forecasted system portfolio costs over a 50-year analysis period.[7] This theory, if adopted, would preclude almost any resource acquisition of any kind because the net estimated benefits of resources rarely—if ever—exceed one percent of total forecasted system portfolio costs over a 50-year analysis period. The projected net benefits of LSR Phase 1 are substantial,[8] and no party in this proceeding has demonstrated otherwise.

(iii) The Public Counsel and ICNU Brief statement that the "benefits of LSR Phase 1 are very small and uncertain"[9] is simply wrong. Indeed, PSE projects that the construction of LSR Phase 1 in 2012 provides net present value benefits that are $190 million higher than the construction of a similarly sized plant in 2016.[10]

(iv) Contrary to assertions by Public Counsel and ICNU, PSE management informed and involved the Board at key junctures throughout the development cycle and presented a comprehensive, 571-page written report ten days prior to the May 5, 2010 Board meeting.[11]

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[6] Public Counsel Br. ¶ 17. PSE's statement that the 2010 Request for Proposal ("2010 RFP") need analysis was "definitive" suggested that such analysis updated assumptions criticized by Public Counsel and ICNU in testimony and did not, in any way, suggest that the earlier analyses were irrelevant.

[7] *See, e.g.,* Public Counsel Br. ¶ 21.

[8] *See* Seelig, Exh. No. AS-4HCT 4:13–6:2 (projecting that construction of LSR Phase 1 in 2012 provides net present value benefits that are $190 million higher than the construction of a similarly sized plant in 2016).

[9] Public Counsel Br. ¶ 25.

[10] Seelig, Exh. No. AS-4HCT 3:12–6:2. Public Counsel and ICNU incorrectly imply that customers will pay an "additional $120 million" as a result of LSR Phase 1. Public Counsel Br. ¶ 25. This omits the significant benefits of and offset provided by the Section 1603 Treasury Grant, even assuming no normalization. Exh. No. RG-13HC 158.

[11] *See* Garratt, Exh. No. RG-1HCT 55:15–59-16; Exh. No. RG-13HC; Exh. No. RG-14HC; Exh. No. RG-15HC;

(v) Any implication that generic costs used in the analysis is not representative of the declining costs of wind projects at the time of the May 5, 2010 Board meeting is simply wrong; PSE has shown that the majority of the wind projects bid into the RFP were more costly than the generic used in the evaluation.[12]

B. PSE Did Not Participate in the RFP Bidding Process or Violate WAC 480-107-135

3. Public Counsel and ICNU erroneously argue that PSE should have participated in the 2010 RFP as a power supplier under the conditions described in WAC 480-107-135.[13] PSE is not required to acquire all of its resources through the RFP process. WAC 480-107-135 applies when a utility, its subsidiary or its affiliate elects to participate in the bidding process. In the RFP, PSE expressly stated that it actively sought to evaluate external and self-build projects:

> [PSE] actively seeks and evaluates external proposals and in-house development and construction projects that provide the greatest benefit to our customers at the lowest reasonable cost. PSE evaluates all resources in a consistent manner, using the same evaluation criteria and economic analysis methodology.[14]

PSE did what that 2010 RFP said that it would do–evaluate external and in-house proposals in a consistent manner. Any suggestion that PSE failed to inform bidders to the 2010 RFP of PSE's intentions, PSE failed to follow the 2010 RFP, or that PSE had an "unfair advantage" is false.[15]

C. The Commission Should Continue To Reject the "Economic Used and Useful" Test

4. Public Counsel and ICNU argue that the Commission should adopt an "economic used and useful" or "economics benefit" principle with respect to LSR Phase 1. The Commission has rejected the "economic used and useful" test in the past and should continue to do so here. The Commission expressly rejected such a principle in a case where Commission Staff ("Staff") and Public Counsel objected to Pacific Power and Light Company's proposed rate increase related to

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Exh. No. RG-16HC; Exh. No. RG-17HC.

[12] Exh. No. AS-3HC 36-37 (listing only six of 29 wind project proposals and one of five renewable energy credit proposals considered by PSE as having positive portfolio benefits (i.e., projected costs lower than the generic costs used by PSE for the evaluation).

[13] Public Counsel Br. ¶¶ 71-75.

[14] Exh. No. RG-5 21.

[15] Mr. Garratt expressly stated that PSE would have recommended the construction or acquisition of a wind resource that evaluated better than LSR Phase 1 in lieu of the construction of LSR Phase 1. Garratt, TR. 210:18-24.

investment in the Colstrip 3 plant.[16] They argued that the addition placed the utility in a situation of excess capacity and was not therefore "used and useful" because it provided no short-run benefits to the customers. The Commission held that Colstrip 3 was, in fact, used and useful because it produced power and was used to serve the utility's load.[17] In PSE's 2009 general rate case, the Commission rejected Public Counsel's argument that PSE acted imprudently in acquiring the Mint Farm because the resource created a situation of capacity surplus for calendar years 2009 and 2010.[18] The Commission recognized that utilities can rarely, if ever, precisely balance resource acquisitions with near-term loads:

> Here, we are convinced that PSE moved to acquire Mint Farm, not because of an immediate need for the resource, but because it offered significant benefits to its generating portfolio at a reasonable price relative to comparable alternatives and the company's longer-term resource needs. There is no evidence that suggests PSE could have waited to act on Mint Farm and achieve the same result.[19]

5. LSR Phase 1 is used and useful. It provides power, will be used to meet PSE's load, and provides renewable energy to comply with state renewable targets. PSE decided to construct LSR Phase 1 because of the significant benefits it offered to PSE's generating portfolio, and there is no evidence suggesting PSE could have waited and achieved the same result.

II. PSE'S CONSERVATION SAVINGS ADJUSTMENT SHOULD BE APPROVED

6. The Commission should not yield to the contradictory logic posed by parties opposing the CSA Rates. The same conservation savings that parties reject here as mere estimates form the basis for mandated conservation targets, which PSE must establish and *meet*.[20] If PSE fails to *achieve* its target, it must pay a penalty.[21] PSE's conservation savings calculations are solid

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[16] *WUTC v. Pac. Power and Light Co.*, 60 P.U.R.4th 188, 191-193 (1984).

[17] *Id*. 192-94 ("Colstrip 3 is used. It now produces power and has been used to meet the company's power needs. Colstrip 3 is useful. It provides a source of reserves and is a relatively low-cost resource.").

[18] *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-090704 and UG-090705, Order 11 (2010). Although Public Counsel styled this challenge as one of prudence, it was actually a challenge to the "used and useful" nature of the resource because it arguably did not benefit ratepayers during this two-year span.

[19] *Id.* ¶ 339.

[20] RCW 19.285.040(1)(b); *see WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-011570 and UG-011571, Twelfth Supp. Order, App. A, Exh. F (June 20, 2002). ("2001 Conservation Settlement") ¶ 39.

[21] RCW 19.285.040(1)(b); WAC 480-109-050(1); *see* 2001 Conservation Settlement ¶ 43.

enough to determine the company-sponsored conservation that is directly causing a reduction in short-term earnings. Arguments to the contrary by parties who participate in setting and reviewing conservation targets are not credible.[22]

7. Public Counsel's brief contains several miscalculations and misstatements. First, PSE did not double count conservation savings. In fact, Public Counsel admitted it had no support for this assertion.[23] Public Counsel mixes two different measurements: The proposed CSA rates address the effects of conservation on revenue collected from base rates in effect during *2011*; in contrast, the base rates resulting from the current general rate case will not go into effect until *2012*.[24] Second, the conservation reflected in the load forecast is not inflated. The manner in which PSE determined conservation in the F2011 forecast differs from the calculation of the biennial targets.[25] Public Counsel erroneously suggests that only one year of conservation should affect the rate year loads, whereas the exhibit cited makes clear that roughly two years of conservation has accumulated in the rate year since the beginning of the F2011 forecast.[26]

8. Although parties argue that conservation savings could be overstated based on usage and changes in circumstances after a measure is installed, the flip side also is true in that conservation may be greater than what is measured. The bottom line is that these savings demonstrate compliance with mandated conservation targets and may also reasonably be used to calculate PSE's unrecovered fixed costs due to conservation.

9. Significantly, ICNU's proposed 20 basis point adjustment to PSE's ROE would eliminate 80 percent of the CSA revenues proposed in this case and, if tied to the decoupling proposal of NWEC that provides no apparent shareholder value, would leave PSE in a worse financial

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[22] WAC 480-109-010(3)(a) ("Participation by the commission staff and the public in the development of the ten-year conservation potential and the two-year conservation target is essential."); WAC 480-109-040(2) ("Commission staff and other interested persons may file written comments regarding utility's report . . .").

[23] *See* Exh. No. JAP-37; Piliaris, Exh, No. JAP-24CT 38:3-39:3.

[24] *See* Piliaris, Exh. No. JAP-24CT 38:19-39:3.

[25] *See* Exh. No. DEG-26CX 1-2.

[26] *See* Exh. No. DEG-26CX 2 ("Conservation targets are received from the Energy Efficiency Services ("EES") group for the current year and the Integrated Resource Planning ("IRP") group for the balance of the forecast period.").

position.[27] The Legislature could not have intended such a result under RCW 80.28.260(3).

10. Public Counsel's assertion that regulatory lag is good does not withstand scrutiny in the context of conservation. Failure to recognize additional incremental conservation savings not reflected in the test year masks a problem the Legislature has asked the Commission to address.[28]

III. PSE'S COST OF CAPITAL IS REASONABLE

11. Staff's brief espouses the unsupportable position that PSE's requested increase in equity ratio from 46 to 48 percent "is inconsistent with PSE's commitment in the merger order that the cost of capital would not increase as a result of the 2009 acquisition."[29] The Commission's Merger Order[30] exposes the fiction of this position. First, the Merger Order clarifies "what this commitment means from the Commission's perspective" and it does *not* mean that PSE authorized equity ratio must remain static.[31] Second, the Merger Order recognized that PSE's equity would increase to 50.4 percent at merger closing, and the Commission spoke approvingly of the prospect of an improved credit rating for PSE as a result of increased equity capitalization.[32] This credit rating upgrade occurred, as the Commission envisioned, and customers reaped a $40 million benefit in lower-interest rates on long-term fixed rate bonds.[33] Staff concedes that "a more equity rich capital structure provides more financial flexibility, more financial stability and perhaps higher bond ratings."[34] The current 46 percent equity ratio resulted from a pre-merger settlement,[35] which the Commission relied on to maintain a 46

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[27] DeBoer, Exh No. TAD-4T 14:3-6.

[28] RCW 80.28.260(3).

[29] Commission Staff Br. ¶ 10.

[30] *In the Matter of the Joint App. of Puget Holdings LLC and Puget Sound Energy, Inc. for an Order Authorizing Proposed Transaction*, Docket No. U-072375, Order 08 (Dec. 30, 2008) ("Merger Order").

[31] Merger Order ¶ 92. The commitment requires (a) debt and equity costs to be viewed in light of the credit rating in effect prior to the merger; (b) PSE to bear the burden to prove prudent any prepayment premium or increased cost of debt associated with retirement of debt as a result of the transaction; and (3) the use of a proxy group to determine the allowed ROE in future rate cases. *Id.* Commitment No. 53.

[32] Merger Order ¶ 197 ("The prospect of an improved credit rating at PSE is also supported by a strengthened PSE balance sheet that results from increasing equity capitalization to 50.4 percent at closing . . . .").

[33] *See* Gaines, Exh. No. DEG-14T 17:3–19:18.

[34] Elgin, Exh. No. KLE-1T 54:2-3.

[35] *See* Gaines, Exh. No. DEG-1T 6:3-5.

percent equity ratio in PSE's 2009 rate case.[36] However, the Commission should now approve a 48 percent equity ratio that more accurately reflects the current and projected equity levels.

12. Staff relies on a beleaguered double-leverage approach to argue that PSE's equity ratio should be held at 46 percent because of debt at Puget Energy ("PE") and the owners' ability to use this debt as equity at PSE.[37] The Commission flatly rejected this argument in the Merger Order. The Commission fully understood that debt at PE would be injected into PSE as equity, but had no qualms given the ring-fencing protections in place and the consistent Commission precedent rejecting double leverage adjustments.[38] Further, the Commission understood that dividends would need to be paid to PE to service debt but even so rejected double leverage adjustments.[39] Staff likewise opposed such arguments during the merger,[40] and it is surprising to see Staff renege on its previous, well-reasoned position. Another problem perpetuated in Staff's brief is its continued double counting of PSE's debt. The additional long-term debt PSE issued in September 2011 replaced existing short-term debt and does not add to the debt at PSE.[41]

13. ICNU misreads the FERC Form 1 and misconstrues double entry accounting conventions.[42] Including the asset associated with subsidiaries as a source of additional common equity is non sensible.[43] The asset side, or debit, of PSE's consolidated balance sheet does not

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[36] *WUTC v. Puget Sound Energy, Inc*., Docket Nos. UE-090704, *et al*., Order 11 ¶ 279 (April 2, 2010); *see also* Gaines, Exh. No. DEG-1T 6:7-9. The test year for that case was 2008, prior to the merger.

[37] *See* Commission Staff Br. ¶¶ 9-10.

[38] Merger Order ¶ 176-77 (recognizing the $1 billion credit facility at PE would be drawn upon and provided as equity on PSE's books); *id.* ¶ 194 ("Commission precedent has rejected consolidating the capital structure of a utility and its parent where adequate ring-fencing is in place."); *id* ¶ 182 ("[W]e cannot take a consolidated perspective on the debt at Puget Energy, treating it as if it is debt at PSE (which among other things implies the necessity for a double-leverage adjustment in setting rates), and simultaneously give the ratepayers the substantial benefits of ring-fencing protection."); *id.* ¶ 179 (acknowledging use of credit at PE to fund PSE infrastructure but adhering to long standing policy of examining financial and accounting issues on a non-consolidated basis).

[39] *See* Merger Order ¶ 185 (discussing commitments limiting dividends if PSE's equity capitalization falls below 44% or PSE's credit rating falls below investment grade).

[40] Merger Order ¶ 194 ("Staff points similarly to Commission precedent regarding adequate ring-fencing obviating the need to impose additional measures to insulate ratepayers from leverage-related risks at a holding company.").

[41] Gaines, Exh. No. DEG-14T 14:4-6.

[42] *See* ICNU Br. ¶ 30-31.

[43] ICNU Br. ¶ 30-31.

represent the subsidiaries impact on PSE's equity, a credit.[44] Also erroneous is ICNU's refusal to adjust for OCI in pension and derivative accounting. ICNU is picking up only one side of the entry. Because the Commission does not allow these costs to be included in cost of service, the offset to equity must be removed.[45]

IV. OTHER ADJUSTMENTS

A. Power Costs:

14. ICNU perpetuates many of its power cost errors in its opening brief. For gas transportation/pipeline escalations, ICNU argues to remove $0.9 million, when the amount of escalation included in PSE's rebuttal filing is less than that amount.[46] PSE has identified numerous other erroneous arguments and adjustments as discussed in testimony and PSE's opening brief. Regarding production operations and maintenance, Staff and ICNU ignore the change in operating procedures for combustion turbines over the past six years.[47] Costs incurred in 2006, more than six years prior to the rate year in this case, understate current costs.[48] Moreover, ICNU compares only selected rate year budget values (for certain plants) to test year costs. When viewed in total, the O&M budget for the rate year is greater than the total test year budget.

B. LSR Phase 1 Plant Adjustment:

15. Although Staff claims its LSR Phase 1 adjustment is based on "actual data," it arbitrarily cuts off the plant balance and refuses to allow for updated expenses and information including "judgment[s] or projection[s] made by people having special expertise" that the Commission has allowed in past cases.[49] The Wild Horse Expansion adjustment from PSE's 2009 rate case demonstrates the concerns with this approach and the significant financial impact it has on PSE.

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[44] Exh. No. DEG-24CX 9 (line 37 column (c)).
[45] *See* Gaines, Exh. No. DEG-14T 7:13-8:12.
[46] *See* Mills, Exh. No. DEM-11CT 12 Table 3; Riding, Exh. No. RCR-4HCT 9:8-12; Deen, Exh. No. MCD-1CT 11:26-27.
[47] *See* Gould, Exh. No. WRG-1T 2:10-4:15.
[48] Gould, Exh. No. WRG-1T 2-7.
[49] *WUTC v. Wash. Natural Gas*, 23 P.U.R.4th 184, 193-94 (1977).

In that case, the Commission excluded $8 million of plant balances as recommended by Staff. However, in retrospect, the actual revenue impact was within $47,419 of PSE's projection, and Staff's revenue was low by $1.2 million. In essence, PSE was penalized $1.2 million so that customers would not be "overbilled" $47,419.[50] For LSR Phase 1, Staff's arbitrary cut off date results in a plant balance $25 million below PSE's adjustment updated for the February 29, 2012 commercial operation date.[51] Customers will benefit from the operation of LSR Phase 1 in the rate year. As in the past cases, the Commission should allow PSE's adjustment that includes the expected cost of the plant that provides these benefits.[52]

16. Additionally, Staff misstates the timing of property tax payments for LSR Phase 1. PSE will pay taxes during the rate year on the value of LSR Phase 1 in CWIP as of December 31, 2011, which is approximately $727 million or 90-95 percent of the plant balance.[53] Finally, Staff's attempt to justify its use of actual LSR Phase 1 plant costs for the deferral but not for the plant adjustment lacks merit.[54] This form over substance double standard should be rejected.

C. Incentive Pay

17. The Commission should reject Staff's arbitrary and unsupported proposal to disallow 50 percent of the test year incentive plan costs. Staff's new argument—that the plan is "skewed" towards financial performance over SQIs—is premised on an erroneous reading of the plan and neglects the impact of SQI results on plan funding caps. The plan plainly states that there is *no payout* if only five out of ten SQIs are met, regardless of how well the company performs financially.[55] Further, "[a]lthough funding of the pool increases as adjusted EBITDA increases, the amount of funding is capped unless SQI results also continue to improve."[56]

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[50] Story, Exh. No. JHS-18T 10:4-15.

[51] *Compare* Exh. No. JHS-20 3 (Rev. 2/16/12) *to* Exh. No. RCM-04 (Adj. 13.02).

[52] *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-090704, *et al.*, Order 11 ¶¶ 23, 31 (April 2, 2010).

[53] Marcelia, TR. 1012:3-16. Contrary to Commission Staff's assertion, 16 months after January 1, 2012 does indeed fall within the rate year in this case. *See* Commission Staff Br. ¶ 113.

[54] Commission Staff Br. ¶ 133 (distinguishing between statutory language for deferral and a rigid interpretation of the known and measurable standard for production plant).

[55] *See* Hunt, Exh. No. TMH-11T 10:4.

[56] *Id.* For example, funding under an SQI performance of 7 out of 10 can only reach 70 percent of target, even

D. Tax Adjustments: Consolidated Tax Adjustment and Net Operating Loss

18. ICNU's arguments in support of its consolidated tax adjustment raise more questions than they answer. For example, ICNU claims the adjustment "does not violate any provision of the IRC,"[57] yet ICNU argues its adjustment does not directly emulate the tax code. Moreover, ICNU's bald assertion that "[s]imilar consolidated tax adjustments have been adopted in other states"[58] must be viewed with skepticism, given ICNU's failure to review any consolidated tax adjustments other than one from Texas, where such adjustment is mandated by law.[59]

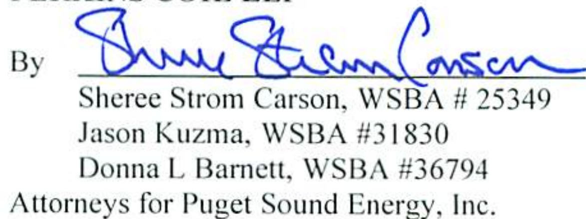
19. Public Counsel argues that the normalization guidance in PLR 8818040 that PSE followed is "too dated to apply to the current tax situation"[60] but fails to reconcile this statement with the fact that numerous binding tax provisions predate 1988. PLR 88818040 is still binding and on point, whereas Public Counsel's position on net operating loss is baseless.

E. Storm Damage

20. Contrary to Staff's argument, both current and future customers benefit from the reconstruction and hardening of the system that results from storm damage repair. It is reasonable for major storm damage costs to be deferred as Staff has previously endorsed.[61]

DATED this 26th day of March, 2012.

PERKINS COIE LLP

By 

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if financial performance is 101 percent, 110 percent, or even 135 percent of plan.

[57] ICNU Br. ¶¶ 86, 88.

[58] *Id.* ¶ 83.

[59] *See* Marcelia, Exh. No. MRM-14T 7:6-8 and 25: 7-12.

[60] Public Counsel Br. ¶ 136 (discussing Exh. No. MRM-36CX).

[61] *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-040640, *et al.*, Order 06 ¶¶ 232, 233, (Feb. 18, 2005).