Docket No. UG-230968
Evidentiary Hearing Transcript - Vol. III
WUTC v. Puget Sound Energy
October 9, 2024

Excerpts Pgs. 61-67, 76-89

MS. BARNETT: No thank you.

JUDGE BONFRISCO: Okay. Thank you. At this point, we are at about 10:21. I just want to take a pulse if we want to take a break or if we want to, you know, I know we tentatively planned for 10:30.

COMMISSIONER RENDAHL: Your Honor, I would appreciate a break.

JUDGE BONFRISCO: Okay. We will take a ten-minute break -- or ten minutes, is that good? So we will be back at 10:32 a.m. Thank you.

(Recess 10:22 a.m. to
10:38 a.m.)

JUDGE BONFRISCO: Okay. We are back on the record. Mr. Callaghan, if you would like to call PSE's next witness.

MR. CALLAGHAN: Thank you, Your Honor. Commission Staff calls Todd Shipman.

JUDGE BONFRISCO: Mr. Shipman, could I have you raise your right hand.

TODD SHIPMAN, witness herein, being first duly sworn on oath, was examined and testified as follows:

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THE WITNESS: I do.

JUDGE BONFRISCO: Okay. Mr. Callaghan, you may proceed with your examination.

MR. CALLAGHAN: Thank you, Your Honor.

CROSS-EXAMINATION

BY MR. CALLAGHAN:

Q Good morning, Mr. Shipman, can you hear me?

A Yes.

Q Do you have a copy of your rebuttal testimony with you?

A Yes, I do.

Q So before we begin, is your argument in your rebuttal testimony that approving adjustment mechanisms ultimately lowers the cost of capital, and that lower cost of capital benefits customers more than any harm that might be caused by approving a given adjustment; is that a fair summary?

A No. I would say we are not recognizing any harm to employing adjustment mechanisms, but other than that I would agree with your statement.

Q Okay. Thank you. So after the Commission approves an adjustment mechanism, assuming all else is equal, that should reduce the approved cost of capital whenever the next opportunity arises, correct?

A Yes, all else being equal.

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Q Okay. So is your argument that approving an adjustment mechanism is always a net benefit to customers because adjustment mechanisms result in a lower rate of return?

A I would say most of the time. I can't think of every circumstance off the top of my head that supports a blanket statement, but I would say under most circumstances any actions that the Commission takes to improve a company's ability to reduce the volatility of its earnings and cash flow is going to rebound to the benefit of the rate payers.

Q All right. Could you turn to Page 7, Lines 6 through 9 of your rebuttal testimony and let me know when you are there.

A I am there.

Q So here you state, quote, Cost of capital experts recognize the risk reducing effects of adjustment mechanisms; is that accurate?

A Yes.

Q All right. So you would disagree with the argument that the approval of an adjustment mechanism has no bearing on an expert witness' recommendation on cost of capital, correct?

A Yes.

Q Have you reviewed the rebuttal testimony of PSE's witness Jamie Martin?

A Yes.
Q Do you have a copy of it readily available?
A No.
Q You don't?
A No.
Q Okay. All right. So just based on your recollection, doesn't witness Martin argue the opposite of what you are arguing in parts of her rebuttal testimony?
A That's best to ask her.
Q Okay. So what's PSE's position in this case? Should the approval of an adjustment mechanism impact the Commission's next cost of capital decision or not?
A I don't know what the position is on that.
Q Okay. Moving on, could you turn to your rebuttal testimony, Page 7, Line 5, and let me know when you are there.
A I'm there.
Q In this answer you state, quote, Utilities have the same incentive to control costs whether the relationship of costs to revenue is positive, neutral, or negative; is that accurate?
A Yes.
Q Are you arguing that the utility has the same incentive to control specific costs that are subject to a pure passthrough adjustment mechanism compared to if those

same costs were embedded in rates?
A Yes. I think their incentive to control costs is constant. They have a profit motive to try to maximize profits and to the extent that they can reduce costs, it's in your best interest.
Q But if a specific set of costs are subject to a pure passthrough mechanism, to the extent they reduce those costs, doesn't that get passed back to the customer?
A Yes, it gets passed through the customers.
Q So in that case reducing those costs would not be beneficial to the utility, would it, from a financial perspective?
A I think it's in their best interest to keep their rates as low as possible. For one thing, it would encourage, you know, people to use their product and that's what most companies strive to do. I would not disagree with the idea that a passthrough mechanism perhaps does not have the same -- doesn't present the same urgency to control costs, but I think a utility like any other company wants to have the lowest price for their product in order to please their customers.
Q All right. So what I think I have heard from your response is that you said it doesn't have the same urgency. So it's not the exact same incentive in the case of a pur passthrough versus those same costs being

embedded in the rates?
A I would agree with that.
Q Okay. So starting on Page 7, Line 5 you state, quote, Utility managers have shown a deal for cost cutting for a variety of different reasons; is that accurate?
A Yes.
Q Okay. So, again, are you arguing here that a utility manager would have the same incentive to cut costs when they have a full passthrough adjustment compared to if those same costs were embedded in rates?
A That's not the issue I was addressing in this section of my testimony.
Q Okay. Can you point me to any evidence in the record that supports the claim that you are making on Page 7, Line 15?
A Okay.
Q Does your testimony cite any prior Commission decisions that come to the same conclusion that you have on this point?
A No.

MR. CALLAGHAN: Nothing further. Thank you, Your Honor.

COMMISSIONER RENDAHL: So that concludes your questions?

MR. CALLAGHAN: Yes.

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JUDGE BONFRISCO: Any redirect?

MS. BARNETT: Yes, just quickly, I think. Thank you, Your Honor.

REDIRECT EXAMINATION

BY MS. BARNETT:

Q Mr. Shipman, you heard counsel for Staff ask you about the passing through costs through a tracker versus costs embedded in rates, and how would you describe the company's ability to control costs related to the Climate Commitment Act compliance?

A My understanding would be that it's limited, that the activities there are really based off of -- or involve costs that are set by a market.

Q Thank you. And regarding the passing through of costs through the tracker, if CCA costs and compliance are increasing risk to a company, PSE, would getting a passthrough on those costs, how would that affect PSE's risk? Would that reduce? Increase? Keep it flat?

A Having a separate tracker mechanism would reduce the risk.

MS. BARNETT: No further questions.

JUDGE BONFRISCO: Thank you. So, Mr. Callaghan, it looks like your next witness is Christopher Mickelson. Could you please call Mr. Mickelson?

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THE WITNESS: I do.
JUDGE BONFRISCO: All right. Thank you. Mr. Callaghan, you may proceed.
MR. CALLAGHAN: Thank you, Your Honor.

CROSS-EXAMINATION

BY MR. CALLAGHAN:
Q Good morning, Ms. Martin. Do you have a copy of your rebuttal testimony?
A Yes, I do.
Q In your rebuttal testimony you opposed Staff's primary recommendation, correct?
A That's correct.
Q And your argument opposing Staff's proposed framework doesn't address the specifics of any of Staff's proposed criteria, correct?
A I'm not sure I follow your question. Could you rephrase it, please?
Q Yes. So in your criticism of Staff's proposed primary recommendation you don't specifically criticize Staff's criteria one, criteria two, et cetera, correct?
A I think the premise of my testimony is that the elimination of a Schedule 111 mechanism isn't the right path for these types of costs. And by making that argument in my testimony, it's implicit that the

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subsequent items in Staff's proposal, from my perspective, do not make sense.

Q Okay. So your rebuttal is focused on Staff's premise that, in general, absent specific circumstances, it is not in the public interest to approve tracking mechanisms; is that accurate?

A Sorry. Do you have a reference point for my testimony?

Q I'm not citing a specific part of the testimony, but I guess my question is, you are attacking the premise that without a specific public interest demonstration, Staff's premise that it's not in the public interest to approve a tracking mechanism, you are attacking that premise, correct?

A What I'm arguing is that retaining a Schedule 111 mechanism for these specific costs is the right thing to do given where we are in implementation of CCA, and more broadly as I reference later in my testimony.

Q Okay. So setting aside your argument about whether Staff's primary recommendation is within the scope of this proceeding or not, is it fair to say that the main point of your rebuttal testimony is essentially that Staff is incorrect that shifting variances from the company onto the customers is a problem that the Commission needs to address in this case; is that a reasonably accurate summary?

A Parts of what I articulate in my testimony is that what Staff suggests is variant interest and considered in returns on equity isn't accurate.
Q Okay. And your reasoning is that shifts in variances from the company to the customer are already accounted for in return on equity analysis and ultimately Commission decisions on higher rates; is that correct?
A Again, is there a specific part of my testimony you are referencing?
Q Let's turn to Page 7, Lines 10 through 13 and let me know when you are there.
A I'm there.
Q Okay. So I will repeat my question. Your reasoning in rebuttal is that shifts in variances from the company to customer are already accounted for in return on equity analysis and Commission decisions on higher rates; is that accurate?
A I don't think the testimony referenced that we are looking at right now is specifically related to that.
Q So here you state, In other words the risk reducing impacts of adjustment mechanism and approved returns on equity established by regulatory bodies are largely imbalanced because the latter incorporates the existence of the former. Am I reading that right?
A You are reading that right.

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Q All right. That's essentially saying that the impacts of adjustment mechanisms are already accounted for in return on equity decisions; isn't it?

A The context of this statement is important and so when you look at the other components of how I wrote about this in my testimony the point here is that the existence of adjustment mechanisms are a component of how returns on equity are set across a set of tiered utilities. Adjustment mechanisms are a common regulatory tool and approved returns on equity consider those in aggregate, often not in isolation, and that is reflected in cost of capital across utilities.

There's other components in my testimony that describe how this specific situation in regards to CCA compliance is risky in and of itself. It's certainly new amongst all of the jurisdictions that consider ROEs in the United States specifically.

And the existence of adjustment mechanisms are appropriate when there is a risk introducing set of activities that a utility needs to participate in because of a policy decision or regulatory decision.

Q But isn't your discussion on ROE and how the Commission decides returns on equity and overall rate of return, isn't the relevance of that for this case that the Commission does not need to worry about the issues that

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Commission Staff is bringing up because those risks are already accounted for in return on equity analysis? Isn't that the argument you are making?

A The argument I'm making is that the cost should not -- the cost of CCA compliance should not be in base rates, they should remain an adjustment mechanism because an adjustment mechanism is an appropriate place for those costs.

Q Okay. So could you turn to Page 4 and let me know when you are there.

A I'm on Page 4.

Q All right. On Lines 7 to 11 you state that Staff incorrectly suggests that ROE compensates utilities for variances, and that this statement is quote, represents a fundamental misunderstanding of bedrock principles related to risk and returns in regulatory law; is that correct?

A Yes. That's correct.

Q That's a strong statement, wouldn't you agree?

A I think it's a comprehensive statement.

Q All right. So is it your opinion that Commission approved ROE does not or is not intended to compensate inventors for variances?

A Part of what I am articulating here is that the variance risk introduced in Staff's testimony isn't consistent

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with how risk and returns are considered inside of regulated activities.
Q So are you saying that ROE -- that ROE analysis does or does not consider variances?
A I think it's important to define variance risk.
Q Okay.
A Staff's definition of variance risk in this case seems to be the costs -- the difference between forecasted cost and actual costs.
Q Based on that definition, is your opinion that Commission approved ROE does or does not compensate investors for variances?
A The question is very broad, and so I think it's important to understand we have to talk in the specifics about what ROE compensates for with regard to the difference between forecasted and actual costs. ROEs are designed to ensure utilities have the opportunity to be compensated for the suite of risks that they face given the environment in which they operate.
The difference between forecasted cost and actual costs is certainly embedded in there, but it's not the only thing that's considered. I think when jurisdictions are setting ROEs, the type of costs, the ability to protect and control those costs, the known and unknowns associated with those costs are all really important

characteristics of what goes into the definition of a variance risk. They can't, in my opinion, be done so broadly.

Q So I think what you said was it's embedded in there along with other risks, so are you saying that you do think that ROE compensates investors for variances?

A Not for the risk we are talking about in this proceeding.

Q All right. So your -- so is your opinion that ROE does not compensate for variance risk as Commission Staff has defined it?

A I don't know that I can give you a better answer than what I just gave you, but the variance risk associated with the volatility in CCA compliance costs are different than other types of costs as I was describing in my answer previously.

Q So but here I'm just asking about variance risk in general.

A Okay. Yes, and my -- the way I'm trying to answer your question is to say that variance risk, as defined by Staff, I don't agree with the definition of the variance risk that Staff's position indicates. It's too broad in my opinion, and that's why I'm giving you the answers that I'm giving you at this time.

Q Okay. So in that same answer, again on Page 4, Lines 12 through 16, you state, quote, Establishing return on

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equity is a regulatory concept in the quest of capital attraction which involves the comparison of risks among alternative investments, unquote.

Wouldn't variance risk as Staff has defined it be one of the risks that a potential investor consider when they compare a specific utility to other to other potential investments?

A I think that utility investors look at a number of things when they look at the risk profile of a particular investment opportunity inside of a utility space. I think they look at the types of compliance requirements the utility has, the construct of the regulatory environment, the ability for the utility to earn a fair return, the ability of a utility to deliver for its customers, and deliver for its debt and equity holders. And, again, the definition of Staff's variance risk in its testimony, I think, is very broad and so to say anything specific about it is difficult for me.

JUDGE BONFRISCO: Ms. Martin, if I could have you bring the microphone closer I'm getting input they are having a difficult time hearing you. Thank you.

THE WITNESS: You're welcome. Is that better?

JUDGE BONFRISCO: Yes.

Q (By Mr. Callaghan) So do you belive that an investor would not consider the potential difference between actual cost and the level of costs embedded in rates when deciding whether or not to invest in a specific utility?
A I believe that an investor would consider the ability of the utility to manage its costs or earn a fair return and recover those costs timely and completely based on its prudent operations.
Q Okay. So it's not a fundamental misunderstanding of bedrock principles of regulatory law to say that variance risk is something that an investor would consider, is it?
A I'm back to saying that the definition of variance risk as offered in Staff's testimony is too broad and there are many factors that an investor would consider in determining whether to invest in a utility, and the principles associated with risk evaluation and establishing returns are much more broad than variance risk.
Q Okay. But are you saying that variance risk as Staff has defined it is not something that is considered in ROE analysis?
A It's a component of.
Q Okay. So could you turn to Page 8 of your rebuttal testimony and let me know when you are there.
A I'm on Page 8.

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Q All right. In Footnote 14 you cite two articles from S&D Global Market Intelligence, and you provide a hyperlink to the 2017 article; is that right?
A Yes.
Q Have you read the article that you cite here?
A Yes.
Q Can you recall whether or not this article gives an opinion on whether or not adjustment mechanisms are beneficial to utilities?
A It's been -- I can't recall the guts of the article. If you want to talk about it specifically you can bring it up.
Q Do you recall whether or not this article states, quote, A defining characteristic of an adjustment clause is that it effectively shifts the risk associated with the recovery of the expense in question from shareholders to customers because if the clause operates as designed, the company is able to change its rates to recover its cost on a current basis without any negative on the bottom line, and without the expense and delay that accompanies a rate case filing?
A I don't recall. I don't have the article in front of me.
Q Okay. But do you agree with that statement?
A Can you read it again?
Q Yes. A defining characteristic of an adjustment clause

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is that it effectively shifts the risk associated with the recovery of the expense in question from shareholders to customers because if the clause operates as designed, the company is able to change its rates to recover its cost on a current basis without any negative on the bottom line, and without the expense and delay that accompanies a rate case filing.

A Could you repeat the question?

Q Do you agree with that statement?

A I would add subject to a prudence review.

MR. CALLAGHAN: I have no further questions, Your Honor.

JUDGE BONFRISCO: Thank you. Do I have any redirect from PSE?

MS. BARNETT: Yes, briefly. Thank you.

JUDGE BONFRISCO: Okay.

REDIRECT EXAMINATION

BY MS. BARNETT:

Q Ms. Martin, you heard Staff counsel asked you about the variance risk definition that Staff had. What can -- could just please articulate your concerns with that definition?

A Sure. My concerns are that that definition is overly

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broad in terms of what it indicates variance risk is. The ROE is specifically designed to compensate utilities for differences in forecasted versus actual costs, that there's more to ROE -- and ROE setting to variance risk.

Q Thank you. And are you aware of how the Commission or in what form the Commission issues or approves an ROE for a utility?

A I am aware, yes.

Q How is that?

A My understanding is that in the state of Washington ROEs are set inside of the rate plan and are evaluated on a number of criteria and then set accordingly in that proceeding.

Q Thank you. And is the CCA implementation costs and the scale of those costs considered in PSE's ROE currently?

A I don't believe it is, no.

Q I believe you were asked about the California cap-in-trade program or a report with other -- regarding other states, are you aware in -- is California the only other jurisdiction with a similar cap-in-trade program as Washington?

A I know California definitely has a cap-in-trade program.

Q Are you aware of if the Commission, the California Public Utilities Commission imposes a risk-sharing mechanism on utilities in the -- like Staff or the Joint Environmental

Advocates are proposing in this case?

MR. CALLAGHAN: Objection, Your Honor. This is outside the scope of my cross-examination.

JUDGE BONFRISCO: I am going to go ahead and sustain that objection. If you could direct more specifically from what was previously --

MS. BARNETT: And I believe the report that Nash Callaghan was reading from was a report regarding other overall jurisdictional applications of risk-sharing mechanisms, and I'm asking a follow-up about other jurisdictions implementing those risk-sharing mechanisms.

JUDGE BONFRISCO: Mr. Callaghan, what specifically do you believe is outside the scope?

MR. CALLAGHAN: Questions related to the CCA. The article that I asked a question about is from 2017 before the CCA existed. I did not ask Ms. Martin about anything related to CCA costs.

CHAIR DANNER: Just to be clear, you are talking about Footnote 14 in the testimony?

MR. CALLAGHAN: That's correct.

CHAIR DANNER: I have a date of 2022.

MR. CALLAGHAN: There are two reports. The last one is the one I asked questions about.

MS. BARNETT: I believe my redirect

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question was not specific to this CCA. It was whether California applies a risk-sharing mechanism, if Ms. Martin is aware of California imposing or applying a risk-sharing mechanism in that jurisdictional utility.

MR. CALLAGHAN: Your Honor, my cross-examination did not ask any questions related to other jurisdictions.

MS. BARNETT: I'm fine with withdrawing that because I believe it's in the record anyway.

JUDGE BONFRISCO: Okay. Thank you.

MS. BARNETT: No further questions.

JUDGE BONFRISCO: Okay. Ms. Martin, you may be excused. Thank you.

Oh, real quick, before I do that I want to make sure, are there any questions from the bench? Okay. You may be excused, Ms. Martin.

Okay. We are now going to move to Public Counsel's cross-examination of Staff's witness.

Mr. Callaghan, if you could please introduce Staff's witness that will be called and I will swear them in.

MR. CALLAGHAN: Thank you, Your Honor, Chris McGuire.

JUDGE BONFRISCO: Oh, just to clarify, I believe Public Counsel's witness is Robert Earle.