

**EXH. DAD-7T
DOCKETS UE-170033/UG-170034
2017 PSE GENERAL RATE CASE
WITNESS: DANIEL A. DOYLE**

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

**Docket UE-170033
Docket UG-170034**

**PREFILED REBUTTAL TESTIMONY
(NONCONFIDENTIAL) OF**

DANIEL A. DOYLE

ON BEHALF OF PUGET SOUND ENERGY

AUGUST 9, 2017

PUGET SOUND ENERGY

**PREFILED REBUTTAL TESTIMONY
(NONCONFIDENTIAL) OF
DANIEL A. DOYLE**

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1 **PUGET SOUND ENERGY**

2 **PREFILED REBUTTAL TESTIMONY**
3 **(NONCONFIDENTIAL) OF**
4 **DANIEL A. DOYLE**

5 **I. INTRODUCTION**

6 **Q. Are you the same Daniel A. Doyle who submitted prefiled direct testimony on**
7 **January 13, 2017, on behalf of Puget Sound Energy (“PSE”) in this**
8 **proceeding?**

9 A. Yes. I filed prefiled direct testimony, Exh. DAD-1T, and five exhibits,
10 Exh. DAD-2 through Exh. DAD-6, on January 13, 2017.

11 **Q. What is the purpose of your rebuttal testimony?**

12 A. My rebuttal testimony presents the following:

- 13 (i) a discussion regarding the success of the rate plan approved
14 by the Commission in June of 2013;
- 15 (ii) a refutation of Commission Staff’s presumption that a rate
16 reduction is reasonable simply because PSE was able to
17 earn its allowed rate of return during the rate plan period;
- 18 (iii) reasons why the Commission should adopt PSE’s proposed
19 Electric Cost Recovery Mechanism;
- 20 (iv) a discussion why the Commission should establish a formal
21 process for PSE’s Expedited Rate Filings;
- 22 (v) reasons why the Commission should maintain the current
23 storm deferral methodology, which has worked well over
24 the past decade;
- 25 (vi) support for PSE’s proposed capital structure, which reflects
26 the regulatory capital structure supporting PSE during the

1 test year and the regulatory capital structure expected to
2 support PSE during the rate year;

3 (vii) support for PSE the reasonableness of PSE's proposed rate
4 of return of 7.74 percent;

5 (viii) arguments why Commission should reject proposals of
6 Commission Staff and the Industrial Customers of
7 Northwest Utilities ("ICNU") regarding
8 depreciation/amortization, decommissioning and
9 remediation costs of Colstrip Units 1 and 2; and

10 (ix) a discussion of how PSE's revenue decoupling mechanism
11 has worked well and should continue to work well with the
12 minor adjustments proposed by PSE.

13 **II. PSE'S RATE PLAN WAS A SUCCESS FOR PSE**
14 **AND ITS CUSTOMERS**

15 **A. The Rate Plan Approved by the Commission in June 2013 Created an**
16 **Appropriate Balance**

17 **Q. How would PSE describe the outcome of PSE's rate plan first approved by**
18 **the Commission in June 2013?**

19 A. PSE would agree with Commission Staff's assessment that the rate plan first
20 approved by the Commission in June 2013 has allowed PSE to improve its
21 earnings.¹ The key difference between PSE and Commission Staff appears to be
22 that PSE would recommend that the mechanisms approved by the Commission in
23 June 2013 continue (with some adjustments), whereas Commission Staff appears
24 to believe that it is "now time to reset the program."²

¹ See, e.g., Schooley, Exh. TES-1T at 10:3-6.

² Schooley, Exh. TES-1T at 10:6-7.

1 **Q. How does PSE respond to Commission Staff’s suggestion that PSE appears**
2 **dissatisfied with the mechanisms approved by the Commission in the rate**
3 **plan?**

4 A. Commission Staff believes PSE “seems to be dissatisfied with the numerous risk-
5 mitigation measures granted by the Commission in recent years.”³ It is
6 unfortunate that Commission Staff interprets PSE’s direct testimony in this way.
7 Recommendations by PSE to adjust mechanisms were never intended to criticize
8 or suggest their elimination. Rather, PSE now has over four years of intimate
9 experience with the mechanisms and has had the opportunity to learn how they
10 work in practice. During the course of those four years, PSE has developed
11 suggestions to refine some of the mechanisms and improve upon them. PSE’s
12 recommendations for refinements of the mechanisms were never intended to
13 express dissatisfaction with the mechanisms.

14 **Q. Please summarize the series of orders issued by the Commission in 2013 that**
15 **created PSE’s rate plan.**

16 A. In 2013, the Commission approved a series of orders that provided and approved
17 the following new and innovative mechanisms for PSE that constituted the rate
18 plan: (i) a revenue decoupling mechanism; (ii) a net rate increase resulting from
19 an expedited rate filing; (iii) annual K-factor increases of 3 percent and

³ Schooley, Exh. TES-1T at 11:1-2.

1 2.2 percent for electric and gas delivery, respectively; and (iv) an earnings sharing
2 mechanism.

3 **Q. How have components of the rate plan operated in practice, both**
4 **individually and collectively?**

5 A. The series of orders issued by the Commission that constitute PSE's rate plan
6 resulted in each of the following financial results over the past years:

- 7 (i) an approximate \$30 million net electric and gas rate
8 increase from the expedited rate filing in July 2013;
- 9 (ii) annual K-factor increases to delivery revenues of
10 3.0 percent for electric and 2.2 percent for gas in July 2013,
11 January 2014, January 2015, January 2016, and
12 January 2017; and
- 13 (iii) the recognition of net electric decoupling revenue of
14 approximately \$66 million and net gas decoupling revenue
15 of approximately \$125 million from July 1, 2013, through
16 June 30, 2017.

17 Coupled with PSE's efforts to pursue cost savings and efficiencies, these financial
18 results have allowed PSE to begin to consistently earn rates of return and returns
19 on equity slightly below its authorized rate of return and return on equity on an
20 adjusted *actual* basis across all time periods. These results indicate that the effects
21 of regulatory lag and attrition were mitigated under the rate plan.

22 Generally speaking, the same is true of *normalized* results in Commission Basis
23 Reports filed for periods subsequent to the implementation of the rate plan,
24 although *normalized* returns tend to trend higher than actual *adjusted* returns, as
25 discussed later as it relates to excess earnings sharing calculations.

1 **Q. Has PSE prepared an updated comparison of adjusted actual and**
 2 **normalized rates of return and returns on equity?**

3 A. Yes. PSE has updated the comparison of adjusted actual and normalized rates of
 4 return and returns on equity to reflect actual results for calendar year 2016. Please
 5 see Table 1 below for a comparison of PSE's adjusted actual and normalized rates
 6 of return and returns on equity (as reflected in PSE's filed Commission Basis
 7 Reports) to the authorized rates of return and returns on equity in place during the
 8 respective calendar year for electric operations.

9 **Table 1. Comparison of PSE's Adjusted Actual and**
 10 **Normalized Rates of Return and Returns on Equity for Electric Operations**

	(A)	(B)	(C)	(D)	(E)	(F)	(G)
	Rate of Return			Return on Equity			
Year	Adjusted Actual ⁽¹⁾	Normalized ⁽²⁾	Authorized	Adjusted Actual ⁽¹⁾	Normalized ⁽²⁾	Authorized	
1 2016	7.90%	8.06%	7.77%	9.96%	10.28%	9.80%	
2 2015	7.52%	8.05%	7.77%	9.13%	10.25%	9.80%	
3 2014	7.53%	7.74%	7.77%	9.01%	9.44%	9.80%	
4 2013	7.50%	7.56%	7.77%	8.95%	9.06%	9.80%	
5 2012	7.46%	7.14%	7.80%	8.78%	8.11%	9.80%	
6 2011	7.75%	6.62%	8.10%	9.31%	6.98%	10.10%	

Notes:

- (1) Adjusted actual returns: Exclude ASC 815 (formerly FAS 133) gains or losses and include tax benefits of interest
- (2) Normalized returns: 2013 - 2016 CBR filed with the Commission

11 Likewise, Table 2 below represents an updated comparison of PSE's adjusted
 12 actual and normalized rates of return and returns on equity (as reflected in PSE's
 13 filed Commission Basis Reports) to the authorized rates of return and returns on
 14 equity in place during the respective calendar year for gas operations.

Table 2. Comparison of PSE’s Adjusted Actual and Normalized Rates of Return and Returns on Equity for Gas Operations

	(A)	(B)	(C)	(D)	(E)	(F)	(G)
	Rate of Return			Return on Equity			
Year	Adjusted Actual ⁽¹⁾	Normalized ⁽²⁾	Authorized	Adjusted Actual ⁽¹⁾	Normalized ⁽²⁾	Authorized	
1 2016	7.80%	7.93%	7.77%	9.75%	10.01%	9.80%	
2 2015	7.62%	8.17%	7.77%	9.34%	10.49%	9.80%	
3 2014	7.80%	7.87%	7.77%	9.56%	9.71%	9.80%	
4 2013	7.22%	7.34%	7.77%	8.37%	8.62%	9.80%	
5 2012	7.99%	7.46%	7.80%	9.87%	8.78%	9.80%	
6 2011	9.19%	6.78%	8.10%	12.25%	7.30%	10.10%	

Notes:

- (1) Adjusted actual returns: Exclude ASC 815 (formerly FAS 133) gains or losses and include tax benefits of interest
- (2) Normalized returns: 2013 - 2016 CBR filed with the Commission

Q. With respect to the rate plan, do these updated results alter any of the observations and conclusions that appear in your direct testimony?

A. No. The rate plan continues to mitigate the ongoing effects of attrition and regulatory lag. The combined effects of the expedited rate filing and K-factor annual increases have allowed PSE to avoid filing at least one, and possibly two, general rate cases during the rate plan period. From PSE’s perspective, this achieved the Commission’s objective of reducing the burden of frequent general rate cases. Additionally, the rate plan was instrumental to PSE’s agreement to delay this rate filing for an additional year.

1 **Q. Did the rate plan impart more predictable and gradual increase to PSE's**
2 **base rates as compared to traditional regulation?**

3 A. Yes. The combination of the expedited rate filing increase and the annual K-factor
4 increases from the rate plan imparted a more predictable and gradual increase to
5 PSE's base rates as compared to increases resulting from general rate cases,
6 which tend to be larger and less predictable from a customer perspective. In fact,
7 had PSE filed this general rate case request without the benefit of the
8 aforementioned rate plan, the requested increase would be approximately
9 \$160 million higher, as illustrated in Table 3 below.

10 **Table 3. Projected 2017 General Rate Case Request**
11 **in the Absence of the Effects of the Rate Plan Benefits**

	(A)	(B)	(C)
Summary (\$ millions)	2013 ERF Impact	2014-2017 K- factor Impact	Total Impact
1 Electric	\$30	\$89	\$119
2 Gas	(\$2)	\$43	\$41
3 Total	\$28	\$132	\$160

12 **B. PSE Has Achieved a Cost Per Customer That is Below Increases in**
13 **PSE's Historical Growth Rate and the Consumer Price Index**

14 **Q. Please describe the cost per customer that PSE has been able to achieve.**

15 A. In its initial filing in this proceeding, PSE provided an analysis of PSE's actual
16 and historical cost per customer and also makes comparisons to various
17 independently prepared measures of inflation.⁴ PSE's analysis shows that the
18 actual cost per customer for combined electric and gas operations grew at a

⁴ Barnard, Exh. KJB-1T at 6:17 – 10:9.

1 compound average rate of only 1.2 percent during the rate plan. This compares
2 favorably to the historical compound average rate of 3.8 percent that was
3 experienced during the period 2006–2011. PSE’s compound average rate of
4 1.2 percent also compares favorably to both national and regional inflation
5 indices, which averaged 1.5 percent and 2.1 percent respectively, during the rate
6 plan period. PSE’s analysis demonstrates that PSE’s cost containment
7 performance contributed favorably to the success of the rate plan.

8 **C. PSE’s Revenue Decoupling Mechanism Has Worked Well**

9 **Q. Does PSE recommend continuing the revenue decoupling mechanism into the**
10 **future?**

11 A. Yes. From PSE’s perspective, the revenue decoupling mechanism continues to
12 operate as intended and has achieved the Commission’s objectives of
13 (i) mitigating the through-put incentive and (ii) normalizing the impacts of
14 weather and other impacts on customer usage patterns. Further, the impacts of
15 decoupling on electric and gas operations (as a percentage of total revenues) were
16 0.76 percent and 3.20 percent, which are not material over the rate plan period
17 through June 30, 2017.

18 **Q. Do you have any observations regarding how the revenue decoupling**
19 **mechanism has operated in practice?**

20 A. Yes. PSE continues to be satisfied that the revenue decoupling mechanism has
21 operated well in practice. First, it properly captures under-recoveries of fixed

1 revenues per customer for future collection as well as over-recoveries of fixed
 2 revenues per customer for future refund. Second, PSE believes that the soft cap is
 3 an appropriate component of the mechanism. PSE has identified minor
 4 adjustments to the soft cap percentages that may be appropriate for certain rate
 5 classes. Please see the Prefiled Direct Testimony of Jon A. Piliaris, Exh. JAP-1T.

6 **D. PSE Would Not Have Earned Its Authorized Rate of Return Without**
 7 **the Expedited Rate Filing and K-Factor**

8 **Q. Would PSE have earned its authorized rate of return without the K-factor?**

9 **A.** No. PSE would not have earned its authorized rate of return without the ERF and
 10 K-factor. The following tables adjust various return benchmarks and metrics
 11 during the rate plan period, by excluding the cumulative effects of the 2013 ERF
 12 and the K-factors that increased revenues on January 1 of each of 2014, 2015, and
 13 2016.

14 **Table 4. PSE’s Adjusted Actual and**
 15 **Normalized Rates of Return and Returns on Equity for Electric Operations**
 16 **excluding the effects of 2013 ERF and K-factors**

	(A)	(B)	(C)	(D)	(E)	(F)	(G)
		Rate of Return			Return on Equity		
	Year	Adjusted Actual ⁽¹⁾	Normalized	Authorized	Adjusted Actual ⁽¹⁾	Normalized	Authorized
1	2016	6.67%	6.82%	7.77%	4.91%	7.75%	9.80%
2	2015	6.55%	7.09%	7.77%	5.12%	8.24%	9.80%
3	2014	6.82%	7.03%	7.77%	6.07%	7.97%	9.80%
4	2013	7.03%	7.08%	7.77%	6.98%	8.08%	9.80%

Notes:

(1) Adjusted actual returns: Exclude ASC 815 (formerly FAS 133) gains or losses and include tax benefits of interest

1
2
3
Table 5. PSE's Adjusted Actual and Normalized Rates of Return and Returns on Equity for Gas Operations excluding the effects of 2013 ERF and K-factors

	(A)	(B)	(C)	(D)	(E)	(F)	(G)
		Rate of Return			Return on Equity		
Year	Adjusted Actual ⁽¹⁾	Normalized	Authorized	Adjusted Actual ⁽¹⁾	Normalized	Authorized	
1 2016	6.63%	6.76%	7.77%	4.96%	7.62%	9.80%	
2 2015	6.80%	7.35%	7.77%	5.94%	8.79%	9.80%	
3 2014	7.33%	7.40%	7.77%	7.63%	8.74%	9.80%	
4 2013	7.12%	7.24%	7.77%	7.93%	8.40%	9.80%	

Notes:

(1) Adjusted actual returns: Exclude ASC 815 (formerly FAS 133) gains or losses and include tax benefits of interest

4 The conclusions are obvious. Without the benefit of the 2013 ERF and the
5 ensuing K-factor increases, PSE would have substantially under-earned against its
6 allowed rate of return and return on equity on both an actual and normalized basis
7 for both electric and gas operations. It is important to note that neither the
8 expedited rate filing nor the K-factor increases would have been sufficient *on*
9 *their own* to close the return gap created by regulatory lag and attrition.

1 **III. THE COMMISSION SHOULD REJECT COMMISSION**
2 **STAFF’S PRESUMPTION THAT A RATE REDUCTION IS**
3 **REASONABLE SIMPLY BECAUSE PSE WAS ABLE TO EARN**
4 **ITS ALLOWED RATE OF RETURN DURING THE RATE**
5 **PLAN PERIOD**

6 **Q. How does PSE respond to the Commission Staff’s testimony regarding policy**
7 **matters?**

8 A. Commission Staff’s testimony begins with an accurate recollection of the events
9 that led to PSE’s current filing.⁵ Commission Staff then summarizes what it
10 considers to be salient statements from the Commission’s determinations relative
11 to the decoupling and rate plan and quotes as follows:

12 We approve the rate plan in part because it is an innovative
13 approach that will provide incentives for PSE to cut costs in order
14 to earn its authorized rate of return. It is important that the
15 commission monitor how, and how well these incentives, operate
16 to improve efficiency and reduce costs that ultimately will mean
17 rates to customers that are lower than they would be absent these
18 gains in efficiency. (Emphasis added.)⁶

19 From this language, the Commission Staff draws the following conclusions:

20 Staff understands the commission was allowing PSE the
21 opportunity to over earn for a period of time with the
22 understanding that next general rate case will be based on a cost
23 structure which may show a need for lower rates.⁷

⁵ Schooley, Exh. TES-1T at 6:11 – 9:4.

⁶ Schooley, Exh. TES-1T at 9:10-16 (quoting *In the Matter of the Petition of Puget Sound Energy, Inc., and Northwest Energy Coalition for an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated With the Mechanisms*, Order 07 at ¶ 214, Dockets UE-121697, *et al.* (2013)) (emphasis in original).

⁷ Schooley, Exh. TES-1T at 9:19-21.

1 **Q. Does PSE agree with Commission Staff’s interpretation?**

2 A. No. Nowhere in the language quoted by Commission Staff does the Commission
3 even come close to suggesting that it was allowing PSE the opportunity to over-
4 earn for any period of time. It is difficult to imagine that this Commission—or
5 any other commission, for that matter—would fathom instituting such a policy.
6 Furthermore, such an interpretation is puzzling when the Commission expressly
7 stated in both the Decoupling Order⁸ and the subsequent Decoupling Remand
8 Order⁹ that (i) the return on equity of 9.8 percent was within the range of
9 reasonableness¹⁰ and (ii) the decoupling mechanisms and rate plan would result in
10 rates during the term of the rate plan that will be fair, just and reasonable and
11 sufficient.¹¹

12 **Q. How does PSE interpret the Commission’s language quoted by Commission**
13 **Staff?**

14 A. PSE interprets the language from paragraph 214 of the Decoupling Order quoted
15 by Commission Staff as representing the Commission’s recognition that the
16 revenue decoupling mechanism and rate plan represented an innovative approach

⁸ *In the Matter of the Petition of Puget Sound Energy, Inc., and Northwest Energy Coalition for an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated With the Mechanisms*, Order 07, Dockets UE-121697, *et al.* (2013) (the “Decoupling Order”)

⁹ *In the Matter of the Petition of Puget Sound Energy, Inc., and Northwest Energy Coalition for an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated With the Mechanisms*, Order 15/14, Dockets UE-121697, *et al.* (2015) (the “Decoupling Remand Order”)

¹⁰ Decoupling Order at ¶¶ 164-65; Decoupling Remand Order at ¶ 163.

¹¹ Decoupling Order at ¶ 228; Decoupling Remand Order at ¶ 170.

1 or an experiment of sorts. Further, PSE understood that, in the Decoupling Order,
2 the Commission afforded PSE an opportunity (but not a guarantee) to earn a
3 return commensurate with returns that could be expected on investments of
4 similar risk. Because the Commission understood that the revenue decoupling
5 mechanism and rate plan were innovative and experimental (at least within the
6 State of Washington), the Commission implemented an excess earnings sharing
7 mechanism to protect consumers in the event that the combined effects of
8 decoupling, the rate plan, or PSE's cost savings and cost efficiency efforts,
9 resulted in PSE over-earning.

10 **Q. Does Commission Staff suggest that PSE has over-earned during the rate**
11 **plan period?**

12 A. Yes. Commission Staff presents evidence that PSE has, *on a normalized basis*,
13 over-earned its allowed rate of return during the rate plan period by up to 40 basis
14 points for gas operations and 30 basis points for electric operations.¹² Commission
15 Staff, however, continues with an ominous statement that “[i]t is now time to reset
16 the program and a rate reduction is therefore reasonable.”¹³

17 **Q. How does PSE respond?**

18 A. On an *actual, non-normalized basis*, PSE did not over-earn during the rate plan
19 period to the extent that *normalized* results would otherwise suggest.¹⁴ PSE has

¹² Schooley, Exh. TES-1T at 10:4-6.

¹³ Schooley, Exh. TES-1T at 10:6-7.

¹⁴ See Doyle, Exh. DAD-1T at 3:19 – 5:5.

1 presented evidence elsewhere, which will not be repeated here, that explains why
2 it is inappropriate to utilize *normalized* earnings to calculate *actual* excess
3 earnings for purposes of the earnings sharing mechanism.¹⁵ In short, Commission
4 Staff ignores PSE’s argument that the normalized rate of return calculation
5 included in the Commission Basis Report can be an inappropriate mechanism for
6 calculating excess earnings with respect to earning sharing mechanisms because
7 certain unforeseen dynamics, such as materially higher or lower power costs, can
8 cause the earnings sharing mechanism, as currently implemented, to produce
9 results that are unexpected and irrational.

10 **Q. How does PSE respond to Commission Staff’s assertion that “[w]e also**
11 **reintroduce PSE to the concept of risk since it seems dissatisfied with the**
12 **numerous risk mitigation measures granted by the commission in recent**
13 **years”?**¹⁶

14 A. First, PSE’s direct testimony in this proceeding never stated that PSE is
15 dissatisfied with the risk mitigation measures granted by the Commission in
16 recent years.

17 Second, Commission Staff cites to various risk-mitigating measures in an attempt
18 to convince the reader that PSE is a uniquely advantaged recipient of favored rate
19 treatment.¹⁷ That is simply not the case. As presented in the Second Exhibit to the

¹⁵ See Doyle, Exh. DAD-1T at 15:7 – 21:6.

¹⁶ Schooley, Exh. TES-1T at 10:15 – 11:2.

¹⁷ Schooley, Exh. TES-1T at 11:4-11.

1 Prefiled Rebuttal Testimony of Daniel A. Doyle, Exh. DAD-8, commissions
2 across the country have, over the past several decades, implemented various and
3 similar mechanisms to accurately track material cost of service items and reduce
4 the need for frequent general rate cases. In this context, there is an important
5 omission in Commission Staff’s testimony—yes, riders and trackers do allow PSE
6 to recover various costs on a dollar-for-dollar basis, but they also provide a
7 significant and meaningful consumer protection goal of ensuring that customers
8 will never over-pay those costs, a feature that Commission Staff’s testimony
9 ignores.

10 Third, Commission Staff’s argument that regulatory mechanisms are beneficial to
11 PSE from a financial standpoint¹⁸ is irrelevant. The Commission establishes PSE
12 allowed return on equity by reference to one or more proxy groups of comparable
13 utilities, and utilities within those proxy groups employ the same or similar
14 regulatory mechanisms. The Commission correctly recognized this fact in its

15 Decoupling Remand Order:

16 The Commission has never tried to account separately in its [return
17 on equity] ROE determinations for specific risks or risk mitigating
18 factors, nor should it. *Circumstances in the industry today and*
19 *modern regulatory practice that have led to a proliferation of risk*
20 *reducing mechanisms being in place for utilities throughout the*
21 *United States* make it particularly inappropriate and unnecessary to
22 consider such an undertaking. The effects of these risk mitigating
23 factors was by 2013, and is today, built into the data experts draw
24 from the samples of companies they select as proxies.¹⁹

¹⁸ Parcell, Exh. DCP-1T at 18:11 – 22:22.

¹⁹ Decoupling Remand Order at ¶ 155 (emphasis added).

1 Similarly, Commission Staff’s own testimony quotes a trade publication that
2 recognizes the proliferation of these mechanisms within the industry: “Over the
3 ensuing years, the use of adjustment clauses has expanded greatly. Adjustment
4 clauses are generally reserved for expenses that are outside the control of the
5 utility or are required by law or rule.”²⁰ Therefore, PSE receives no special
6 advantage as Commission Staff’s testimony would have us believe.

7 Finally, Commission Staff’s testimony would suggest that PSE, as a beneficiary
8 of recent regulatory mechanisms implemented during the rate plan period, now
9 requires some abstract, unfounded risk adjustment. Nothing could be further from
10 the truth. Power cost only rate cases, the power cost adjustment, the purchase gas
11 adjustment, the gas cost recovery mechanism and a few other riders and trackers
12 have been part of the Commission’s regulatory construct for years. There is
13 nothing new here.

14 **Q. Does PSE need a reintroduction to the concept of risk?**

15 A. No. As discussed earlier in this rebuttal testimony, in the absence of the K-factor
16 increases, PSE would have substantially under-earned against the allowed rate of
17 return and the allowed return on equity. This analysis demonstrates that regulatory
18 lag and attrition appear to be alive and well within the existing regulatory regime.
19 If left unaddressed, regulatory lag and attrition will remain alive and well in the
20 rate year and beyond.

²⁰ Parcell, Exh. DCP-1T at 20:9-11 (quoting Regulatory Research Associates, “Adjustment Clauses – a State-By-State Overview” (Oct. 2, 2015)).

1 **Q. Does Commission Staff address the risks related to the long-standing and**
2 **continuing effects of regulatory lag and attrition?**

3 A. No. Commission Staff fails to address the risks related to the long-standing and
4 continuing effects of regulatory lag and attrition that PSE will face with the
5 elimination of the rate plan. Notwithstanding the existing risks related to the long-
6 standing and continuing effects of regulatory lag and attrition, Commission Staff
7 appears intent on introducing PSE to several new, incremental risks.

8 **Q. Please describe the incremental risks that Commission Staff seeks to**
9 **introduce.**

10 A. First, Commission Staff proposes to change PSE's long-standing storm recovery
11 mechanism. Commission Staff's proposal would require PSE to experience a
12 pretax write-off of over \$60 million of storm damage costs that PSE currently
13 defers in conformity with the mechanism that has existed (and PSE has followed)
14 for over a decade. Although Commission Staff's testimony expresses
15 dissatisfaction with the long-standing storm recovery mechanism, Commission
16 Staff's testimony fails to provide a clear, understandable rationale for the
17 recommended change.²¹ PSE and the investing public depend on the Commission
18 to establish clear and consistent regulatory policy (i.e., clearly established policy
19 along with rules and procedures that are understood and implemented on a
20 consistent basis). If that is not the case, uncertainty and risk (both perceived and

²¹ Schooley, Exh. TES-1T at 18:10 – 25:13.

1 real) will increase for all. In short, Commission Staff’s proposed change to PSE’s
2 long-standing storm damage accounting and regulatory recovery mechanism
3 represents punitive and ill-advised regulatory policy counsel that incrementally
4 increases PSE’s risk well beyond the confines of regulatory storm accounting.

5 Second, PSE’s deferred balance sheet accounts emanate directly from the
6 accounting and regulatory prescriptions, rules, guidelines, and methodologies
7 mandated by the Commission, the Federal Energy Regulatory Commission, and
8 the various bodies that administer generally accepted accounting principles. PSE’s
9 deferred accounting balance sheet accounts exist in full compliance with these
10 mandates, and they fluctuate over time. Accordingly, it is not appropriate to
11 evaluate the extent to which PSE utilizes deferred accounting based on dollar
12 values at any given point in time.

13 Finally, Commission Staff collectively seeks to introduce the following
14 incremental risks for PSE:

- 15 (i) Commission Staff seeks to reduce PSE’s allowed return on
16 equity by 60 basis points (from 9.8 percent to
17 9.2 percent);²²
- 18 (ii) Commission Staff seeks to reject PSE’s request for a minor
19 increase in its equity ratio (from 48.0 percent to
20 48.5 percent) to reflect the regulatory capital structure
21 supporting PSE during the test year and the regulatory
22 capital structure expected to support PSE during the rate
23 year;²³

²² See generally Parcell, Exh. DCP-1T at 31:13 – 46:8.

²³ See generally Parcell, Exh. DCP-1T at 22:23 – 31:11.

- 1 (iii) Commission Staff seeks to reject PSE’s pro forma
2 adjustment and its method for recovering costs related to
3 PSE’s participation in the CAISO Energy Imbalance
4 Market and proposes the recovery of all such costs as a line
5 item adjustment to actual costs in the Power Cost
6 Adjustment process;²⁴
- 7 (iv) Commission Staff seeks to summarily reject PSE’s costs to
8 comply with the Washington State Department of
9 Ecology’s Clean Air Rule;²⁵
- 10 (v) Commission Staff seeks to reject the placement of certain
11 regulatory liabilities (i.e., Treasury Grants and wind-related
12 Production Tax Credits) into retirement accounts to offset
13 decommissioning and remediation costs for Colstrip
14 Units 1 and 2 as authorized by Chapter 80.84 RCW
15 (Transition of Eligible Coal Units);²⁶ and
- 16 (vi) Commission Staff seeks to (a) re-value the plant in service
17 for Colstrip Units 1 and 2 by ordering a \$127.6 million
18 increase to the reserve for accumulated depreciation and
19 (b) amortize the \$127.6 million adjustment to accumulated
20 reserve over 18 years.²⁷

21 These proposals, if adopted, would incrementally, substantially, and inordinately
22 increase PSE’s risk profile.

23 **Q. How does PSE respond to Commission Staff’s apparent frustration in PSE’s**
24 **reference to the “traditional balance” in a utility’s opportunity to earn its**
25 **return?**

26 A. Commission Staff’s testimony discussing the direct testimony’s reference to
27 “traditional balance” in a utility’s opportunity to earn its return appears to reveal

²⁴ See generally Frankiewich, KAF-1T at 3:18 – 17:9.

²⁵ See generally Frankiewich, KAF-1T at 17:11 – 30:15.

²⁶ See generally Hancock, Exh. CSH-1CT at 4:4 – 29:2.

²⁷ See generally McGuire, Exh. CRM-1T.

1 some frustration on the part of Commission Staff. PSE did not intend to upset
2 Commission Staff or intend that this phrase be interpreted as a criticism of the
3 Commission or any stakeholder. Instead, the reference to a “traditional balance”
4 in a utility’s opportunity to earn its return was simply a reference to the long-
5 standing legal constructs that regulation should afford a utility an opportunity
6 (and not a guarantee) to earn a return commensurate with returns that could be
7 expected on investments of similar risk.²⁸ PSE only meant to request that the
8 Commission implement regulatory policies that would allow PSE the possibility
9 to earn its allowed rate of return and allowed return on equity.

10 **Q. Can PSE cite a real example of where it has not been easy, but possible, for**
11 **PSE to earn the allowed rate of return and allowed return on equity?**

12 A. Yes. The years during the rate plan provide an excellent example of where it has
13 not been easy, but possible, for PSE to earn the allowed rate of return and allowed
14 return on equity. As part of the multi-year rate plan, the Commission embarked on
15 its innovative experiment to approve the revenue decoupling mechanism, an
16 expedited rate filing, and K-factor rate increases), and the Commission expected
17 that PSE would vigorously pursue cost efficiencies to achieve its allowed rate of
18 return and allowed return on equity. Table 1 and Table 2 provided earlier in this
19 rebuttal testimony demonstrate the traditional balance achieved by the rate plan.

²⁸ See, e.g., *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm’n of W. Va.*,
262 U.S. 679 (1923); *Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

1 PSE's adjusted actual returns for both electric and gas operations follow
2 (sometimes exceeding, but mostly trailing) PSE's allowed rate of return and
3 allowed return on equity in a balanced manner. In other words, PSE neither over-
4 nor under-earns its allowed rate of return and allowed return in any material way.
5 This is exactly what should happen when regulatory mechanisms (whether
6 innovative, experimental, or traditional) combine with a utility's cost-
7 effectiveness and efficiency efforts to provide an opportunity (but not a
8 guarantee) to earn the allowed rate of return and the allowed return on equity.

9 **Q. Do Commission Staff's policies in this general rate case "thread the needle of**
10 **reasonable outcomes both temporal and practical" and "carefully balance**
11 **the risks for PSE and its customers"?**

12 A. No. Commission Staff's policies in this general rate case neither "thread the
13 needle of reasonable outcomes both temporal and practical" nor "carefully
14 balance the risks for PSE and its customers." Commission Staff's policy
15 testimony appears to show an unwavering support for the continuation of
16 regulatory lag and attrition that the rate plan effectively mitigated. Commission
17 Staff's policies, if adopted, would introduce PSE to numerous incremental risks
18 that substantially increase PSE's risk profile, which Commission Staff
19 purportedly justifies based on PSE's successful financial performance during the
20 rate plan. It would appear that Commission Staff not only wants to eliminate
21 PSE's opportunity to earn its allowed return benchmarks but Commission Staff
22 will not be satisfied until it is impossible for PSE to do so.

1 **IV. PSE'S CASE FAIRLY BALANCES CUSTOMERS'**
2 **INTERESTS IN REASONABLE COSTS AND RELIABLE**
3 **SERVICE AND PSE'S FINANCIAL NEEDS**

4 **A. The Commission Should Adopt PSE's Proposed Electric Cost**
5 **Recovery Mechanism**

6 **Q. Please describe PSE's proposed Electric Cost Recovery Mechanism.**

7 A. PSE has proposed an Electric Cost Recovery Mechanism that is based, in part, on
8 the framework set forth by the Commission in the natural gas Accelerated
9 Replacement Policy. An Electric Reliability Plan and associated Cost Recovery
10 Mechanism would allow PSE to improve electric reliability and resilience by
11 investing in certain targeted work beyond historic levels of spending, in order to
12 prevent outages that adversely affect PSE's customers. This process would allow
13 transparency and a predictable roadmap that drives construction and work
14 efficiencies that minimize customer impacts (i.e., projects can be coordinated to
15 address replacement of assets more holistically within an area in order to prevent
16 multiple planned outages which occur when replacing failed sections
17 incrementally). More importantly, it would allow PSE to proactively address
18 deteriorating underground direct-bury high molecular weight cable before an
19 outage impacts customers and to more aggressively address infrastructure failures
20 or limitations of PSE's worst performing distribution.

1 **Q. Do other parties support PSE's proposed Electric Cost Recovery**
2 **Mechanism?**

3 A. No. Each of Commission Staff, Public Counsel, ICNU, and Kroger has
4 recommended that the Commission reject PSE's proposed Electric Cost Recovery
5 Mechanism. Commission Staff asserts that the traditional ratemaking processes
6 address recovery of such costs okay.²⁹ Similarly, Public Counsel and Kroger
7 assert that the proposed Electric Cost Recovery Mechanism would be a departure
8 from traditional ratemaking.³⁰ Finally, ICNU asserts that the costs that the
9 proposed Electric Recovery Mechanism would recover are not sufficiently large
10 or volatile to justify the use of a rider.³¹

11 **Q. How does PSE respond to assertions that the traditional ratemaking model**
12 **adequately addresses recovery of costs that PSE proposes to recover in the**
13 **proposed Electric Cost Recovery Mechanism?**

14 A. PSE embarked on its program to address worst-performing circuits and failing
15 underground cable during calendar year 2017. For the six months ended June 30,
16 2017, PSE has already spent over \$38 million to address worst-performing
17 circuits and failing underground cable, and PSE expects to spend approximately
18 \$78 million in total for 2017. These substantial expenditures clearly are not and
19 will not be included in rates from this proceeding.

²⁹ See Schooley, Exh. TES-1T at 28:13-21.

³⁰ See Brosch, Exh. MLB-1T at 60:20 – 61:11; Higgins, Exh. KCH-1T at 22:10-19.

³¹ Gorman, Exh. MPG-1T at 43:19 – 44:5.

1 Without the proposed Electric Cost Recovery Mechanism, PSE will be subject to
2 significant regulatory lag until its next general rate case or expedited rate filing.

3 Absent an Electric Cost Recovery Mechanism, the regulatory lag that PSE would
4 experience would require PSE to file for rate relief more frequently, through
5 either a general rate case or an expedited rate filing.

6 Finally, the Electric Cost Recovery Mechanism takes advantage of one of the
7 significant benefits from the rate plan: it imparts smaller and more predictable
8 annual rate increases on customers and eliminates the need to include much larger
9 accumulated amounts of rate base and depreciation expense in a general rate case
10 or expedited rate filing. For these reasons, the Electric Cost Recovery Mechanism
11 is a more reasonable and effective cost recovery approach.

12 **Q. How does PSE respond to assertions that the costs the proposed Electric**
13 **Recovery Mechanism would recover are not sufficiently large or volatile to**
14 **justify the use of a rider?**

15 A. It is irrefutable that the Electric Reliability Plan is a material and substantial
16 program in terms of dollars spending. As previously stated, PSE intends to spend
17 over \$78 million on the Electric Reliability Plan in 2017. That amount exceeds
18 what PSE will spend through the Gas Cost Recovery Mechanism in 2017.

19 In some cases, volatility is a factor in determining whether it is appropriate to
20 establish a tracking mechanism. PSE's gas adjustment clause and property tax
21 trackers are examples of where volatility matters. However, this is not always the
22 case. For example, expenditures that are processed through PSE's conservation

1 tracker have been quite stable over the recent past. Nevertheless, PSE's
2 conservation tracker is a very significant program in terms of dollars spend,
3 approximately \$110 million per year. Recovering these significant costs through a
4 tracking mechanism ensures dollar-for-dollar recovery, which protects customers
5 by eliminating the risk that PSE would over-collect these costs.

6 In summary, the Electric Reliability Plan is substantial in terms of dollars spend,
7 and considerations of volatility are less relevant to whether or not the Electric
8 Recovery Mechanism should be approved.

9 **Q. How does PSE respond to assertions that the proposed Electric Cost**
10 **Recovery Mechanism would be a departure from traditional ratemaking?**

11 A. As previously recognized by the Commission, “[c]ircumstances in the industry
12 today and modern regulatory practice that have led to a proliferation of risk
13 reducing mechanisms being in place for utilities throughout the United States”³²
14 Accordingly, what was traditional ratemaking in the 1970s or 1980s (when the
15 existence of cost recovery mechanisms outside a general rate case were not
16 prevalent) is not representative of how traditional ratemaking would be viewed
17 today (when the existence of cost recovery mechanisms outside a general rate
18 case is quite prevalent). Viewed in this context, the establishment of the Electric
19 Cost Recovery Mechanism is not a departure from today’s ratemaking practices.

³² Decoupling Remand Order at ¶ 155 (emphasis added).

1 **Q. Public Counsel cites the reduction of \$178 million in capital spending from**
2 **2012 to 2016 and suggests there is ample capability for PSE to fund the ERP**
3 **through traditional ratemaking.³³ Does PSE agree?**

4 A. No. Public Counsel inappropriately references only a portion of the PSE's capital
5 expenditures, which categorically will shift and fluctuate year-to-year.
6 Accordingly, Public Counsel's suggestion that there is ample capacity for PSE to
7 fund the ERP is invalid and based on incomplete analyses. In addition, Public
8 Counsel refers to PSE's April 2017 Bondholder Presentation to further support
9 the suggestion by citing PSE's "strong liquidity position, manageable debt profile
10 and access to capital" and "access to more than \$1.5 billion of liquidity."³⁴ While
11 all of this is true, it is simply not relevant or accurate support for the contention
12 that PSE has ample capacity to fund the ERP *because it only refers to the debt*
13 *side of the equation*. Public Counsel's analysis does not address funding the
14 equity component of the capital expenditure, and Public Counsel incorrectly
15 assumes that debt can be issued without constraint. PSE must maintain the equity
16 component of its capital structure, which does not allow PSE to issue debt without
17 constraint. Finally, of the \$1.5 billion of liquidity to which Public Counsel refers,
18 \$800 million belongs to Puget Energy and another \$350 million is dedicated to
19 PSE hedging program. Accordingly, Public Counsel greatly overstates PSE's
20 liquidity position. For these reasons, Public Counsel's arguments should be
21 rejected.

³³ Brosch, Exh. MLB-1T at 58:11 – 59:12.

³⁴ Brosch, Exh. MLB-1T at 58:21 – 59:1.

1 **Q. What PSE witnesses provide testimony and exhibits that directly address**
2 **arguments regarding PSE’s proposed Electric Recovery Mechanism?**

3 A. Please see the Prefiled Rebuttal Testimony of Ms. Catherine A. Koch, Exh. CAK-
4 4T, for PSE’s response to (i) the need and relevance of the Gas Cost Recovery
5 Mechanism and (ii) reliability performance and benefits arguments regarding
6 PSE’s proposed Electric Recovery Mechanism.

7 Please see the Prefiled Rebuttal Testimony of Ms. Katherine J. Barnard,
8 Exh. KJB-17T, for PSE’s response to accounting arguments regarding PSE’s
9 proposed Electric Recovery Mechanism.

10 **B. The Commission Should Establish a Formal Process for PSE’s**
11 **Expedited Rate Filings**

12 **Q. Is an expedited rate filing a useful mechanism that the Commission should**
13 **seriously consider?**

14 A. Yes. The expedited rate filing that was part of the rate plan was integral to
15 mitigating the impacts of regulatory lag and attrition. As such, it contributed
16 substantially to enhancing PSE’s ability to earn at or near its allowed benchmarks.
17 As it operated in the rate plan, ERFs can be an efficient and useful mechanism to
18 modestly update cost of service in a limited fashion in the future without the time
19 cost and effort that accrues to all parties in a fully litigated GRC. PSE encourages
20 the Commission to establish an ERF mechanism with a clear set of rules and
21 guidelines to eliminate the potential for additional regulatory burden like the legal
22 challenge that occurred after approval of the ERF and rate plan.

1 **Q. What PSE witness provides testimony and exhibits that directly address**
2 **arguments regarding PSE’s proposed Electric Recovery Mechanism?**

3 A. Please see the Prefiled Rebuttal Testimony of Ms. Katherine J. Barnard,
4 Exh. KJB-17T, for PSE’s response to arguments regarding PSE’s expedited rate
5 filing proposal.

6 **C. The Commission Should Maintain the Current Storm Deferral**
7 **Methodology, Which Has Worked Well Over the Past Decade**

8 **Q. Please summarize Commission Staff’s proposal regarding storm deferral**
9 **accounting.**

10 A. Commission Staff (i) accepts deferral of the January 2012 snowstorm and
11 recommend that these costs be recovered over six years; (ii) rejects PSE’s
12 proposed amortization and recovery of the storm damage deferrals “pending
13 approval” in Exh. KJB-14, Adj. 14.05, (iii) proposes to use an average of all the
14 costs for storm damages in the past six years to establish a level of ongoing cost
15 recovery; and (iv) propose to discontinue the storm deferral mechanism that has
16 been operating for more than a decade.³⁵ In effect, this proposal has the following
17 effects:

- 18 (i) the proposal increases the average annual expense for
19 normal storms to \$18,769,050 (or \$7,709,493 more than the
20 test year level); and
- 21 (ii) the proposal amortizes the remaining balance of the
22 2012 snowstorm (about \$52.5 million) over six years, or

³⁵ See Schooley, Exh. TES-1T at 21:15-23.

1 \$8,748,972 per year (or \$6,728,425 less than the test year
2 amortization expense) but does not allow PSE to amortize
3 and recover several other storms that have been deferred
4 under the mechanism.

5 The net effect of Commission Staff's proposal in this proceeding is to reduce
6 revenue requirement by about \$2.7 million.³⁶

7 **Q. Please describe Commission Staff's proposal regarding storm deferral**
8 **accounting.**

9 A. Commission Staff's proposal regarding storm deferral accounting is a
10 fundamental change to current practice over the last decade without sufficient
11 justification. Commission Staff acknowledges as much by stating that "[t]here
12 may be consequences when methods are changed, but if the new method is fairer
13 to all, then it is acceptable."³⁷

14 As previously stated, PSE and the investing public depend on the Commission to
15 establish clear and consistent regulatory policy (i.e., clearly established policy and
16 rules that are understood and implemented on a consistent basis). If that is not the
17 case, uncertainty and risk (both perceived and real) will increase for all. Policy
18 changes with respect to material cost of service items like storms should only be
19 implemented when the facts demonstrate that change is warranted. Commission
20 Staff's position with respect to storm deferral accounting does not meet this test.

³⁶ See Schooley, Exh. TES-1T at 23:2-10.

³⁷ Schooley, Exh. TES-1T at 23:14-15.

1 The Commission should not rely on vague assertions that the current
2 methodology “has shown to be biased in favor of” PSE.³⁸ PSE is unaware of—
3 and Commission Staff has not presented in this proceeding—any evidence of any
4 such bias. Indeed, the storm deferral methodology has worked well over the past
5 decade, and there is no rationale to change this methodology.

6 **Q. What PSE witness provides testimony and exhibits that directly address**
7 **Commission Staff’s proposal regarding storm deferral accounting?**

8 A. Please see the Prefiled Rebuttal Testimony of Ms. Katherine J. Barnard,
9 Exh. KJB-17T, for PSE’s response to Commission Staff’s proposal regarding
10 storm deferral accounting.

11 **D. PSE Proposed Capital Structure Reflects the Regulatory Capital**
12 **Structure Supporting PSE During the Test Year and the Regulatory**
13 **Capital Structure Expected to Support PSE During the Rate Year**

14 **Q. What capital structure is PSE requesting in this proceeding?**

15 A. PSE’s is requesting a capital structure in this proceeding that contains a
16 48.5 percent equity ratio, as shown in Table 8 below:

17 **Table 8. PSE’s Requested Capital Structure**

Components of Capital Structure	Ratio
Short-Term Debt	1.0%
Long-Term Debt	50.5%
Common Equity	48.5%

³⁸ Schooley, Exh. TES-1T at 23:15-16.

1 **Q. Has any party to this proceeding expressly adopted PSE’s requested capital**
2 **structure?**

3 A. Yes. Public Counsel has “adopted this capital structure, as it is reflective of the
4 capital structures of Professor Woolridge’s proxy groups of electric, combination
5 electric and gas, and gas distribution companies.”³⁹ ICNU has also adopted a
6 capital structure with an equity ratio of 48.5 percent.⁴⁰

7 **Q. Has any party to this proceeding recommended changes to PSE’s requested**
8 **capital structure?**

9 A. Yes. Commission Staff proposes that “the 48.0 percent equity ratio adopted in
10 PSE’s most recent cases be continued.”⁴¹ Commission Staff presents at least eight
11 separate arguments for a 50 basis point reduction to PSE’s proposed equity ratio
12 of 48.5 percent. None of their arguments, individually or in the aggregate, justify
13 such a reduction for the reasons set forth below.

³⁹ Woolridge, Exh. JRW-1T at 3:17-18.

⁴⁰ See Mullins, Exh. BGM-3 at 9.

⁴¹ Parcell, Exh. DCP-1T at 4:11-12 (footnote omitted).

1 **Q. How does Commission Staff justify a reduction to PSE’s proposed equity**
2 **ratio of 48.5 percent to Commission Staff’s proposed equity ratio of**
3 **48.0 percent?**

4 A. Commission Staff asserts that “PSE’s actual consolidated capital structure as of
5 December 31, 2016 contained 46.6 percent common equity while its regulatory
6 capital structure contained 47.9 percent equity on a year-end basis....”⁴²

7 Although it is a fact that PSE’s actual consolidated capital structure as of
8 December 31, 2016 contained 46.6 percent common equity, that fact is irrelevant
9 for purposes of establishing electric and gas rates. The actual consolidated capital
10 structure to which Commission Staff refers reflects balance sheet impacts of
11 (i) common equity supporting Puget Western, Inc. (“Puget Western”), a non-
12 regulated real estate subsidiary of PSE, and (ii) Other Comprehensive Income
13 (“OCI”) related to pension income and expense and derivative accounting.

14 Neither is an appropriate consideration in establishing PSE’s electric and gas
15 rates, and PSE has appropriately removed these items from its proposed capital
16 structure to be used for establishing electric and gas rates. Further, PSE’s removal
17 of these items from its actual consolidated capital structure in proposing a capital
18 structure appropriate for ratemaking is consistent with past practice approved by
19 this Commission.⁴³

⁴² Parcell, Exh. DCP-1T at 27:12-14.

⁴³ See Decoupling Order at ¶¶ 59-62; *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy*, Dockets UE-111048 & UG-111049 (consolidated), Order 08 at ¶¶ 48-57 (2012).

1 PSE has historically removed equity balances supporting non-regulated
2 subsidiaries, such as Puget Western, from PSE's actual consolidated equity in
3 proposing a common equity ratio for ratemaking. Similarly, the Commission has
4 traditionally reflected cash pension contributions, averaged over a four-year
5 period, in rates. This practice looks solely to cash pension contributions and does
6 not look at the accounting pension income or expense. Since neither pension
7 income nor expense is reflected in PSE's rates, it is appropriate to remove the
8 balance sheet impact of pension accounting from PSE's common equity for rate
9 making purposes.

10 Further, the Commission has reflected in rates the actual commodity costs that
11 PSE has, or expects, to incur, exclusive of unrealized, non-cash gains and losses
12 from derivatives. PSE recovers these costs through the PGA and PCA
13 mechanisms, with general rates set to reflect the expected level of commodity
14 costs in base rates. Unrealized non-cash gains or losses from marking derivatives
15 to market—as required by Generally Accepted Accounting Principles—are not,
16 and should not, be reflected in rates. Indeed, setting rates on PSE's actual
17 consolidated capital structure without adjustment could result in falsely over-
18 inflated equity in the capital structure in years where the non-cash and unrealized
19 marks of derivatives result in unrealized gains rather than losses. As a result, the
20 impact of these non-cash unrealized mark-to-market accounting gains or losses on
21 PSE's capitalization, generally reflected in OCI, must also be removed for
22 ratemaking purposes.

1 **Q. Does Commission Staff justify a reduction to PSE’s proposed equity ratio of**
2 **48.5 percent to Commission Staff’s proposed equity ratio of 48.0 percent in**
3 **other ways?**

4 A. Yes. Commission Staff asserts that PSE’s “regulatory capital structure contained
5 47.9 percent equity on a year-end basis”⁴⁴

6 Reference to a regulatory capital structure as of December 31, 2016, is
7 inappropriate for a number of reasons. First, the test year in this proceeding is the
8 twelve months ending September 30, 2016, and the regulatory capital structure as
9 of December 31, 2016, captures a point in time that is outside the test year.

10 Second, and more importantly, the use of an “end-of-period” or “point-in-time”
11 capital structure rather than an average capital structure over a period of time
12 (typically, the average of monthly averages over the course of the test year, as
13 used by PSE in this proceeding) ignores the variability in equity ratio that can
14 occur over a period of time. For example, the equity ratio in PSE’s regulatory
15 capital structure varied from a low of 47.9 percent (December 2015) to a high of
16 49.7 percent (each of April and May 2016), with an average of 48.9 percent,
17 which is higher than PSE’s proposed equity ratio of 48.5 percent.⁴⁵ Use of a
18 capital structure that calculates an equity ratio based on the average of monthly
19 averages more accurately reflects the equity ratio of the utility throughout the
20 course of a test year than a capital structure calculation based on an equity ratio

⁴⁴ Parcell, Exh. DCP-1T at 27:12-14.

⁴⁵ See Lohse, Exh. BJL-3 at 2:13.

1 that is an “end-of-period” or “point-in-time,” which can be “cherry-picked” to
2 obtain a desired result such as a low or high equity ratio. And it happens to be
3 long standing Commission policy to do so.

4 In sum, the Commission should reject any suggestion that the Commission rely on
5 a capital structure calculation based on an equity ratio that is an “end-of-period”
6 or “point-in-time” and should, instead, rely on a capital structure calculation
7 based on an average of monthly average equity ratio over the course of the test
8 year. In this proceeding, the average of monthly average equity ratio over the
9 course of the test year results in an equity ratio of 48.9 percent, which is higher
10 than PSE’s proposed equity ratio of 48.5 percent.⁴⁶

11 **Q. What other justifications does staff propose to support its position?**

12 A. Commission Staff further asserts that PSE’s “actual equity ratios have not
13 materially increased from the time period of its last rate proceeding (i.e., 2012)
14 when the 48.0 percent common equity ratios was established.”⁴⁷

15 Although Commission Staff is correct that the equity ratios in PSE’s regulatory
16 capital structure have not materially increased from the time period of its last rate
17 proceeding, this argument ignores the fact that PSE is not requesting a material
18 increase in equity ratio that violates the standards of safety and economy. Indeed,
19 Commission Staff has not, and cannot, demonstrate that the requested equity ratio
20 fails to balance safety and economy. Further, PSE proposed equity ratio of

⁴⁶ See Lohse, Exh. BJL-3 at 2:13.

⁴⁷ Parcell, Exh. DCP-1T at 27:19-21.

1 48.5 percent is the only proposed capital structure in this proceeding that reflects
2 the regulatory capital structure supporting PSE during the test year and the
3 regulatory capital structure expected to support PSE during the rate year.

4 **Q. Does Commission Staff present additional arguments to justify a reduction to**
5 **PSE’s proposed equity ratio of 48.5 ?**

6 A. Yes. Commission Staff asserts that the equity ratios of Puget Energy, Inc. (“Puget
7 Energy”) are below those of PSE.⁴⁸ The equity ratio in Puget Energy’s capital
8 structure is irrelevant to the determination of what the equity ratio should be in
9 PSE’s capital structure for ratemaking purposes. Further, PSE is the respondent in
10 this proceeding not Puget Energy.

11 **Q. How does the Commission Staff justify a reduction to PSE’s proposed equity**
12 **ratio of 48.5 percent to Commission Staff’s proposed equity ratio of**
13 **48.0 percent?**

14 A. Commission Staff asserts that the equity ratio of 48.0 percent “matches the capital
15 structure adopted by the Commission in PSE’s last rate proceeding.”⁴⁹ The fact
16 that PSE requested—and the Commission accepted—an equity ratio of
17 48.0 percent for ratemaking purposes in Dockets UE-111048 and UG-111049 is
18 irrelevant to this proceeding. That said, the Commission granted an equity ratio of
19 48 percent with a firm expectation that PSE manage its equity balance to meet

⁴⁸ Parcell, Exh. DCP-1T at 28:1-2.

⁴⁹ Parcell, Exh. DCP-1T at 28:3-4.

1 that target. In the final order in Dockets UE-111048 and UG-111049, the
2 Commission stated:

3 Moreover, we have no reason to doubt at this juncture Mr.
4 Gaines's testimony that what the Company proposes here is the
5 most likely actual capital structure during the rate year. Should this
6 turn out not to be true, a contrary result may be taken into account
7 when the Commission evaluates evidence presented in PSE's next
8 general rate case.⁵⁰

9 As PSE's testimony clearly shows, PSE has not only managed its equity balances
10 to meet the commission approved 48 percent equity ratio, it has exceeded it. The
11 Commission can expect the same performance from PSE if it approves our
12 requested increase to an equity ratio of 48.5 percent.

13 **Q. Does the Commission Staff justify a reduction from PSE's proposed equity**
14 **ratio of 48.5 percent with additional arguments?**

15 A. Yes. Commission Staff presents three more arguments. First, Commission Staff
16 asserts that the equity ratio of 48.0 percent "is similar to that of other electric and
17 combination electric utilities."⁵¹ However, the evidence refutes this assertion.

18 Commission Staff's own evidence demonstrates that

19 (i) the utilities in Mr. Parcell's own proxy group have a
20 median equity ratio of 50.4 percent and an average equity
21 ratio of 51.2 percent over the 2012-2016 period; and

⁵⁰ *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049, Order 08, ¶ 55 (May 7, 2012).

⁵¹ Parcell, Exh. DCP-1T, at 28:5-6.

1 (ii) the utilities in Dr. Morin’s proxy group have a median
2 equity ratio of 49.4 percent and an average equity ratio of
3 50.1 percent over the 2012-2016 period.⁵²

4 Thus, Commission Staff’s own evidence demonstrates that both Commission
5 Staff and PSE have proposed equity ratios that are below the median and average
6 equity ratios of the utilities in their respective proxy groups. Further, unlike
7 Commission Staff’s proposed equity ratio, PSE’s proposed equity ratio of
8 48.5 percent is fully supported by actual test year results and represents the equity
9 ratio that PSE is committed to maintaining during the rate year and beyond.

10 Second, Commission Staff asserts that PSE’s “ratings have been upgraded by
11 Moody’s and the Commission has approved revenue decoupling for both electric
12 and gas operations.”⁵³ In 2013, both Moody’s and S&P upgraded PSE’s ratings
13 almost simultaneously. Those upgrades were not unique to PSE but rather they
14 were reflective of a general across-the-board upgrade of the utility sector as a
15 whole. These upgrades are wholly unrelated to and are irrelevant with respect to
16 determining the reasonableness of PSE’s requested equity ratio. With respect to
17 decoupling, Commission Staff vaguely implies that because of the perceived risk
18 reducing nature of decoupling, the Commission should reject PSE’s request.

19 However, Commission Staff presented no evidence to justify its position and
20 ignores the fact that the Commission rejected similar arguments in the remand
21 proceedings related to the rate plan. . In the final order in the remand proceeding
22 Dockets UE-121697 and UG-121705, the Commission stated:

⁵² Parcell, Exh. DCP-7 at 2.

⁵³ Parcell, Exh. DCP-1T at 28:7-9; *see also id.*, at 30:9-17.

1 The Commission has never tried to account separately in its ROE
2 determinations for specific risks or risk mitigating factors, nor
3 should it. Circumstances in the industry today and modern
4 regulatory practice that have led to a proliferation of risk reducing
5 mechanisms being in place for utilities throughout the United
6 States make it particularly inappropriate and unnecessary to
7 consider such an undertaking. The effects of these risk mitigating
8 factors was by 2013, and is today, built into the data experts draw
9 from the samples of companies they select as proxies.⁵⁴

10 Finally, Commission Staff asserts that PSE's "'weighted cost of debt' reflecting
11 the continuation of a 48.0 percent equity ratio and a declining cost of long-term
12 debt, has declined since the 48.0 percent equity ratio was accepted by the
13 Commission."⁵⁵ I understand this quote to mean that Commission Staff argues
14 that since cost of long-term debt has declined, more debt should be used. PSE's
15 weighted cost of debt is equal to the product of PSE's debt ratio and PSE's debt
16 costs. If one of the two variable remains constant (i.e., PSE's authorized debt
17 ratio) and the other variable decreases (i.e., PSE's cost of debt), then PSE's
18 weighted cost of debt decreases. This mathematical truth neither supports nor
19 refutes PSE's proposed equity ratio of 48.5 percent. Indeed, it is irrelevant to this
20 proceeding and fails to address the fact that PSE's proposed equity ratio of
21 48.5 percent reflects the regulatory capital structure supporting PSE during the
22 test year and the regulatory capital structure expected to support PSE during the
23 rate year.

⁵⁴ *WUTC v. Puget Sound Energy*, Dockets UE-121697 and UG-121705, Order 15, ¶ 155 (June 29, 2015).

⁵⁵ Parcell, Exh. DCP-1T at 28:10-12.

1 **E. PSE Proposed Rate of Return of 7.74 Percent is Reasonable and**
2 **Should be Accepted by the Commission**

3 **Q. What rate of return is PSE requesting in this proceeding?**

4 A. PSE's requested overall rate of return in this proceeding is 7.74 percent, as shown
5 in Table 9 below and the calculations of which can be found in Exh. BJL-4:

6 **Table 9. Capital Structure and Rate of Return**

Components of Rate of Return	Capital Structure	Cost Rate	Weighted Cost
Marginal Short-Term Debt Rate	1.0%	3.06%	0.03%
Commitment Fees			0.02%
Amortization of Short-Term Debt Issue Cost			0.01%
Weighted Short-Term Debt Rate			0.06%
Marginal Long-Term Debt Rate	50.5%	5.74%	2.90%
Amortization of Reacquired Debt			0.03%
Weighted Long-Term Debt Rate			2.93%
Total Debt	51.5%		2.99%
Common Equity	<u>48.5%</u>	<u>9.80%</u>	<u>4.75%</u>
Overall Rate of Return	100.0%		7.74%

7 **1. PSE Proposed Return on Equity of 9.8 Percent is Reasonable**
8 **and Should be Accepted by the Commission**

9 **Q. Does PSE provide a response to proposed returns on equity methodologies**
10 **and related assumptions presented by Commission Staff, Public Counsel, and**
11 **ICNU?**

12 A. Yes. The Prefiled Rebuttal Testimony of Dr. Roger A. Morin, Exh. RAM-12T,
13 presents PSE's response to the appropriate models, methodologies, and
14 assumptions for determining return on equity for PSE. This rebuttal testimony

1 does not offer any comment with respect to the proper use of discounted cash
2 flow model, capital asset pricing model, risk premium models, etc., and what
3 assumptions ought to be employed in these models and methodologies, based on
4 current economic conditions.

5 **Q. Does PSE consider the allowed return on equity proposed by Public Counsel**
6 **to be reasonable?**

7 A. No. Public Counsel's proposed allowed return on equity of only 8.85 percent is
8 not reasonable by any prudent standard. Dr. Morin provides a thorough review
9 and dismantling of the various return on equity analyses of Public Counsel and
10 reaches the conclusion that the Commission should reject Public Counsel's return
11 on equity studies.⁵⁶

12 Further, Public Counsel's proposed allowed return on equity of 8.85 percent is
13 significantly below the allowed returns on equity authorized by state utility
14 commissions across the country. As Dr. Morin points out in his rebuttal
15 testimony, the averaged allowed return on equity authorized by state utility
16 commissions for electric utilities for the first three months of calendar year 2017
17 was 9.9 percent. Additionally, the average allowed return on equity for the
18 electric utilities in Public Counsel's own peer group is 10.0 percent.⁵⁷ Curiously,
19 the low end (7.7 percent) of Public Counsel's purported "range of reasonableness"
20 is closer to PSE's embedded cost of long-term debt (5.73 percent) than it is to

⁵⁶ See generally Morin, Exh. RAM-12T.

⁵⁷ See Morin, Exh. RAM-12T at [xx]:Table 1.

1 either PSE's currently allowed return on equity (9.8 percent) or the average
2 allowed return on equity of Public Counsel's own peer group (10.0 percent).

3 **Q. Does PSE have any comment on the allowed return on equity proposed by**
4 **Commission Staff?**

5 A. Commission Staff recommends an allowed return on equity for PSE in the range
6 of 8.85 percent to 9.5 percent.⁵⁸ In his rebuttal testimony, Dr. Morin makes
7 necessary adjustments to Commission Staff's studies, and these adjustments result
8 in an amended range of 9.0 percent to 10.5 percent.⁵⁹

9 **Q. Does PSE have an comment on the allowed return on equity proposed by**
10 **ICNU?**

11 A. Although ICNU does not present its own independent return on equity analyses,
12 ICNU appears to recommend an allowed return on equity for PSE in the range of
13 8.6 percent to 9.6 percent based on adjustments made to Dr. Morin's return on
14 equity analyses.⁶⁰ In his rebuttal testimony, Dr. Morin makes necessary
15 adjustments to ICNU's adjustments, and these adjustments result in an amended
16 range of 9.3 percent to 10.7 percent.⁶¹

⁵⁸ Parcell, Exh. DCP-1T at 4:2-5.

⁵⁹ Morin, Exh. RAM-12T at 64:1 – 82:6.

⁶⁰ Parcell, Exh. DCP-1T at 4:4-6.

⁶¹ Morin, Exh. RAM-12T at 82:7 – 95:13.

1 **Q. Is PSE's proposed allowed return on equity of 9.8 percent reasonable?**

2 A. Yes. PSE's proposed allowed return on equity of 9.8 percent is reasonable for
3 several reasons.

4 First, PSE's proposed allowed return on equity of 9.8 percent is below the average
5 allowed return on equity authorized by state utility commissions for electric
6 utilities for the three months ended March 31, 2017. As stated in the Prefiled
7 Rebuttal Testimony of Dr. Roger A. Morin, Exh. RAM-12T, the average allowed
8 return on equity authorized by state utility commissions for electric utilities for
9 the three months ended March 31, 2017, was 9.9 percent.

10 Second, Dr. Morin's return on equity analyses produced a recommended allowed
11 return on equity for PSE in the range of 9.3 percent to 10.7 percent. The average
12 estimate was 9.9 percent, the median result was 9.8 percent, and the truncated
13 mean was 9.9 percent.⁶² In light of those central results, the allowed return on
14 equity of 9.8 percent requested by PSE is reasonable.

15 **2. PSE Proposed Costs of Debt are Reasonable and Should be**
16 **Accepted by the Commission**

17 **Q. Does any party to this proceeding question PSE's proposed marginal short-**
18 **term debt rate of 3.06 percent?**

19 A. No party to this proceeding questions PSE's proposed marginal short-term debt
20 rate of 3.06 percent. Each of Commission Staff and Public Counsel expressly

⁶² Morin, Exh. RAM-1T at 55:13-16.

1 adopts PSE's proposed marginal short-term debt rate of 3.06 percent.⁶³ ICNU's
2 cost of capital testimony does not address PSE's cost of long-term debt.⁶⁴

3 **Q. Does any party to this proceeding question PSE's proposed marginal long-**
4 **term debt rate of 5.73 percent?**

5 A. No party to this proceeding questions PSE's proposed marginal long-term debt
6 rate of 5.73 percent. Each of Commission Staff and Public Counsel expressly
7 adopts PSE's proposed marginal long-term debt rate of 5.73 percent.⁶⁵ ICNU's
8 cost of capital testimony does not address PSE's cost of short-term debt.⁶⁶

9 **Q. Does any party to this proceeding question PSE's proposed adjustments to**
10 **the short-term and long-term debt cost rate for commitment fees and**
11 **amortization of term issuance costs and reacquired debt?**

12 A. No party to this proceeding expressly questions either (i) PSE's proposed
13 adjustments to the weighted short-term debt of 0.02 percent for commitment fees
14 and 0.01 percent for the amortization of short-term issue costs or (ii) PSE's
15 proposed adjustments to the weighted long-term debt of 0.03 percent for the
16 amortization of reacquired debt. In fact, Public Counsel's cost of capital
17 testimony expressly adopts PSE's proposed adjustments to the short-term and

⁶³ See Parcell, Exh. DCP-1T at 31:2-4; Woolridge, Exh. JRW-1T at 23:12-13.

⁶⁴ See generally Gorman, Exh. MPG-1T.

⁶⁵ See Parcell, Exh. DCP-1T at 31:2-4; Woolridge, Exh. JRW-1T at 23:12-13.

⁶⁶ See generally Gorman, Exh. MPG-1T.

1 long-term debt cost rate for commitment fees and amortization of term issuance
2 costs and reacquired debt.⁶⁷

3 Although Commission Staff's cost of capital testimony does not question these
4 adjustments proposed by PSE, it also fails to include the adjustments in the
5 calculation of PSE's proposed overall rate of return for PSE. Therefore, the
6 Commission should adjust

- 7 (i) Commission Staff's weighted short-term debt rate from
8 0.03 percent to 0.06 percent to reflect commitment fees and
9 the amortization of short-term issue costs and
- 10 (ii) Commission Staff's weighted long-term debt rate from
11 2.92 percent to 2.95 percent to reflect the amortization of
12 reacquired debt.

13 These adjustments to the weighted short-term and long-term debt rates would
14 similarly require adjustment of Commission Staff's recommended rate of return
15 by 0.06 percent. Assuming Commission Staff's proposed return on equity of
16 9.20 percent on a capital structure with an equity ratio of 48.0 percent, this would
17 increase Commission Staff's recommended rate of return from 7.37 percent to
18 7.43 percent.⁶⁸

⁶⁷ See Woolridge, Exh. JRW-1T at 23:13-15.

⁶⁸ PSE provides these adjustments for illustrative purposes only to show the effects on Commission Staff's proposed rate of return of the adjustments to the weighted short-term and long-term debt rates necessary to reflect commitment fees, the amortization of short-term issue costs, and the amortization of reacquired debt. For the reasons discussed elsewhere in this testimony and in the Prefiled Rebuttal Testimony of Dr. Roger A. Morin, Exh. RAM-12T, Commission Staff's proposed return on equity of 9.20 percent on a capital structure with an equity ratio of 48.0 percent is neither reasonable nor reflective of PSE's cost of equity or capital structure.

1 **V. THE COMMISSION SHOULD REJECT ICNU'S AND**
2 **COMMISSION STAFF'S PROPOSALS REGARDING**
3 **DEPRECIATION/AMORTIZATION, DECOMMISSIONING AND**
4 **REMEDATION COSTS OF COLSTRIP UNITS 1 AND 2**

5 **Q. Why should the Commission reject ICNU's and Commission Staff's**
6 **proposals?**

7 A. First, neither proposal is consistent with the intent of the legislation to use
8 regulatory liabilities to recover decommissioning and remediation costs. Second,
9 neither proposal provides for full recovery of decommissioning and remediation
10 costs supported by PSE in its testimony. Last, neither proposal provides full cost
11 recovery of the undepreciated balance of Colstrip Units 1 and 2 that reliably and
12 cost effectively served customers for over 45 years.

13 **Q. Does PSE have other concerns with Commission Staff's proposal?**

14 A. Yes. Commission Staff's proposal to amortize approximately \$127 million of
15 undepreciated plant costs over 18 years with no return will require PSE to incur
16 an approximate \$33 million write-off under the Plant Abandonment Accounting
17 standards prescribed by Generally Accepted Accounting Principles ("GAAP").
18 This result could potentially require PSE to make an equity infusion to maintain
19 equity in its capital structure at 48.5 percent. It is not clear from Commission
20 Staff's proposal whether it contemplated the necessity for a write-off as a result of
21 its proposal. Regardless, the write-off itself coupled with the resulting challenge
22 to maintain equity in the capital structure at 48.5 percent imposes double jeopardy
23 on PSE.

1 This impact is exacerbated by the approximate \$60 million write-off that would
2 be required if the Commission were to adopt Commission Staff's storm
3 accounting and cost recovery proposal. Again, it is not clear whether Commission
4 Staff contemplated write-offs of storm costs previously deferred in full
5 accordance with long standing Commission policy. In short, the double jeopardy
6 is compounded.

7 In summary, the full impact of Commission Staff's proposals that would result in
8 accounting write-offs, whether intended or not, is punitive, inappropriate,
9 unnecessary, and can only be proffered to deny recovery of otherwise prudently
10 incurred costs.

11 **Q. Does PSE have a similar concern with ICNU's proposal?**

12 A. Yes. ICNU's proposal would result in a write-off under GAAP for the Colstrip
13 Units 1 and 2, but the calculation would be more involved and complex because
14 ICNU appears to provide at least a partial return in its approach. Accordingly,
15 more through and detailed analysis would be required to develop a reliable
16 estimate of the write-off.

1 **VI. PSE'S REVENUE DECOUPLING MECHANISM HAS**
2 **WORKED WELL AND SHOULD CONTINUE TO WORK WELL**
3 **WITH THE MINOR ADJUSTMENTS PROPOSED BY PSE**

4 **A. The Commission Should Adopt PSE's Modest Proposals to the**
5 **Earnings Sharing Mechanism and Adopt PSE's Recommendations**
6 **Concerning the Dead Band**

7 **1. The Commission Should Adopt PSE's Recommendation to**
8 **Exclude Normalizing Adjustments from the Earnings Sharing**
9 **Calculation of the Earnings Sharing Mechanism**

10 **Q. Does PSE have any response to criticisms of PSE's recommendation to**
11 **exclude normalizing adjustments from the earnings sharing calculation of**
12 **the earnings sharing mechanism?**

13 A. Yes. First, to clarify the record, Commission Staff mischaracterizes PSE's direct
14 testimony by suggesting that "the earnings sharing element in the 2013 rate plan
15 is unfair."⁶⁹ PSE's direct testimony never claims that the earnings sharing
16 mechanism in the 2013 rate plan was unfair. To the contrary, PSE's direct
17 testimony illustrates with two very simple hypothetical examples and an actual
18 example (based off of the electric and gas commission basis reports filed for the
19 twelve months ended December 31, 2015) the following point—normalization
20 adjustments can skew, have skewed, and will likely continue to skew the
21 measurement of financial performance for excess earnings sharing purposes.⁷⁰

⁶⁹ Schooley, Exh. TES-1T at 14:2.

⁷⁰ See Doyle, Exh. DAD-1T at 16:21 – 21:6.

1 Second, both Commission Staff⁷¹ and Public Counsel⁷² (and ICNU, although to a
2 more limited extent⁷³) engage in an inconclusive exploration of why
3 normalization adjustments, as they have been traditionally used in the commission
4 basis reports, are appropriate in the determination of excess earnings for sharing
5 purposes. However, not one of these three witnesses directly addresses the
6 economics illustrated in the examples— both hypothetical and real— presented in
7 my direct testimony.

8 Third, not one witness addresses the recommendation that excess earnings for
9 sharing purposes be calculated from PSE's *actual* financial results that are not
10 altered or adjusted by normalizing adjustments. Indeed, each of Commission
11 Staff, Public Counsel, and ICNU overlook the central tenet of PSE's concern and
12 recommendation—i.e., actual, non-normalized financial results reconcile directly
13 with and to PSE's bank account and cash position, whereas hypothetical,
14 normalized financial results do not.

15 **Q. Why is this important?**

16 A. Common sense dictates that whatever excess earnings calculation is utilized by
17 the Commission in the future, it should have a strong tie to actual economic
18 results. If an earnings sharing calculation determines that excess earnings exist
19 and should be shared, PSE should actually see those excess earnings in its bank

⁷¹ See generally Schooley, Exh. TES-1T at 14:1 – 15:17.

⁷² See generally Liu, Exh. JL-1CT at 4:1 – 23:4.

⁷³ See generally Gorman, Exh. MPG-1CT at 34:10 – 35:20.

1 account. Conversely, if an earnings sharing calculation determines that no excess
2 earnings exist and no sharing is required, PSE should be able to provide evidence
3 of under-earning through incremental borrowings. This is simply not the case with
4 normalized earnings, as demonstrated in my prefiled direct testimony.

5 PSE's recommendation to modify the earnings sharing mechanism simply aligns
6 the mechanism to economic realities. In other words, PSE should share *actual*
7 excess earnings only if excess earnings actually exist and should not share
8 *phantom* excess earnings that result solely from normalizing adjustments.

9 **Q. Does this suggest that normalizing adjustments utilized in the commission**
10 **basis report calculations do not represent economic reality?**

11 A. No. PSE's direct testimony in this proceeding never suggested that normalizing
12 adjustments utilized in the commission basis report calculations do not represent
13 economic reality. Rather, PSE's direct testimony expressly stated as follows:

14 The commission basis report is an important document for
15 monitoring a utility's earnings performance on a normalized test
16 year basis between rate cases. It answers the question, "if the
17 company filed a rate case for the test year/reporting period in
18 question, would it be under or over earning its allowed rate of
19 return after considering all appropriate conforming and
20 normalizing adjustments?" In this regard, the commission basis
21 report provides timely and useful information not only to the
22 Commission but to PSE and intervenors as well. That said the
23 normalized rate of return calculation included in the commission
24 basis report are not an inappropriate mechanism for calculating
25 excess earnings with respect to earning sharing mechanisms.⁷⁴

⁷⁴ Doyle, Exh. DAD-1T at 16:11-20.

1 Neither PSE's analysis nor its recommendation regarding the earnings sharing
2 mechanism applies to normalized earnings in the commission basis report itself,
3 but rather each suggests an improvement to the earnings sharing calculation based
4 on empirical data for purposes of the earnings sharing mechanism.

5 **Q. Has PSE analyzed the level of phantom excess earnings that result solely**
6 **from normalizing adjustments that PSE has refunded to customers?**

7 A. Yes. As of December 31, 2016, PSE refunded excess earnings of \$22,305,805 for
8 electric operations and \$8,660,023 for gas operations to customers. However,
9 excess earnings PSE actually earned during the same time period was \$5,142,532
10 for electric operations and \$786,610 for gas operations. Therefore, PSE refunded
11 excess phantom earnings of \$17,163,273 for electric operations and \$7,873,413
12 for gas operations to customers.

13 **Q. Is PSE asking the Commission to accept PSE's recommendation to exclude**
14 **normalizing adjustments from the earnings sharing calculation of the**
15 **earnings sharing mechanism and apply that mechanism retroactively for the**
16 **period of the rate plan?**

17 A. No. Even though PSE has refunded phantom excess earnings of over \$25 million
18 to customers as of December 31, 2016, PSE seeks solely to improve the
19 prospective application of the earnings sharing mechanism.

1 **Q. How does PSE recommend that the Commission proceed?**

2 A. First, PSE recommends that the Commission specifically order that normalizing
3 adjustments be excluded from the calculation of the excess earnings on a
4 prospective basis. The exclusion of normalizing adjustments from the earnings
5 sharing calculation ensures that future calculations of excess earnings more
6 closely reconcile with PSE's bank account and cash position. Further, a
7 Commission directive to specifically exclude normalizing adjustments from the
8 earnings sharing calculation would provide PSE, Commission Staff, and other
9 parties clear direction for the future: normalizing adjusting entries should no
10 longer be included in the calculation of *actual* excess earnings.

11 Second, the Commission should allow PSE to file a revised earnings sharing
12 mechanism that (i) excludes normalizing adjustments and (ii) addresses the
13 intricacies and interactions of the earnings sharing mechanism with certain
14 components of decoupling and the power cost adjustment mechanism.

15 Mr. Schooley is correct that further analysis is warranted to gain clarity around
16 the interaction of the various mechanisms that interface with and operate within
17 PSE's earnings sharing mechanism. This would give stakeholders an opportunity
18 to address the complex issues inherent in the earning sharing mechanism in a
19 transparent and collaborative manner. Further analysis of the earnings sharing
20 mechanism could address potentially clear misunderstandings regarding the
21 mechanism. For example, Commission Staff testimony asserts as follows:

22 Temperature normalizing is a moot point for the decoupling
23 delivery cost. PSE also proposes that fixed power cost be included

1 in the per customer decoupling calculation. If so, temperature will
2 no longer have an effect on the recovery of delivery costs *or* fixed
3 power costs.⁷⁵

4 This assertion is incorrect to the extent that (i) 24-month GAAP revenue
5 recognition reserves are established, which reduce decoupled revenues in a given
6 period, or (ii) 24-month GAAP revenue recognition reserves are reversed, which
7 increase decoupled revenue in a given period. Continued analysis of the earnings
8 sharing mechanism and discourse among stakeholders regarding the interplay of
9 many factors in the earnings sharing calculation could serve to improve the
10 mechanism and reflect PSE's actual earnings, bank account balances and cash
11 position.

12 **2. The Commission Should Adopt PSE's Proposal to Reintroduce**
13 **the 25 Basis Point Dead Band into the Earnings Sharing**
14 **Mechanism**

15 **Q. Has any party addressed PSE's proposal to reintroduce the 25 basis point**
16 **dead band into the earnings sharing mechanism?**

17 A. Yes. Commission Staff summarily dismisses PSE's proposal to reintroduce the
18 25 basis point dead band into the earnings sharing mechanism by asserting that "a
19 dead band simply provides an avenue by which [PSE] avoids sharing in gained
20 efficiencies."⁷⁶ Public Counsel suggests that a dead band in the sharing
21 mechanism "would weaken the consumer protection provided by the earnings

⁷⁵ Schooley, Exh. TES-1T at 14:22 – 15:3 (italics in original).

⁷⁶ Liu, Exh. JL-1CT at 61:2-3.

1 test”⁷⁷ ICNU opposes PSE’s proposed dead band but suggests that the
2 Commission could “require PSE to retain all earnings within the 25 basis points
3 dead band but refund to customers 100% of all earnings above the 25 basis points
4 dead band (excess earnings).”⁷⁸ Finally, Kroger acknowledges the asymmetrical
5 nature of the earnings sharing mechanism but opposes the PSE proposal for a
6 dead band.⁷⁹

7 **Q. Is Commission Staff correct that PSE’s proposal to reintroduce the 25 basis**
8 **point dead band into the sharing mechanism would allow PSE to avoid**
9 **sharing in gained efficiencies?**

10 A. No. Commission Staff is incorrect in asserting that PSE’s proposal to reintroduce
11 the 25 basis point dead band into the sharing mechanism would allow PSE to
12 avoid sharing in gained efficiencies.

13 First, Commission Staff relies on the Commission’s 2013 Decoupling Order,⁸⁰ in
14 which the Commission suggested that a dead band was inappropriate because
15 PSE’s return on equity, at that time, appeared to be in the higher end of the range
16 of reasonableness. Commission Staff implies from this statement “PSE is already
17 enjoying profits beyond what it would enjoy if the authorized return on equity

⁷⁷ Brosch, Exh. MLB-1T at 51:20-21.

⁷⁸ Gorman, Exh. MPG-1T at 34:24 – 35:2.

⁷⁹ See Higgins, Exh. KCH-1T, at 16:17 – 17:5.

⁸⁰ *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy, Inc.*, Dockets UE-121697, UG-121705, UE-130137, and UG-130138, Order 07 (Jun. 25, 2013) (the “2013 Decoupling Order”).

1 were at the midpoint of reasonableness.”⁸¹ This reasoning, however, is limited to
2 the facts and circumstances in existence at the time of the 2013 Decoupling Order
3 and has no bearing with respect to the prospective application of the earnings
4 sharing mechanism.

5 Second, Commission Staff asserts that PSE has proposed “a return on equity that
6 is objectively high”⁸² and that PSE’s “profits do not need to be expanded beyond
7 what the Commission determines is appropriate.”⁸³ Simply put, Commission
8 Staff’s argument is circular and fails to address the substance of PSE’s proposal.
9 The Commission will determine PSE’s return on equity and revenue requirement
10 in this proceeding. To assume an *ex post* result (i.e., the Commission will grant an
11 increase in PSE’s revenue requirement in this proceeding based on PSE’s
12 requested ROE of 9,8%, which Commission Staff views as “objectively high”) to
13 take an *ex ante* position (i.e., the Commission should not adopt PSE’s proposal to
14 reintroduce the 25 basis point dead band into the sharing mechanism) is flawed
15 logic.

16 In short, Commission Staff failed to provide a substantive response to the
17 asymmetrical earnings profile presented by PSE.

⁸¹ Liu, Exh. JL-1CT at 60:13-16.

⁸² Liu, Exh. JL-1CT at 60:18.

⁸³ Liu, Exh. JL-1CT at 60:19-20.

1 **Q. How does PSE respond to arguments made by Public Counsel in opposition**
2 **to PSE’s proposal to reintroduce the 25 basis point dead band into the**
3 **sharing mechanism?**

4 A. Public Counsel presents a rather confusing exploration of several unrelated issues
5 in apparent response to PSE’s proposal to reintroduce the 25 basis point dead
6 band into the sharing mechanism. Public Counsel randomly discusses PSE’s
7 control over cost management issues,⁸⁴ asserts that PSE has an information
8 advantage in regulatory proceedings,⁸⁵ and confounds the presentation by
9 referring to PSE’s revenue decoupling mechanism, formalized expedited rate
10 filing proposal, and electric cost recovery mechanism proposal.⁸⁶ None of this is
11 relevant. Public Counsel, like Commission Staff, simply fails to address the
12 substance of PSE’s proposal to reintroduce the 25 basis point dead band into the
13 sharing mechanism.

14 Like Commission Staff, Public Counsel failed to provide a substantive response to
15 the asymmetrical earnings profile presented by PSE.

⁸⁴ Brosch, Exh. MLB-1T at 50:12-14.

⁸⁵ Brosch, Exh. MLB-1T at 50:14-21.

⁸⁶ Brosch, Exh. MLB-1T at 50:22 – 51:3.

1 **Q. How does PSE respond to arguments made by Kroger in opposition to PSE's**
2 **proposal to reintroduce the 25 basis point dead band into the sharing**
3 **mechanism?**

4 A. Kroger attempts to argue that there is an inherent tradeoff between (i) the benefits
5 of decoupling and (ii) the asymmetrical structure of the earnings sharing
6 mechanism. Kroger fails to provide any evidence whatsoever of a connection
7 between decoupling and the lack of a dead band in the earning sharing
8 mechanism.

9 As previously mentioned, the sole basis provided by the Commission for rejection
10 of the 25 basis dead band proposed by PSE and NWECA in the original earnings
11 sharing mechanism was the Commission's view that PSE's return on equity was
12 in the higher end of the range of reasonableness at the time of issuance of the
13 2013 Decoupling Order:

14 However, we do determine that the currently authorized 9.8
15 [percent return on equity], which we determined to be in the
16 middle of the range of reasonableness in PSE's last rate case, now
17 at best is in the higher end of that range.

18 Accordingly, we determine that to the extent PSE's earnings
19 exceed its currently authorized rate of return (ROR) of
20 7.80 percent (which will be adjusted slightly downward on its
21 compliance filing due to lower long-term debt costs), [PSE] and
22 consumers should share 50 percent each of such potential over-
23 earning.⁸⁷

⁸⁷ 2013 Decoupling Order at ¶¶ 164-65.

1 Kroger fails to provide any evidence of any alleged trade-off between the revenue
2 decoupling mechanism and the asymmetrical nature of the earnings sharing
3 mechanism, presumably because no such tradeoff exists.

4 Further, Kroger's argument appears to suggest that the lack of a dead band in the
5 earnings sharing mechanism could serve as a disguised reduction in PSE's return
6 on equity due to decoupling. For example, the Kroger testimony asserts that the
7 lack of a dead band in the earning sharing mechanism reflected a tradeoff
8 necessary due to a purported transfer in risk resulting from approval of PSE's
9 revenue decoupling mechanism:

10 The approval of PSE's current revenue decoupling mechanism
11 transferred risk from [PSE] to customers. It was an asymmetrical
12 transfer to the benefit of PSE. If, in partial mitigation of that
13 transfer, an earnings test was adopted, it is not necessary for the
14 earnings test itself to be symmetrical since it was adopted to
15 partially mitigate the effects of a ratemaking change that itself was
16 not symmetrical.⁸⁸

17 If, and to the extent, that Kroger suggests that the rejection of PSE's proposal to
18 reintroduce the dead band to the earnings sharing mechanism could substitute as a
19 reduction in PSE's return on equity due to the presence of the revenue recoupling
20 mechanism, such a suggestion would be improper. The Commission has already
21 expressly determined that the risk reducing effect of decoupling is reflected in the
22 underlying data used to determine allowed returns on equity and that a separate
23 adjustment is unnecessary:

⁸⁸ Higgins, Exh. KCH-1T at 16:19 – 17:1.

1 In sum, we find persuasive the expert opinions of Dr. Morin and
2 Mr. Gorman and find that the risk reducing effect of decoupling is
3 reflected adequately in the data derived from the companies in
4 their respective proxy groups. We reject the idea of a separate
5 decrement to ROE to account for the same risk reduction. We also
6 find persuasive the point that cost of capital analysis cannot
7 achieve the level of granularity necessary to support a discrete
8 adjustment to ROE to account for particularized risks—up or
9 down.⁸⁹

10 **Q. How does PSE respond to arguments made by ICNU in opposition to PSE’s**
11 **proposal to reintroduce the 25 basis point dead band into the sharing**
12 **mechanism?**

13 A. Although the ICNU testimony purports to reject PSE’s proposal to reintroduce the
14 25 basis point dead band into the sharing mechanism, it does appear to agree with
15 PSE regarding the asymmetrical effects of the existing earnings sharing
16 mechanism. To that end, ICNU offers an alternative modification to the earnings
17 sharing mechanism that would (i) reintroduce the 25 basis point dead band into
18 the sharing mechanism and (ii) institute a “hard cap” in which PSE would refund
19 to customers 100% of all earnings above the 25 basis points dead band.⁹⁰ ICNU
20 asserts that its alternative proposal would provide a middle ground that corrects
21 the asymmetrical aspect of the current earnings sharing mechanism while
22 mitigating rate impacts:

23 This will accomplish PSE’s objective of symmetrical earnings
24 around the authorized equity return over time while also mitigating
25 rate impacts on customers. In effect, PSE can earn less than its

⁸⁹ *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy, Inc.*, Dockets UE-121697, UG-121705, UE-130137, and UG-130138, Order 15/14 at ¶ 156 (June 29, 2015).

⁹⁰ Gorman, Exh. MPG-1T at 34:23 – 35:2.

1 authorized returns in some years, and make up the under earnings
2 in other years with the 25 basis point dead band. This corrects the
3 asymmetrical aspect of the current earnings sharing mechanism
4 that was a concern expressed by Mr. Doyle. However, requiring
5 100% of excess earnings to be refunded to customers will mitigate
6 the rate impacts on PSE's customers while still providing PSE with
7 fair and reasonable compensation.⁹¹

8 This proposal presents an interesting middle ground, and while it is not perfect, it
9 is an alternative that PSE could accept.

10 **Q. Does PSE still propose to reintroduce the 25 basis point dead band into the**
11 **sharing mechanism?**

12 A. Yes. PSE still proposes that the Commission allow PSE to reintroduce the
13 25 basis point dead band into the earnings sharing mechanism as originally
14 proposed by PSE and NWEA. Doing so will reestablish parity and balance in
15 PSE's earnings profile and eliminates the need for any adjustment to return on
16 equity. To the extent the Commission opposes reintroducing the 25 basis point
17 dead band, it should consider no less than a 14 basis point adder to Dr. Morin's
18 recommended return on equity, which is supported by the Third Exhibit to the
19 Prefiled Direct Testimony of Daniel A. Doyle, Exh. DAD-4. Alternatively, PSE
20 would accept the alternative proposed by ICNU as discussed above.

⁹¹ Gorman, Exh. MPG-1T at 35:3-10.

1 **B. The Commission Should Adopt PSE's Proposal to Increase the Cap**
2 **from 3 Percent to 5 Percent**

3 **Q. Please summarize the various parties' responses to PSE's proposal to**
4 **increase the cap rate test in the decoupling mechanisms from 3 percent to**
5 **5 percent.**

6 A. Commission Staff supports increasing the rate cap to 5 percent for all customers
7 subject to the decoupling mechanisms.⁹² This includes non-residential gas
8 customers for which PSE had recommended retaining the three percent cap.
9 Public Counsel, Kroger, and FEA recommend retaining the existing rate cap of 3
10 percent.⁹³ FEA would witness goes one step further by recommending that the
11 soft cap be replaced with a hard cap.⁹⁴ NW Energy Coalition, Renewable
12 Northwest, and Natural Resources Defense Council support a 5 percent rate cap
13 for gas residential customers until PSE's next rate filing where improvement to
14 weather forecasting can be implemented⁹⁵ but reject the increase for residential
15 electric customers.⁹⁶ The Energy Project similarly expresses concerns about
16 PSE's proposed increases to the rate caps.⁹⁷

⁹² Liu, Exh. JL-1CT at 64:1-4.

⁹³ Brosch, Exh. MLB-1T at 46:7-8. Higgins, Exh. KCH-1T at 17:11-15. Al-Jabir, Exh. AZA-1T at 16:12-18.

⁹⁴ Al-Jabir, Exh. AZA-1T at 17:6-15.

⁹⁵ Levin, Exh. AML-1T at 24:17-21.

⁹⁶ *Id.* at 25:21-26:2.

⁹⁷ Collins, Exh. SMC-1T at 27.

1 **Q. How does PSE respond to calls for a change to PSE’s proposed rate cap**
2 **levels?**

3 A. As discussed in the Prefiled Rebuttal Testimony of Jon A. Piliaris, Exh. JAP-
4 46CT, PSE recommends, at a minimum, that the Commission adopt 5 percent
5 caps for both the gas and electric residential customers. If and to the extent that
6 the Commission has any concerns about the potential for higher deferrals for the
7 non-residential customers that may present cost shifting between current and
8 future customers, the Commission may also want to raise the rate caps for these
9 customers as well. This would be in line with the decoupling mechanism recently
10 approved for PacifiCorp and, as suggested by Commission Staff, would simplify
11 the tariff.⁹⁸

12 Please see Prefiled Rebuttal Testimony of Jon A. Piliaris, Exh. JAP-46CT, for
13 PSE’s detailed response to calls for a change to PSE’s proposed rate cap levels.

14 **C. The Commission Should Adopt PSE’s Proposal to Recover Fixed**
15 **Production Costs in the Decoupling Mechanism**

16 **Q. Please summarize the various parties’ responses to PSE’s proposed inclusion**
17 **of fixed production costs in its electric decoupling mechanism.**

18 A. Commission Staff agrees with PSE’s proposal to include fixed production costs,
19 but proposes that allowed fixed production costs be set at a fixed level rather than

⁹⁸ Liu, Exh. JL-1CT at 64:3-4.

1 tied to the number of customers.⁹⁹ Public Counsel takes this a step further and
2 recommends that all costs within PSE's decoupling mechanisms, including fixed
3 production costs, be set at a fixed level rather than being tied to the number of
4 customers.¹⁰⁰ NW Energy Coalition, Renewable Northwest, and Natural
5 Resources Defense Council have concerns with the inclusion of fixed production
6 costs within PSE's electric decoupling mechanism but outline two alternatives
7 that would allay those concerns: (1) return the recovery of fixed production costs
8 to PSE's PCA mechanism or (2) recalculate the allowed fixed production costs
9 per customers annually to reflect the expected average customer count and any
10 cost changes for the applicable year.¹⁰¹ Kroger and FEA recommend against
11 including fixed production costs in PSE's electric decoupling mechanism.¹⁰²

12 **Q. How does PSE respond to these proposals?**

13 A. As discussed in the Prefiled Rebuttal Testimony of Jon A. Piliaris, Exh. JAP-
14 46CT, the inclusion of fixed production costs in the revenue decoupling
15 mechanism would substantially align the recovery of all production costs across
16 the Commission's three jurisdictional electric utilities, where each utility would
17 recover fixed production costs through their decoupling mechanisms and each
18 would recover variable production costs through their PCA-like mechanisms.

⁹⁹ Liu, Exh. JL-1CT at 49:1-8.

¹⁰⁰ Brosch, Exh. MLB-1T at 35:11-17.

¹⁰¹ Levin, Exh. AML-1T at 22:8-23:8.

¹⁰² Higgins, Exh. KCH-1T at 15:1-5. Al-Jabir, Exh. AZA-1T at 15:21-16:5.

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Please see Prefiled Rebuttal Testimony of Jon A. Piliaris, Exh. JAP-46CT, for PSE’s detailed response to proposals regarding the recovery of fixed production costs in the revenue decoupling mechanism.

VII. CONCLUSION

Q. Does this conclude your rebuttal testimony?

A. Yes.