

**BEFORE THE WASHINGTON  
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

DOCKETS UE-170033 and  
UG-170034 (*consolidated*)

ORDER 08

FINAL ORDER REJECTING TARIFF  
SHEETS; APPROVING AND  
ADOPTING SETTLEMENT  
STIPULATION; RESOLVING  
CONTESTED ISSUES; AND  
AUTHORIZING AND REQUIRING  
COMPLIANCE FILING

***Synopsis:** The Commission approves and adopts a Settlement Stipulation that all parties to this proceeding except Public Counsel support as proposed resolutions of most of the many issues initially contested. The Settlement Stipulation would establish new revenue requirements, update PSE's cost of capital, address increased depreciation expense established in connection with shortened depreciation schedules for PSE's coal-fired production assets in Colstrip, Montana, accept numerous uncontested individual revenue requirement adjustments, and resolve several individual adjustments to which Public Counsel objects, including depreciation of natural gas capital investments, pension expense, non-Colstrip environmental remediation costs, storm damage expense, and the costs of assets held for future use. The Settling Parties agreed to, and the Commission approves in this Order, an overall electric revenue increase of \$20 million (1.0 percent increase) and an overall natural gas revenue decrease of \$35 million (3.9 percent decrease).*

*The Settlement Stipulation also addresses several contested non-revenue issues, including guidelines for a possible expedited rate filing (ERF) to update PSE's rates within 12 months after the date of this order, plans to address the continuation of the Company's water heater program, and a changed metric for PSE's Service Quality Index. Finally, the Settlement Stipulation expressly recognizes as prudent eight projects, including capital projects improving or acquiring production, distribution, and storage assets, a power purchase agreement acquiring additional hydropower, new and renewed BPA transmission contracts, and deferred non-Colstrip depreciation expense.*

*The Commission, in addition, resolves a number of fully contested non-revenue issues related to decoupling, class cost of service studies, rate spread, rate design, and PSE's proposed cost recovery mechanism for certain capital costs. The parties to the Settlement Stipulation agreed these issues should be reserved for decision on the basis of a fully developed record and the parties' briefing of the issues. The Commission's decisions on these issues are summarized briefly in the discussion of Commission determinations in the Summary section of this Order at paragraphs 8 – 23.*

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**SUMMARY**

- 1 **PROCEEDINGS:** On January 13, 2017, Puget Sound Energy (PSE or Company) filed with the Washington Utilities and Transportation Commission (Commission) revisions to its currently effective Tariffs WN U-60, Electric Service, and WN U-2, Natural Gas Service. This is PSE's first general rate case since Dockets UE-011048/UG-011049, filed in 2011 and resolved by the Commission's Final Order in 2012.<sup>1</sup> PSE's rate schedules, however, have been adjusted several times since May 2012 following the Commission's approval in June 2013 of a multi-year Rate Plan.
- 2 The Commission's 2013 order updated the rates approved in 2011 based on a novel approach identified as an Expedited Rate Filing (ERF) that allowed limited adjustments to rates. The order also approved full decoupling for electric and natural gas rates, and the use of a so-called K-factor that provided for modest annual rate increases during the term of the Rate Plan.<sup>2</sup> These adjustments to the rate schedules approved in 2012 offset to a significant degree the Company's proposed increase to base rates in this case. Including the impacts of these offsets, PSE stated in its filing that the net impact to customers' rates was anticipated to be an increase in electric rates of \$86,694,000 (4.1 percent) and a decrease to natural gas rates of \$22,323,105 (-2.4 percent).<sup>3</sup>
- 3 The Commission, in Order 01, suspended the tariff filings on January 19, 2017, consolidated the two dockets, and determined that it would hold public hearings, as necessary, to determine whether the proposed increases are fair, just, reasonable, and sufficient.<sup>4</sup> The Commission held two public comment hearings, an evidentiary hearing

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<sup>1</sup> *WUTC v. Puget Sound Energy*, Dockets UE-011048 and UG-011049 (consolidated), Order 08 (May 7, 2012).

<sup>2</sup> *In the Matter of the Petition of Puget Sound Energy and NW Energy Coalition For an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms*, Dockets UE-121697 and UG-121705 (consolidated) (Decoupling) and *Washington Utilities and Transportation Commission v. Puget Sound Energy*, Dockets UE-130137 and UG-130138 (consolidated) (ERF), Order 07 - Final Order Granting Decoupling Petition and Final Order Authorizing ERF Rates (June 25, 2013) (Order 07-2013 Rate Plan).

<sup>3</sup> On April 3, 2017, PSE filed supplemental testimony proposing an increase of \$68.3 million, or 3.2 percent for electric, and a rate decrease of \$29.3 million, or 3.2 percent for gas. On August 9, 2017, PSE filed rebuttal testimony revising its position on several issues, and incorporating the revenue requirement updates provided in its supplemental filing. The Company's rebuttal rate request was an increase of \$57.9 million, or 2.8 percent for electric, and a rate decrease of \$29.4 million, or 3.4 percent for gas.

<sup>4</sup> The suspension date for the as-filed tariffs is December 13, 2017.

on contested issues, and an evidentiary hearing concerning a contested multi-party, partial settlement.<sup>5</sup> The Settlement Stipulation, if approved, would resolve most issues in these dockets, including all revenue requirements issues. In this Order, the Commission makes its determinations concerning all uncontested and contested adjustments to revenue requirements and rates in this Final Order, and resolves important non-revenue and policy issues presented by the parties.

- 4 **PARTY REPRESENTATIVES:**<sup>6</sup> Sheree Strom Carson, Jason Kuzma, Donna Barnett, and Jason S. Steele, Perkins Coie LLP, Bellevue, Washington, represent PSE. Lisa W. Gafken and Armikka R. Bryant, Assistant Attorneys General, Seattle, Washington, represent the Public Counsel Unit of the Washington State Attorney General’s Office (Public Counsel). Sally Brown, Senior Assistant Attorney General, and Julian Beattie, Jennifer Cameron-Rulkowski, Chris Casey, Andrew O’Connell, Jeff Roberson, and Brett P. Shearer, Assistant Attorneys General, Olympia, Washington, represent the Commission’s regulatory staff (Staff).<sup>7</sup>
- 5 Patrick Oshie and Tyler Pepple, Davison Van Cleve, P.C., Portland, Oregon, represent the Industrial Customers of Northwest Utilities (ICNU). Chad M. Stokes and Tommy A. Brooks, Cable Huston, Portland, Oregon, represent the Northwest Industrial Gas Users (NWIGU). Kurt J. Boehm and Jody Kyler Cohn, Boehm, Kurtz & Lowry, Cincinnati, Ohio, represent The Kroger Company, Fred Meyer Stores, and Quality Food Centers (Kroger). Damon E. Xenopolous and Shaun Mohler, Stone Mattheis Xenopolous & Brew, PC, Washington, D.C., represent Nucor Steel Seattle (Nucor).

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<sup>5</sup> The Commission’s procedural rules recognize multi-party settlements as those agreed to by some, but not all parties, and recognize partial settlements as those that propose to resolve some, but not all issues. WAC 480-07-730. In this case, all parties but one either support or do not oppose the settlement before us and most issues are proposed for resolution by the Settlement Stipulation. *See infra*. ¶39, which identifies the “Settling Parties.”

<sup>6</sup> Invenergy LLC, represented by Richard H. Allan, Marten Law, Portland, Oregon, petitioned to intervene during the first prehearing conference on February 8, 2017. The Commission denied Invenergy’s petition because it failed to demonstrate a substantial interest in the proceeding or that its participation would be in the public interest. TR. at 22:25-29:4; *see* WAC 480-07-355(3).

<sup>7</sup> In formal proceedings, such as this, the Commission’s regulatory staff participates like any other party, while the Commissioners make the decision. To assure fairness, the Commissioners, the presiding administrative law judge, and the Commissioners’ policy and accounting advisors do not discuss the merits of this proceeding with the regulatory staff, or any other party, without giving notice and opportunity for all parties to participate. *See*, RCW 34.05.455.



6 Simon J. ffitch, attorney, Bainbridge Island, Washington, represents The Energy Project. Travis Ritchie and Gloria D. Smith, Sierra Club Environmental Law Program, Oakland, California, represent the Sierra Club. Amanda Goodin, Kristen Boyles, and Matthew Gerhart, Earthjustice, Seattle, Washington, represent NW Energy Coalition (NWECC), Renewable Northwest, and Natural Resources Defense Counsel.<sup>8</sup>

7 Rita Liotta and John Cummins, U.S. Navy, San Francisco, California, represent the Federal Executive Agencies (FEA). Robert McKenna, Brian T. Moran and Adam Tabor, Orrick, Herrington & Sutcliffe, LLP, Seattle, Washington, represent the State of Montana (Montana).

8 **COMMISSION DETERMINATIONS:** We agree with the parties that the scope of this proceeding distinguishes it as one of the major complex litigations before the Commission during the past two decades. Our Order today approves a historic agreement, which addresses, among other things, many challenging issues regarding the Colstrip coal-fired power plants that the Commission and parties have grappled with for more than a decade while resulting in a modest 1 percent increase in electric rates and a nearly 4 percent decrease in natural gas rates. Ten parties propose to resolve most issues in these dockets through the terms of a multi-party, partial settlement, as those terms are defined in WAC 480-07-730. One party takes no position on the settlement. One party, Public Counsel, supports, accepts, or takes no position with respect to most of the settlement's terms, but opposes the Settling Parties' proposed resolution of rate of return on equity, a key part of the Company's capital structure that significantly affects revenue requirements. Public Counsel also partially opposes the settlement on a second key issue; the treatment of depreciation expense related to the scheduled closure of Colstrip coal-fired generation Units 1 & 2, and depreciation expense at Colstrip Units 3 & 4. Finally, in terms of revenue requirements, Public Counsel opposes the settlement on a few smaller issues. Public Counsel also opposes the settlement's proposed resolution of several non-revenue issues that would: 1) expressly allow PSE to file an update to the rates approved in this proceeding within 12 months after the date of this Order; 2) continue the Company's water heater program subject to a collaborative; and 3) adjust the measure of PSE's promptness in answering customer calls included in the Company's Service Quality Index. Considering the full record in this proceeding, including Public Counsel's testimony and argument opposing specific provisions, the Commission approves and

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<sup>8</sup> Identified collectively in this Order as NWECC/RNW/NRDC, for ease of reference.

adopts the Settlement Stipulation, without condition, for the reasons discussed in this Order.<sup>9</sup>

- 9 The Commission, in addition, resolves a number of non-revenue issues expressly reserved by the parties as fully contested issues. Briefly, the Commission approves the continued use of PSE's decoupling mechanisms, excluding electric Schedules 46 and 49, subject to certain modifications including increased demand charges, continued reporting requirements for four years, and another review at the end of the four year period. The Commission increases the "soft cap" for rate increases that result from natural gas decoupling for four years; removes normalizing adjustments from the earnings test; rejects a proposed dead band for the earnings sharing mechanism; and refines the grouping of non-residential electric and natural gas customers taking service under certain rate schedules.
- 10 The Commission rejects PSE's proposed Electric Cost Recovery Mechanism.
- 11 Although not part of the Settlement Stipulation, all parties except Public Counsel ultimately agreed to use PSE's class cost of service study (CCOSS) for electric rate spread and rate design. We require PSE to follow the terms of the Rate Design Settlement in Docket UE-141368, including use of the 4-Coincident Peak (CP) allocation factor for demand-related production and transmission costs, and the classification of 25 percent of production costs as demand and 75 percent as energy. We reject Public Counsel's proposal to treat fuel costs as 100 percent energy, contrary to the Rate Design Settlement to which Public Counsel is a party. We accept adjustment of Schedule 35 (irrigation) by 150 percent of the system average percentage increase because it is significantly out of parity, adjustment of non-residential schedules that are at higher than 108 percent of parity by 65 percent of the system average increase, and adjustment of all schedules that are within 10 percent of parity by the system average increase.<sup>10</sup>

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<sup>9</sup> The Settlement Stipulation is attached to, and made a part of, this Order as Appendix B.

<sup>10</sup> We emphasize here that parties who contend the Commission has established 10 percent out of parity as a criterion for what is acceptable are incorrect. In principle, each customer class should pay exactly 100 percent of the costs it causes PSE to incur. Were this achieved for all customer classes it would eliminate any cross-subsidization between customer classes. In practice, parity is rarely, if ever, achieved because there simply are too many variables at play and the relationships among them are dynamic, not static. In one prior case, the Commission determined that parity ratios in the range of 97 percent to 107 percent of full parity do not require rate spread adjustments, taking into account principles of gradualism and rate stability. *See WUTC v. PacifiCorp, Docket UE-100749, Order 06, ¶ 316 (March 25, 2011)*. In Pacific Power's 2015

- 12 We reject PSE's proposed increased basic charges for residential electric customers and Staff's proposed minimum bill considering that both proposals depend on our accepting that transformer costs should be recovered in this way instead of as part of the distribution rates subject to decoupling. We see no reason to change the recovery of these costs from what is currently in place. We also reject Staff's proposed seasonal rates finding persuasive PSE's argument that the limited benefits of Staff's proposal is outweighed by the complexity and cost of implementation. We may wish to revisit possible changes to residential rate design as PSE moves toward adoption of advanced metering infrastructure, or AMI.
- 13 We accept NWEA/RNW/NRDC's proposal to convene another technical conference on the subject of 3-tier residential rate design, finding unacceptable PSE's failure to follow the requirements of the settlement agreement in Docket UE-141368.
- 14 With respect to residential electric rate design, we will not at this time require development of a net metering rate schedule. We also reject Public Counsel's suggestion that PSE's bills are insufficiently informative. Finally, we find Public Counsel's recommendations concerning the automatic application of outage credits, as proposed by Ms. Alexander's testimony, infeasible.
- 15 In terms of non-residential rate design, we expressly approve several settled or uncontested changes, as PSE requests. Specifically, we approve increased demand charges for Schedules 46 and 49, changes to lighting rates as proposed by PSE and Staff,

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general rate case, with reference to Docket UE-100749, the Commission noted in its Final Order that:

A COSS uses precise math to follow elaborate cost assignments. Commission practice considers the error or range of accuracy to be +/-0.05. In other words, COSS results within the range 0.95 to 1.05 are considered within the precision of the COSS. A parity ratio of 0.90 means that the utility is collecting 90 percent of the revenue needed to cover the cost of serving that customer class, or put another way, that customer class is not paying its full share of costs. A parity ratio of 1.10 means that the utility is collecting 110 percent of the revenues needed to serve that customer class, or put another way, that customer class is paying more than needed to cover its share of costs.

*WUTC v. Pacific Power & Light Company*, Docket UE-152253, Order 12 ¶ 225 n 350 (September 1, 2016). *See also WUTC v. Pacific Light and Power Company*, Docket UE-130043, Order 05 ¶ 244 (December 4, 2014) (Considering that rate schedules other than street lighting were within 10 percent of parity, the parties agreed in a settlement that any revenue requirement increase should be applied as a uniform percentage increase for all rate schedules, except street lighting, which should receive no increase).

and simplification of pricing for Power Supplier Choice and Retail Wheeling service under Schedules 448 and 449, as proposed by PSE.

- 16 We approve of PSE's updated classification and allocation of gas costs that is undisputed in this proceeding. We direct PSE to use this updated classification and allocation in future PGA filings.
- 17 We accept PSE's peak and average methodology for allocating the costs of gas distribution mains 67 percent based on design day peak and 33 percent based on average throughput. We reject NWIGU's proposal to use only coincident demand because we believe this ignores the way customers use the system. We reject Staff's proposal to allocate peak demand on the average class use in the highest five-day period for each of the last three years because it places too much emphasis on how the system is used, as opposed to how it is designed.
- 18 We approve PSE's proposed natural gas rate spread that would (i) apply the system average increase to those classes with parity percentages between 90 percent and 110 percent (Schedules 23, 16, 53, 41, 41T, 85 and 85T); (ii) apply 50 percent of the average increase to those classes between 110 and 150 percent of parity (Schedules 86 and 86T); (iii) apply no increase to those above 150 percent of parity (Schedules 71, 72 and 74); and (iv) apply 150 percent of the average increase to those below 90 percent of parity (Schedules 31, 31T, 87 and 87T).
- 19 The Commission agrees with NWIGU that we should not express in this Order preferences concerning the cost of service methodologies used in this proceeding. The Commission will maintain the status quo and allow all parties the opportunity to continue participating in the generic proceedings the Commission initiated in Dockets UE-170002 and UG-170003 to develop clear guiding principles for cost of service studies to be used in future rate cases.<sup>11</sup>
- 20 The Commission will also maintain the status quo in terms of the treatment of Special Contracts. We reject Staff's proposals to change fundamentally the Commission's long-standing principles governing Special Contracts.

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<sup>11</sup> See *Washington Utilities and Transp. Comm'n v. Avista Corp.*, Dockets UE-160228 and UG-160229, Order 06 (Dec. 15, 2016) at ¶¶ 94-100.

- 21 We accept PSE's proposal to raise the natural gas residential basic charge to \$11 per month. This acknowledges that actual costs may be a good bit higher, but recognizes the principle of gradualism that also guides our decision.
- 22 We approve PSE's proposals to apply its Gas Procurement Charge to Schedules 31 and 41, and to eliminate this charge for Schedules 31T and 41T. This will align better with the rate structure of the interruptible sales schedules that have a similar charge and eliminate confusion with respect to the transportation schedules.
- 23 Finally, we reject PSE's proposals to implement annual maximum volume limitations on Schedules 41 and 41T, effectively requiring customers exceeding these volume limits to take service on Schedule 85 or 85T; to eliminate the existing annual minimum load charge on Schedules 85 and 85T; to charge fully-firm customers on Schedules 85 and 85T based on their actual demands; and to relieve gas sales customers receiving fully-firm service of the obligation to sign a separate customer agreement for service under these schedules.

## MEMORANDUM

### I. Background and Procedural History

- 24 As summarized briefly above, PSE filed on January 13, 2017, its first general rate case since 2012.<sup>12</sup> PSE based its revenue requirements requests for electric and natural gas operations on a test year from October 1, 2015, through September 30, 2016. PSE asked in its filing for approval of an overall rate of return (ROR) of 7.74 percent,<sup>13</sup> based on a capital structure consisting of 48.5 percent equity and 51.5 percent debt,<sup>14</sup> a return on

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<sup>12</sup> See *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-011048 and UG-011049 (*consolidated*), Order 08 (May 7, 2012).

<sup>13</sup> Lohse, Exh. BJL-1T at 2:5-10. This compares to the Company's currently approved ROR of 7.77 percent.

<sup>14</sup> Actual average test year capital structure included 48.9 percent equity and 51.1 percent debt. Doyle, Exh. DAD-1T at 36:7, Table 6. We note, however, Mr. Lohse's testimony, later adopted by Mr. Doyle, that PSE's effective rate year capital structure includes 1.0 percent short-term debt plus 3.3 percent in floating rate Junior Subordinated Notes for a total short-term debt equivalent of 4.3 percent. Lohse, Exh. BJL-1T at 3:1-16. Mr. Lohse said long-term debt in the rate year will be 47.2 percent. Thus, total debt equals 51.5 percent, as the Company proposed in this case. *Id.*

equity (ROE) of 9.80 percent,<sup>15</sup> long-term debt costs of 5.73 percent,<sup>16</sup> and short-term debt costs of 3.06 percent.<sup>17</sup>

25 PSE's filing reflected the Company's commitment to decommission Colstrip Units 1 & 2, approximately 614 MW of coal-fired generation located in Montana, of which PSE is a 50 percent owner.<sup>18</sup> The retirement date will be no later than July 1, 2022.<sup>19</sup> PSE agreed to this commitment as part of the settlement of a lawsuit brought by the Sierra Club and Montana Environmental Information Center in 2013 against Colstrip's owners alleging violations of the Clean Air Act. A Montana district court approved the settlement during 2016. Decommissioning and remediation costs for Colstrip Units 1 & 2 are estimated at approximately \$103 million in today's dollars.<sup>20</sup>

26 With the agreement to retire Colstrip Units 1 & 2, PSE commissioned a full depreciation study related to Electric, Gas, and Common plant as of September 30, 2016. Specifically regarding Colstrip Units 1 & 2, the study moved the depreciable life from 2035 to the anticipated retirement date in mid-2022.<sup>21</sup> The Company sought authorization from the Commission in this proceeding to repurpose certain Treasury Grant funds on its books and to use existing Production Tax Credits, when monetized, to offset the anticipated decommissioning and remediation costs and the increased depreciation expense for these units rather than passing back these government benefits to customers in other ways. PSE stated its intent was to mitigate the negative rate impacts and intergenerational inequities that would likely otherwise occur as a result of closing Colstrip Units 1 & 2 in the relative near term.

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<sup>15</sup> Doyle, Exh. DAD-1T at 34:11. This is the same as the Company's currently approved ROE. *See also* Morin, Exh. RAM-1T at; Lohse, Exh. BJL-1T at 2:9:10, Table 1.

<sup>16</sup> Lohse, Exh. BJL-1T at 2:9:10, Table 1.

<sup>17</sup> *Id.*

<sup>18</sup> Talen Energy, which owns the other 50 percent of Colstrip Units 1 & 2, also is committed to the retirement of these units. Roberts, Exh. RJR-1CT at 34:1-35:9.

<sup>19</sup> PSE owns a smaller share of Colstrip Units 3 & 4, which have a combined capacity of about 1,480 MW. No decommissioning date has been established for these assets.

<sup>20</sup> Roberts, Exh. RJR-1CT at 54:8-13.

<sup>21</sup> The 2035 retirement dates for purposes of depreciation was established by a Commission order approving a settlement agreement in PSE's 2007 general rate case. PSE proposed in that case a 2019 retirement date but agreed in settlement to Public Counsel's and Staff's arguments that the date should be extended to 2035. *See WUTC v. Puget Sound Energy, Inc.*, Dockets UE-072300 and UG-072301 (consolidated), Order 12, ¶ 57 (October 8, 2008).

- 27 PSE's depreciation study also moved up the end date for depreciation of Colstrip Units 3 & 4 to 2035, from 2044 and 2045, respectively. This was based on PSE's view that 2035 represented a "probable retirement date" for these units.<sup>22</sup>
- 28 In terms of other adjustment to revenue requirements, PSE proposed a significant number of restating and pro forma adjustments such as: weather normalization, pro forma capital expense, labor costs, pension plan expenses and compensation and benefit costs, environmental remediation costs, and storm damage costs. Many of these proposed adjustments are now uncontested by any party, but a few remain in dispute.
- 29 Other notable issues in PSE's as-filed case included proposed increased funding for the Company's Home Energy Lifeline Program (HELP) available to eligible low-income customers; modifications to the Company's decoupling mechanisms; a power cost update; the entrance of PSE into the CAISO Energy Imbalance Market (EIM); a proposed electric cost recovery mechanism (ECRM); a proposal to formalize the ERF process as an alternate form of ratemaking to address potential attrition and regulatory lag issues; and issues related to service quality and customer relations.
- 30 PSE proposed to use the results of its electric, and natural gas CCOSS to inform rate spread and rate design recommendations. These studies use very similar methodologies to what the Company relied on in its 2011/2012 general rate case.<sup>23</sup> Mr. Piliaris testified that PSE's proposed rate spread is based on the desire to move gradually towards full parity among customer classes.<sup>24</sup> PSE proposed increases to basic charges for both residential electric and natural gas customers, and increased demand charges for non-residential gas customers.
- 31 On April 3, 2017, PSE filed, without objection, supplemental direct testimony providing several updates including: power costs, storm damage expenses, contingent calculations for the anticipated effects of the Microsoft Retail Wheeling settlement then pending in Docket UE-161123,<sup>25</sup> corrections for minor errors, and updated compensation and benefit expenses. The Company's supplemental rate request proposed an increase of

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<sup>22</sup> Spanos, Exh. JJS-1T at 9:9-10.

<sup>23</sup> The 2011 PSE general rate case is the most recent rate case in which the Company's cost of service was reviewed.

<sup>24</sup> A rate schedule reaches parity when its proportionate share of total revenue requirement is collected from the customers in that rate schedule. This is a parity ratio of 1.0, most often expressed in terms of the customer class being at 100 percent parity.

<sup>25</sup> See *WUTC v. Puget Sound Energy*, Docket UE-161123, Order 06 Approving Settlement Agreement (July 13, 2017).

\$68.3 million, or 3.2 percent for electric, and a rate decrease of \$29.3 million, or 3.2 percent for gas. These requests did not include the contingency calculations for the Retail Wheeling settlement, which was not filed until April 11, 2017.

- 32 Commission Staff, Public Counsel, ICNU, Kroger, FEA, the Energy Project, Sierra Club, NWEK/RNW/NRDC, and NWIGU filed response testimonies and exhibits opposing the Company's rate and revenue requests, and addressing numerous other issues, on June 30, 2017. The parties' updated issues list submitted to the presiding officers on August 4, 2017, identified 111 issues concerning electric operations, 69 issues concerning natural gas operations, and five service quality and customer service issues.
- 33 The Commission held the first of two planned public comment hearings in Bellevue, Washington, on July 31, 2017, and heard comments from numerous members of the public.
- 34 On August 9, 2017, PSE filed rebuttal testimony revising its position on several issues, and incorporating the revenue requirement updates provided in its supplemental filing. The Company's rebuttal case proposed an increase of \$57.9 million, or 2.8 percent for electric, and a rate decrease of \$29.4 million, or 3.4 percent for gas.
- 35 Also on August 9, 2017, the parties filed their cross-answering testimonies and exhibits concerning select issues raised by Staff, Public Counsel, and various intervenors in their response testimonies. The State of Montana filed testimony on August 9, 2017, that it styled as cross-answering testimony. Staff and ICNU objected that Montana's filing was untimely and inadmissible into the evidentiary record because it should have been filed by the June 30, 2017, deadline for response testimony, and for other reasons. The Commission, in Order 07, sustained these objections and ruled that it would not accept the State of Montana's testimony into the evidentiary record. Order 07, however, acknowledged Montana's filing as a statement of the state's interests and accepted it for that purpose.
- 36 On August 25, 2017, several parties, including PSE and Staff, informed the presiding officers that most parties had reached a settlement in principle concerning most of the issues in this proceeding. In subsequent discussions, the parties informed the Commission that most issues in the case were resolved insofar as they were concerned, but they identified specifically several issues, largely concerning cost of service (COS), rate spread, rate design, and related matters (*e.g.*, decoupling and PSE's proposed electric cost recovery mechanism) that remained unresolved and would require Commission determination based on a full evidentiary record. NWIGU represented at the time that it would contest the settlement and also would contest at least certain of the issues



remaining more broadly in dispute among the parties. Public Counsel did not state at the time a position supporting or opposing the settlement.

37 The Commission conducted evidentiary hearings at its headquarters in Olympia, Washington, on August 30, 2017, on the issues identified by the parties as being contested.<sup>26</sup> It admitted all prefiled testimony and exhibits as well as all previously submitted cross-examination exhibits relevant to the contested issues.<sup>27</sup>

38 The Commission held its second public comment hearing in Olympia, Washington, on August 31, 2017. Over the course of the proceeding, including the two public comment hearings, the Commission and Public Counsel received 495 comments regarding the proposed rate increases from Washington customers, with 432 comments opposing the increases, seven comments supporting the increases, and 56 comments neither supporting nor opposing. Notably, the Commission received numerous comments submitted by residential customers urging PSE to move away from coal-fired power even if there is additional cost associated with this move.<sup>28</sup> We note, in fairness, that other customers supporting Colstrip's early closure objected to the increased cost in rates.

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<sup>26</sup> Public Counsel informed the Commission that it remained unsure of its position on the settlement. On September 11, 2017, Public Counsel filed a letter with the Commission stating it would not join in the settlement and wished an opportunity to present an "alternative viewpoint."

<sup>27</sup> PSE objected to Exhibit JAP-60X, identified as a cross-examination exhibit by ICNU. The exhibit was admitted not for the truth of what it asserted, but only as an illustrative exhibit for convenience of reference. TR. 305:6-306:8.

<sup>28</sup> See Public Comment Exh. BR 5. By way of examples:

Kent and Maureen Canny followed up their participation in our Bellevue public comment hearing with an email stating in part:

We, too, hope that you adjust PSE's payment schedule for the Colstrip facility so that the two units are retired by at least 2025!

Many others spoke very eloquently about getting off coal and onto renewable sources of energy. We wholeheartedly support those statements and hope that this happens as soon as possible Thank you for your reasoned decisions as you "protect the people of Washington by ensuring that investor-owned utility and transportation services are safe, available, reliable and fairly priced.

F. Aglow, another PSE customer, commented via the internet that "I am writing to you UTC commissioners to advocate for PSE to pay off and close the remaining coal-fired units in Colstrip, Montana, by the year 2025." This commenter later added via email:

Besides retiring the two Colstrip Montana coal units and replacing them, I'd like to ask the following:

- 39 On September 15, 2017, PSE, Staff, ICNU, FEA, Kroger, Energy Project, Sierra Club, State of Montana and NWEC/RNW/NRDC filed their partial settlement proposing resolution of all issues except the expressly reserved contested issues heard on August 30, 2017. NWIGU joined the settlement reserving its rights with respect to contested issues related principally to natural gas cost of service, rate spread, and rate design. We refer to these 10 parties collectively as “Settling Parties.” Nucor Steel neither supported nor opposed the settlement. Public Counsel earlier informed the Commission by letter filed on September 11, 2017 that it “has not joined the multiparty settlement” and would “present an alternative viewpoint for the Commission’s consideration.”
- 40 Also on September 15, 2017, the Settling Parties filed their Joint Memorandum in Support of Multiparty Partial Settlement. PSE, ICNU and NWIGU jointly, and Sierra Club filed testimony in support of the settlement. On September 18, 2017, FEA, Staff, Energy Project, Kroger, and NWEC/RNW/NRDC filed testimony in support of the settlement. The State of Montana filed a letter in support of the settlement. On September 22, 2017, Public Counsel filed testimony opposing the settlement.
- 41 The Commission conducted a settlement hearing on September 29, 2017, to receive evidence and statements from the parties both supporting and opposing the Settlement Stipulation.
- 42 Altogether, the record includes 748 exhibits admitted, including prefiled testimony from 55 witnesses, all of whom were available for cross-examination during the evidentiary hearings, as appropriate.<sup>29</sup> The transcript of this proceeding is approximately 625 pages in length.
- 43 The parties filed initial post-hearing briefs on October 18, 2017, and reply briefs on October 27, 2017.<sup>30</sup>

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--I'd like a firm timeline for retiring the 3rd and 4th Colstrip units by 2025 AND a decision to replace units 100% with efficiency increases and renewable sources.

<sup>29</sup> The one exception being PSE witness Mr. Lohse who left the Company prior to hearing. Mr. Doyle, PSE’s Senior Vice President and Chief Financial Officer, adopted Mr. Lohse’s testimony as his own and was available to be cross-examined concerning its substance. Doyle, TR. 171:8-18. All parties had the opportunity to identify witnesses they wished to cross-examine concerning prefiled direct testimony, response testimony, cross-answering testimony, rebuttal testimony, and settlement testimony.

<sup>30</sup> Public Counsel expressly supported in its Initial Brief many significant terms included in the Settlement Stipulation, expressly accepted additional terms, and took no position with respect to many other terms. Public Counsel nevertheless exercised what it described as a right to express

## II. PSE's 2013 Rate Plan

44 The passage of more than five years since the Commission approved rates for PSE in Dockets UE-111048 and UG-111049 makes it appropriate, for purposes of context, to review briefly the history of PSE's rates since that time. Specifically, we discuss below the effects of the Commission's 2013 approval, in joint proceedings involving four dockets, of an update to the Company's rates, a decoupling mechanism, and a multi-year Rate Plan.

45 The Commission entered Order 07, its Final Order in Dockets UE-130137, *et al.*, on June 25, 2013.<sup>31</sup> Order 07 approved several innovative ratemaking mechanisms to address the Commission's policy goal of breaking the pattern of almost continuous rate cases for PSE. These mechanisms included:

- An Expedited Rate Filing (ERF) process to implement a \$31.9 million (1.6 percent) electric delivery revenue increase and a \$1.2 million (0.1

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"alternative viewpoints" with respect to two key issues and several less significant issues, and wished to have its alternative viewpoints considered as opposition to these specific terms and as alternative results with respect to the issues addressed. Public Counsel's position with respect to the settlement in general is unclear. On the one hand, Public Counsel states (incorrectly) that "the Commission only allows binary positions with respect to settlements: support or opposition." IB ¶6. On the other hand, Public Counsel says, two sentences later, that it "recommends that the Commission adopt certain terms and modify other terms of the Settlement in setting Puget Sound Energy's (PSE or Company) rates in this proceeding." IB ¶7. It appears that Public Counsel recognizes that parties' choices in Commission proceedings are not "binary;" a party can offer partial opposition to a settlement while accepting other parts, as Public Counsel did in this case.

<sup>31</sup> *In the Matter of the Petition of Puget Sound Energy and NW Energy Coalition For an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms*, Dockets UE-121697 and UG-121705 (consolidated) (Decoupling) and *Washington Utilities and Transportation Commission v. Puget Sound Energy*, Dockets UE-130137 and UG-130138 (consolidated) (ERF), Order 07 - Final Order Granting Decoupling Petition and Final Order Authorizing ERF Rates (June 25, 2013) (Order 07-2013 Rate Plan). ICNU and Public Counsel appealed Order 07 in Thurston County Superior Court, Case Nos. 13-2-01576-2 and 13-2-01582-7 (consolidated). The Superior Court entered its order on July 25, 2014, Granting in Part and Denying in Part Petitions for Judicial Review. The Court remanded this case to the Commission "for further adjudication," finding the ERF to be flawed procedurally because the Commission did not comprehensively review PSE's market cost of equity as of early 2013 in the context of the multi-year Rate Plan. Considering the overall framework of the actions it took in Order 07 and taking additional evidence as the Court directed, the Commission's order on remand left the previously approved "innovative rate mechanisms" in place and determined the Company's cost of equity as of early 2013 to be 9.8 percent, which was the same cost of equity allowed by Order 07. *Id.*, Orders 15 (Decoupling) and 14 (ERF) (June 29, 2015).

percent) gas delivery revenue reduction.<sup>32</sup> The limited purpose of the filing was to update PSE's delivery services costs established in May 2012 in Dockets UE-111048 and UG-111049.<sup>33</sup>

- Approval of a joint petition by PSE and NWECC/RNW/NRDC seeking authority to implement full decoupling of electric and natural gas rates.
- Approval of a Rate Plan that allowed for modest annual increases in PSE's rates while requiring that the Company not file a general rate increase before April 1, 2015, at the earliest.

46 Under the Rate Plan, however, PSE was required to file a general rate case by April 1, 2016. Following a hearing on a motion to amend Order 07, the Commission relieved PSE of this obligation and instead required the Company to file a general rate case no later than January 17, 2017. One key purpose of the general rate case filing requirement was to provide the Commission an opportunity to examine fully the results achieved following implementation of the several mechanisms identified above. It is appropriate, then, to provide here a brief summary of those results during the Rate Plan effective period since June 2013.

47 Mr. Doyle discussed in his direct testimony the results of decoupling, the earnings sharing mechanism, the expedited rate filing, and annual K-factor increases since they were instituted by approval of PSE's compliance filing in July of 2013. He discusses, in addition, certain cost management and efficiency efforts at PSE during the period since that time, as contemplated by the Commission when it approved these mechanisms in the context of the multi-year Rate Plan.<sup>34</sup>

48 In terms of overall results, Mr. Doyle testified that the Rate Plan resulted in the following financial results:

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<sup>32</sup> These amounts were subsequently revised to \$31,138,511 for electric and \$1,717,826 for natural gas to adjust for lower long-term debt costs.

<sup>33</sup> *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049 (consolidated), Order 08 (May 7, 2012).

<sup>34</sup> The Commission stated in Order 07-2013 Rate Plan ¶ 22 that:

This multi-year Rate Plan will provide the Company with ample opportunity to implement efficiencies that will afford the Company with the earnings opportunities it seeks. And these cost savings, which we will monitor carefully, will then be incorporated into rates for the benefit of ratepayers.

- An approximate \$30 million net electric and gas rate increase from the expedited rate filing in July 2013.
- Annual K-factor increases to delivery revenues of 3.0 percent for electric and 2.2 percent for gas in July 2013, January 2014, January 2015, January 2016, and January 2017.
- Recognition of net electric decoupling revenue of approximately \$59 million and net gas decoupling revenue of approximately \$116 million from July 1, 2013, through September 30, 2016.

These financial results, coupled with cost savings and efficiencies realized during the Rate Plan effective period, “allowed PSE to begin to consistently earn rates of return and returns on equity slightly below its authorized rate of return and return on equity on an adjusted actual basis across all time periods.”<sup>35</sup> According to Mr. Doyle, these results show that the Rate Plan mitigated the effects of regulatory lag and attrition during the Rate Plan effective period.<sup>36</sup>

49 Mr. Doyle presented in his testimony two tables, reproduced here, which provide comparisons of adjusted actual and normalized rates of return and returns on equity to reflect actual results for electric and natural gas operations during the period from 2011 through calendar year 2016.

**Table 1. Comparison of PSE’s Adjusted Actual and 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 (2)	Normalized (3)	Authorized	Adjusted Actual (2)	Normalized (3)	Authorized	
1 2016 (1)	7.76%	7.99%	7.77%	9.66%	10.13%	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) 12 months ended June 30, 2016

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

(3) Normalized returns: 2011 - 2016 (June) CBR filed with WUTC

<sup>35</sup> Doyle, Exh. DAD-1T at 3:1-17.

<sup>36</sup> Doyle, Exh. DAD-1T at 3:17-18.

**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)
Year	Rate of Return			Return on Equity		
	Adjusted Actual (2)	Normalized (3)	Authorized	Adjusted Actual (2)	Normalized (3)	Authorized
1 2016 (1)	8.16%	8.44%	7.77%	10.49%	11.06%	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) 12 months ended June 30, 2016

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

(3) Normalized returns: 2011 - 2016 (June) CBR filed with WUTC

50 Mr. Doyle identified four principal ways in which PSE achieved cost management efficiencies during the Rate Plan period:

- PSE aligned its growth rate in operating expenses with customer growth to set annual operating and maintenance budgets.<sup>37</sup>
- PSE restructured its benefit plans, slowing the increase in costs associated with employee benefit programs.
- PSE implemented additional efficiencies related to debt refinancings, bonus depreciation elections, efficiencies from certain lobbying activities to change the normalization requirements for treasury grants, and reduced to the extent possible the cost of decommissioning and remediating Colstrip Units 1 & 2.

51 Mr. Doyle testified that PSE implemented a broad-based approach to manage its operating expenditures, following a guideline aimed at having growth in budgets and spending align with the rate of customer growth. Specifically, PSE managed its actual operating expenditures, on a combined basis, to achieve a compound average growth rate of approximately 1.2 percent from 2011 to 2016. According to Mr. Doyle, relying on Ms. Barnard’s testimony, this equates to a compound average customer growth rate on a combined basis of 0.8 percent over the same timeframe. Mr. Doyle testifies that “[t]his is an extremely positive result given that (i) PSE’s approved operating expense growth rate from 2006 to 2011 was approximately 3.8%, and (ii) general inflation from 2011 to 2016

<sup>37</sup> Doyle, Exh. DAD-1T at 26:15-18.

was 1.2%.<sup>38</sup> This compares favorably to PSE's historical operating expense growth rate of 3.8 percent, which, if sustained through the Rate Plan period, would have resulted in an additional \$136 million in operating expenses.

52 In summary, in terms of cost savings over the course of the Rate Plan, PSE:

- (i) Estimates that it saved approximately \$136 million against historical operational spending trends through its efforts to limit growth in operational spending to the rate of customer growth.
- (ii) Saved \$19.3 million annually through refinancings and managing its capital structure.
- (iii) Saved \$23.7 million through its voluntary bonus depreciation elections and resulting rate base reductions, which will continue into the future.
- (iv) Provided customers \$65.9 million in interest credits through September 2016 associated with the Lower Snake River wind farm Treasury Grants related to the elimination of normalization requirements for Treasury Grants, an effort which also made it possible to repurpose Treasury Grants to offset future Colstrip Units 1 & 2 decommissioning and remediation costs. Similar benefits exist with respect to Wild Horse wind farm Treasury Grants in the amount of \$8.1 million.
- (v) Will save customers an estimated \$71.2 million nominally and \$49.5 million on a net present value basis through the repurposing of certain Treasury Grants and Production Tax Credits to offset future Colstrip Units 1 & 2 decommissioning and remediation costs.
- (vi) Agreed to participate in the CAISO Energy Imbalance Market providing future power cost savings.
- (vii) Restructured certain benefit plans. The operating expense portion of those savings are included in the \$136 million discussed in (i) above. The capital component is "netted" in PSE's rate base in this proceeding. PSE expects these savings to continue into the future as well.<sup>39</sup>

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<sup>38</sup> Doyle, Exh. DAD-1T at 27:18-28:3 (citing Barnard, Exh. KJB-1T).

<sup>39</sup> Doyle, Exh. DAD-1T at 33:3-34:7.

53 It is in this context that PSE filed its 2017 general rate case that is the subject of our Final Order here.

### III. Present Posture of PSE's 2017 General Rate Case

54 As previously summarized, the 12 parties that participated in these dockets identified 185 issues at the time response testimony was filed on June 30, 2017. The Commission received five sets of prefiled testimony from 55 witnesses (*i.e.*, direct and supplemental from PSE, response from Staff, Public Counsel, and nine intervenors, rebuttal from PSE, and cross-answering from Staff, Public Counsel, and seven intervenors).<sup>40</sup> The parties filed numerous exhibits supporting their witnesses' narrative testimonies. The Commission thoroughly reviewed the prefiled testimony and exhibits in preparation for a multi-day evidentiary hearing scheduled to begin on August 29, 2017. Then, the posture of the case changed when late in the day on Thursday, August 25, 2017, counsel for PSE, Staff, and ICNU gave informal notice that they had reached a settlement in principle concerning all contested revenue requirements issues for electric operations and were actively soliciting support from additional parties.

55 The parties continuing efforts over the next 24 hours informed an email from Staff counsel to the presiding administrative law judges and all parties' representatives at the close of business on Friday, August 26, 2017. Staff counsel related that "PSE, Staff, Kroger, Sierra Club, NWECA, and The Energy Project have agreed to a partial settlement. Four additional parties are still in the process of reviewing the settlement and intend to make a final decision by Monday. One party has indicated it will not support the settlement."

56 Staff counsel's email stated that the parties' agreement in principle left only a discrete set of fully contested issues concerning electric operations, as follows:

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<sup>40</sup> As noted above in ¶ 33, the Commission received testimony from the State of Montana as part of the general record of this proceeding as a statement of the state's interests, but not as part of the evidentiary record for decisions.



- Electric Cost Recovery Mechanism.
- Decoupling, except for the parties' agreement to accept Staff's proposal for treatment of fixed production costs.
- Electric rate spread and rate design with five specific exceptions identified in Staff counsel's email.

57 Staff counsel also stated that none of the issues concerning natural gas rate spread and rate design had been settled. Thus, in something of a mirror image to the circumstances six years earlier in Dockets UE-111048/UG-111049, it appeared from Staff counsel's email that the settlement would propose agreed outcomes for revenue requirements issues while reserving for full litigation issues concerning cost of service, rate spread, and rate design for both electric and natural gas services.

58 The Settling Parties proposed without objection, and the Commission agreed, to proceed with its evidentiary hearing on August 30, 2017, instead of August 29, 2017, for the purpose of cross-examination of witnesses whose testimony concerned the issues that would require decisions by the Commission based on the evidentiary record and the parties' advocacy in briefs. Ten witnesses were individually sworn and made available for cross-examination. The parties agreed to stipulate into the record all prefiled testimony and exhibits from all witnesses, and all but one of the cross-examination exhibits identified for the 10 witnesses.<sup>41</sup> The one exhibit to which a party objected was admitted later as an illustrative exhibit.<sup>42</sup>

59 On September 15, 2017, PSE, Staff, ICNU, FEA, Kroger, Energy Project, Sierra Club, State of Montana, NWEA/RNW/NRDC, and NWIGU filed their Settlement Stipulation and a joint narrative statement in support. The State of Montana filed a letter supporting the settlement. Settling Parties filed individual party testimonies on September 15 and 18, 2017. Public Counsel filed testimony opposing the settlement, in part, on September 22, 2017.

60 Public Counsel's witness Colamonici testified that Public Counsel *supported* the discontinuance of Schedule 40.<sup>43</sup> She said further that Public Counsel *supported* the Settlement Stipulation's terms concerning low-income issues, decoupling, and the

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<sup>41</sup> TR. 157:13 - 159:9.

<sup>42</sup> TR. 305:6 - 306:7

<sup>43</sup> Colamonici, Exh. CAC-1T at 5:14. *See* Settlement Stipulation ¶96.

Colstrip Reporting Requirements, Operational Study, and Workshop.<sup>44</sup> Ms. Colamonici also testified that Public Counsel *accepted* the Settling Parties' proposed resolution of 10 revenue requirements issues, and was *neutral* with respect to the Settling Parties' proposed resolution of 18 additional revenue requirements issues.<sup>45</sup> The Commission conducted a settlement hearing on September 29, 2017. The parties filed initial and reply briefs on October 18 and 27, 2017, respectively.

61 Considering the changed posture of this proceeding, we observe for the sake of clarity that our responsibility is no less in a case such as this where most, but not all, parties have negotiated a settlement agreement covering most, but not all, issues, than in a case in which most issues are fully litigated, with only a few issues settled, such as in PSE's 2011/2012 general rate case.<sup>46</sup> The Commission's process for considering settlements is spelled out in WAC 480-07-740, which provides among other things that:

Each party to a settlement agreement must offer to present one or more witnesses to testify in support of the proposal and answer questions concerning the settlement agreement's details, and its costs and benefits. Proponents of a proposed settlement must present sufficient evidence to support its adoption under the standards that apply to its acceptance. Counsel must make a brief presentation of the settlement, and address any legal matters associated with it. Counsel must be available to respond to questions from the bench regarding those subjects.

WAC 480-07-740(2)(b), and

Parties opposed to the commission's adoption of a proposed settlement retain the following rights: The right to cross-examine witnesses supporting the proposal; the right to present evidence opposing the proposal; the right to present argument in opposition to the proposal; and the right to present evidence or, in the commission's discretion, an offer of

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<sup>44</sup> Colamonici, Exh. CAC-1T at 13:2-6. *See* Settlement Stipulation ¶¶102-111 (low-income); ¶¶113-14 (decoupling); ¶¶119-21 (Colstrip issues).

<sup>45</sup> Public Counsel did not address, and therefore is deemed to have not contested one additional settled revenue requirements issue, Investor Supplied Working Capital.

<sup>46</sup> In the prior case, the parties settled only issues related to cost of service, rate spread, and rate design. Revenue requirements issues and, hence, rates, remained in dispute and required Commission determinations on a fully developed record. This case is, to this general extent, a mirror image of the earlier case.

proof, in support of the opposing party's preferred result. The presiding officer may allow discovery on the proposed settlement in the presiding officer's discretion.

WAC 480-07-740(2)(c).

62 All parties met their obligations under, and availed themselves of their rights as identified in, these rules.<sup>47</sup>

63 The Commission approves settlements when doing so is lawful, the settlement terms are supported by an appropriate record, and the result is consistent with the public interest in light of all the information available to the Commission. Ultimately, in settlements, as in fully-litigated rate cases, the Commission must determine that the resulting rates are fair, just, reasonable, and sufficient, as required by state law.<sup>48</sup>

64 In this case, all parties but one support or do not oppose the terms of the Settlement Stipulation with respect to all revenue requirements issues that are determinative of electric and natural gas rates. A significant number of restating and pro forma adjustments to test year results were uncontested by any party at the time set for

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<sup>47</sup> We note here Public Counsel's complaint in its Initial Brief that "[e]ven though the Settling Parties [sic] testimony regarding the cost of capital relies on the direct testimony of the Settling Parties' witnesses, Public Counsel was prohibited from questioning the witnesses *on that direct testimony*." Public Counsel Initial Brief ¶39 (emphasis added). Public Counsel was free to, and did, cross-examine the settlement witnesses with respect to their testimony supporting the 9.5 percent return on equity included in the Settlement Stipulation. TR. 592:21-594:223; TR. 600:17-601:24. As the cited colloquy shows, however, Public Counsel failed to take Ms. Barnard's point that as a settlement witness, not an expert witness on cost of capital, she could "only talk at a high level about the settlement and the 9.5 and why we believe it's reasonable." TR. 593:8-10. Public Counsel sought to cross-examine Ms. Barnard about PSE cost of capital expert witness Dr. Morin's testimony. TR. 592:21- 593:11. The presiding administrative law judge (ALJ) cut off this line of inquiry considering that it would be fundamentally improper to allow cross-examination of witnesses except with respect to their own testimony. Settlement witnesses cannot be cross-examined in a settlement hearing with respect to the testimony of other witnesses, such as cost of capital expert witnesses, just as they would not be allowed to be so cross-examined in a fully litigated case. The presiding ALJ explained that the Commission would consider all relevant information available to it, including the prefiled testimony of all cost of capital witnesses, when weighing whether the Settlement Stipulation proposed a reasonable resolution of this issue supported by the record, and would consider Public Counsel's "alternative view" of what would be a reasonable outcome. TR. 593:12 - 594:8.

<sup>48</sup> WAC 480-07-750(1). See, e.g., *WUTC v. Avista Corporation d/b/a Avista Utilities*, Dockets UE-150204 and UG-150205 (consolidated), Order 05 ¶¶20-22 (January 6, 2016).

evidentiary hearings. The Settling Parties agreed to specific results to other issues that remained contested as the hearing date approached.

65 Even Public Counsel, while contending it is generally opposed to the Settlement Stipulation,<sup>49</sup> stated its agreement to numerous discrete issues.<sup>50</sup> Indeed, Public Counsel identified in its Initial Brief only seven revenue requirements issues and three non-revenue requirements proposals by the Settling Parties to which it takes exception.<sup>51</sup> In contrast, Public Counsel acknowledged 28 revenue requirements issues as to which it either was “neutral” or “accepted” the Settling Parties’ proposed resolutions. Public Counsel also agreed with the Settlement Stipulation’s proposed resolution of Adjustments 11.20 and 13.20, Payment Processing Costs for natural gas and electric operations. Public Counsel elected not to address in its Initial Brief, and hence waived, any objection with respect to one additional revenue requirements issue.<sup>52</sup> In addition, as previously discussed, Public Counsel supported the Settlement Stipulation with respect to phased elimination of Schedule 40, Low-Income issues, Decoupling to the extent settled,<sup>53</sup> the use of Production Tax Credits (PTCs) and Treasury Grants to offset Colstrip costs (*i.e.*, otherwise unrecovered depreciation at Colstrip Units 1 through 4; decommissioning and remediation costs), and the non-revenue conditions concerning Colstrip (*i.e.*, reporting requirements, operational study, and workshop).

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<sup>49</sup> Colamonic, Exh. CAC-1T at 15:10-13.

<sup>50</sup> Colamonic, Exh. CAC-1T at 11:15-12:24.

<sup>51</sup> It may be that in Public Counsel’s view there are eight contested issues, including what it refers to as “overall revenue requirement.” The Company’s overall revenue requirement, however, is not independently determined. It reflects the Commission’s determination of many underlying issues, including those contested by Public Counsel, such as cost of capital, Colstrip depreciation, and five specific revenue requirement adjustments that Public Counsel contests: natural gas distribution plant future net salvage, pension expense, environmental remediation, plant held for future use, and storm amortization.

<sup>52</sup> Investor-Supplied Working Capital Adjustments (Adjustment 13.23 electric; Adjustment 11.23 natural gas).

<sup>53</sup> We note that the Settling Parties agree only to Staff’s proposal to set the total Allowed Revenue for fixed production costs recovery per decoupled group at the level the Commission authorizes in this general rate proceeding. Settlement Stipulation ¶113. All other issues with respect to PSE’s revenue decoupling mechanism, including the earnings sharing mechanism, are not affected by the Settlement and are expressly identified as being subject to litigation. Settlement Stipulation ¶114.

66 Specifically benefitting low-income customers, the Settlement Stipulation recommends:

- Increased HELP bill assistance funding.
- Continuation of existing low-income weatherization funding commitments, including a shareholder contribution.
- \$2 million in increased low-income weatherization funding over current levels.<sup>54</sup>
- HELP eligibility improvements.
- Establishment of a PSE Low-Income Advisory Committee.
- Consultation agreements regarding program modifications.

These components reflect PSE's long-standing commitment to its bill assistance and weatherization programs for low-income customers. This is reflected in the fact that many of the low-income provisions included in the Settlement were proposed by PSE in its initial filing in the case.

67 In terms of cost of capital, one of the two key factors determining revenue requirements in this case, the Settling Parties agree to reduce the return on equity component in the Company's capital structure to 9.5 percent from 9.8 percent, which is the level in effect today. The settled return on equity matches the return on equity currently approved for Avista and Pacific Power. Public Counsel contends this is "an unreasonably high authorized return on equity."<sup>55</sup>

68 In terms of the second key revenue requirements issue, Colstrip depreciation, the Settling Parties agree to continue using straight-line depreciation to allow PSE to recover the undepreciated shareholder investment in Colstrip Units 1 & 2, adjusting the depreciation schedule to reflect the planned closure of these facilities by July 1, 2022. Ms. Colamonici testified that "Public Counsel agrees that depreciation should be accelerated for Units 1

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<sup>54</sup> Ms. Collins testified for The Energy Project that:

This is a one-time commitment that is in place until June 30, 2019. This will benefit the programs by making additional resources available for installation of Department of Commerce approved cost-effective energy efficiency measures. The funding can be applied to project coordination, health and safety measures, and repairs necessary for the installation, adding to the flexibility and effectiveness of weatherization program delivery.

S. Collins, Exh. SMC-4T at 5:10-15.

<sup>55</sup> Colamonici, Exh. CAC-1T at 2:13.

and 2.”<sup>56</sup> Indeed, Public Counsel does not dispute the proposed use of a depreciation schedule tied to the planned closure date for Colstrip Units 1 & 2. At the same time, however, she testified the “Settlement’s proposed annual depreciation expense for Colstrip Units 1 and 2 is excessive.”<sup>57</sup> She proposes that “surplus depreciation” tied to other production assets should be used to offset Colstrip depreciation.<sup>58</sup>

69 The decision to close Colstrip Units 1 & 2 well in advance of them being fully depreciated under current depreciation schedules that run to 2035, raised not only issues of depreciation expense, but also questions concerning the costs of decommissioning and remediation that will be incurred in the future. PSE proposed, and the parties agreed in their settlement, to “repurpose” current regulatory liabilities consisting of Treasury Grants received in connection with the relicensing of the Lower Baker River and Snoqualmie River hydroelectric facilities, and Production Tax Credits arising from several wind power projects, as sources of funds to cover depreciation and future decommissioning and remediation costs.

70 Public Counsel does not oppose this means of financing Colstrip decommissioning and remediation cost, but Ms. Colamonici stated that “Public Counsel has some concerns on whether PSE’s PTCs will be monetized . . . to offset any unrecovered depreciation expense associated with Colstrip Units 1 and 2.”<sup>59</sup> She testified in addition, however, that “Public Counsel believes the risk of monetization is appropriately placed on PSE.”<sup>60</sup>

71 The Settling Parties also agreed that the depreciation schedule, and corresponding depreciation expense, for Colstrip Units 3 and 4 would be recalculated to run through December 31, 2027. This compares to the current depreciation schedules ending in 2044 and 2045, respectively. Ms. Colamonici testified, “Public Counsel believes that a depreciation schedule ending in 2035 is more suitable for Units 3 and 4; however, Public Counsel would accept a depreciation schedule ending in 2030 as a reasonable settlement outcome.”<sup>61</sup>

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<sup>56</sup> We note that there is no proposal in this case to use accelerated depreciation for any Colstrip assets as that term is used in the accounting profession. The Settlement Stipulation proposes to continue the use of straight-line depreciation but over a shorter time period.

<sup>57</sup> Colamonici, Exh. CAC-1T at 2:18-19.

<sup>58</sup> Colamonici, Exh. CAC-1T at 4:3-11; 20-22.

<sup>59</sup> Colamonici, Exh. CAC-1T at 5:8-10.

<sup>60</sup> Colamonici, Exh. CAC-1T at 5:11-12.

<sup>61</sup> Colamonici, Exh. CAC-1T at 4:22-5:2.

72 In terms of disputed issues not addressed by the Settlement Stipulation, we must resolve exclusively on the basis of our evidentiary record important cost of service study, rate design, and tariff related issues. The continuation of decoupling and the form it should take, if continued, remains in dispute, except that the parties agreed to accept Staff's proposed treatment of fixed production costs. Electric rate spread and rate design remain in dispute except that the Settling Parties propose that we accept:

- Staff's proposal for demand charges for Schedules 46 and 49.
- Staff's proposal to discontinue Schedule 40 at the conclusion of PSE's next general rate case.
- Recalculation of the allowed revenue per customer for schedules other than Schedule 40 when Microsoft is removed from Schedule 40, recalculated consistent with the contingent allowed revenue calculations illustrated in Exh. JAP-43 for all customers who continue to be a part of PSE's electric rate decoupling mechanism at that time.
- Kroger's proposed changes to Schedule 25.
- The change in the allocation (*i.e.*, rate spread) of PSE's electric revenue deficiency for Schedules 7A, 10, 11, 12, 25, 26, 29, 31, 46, and 49 from 75 percent to 65 percent of the average rate increase.

73 PSE's proposed Electric Cost Recovery Mechanism (ECRM), modeled after its natural gas pipeline Cost Recovery Mechanism (CRM), remains in dispute. Only PSE supports this proposal.

74 Natural gas rate spread and rate design are not part of the Settling Parties' agreement. A variety of proposals require our decisions on these issues.

75 We address first below the uncontested adjustments. Second, we discuss the two key contested issues that are the subject of the parties' Settlement Stipulation: 1) cost of capital and, specifically, return on equity; and 2) Colstrip issues, including depreciation related to Colstrip Units 1 & 2, and Colstrip Units 3 & 4. Third, in terms of revenue requirements, we resolve issues addressed by the Settlement Stipulation but contested by Public Counsel. Fourth, we address four non-revenue issues addressed in the Settlement Stipulation including: the prudence of eight specific decisions mostly related to uncontested power costs; PSE's proposed expedited rate filing (ERF) process; the proposed treatment of the Company's water heater program; and service quality. The first of these is uncontested, but the Settling Parties request express determinations of prudence. Public Counsel contests the other three.

76 With respect to the issues that are the subjects of the Settlement Stipulation, whether or not contested, the Commission must reach one of three possible results:

- Accept the proposed settlement without condition.
- Accept the proposed settlement subject to one or more conditions.
- Reject the proposed settlement.<sup>62</sup>

77 Any conditions imposed must be supported by the record. Conditions may result from Public Counsel's advocacy opposing the Settlement Stipulation, in part, or may be determined independently by the Commission considering the broader record. Ultimately, to the extent we approve settlement terms, the Commission formally adopts them as its own resolution of the issues.

78 Finally, we turn to our resolution of the non-revenue issues that are not addressed by the Settlement Stipulation and remain fully contested, including most decoupling proposals, PSE's proposed ECRM, and some electric and all natural gas cost of service, rate spread, and rate design issues identified by the parties. We resolve these issues based on the full record.

#### **IV. Revenue Requirements**

##### **A. Uncontested Adjustments**

79 Thirty adjustments to electric revenue requirements and twenty-one adjustments to natural gas revenue requirements proposed by PSE and reflected in the parties' Settlement Stipulation are uncontested. These are depicted in Appendix A to this Order, including revenue requirements metrics. These adjustments are uncontested and adequately supported by the record. We find they should be approved without exception or condition.

80 An additional adjustment, Tax Benefit of Pro Forma Interests, is a pass-through adjustment determined using an uncontroversial approach familiar to all parties. No party contested the manner in which Adjustments 13.05 (electric) and 11.05 (natural gas) – Tax Benefit of Pro Forma Interest should be calculated, although parties differed in the results based on the rate base items included. Accounting for the rate base items included in the Settlement Stipulation, the Settling Parties agreed that this adjustment increases net

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<sup>62</sup> WAC 480-07-750(2).



operating income for electric operations by \$54,067,781 and increases net operating income for natural gas operations by \$18,475,298.<sup>63</sup>

81 Public Counsel contests certain rate base items addressed by the Settlement Stipulation. It would be a relatively straightforward matter to adjust the Tax Benefit of Pro Forma Interest calculation to adjust for any changes in rate base that result from our decisions in this Order. However, because we accept none of Public Counsel's proposed adjustments to rate base, the adjustment amounts agreed by the Settling Parties are approved and adopted for purposes of this Order.

### **B. Key Contested Issues Addressed by Settlement Stipulation**

82 Taking a high level view of this general rate case, we see two principal drivers of revenue requirements. The first is the cost of capital; specifically, the rate of return on equity. The second is the depreciation expense attributable to Colstrip Units 1 through 4. Colstrip raises non-revenue issues as well, including the proposed use of Treasury Grants and not yet monetized PTCs to pay for increased depreciation expenses and, later, decommissioning and remediation costs. The Settling Parties propose, in part, resolutions of these issues in their stipulation. Public Counsel opposes the Settling Parties' recommendations concerning cost of capital and Colstrip. Because cost of capital and Colstrip issues have special significance in the context of this proceeding, we discuss them first below.

#### **1. Capital Structure and Cost of Capital**

##### **a. Settlement Stipulation**

83 The Settling Parties agree to a capital structure for PSE that includes 48.5 percent equity and 51.5 percent debt, an authorized return on equity for PSE of 9.50 percent, and an authorized cost of debt for PSE of 5.81 percent. Application of these factors results in an overall authorized rate of return for PSE of 7.60 percent, as reflected in Table 3A below.

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<sup>63</sup>Settlement Stipulation ¶23 n3 (Adjustment No. 13.05 – Tax Benefit of Pro Forma Interest is equal to the product of (i) electric rate base of \$5,166,534,272, multiplied by (ii) the weighted average cost of debt of 2.99 percent, multiplied by (ii) the federal tax rate of 35 percent.)

**Table 3A**  
**Proposed Cost of Capital**

	<b>Capital Structure</b>	<b>Cost</b>	<b>Weighted Cost</b>
Debt	51.5%	5.81%	2.99%
Equity	48.5%	9.50%	4.61%
Overall Rate of Return	100.0%		7.60%

This compares to PSE’s currently approved cost of capital, as shown below in Table 3B.

**Table 3B**  
**Authorized Cost of Capital**

	<b>Capital Structure</b>	<b>Cost</b>	<b>Weighted Cost</b>
Debt	52.0%	5.96%	3.10%
Equity	48.0%	9.80%	4.70%
Overall Rate of Return	100.0%		7.80%

84 Both tables reflect a blended cost of debt, most of which is priced at the higher rates for long-term debt relative to short-term debt, which is less than 5 percent of total debt. Expressed in dollars of revenue requirement, the proposed 30 basis point reduction in return on equity (ROE) from the current rate amounts to approximately \$37.5 million less for electric operations and \$11.25 million less for natural gas operations.<sup>64</sup>

85 The primary issue in dispute at this juncture is whether the Settlement Stipulation proposes a reasonable level for PSE’s ROE, at 9.5 percent, or should be rejected in favor of Public Counsel’s alternative view that PSE’s ROE should be reduced by 95 basis points to 8.85 percent.<sup>65</sup> We evaluate this issue with reference to the full record.<sup>66</sup> This

<sup>64</sup> See Cheesman, Exh. MCC-1T at 24:4-5, Table 4.

<sup>65</sup> Viewed on a stand-alone basis, a 95 basis point reduction in ROE represents a \$118.8 million reduction in revenue requirement for electric operations and a \$35.6 million reduction in revenue requirement for natural gas operations.

<sup>66</sup> We note Public Counsel’s support in its Initial Brief of this familiar approach to contested issues in the context of the Commission’s consideration of a Settlement Stipulation. Public Counsel, with reference to WAC 480-07-740(2)(c), observes that:

Non-settling parties, such as Public Counsel in this case, may offer evidence and argument in opposition, and opponents retain certain expressed rights, including cross examination and the right to present evidence. WAC 480-07-740(2)(c). As

includes the settlement testimony supporting and opposing the compromise reflected in the Settlement Stipulation and the prefiled testimony prepared by four highly credentialed expert witnesses who provided for our record their detailed analyses of what PSE's ROE should be going forward from this point in time.<sup>67</sup>

86 The expert witnesses do not dispute that determining an appropriate ROE presents challenges. They rely on familiar analytic tools such as discounted cash flow (DCF) models and capital asset pricing models (CAPM). They use a variety of data sources to populate these and other models to arrive at and support their respective ROE recommendations. The results of the analytic models they use to estimate ROE can vary significantly due to subjective judgments they make when selecting specific approaches to each model and when selecting the information to use as inputs to their models. This is illustrated, for example, by the fact that all four experts use a form of the DCF model, yet arrive at results that range from 8.65 percent ROE to 9.8 percent ROE. Similarly, all four experts relied on CAPM approaches, yet determined results that range from 6.75 percent to 9.8 percent. The results vary with the experts' selection of proxy groups and their reliance on different sources for growth rates, discount rates, and risk premiums. All of the expert witnesses' analytical results are portrayed in Table 4.

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a result, the Commission must resolve the issues in this case as contested matters on the basis of the record before it while determining whether it will accept, reject, or modify the multiparty settlement. [*In re Puget Sound Energy*, Dockets UE-121373, UE-121697 and UG-121705, and UE-130137 and UG-130138, Order 06 and 07, Order Rejecting Multiparty Settlement ¶ 17 (Jun. 25, 2013)].

To do this, the Commission "weighs the evidence offered in support of the common positions advocated by the Settling Parties against the evidence opposing the results advocated by the Settling Parties, and the evidence offered by the non-settling parties in support of the alternative results that they advocate." [*Id.*] The Commission decides each contested issue on its merits considering the full record. [*Id.*]

Public Counsel Initial Brief ¶¶36-37 (including footnoted citations in original).

<sup>67</sup> Each witness included testimony and an exhibit summarizing their professional credentials. *See* Morin, Exh. RAM-1T at 1:5-3:9; Exh. RAM-2; Woolridge, Exh. JRW-1T at 1:2-9; Exh. JRW-2; Parcell, Exh. DCP-1T at 1:3-19; Exh. DCP-2; Gorman, Exh. MPG-1T at 1:1-9; Exh. MPG-2.

**Table 4: Summary of Witness ROE Financial Modeling Results**

	Morin <sup>68</sup>	Parcell <sup>69</sup>	Gorman <sup>70</sup>	Woolridge <sup>71</sup>
<b>DCF:</b>				
Value Line Growth	9.8%		9.4%	
Analysts Growth	9.4%		9.4%	
Traditional DCF		8.85%		
Electric Proxy Group				8.65%
Morin Proxy Group				8.85%
Gas Proxy Group				8.9%
<b>CAPM:</b>				
Traditional CAPM:	9.3%	6.75%	8.6%	
Empirical CAPM:	9.8%		Reject Morin	
Electric Proxy Group				7.7%
Morin Proxy Group				7.7%
Gas Proxy Group				7.9%
<b>Risk Premium:</b>				
Historical Electric	10.5%		9.8%	
Allowed ROE	10.7%		9.3%	
Comparable Earnings		9.5%		
<b>ROE Recommendation</b>	<b>9.80%</b>	<b>9.20%</b>	<b>9.10%</b>	<b>8.85%<sup>72</sup></b>

<sup>68</sup> Morin, Exh. RAM-1T at 55:14.

<sup>69</sup> Parcell, Exh. DCP-1T at 4:1. Mr. Parcell actually selected the midpoints of a range of modeling results based on analysis of two proxy groups used for comparison purposes. The ranges of his DCF, CAPM and CE analysis are 8.7-9.0 percent (8.85 percent mid-point), 6.5-7.0 percent (6.75 percent mid-point), and 9.0-10.0 percent (9.5 percent mid-point), respectively.

<sup>70</sup> Gorman, Exh. MPG-1T at 12:1. Unlike his customary approach in previous Washington proceedings to produce his own modeling results, Mr. Gorman presents his analysis as a series of adjustments to the modeling employed by the Company's witness, Dr. Morin

<sup>71</sup> Woolridge, Exh. JRW-1T at 53:18. It is worth noting that Mr. Woolridge relies primarily on his DCF analysis to estimate PSE's cost of equity. He also prepared a CAPM study but places less weight on it because it provides a less reliable indication of equity cost rates for public utilities.

<sup>72</sup> Woolridge, Exh. JRW-1T at 54:2-5.

**b. Public Counsel**

87 Public Counsel does not contest PSE's proposed capital structure. Dr. Woolridge testified for Public Counsel that he accepted the Company's proposed short-term and long-term debt cost rates of 3.06 percent and 5.73 percent and also used PSE's proposed adjustments to the short-term and long-term debt cost rate for commitment fees and amortization of term issuance costs and of reacquired debt.

88 Ms. Colamonici testified that Public Counsel believes the record in this case supports returns that are lower than the Settlement's proposed 9.50 percent ROE and 7.6 percent ROR.<sup>73</sup> She points to the fact that two other Settling Parties, Commission Staff and ICNU, filed evidence indicating significantly lower recommendations. She fails to mention that these parties no longer advocate, respectively, 9.2 percent ROE and 9.1 percent ROE; they now support the 9.5 percent ROE that is the Settling Parties' compromise position within the ranges of possible and reasonable returns indicated by the expert testimony. Ms. Colamonici testified that Public Counsel's alternative view is that ROE is more appropriately set at 8.85 percent with an ROR of 7.28 percent.<sup>74</sup> As Dr. Woolridge recognized in his settlement response testimony:

The primary reason provided in Staff's joint testimony . . . for supporting the ROE of 9.50 percent is that this figure is within the ROE ranges of PSE witness Dr. Roger Morin, Staff witness Mr. David Parcell, and ICNU witness Mr. Michael Gorman.<sup>75</sup>

89 Thus, Staff and the other Settling Parties recognized that a 9.5 percent ROE is in the range of reasonable returns shown by the record. In contrast, Ms. Colamonici testified that PSE's ROE should be set at 8.85 percent with an ROR of 7.28 percent,<sup>76</sup> based exclusively on Dr. Woolridge's ROE analyses and testimony, ignoring completely the

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<sup>73</sup> Colamonici, Exh. CAC-1T at 3:9-10.

<sup>74</sup> Colamonici, Exh. CAC-1T at 3:14-16 (with reference to Woolridge, Exh. JRW-1T – JWR-16).

<sup>75</sup> Woolridge, Exh. JRW-18T at 2:14-17. Dr. Woolridge's testimony belies the argument in Public Counsel's Initial Brief that "the Settlement testimony offers no rationale for why they chose this figure." Public Counsel Initial Brief ¶41. We note, too, that during cross-examination of Staff witnesses Schooley and Cheesman, Public Counsel elicited testimony confirming that "the ROE is 9.5, within the range of Dr. Morin, PSE[s] witness, and Staff[s] witness] Mr. Parcell." TR. 601:14-18.

<sup>76</sup> Colamonici, Exh. CAC-1T at 3:14-16 (with reference to Woolridge, Exh. JRW-1T through Exh. JWR-16).

higher ROE levels shown by similar analyses performed by the other three cost of capital expert witnesses in this case, Dr. Morin, Mr. Parcell, and Mr. Gorman.

*Commission Determination*

- 90 Public Counsel’s “alternative view” fails to acknowledge that it is well established regulatory practice, and indeed the Commission’s long-standing practice, to first identify within the range of *possible* returns shown by expert analyses a range of *reasonable returns* on equity considering all cost of capital testimony in the record. Then, the Commission weighs the analysts’ results falling within that range and considers other evidence relevant to the selection of a specific point value within the range. The Commission’s final determination of what is an acceptable return on equity recognizes fully the guiding principles of regulatory ratemaking that require us to reach end results that yield fair, just, reasonable and sufficient rates.<sup>77</sup>
- 91 The Commission benefits significantly from being informed by the different perspectives the expert witnesses take in making their subjective judgments, but must carefully balance their results to establish the end points of a zone of reasonableness within which the selection of a specific point value can be made for ROE considering the modeling and other factors in evidence. Public Counsel’s alternative view that we should ignore the larger body of evidence in favor of deciding the issue of ROE based largely, if not exclusively, on Dr. Woolridge’s testimony is inconsistent with what we believe to be sound regulatory practice.<sup>78</sup>

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<sup>77</sup> See *Fed. Power Comm'n v. Hope Nat. Gas Co.*, (Hope) 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944); *Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n of W. Va.*, (Bluefield) 262 U.S. 679, 43 S. Ct. 675, 67 L. Ed. 1176 (1923).

<sup>78</sup> Reliance on a single cost of capital expert witness would ignore that these witnesses have testified in many cases during their careers and are known to routinely testify on behalf of one class of interests or another among the diverse interests that regularly are represented in the utility ratemaking process. As the Commission discussed in an earlier order, it is not a criticism to observe that:

They unquestionably are selected by their clients, in part, on the basis of their tendency to occupy a reasonably predictable relative position concerning the range and point values they recommend for return on equity in any given case. This merely emphasizes the point that regulators, considering the subjective and judgment-based models on which these experts rely, face the challenge in every case of weighing diverse testimony and sometimes wide-ranging estimates of the cost of equity capital. We must weigh this evidence carefully, considering the context in which the case is being considered and also factors such as the general state of the economy, investment cycles in the industry, the principle of

92 Dr. Woolridge’s analytical results contribute to our determinations, being indicative as they are of lower rates of return now prevalent in the industry relative to earlier periods. Dr. Woolridge’s reported results for PSE, however, are markedly low relative to the other witnesses’ results and relative to the measures he cites throughout his own testimony as being indicative of ROE trends in the industry.<sup>79</sup> Dr. Morin critiques Dr. Woolridge’s recommended ROE of 8.85 percent as being “well outside the zone of reasonableness and outside the zone of currently allowed returns on equity authorized by state utility commissions in 2017, which averages 9.9 percent.” He also points out that Dr. Woolridge’s recommended ROE lies well below the zone of the allowed and expected returns on equity of his own proxy group of electric utilities, whose earned returns on equity are 9.3 percent (electric) and 9.4 percent (gas).<sup>80</sup> Similar criticisms might be leveled at Dr. Morin’s risk premium results at 10.5 percent and 10.7 percent. These might be considered markedly high results relative to what the full body of evidence otherwise suggests. Indeed, Dr. Woolridge offers an extensive critique of Dr. Morin’s risk premium analyses.<sup>81</sup>

93 The range of possible returns on equity shown by the expert witnesses’ respective analyses is 6.75 percent to 10.7 percent, a spread of nearly 400 basis points. Such a spread suggests that the lower end results and the higher end results shown in Table 4 are outside of the zone of reasonable returns, which typically is determined to fall within a somewhat narrower range. This is suggested, too, by broader trends in the industry, reflected for example in the expected and earned returns on equity experienced by the

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gradualism, and so forth. In the final analysis, we must exercise our own informed judgment to determine, in the public interest, what constitutes a reasonable range of returns and what point value to select within this range to determine a company’s revenue requirements and, hence, its rates.

*In the Matter of the Petition of Puget Sound Energy and NW Energy Coalition For an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms*, Dockets UE-121697 and UG-121705 (consolidated) (Decoupling) and *Washington Utilities and Transportation Commission v. Puget Sound Energy*, Dockets UE-130137 and UG-130138 (consolidated) (ERF), Order 15/14 ¶32 (June 29, 2015).

<sup>79</sup> See, e.g., Woolridge, Exh. JRW-1T at 54:20-55:3 (“The authorized ROEs for electric utilities have declined from 10.01 percent in 2012, to 9.8 percent in 2013, to 9.76 percent in 2014, 9.58 percent in 2015, and 9.60 percent in 2016, according to Regulatory Research Associates. The authorized ROEs for gas distribution companies have declined from 9.94 percent in 2012, to 9.68 percent in 2013, to 9.78 percent in 2014, 9.60 percent in 2015, and 9.50 percent in 2016.”).

<sup>80</sup> Woolridge, Exh. JRW-1T at 20:11-12, 21.

<sup>81</sup> Woolridge, Exh. JRW-1T at 66:10-75:3.

companies in Dr. Woolridge's proxy groups. The conservative approach favored by the Commission leads us to reject the analytical results reported in this case that fall below 9.0 percent or above 10.0 percent and to select a narrower range of reasonable returns focusing on the cluster of values in the range from 9.3 percent to 9.8 percent. Indeed, considering all of the expert witnesses' analytical results and industry trends during recent periods, we determine that the range of reasonable returns is from 9.3 percent to 9.8 percent. Giving equal weight to all of the expert's results that fall within this range we determine that the Settlement Stipulation's proposed ROE of 9.5 percent is reasonable and fully supported by the record.<sup>82</sup>

94 The Commission determines for these reasons that it should approve and adopt the Settlement Stipulations recommended ROE of 9.5 percent. Inasmuch as the balance of the capital structure and cost of capital results proposed by the Settlement Stipulation are not contested, we also determine that we should approve and adopt an overall rate of return of 7.60 for purposes of establishing revenue requirements and rates in this proceeding.<sup>83</sup>

## 2. Colstrip Costs: Depreciation Expense; Future Decommissioning and Remediation Expense

95 PSE owns a 50 percent interest in two, and a 25 percent interest in two other, coal-fired generation facilities located in Colstrip, Montana. The first two facilities, known as Colstrip Units 1 & 2, were placed into service in 1975 and 1976, respectively. The other two facilities, known as Colstrip Units 3 & 4, were placed in service in 1984 and 1986. These are large baseload plants. Colstrip Units 1 & 2 have a combined capacity of approximately 614 MW. Colstrip Units 3 & 4 have a combined capacity of approximately 1480 MW.

96 The genesis of the problems we face today with respect to the Colstrip units is found, in part, in a Commission decision in 2008 in PSE's 2007 general rate case in Docket UE-072300. The Company put into evidence a depreciation study indicating a probable retirement year of 2019 for Colstrip Units 1 & 2 based on a projected 44-year lifespan for Unit 1 and a projected 43-year lifespan for Unit 2.<sup>84</sup> Based on similar projected lifespans,

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<sup>82</sup> We note, too, that a 30 basis point reduction from PSE's currently effective 9.8 percent ROE appropriately reflects the principle of gradualism in adjusting rates. In contrast, to approve the 95 basis point reduction Public Counsel advocates would be antithetical to this important ratemaking principle.

<sup>83</sup> See *supra* ¶ 49, Table 3A.

<sup>84</sup> Hausman, Exh. EDH-1T at 8:8-14.



PSE's 2007 depreciation study used 2024 and 2025 end-of-life dates for Colstrip Units 3 & 4, respectively.

97 Ultimately, however, the Company joined a multi-party settlement in Docket UE-072300 that recommended a 60-year life for these assets, thereby extending the depreciation schedule for the recovery of remaining plant balances through 2035 for Units 1 & 2 and through 2044 and 2045 for Units 3 & 4. This resulted in the Company recovering less depreciation expense year by year going forward.<sup>85</sup> The Commission approved and adopted the proposed settlement, accepting these recommendations by Staff and Public Counsel to which PSE acceded during the negotiation process.<sup>86</sup>

98 The Commission's 2008 order merely acknowledged this feature of the parties' settlement in a single paragraph<sup>87</sup> and did not discuss that the recommendations by Staff and Public Counsel focused on comparisons to other coal plants and historical data. Mr. Hausman, testifying in this case for Sierra Club, related that the data presented in 2007 included, for example, testimony from Public Counsel's witness Mr. King presenting an analysis of coal-fired plant retirements going back to 1900.<sup>88</sup> Thus, it appears that neither the parties recommending a change in Colstrip depreciation nor the Commission considered in 2007 that the operating environment affecting these facilities began changing significantly during the later years of the 20<sup>th</sup> Century and since 2000. Particularly during the current era, growth in demand for electricity slowed with the advent of stringent appliance energy efficiency standards, and successful utility-run energy efficiency programs such as PSE's conservation initiatives. Environmental regulations have required existing coal-fired plants to reduce their emissions, often necessitating expensive equipment additions and upgrades. The development of specific renewable energy sources has been subsidized by the federal government including

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<sup>85</sup> Another accounting measurement of the impact from recognizing the extended depreciation can be made by calculating a theoretical depreciation reserve for these assets.<sup>85</sup> In the case of all four Colstrip units this would be accomplished by calculating depreciation from each plant's in-service date, if built, or acquisition date, if purchased, *as if* the newly established, longer depreciation schedule had been in place from the beginning. The result would be a theoretical reserve surplus indicating depreciation over recovery.

<sup>86</sup> *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-072300 and UG-072301 (consolidated), Order 12, ¶¶ 57, 102 (October 8, 2008).

<sup>87</sup> *Id.* ¶ 57.

<sup>88</sup> Hausman, Exh. EDH-1T at 9:1-2 (citing WUTC Docket No. UE-072300, Testimony of William H. Weinman, (Exh. EDH-4 p. 8 at 7); and Testimony of Charles W. King, (Exh. EDH-5 pp. 11-12)).

Production Tax Credits for wind projects, and Treasury Grants for hydroelectric facilities. At the same time, the costs of renewables has come down significantly, while the demand for renewable sourced energy has increased as a result of state Renewable Portfolio Standards and other state policies. Finally, the availability of natural gas has increased and the current and expected cost of gas has dropped to the point where it is often cost-preferable to coal as a generation fuel.

99 All of these factors have combined to create conditions in which many coal plants cannot compete economically and cannot justify increased investments in environmental control technologies or improved operational efficiencies. According to Sierra Club witness Dr. Hausman, more than 250 coal plants, or about 50 percent of all coal plants in the United States, have retired or committed to retire since 2010.<sup>89</sup> In this environment where “even larger, younger coal plants are struggling to survive the economic competition from cleaner, cheaper energy sources,”<sup>90</sup> plants such as Colstrip Units 1 & 2, which are more than 40 years old, and even Colstrip Units 3 & 4, which are more than 30 years old, are at, or at least approaching, the end of their useful lives. There is a new focus, too, on the costs of decommissioning these facilities and remediating environmental damage they have caused. Many older coal-fired power plants, including the Colstrip facilities, were built and approved for recovery in utility rates before planning for decommissioning and remediation costs was standard practice.

100 These facts significantly implicate rates in the case of regulated utilities such as PSE, which is entitled to recover both return of, and return on, its prudent investments in assets over their useful lives. If changed circumstances, particularly circumstances beyond the utility’s ability to control, result in it being prudent for power production assets to be retired earlier than anticipated, then rate regulatory authorities such as the Commission face the potentially daunting task of balancing the interests of shareholders in recovering the full costs of their investments and ratepayers in bearing those costs without suffering undue rate increases. In addition, earlier than anticipated plant closures, particularly coal plant closures, may impose decommissioning and environmental remediation costs for which adequate plans have not been made. Such are the challenges we face in this case with respect to Colstrip Units 1 through 4.

101 On July 12, 2016, PSE, current Colstrip coal plant operator Talen Energy (Talen), Sierra Club, and Montana Environmental Information Center filed a consent decree in the

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<sup>89</sup> Hausman, Exh. EDH-1T at 12:7-9.

<sup>90</sup> Hausman, Exh. EDH-1T at 12:9-10.

United States District Court of Montana setting a closure date for Colstrip Units 1 & 2 of no later than July 1, 2022.<sup>91</sup> PSE and Talen may shut these units down at an earlier date.

- 102 Preparing for this general rate case, which the Company was required to file by mid-January 2017, PSE commissioned a full depreciation study related to Electric, Gas, and Common plant as of September 30, 2016. Specifically regarding Colstrip Units 1 & 2, the study moved the depreciable life up by 13 years from 2035 to the agreed retirement date and used straight-line depreciation to recover the remaining net book value by mid-2022.
- 103 Although there is today no definite plan to close Colstrip Units 3 & 4 by a specific date, environmental and financial concerns affecting the prospects for continued operation of these plants influenced PSE to take a cautious and conservative approach to depreciation of these assets as well. PSE proposed in its depreciation study to shorten the depreciable lives of Colstrip Units 3 & 4 by about 10 years, from 2044 and 2045, respectively, to 2035. PSE's study again used straight-line depreciation to recover the remaining book value by December 31, 2035.
- 104 PSE also proposed in its filing in this case to place Treasury Grants it received in connection with its Lower Baker River and Snoqualmie River hydroelectric facilities and its existing PTCs into a regulatory liability account to fund decommissioning and remediation costs of Colstrip Units 1 & 2. This reflected both PSE's recognition of the necessity of planning for these future costs and the fact that during the 2016 legislative session, the Washington legislature passed Engrossed Substitute Senate Bill 6248 (ESSB 6248) expressly allowing the Commission to authorize electric companies to utilize regulatory liabilities to create reserve accounts for the purpose of funding decommissioning and remediation costs for eligible coal units.
- 105 With this background, we turn our attention to the Settling Parties' proposals related to depreciation and decommissioning and remediation costs, and to Public Counsel's alternative viewpoint that focuses on depreciation.

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<sup>91</sup> McGuire, Exh. CRM-1T at 9:1-4.

**a. Settlement Stipulation**

**i. Depreciation Study (Electric Adjustment 13.06)<sup>92</sup>**

106 The Settling Parties, putting their various litigation positions aside, ultimately agreed to use the depreciation study provided by PSE witness, Mr. Spanos,<sup>93</sup> subject to modifications, particularly with respect to Colstrip Units 3 & 4. Based on the projected closure date of mid-2022, the Settlement Stipulation sets depreciation rates for Colstrip Units 1 & 2 at amounts that would yield annual depreciation expense of \$18.5 million for the remaining operational lives of those units.<sup>94</sup> PSE will recover the remaining plant balances for these assets using monetized PTCs as they become available for placement in a separate account that is expressly “not established” under the ESSB 6248.<sup>95</sup> PSE, however, assumes the risk that it may be unable to monetize the PTCs to offset all, or some part of, the unrecovered plant balances for these assets; provided, however, that if Colstrip Units 1 & 2 close prior to the monetization of sufficient PTCs to offset unrecovered plant balances, PSE will hold the remaining unrecovered plant balances in rate base as a regulatory asset until the earlier of (i) the recovery of all plant balances for Colstrip Units 1 & 2 through monetized PTC offsets or, (ii) December 31, 2029.<sup>96</sup>

107 The Settling Parties agreed to a depreciation schedule for Colstrip Units 3 & 4 that assumes a remaining useful life of those units through December 31, 2027. This is eight years less than what PSE proposed in its original filing. Staff’s settlement witnesses point out that “the 2027 date is not a retirement date, but simply reduces the depreciable life for Units 3 and 4 by eight years compared to Mr. Spanos’ depreciation study.”<sup>97</sup> December 31, 2027, reflects a compromise position considering competing proposals presented by PSE and several other parties. The Settlement Stipulation sets depreciation rates for Colstrip Units 3 & 4 at amounts that will yield annual depreciation expense of

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<sup>92</sup> The Settling Parties similarly agree to use Mr. Spanos’s depreciation study for Adjustment No. 11.06 – Depreciation Study (Natural Gas). They further agree that this adjustment is uncontested for natural gas operations and (i) increases net operating income for natural gas operations by \$13,174,098 and (ii) increases rate base for natural gas operations by \$6,587,049. The adjustment, however, is contested by Public Counsel. We discuss this separately below.

<sup>93</sup> Exh. JJS-3r.

<sup>94</sup> Schooley/Cheesman, Exh. TES-4T at 7:21-22.

<sup>95</sup> Codified as RCW Chapter 80.84.

<sup>96</sup> Settlement Stipulation ¶25.

<sup>97</sup> Schooley/Cheesman, Exh. TES-4T at 8:16-18.

approximately \$23.3 million for the remaining depreciable lives of those units.<sup>98</sup> The settlement again provides that monetized PTCs will be used to recover any remaining plant balances. In contrast to the settlement provisions concerning Units 1 & 2, the Settlement Stipulation does not address the eventuality of there not being sufficient monetized PTCs to cover fully the remaining plant balances.

108 Sierra Club settlement witness Mr. Howell, while acknowledging that the Settlement Stipulation does not set a closure date for Colstrip Units 3 & 4, testified that it “sets a clear path for PSE to pay down the undepreciated plant balances on a schedule that better recognizes the fact that the entire Colstrip coal plant is unlikely to operate past 2025.”<sup>99</sup> Mr. Howell testified in some detail concerning Sierra Club’s view that “current economic, environmental and political factors demonstrate that Colstrip Units 3 and 4 are unlikely to operate past December 31, 2024.”<sup>100</sup> Mr. Howell testified that Sierra Club would prefer an earlier date, but 2027 “represents a reasonable compromise for purposes of settlement that is in the public interest.”<sup>101</sup> Indeed, Mr. Howell testified that “setting the depreciation schedule for Colstrip Units 3 and 4 at December 31, 2027, is a critical step in planning for the retirement of those units.”<sup>102</sup> He referred to Dr. Hausman’s testimony that current economic, environmental, and political factors suggest that Colstrip Units 3 & 4 are unlikely to operate past December 31, 2024,”<sup>103</sup> and then discussed specific examples reflecting these factors.<sup>104</sup>

109 PSE’s settlement witnesses testified that “the realignment of the depreciation life for Colstrip Units 3 and 4 to December 31, 2027, is a way to minimize any future intergenerational inequities that could occur should circumstances change that further shorten the life of any of the Colstrip units.”<sup>105</sup> Thus, “the 2027 depreciation date helps to lessen the risk of repeating the situation that arose with Colstrip Units 1 and 2 in 2008,

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<sup>98</sup> Joint Memorandum in Support of Multiparty Partial Settlement ¶ 13.

<sup>99</sup> Howell, Exh. DHH-1T at 4:8-10.

<sup>100</sup> Howell, Exh. DHH-1T at 6:17-18. *See also id.* at 6:19-9:10.

<sup>101</sup> Howell, Exh. DHH-1T at 4:11-12. *See also id.* at 5:1-8.

<sup>102</sup> Howell, Exh. DHH-1T at 6:15-16,

<sup>103</sup> Howell, Exh. DHH-1T at 6:16-18.

<sup>104</sup> Howell, Exh. DHH-1T at 6:19-9:7

<sup>105</sup> Exh. PSE-1JT at 6:20-7:3.

when the assets' depreciable lives were extended, resulting in an undepreciated plant balance for those units at the time of retirement."<sup>106</sup>

110 Staff settlement witnesses Schooley and Cheesman testified concerning the difficulty of projecting the lives of coal-fired production plant. Though they do not refer to it, this difficulty is clearly evidenced by the unintended consequences of the Commission's decision in PSE's 2007 general rate case with respect to the depreciable lives for Colstrip Units 1 & 2. Had the Commission accepted PSE's original depreciation study in that case we would not be facing today the significant financial consequences of a decision in 2008 that proved with the passage of time to be ill-advised. Instead, Colstrip Units 1 & 2 would have been fully depreciated by 2019, and Units 3 & 4 would have been fully depreciated by 2024 and 2025. Informed by this experience, the Settlement Stipulation reconciles with recent decisions to close Units 1 & 2, reflects a more focused view with respect to Colstrip Units 3 & 4, and reduces the potential risk of large unrecoverable plant balances and the likelihood of facing intergenerational inequities for Units 3 and 4.<sup>107</sup>

ii. **Accounting for Depreciation, and Decommissioning and Remediation**

111 Balancing PSE's interest in recovering all of the net plant amounts remaining on its books for the Colstrip units as of September 30, 2016, against the Settling Parties' common interest in protecting ratepayers from significant rate impacts and avoiding intergenerational inequities, the Settlement Stipulation establishes two new accounts. One account will be used to manage repurposed Treasury Grants to fund decommissioning and remediation costs that will follow in the wake of the closure of the Colstrip plants. PSE will place \$95 million in hydro-related Treasury Grants into a retirement account established pursuant to RCW 80.04.350 to fund and recover prudently incurred decommissioning and remediation costs for Colstrip Units 1 & 2, consistent with Chapter 80.84 RCW. In joint testimony supporting the Settlement Stipulation, Ms. Barnard, Ms. Free, and Mr. Piliaris testified that "[t]he existing \$95 million in hydro-related Treasury Grants addresses nearly all of the estimated decommissioning and remediation costs for Colstrip Units 1 and 2."<sup>108</sup>

112 As PTCs are monetized, PSE will place them in a second, more flexible account that the Settling Parties expressly agree will not be established pursuant to Chapter 80.84 RCW.

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<sup>106</sup> Exh. PSE-1JT at 7:6-12.

<sup>107</sup> See Schooley/Cheesman, Exh. TES-4T at 8:14-22.

<sup>108</sup> Exh. PSE-1JT at 5:13-14.

PSE will use the monetized PTCs in the second account with the following priorities: (i) to fund community transition planning funds of \$5 million for the benefit of citizens in Colstrip, Montana; (ii) to recover unrecovered plant balances for Colstrip Units 1 through 4; and (iii) to fund and recover prudently incurred decommissioning and remediation costs for Colstrip Units 1 through 4. PSE's witnesses supporting the settlement stated that "[b]ased on the average of the monthly averages balances in 2016, the PTCs available are estimated at approximately \$280 million."<sup>109</sup> In addition to applying remaining available monetized PTCs to fund decommissioning and remediation costs, PSE will also apply the \$95 million in Treasury Grants that will be statutorily earmarked for this purpose.<sup>110</sup>

113 PSE's witnesses testified that from the Company's perspective a key rationale for taking these accounting measures to address depreciation is that it is a way to avoid intergenerational inequities. They discuss that:

Customers received the benefit of lower depreciation rates for all four units of the Colstrip Generating Plant during the 2009 through 2017 period due to the extension of the assets depreciable life to 60 years, as proposed by Public Counsel and Commission Staff in the 2007 general rate case, and as ultimately agreed to by PSE in the settlement of that case. This contributed to the undepreciated plant balance for Colstrip Units 1 and 2 that we now face, with Colstrip Units 1 and 2 scheduled to close no later than 2022. The time period when the depreciable lives were extended closely aligns with the period that the PTCs were generated; however, due to ongoing net operating losses PSE has not been able to ... utilize these PTCs on its tax return and customers have not yet received the benefit of these credits. The use of some of the monetized PTCs to address the undepreciated balance of Colstrip units is a reasonable approach, and it allows the credits earned over this time period to pay for the undepreciated plant balance that accrued over approximately the same time period. This use of PTCs, along with the realignment of the depreciation life for Colstrip Units 3 and 4 to December 31, 2027, is a way to minimize any future intergenerational inequities that could occur should circumstances change that further shorten the life of any of the Colstrip units.<sup>111</sup>

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<sup>109</sup> Exh. PSE-1JT at 5:17-19 (citing Marcelia, Exh. MRM-1T at 9:Table 1).

<sup>110</sup> Exh. PSE-1JT at 5:19-6:3.

<sup>111</sup> Exh. PSE-1JT at 6:4-7:3.

Staff's settlement witnesses testified that by using PTCs in this fashion "there is a better balance between today's generation of customers and the future generations."<sup>112</sup> In addition, "PSE will be largely made whole for Colstrip Units 1 and 2; and the tax credits mitigate potential rate impacts if the depreciation expense is insufficient to recover the entire plant balances."<sup>113</sup>

114 Ms. Gerlitz testified for NWECC/RNW/NRDC that aligning the accounting treatment for Colstrip Units 1 & 2 with the agreement to close of these units no later than 2022 "reduces intergenerational inequity by paying off balances that have been historically under-recovered from customers utilizing Production Tax Credits that have been earned over approximately the same time-period under which the plant balances were under-recovered."<sup>114</sup> In addition, she testified that shortening the depreciation schedule for Colstrip Units 3 & 4 to December 31, 2027, aligns with a more accurate estimate of the useful life of these units and "reduce[s] the chances of repeating the mistakes made with regard to the unrecovered plant balances of Colstrip Units 1 and 2."<sup>115</sup> Referring to Dr. Power's response testimony for NWECC/RNW/NRDC, Ms. Gerlitz testified that "PSE failed to recover decommissioning and remediation costs for Colstrip Units 1 and 2 during their 40+ year lifetime ... leaving current rate payers on the hook for substantial [retirement] costs."<sup>116</sup> The Settlement Stipulation, in contrast, aligns the recovery of Colstrip costs with the use of the assets thus providing inter-generational equity for costs of remediation, decommissioning, and demolition.<sup>117</sup>

115 Ms. Gerlitz testified further that:

The Settlement provides a plan to fund future decommissioning and remediation costs at Colstrip Units 1, 2, 3, and 4. Decommissioning and remediation costs are among those that should have been collected throughout the useful life of these units, but were not adequately collected. Establishing a plan to fund these future costs with Treasury Grants, pursuant to RCW 80.84.020(2), and Production Tax Credits that have been

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<sup>112</sup> Schooley/Cheesman, Exh. TES-4T at 8:11-12.

<sup>113</sup> Schooley/Cheesman, Exh. TES-4T at 8:8-11.

<sup>114</sup> Gerlitz, Exh. WMG-1T at 5:14-19.

<sup>115</sup> Gerlitz, Exh. WMG-1T at 6:1-4.

<sup>116</sup> Gerlitz, Exh. WMG-1T at 6:6-10.

<sup>117</sup> *Id.*



earned but not yet collected will provide more equitable treatment to customers and ensure that the initial estimates of the costs of these important responsibilities are fully and adequately funded.<sup>118</sup>

116 With respect to Colstrip Units 3 & 4, the Company's settlement witnesses emphasize that PSE is not the sole owner and cannot unilaterally set a retirement date for the plants. The 2027 depreciation date to which the Settling Parties agree, however, "helps to lessen the risk of repeating the situation that arose with Colstrip Units 1 and 2 in 2008, when the assets' depreciable lives were extended, resulting in an undepreciated plant balance for those units at the time of retirement."<sup>119</sup> Staff agrees that the settlement "dramatically reduces the potential for unrecovered plant in Colstrip Units 3 and 4."<sup>120</sup>

117 Staff's settlement witnesses testified similarly that 2027 is not a retirement date for Colstrip Units 3 & 4, but by addressing the difficult task of projecting coal-related plant lifespans, "the Settlement reduces the potential risk of large, unrecoverable plant balances [thus] drastically [reducing] the likelihood of facing intergenerational inequities for Units 3 and 4."<sup>121</sup>

#### **b. Public Counsel's Alternative Viewpoint**

##### **i. Electric Depreciation Study (Electric Adjustment 13.06)**

118 Public Counsel agrees that depreciation should be accelerated for Colstrip Units 1 & 2 and does not challenge the adoption of a depreciation schedule tied to the specific circumstances facing these assets, including their planned retirement date no later than 2022.<sup>122</sup> Nor, despite Ms. Colamonici's testimony that the depreciation expense contemplated under the Settlement Stipulation is "excessive,"<sup>123</sup> does Public Counsel suggest that PSE should be denied recovery of any part of its return of, or on, investment in these facilities. Instead, Public Counsel's witness Ms. McCullar advances an alternative approach to determining an effective depreciation schedule for recovery of the net book value of Colstrip Units 1 & 2. Ms. McCullar's proposal is based on theoretical

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<sup>118</sup> Gerlitz, Exh. WMG-1T at 6:11-17.

<sup>119</sup> Exh. PSE-1JT at 7:9-12.

<sup>120</sup> Schooley/Cheesman, Exh. TES-4T at 8:18-20.

<sup>121</sup> Schooley/Cheesman, Exh. TES-4T at 8:21-22. *See also* Howell, Exh. DHH-1T at 9:11-11:12.

<sup>122</sup> Public Counsel Initial Brief ¶ 54.

<sup>123</sup> Colamonici, Exh. CAC-1T at 2:18-19;

reserve calculations that are tied not to the retirement date for these assets, but rather to the reserve balances and wide ranging depreciation schedules of Colstrip and all other steam production plant included by PSE for accounting purposes in the same FERC functional classification accounts, Steam Production Accounts 311-316.<sup>124</sup>

119 Taking this expansive view, Ms. McCullar identified certain plants that have a theoretical reserve deficiency and others that have a theoretical reserve surplus.<sup>125</sup> Specifically, she testified that Colstrip Units 1 & 2 have a theoretical reserve deficiency of approximately \$44 million, while the Goldendale plant alone has a theoretical reserve surplus of approximately \$44 million.<sup>126</sup> PSE's overall Steam Production Plant, she testified, carries a surplus reserve balance even though there is a significant deficiency for Colstrip Units 1 & 2.<sup>127</sup> Despite having identified an example of a reserve surplus for Goldendale that more or less perfectly offsets the reserve deficiency attributable to Colstrip Units 1 & 2 in gross dollars, she identified the shortened remaining life of Colstrip Units 1 & 2 as a major reason for the overall reserve deficiency in these accounts.<sup>128</sup>

120 Public Counsel, through Ms. McCullar's testimony, proposes to reallocate the reserve surplus indicated for some steam production assets to offset the reserve deficiency attributable to Colstrip Units 1 & 2. In addition, Public Counsel contends "it is reasonable to use remaining life depreciation rates to address the reserve imbalances."<sup>129</sup> Thus, in effect, under Public Counsel's proposal, depreciation expenses for Colstrip Units 1 & 2 would be recovered not during the remaining life of the Colstrip assets, but rather over a range of remaining lives ranging from 5.6 years to 25.9 years.<sup>130</sup> This assumes, however,

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<sup>124</sup> Account 311 – *Structures and Improvements*, Account 312 – *Boiler Plant Equipment*, Account 314 – *Turbogenerator Units*, Account 315 – *Accessory Electric Equipment*, and Account 316 – *Miscellaneous Power Plant Equipment*.

<sup>125</sup> A reserve surplus indicates that there is more in the actual book reserve than is calculated to be needed based on the current depreciation study, and lowers the depreciation rate over the remaining life of the asset. A reserve deficiency indicates that there is not enough actual book reserve than is calculated to be needed based on the current depreciation study and would be recovered through higher depreciation rates over the remaining life of the asset. McCullar, Exh. RMM-1T at 8:13-20.

<sup>126</sup> McCullar, Exh. RMM-1T at 9:16-19.

<sup>127</sup> McCullar, Exh. RMM-1T at 8:8-11.

<sup>128</sup> McCullar, Exh. RMM-1T at 9:10-11. Goldendale depreciation, in contrast, currently is on a schedule with a remaining life of nearly 26 years.

<sup>129</sup> Public Counsel Initial Brief ¶ 55.

<sup>130</sup> See McCullar, Exh. RMM-1T at 12:1 Table 4.

that the remaining lives of all plant remains unchanged from this time forward, an assumption already undercut in the case of Colstrip Units 3 & 4 that are shown by Ms. McCullar to have remaining lives of 11.6 years through 2035, which is eight years longer than what is proposed under the Settlement Stipulation. It is entirely possible, too, that there will be a need to adjust the depreciation schedules for other steam production plant in future years. This raises uncertainties concerning whether reallocating depreciation reserves as Public Counsel proposes might lead to unintended consequences just as the 2007 adjustment to Colstrip depreciation led to the problems we address here. Public Counsel does not consider this possibility.

- 121 Ms. McCullar's proposal, in essence, is to establish a cross-subsidization among the individual plant balances to apply surplus monies from some plants within the Steam Production Accounts functional classification to offset the deficiencies of other plants.<sup>131</sup> This reallocation results in an overall decrease to the depreciation rates proposed by PSE and, consequently, a reduction in the depreciation accrual.
- 122 Mr. Spanos testified for PSE in rebuttal that Public Counsel's proposal would result in future customers paying the costs of Colstrip Units 1 & 2 after the facility is retired. This would, by definition, "result in intergenerational inequity, as future customers will be forced to pay the costs of a facility from which they receive no service."<sup>132</sup> Mr. Spanos testified specifically that Ms. McCullar's proposal that a portion of the Colstrip Units 1 & 2 book reserve be transferred to other steam production plants, including PSE's combined cycle facilities, would result in Colstrip Units 1 & 2 costs being recovered over the remaining lives of the other plants in steam production. Thus, he said, "customers would still be paying for Colstrip Units 1 and 2 for 25 years after the plants are retired."<sup>133</sup>
- 123 Mr. Spanos also identified and discussed calculation issues in Public Counsel's proposal due to Ms. McCullar's failure to account properly for the age of many of PSE's facilities. This is important, he testified, because a theoretical reserve calculation such as that on which Ms. McCullar relies, is a function of the estimated life and net salvage estimates, as well as the vintages of plant in service in the calculation.<sup>134</sup> According to Mr. Spanos,

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<sup>131</sup> McCullar, Exh. RMM-1T at 12:9-13:2.

<sup>132</sup> Spanos, Exh. JJS-4T at 9:2-7.

<sup>133</sup> Spanos, Exh. JJS-4T at 12:18-23.

<sup>134</sup> Spanos, Exh. JJS-4T at 16:15-19. By way of background, Mr. Spanos testified that "net salvage as used in depreciation is defined as gross salvage less cost of removal." Put another way, net salvage is gross salvage (*i.e.*, scrap or reuse value) less the costs to retire the asset. Mr. Spanos testified that like "[m]ost types of utility property" PSE's assets "typically experience negative

Ms. McCullar failed to recognize that with respect to many of the combined cycle plants the vintages recorded on PSE's books are the dates the plants were acquired, not the dates when they were placed into service. By way of examples, he testified that the three plants Ms. McCullar identifies as having the largest reserve imbalances, Goldendale, Sumas, and Ferndale, were placed in service in 2004, 1993, and 1994, respectively. Ms. McCullar, using the acquisition dates of 2007, 2008, and 2012 as the vintage dates for her theoretical reserve calculation, understated the actual reserve balances for these plants by close to \$20 million.<sup>135</sup>

124 Mr. Spanos testified for PSE that Ms. McCullar's proposal defers costs to future customers and "will not result in the full recovery of the costs associated with PSE's power plants through straight line depreciation rates."<sup>136</sup> Thus, her proposal would increase the risk of a recurrence of situations such as the one currently facing PSE and its customers with respect to Colstrip Units 1 & 2, where a high level of unrecovered costs must be recovered over a relatively short period of time.<sup>137</sup>

125 Raising another issue that affects depreciation rates, Ms. McCullar testified that PSE inflated the estimated terminal net salvage costs of Colstrip Units 1 & 2 through the end of their lives, but proposes to recover the future inflated estimated salvage costs in today's more valuable dollars.<sup>138</sup> She recommended collecting the estimated net salvage costs in 2018-dollars.

126 Similarly, Ms. McCullar stated that PSE calculated Colstrip Units 3 & 4 terminal net salvage costs in 2016-dollars and then assumed an annual 2.5 percent inflation rate to

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net salvage, meaning that cost of removal exceeds gross salvage." Net salvage is expressed as a percentage of the original cost retired estimated using a combination of statistical analysis of historical data and applying informed judgment that incorporates other factors. Spanos, Exh. JJS-4T at 19:1-6 (internal citations omitted).

<sup>135</sup> Spanos, Exh. JJS-4T at 16:22-17:13.

<sup>136</sup> Spanos, Exh. JJS-4T at 31:16-19.

<sup>137</sup> Spanos, Exh. JJS-4T at 31:19-22.

<sup>138</sup> McCullar, Exh. RMM-1T 14:22-15:4. Terminal net salvage costs are costs associated with the closure of a production plant. Net salvage is defined as the gross salvage for the property retired less its cost of removal. Gross salvage is the amount recorded for the property retired due to the sale, reimbursement, or reuse of the property. Cost of removal is the cost incurred in connection with the retirement from service and the disposition of depreciable plant. Cost of removal may be incurred for plant that is retired in place. NARUC, *Public Utilities Depreciation Practices* at Glossary.

2035-dollars.<sup>139</sup> PSE then used the 2035-dollars to calculate the amount to be collected in 2018. This is unfair, Ms. McCullar argued, because 2035-year dollars will have a lower purchasing power than 2018-year dollars. Thus, she said, PSE essentially assumed 2035-dollars will be worth only \$0.63 compared to 2016-year dollars.<sup>140</sup> The problem, she testified, is determining the quantity of dollars in the lower value year 2035-dollars and collecting that quantity in the more valuable current dollars. She described this approach as being unreasonable and unfair to ratepayers.

127 With respect to terminal net salvage, Mr. Spanos stated that if PSE is to recover the service value of its assets, “net salvage must be determined at the cost that will be incurred in the future.”<sup>141</sup> Furthermore “[u]nder the straight line method of depreciation, these costs are recovered ratably, or in equal amounts each year, over the life of PSE’s power plant.”<sup>142</sup> The costs of removal thus must be recovered through depreciation during the life of the plant as part of net salvage, but those costs will occur in the future. It follows, according to Mr. Spanos that “it is the future costs that must be included in depreciation rates.”<sup>143</sup>

128 Ms. McCullar also challenges the Settling Parties’ treatment of net salvage for mass assets such as electric poles and wires. She contends that future net salvage estimates should depend on historical net salvage actually measured over five years.

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<sup>139</sup> This testimony was tied to PSE’s original proposal in this proceeding for a depreciation schedule for Colstrip Units 3 & 4 that would end in 2035. Ms. McCullar filed settlement testimony for Public Counsel but did not update her analysis to reflect the different depreciation schedule recommended by the Settling Parties. We nevertheless can address the principles upon which her testimony rests.

<sup>140</sup> McCullar, Exh. RMM-1T at 15:9–16:11. As an example, Ms. McCullar asks the reader to assume a widget costs \$36,000 today. With 2.5 percent inflation, PSE assumes that widget would cost \$58,000 in 2035 dollars. She argues it is not reasonable to charge someone \$58,000 in today’s dollars to buy something that only costs \$36,000 just because PSE claims it will cost \$58,000 in 19 years.

<sup>141</sup> Spanos, Exh. JJS-4T at 32:1-3.

<sup>142</sup> Spanos, Exh. JJS-4T at 32:3-5. Mr. Spanos later testified that:

[T]he vast majority of jurisdictions use a method for net salvage in which future net salvage is estimated at its future cost and recovered through straight-line depreciation. To my knowledge, the method of recovering future costs using straight line depreciation is used by 46 of the 50 states as well as by FERC.

*Id.* at 35:4-8.

<sup>143</sup> Spanos, Exh. JJS-4T at 33:2-3.

129 This is, according to PSE witness Mr. Spanos, an issue related to, but distinct from, the terminal net salvage issues Public Counsel raises with respect to Colstrip. According to Mr. Spanos, both proposals reduce the amount of net salvage in depreciation rates and defer these costs to future customers.<sup>144</sup> With respect to net salvage for mass property, Mr. Spanos testified that Ms. McCullar’s proposal for Public Counsel is not based on accepted depreciation practice and appears to be designed to arbitrarily reduce depreciation expense and defer costs to future customers who would be required to pay for assets that no longer provide service.<sup>145</sup>

130 Finally, Ms. Colamonici asserted for Public Counsel that the record does not provide the necessary evidence for the Settlement Stipulation’s recommended depreciation date of 2027 for Units 3 & 4, but testified that Public Counsel would accept a depreciation schedule ending in 2030 as a reasonable settlement outcome.”<sup>146</sup> Ms. McCullar testified that PSE’s original proposal in this case, a 2035 retirement year, “is reasonable for calculating depreciation rates.”<sup>147</sup> However, in apparent contradiction to her support for a 2035 date, she further testified that “a 2030 retirement year seems more reasonable for settlement purposes given the 2025 to 2035 range in the proceeding.”<sup>148</sup>

*Commission Determinations*

131 The Settling Parties’ proposal is straightforward and transparent. It takes into account the fact that shortening the depreciation schedules for PSE’s share of the four Colstrip plants means that the large net book balances that have not yet been recovered by PSE through depreciation expense in rates must now be recovered over a much shorter period of time.

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<sup>144</sup> Spanos, Exh. JJS-4T at 17:10-20.

<sup>145</sup> We discuss net salvage for mass assets in more detail below in connection with Adjustment 11.06 for Natural Gas. *See infra* ¶¶ 156-66. The same points discussed there are equally relevant here.

<sup>146</sup> Colamonici, Exh. CAC-1T at 4:22-5:2. We note here the perfect symmetry between Sierra Club’s preference for a depreciation schedule through 2024 for Colstrip Units 3 & 4, Public Counsel’s willingness to accept a depreciation schedule through 2030, and the Settlement Stipulation that provides for a depreciation schedule that ends in 2027.

<sup>147</sup> McCullar, Exh. RMM-12T at 7:7-8.

<sup>148</sup> McCullar, Exh. RMM-12T at 8:1-2. As previously discussed, the range in the underlying testimony actually is from 2024 (Sierra Club) to 2035 (PSE) and the range identified in the settlement testimony, including Mr. Howell’s testimony for Sierra Club, and Ms. McCullar’s and Ms. Colamonici’s testimony for Public Counsel concerning these parties’ preferred settlement outcome, is 2024 to 2030. This being true, the Settling Parties’ selection of a 2027 date appears to be a reasonable compromise.

The Settling Parties' agreement adheres to the requirements of the familiar straight-line methodology for depreciation of assets that the Company has been authorized to use for all of its steam generation plants over many years. This approach results in a significant, even dramatic, increase in the recovery of depreciation expense in rates over the shortened remaining lives of the Colstrip assets relative to what has been recovered annually since 2008. Considering several fundamentally important principles of utility rate regulation, this confronts us with an intractable, but not impossible problem: How can the Commission best maintain reasonable stability in rates, protect ratepayers from rate shock, and avoid intergenerational inequities by shifting these costs into periods beyond the time the assets are no longer used and useful, while at the same time protecting the right of PSE's shareholders to full and timely recovery of the costs of their investments in Colstrip?<sup>149</sup>

132 The Settling Parties answer this question by proposing to use monetized PTCs to offset fully the remaining depreciation balances over the remaining lives of the Colstrip facilities. It appears these funds will be adequate to accomplish this offset with respect to Colstrip Units 1 & 2, but recognizing that this might turn out for one reason or another not to be the case, PSE assumes the risk in the manner previously described. It also appears that the PTC balances, if fully monetized, will be adequate to offset any unrecovered Colstrip Units 3 & 4 depreciation. The Settling Parties, however, agree it is premature to consider any allocation of risk if this turns out not to be the case at some point in the future.

133 Public Counsel's alternative viewpoint on recovery, in contrast to that of the Settling Parties, was presented through Ms. McCullar's testimony in a proposal that is neither straightforward nor entirely clear. In general, Public Counsel's proposal depends on flawed theoretical depreciation reserve calculations<sup>150</sup> and cost shifting effecting a cross-subsidization of depreciation expense recovery among all of PSE's steam production plants. Public Counsel's proposal also includes temporal shifts in depreciation cost

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<sup>149</sup> We recognize the shareholders also have a right to recover a return on their investments but there seems to be at least tacit agreement among all parties that the *return on investment* impact of whatever solution we adopt will simply follow from our determination of a plan for the *return of investment* to PSE.

<sup>150</sup> Theoretical reserve calculations are performed a function of the estimated life and net salvage estimates, as well as the vintages of plant in service in the calculation. These calculations may be useful tools in depreciation studies, allowing, as they do, consideration of alternatives when evaluating what might be an appropriate schedule to maintain or to change going forward. Ms. McCullar, however, does not refer us to any example in practice, or identify any professional literature, that supports using theoretical depreciation reserve calculations as she proposes in this case.

recovery so that significant depreciation expense attributable to the Colstrip units would not be recovered during the remaining useful lives of Units 1 & 2 that is pegged to the planned closure of those facilities, or the projected remaining useful life of Units 3 & 4 that we approve in this Order. Instead, Colstrip depreciation costs would effectively be recovered over periods that extend forward by as much as 25.9 years. This feature alone undercuts two of the Commission's goals: avoiding intergenerational cost shifting and allowing PSE to recover timely the remaining net balances on PSE's books today considering the significantly shortened depreciation schedules of the Colstrip assets.

134 Public Counsel's proposal also fails to make clear the bases for reallocating depreciation expense among PSE's 10 steam production plants. Ms. McCullar does not explain her methodology, so we cannot evaluate whether it has some principled basis or is simply arbitrary. With no explanation, Ms. McCullar would not limit the reallocation of theoretical depreciation reserve surpluses to offset increased Colstrip depreciation. She also reallocates some part of the theoretical depreciation reserve surpluses to other plant for which her analysis indicates theoretical depreciation reserve deficiencies. Yet, she offers no details concerning what specific surpluses she proposes to offset what specific deficiencies. This leaves us in the dark concerning the question of over what periods PSE could expect to recover its full investment in every plant in the Company's steam production plant portfolio.

135 It also appears that Public Counsel's proposal reflects flaws in both Ms. McCullar's method and her calculations of actual depreciation expense, net salvage, and theoretical depreciation reserves.<sup>151</sup> While Public Counsel suggests in its Initial Brief that we need not be concerned with a \$20 million error in Ms. McCullar's determination of theoretical reserve balances,<sup>152</sup> an apparent error of this magnitude undermines the credibility of her entire analysis. Finally, Public Counsel offers no response through its brief to Mr. Spanos' testimony that Ms. McCullar's approach to determining net salvage is not supported by the accounting literature.

136 In the final analysis, we determine that the Settlement Stipulation takes advantage of the unique circumstances<sup>153</sup> in which PSE, without significant rate impacts, is able to recover

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<sup>151</sup> See *supra* ¶ 129.

<sup>152</sup> Public Counsel Initial Brief ¶56.

<sup>153</sup> We note that other Washington utilities with an ownership interest in the Colstrip plant may not have the same financial tools available to them as PSE did in this case to mitigate rate impacts from any proposed change to their current depreciation schedule or to pay for decommissioning and remediation costs for Colstrip Units 3 & 4. For these utilities, the Commission will need to



fully the undepreciated Colstrip plant balances on the Company's books on significantly shortened depreciation schedules tied to the known retirement date for Units 1 & 2 and a well-considered change for Units 3 & 4. The Settling Parties also have found the means to provide funding for future decommissioning and remediation costs that will be incurred in connection with the closure of all Colstrip facilities. Finally, the Settling Parties have identified existing funds to match shareholder funds that PSE commits to use in assisting the Colstrip community's transition to a new future. We find the use of Treasury Grant funds, repurposed as allowed by the Washington legislature, and monetized Production Tax Credits to fund these purposes provides direct benefits to PSE's ratepayers commensurate with the amounts PSE expects to expend.

- 137 Public Counsel's alternative viewpoint seems to present an unnecessary and unjustified complication to the Settling Parties' proposals most of which Public Counsel either supports or, at least, does not meaningfully oppose. Moreover, we find Public Counsel's proposed cost shifting, while giving the appearance of reducing customer impacts, actually does no more than shift costs to future generation of customers who would be required to pay for plant that is no longer used and useful.
- 138 In the final analysis, we determine that the Commission should approve and adopt the Settlement Stipulation's proposed resolutions of the issues related to Colstrip, as discussed above. The results are lawful, supported by the record, in the public interest, and reasonable.

#### ii. **Other Colstrip Issues**

- 139 As previously discussed, the remaining Colstrip issues are uncontested. Public Counsel supports the use of PTCs and Treasury Grants to pay otherwise under-recovered depreciation expense, as well as decommissioning and remediation costs. Public Counsel supports the proposal for Colstrip community transition planning and funding, despite having "some concerns" with prioritization of the use of PTCs for this undertaking. Public Counsel also supports the Settlement Stipulation's Colstrip provisions that establish reporting requirements, provide for a transmission system operational study, and provide for a transmission system workshop. We discuss below two somewhat nuanced arguments from Public Counsel on these issues.

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carefully consider the rate impacts of changing depreciation schedules or setting aside funds for decommissioning and remediation costs against the evidentiary record in those proceedings and parties' arguments for consistency with today's decision.

140 Public Counsel acknowledges that the balance of Production Tax Credits on PSE’s books that the Settlement Stipulation proposes to use to fund Colstrip expenses that will be incurred in the future appears to be adequate to meet the anticipated costs of all proposed uses. However, Public Counsel states it “has some concerns about the prioritization given to the various uses.”<sup>154</sup>

141 Ms. Colamonici acknowledged that community transition and planning is a key issue for the community of Colstrip, Montana, but testified that this obligation, insofar as PSE is implicated, is primarily a shareholder obligation, not an obligation of PSE’s ratepayers.<sup>155</sup> Public Counsel believes the first priority for monetized PTCs should be to benefit ratepayers and recommends the following order of priority:

- Pay prudently incurred decommissioning and remediation costs for Colstrip Units 1 through 4.
- Offset unrecovered plant balances for Colstrip Units 1 through 4. Provide community transition planning funds of \$5 million.

142 Ms. Colamonici would place the risk of monetization fully on the Company and, if the balance of monetized PTCs proves ultimately to be insufficient to cover all three categories of costs, “PSE’s shareholders should reimburse the \$5 million in PTCs so those funds can be used to either offset plant balances or pay for cleanup costs.”<sup>156</sup> Ms. Colamonici notes that as a practical matter “the transition planning will occur first in time. Thus, PSE would likely be in a scenario of reimbursing the funds so that future cleanup costs can be paid or unrecovered plant can be offset.”<sup>157</sup>

143 Finally, Public Counsel supports PSE’s assumption of risk under the terms of the Settlement Stipulation with respect to the adequacy of monetized PTCs to cover costs at Colstrip Units 1 & 2.<sup>158</sup> Public Counsel recommends that we require PSE to accept the same assumption of risk with respect to possible use of such funds to offset unrecovered plant costs for Colstrip Units 3 & 4.<sup>159</sup> PSE argues this would not be reasonable

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<sup>154</sup> Public Counsel Initial Brief ¶63.

<sup>155</sup> Colamonici, Exh. CAC-1T at 13:19-22.

<sup>156</sup> Colamonici, Exh. CAC-1T at 14:10-18.

<sup>157</sup> Colamonici, Exh. CAC-1T at 14, n47.

<sup>158</sup> Settlement Stipulation ¶25.

<sup>159</sup> Public Counsel Initial Brief ¶64.

considering its status as a minority owner with no ability to control decisions concerning the timing of plant closure at Units 3 & 4.

*Commission Determination*

- 144 It appears that while Public Counsel discusses its concerns regarding the priorities established by the Settlement Stipulation for the use of monetized PTCs, Public Counsel does not advocate that we condition our approval of the settlement in this regard. In contrast, Public Counsel recommends that we require PSE to accept the same assumption of risk with respect to possible use of such funds to offset unrecovered plant costs for Colstrip Units 3 & 4.
- 145 We find it unnecessary at this point in time to impose a condition with respect to either of these concerns. The potential for actual problems in these regards is remote, considering the expected time-frame during which PSE should be able to monetize PTCs in amounts sufficient to cover all of the proposed costs they are targeted to cover and that Colstrip Units 3 & 4 are not on a definite schedule for closure. We determine that the Commission should approve and adopt the Settlement Stipulation’s proposed resolution of these issues.

**C. Contested Revenue Requirement Adjustments**

**1. Overall Revenue Requirement**

- 146 By way of introduction to its arguments concerning revenue requirements, other than the cost of capital impact that Public Counsel discusses separately below, Public Counsel presents an argument in its Initial Brief concerning the Settlement Stipulation’s “overall annual increase to electric revenues of \$20 million” and “decrease to natural gas revenues of \$35 million.” Public Counsel compares these overall revenue adjustments to the parties’ respective litigation positions.<sup>160</sup> Although not entirely clear on this point, it appears that Public Counsel would have us accept these litigation positions, as “potential reasonable outcomes in the case.”<sup>161</sup> Acknowledging the extreme range of results the parties advocate, from a \$63.3 million revenue requirement increase advocated by PSE to a \$34.6 million revenue requirement decrease advocated by Staff for electric operations, Public Counsel nonetheless infers that a \$20 million increase “is too generous and not in the public interest.” Public Counsel says in addition that “the overall revenue provided

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<sup>160</sup> Public Counsel Initial Brief ¶¶44-46.

<sup>161</sup> Public Counsel Initial Brief ¶44.

under the settlement exceeds what PSE needs to reasonably and fairly run its utility business.”<sup>162</sup>

- 147 As in the case of its arguments concerning cost of capital, Public Counsel ignores that, in every general rate case, the Commission is presented with a range of results, some of which will ultimately be found reasonable and some of which will not. Almost without exception, in the final analysis the Commission will determine revenue requirements and rates that fall somewhere within the range of *possible* outcomes as to which evidence was presented. The Settlement Stipulation reflects such results and clearly is the product of compromise resulting in PSE recovering a lower revenue requirement for electric operations, as advocated by the other parties, and greater revenue requirement reductions for natural gas operations, again as advocated by the other parties.
- 148 Accepting for the purpose of discussion that we can view each party’s litigation position as a “potential reasonable outcome,” we reject Public Counsel’s inferences. We consider, for example, that to reach the settlement result, PSE had to accept \$48.3 million less than the amount it advocated. Relative to Public Counsel’s litigation position, the \$20 million compromise in the settlement represents an increase of \$35.9 million. Ignoring the host of other considerations involved in determining revenue requirements, the Settlement Stipulation strikes a reasonable compromise that is much in Public Counsel’s favor. Viewed in this context, Public Counsel’s inferences do not hold up.
- 149 If, then, we give any credence to the comparison Public Counsel draws, it demonstrates not that the Settlement Stipulation is “too generous and not in the public interest” but, to the contrary, shows it to represent outcomes we can measure against the fair, just, reasonable, and sufficient standard that governs our determinations. The revenue requirements the parties negotiated in the Settlement Stipulation do not reflect a “black box” agreement, *i.e.*, numbers with little or no explanation of how they were derived, but are based upon specific agreements on discrete adjustments, discussed further below, to reach the final revenue requirement. We consider, too, the Settling Parties’ testimonies in support of their compromise on revenue requirements.
- 150 Mr. Mullins testified for ICNU that with respect to electric service, the Settlement Stipulation yields “yield[s] a fair and reasonable result for ICNU’s members who take service from [PSE because] it reduces the Company’s requested rate increase from net

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<sup>162</sup> *Id.*

3.2% overall in its supplemental filing to 0.9%.<sup>163</sup> With respect to gas services, Mr. Mullins testified that “[t]he settlement will result in a net revenue requirement decrease of approximately (-)3.8% for gas services, compared to rates customers are paying today,” while “the Company’s supplemental filing requested a decrease of only (-)3.2%, compared to today’s rates.”<sup>164</sup> This represents about \$5 million in savings to gas customers, and NWIGU is supportive of the reasonableness of that result.<sup>165</sup>

151 Mr. Al-Jabir testified for FEA that the Settlement Stipulation is acceptable because it reduces the overall net electric revenue requirement increase from approximately \$68 million (3.2 percent) under PSE’s supplemental filing in this proceeding to approximately \$20 million (0.9 percent) under the Settlement.<sup>166</sup> Kroger, too, agrees that “the overall electric revenue requirement negotiated by the parties to the Settlement produces a just and reasonable result that is in the public interest.”<sup>167</sup>

152 Reflecting on the parties’ joint efforts in their settlement testimony, Mr. Schooley and Ms. Cheesman testified that:

Staff’s recommendation [that the Commission adopt the settlement without condition] is the result of four rounds of testimony, several months of discovery, and a series of complex, and at times contentious negotiations, settlement discussions with interested parties, representing stakeholders with very different interests. The Settling Parties’ proposed Settlement brings 10 of those stakeholders together and provides a fair and reasonable resolution to the settled issues in this case.

As part of its decision to join the Settlement, Staff considered the range of potential outcomes of further litigation (or litigation risk) and concluded that this Settlement was a just and reasonable compromise of the issues presented in the case.<sup>168</sup>

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<sup>163</sup> Mullins, Exh. BGM 17-T at 2. The increase, taken to two decimal places is .99 percent. This is more appropriately rounded up to 1.0 percent rather than down, to .9 percent.

<sup>164</sup> *Id.* The decrease, taken to two decimal places is 3.88 percent. This is more appropriately rounded up to 3.9 percent rather than down, to 3.8 percent.

<sup>165</sup> *Id.*

<sup>166</sup> Al-Jabir, Exh. AZA 7-T at 2:4-7.

<sup>167</sup> Townsend, Exh. NT-1T at 2:19-21.

<sup>168</sup> Schooley/Cheesman, Exh. TES-4T at 2:11-3:5.

153 Considering the overall settlement, they testified in addition that:

Staff is pleased to support the Settlement as a major and historic accomplishment by all the Settling Parties. The diversity of opinions expressed in testimonies could lead to many possible outcomes, any of which could be decided by the Commission as in the public interest. The outcome embedded in this Settlement represents many “gives and takes” and compromises by the Settling Parties and is a tribute to all parties trying to reach what is, in total, in the public interest. To do so with only a one percent increase in electric rates and a four percent decrease in gas rates is astonishing. Staff recommends the Commission accept the Settlement in its entirety, without condition.<sup>169</sup>

154 PSE’s settlement witnesses testified that “PSE and the Settling Parties have compromised to reach a fair, just, reasonable, and sufficient revenue requirement and cost of capital for PSE.”<sup>170</sup> They state, in addition, reflecting on the settlement outcomes concerning revenue requirements and rates, that:

[T]he proposed Settlement satisfies the public interest because it will result in overall rates that are fair, just, reasonable and sufficient. In terms of customer benefits, the natural gas rates that will result from this agreement will provide an immediate overall rate reduction of 3.8 percent to PSE customers, which is beyond the decreases proposed by PSE in its direct and rebuttal filing. The resulting increase to overall electric rates is less than those proposed by PSE in its direct and rebuttal filing and represents an approximate one percent increase in overall electric rates compared to the 2.7 percent increase proposed by PSE in its rebuttal filing.<sup>171</sup>

*Commission Determination*

155 We reject Public Counsel’s “alternative viewpoint” concerning overall revenue requirements and find on the basis of the discussion here, and our discussion below concerning specific adjustments to revenue requirements, that the Settlement Stipulation

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<sup>169</sup> Schooley/Cheesman, Exh. TES-4T at 22:8-17.

<sup>170</sup> Exh. PSE-1JT at 3:7-8.

<sup>171</sup> Exh. PSE-1JT at 15:1-9.

satisfies the public interest because it reaches end results in terms of overall rates that are fair, just, reasonable and sufficient.<sup>172</sup>

## 2. Depreciation Study (Natural Gas Adjustment 11.06)

### a. Settlement Stipulation

156 As previously noted, the Settling Parties agreed to use the depreciation study provided by PSE as the basis for this adjustment, resulting in a \$13,174,098 increase to net operating income (NOI) for natural gas operations and a \$6,587,049 increase to natural gas rate base.<sup>173</sup> The Settling Parties state in their Settlement Stipulation that this issue is uncontested.<sup>174</sup> While it is true that accepting PSE's natural gas depreciation study resolved any disputes over this issue presented through the response testimonies of Staff and several intervenor parties, their agreement did not resolve Public Counsel's challenge to PSE's depreciation study for natural gas.<sup>175</sup> Public Counsel relies on Ms. McCullar's Response Testimony for its "recommendation on this adjustment."<sup>176</sup>

### b. Public Counsel's Recommendation

157 Public Counsel's recommendations concerning the measurement and inclusion of net salvage for natural gas assets in depreciation rates would use more positive measures of net salvage value, thus lowering depreciation rates relative to what PSE proposed.<sup>177</sup> It is not clear from Ms. McCullar's testimony what she relied on to derive her proposed measures. She simply reports her results without explaining her methodology.

158 Ms. McCullar testified in her response testimony that she based her recommendation on a comparison of PSE's and her own proposed depreciation accruals going forward and "the actual average net salvage costs PSE has incurred over the recent five-year period 2011-2015." Because her approach resulted in lower annual accruals of net salvage than PSE's, Ms. McCullar testified that her "recommended future net salvage accrual," like PSE's,

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<sup>172</sup> See *Fed. Power Comm'n v. Hope Nat. Gas Co.*, (Hope) 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944); *Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n of W. Va.*, (Bluefield) 262 U.S. 679, 43 S. Ct. 675, 67 L. Ed. 1176 (1923).

<sup>173</sup> *Supra* n.65.

<sup>174</sup> Settlement Stipulation ¶28.

<sup>175</sup> Colamonici, Exh. CAC-1T at 4:15-17; 12:27-28.

<sup>176</sup> Colamonici, Exh. CAC-1T at 12:28-30.

<sup>177</sup> See generally McCullar, Exh. RMM-1T at 18:1-25:3.

will “provide a reserve for estimated future net salvage costs, but at a more reasonable annual amount.”<sup>178</sup> When asked to explain how Public Counsel’s proposed net salvage accrual is more reasonable than PSE’s, Ms. McCullar replied:

Public Counsel’s proposed net salvage accrual is more reasonable than PSE’s proposed net salvage accrual based on analysis of the recent five-year period. PSE’s proposed net salvage accrual of 4.3 times the actual incurred unnecessarily accelerates the building of the book reserve for future estimated net salvage costs, which increases the depreciation expense charged to current customers. However, Public Counsel’s proposed net salvage accrual is 2.5 times the actual incurred [by] PSE, which will build the book reserve for future estimated net salvage costs at a more reasonable rate. Public Counsel’s proposed net salvage accrual is a good balance between the depreciation expense charged to current customers and the building of the book reserve to cover any PSE future net salvage costs associated with the retirement of an asset.<sup>179</sup>

This, however, seems to do no more than reiterate Ms. McCullar’s otherwise unsupported conclusion that because she advocates slower growth in the accrual reserves relative to historic actuals than does PSE, her recommendation is therefore “more reasonable than PSE’s.”

159 Mr. Spanos testified that he estimated net salvage based on statistical analyses performed by comparing historical cost of removal and gross salvage to historical retirements as recorded in PSE’s property records. He analyzed both annual activity and longer and shorter term averages of the experienced net salvage expressed as a percent of retirements.<sup>180</sup> He verified that his approach “is consistent with the approaches described in authoritative depreciation texts,” including the National Association of Regulatory Utility Commissioners’ *Public Utility Depreciation Practices* (the “NARUC Manual”) and *Depreciation Systems* by Wolf and Fitch. Mr. Spanos said that both these authoritative sources support that net salvage should be accrued over the life of the related property and should be estimated using the methodology he used.<sup>181</sup> In contrast,

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<sup>178</sup> McCullar, Exh. RMM-1T at 23:1-3.

<sup>179</sup> McCullar, Exh. RMM-1T at 24:10-19.

<sup>180</sup> Spanos, Exh. JJS-4T at 19:8-17.

<sup>181</sup> *Id.*; *see id.* at 21:15-24:8 for a detailed discussion of these texts; *see also* Barnard, Exh. KJB-56X (Excerpt from *Depreciation Systems*, Wolf and Fitch, Chapters 4 and 14, Iowa State University Press (1994) (Originally designated as Spanos, Exh. JJS-8X) and McCullar, Exh.



Mr. Spanos said that these texts do not support Ms. McCullar's approach and he is not familiar with any authoritative source that supports her approach.<sup>182</sup>

160 Mr. Spanos said he found Ms. McCullar to be unclear with respect to the methodology she used. He described her net salvage estimates as being "arbitrarily based on a false premise that net salvage accruals should be similar to recent net salvage expenditures."<sup>183</sup> The NARUC Manual explains that "net salvage is expressed as a percentage of plant retired by dividing the dollars of net salvage by the dollars of original cost of plant retired."<sup>184</sup> This methodology, in other words, recognizes net salvage as part of depreciation expense, not operating expense.

161 In addition, net salvage is a function of the number of assets retired in a given year and this may vary considerably from year to year.<sup>185</sup> Mr. Spanos criticizes Ms. McCullar's methodology because it fails to recognize this, "effectively assuming that PSE will experience the same net salvage costs independent of whether it retires 100 poles or 1,000 poles."<sup>186</sup>

162 Mr. Spanos found Ms. McCullar's comparison of net salvage accruals with net salvage expenditures PSE incurred during recent years to be "not a particularly meaningful comparison,"<sup>187</sup> and suggests a belief that annual net salvage accruals should approximate, or even be the same as, costs incurred during the same year. This, he testified, would effectively recover net salvage as an operating expense "instead of recovering the service value of assets over the assets' service lives."<sup>188</sup> According to Mr. Spanos, while Ms. McCullar's approach would result in lower revenue requirements today, it would result in less than full recovery of net salvage for plant in service, deferring a portion of removal costs for recovery from future customers.<sup>189</sup> The survivor

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RMM-6 (excerpt from NARUC's *Public Utility Depreciation Practices* (August 1996)). We supplemented RMM-6 indirectly by taking official notice Chapter XIII of the NARUC *Public Utility Depreciation Practices* Manual at TR. 554:7-17.

<sup>182</sup> Spanos, Exh. JJS-4T at 24:5-8.

<sup>183</sup> Spanos, Exh. JJS-4T at 19:19-21.

<sup>184</sup> Spanos, Exh. JJS-4T at 23:22-24 (citing NARUC Manual at 18).

<sup>185</sup> Spanos, Exh. JJS-4T at 20:20:22-21:1.

<sup>186</sup> Spanos, Exh. JJS-4T at 21:1-14.

<sup>187</sup> Spanos, Exh. JJS-4T at 20:1-4.

<sup>188</sup> Spanos, Exh. JJS-4T at 20:8-9.

<sup>189</sup> Spanos, Exh. JJS-4T at 20:9-14.

curve for these assets shows that “many more mains should be expected to retire on an annual level in the future than has occurred in the recent past.”<sup>190</sup>

163 Mr. Spanos illustrated how Ms. McCullar’s approach is flawed by providing detailed discussion of Gas Account 376.2 Mains Plastic and Gas Account 376.4 Mains – Wrapped Steel, which Ms. McCullar discusses as examples to support her position. He shows Ms. McCullar’s failure to consider that all of the assets in Account 376.2 are relatively new and have a relatively long expected life of 60 years. Both accounts are relatively young, particularly when compared to the overall average service life for each account. As a result, both retirements and net salvage should be expected to occur at much higher levels in the future than has occurred in recent years.<sup>191</sup>

*Commission Determination*

164 Public Counsel’s proposed alternative to the Settlement Stipulation’s treatment of net salvage of mass assets used in natural gas operations appears to be based on testimony by Ms. McCullar that we find to be vague in its methodology, not supported by authoritative accounting literature, and supported by unwarranted assumptions. Mr. Spanos’ estimates of net salvage for natural gas mass assets, in contrast, does not suffer from these deficiencies.

165 In addition, Ms. McCullar’s comparison of net salvage accruals to net salvage expenditures PSE incurred during recent years would effectively recover net salvage as an operating expense, not a depreciation expense. We do not accept this result.

166 Thus, we reject Public Counsel’s alternative viewpoint and approve the Settlement Stipulation with respect to net salvage of mass assets that support PSE’s natural gas operations.

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<sup>190</sup> Spanos, Exh. JJS-4T at 27:1-2.

<sup>191</sup> Spanos, Exh. JJS-4T at 25:3-26:7:13.

**3. Pension Plan (Electric Adjustment 13.15; Natural Gas Adjustment 11.15)**

167 The Settling Parties agree to use the adjustments proposed by PSE and Staff. The agreed adjustments include a decrease for electric NOI of \$1,184,945 and a decrease in natural gas NOI of \$572,091.<sup>192</sup>

168 Public Counsel argues in its Initial Brief only that “Public Counsel witness Mr. Smith provided testimony on specific adjustments,” and that it “incorporates” Mr. Smith’s testimony into its Initial Brief for the Commission’s “consideration.” While we expect more complete argument in brief when a party opposes a specific term in the Settlement Stipulation, we nevertheless consider fully below both PSE’s direct testimony that supports the Settling Parties’ agreement on this issue and Public Counsel’s response testimony that expresses its “alternative view” and preferred outcome.

**a. PSE Direct Case Supporting Settlement Stipulation**

169 PSE’s witness, Mr. Hunt, provides an overview of the Company’s current pension plans and provides illustrative exhibits of the current and future estimated service costs, contributions, and program valuation. Mr. Hunt testifies that PSE contributed \$24 million to the pension plan during 2016.

170 PSE revenue requirement witnesses, Ms. Barnard (electric) and Ms. Free (gas), provide additional testimony on the pension expense calculation. Both testify that the Company calculated the restating adjustment for pension expense using a four-year average of cash contributions to the PSE qualified retirement fund.<sup>193</sup> Ms. Free testified that the Commission previously approved this methodology in the Company’s 2009 general rate case. She testified more substantively that using cash contributions instead of expenses recognized under Financial Accounting Standards Board (FASB) codifications, including Financial Accounting Standard (FAS) 87, allows for consistency when applying this adjustment.<sup>194</sup> The four-year average contributions the Company allocated between electric and gas is \$21.2 million for the test period ending September 30, 2016.<sup>195</sup>

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<sup>192</sup> Settlement Stipulation ¶ 46 (citing Cheesman, Exh. MCC-2r at 4; Barnard, Exh. KJB-19 at 4 (labeled there as “Adjustment No. 20.15 – Pension Plan”)); *Id.* ¶47 (citing Cheesman, Exh. MCC-7r at 3; Free, Exh. SEF-14 at 3 (labeled there as “Adjustment No. 15.15 – Pension Plan”)).

<sup>193</sup> Barnard, Exh. KJB-1T at 36:16-17; Free, Exh. No. SEF-1T at 18:21-22.

<sup>194</sup> Free, Exh. SEF-1T at 19:1-5.

<sup>195</sup> Free, Exh. SEF-1T at 19:7-9.

**b. Public Counsel Response Testimony**

- 171 Public Counsel’s witness, Mr. Smith, proposed using the four-year average of net periodic pension cost for the period ending December 31, 2016.<sup>196</sup> He supported the use of a four-year average to normalize the expense allowance and remain consistent with prior Commission practice.<sup>197</sup> Mr. Smith provided detailed testimony that walks the Commission through the history of Financial Accounting Standard (FAS) 87, and funding requirements established by the Employee Retirement Income Security Act (ERISA) and the Pension Protection Act of 2006.
- 172 Opposing PSE’s recommendation to continue using cash contributions to determine pension expense for ratemaking purposes, Mr. Smith testified that cash contributions to a utility’s pension plan in any given year allow for a wide range of discretion. On the low end of the range, the Company is required to meet the minimum funding obligation (full funding)<sup>198</sup> while the ceiling is the maximum tax-deductible funding contribution.<sup>199</sup> He acknowledged that the level of cash contribution determined by the Company impacts the net periodic pension cost, predominately in the expected return portion of the calculation that subsequently reduces the net periodic pension cost.<sup>200</sup>
- 173 Additionally, Mr. Smith argued the Company’s proposal overstates the 2018 rate year pension expense,<sup>201</sup> pointing to the data in one of Mr. Hunt’s exhibits and his graphic representation of that data.<sup>202</sup> Mr. Smith’s analysis identified approximately \$3.0 million in what he considers to be overstated expense under PSE’s proposal. Public Counsel’s recommendation allows for \$18.4 million in pension expense.

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<sup>196</sup> The net Periodic Pension Cost Formula is: Service Cost + Interest Cost – Return on Plan Assets +/- Amortization of Deferred Net Loss or Net Gain.

<sup>197</sup> Smith, Exh. RCS-1CT at 56:11-13.

<sup>198</sup> “The full-funding limit is defined as the lesser of 100 percent of the plan’s actuarial accrued liability (including normal cost) or 150 percent of the plan’s current liability.” Smith, Exh. No. RCS-1CT at 53:21-54:1.

<sup>199</sup> Smith, Exh. RCS-1CT at 55:3-12.

<sup>200</sup> Smith, Exh. RCS-1CT at 55:16-20.

<sup>201</sup> Smith, Exh. RCS-1CT at 57:7-8.

<sup>202</sup> See Exh. RCS-12C.

**c. PSE Rebuttal Testimony**

- 174 Responding to Mr. Smith’s recommendation to use the four-year average FAS 87 actuarial pension expense, Ms. Barnard testified that the components of his calculation are based on estimates and are not known and measureable. Additionally, she stated that FAS 87 is based on assumptions made today for transactions in the future, suggesting this is similar to the Accounting Standards Codification (ASC) 815 Derivatives and Hedging, formerly FAS 133, where it is recognized that the costs appropriate for inclusion in rates are not the same as those reported for GAAP purposes.<sup>203</sup> Ms. Barnard testified that the contribution method PSE used reflects the actual cash paid by the Company resulting in a known and measureable expense that better aligns with the cash basis for accounting used in rate setting.<sup>204</sup> Finally, Ms. Barnard argued Mr. Smith did not provide a fully developed record to support his adjustment and that his testimony “merely concludes that PSE’s projected<sup>205</sup> pension contributions are higher than its projected FAS 87 expense and, therefore, moving to the FAS 87 expense should be accepted.”<sup>206</sup>
- 175 Ms. Barnard also addressed Public Counsel’s claim that management has a wide range of discretion as to the amount of pension contributions each year. First, she characterized today’s pension environment as “heavily scrutinized” thus serving as a natural check and balance system for the contribution rates set by companies.<sup>207</sup> Second, she testified PSE has no incentive to under- or over-contribute to the fund. Ms. Barnard pointed to the same federal regulations that Mr. Smith did for a fully-funded pension trust, identified the premium (penalty) by the Pension Benefit Guaranty Corporation for underfunding, and pointed to PSE’s limited cash flow coupled with the acknowledgement that the cash contributed may never be taken back from the pension trust to avoid overfunding.<sup>208</sup>
- 176 Finally, Ms. Barnard testified to the importance of consistency. She recommends the Commission maintain the use of the cash basis methodology to ensure PSE customers do not pay more or less simply because of changing methods, thereby supporting her

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<sup>203</sup> Barnard, Exh. KJB-17T at 39:16-41:4.

<sup>204</sup> Barnard, Exh. KJB-17T at 41:16-42:2.

<sup>205</sup> The term “projected” here refers to Mr. Hunt’s exhibit TMH-7C, not the inclusion of projected pension expense in rates.

<sup>206</sup> Barnard, Exh. KJB-17T at 43:10-12.

<sup>207</sup> Barnard, Exh. KJB-17T at 43:15-17.

<sup>208</sup> Barnard, Exh. KJB-17T at 43:17-44:1; 44:17-45:2.

position to continue the use of the four-year average cash contributions to determine the pension expense included in general rates.<sup>209</sup>

*Commission Determination*

177 We find that PSE’s approach to determining pension expense, accepted in the Settlement Stipulation, follows the Commission’s long-held regulatory treatment of using a four-year average of cash contributions for setting rates, and is the appropriate methodology.<sup>210</sup> Public Counsel has not presented a compelling reason to alter this approach.

**4. Environmental Remediation (Non-Colstrip) (Electric Adjustment 13.19; Natural Gas Adjustment 11.19)**

**a. Settlement Stipulation**

178 The Settling Parties agree to use the adjustment for non-Colstrip Environmental Remediation proposed by PSE. This decreases electric NOI by \$925,460 and natural gas NOI by \$5,592,128.<sup>211</sup> The Settlement Stipulation provides that within six months of approving the settlement, the Commission will initiate a process to determine a methodology for assigning insurance recoveries with annual environmental reports.

179 PSE requested in this case to recover amortization of deferred environmental remediation costs incurred from 2000 through 2016. PSE proposes to offset the deferred remediation costs with a portion of the third-party payments and insurance recoveries it has received. PSE would set aside the remaining portion of the recoveries to offset its estimated future environmental remediation liabilities.<sup>8</sup>

180 PSE Witness Mr. Rork provided a description of PSE’s environmental remediation sites, most of which are former manufactured gas sites that operated during the middle part of the 20<sup>th</sup> Century extracting methane from coal and oil. These sites represent PSE’s most

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<sup>209</sup> Barnard, Exh. KJB-17T at 47:15-20.

<sup>210</sup> See Barnard, KJB-17T at 38:16-47:20.

<sup>211</sup> Settlement Stipulation ¶47 (citing Barnard, Exh. KJB-19 at 4 (labeled there as “Adjustment No. 20.19 – Environmental Remediation”)); *Id.* ¶48 (citing Free, Exh. SEF-14 at 4 (labeled there as “Adjustment No. 15.19 – Environmental Remediation”)).

significant cost exposure for remediation responsibilities aside from Colstrip, which we discuss separately above.<sup>212</sup>

181 Mr. Rork's testimony included an overview of the Company's management and accounting of its environmental remediation responsibilities. He also testified that the costs PSE has deferred for environmental remediation are reasonable and the result of prudent operations.<sup>213</sup> According to Mr. Rork, "PSE performs all remediation activities in compliance with applicable federal and state laws and regulations,"<sup>214</sup> and is careful to take responsibility for remediation only of sites where it contributed to the contamination. He stated that PSE pursued third-party and insurance recoveries where available and works diligently to fulfill its remediation responsibilities cost-effectively.<sup>215</sup>

182 Mr. Rork testified that the remediation process typically is complex and requires implementation over many years.<sup>216</sup> Thus, he said:

PSE will have continuing remediation obligations at some sites, and ongoing monitoring obligations at other sites. Under the applicable laws governing remediation, these obligations can continue for substantial periods of time or even indefinitely. As such, PSE expects that some level of continuing environmental remediation costs will continue for the foreseeable future.<sup>217</sup>

183 Ms. Free testified concerning PSE's rate recovery recommendation for non-Colstrip environmental remediation costs. She explained that PSE has had deferred accounting for its environmental remediation costs and recoveries since the early 1990s.<sup>218</sup> Indeed, the gas environmental treatment was approved in Docket UG-920781 in 1992. In a 2008 order approving an accounting petition from PSE, the Commission said with respect to certain electric remediation sites:

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<sup>212</sup> Rork, Exh. JKR-1T at 2:13-16.

<sup>213</sup> Rork, Exh. JKR-1T at 11:1 – 13:16.

<sup>214</sup> Rork, Exh. JKR-1T at 11:11-12.

<sup>215</sup> Rork, Exh. JKR-1T at 12:12-22.

<sup>216</sup> Rork, Exh. JKR-1T at 12:6-7.

<sup>217</sup> Rork, Exh. JKR-1T at 13:8-16.

<sup>218</sup> Free, Exh. SEF-1T at 23:17-18.

Allowed net deferred costs will be amortized over a five year period on the date all costs, net of recoveries, become known and declared prudent. The deferrals will be consistent with the Commission's Merger Order in Docket UE-960195.<sup>219</sup>

Ms. Free testified that this brought the treatment of environmental deferrals into alignment for electric and gas operations.<sup>220</sup>

184 In this case, Ms. Free testified, PSE seeks recovery of certain of its net deferred environmental costs because the potential for future recoveries from insurance policies has declined in relation to amounts previously recovered. In addition, although there are still some viable third-party claims that remain, PSE believes it has substantially exhausted known third-party claims for remediation sites.<sup>221</sup>

185 Ms. Free testified that the amount of deferred net costs PSE seeks to recover in this case was determined considering only actual costs through September 30, 2016, which PSE expected to, and did, update to more current amounts during this proceeding. In order to maintain insurance and third-party recoveries to offset future remediation costs on existing environmental sites, PSE proposed to include only a portion of the unassigned insurance and third party recoveries to offset the actual costs included in this proceeding. PSE segregated insurance and third-party recoveries into two categories—site specific and unassigned. Actual site specific recoveries were assigned 100 percent against the actual September 30, 2016 deferred costs for those sites. The portion of unassigned recoveries to apply against all September 30, 2016, deferred costs was determined by taking the actual costs as of September 30, 2016, as a proportion of the estimated total cost of all existing remediation projects. The estimated total cost was determined as the midpoint between the high and low estimate of total future costs. Consistent with Order 01 in Docket UE-070724,<sup>222</sup> PSE proposed a five-year amortization period for the net deferred costs.

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<sup>219</sup> *In the Matter of the Petition of Puget Sound Energy, Inc., for an Accounting Order Regarding the Accounting Treatment for Costs of its Electric Environmental Remediation Program*, Docket UE-070724, Order 01 ¶6 (October 8, 2008).

<sup>220</sup> Free, Exh. SEF-1T at 24:1-9,

<sup>221</sup> Free, Exh. SEF-1T at 24:10-15.

<sup>222</sup> *In the Matter of the Petition of Puget Sound Energy, Inc., for an Accounting Order Regarding the Accounting Treatment for Costs of its Electric Environmental Remediation Program*, Docket UE-070724, Order 01 ¶6 (October 8, 2008).



**b. Public Counsel**

186 Public Counsel's position is that PSE should be required to use 100 percent of the insurance recoveries balance on its books to offset current liabilities.<sup>223</sup> Mr. Smith testified that "[t]his contrasts with PSE's proposal to only use 46 percent of the electric related proceeds and 58 percent of the gas related proceeds to offset environmental remediation costs through the end of the test year."<sup>224</sup> According to Mr. Smith, PSE's proposal creates a mismatch between costs and recoveries because future costs that PSE wishes to offset are not known and measurable.<sup>225</sup>

187 Ms. Free responded in her rebuttal testimony directly to Mr. Smith's testimony concerning the alleged mismatch between *expenditures* and recoveries, arguing it is Mr. Smith's proposal, not PSE's, that would create a mismatch between *costs* and recoveries. Ms. Free discusses the problem of intergenerational inequity as a factor weighing against use of all unassigned recoveries to offset existing deferred cost balances. She testified that:

The insurance policies and third-party recoveries PSE has obtained are intended to cover costs for past, present, and future environmental remediation on the covered sites. Applying all of these proceeds to past and current costs would unnecessarily harm future customers who would be responsible for paying for remediation costs without receiving the offsetting benefit of related insurance recoveries. Likewise, existing customers would receive a disproportionate amount of the insurance recoveries while only paying a portion of the related remediation costs.<sup>226</sup>

188 Mr. Secrist testified for PSE in rebuttal identifying another reason to carry unassigned recoveries on the Company's books. Mr. Secrist said that assigning recoveries to specific environmental remediation projects prior to exhausting all litigation and insurance recoveries could result ultimately in the recovery of fewer funds for the benefit of ratepayers. Mr. Secrist described litigation in which an insurer attempted to have its

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<sup>223</sup> Colamonici, Exh. CAC-1T at 10:9-14 (with reference to Smith, Exh. RCS-1CT at 59-65). Ms. Colamonici testified that "This adjustment decreases electric net operating income by \$552,786 and decreases natural gas net operating income by \$2,850,219." It is not clear, however, whether this is a proposed adjustment to per books or to PSE's original proposal.

<sup>224</sup> Smith, Exh. RCS-1CT at 65:7-10.

<sup>225</sup> Smith, Exh. RCS-1CT at 64:5-65:3.

<sup>226</sup> Free, Exh. SEF-12T at 24:3-14.

liability reduced by assigning some of the recoveries PSE had received, but not assigned, to the environmental remediation project that was the subject of the litigation.<sup>227</sup>

According to Mr. Secrist, this legal tactic did not succeed because PSE had not assigned the recoveries to that project.<sup>228</sup>

*Commission Determination*

189 The fundamental issue here is whether PSE should be required to use 100 percent of the insurance and third-party recoveries in deferral balances on its books to offset current liabilities or should be allowed to carry on its books the unassigned portions of those costs to offset future liabilities. Considering Ms. Free's and Mr. Secrist's rebuttal testimonies, we can restate this as two questions: 1) whether we should approve the Settling Parties' recommendation to continue carrying a portion of deferred recoveries in the interests of protecting the Company's ability to maximize recovery of unassigned environmental remediation costs and; 2) whether maintaining part of the current deferrals will avoid intergenerational inequities that will occur if all deferred recoveries to date are used to benefit current ratepayers, leaving none of these funds available to offset future costs that are certain to occur but in uncertain amounts and at uncertain times.

190 The Commission provided Public Counsel the opportunity to file testimony concerning the proposed settlement's adoption of (1) PSE's proposal to continue deferring the unassigned portion of its cost recoveries subject to detailed reporting requirements, and (2) the requirement that within six months of approving the settlement the Commission will initiate a process to determine a methodology for assigning insurance recoveries with annual environmental reports. Mr. Smith took this opportunity to testify that "Public Counsel generally supports the annual environmental reports and requirements listed in paragraph 55." However, Mr. Smith cited to his Response Testimony as support for his recommendation that 100 percent of recoveries be offset against current liabilities, apparently rejecting the idea that this question should be the subject of further study after this general rate case. Mr. Smith did not respond directly to PSE's concerns about potentially reduced recoveries going forward or intergenerational inequities.

191 Public Counsel argues in its Initial Brief that "the Settling Parties do not propose to use any of the electric or gas related proceeds to offset environmental remediation costs."<sup>229</sup> This is incorrect. The Settling Parties agree to use the adjustment for Environmental

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<sup>227</sup> Secrist, Exh. SRS-1T at 11:13-15.

<sup>228</sup> Secrist, Exh. SRS-1T at 11:15-18.

<sup>229</sup> Public Counsel Initial Brief ¶47.

Remediation proposed by PSE, which reflects PSE's proposal to use 46 percent of the electric-related insurance and settlement proceeds and 58 percent of the gas-related insurance and settlement proceeds to offset environmental remediation costs through the end of the test year. Under PSE's proposal, adopted by the Settling Parties, the unassigned balances in these accounts will be carried forward to offset future environmental remediation costs.

192 We favor the more deliberate approach recommended by the Settling Parties. This will provide immediate recovery though rates of significant third-party and insurance recoveries. It will also set aside significant funds to offset the costs that future generations of ratepayers will be expected to pay as environmental remediation efforts continue. Whether maintaining flexibility with respect to unassigned costs will help to maximize future recoveries is a more speculative question, but not one to be dismissed out of hand. The reporting requirements and commitment to a process that will bring greater clarity and certainty to the treatment of environmental remediation cost recoveries seems to us a more reasonable approach than simply earmarking 100 percent of the available funds for the benefit of current ratepayers.

193 Having discussed the record on this issue, and considering the parties arguments, we determine on balance that the interests of PSE's ratepayers, the Company, and the public interest are better served by our approval and adoption of the Settlement Stipulation's proposed resolution of this issue than by the alternative favored by Public Counsel.

#### **5. Storm Damage (Electric Adjustment 14.05)**

194 In its Initial Brief, as in the case of the Pension Expense Adjustments, Public Counsel's entire argument simply points out that "Public Counsel witness Mr. Smith provided testimony on specific adjustments." Public Counsel nominally "incorporates" Mr. Smith's testimony concerning storm damage into its brief for our "consideration." In this instance we are even less satisfied with Public Counsel's advocacy on this issue because the Settlement Stipulation reflects a detailed compromise of PSE's and Staff's fully developed and strongly divergent litigation positions. In the discussion below, we summarize the Settlement Stipulation's terms, which the Settling Parties ask us to adopt to resolve this issue. We also identify to the extent we can from Mr. Smith's testimony, the specific objections Public Counsel may have with respect to the Settling Parties' compromise.

**a. Settlement Stipulation**

- 195 Under the Settlement, PSE will defer the costs of any storms that occur on or after the Settlement Date and on or before December 31, 2017, under the terms of the storm loss deferral mechanism established in Order 6 in Dockets UE-040641 & UG-040640, *et al.*, and as revised in Order 12 in Dockets UE-072300 & UG-072301 (the “Qualifying Storm Loss Deferral Mechanism”). PSE will propose amortization of any such storm costs deferred pursuant to the terms of the prior sentence for recovery in PSE’s next general rate case or any ERF or limited rate proceeding to revise transmission and distribution rates.
- 196 PSE will retain the Qualifying Storm Loss Deferral Mechanism for any storm costs incurred on or after January 1, 2018, subject to the following modifications: (i) the cumulative annual cost threshold for deferral of storms under the Qualifying Storm Loss Deferral Mechanism will be increased from \$8 million to \$10 million, (ii) qualifying events that cost less than \$500,000 will not qualify for deferral, and (iii) the cumulative annual cost threshold for the Qualifying Storm Loss Deferral Mechanism will exclude storm events with costs less than \$500,000.
- 197 The Settling Parties agree to a six-year average of \$10,656,246 for normalized storm expense.
- 198 The Settling Parties acknowledge that PSE has an over-amortization of \$12,560,038 associated with the 2010 storms. PSE will use the over-amortization to absorb the remaining balance of December 2006 wind storm costs and the remaining balance of the over-amortization to reduce the balance of costs from the January 2012 snowstorm. PSE will amortize remaining storm deferrals, over four years, once approved for recovery in rates; provided, however, that PSE will amortize the January 2012 snowstorm over six years.
- 199 The Settling Parties agree that PSE will calculate normalized operating income, for purposes of PSE’s Earnings Sharing Mechanism by removing the storm normalization adjustment from PSE’s annual Commission Basis Report per WAC 480-100-257.
- 200 The Settling Parties agree that Adjustment No. 14.05 – Storm Damage decreases net operating income for electric operations by \$6,137,438, the calculation of which is provided as Exhibit F to this Settlement.

**b. Public Counsel**

201 Asked in his Response Testimony whether he recommends any adjustments to the Company's proposed storm damage amortization expense, Mr. Smith answered:

Yes, I am recommending one adjustment. Specifically, I recommend that the \$60.3 million cost related to the January 2012 catastrophic Snowmageddon events be amortized over 10 years, rather than PSE's proposed six years. Reasons for this recommendation include the following:

1. Using a longer amortization period for this extremely costly storm will help ameliorate the rate impacts.
2. Using a longer amortization period is better correlated with the infrequent experience of storms as devastating and costly as the extraordinary January 2012 Snowmageddon event.

202 Mr. Smith acknowledged that PSE recognized, and proposed in its direct case to use a longer amortization period for the January 2012 storm. He referred specifically to Ms. Barnard's testimony that "[d]ue to the relative size of the balance, PSE proposes that this amount be amortized over six years instead of four years in order to mitigate rate impact on customers."<sup>230</sup>

203 Public Counsel's alternative recommendation of a 10 year amortization period for the January 2012 storm, would decrease electric net operating income by \$5,776,213.39. Public Counsel referred to, and purports to "incorporate Mr. Smith's evidentiary presentation" into its brief for "the Commission's consideration." Public Counsel did not refer to any specific testimony by Mr. Smith and did not even cite to his testimony or exhibits. Public Counsel presented no argument in response to the resolution proposed in the Settlement Stipulation, to continue using the Qualifying Storm Loss Deferral Mechanism approved by prior Commission Orders, as referenced above.

*Commission Determination*

204 Public Counsel referred us in its initial brief to its "alternative viewpoint" of how PSE should account for storm damage. Public Counsel offered no reasoned argument or, indeed, any argument at all, supporting Mr. Smith's suggestion that PSE be required to use a 10-year amortization period for the storm events of January 2012. Mr. Smith's

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<sup>230</sup> Smith, Exh. RCS-1CT at 36:17-19 (quoting Barnard, Exh. KJB-1T at 46).

testimony failed to demonstrate why, or how, his recommendation is somehow a better approach than the more incremental change from a 4-year to a 6-year amortization, the revised amortization period to which the Settling Parties agreed.

205 We determine on the basis of the full record on this issue that the Settlement Stipulation's proposed resolution is supported by substantial evidence and by our prior orders approving this approach to storm damage accounting and recovery. We find, in addition, that the Settlement Stipulation's proposal to use excess over-amortization of \$12,560,038 associated with storm events in 2010 to absorb the remaining balance of the December 2006 wind storm, and to use the remaining balance of the over-amortization to reduce the balance of the January 2012 snowstorm, well-considered. These offsets will provide substantial benefits to ratepayers.

206 We approve and adopt, for the reasons discussed above, the Settlement Stipulation's Electric Adjustment 14.05 and the Settling Parties proposals for the treatment of storm damage costs going forward.

#### **6. Plant Held for Future Use (Public Counsel Electric Adjustment B-5)**

207 Three parties opposed PSE's adjustment in the category of Plant Held for Future Use: ICNU and NWIGU jointly, and Public Counsel. The Settlement Stipulation does not address Plant Held for Future Use. ICNU and NWIGU support the Settlement Stipulation as a resolution of all issues not expressly reserved for an adjudicated result. Thus, they have effectively abandoned their litigation position on this issue.

208 Public Counsel reiterated its litigation position through Ms. Colamonici's settlement testimony,<sup>231</sup> which relies on Public Counsel witness Mr. Smith's testimony. He recommended in his response testimony and his settlement testimony that we remove two portions of Kitsap Naval Land, considering the Commission's decision on plant held for future use in the Eleventh Supplemental Order in Dockets UE-920433, UE-920499, and UE-92162. Mr. Smith contends that this Order established a benchmark that would remove plant held for longer than 20 years. Public Counsel witness Mr. Smith's adjustment would decrease electric rate base by \$436,566.<sup>232</sup>

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<sup>231</sup> Colamonici, Exh. CAC-1T at 10:15-11:2.

<sup>232</sup> Smith, Exh. RCS-3 Supplemental at tab KJB-12 column AR in response to BR 1B.

209 The Commission's 1993 order stated:

The Commission is also concerned with the number of properties which have been held in this account for many, many years without action. Although litigation may cause some delays in a proposed use of property, some of the properties are apparently just "sitting". The Commission therefore adopts the Commission Staff's proposal for treatment of this account, including Mr. Martin's twenty-year benchmark for exclusion of properties. If property has not been acted on within twenty years, the ratepayers should not continue to bear these costs. The Commission specifically rejects the company's claim that establishment of a benchmark would be retroactive ratemaking. If that were the case, the Commission would never be able to establish reasonable guidelines.<sup>233</sup>

Mr. Smith testified the Kitsap Naval Land property was first included in plant held for future use on December 31, 1992. He argued the plant will have been held for nearly 27 years if put in service on the current projected date of October 1, 2019.

210 In rebuttal, PSE witness Mr. Marcellia testified to the benefits to ratepayers of holding assets in this account, and the consequence to ratepayers if the assets are removed from the utility's books. He stated:

Almost all the assets in future use have appreciated in value. Once they are placed in service, the customers get the benefit of the historical (lower) cost of the asset. If PSE were to sell the assets and then repurchase them at a later date, the customer would almost certainly be worse off. If PSE were to remove the assets from future use to non-utility property, any gain on appreciation would be shared with shareholders. In contrast, any gain from the disposition of an asset in future use flows completely to customers. The sale of LSR Development Rights in 2014 provides an example.<sup>234</sup>

Mr. Marcellia also testified that the plant held consists almost exclusively of land that is unique in one way or another and not easily replaced if removed from the utility books.<sup>235</sup>

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<sup>233</sup> Smith, Exh. RCS-1T at 18:3-20 (citing *WUTC vs. Puget Sound Power & Light Company*, Dockets UE- 921262 *et al.* (consolidated), Eleventh Supplemental Order at 90 (Sept. 21, 1993)).

<sup>234</sup> Marcellia, Exh. MRM-1T at 13:15-14:1.

<sup>235</sup> Marcellia, Exh. MRM-1T at 14:2-4.

211 In addition, Ms. Barnard testified in rebuttal concerning the Kitsap Naval Land that, “These two properties have been held in future use longer than the 20 year period...because the timing of the transmission line for which the properties were acquired had to be extended as a result of the [Jefferson Public Utility District] transition.”<sup>236</sup> Ms. Barnard stated further that the line upgrade for which the property was held is now anticipated to be in place by 2019.<sup>237</sup>

*Commission Determination*

212 PSE’s planned use for the Kitsap Naval Land properties was delayed for a period of time due to circumstances outside the Company’s control. It would be wasteful to require PSE to dispose of these lands now only to have to reacquire them later, if available, and probably at higher cost than the amount of proceeds that would be recovered through a sale today.

213 We are not persuaded that we should make Mr. Smith’s recommended adjustments to this account. Indeed, we are convinced by Mr. Marcellia’s and Ms. Barnard’s testimony that it would be inappropriate and counterproductive, and to some extent punitive, to remove from rate base the Kitsap Naval Land properties that PSE plans to use in the relatively near future for a transmission project. We approve and adopt the Settlement Stipulation’s proposed resolution of this issue.

**V. Non-Revenue Issues Addressed in the Settlement Stipulation and Contested by Public Counsel**

**A. Expedited Rate Filing**

**1. Settlement Stipulation**

214 The Settling Parties agree that PSE may file one ERF within one year after the effective date of the tariffs resulting from this proceeding that is consistent with the process and procedures used by the Commission in Dockets UE-130137 and UG-130138 and the parameters identified in Exhibit I to the Settlement Stipulation. Exhibit I provides that any ERF will be based on a Commission Basis Report (CBR) developed for a recently completed accounting period consistent with the approach defined in WAC 480-90-257 and WAC 480-100-257.

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<sup>236</sup> Barnard, Exh. KJB-17T at 83:4-7.

<sup>237</sup> Barnard, Exh. KJB-17T at 83:8-9.



- 215 The ERF will use only restating adjustments most recently approved by the Commission, with the following exceptions:
- (i) Use of end of period rate base is acceptable.
  - (ii) Annualization of any revenues that occurred after the test period and annualization of the underlying costs associated with those revenues to the extent not fully included in the test year results. This is necessary to maintain proper matching of the annualized revenue and expenses.
- 216 The ERF will remove power costs, purchased gas, and gas pipeline cost recovery mechanism related revenues, and expenses. Thus, only transmission, distribution, administration and general costs, and rate base will be used to determine the electric and natural gas revenue requirements to be considered in the expedited rate filing.
- 217 The ERF will use the rate of return established in the Company's most recent general rate case, except to update the interest rate on debt, if necessary.
- 218 The ERF will not include changes to rate spread or rate design from the most recently filed general rate case.
- 219 The Settling Parties will support, or not oppose, a schedule for an ERF that would allow rates to take effect within 120 calendar days after filing. Any subsequent ERF or limited rate proceeding filed by PSE will be required to be consistent with Commission guidance provided by rule or policy statement in Docket A-130355.

## 2. Public Counsel

- 220 Mr. Brosch testified for Public Counsel that the Company has not provided evidence as to why it needs an ERF.<sup>238</sup> Additionally, according to Ms. Colamonici, the terms in the Settlement regarding ERFs are ambiguous and unclear at best.<sup>239</sup> She testified, too, that the Settlement Stipulation concerning the ERF “inappropriately allows PSE to employ certain tools that are generally used to reduce regulatory lag without any demonstration that PSE needs such relief. One example is application of end of period rate base.”<sup>240</sup> Ms. Colamonici also contends, with reference to Mr. Brosch's testimony, that “the ERF

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<sup>238</sup> Brosch, Exh. MLB-1T at 69.

<sup>239</sup> Colamonici, Exh. CAC-1T at 7:21-22.

<sup>240</sup> Colamonici, Exh. CAC-1T at 7:22-8:1.

proposal mistakenly assumes intervener [sic] parties have unlimited resources for participating in ERFs.”<sup>241</sup>

*Commission Determination*

221 This term in the Settlement Stipulation provides guidance to the parties if PSE elects to seek rate relief between general rate cases, an option available to the Company in any event. In terms of what any such filing should include, we agree with the guidance offered by the Settlement Stipulation. Thus, we require that PSE and other parties follow the limits agreed to in the Settlement Stipulation for such a proceeding if filed within 12 months following the rate effective date of PSE’s compliance filing in this proceeding. PSE will have the burden to show it needs such rate relief. The Commission retains the power to reject any ERF filing, approve it with or without modifications or conditions, or take such other action as it deems to be in the public interest. The Commission will endeavor to expedite the ERF process, but will not be bound by the parties’ proposed 120-day schedule if it determines additional time is required to afford due process to all parties. PSE, of course, would be well-advised to be fully transparent and forthcoming with supporting schedules and workpapers at the time of any such filing so as to limit the need for discovery.

222 We do not find the Settlement Stipulation to be ambiguous or unclear in this connection. Our continuing willingness to accept the ERF concept here, contrary to what Public Counsel suggests, does not amount to preapproval of the use of end of period rate base or any other specific regulatory tool. Finally, while we sympathize with Ms. Colamonici’s concern that “intervener [sic] parties [do not] have unlimited resources for participating in ERFs,” we note that the ERF is by its terms a limited proceeding and all intervenors in this case support the Settlement Stipulation, including this provision.

**B. Water Heater Program**

**1. Settlement Stipulation**

223 PSE did not address this issue in its direct case. Staff witness Ms. O’Connell recommended in her response testimony that the Commission phase out PSE’s rental programs in Schedules 71, 72, and 74 (rental programs).<sup>242</sup> The Settlement Stipulation provides that PSE will participate in a collaborative with Commission Staff and other

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<sup>241</sup> Colamonici, Exh. CAC-1T at 8:5-6.

<sup>242</sup> O’Connell, Exh. ECO-1CT at 25:18-31:2.

interested stakeholders to discuss the future of the water heater rental programs in PSE's natural gas Schedules.<sup>243</sup>

## 2. Public Counsel

224 Public Counsel filed no rebuttal or cross answering testimony on this issue. Nevertheless it recommended through Ms. Colamonici's testimony concerning the proposed Settlement Stipulation that the Commission should order the discontinuance of Schedules 71, 72, and 74.<sup>244</sup> This is based on Staff's litigation position, which Staff now has set aside in favor of a compromise on this issue.

### *Commission Determination*

225 We determine that the Commission should approve the Settling Parties agreement to rely on a collaborative discussion by interested parties to give considered attention to this issue. Although Public Counsel adopts Staff's litigation position on this issue in opposing the Settlement, it would be inappropriate for the Commission to adopt a position Staff has compromised in favor of settlement and further discussion. A collaborative process will provide an opportunity for further discussion in which Public Counsel, and all interested parties, may participate.

## C. SQI-5

### 1. Settlement Stipulation

226 PSE will revise Service Quality Index (SQI) No. 5 to establish an annual benchmark of 80 percent of calls answered within 60 seconds after a request to speak with a representative. This changes the standard that PSE must currently meet of answering 75 percent of calls within 30 seconds. The Settlement provides that the calculation will not include Integrated Voice Response System (IVR) transactions.

227 PSE observes in its Initial Brief that "the current SQI-5 metric was set two decades ago, when the methods available to customers to contact PSE were very different than today."<sup>245</sup> PSE argues it is reasonable for the Settling Parties "to agree to an updated metric reflecting the fact that many of the more basic calls are now handled through

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<sup>243</sup> Settlement Stipulation ¶123. PSE relied on Company witness Mr. Einstein who offered rebuttal to Ms. O'Connell's testimony. Einstein, Exh. WTE-1T at 1:13-22.

<sup>244</sup> Colamonici, Exh. CAC-1T at 15:9.

<sup>245</sup> PSE Initial Brief ¶ 18.

automated systems such as Integrated Voice Response.”<sup>246</sup> PSE also argues that revising the SQI-5 standard to match what the Commission set for Avista two years ago is particularly reasonable considering that, “unlike Avista, PSE faces a \$1.5 million annual penalty for failure to comply with its standard.”<sup>247</sup> Ms. Barnard testified during Public Counsel’s cross-examination that the Company’s direct and rebuttal testimonies included significant documentation on why PSE supported changing the standard established in 1997 and that while Staff’s litigation position was to maintain the status quo, the settlement includes a “compromised position.”<sup>248</sup>

228 Responding to questions from the Bench, Mr. Schooley testified that Staff came to view the compromised position as being a reflection of improved technologies relative to 20 years ago that now allow the “easy questions” that come in to customer service centers to be handled by IVR. Other questions that are more involved and require conversation with a customer representative, “are ones that are much harder to deal with, so each question takes longer to answer for that customer.”<sup>249</sup> Mr. Schooley testified that this means either allowing additional time for each call to be completed, resulting in slightly longer wait times for live responses to incoming calls, or overstaffing of customer service centers, which is inefficient.<sup>250</sup>

229 Mr. Collins testified for The Energy Project that The Energy Project’ concern was that customers needing to make billing arrangements to address past due arrearages would be handled by a live person. He said The Energy Project “felt comfortable that this particular item allowed for that to occur since the SQI [is] specific to the live answer calls. So we were comfortable with that.”<sup>251</sup>

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<sup>246</sup> PSE Initial Brief ¶ 18 (citing *See* Schooley, Tr. 606:19-607:18; *see also* Collins, Tr. 608:1-7).

<sup>247</sup> PSE Initial Brief ¶ 18 (citing *See WUTC v. Puget Sound Energy*, Docket UE-072300, Order 29 ¶ 13 (June 17, 2016) (referencing amendment to SQI program in 2007 general rate case that increased penalties to \$1.5 million) *cf* *Avista Corp*, Dockets UE-140188 and UG-140189, Order 06 ¶¶ 13, 16-20 (declining to include penalties for Avista’s service quality metric program); *see also* TR. 591:24-592:2.

<sup>248</sup> TR. 589:2-14; *see generally* TR. 589:2-592:8.

<sup>249</sup> TR. 607:3-6.

<sup>250</sup> TR. 607:7-11.

<sup>251</sup> TR. 608:1-7.

## 2. Public Counsel

230 Public Counsel, through its Initial Brief, opposes this change, arguing that it “gives PSE twice as much time to answer only five percent more calls.”<sup>252</sup> According to Public Counsel, the proposed change to SQI-5 “erodes the foundation for which the Commission initially adopted the Service Quality Index” in connection with its approval of the merger of Washington Natural Gas Company and Puget Sound Power & Light Company during the mid-1990s. The Commission approved the standard to “provide a specific mechanism to assure customers that they will not experience deterioration in quality of service” and “to protect customers of PSE from poorly-targeted cost cutting.”<sup>253</sup>

### *Commission Determination*

231 We are persuaded by the record evidence and the arguments summarized above that it may be time to update the SQI-5 metric, especially considering how different communications technology and practice is today relative to 20 years ago. While we understand Public Counsel’s concern about deterioration in customer service quality, we find that the Settling Parties’ agreement on this issue is supported by the evidence, and is consistent with the public interest. To ensure that this change does not lead to deteriorating service for those customers trying to contact the Company by phone, we require PSE report to the Commission after one year of the change in this measure data concerning the customer’s experience in contacting the company by phone, through the company’s website and through the IVR methodology. Specifically, the Company must file evidence demonstrating that the new standard has not led to a deterioration in service quality and has not led to poorly targeting cost cutting.

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<sup>252</sup> Public Counsel Initial Brief ¶ 71.

<sup>253</sup> Public Counsel Initial Brief ¶ 71 (citing *In re Proposal by Puget Sound Power & Light Co. to Transfer Revenue from PRAM Rates to General Rates, In re Application of Puget Sound Power & Light Co. and Wash. Nat. Gas Co. for an Order Authorizing the Merger of Wash. Energy Co. and Wash. Nat. Gas Co. with and into Puget Sound Power & Light Co., and Authorizing the Issuance of Securities, Assumption of Obligations, Adoption of Tariffs, and Authorizations in Connection Therewith*, Dockets UE-951270 & UE-960195, Fourteenth Supplemental Order Accepting Stipulation; Approving Merger at 30 (Feb. 5, 1997); *Id.* at 32).

## VI. Miscellaneous Uncontested Issues Addressed by the Settlement

### A. Prudence

#### 1. Settlement Stipulation

232 The Settling Parties agree to support a Commission determination that the following eight projects and actions were prudent and that PSE will fully recover its demonstrated costs:

- Snoqualmie Falls hydroelectric redevelopment project.
- Acquisition of the Buckley Natural Gas Distribution System.
- Acquisition and development of the Glacier Battery Storage System.
- Development and construction of the Ardmore Substation.
- Power purchase agreement with Public Utility District No. 1 Public Utility District No. 1 of Douglas County, Washington to purchase power from the Wells Hydroelectric Project.
- Acquisition of transmission capacity from Bonneville Power Administration (BPA) for the Goldendale Generation Facility (38 MW) and the Mint Farm Generation Facility (15 MW).
- Renewal of agreements for transmission capacity from BPA associated with the Coal Transition Power Purchase Agreement (100 MW), the Mint Farm Generation Facility (20 MW), and purchases from Garrison, Montana (94 MW).
- Total amount of actual costs accumulated and deferred until September 30, 2016, associated with PSE's electric and natural gas Environmental Remediation program.

233 PSE upgraded its Snoqualmie Falls facilities to ensure compliance with Federal Energy Regulatory Commission (FERC) relicensing requirements. Mr. Bamba provided detailed testimony concerning this project and its costs, which are now final.<sup>254</sup> Mr. Bamba testified among other things to the Commission's previous determinations in the Company's 2005, 2013, and 2014 PCORC proceedings in Dockets UE-050870, UE-130617, and UE-141141, respectively, that significant project costs incurred at those times were prudent.<sup>255</sup> Thus, approximately 75 percent of the total project costs already have been determined to be prudent and are being recovered in rates.

234 Mr. Mullally, Manager, Business Initiatives for PSE, testified in detail concerning PSE's purchase of the Buckley Natural Gas Distribution System; PSE's Glacier Battery Storage System pilot project; and PSE's agreement to purchase power from the Wells Hydroelectric Project. His testimony discusses, with respect to each of these projects,

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<sup>254</sup> Bamba, Exh. RB-1T at 1:14-15:5

<sup>255</sup> Bamba, Exh. RB-1T at 3:3-11; 5:12-7:3.

PSE's evaluation of the project by cross-functional teams of internal experts and outside consultants including engineering and operations, gas supply and transportation, community and customer relations, legal, insurance, real estate, environmental, rates and regulatory, accounting, human resources, and financial planning and strategic initiatives.<sup>256</sup> Mr. Mullally also described how PSE kept management informed during the evaluation of these projects and identified key management decisions approving the projects and project costs. The status of each project and project costs also are part of Mr. Mullally's testimony. In addition, he discusses the benefits of each project to PSE and its customers.

- 235 Mr. Wetherbee testified with respect to PSE's acquisition of transmission capacity from BPA for the Goldendale Generation Facility (38 MW) and the Mint Farm Generation Facility (15 MW). He discussed that PSE relies on existing BPA transmission contracts from Mid-C to PSE's system to meet its capacity need in that the Company may use this transmission to wheel short-term market power from Mid-C to PSE's load.<sup>257</sup> PSE requires firm transmission from its generation resources and contracts in order to ensure reliable delivery to PSE's system to serve load, according to Mr. Wetherbee.<sup>258</sup> Mr. Wetherbee testified that "PSE performed a full and detailed justification for the reasonableness of the costs of renewing and acquiring these BPA transmission contracts."<sup>259</sup>
- 236 Concerning PSE's renewal of agreements for 100 MW of transmission capacity from BPA associated with the Coal Transition Power Purchase Agreement, Mr. Wetherbee said the Company's original contract with BPA for this capacity would have expired on September 26, 2016, but the Coal Transition PPA runs through 2025. PSE renewed the contract for five years to allow for continued delivery of power from the facility until September 20, 2021.<sup>260</sup>
- 237 Similarly, PSE's two contracts with BPA for 12 MW and 8 MW of transmission used to wheel power from Mint Farm would have expired November 15, 2015, and June 1, 2016, respectively. PSE renewed both contracts for additional five-year terms.<sup>261</sup>

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<sup>256</sup> See, e.g., Mullally, Exh. MM-1T at 5:8-9:5.

<sup>257</sup> Wetherbee, Exh. PKW-1CT at 34:3-5.

<sup>258</sup> Wetherbee, Exh. PKW-1CT at 34:7-9.

<sup>259</sup> Wetherbee, Exh. PKW-1CT at 34:9-11.

<sup>260</sup> Wetherbee, Exh. PKW-1CT at 25:3-10.

<sup>261</sup> Wetherbee, Exh. PKW-1CT at 24:11-16.

- 238 Finally, Mr. Wetherbee testified concerning the expiration date of September 30, 2016, for the Company's 94 MW transmission contract that provides transmission from Garrison, Montana to the PSE system. This transmission supports PSE's wheeling of a 75 MW physical index power purchase during winter months, provides an alternative path, receiving at the Garrison 230 kV substation, to wheel power from PSE's generation assets in Montana if there are outages or derates on the 500 kV transmission system, and provides access to short-term power purchases at the Garrison hub at prices that are generally below Mid-C prices.<sup>262</sup> Mr. Wetherbee testified the Company evaluated its options in conjunction with the assumed replacement of the winter peaking physical index power purchase that expired in February 2015. The portfolio analysis showed a \$27 million portfolio benefit associated with the 94 MW transmission renewal.
- 239 Staff testified in support of the settlement that it did not contest the prudence of these projects, agrees that they are prudent, and that the result reflected in the Settlement Stipulation "is fair."<sup>263</sup>
- 240 PSE did not address the Ardmore substation in its direct case. ICNU, in its response case, objected to the prudence of the costs PSE incurred in connection with the Ardmore substation development and raised concerns about the allocation of these costs.<sup>264</sup> Ms. Koch testified to this issue for PSE on rebuttal. She challenged ICNU witness Mullins's reliance on a planning document that did not reflect the actual final budget for this project. She testified that cost increases (and savings) for the project resulted from a variety of causes including an evolving scope of work over time associated with changing requirements, stakeholder input, property permitting costs, increased materials and construction costs, costs associated with adding Interlaken, constraints and opportunities in the area, and construction site conditions.<sup>265</sup> Ms. Koch stated that PSE followed standard practices including a competitive bid process and close monitoring of the project by management.<sup>266</sup> Ms. Koch explained that it would not have been reasonable for PSE to abandon the project as costs increased because project benefits also were "increased by absorbing the function of the Interlaken substation, eliminating the need to upgrade that

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<sup>262</sup> Wetherbee, Exh. PKW-1CT at 25:15-26:2.

<sup>263</sup> Schooley/Cheesman, Exh. TES-4T at 19:11-15.

<sup>264</sup> See Mullins, Exh. BGM-1T at 51:16-56:8.

<sup>265</sup> Koch, Exh. No. KAK-4T at 37:9-19. "Project Change Requests" contain the processes for approval for budget and associated scope changes. Exhibit CAK-8 provides a chronology of the entire project cost and scope details.

<sup>266</sup> Koch, Exh. No. KAK-4T at 41:19-42:13.



station and incur additional cost.” Ultimately, ICNU compromised its litigation position by expressly agreeing to the prudence of these costs while reserving its right to address their allocation in a subsequent proceeding.<sup>267</sup>

## 2. Public Counsel

241 Ms. Colamonici testified that Public Counsel supports generally PSE’s power costs as originally filed and is “neutral” with respect to the Glacier Battery Storage System, the Goldendale capacity upgrade, and the Mint Farm Capacity upgrade, specifically.<sup>268</sup> It appears, then, that the prudence of the projects identified above is not at issue.

### *Commission Determination*

242 We find substantial competent evidence in the record, largely unrebutted, as discussed above and earlier in this Order,<sup>269</sup> supporting the prudence of these eight projects. We determine accordingly that the projects the Settling Parties identify in their Settlement Stipulation, as set forth above, should be found to be prudent.

## VII. Issues that Remain in Dispute Outside the Settlement

### A. Decoupling

243 The Commission approved PSE’s decoupling mechanism in mid-2013 as part of the Rate Plan that is now drawing to a close.<sup>270</sup> It was designed to encourage PSE to place a greater emphasis on energy conservation by weakening the Company’s incentive to increase revenue by increasing sales, *i.e.*, the throughput incentive. PSE’s decoupling mechanism does this by separating out the Company’s energy delivery costs and calculating them on a per-customer basis. Once that figure has been determined, the amount of revenue PSE recovers through the decoupling mechanism is a simple calculation: revenue per customer multiplied by number of customers equals decoupling revenue.

244 The decoupling mechanism was designed with the various customer classes separated into four different rate groups. Each group’s decoupling revenue is calculated

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<sup>267</sup> See Exh. PSE-1JT at 12:7-19.

<sup>268</sup> Colamonici, Exh. CAC-1T at 11:17-18, 12:14, 12:19, and 12:20-21.

<sup>269</sup> See *supra* ¶¶ 178-193.

<sup>270</sup> See *supra* n.1 (Order 07-2013 Rate Plan).

independently. This was done to limit cross-subsidization between classes with different load shapes.

245 The mechanism is set forth in a separate tariff, and guarantees PSE decoupling revenue recovery by allowing the Company to true up any revenue deficiencies each year. In each true-up filing, PSE's decoupling earnings are subject to a rate test, which determines how much revenue PSE was authorized to earn for the year based on how many customers it served, and then compares that figure to the decoupling revenue that PSE actually earned. If PSE did not recover its authorized decoupling revenue, the mechanism allows the Company to defer the unrecovered costs and increase the decoupling tariff to recover them in the following year. Annual rate increases are capped at 3 percent.

246 In tandem with the decoupling mechanism, the Commission instituted an earnings test for PSE. The earnings test applies to the Company's overall revenues – not just those collected through decoupling. The earnings test compares PSE's normalized revenue each year against its authorized revenue requirement, and requires the Company to share any earnings above its authorized revenue requirement with customers on a 50-50 basis.

247 In this case, PSE proposes to continue permanently its use of decoupling but recommends four major changes to the decoupling mechanism. Specifically, the Company asks the Commission to approve:

- Including fixed production costs for recovery via the decoupling mechanism.
- Re-alignment of the rate groups.
- Changes to the rate test and rate cap.
- Removal of normalizing adjustments from the earnings test.

248 ICNU and FEA recommend the Commission reject the Company's request to continue the decoupling mechanism. Staff, Public Counsel, NWEC/RNW/NRDC, Kroger, and The Energy Project support the continued use of the decoupling mechanism but do not agree with all four changes PSE recommends, or a permanent extension of the mechanism.

### **1. Should the Commission Approve PSE's Continued Use of Decoupling?**

249 PSE argues that its contention that the decoupling mechanisms are operating as intended is supported by the evidence in this case.<sup>271</sup> Specifically, PSE cites to a third-party

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<sup>271</sup> PSE Initial Brief ¶ 60.

evaluation of PSE's decoupling mechanisms conducted by Gil Peach and Associates. PSE says the study "confirmed the success of the decoupling mechanisms and specifically found that PSE is calculating decoupling deferrals and rates in accordance with Commission orders."<sup>272</sup> In addition, PSE argues that that "rate impacts have been small for electric customers and most gas customers, including low-income customers; conservation program performance has been stable during the evaluation period; and removing the throughput incentive has been a positive step in removing barriers to energy efficiency performance."<sup>273</sup>

250 Staff agrees that the decoupling mechanism should continue.<sup>274</sup> Staff argues that PSE's decoupling mechanism is successful because the Company has achieved higher levels of conservation and has experienced revenue stability.<sup>275</sup> Staff also supports the continuance of decoupling considering that PSE has committed itself to continuing its conservation achievement of five percent above its biennial conservation target, or suffer the consequence of penalties and proposes a natural gas conservation achievement of five percent above that contained in its integrated resource plan, coupled with a penalty for failure to meet this target.<sup>276</sup>

251 ICNU argues that decoupling is inconsistent with sound ratemaking practices, violates the Commission's governing statutes, and does not appropriately balance the interests of the Company with customers that take service under Schedules 46 and 49 (High Voltage).<sup>277</sup> The first two arguments depend on ICNU's perspective that PSE's revenue per customer decoupling design "allows it to charge customers for kilowatt hours never used by[,] and never before billed to[,] the] customer."<sup>278</sup> That is, "the service received by a customer from PSE during a billing period no longer determines the monthly charge demanded by PSE."<sup>279</sup>

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<sup>272</sup> PSE Initial Brief ¶ 60.

<sup>273</sup> PSE Initial Brief ¶ 60 (citing *see* Piliaris, Exh. JAP-29 at 14-27).

<sup>274</sup> Staff Initial Brief ¶ 53 (citing Liu, Exh. JL-1CT at 27:7-8).

<sup>275</sup> *Id.* (citing Liu, Exh. JL-1CT at 26:4 - 27:4).

<sup>276</sup> *Id.* (citing Piliaris, Exh. JAP-1T at 144:17-21; 145:7-20).

<sup>277</sup> ICNU Initial Brief ¶ 42. Schedules 46 and 49 provide service to PSE's larger industrial customers.

<sup>278</sup> ICNU Initial Brief ¶ 44.

<sup>279</sup> ICNU Initial Brief ¶ 44.

252 Citing RCW 80.28.010 and .020, ICNU says the Commission’s authority over rates “is expressly and undeniably linked to the services” it provides.<sup>280</sup> ICNU finds support for this proposition in “the seminal 1985 *Power* case” in which the Court said:

In reading the *rate setting* statutes [citing RCW 80.28.010 and .020], it is clear that they are simply referring to “service rendered” in the context of utilities charging customers “for services rendered” or “services to be rendered” to their customers, and that these terms are used in much the same sense that lawyers charge their clients “for services rendered” and doctors charge their patients “for services rendered.”<sup>281</sup>

It follows from this, ICNU argues, that “service must be *rendered* or otherwise delivered to the customer before charges for such services can be included in rates.”<sup>282</sup>

The *POWER* case, however, supports the broad powers of the Commission to set rates under RCW 80.28.010 and .020. Indeed, the Court states unequivocally that “within a fairly broad range, regulatory agencies exercise substantial discretion in selecting the appropriate rate making methodology.”<sup>283</sup> Decoupling is a deferred accounting mechanism that allows for annual true-ups. Both deferred accounting and true-up mechanisms are commonplace rate making methodologies that are widely used throughout the United States and routinely used by the Commission.

253 ICNU discusses two Washington telecommunications cases in which courts overturned Commission orders that approved rates or surcharges unrelated to services rendered.<sup>284</sup> ICNU argues that “[a]s in *Tracer* and *Jewell*, there is no connection between the deferred costs created by PSE’s decoupling program and service rendered to the customers who would be required to pay rates to cover these deferred costs.”<sup>285</sup> ICNU contends the decoupling charge on PSE’s customers’ bills is a charge that is “unrelated to service

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<sup>280</sup> ICNU Initial Brief ¶ 47.

<sup>281</sup> ICNU Initial Brief ¶ 48 (citing *People’s Organization for Washington Energy Resources v. Washington Utilities and Transp. Comm’n*, 104 Wash.2d 798, 825 (1985) (*POWER*)).

<sup>282</sup> ICNU Initial Brief ¶ 49.

<sup>283</sup> *POWER*, 104 Wash.2d 798, 812.

<sup>284</sup> ICNU Initial Brief ¶¶50-51 (citing *Washington Independent Telephone Ass’n v. Telecommunications Ratepayers Ass’n for Cost-Based & Equitable Rates* (“*Tracer*”) 75 Wash. App. 356 (1994); and *Jewell v. WUTC*, 90 Wn.2d 775 (1978)) (*Jewell*).

<sup>285</sup> ICNU Initial Brief ¶52.

provided by the company.”<sup>286</sup> Because of this, ICNU says, the Commission should reject the Company’s decoupling program.

254 *Tracer* and *Jewell*, however, are distinguished by the fact that, in both cases, the costs the Commission approved for recovery were completely unrelated to any utility service provided. In *Tracer* the court struck down a Commission rule that essentially required larger local exchange carriers (LECs), such as US West and AT&T, to pay into a fund that would subsidize smaller LECs. The Court ruled the Commission lacked power to impose what essentially was a tax allowing for cross-subsidization of smaller LECs by large ones.<sup>287</sup> In *Jewell*, the Court rejected the Commission’s allowed recovery of charitable contributions, finding these did not result in customers receiving more prompt or expeditious service and the relevant statutes did not direct telephone companies to be “good corporate neighbor[s].”<sup>288</sup> PSE’s decoupling mechanisms, in contrast, allow for recovery of fixed costs the Company incurs to deliver electricity and natural gas to its customers. Nothing could be more central to the utility’s purpose.

255 FEA argues that “revenue decoupling is an inappropriate and unwarranted departure from traditional ratemaking principles.”<sup>289</sup> According to FEA, revenue decoupling alters the traditional ratemaking process by allowing automatic adjustments to base rates outside of a general rate case to reflect the impact of changing sales levels over time. In FEA’s opinion, this removes the Company’s incentives to operate efficiently and promote economic growth in its service territory to improve its financial results between rate cases.<sup>290</sup> FEA argues in addition that decoupling has the effect of discouraging voluntary conservation efforts by customers because reduced sales result in higher revenue per customer charges between rate cases.<sup>291</sup> In addition, decoupling shifts the risks of a downturn in sales between rate cases to customers even if reduced sales result from abnormal weather conditions or a general economic downturn.<sup>292</sup> Absent a reduction in return to reflect this risk shifting, decoupling results in overcompensation to the

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<sup>286</sup> *Id.*

<sup>287</sup> *TRACER*, 75 Wn. App. 356, 361.

<sup>288</sup> *Jewell*, 90 Wn.2d 775, 777.

<sup>289</sup> FEA Initial Brief at 5.

<sup>290</sup> *Id.*

<sup>291</sup> Al-Jabir, Exh. AZA-1T at 7:1-7.

<sup>292</sup> Al-Jabir, Exh. AZA-1T at 7:11-24.

Company's shareholders.<sup>293</sup> FEA argues that decoupling makes the Company less responsive to its customers' needs and creates increased rate volatility in the event that an economic recession or abnormal weather causes a dramatic decline in sales between rate cases.<sup>294</sup>

256 NWEC/RNW/NRDC argue that empirical evidence in the form of two independent reviews of the performance of PSE's decoupling mechanism concluded that PSE's program is working as intended, with no identifiable problems.<sup>295</sup> The parties argue more specifically that:

In both the Second- and Third-Year Reports, the consultants concluded that “[t]here is overall stability of good performance (energy efficiency and conservation achievement) in decoupling as compared with the time just prior to decoupling.” The independent reviews found no evidence that decoupling had harmed customer service, as only one of 22 customer service indicators declined in the years after decoupling—and even for the one declining indicator, PSE's performance remained within the target values. The overall revenue impacts of decoupling have been small (*i.e.*, less than 2% of total revenues), and annual average O&M costs have grown at a lower rate after decoupling than historically.<sup>296</sup>

NWEC/RNW/NRDC said that FEA witness Mr. Al-Jabir opposes the extension of decoupling on the ground that it discourages customer investments in energy efficiency,<sup>297</sup> yet when asked to substantiate these claims, Mr. Al-Jabir responded that he

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<sup>293</sup> Al-Jabir, Exh. AZA-1T at 8:1-10.

<sup>294</sup> Al-Jabir, Exh. AZA-1T at 8:11-9:10.

<sup>295</sup> NWEC/RNW/NRDC Initial Brief ¶ 12 (citing Docket No. UE-121697, “Puget Sound Energy Electric and Natural Gas Decoupling Second Year Evaluation” by H. Gil Peach & Associates LLC with Forefront Economics, Inc. & Joseph Associates, Inc. (Apr. 14, 2016) [“*Second-Year Report*”]; Exh. JAP-29, “Puget Sound Energy Electric and Natural Gas Evaluation: Three Years of Decoupling” by H. Gil Peach & Associates LLC with Forefront Economics, Inc. & Joseph Associates, Inc. (Dec. 31, 2016) [“*Third-Year Report*”]).

<sup>296</sup> NWEC/RNW/NRDC Initial Brief ¶ 13 (citing *Second-Year Report* at 5; *see also Third-Year Report* at 20, 87-88, 94; *Second-Year Report* at 6; *Second-Year Report* at 2; *Third-Year Report* at 14-16, 55-57, 114).

<sup>297</sup> NWEC/RNW/NRDC Initial Brief ¶ 15 (citing Al-Jabir, Exh. AZA-1T at 5:17, 7:3-7).

had no supporting evidence.<sup>298</sup> Moreover, NWEC/RNW/NRDC argues “the financial benefits to customers from implementing energy efficiency measures exceed the decoupling adjustments, and the decoupling adjustments have been too small to discourage customer investments in energy conservation.”<sup>299</sup>

257 In addition, NWEC/RNW/NRDC argues:

[W]hile Mr. Al-Jabir claimed that decoupling reduces PSE’s incentive to control costs, the Third-Year Report undermines Mr. Al-Jabir’s claim by showing that O&M costs grew at a slower rate after decoupling than before decoupling. Likewise, when asked to provide evidence to support his claim that decoupling reduces PSE’s incentive to provide quality customer service, Mr. Al-Jabir could provide no such evidence. Mr. Al-Jabir’s claim is refuted by the record evidence, which shows that only one of 22 customer service indicators declined in the years after decoupling.<sup>300</sup>

258 PSE argues that the Commission should reject the recommendations by ICNU and FEA to discontinue PSE’s decoupling mechanism because, among other reasons, “they rely on arguments that the Commission rejected when it authorized PSE’s decoupling mechanisms just four years ago.”<sup>301</sup> Moreover, PSE says the Gil Peach Report “concludes that there is no evidence that the decoupling mechanism created a disincentive for PSE’s customers to conserve, that it does not have an adverse impact on PSE’s service quality, and that it only leads to minor rate adjustments, particularly excluding the effects of the associated K-factor increases under the Rate Plan.”<sup>302</sup>

259 Staff supports the continuation of PSE’s decoupling mechanisms, but not on a permanent basis as PSE proposes. Staff argues that it should be only be extended for four years to ensure that the mechanism is regularly reviewed.<sup>303</sup> PSE argues, for the reasons stated in

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<sup>298</sup> NWEC/RNW/NRDC Initial Brief ¶ 15 (citing Exh. AML-14 (FEA Response to NWEC/RNW/NRDC Data Request No. 001)).

<sup>299</sup> NWEC/RNW/NRDC Initial Brief ¶ 15 (citing *Third-Year Report* at 138).

<sup>300</sup> NWEC/RNW/NRDC Initial Brief ¶ 16 (citing *See Third-Year Report* at 114; Piliaris, Exh. JAP-1T at 127:11-14; Exh. AML-15 (FEA Response to NWEC/RNW/NRDC Data Request No. 003); *Second-Year Report* at 6).

<sup>301</sup> PSE Initial Brief ¶ 63.

<sup>302</sup> *Id.* (citing Piliaris, Exh. JAP-29 at 130, Tables VII.5 and VII.6).

<sup>303</sup> Liu, Exh. JL-1CT at 62:3-13. *See also* Staff Initial Brief ¶¶ 55-59.

the preceding paragraph, that Commission Staff's proposal that PSE file within four years to renew its decoupling mechanisms should be rejected.<sup>304</sup>

*Commission Determination*

260 The Commission has addressed previously the legal and policy bases for decoupling. Specifically with respect to PSE, the Commission determined in 2013 that PSE's decoupling mechanisms were warranted, consistent with the State's energy policy and with the Commission's decoupling policy statement:

The decoupling mechanisms we approve mean that PSE's recovery of the fixed costs it incurs for infrastructure and operations necessary to deliver power and natural gas will no longer depend on the amounts of electricity and natural gas the company sells. This removes the so-called throughput incentive, thus promoting PSE's more aggressive pursuit of cost-effective conservation to which it commits as part of the decoupling mechanisms. With the throughput incentive eliminated, the company will be indifferent to sales lost as a result of the success of its conservation efforts. The full decoupling approved here is the first utility -supported mechanism that is both generally consistent with, and truly targeted to achieve, this key objective embodied in the Commission's 2010 Decoupling Policy Statement.<sup>305</sup>

We discuss in some detail above, and earlier in this Order, PSE's evidence showing that decoupling is working as intended.<sup>306</sup> We find unpersuasive ICNU's argument that decoupling is illegal because it is not a charge for "services rendered." To the contrary, it is a rate methodology for recovering a defined portion of the fixed costs PSE incurs to deliver electricity and natural gas to its customers. Delivery of power and gas unquestionably are services rendered by PSE and the Company is entitled to recover its delivery costs by the means we establish through our orders in general rate cases consistent with both law and policy.

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<sup>304</sup> PSE Initial Brief ¶ 64.

<sup>305</sup> *In re PSE and NW Energy Coalition*, Dockets UE-121697 & UG-130137, Order 07, Synopsis at ii (June 25, 2013). See *In re WUTC Investigation into Energy Conservation Incentives*, Docket U-100522, Report and Policy Statement on Regulatory Mechanisms, including Decoupling, To Encourage Utilities To Meet or Exceed Their Conservation Targets at (Nov. 4, 2010) (Decoupling Policy Statement).

<sup>306</sup> See *supra*. ¶¶ 42-51.



261 We also are not persuaded by ICNU's and FEA's policy arguments that we have heard, and rejected, in earlier proceedings. In contrast, we find NWEC/RNW/NRDC's arguments, discussed above, to be sound and well supported. We have no need to revisit further decoupling's legal and policy justifications in the context of this general rate case. We determine that PSE will be authorized to continue using its decoupling mechanisms.

262 We agree with Staff, however, that it would be prudent for the Commission to review the operation of the mechanisms again after they have operated for four more years, especially given the modifications discussed below. We will wish to again review PSE's specific mechanisms in its first general rate case filed in or after 2021, or in a separate proceeding, if appropriate.

**2. Should Non-Residential Customers be Regrouped; Should Some or All Large Non-residential Customers be Removed from the Decoupling Mechanisms?**

263 PSE's current electric decoupling mechanism includes a residential electric rate group and three non-residential electric rate groups: (i) customers served under Schedules 12 and 26, (ii) customers served under Schedules 10 and 31, and (iii) the remaining non-residential rate schedules.<sup>307</sup> PSE proposes to separate the third group into three new groups, as follows:

- Customers served under Schedules 8 and 24: These customers have smaller use per customer and are so great in number and aggregate load that they tend to dominate the overall results for the existing non-residential group.<sup>308</sup>
- Customers served under Schedules 40, 46 and 49: These customers have significantly different load and service characteristics from the other customers in the existing non-residential group.<sup>309</sup>
- All remaining non-residential rate schedules that are currently in the third existing rate group.

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<sup>307</sup> See Piliaris JAP-1T at 130:1-6.

<sup>308</sup> See *id.* at 130:12-15.

<sup>309</sup> *Id.* at 130:9-12. All parties agree that Schedule 40 should be phased out during the rate year following from this Order.

- 264 Non-residential natural gas customers included in the decoupling mechanisms are presently in a single group.<sup>310</sup> PSE proposes two groups: (i) customers served under Schedules 31 and 31T, and (ii) all remaining non-residential gas customers that are currently in the decoupling mechanism. PSE argues that the large number of small commercial customers served under Schedules 31 and 31T tend to dominate the results for the rest of their existing decoupling rate group, and the remaining customers in the non-residential decoupling rate group have a use and revenue per customer more similar to one another than to customers served under Schedules 31 and 31T.<sup>311</sup>
- 265 In his testimony, Mr. Piliaris argues that dividing the largest of the non-residential electric groups into three new groups, and splitting the single non-residential group in the gas decoupling mechanism into two groups, will reduce cross subsidies by better aligning customers with similar load profiles.<sup>312</sup> PSE argues its proposals to regroup non-residential customer groups “walk a fine line.”<sup>313</sup> This is because “[i]f decoupling groups are too big there may be cross subsidies of the customers within the decoupling group. If decoupling groups are too small, there may be rate volatility within the group.”<sup>314</sup> PSE argues that its proposed regrouping balances appropriately the competing objectives of minimizing cross subsidies while mitigating rate volatility.
- 266 While Ms. Liu agrees with the Company’s assessment that non-residential customers are improperly grouped, she presents an alternate plan that would remove all large industrial and irrigation customers from the electric decoupling mechanism altogether. Specifically, Staff proposes to remove electric Schedules 12/26, 10/31, 29, 35, 40, 43, 46 and 49. Staff proposes three decoupling groups for the remaining electric customers: residential (Schedule 7), small demand (schedules 8 and 24) and medium demand (schedules 7A, 11 and 25).<sup>315</sup> Ms. Liu testifies that decoupling is no longer appropriate for large industrial customers because it adds little value to conservation savings, it does not lend itself to relatively small groups of customers with diverse load profiles, and that rate design (*e.g.*, increased demand charges) is a more effective means of addressing the issue of revenue

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<sup>310</sup> *Id.* at 108:13-15. This includes Schedules 31, 31T, 41, 41T, 86 and 86T.

<sup>311</sup> *See* Piliaris, Exh. JAP-1T at 132:2-14.

<sup>312</sup> *See* Piliaris, Exh. JAP-1T at 131:10-16.

<sup>313</sup> PSE Initial Brief ¶ 65.

<sup>314</sup> PSE Initial Brief ¶ 65.

<sup>315</sup> Liu, Exh. JL-1CT at 30:15-31:6

stability from large customers. The Settling Parties agree to increase the demand charges for Schedules 46 and 49 by 48 percent as proposed by Commission Staff.<sup>316</sup>

267 On the natural gas side, Ms. Liu proposes realigning electric customers into three groups: residential (Schedule 23), small volume (Schedule 31) and large volume (Schedule 41), while removing interruptible customers on Schedules 86 and 86T from the mechanism.<sup>317</sup> Large natural gas customers on Schedules 85, 85T, 87 and 87T already have been removed from decoupling. Ms. Liu testified that their exclusion did not negatively affect the Company's conservation achievement.<sup>318</sup>

268 Mr. Higgins, for Kroger, filed cross-answering testimony supporting Staff's recommendation to remove large customers from the electric decoupling mechanism. He supports Staff's rationale that "rate design is a better tool than revenue decoupling to address the concern of fixed cost recovery for large customers."<sup>319</sup> He testified in addition that when "customers reduce usage in response to economic conditions or otherwise practice self-funded energy conservation, these behaviors are captured in the decoupling adjustment and unduly increase rates to customers."<sup>320</sup>

269 If the Commission continues the decoupling mechanism, FEA witness Mr. Al-Jabir recommends that large customers should be exempted because their demand charges remedy the revenue stability issue, and they already have significant economic incentive to pursue energy conservation.<sup>321</sup> Mr. Al-Jabir states that decoupling "penalizes customers for undertaking successful, voluntary energy efficiency efforts by increasing their distribution charges when their retail consumption levels decline between base rate cases."<sup>322</sup>

270 Testifying on behalf of ICNU, Mr. Gorman argues that if the Commission continues the decoupling mechanism it should no longer apply to large industrial customers on Schedules 40, 46, and 49, since those customers have steady load and enough of an

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<sup>316</sup> See Ball, Exh. JLB-1T at 54:3-10.

<sup>317</sup> Liu, Exh. JL-1CT at 31:11-17.

<sup>318</sup> Liu, Exh. JL-1CT at 35:8-11.

<sup>319</sup> Higgins, Exh. KCH-4T at 9:15-21.

<sup>320</sup> Higgins, Exh. KCH-1T at 15:19-21.

<sup>321</sup> Al-Jabir, Exh. AZA-1T at 11:14-12:7.

<sup>322</sup> Al-Jabir, Exh. AZA-1T at 7:3-5.

economic incentive to pursue conservation on their own.<sup>323</sup> Mr. Gorman testifies that “revenue stability can be accomplished through rate designs on those schedules,”<sup>324</sup> instead of through decoupling.<sup>325</sup>

271 Mr. Piliaris, testifying for PSE on rebuttal, recommends the Commission reject Staff’s proposal to exclude large industrial customers from the electric decoupling mechanism, arguing that removing those customers’ share of fixed production costs from the mechanism would amount to a collateral attack against the PCA settlement agreement that the Commission approved in Docket UE-130617. Mr. Piliaris argues that “[t]his alone should call into question any recommendation to move electric customers out of the decoupling mechanism.”<sup>326</sup> He further contends that Staff’s proposal fails to address how any remaining deferral balance associated with a class that exits the decoupling mechanism would be handled, and the Commission should reject the proposal based on that infirmity.<sup>327</sup>

272 PSE argues in its Initial Brief that the state’s energy policy is to reduce electric utility companies’ throughput incentive.<sup>328</sup> The Company states that

The customers ICNU and FEA propose to exclude from the electric decoupling mechanism have among the largest declines in use per customer. To remove them from the decoupling mechanism would amplify PSE’s throughput incentive, contrary to the state energy policy.<sup>329</sup>

273 Staff argues that PSE’s throughput incentive “is not the deciding factor in this instance.”<sup>330</sup> According to Staff, PSE’s influence on large non-residential customers is limited to offering conservation rebates. Staff’s analysis shows, however, that these customers are better able to respond to the conservation incentive inherent in their

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<sup>323</sup> Gorman, Exh. MPB-1T at 30:21-32:12

<sup>324</sup> TR 257:20-24.

<sup>325</sup> Gorman, Exh. MPG-7Tr at 4:20 - 5:4.

<sup>326</sup> Piliaris, Exh. JAP 46-CT at 17:16-19.

<sup>327</sup> Piliaris, Exh. JAP 46-CT at 21:1-10.

<sup>328</sup> PSE Initial Brief ¶ 69.

<sup>329</sup> *Id.*

<sup>330</sup> Staff Reply Brief ¶ 9.

bills.<sup>331</sup> Staff contends that its recommendation to exclude certain customers from the decoupling mechanism is consistent with the state's energy policy and actually promotes conservation by removing any disincentive to conserve.<sup>332</sup>

274 ICNU counters that PSE's assertion that exempting Schedule 46 and 49 customers from decoupling would "undermine the PCA settlement agreement" is simply wrong. ICNU points out that the PCA settlement agreement states that the "Settling Parties are not bound to any position with respect to the continuation of decoupling or the treatment of Fixed Production Costs within the decoupling mechanism in PSE's next general rate case."<sup>333</sup> ICNU asserts that PSE's position – that the PCA settlement precludes parties from proposing to exempt customers from decoupling because the settlement allows for the inclusion of fixed production costs in decoupling if the mechanism continues – is, in fact, the position that is contrary to that settlement.

275 Staff agrees with ICNU that proposals to remove some customers from decoupling are not a collateral attack on the settlement approved in Docket UE-130617. Staff cites to the relevant language in the PCA settlement, as follows:

The Settling Parties are not bound to any position with respect to the continuation of decoupling or the treatment of Fixed Production Costs within the decoupling mechanism in PSE's next general rate case. However, if the electric decoupling mechanism continues for PSE after the review of decoupling in PSE's next general rate case, the electric decoupling mechanism will include Fixed Production Costs that were formerly tracked in the PCA mechanism .... Nothing in this Settlement binds any party to any position with regard to treatment of costs in an automatic escalation factor mechanism (such as a K-factor) or in a multi-year rate plan.<sup>334</sup>

Staff, in agreement with ICNU, interprets this language to mean that the Settling Parties are not obliged to take any particular position regarding the continuation of PSE's decoupling mechanism.<sup>335</sup> In addition, Staff argues that its interpretation is the only

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<sup>331</sup> Liu, Exh. JL-1CT at 36:6 - 38:6.

<sup>332</sup> Staff Reply Brief ¶ 9.

<sup>333</sup> ICNU Reply Brief ¶ 5 (citing Docket UE-130617, Order 11, App. A ¶ 9 (Mar. 27, 2015)).

<sup>334</sup> *WUTC v. Puget Sound Energy*, Docket UE-130617 (consolidated), Settlement Stipulation (March 27, 2015), ¶6.

<sup>335</sup> Staff Reply Brief ¶ 4.

sensible one because PSE's argument that no customer group can be removed from decoupling without violating the PCA Settlement would require the indefinite continuation of decoupling, while the continuation of the decoupling mechanism most definitely is an issue in this proceeding.

276 Concerning PSE's argument that proposals for removing customers from the decoupling mechanism are not fully developed, Staff observes that this is not a reason to reject the proposals. Staff relates that while natural gas Schedules 85, 85T, 87, and 87T were originally included in the decoupling mechanism (as of June 25, 2013), they were removed after reconsideration by the Commission (on December 12, 2013) after only six months.<sup>336</sup> At that time, PSE did not require specific guidance in how to exclude these schedules from decoupling.<sup>337</sup> Staff does not believe it would be difficult for PSE, with its expertise, to devise a reasonable procedure to remove certain schedules now, as it did when Schedules 85, 85T, 87, and 87T were removed from the decoupling mechanism.

*Commission Determination*

277 The parties' respective proposals to regroup rate schedules within the decoupling mechanisms are conceptually well grounded. Establishing greater homogeneity within groups will reduce the potential for cross subsidies and reduce rate volatility by better aligning customers with similar load profiles. How, exactly, we should regroup the electric and natural gas rate schedules turns in significant part on the question whether certain large non-residential customers should be removed from the decoupling mechanisms.

278 In general, we find that the concerns about fixed revenue erosion that motivate revenue decoupling proposals are a relevant concern for residential and small commercial customers but not for large industrial and commercial customers. While PSE recovers its fixed costs from residential customers through energy charges, raising the risk of fixed revenue erosion resulting from the implementation of energy efficiency programs, large non-residential customers operate under a rate structure that includes both a demand charge and an energy charge. Therefore, any fixed revenue erosion concerns associated with large non-residential customers can be addressed by ensuring that the majority, or even all, of fixed costs associated with serving large customers are recovered through

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<sup>336</sup> Staff Initial Brief ¶ 71 (citing *See* 2013 PSE Decoupling Order at 93, ¶ 237; *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-121697, UG-121705, UE-130137, & UG-130138, Order 09, at 32, ¶ 77; 33, ¶ 80 (Dec. 12, 2013)).

<sup>337</sup> *Id.* (citing *See* 2013 PSE Reconsideration Order at 32, ¶ 77, 33, ¶ 80).

demand charges or customer charges, rather than energy charges that fluctuate with energy consumption.

- 279 This is a critical factor as we consider several parties' proposals to remove from decoupling, at the very least, electric Schedules 40,<sup>338</sup> 46, and 49. We consider at the same time Staff's proposal, supported by several parties, to remove from decoupling additional large non-residential customer schedules, including electric Schedules 12/26, 10/3 1, 29, 35, and Staff's proposal to remove natural gas Schedules 86/86T from decoupling.<sup>339</sup>
- 280 Ms. Liu's analysis shows generally that decoupling may not be well suited for large industrial and farm irrigation schedules with relatively few customers and a wide variation in usage.<sup>340</sup> Mr. Ball, Staff's witness for cost of service, rate spread, and rate design issues, conducted a detailed cost-of-service study and proposed a sizable increase in demand charges for Schedules 46 and 49 to address fixed cost recovery concerns due to these customers' declining usage per customer.<sup>341</sup> Another factor we must consider in this connection, however, is the Settling Parties' and Public Counsel's agreement to accept Staff's recommendation to include fixed production costs in the decoupling mechanism. This will approximately double the amount of fixed costs recovered through the decoupling mechanism.
- 281 By definition, fixed production costs would be recovered through decoupling only for the schedules for which decoupling will continue. For those schedules that Staff recommends discontinuing decoupling, fixed production costs of serving those schedules would be recovered, as proposed by Staff, through an updated or modified rate structure. Mr. Ball would address the fixed cost recovery concerns due to these customers' declining usage per customer through his detailed cost-of-service study and proposed 48 percent increase to demand charges for Schedules 46 and 49.<sup>342</sup> While we cannot be certain this modified rate structure will adequately protect PSE's recovery of fixed costs from Schedule 46 and

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<sup>338</sup> The Settlement Stipulation provides in ¶ 96 that Schedule 40 will be discontinued by the tariff effective date of PSE's next general rate case, and Schedule 40 will be closed to new customers effective as of September 15, 2017, the "Settlement Date." The Settlement Stipulation provides in ¶ 98 for a recalculation of allowed revenue per customer under the decoupling mechanism when Microsoft is removed from Schedule 40. Thus, the Settling Parties tacitly agreed to continue decoupling for this Schedule, pending its termination.

<sup>339</sup> Staff Initial Brief ¶ 69 (citing Liu, Exh. JL-1CT at 45:16-22).

<sup>340</sup> Liu, Exh. JL-1CT at 41:9-16.

<sup>341</sup> Ball, Exh. JLB-1T at 54:3-10.

<sup>342</sup> Ball, Exh. JLB-1T at 54:3-10.

48 customers, there is no evidence refuting this proposal. Further, the significant increase in demand charges seems more likely than not to protect the large non-residential customers better from rate volatility associated with decoupling and declining usage per customer.

282 PSE's arguments against proposals to remove Schedule 46 and 49 are not persuasive. We read the PCA settlement to mean that PSE would include as part of its litigation position in this rate case the inclusion of fixed production costs in the decoupling mechanism, but that the parties were free to oppose that proposal. What is more, the fixed production costs provisions of the PCA settlement are not prescriptive in terms of how fixed production costs would be included in the decoupling mechanism, if allowed by the Commission, or from whom they would be recovered under the decoupling tariff. Indeed, PSE abandoned its litigation position on this issue when it adopted, in part, Staff's position in the Settlement Stipulation in this case.

283 Second, PSE's rebuttal case, presented in Mr. Piliaris's testimony, largely rests on the argument that rejecting PSE's approach to fixed production cost would undermine the PCA settlement, which would have a chilling effect on future settlement negotiations. As we stated previously, the Commission does not share PSE's interpretation that the PCA settlement essentially guaranteed the move of fixed production costs into the decoupling mechanism in the manner PSE proposed, if at all. Moreover, it is not possible to reconcile PSE's argument here with its contradictory approach to the cost of service/rate design settlement in Docket UE-141368, which required the Company to include a declining third block rate in its residential rate design in this case. PSE did not include such a rate in its filing in this proceeding. PSE cannot choose whether or not to comply with the terms of settlements it reaches with other parties, and then argue that other parties are not following settlement terms.

284 In contrast to its proposal with respect to Schedules 46 and 49, going forward, Staff is not proposing at this time to restructure rates for electric Schedules 12/26, 10/31, 16, 29, 35, 43, or gas Schedules 86 and 86T. Ms. Liu testified that the rate structure approved in 2013 and currently in place for Schedule 12/26 and 10/31 customers "is sufficient to allow an opportunity for fixed cost recovery."<sup>343</sup> Demand charges were increased as a compromise between customers arguing for higher demand charges instead of a decoupling mechanism and PSE, which argued decoupling was necessary to produce stable revenue for the Company. Ms. Liu testified that "[t]he increased demand charges

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<sup>343</sup> Liu, Exh. JL-1CT at 42:16-18.



better aligned rate design with the underlying cost of service for these schedules and can serve as a model for decoupling other PSE non-residential electric rate classes.”<sup>344</sup>

285 As to the remaining schedules, however, Ms. Liu testified they are “all unique in their own ways.”<sup>345</sup> She said, moreover, that “it is difficult to predict revenue volatility from these schedules.”<sup>346</sup> While Staff recommends excluding these electric and natural gas schedules from decoupling, this is coupled with a suggestion that PSE “monitor the usage pattern of these customers and assess whether the current rate structure for electric Schedules 29, 35, 43 and gas Schedules 86/86T needs to be improved.”<sup>347</sup>

286 We are persuaded on the basis of the evidence and argument discussed above that we should approve the removal of Schedules 46 and 49 from PSE’s electric decoupling mechanism. The Commission will have the opportunity over the next four years to monitor how successfully the increased demand charges, to which the Settling Parties agreed, serve to make decoupling unnecessary for these large non-residential customers.

287 With respect to the remaining electric rate schedules that Staff and other parties recommend for removal from decoupling, we think a more cautious approach is in order considering the significant increase in fixed costs recovery with the addition of fixed production costs to the decoupling mechanism. We do not order these schedules to be removed from the Company’s decoupling mechanisms at this time. However, we expect PSE to continue monitoring closely the operation and results of decoupling mechanisms for all of its rate schedules and to examine the rate design of its non-residential rate schedules with an eye to improvements that may better serve the needs of customers and the Company. We expect to consider again within the next four years whether changes in rate design, such as what we authorize here with respect to Schedules 46 and 49, offer a superior alternative to decoupling for other non-residential electric customers.

288 As to Staff’s proposal to remove certain non-residential natural gas rate schedules from decoupling (*i.e.*, Schedules 86 and 86 T), we are not persuaded that the small increases PSE proposes to demand charges for these customers would adequately support this

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<sup>344</sup> Liu, Exh. JL-1CT at 44:2-4.

<sup>345</sup> Liu, Exh. JL-1CT at 44:12.

<sup>346</sup> Liu, Exh. JL-1CT at 45:7.

<sup>347</sup> Liu, Exh. JL-1CT at 45:11-13.

result. Staff does not independently propose changes to demand charges for PSE's non-residential natural gas customers.

### 3. Other Decoupling Issues

289 Public Counsel witness Mr. Brosch testified that PSE's revenue-per-customer model of decoupling<sup>348</sup> should be replaced entirely with a "complete" decoupling model, which tracks all drivers of sales fluctuations in separate accounts.<sup>349</sup> Doing so, he argues, would address the "found margin" issue, discussed in both the Commission's Decoupling Policy Statement and in Order 07 that approved PSE's decoupling mechanism, and ensure that the decoupling mechanism nets the increased costs that PSE incurs from serving new customers against the increased revenue that it receives.<sup>350</sup>

290 Mr. Brosch testified that "[i]f the intent of decoupling is to completely break the link between sales volumes and utility revenues, all of the drivers of revenue change must be recognized."<sup>351</sup> The mechanism approved for PSE in 2013, he states, addresses changes in utility sales volumes caused by fluctuations in weather, changes in economic conditions and shifts in large commercial customer demand, and caused by systematic reductions in sales through time resulting from utility sponsored conservation programs, customers' conservation efforts, improvements in appliance efficiency, improved building standards, and the influx of distributed energy resources. He contends, however, that PSE's decoupling mechanisms do not account for fluctuations caused by systematic

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<sup>348</sup> We note that the Settling Parties agreed that the inclusion of fixed production costs in the decoupling mechanism should be based on a revenue per class model, as proposed in Ms. Liu's testimony. Settlement Stipulation ¶ 113; *see* Liu, Exh. JL-1CT at 53:10-54:11. Thus, going forward, only about one-half the costs recovered through the decoupling mechanism are implicated by Mr. Brosch's testimony.

<sup>349</sup> Brosch, Exh. MLB-1T at 35:10-17. The Energy Project, relying on Mr. Brosch's testimony, supports this recommendation. *See* Energy Project Initial Brief ¶¶ 30-32.

<sup>350</sup> Brosch, Exh. MLB-1T at 34:4-35:9. The Commission said in Order 07, approving the Rate Plan and decoupling, that in light of "the uncertain future, the Commission will wish to monitor carefully the actual results of customer growth in terms of earnings over the next several years and rely on the protection of the earnings test, as modified by this Order, that will keep any excess earnings that may be attributable in part to customer growth from becoming a windfall for PSE." *See supra* n.1 (Order 07-2013 Rate Plan ¶117).

<sup>351</sup> Brosch, Exh. MLB-1T at 30:1-2.

growth in sales through time caused by the continuous addition of new customers for PSE, which, he contends benefits from significant customer growth.<sup>352</sup>

291 PSE argues that the revenue-per-customer approach to decoupling approved by the Commission in 2013 has not resulted in “found margin.”<sup>353</sup> The Commission recognized in the Decoupling Policy Statement, “revenue associated with new customers is offset by the costs to serve those customers.”<sup>75</sup> In other words, there is “margin” only if incremental revenue exceeds incremental costs. PSE demonstrated through the testimony of Ms. Barnard and Mr. Piliaris that the cost of serving new customers exceeds the revenue generated from the new customers by 1.2 percent per year. It follows, PSE argues, that there is no found margin.<sup>354</sup>

292 PSE argues further that “Public Counsel and The Energy Project consider only the incremental revenue and ignore the incremental costs associated with new customers.”<sup>355</sup> Citing Mr. Piliaris’ testimony concerning line transformer costs and overhead administrative costs,<sup>356</sup> PSE says the Company has demonstrated that Public Counsel’s claim that most “fixed costs do not vary with the number of customers served” is incorrect.<sup>357</sup> PSE points also to Ms. Liu’s testimony that revenue-per-customer decoupling is based on the assumption that there is cost associated with serving each additional customer and that the allowed revenue should follow the cost.<sup>358</sup> Ms. Liu explains that:

There is a correlation between delivery costs and the number of customers. Typically, the Company will need to invest in lines and feeder plant to serve customers in a new development. The Company will also incur costs (*e.g.*, line maintenance, customer service, general administrative costs) to serve the additional customers.<sup>359</sup>

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<sup>352</sup> Brosch, Exh. MLB-1T at 30:3-11.

<sup>353</sup> PSE Reply Brief ¶ 21.

<sup>354</sup> See Barnard, Exh. KJB-1T at 6:10-11; Piliaris, Exh. JAP-46CT at 23:9-14.

<sup>355</sup> PSE Reply Brief ¶ 22.

<sup>356</sup> See Piliaris, Exh. JAP-46CT at 44:8 – 49:3 (line transformer costs), 50:10 – 51:13 (overhead administrative costs).

<sup>357</sup> PSE Reply Brief ¶ 22.

<sup>358</sup> Liu, Exh. JL-1CT at 49:12-15.

<sup>359</sup> Liu, Exh. JL-1CT at 49:15-19.

Citing Ms. Barnard's testimony, Ms. Liu says PSE's "operating expense increased at a growth rate of 2.0 percent between 2011 and June 2016, outstripping the customer count growth rate of 0.8 percent."<sup>360</sup> Ms. Liu concludes that "the Revenue per Customer approach [adopted in 2013] works well when the delivery costs and customer counts both trend upwards."

293 Ms. Liu undercuts The Energy Project's implied argument that the Commission should now abandon revenue-per-customer decoupling entirely based on the fact that "PSE and other parties effectively agreed to use Public Counsel's alternative approach in the case of fixed production costs."<sup>361</sup> The Settling Parties agreed that the inclusion of fixed production costs in the decoupling mechanism should be based on a revenue per class model, as proposed in Ms. Liu's testimony, not a revenue per customer model.<sup>362</sup> Thus, going forward, only about one-half the costs recovered through the decoupling mechanism are implicated by Mr. Brosch's testimony. Ms. Liu testified that in contrast to the correlation between delivery costs and the customer counts:

Such a correlation does not exist between fixed production costs and customer counts. When the Company needs to serve increased load due to customer growth, it has the choice of whether to build new generation plants or buy power from the market. But a bigger customer base, or higher load, does not necessarily mean higher fixed production costs. Fixed production costs, at best, increase in big steps, when the load demand grows over a long time period, as shown in my trend analysis in Exh. JL-7C.<sup>363</sup>

*Commission Determination*

294 We are persuaded by the evidence discussed above that the Commission's approach to decoupling, going forward, should continue to use a revenue-per-customer approach for most costs and a revenue-per-class approach for fixed production costs. We reject the "complete decoupling" approach advocated by Public Counsel and The Energy Project because it fails to take into account all relevant factors and ignores salient facts, as discussed above.

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<sup>360</sup> Liu, Exh. JL-1CT at 49:19-21 (citing Barnard, Exh. KJB-1T at 7:10-11).

<sup>361</sup> Energy Project Initial Brief ¶ 32.

<sup>362</sup> Settlement Stipulation ¶ 113; *see* Liu, Exh. JL-1CT at 53:10-54:11.

<sup>363</sup> Liu, Exh. JL-1CT at 50:3-9.

**4. Proposed changes to the soft cap, the earnings sharing test, and the earnings sharing mechanism (i.e., establishing a 25 basis point deadband for earnings sharing)**

**a. Rate Cap**

295 The decoupling mechanism's 3 percent annual rate cap means that in some years, PSE's unrecovered costs may need to be deferred by more than a year. Mr. Piliaris stated that costs deferred beyond a year create an earnings challenge for PSE because Generally Accepted Accounting Practice (GAAP) requires revenues to be recovered within 24 months to be counted as current-year revenue.

296 PSE proposes two changes to the rate cap, which it refers to as the Rate Test. First, PSE proposes to use weather-normalized billing determinants when testing whether the Company exceeded its authorized decoupling revenue. Second, PSE proposes to increase the soft cap from 3 to 5 percent for residential natural gas customers and all electric customers "in response to concerns about growing deferral balances expressed by the Commission at annual Schedule 142 filings."<sup>364</sup>

297 PSE argues that the Company's proposal to change the Rate Test calculation will make it more simple and transparent, while increasing the soft cap will address the issue of large deferrals on the gas side and allow greater flexibility on the electric side if fixed production costs are included. In support of its proposed soft cap increase, PSE provides analysis demonstrating that had fixed production costs been included in the original decoupling mechanism, the Company would have exceeded the 3 percent cap in 2015.<sup>365</sup> PSE also argues that a 5 percent cap is aligned with Pacific Power's mechanism and, as Staff stated, would simplify the mechanism's operation.<sup>366</sup> Finally, PSE argues that its proposal is supported by the recommendations in the Gil Peach Report<sup>367</sup> and analysis PSE has performed showing that the decoupling-related gas residential deferrals would

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<sup>364</sup> PSE Initial Brief ¶ 78.

<sup>365</sup> Piliaris, Exh. JAP-46 CT at 13:10.

<sup>366</sup> Piliaris, Exh. JAP-46 CT at 13:16-14:2.

<sup>367</sup> See Piliaris, Exh. JAP-29 at 132 ("We recommend that the Rate Test be adjusted from a 3% soft cap to a 5% soft cap to clear balances in most years while still providing a level of protection to the customer against extreme rate changes. As discussed earlier in this section, the benefit of raising the soft cap from 3% to 5% on rate increases includes better temporal alignment between incurred cost of service and the actual payment for service. This benefits both the customer class and PSE.").

have cleared if a 5 percent cap on rate increases had been in place in the 2015 and 2016 annual filings, rather than the 3 percent cap.<sup>368</sup>

298 PSE's rationale for increasing the soft cap for electric rates reflects that a greater amount of electric revenues would be subject to decoupling under the terms of the PCA Settlement, which provides that fixed production costs will be included in PSE's electric decoupling mechanism.<sup>369</sup>

299 Mr. Brosch testifies against PSE's proposed changes to the soft cap, stating that the limited unamortized balances the Company has recorded are justified by the protections that the test offers customers.<sup>370</sup> He also opposes the proposed changes to the earnings test – the removal of normalizing adjustments and the establishment of a dead band – arguing that the test provides an important safeguard against excess earnings that could result from the decoupling mechanism.<sup>371</sup>

300 Ms. Levin, testifying for NWEK/RNW/NRDC, accepts the Company's proposal to increase the rate cap to 5 percent for residential gas customers only, based on the large deferrals that exist, but recommends that the Commission only do so temporarily, and directs PSE to improve its weather forecasting model.<sup>372</sup> NWEK/RNW/NRDC opposes the proposed rate cap increase for electric customers, arguing that PSE has not demonstrated any harm arising from the current cap.<sup>373</sup>

301 Mr. Collins, testifying for The Energy Project, expresses concern with PSE's proposal to increase the rate cap, given the impacts that the decoupling mechanism has had on low-income customers under the existing 3 percent cap.<sup>374</sup> He states that decoupling has resulted in annual bill increases of more than \$100 for customers receiving bill assistance, representing about 25 percent of the \$409 average HELP grant that those customers received in 2016.<sup>375</sup> These increases have come at a time when federal energy assistance

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<sup>368</sup> See Piliaris, Exh. JAP-1T at 135:13-17.

<sup>369</sup> PSE Initial Brief ¶ 80 (citing *See* Settlement Agreement ¶ 113).

<sup>370</sup> Brosch, Exh. MLB-1T at 46:7-21.

<sup>371</sup> *Id.*, 48:15-20.

<sup>372</sup> Levin, Exh. AML-1T at 24:1-25:5.

<sup>373</sup> Levin, Exh. AML-1T at 25:21-26:1.

<sup>374</sup> Collins, Exh. SMC-1T at 27:8-18.

<sup>375</sup> Collins, Exh. SMC-1T at 25:9-13.

funding has been decreasing at a rate faster than PSE has increased its program funding.<sup>376</sup>

*Commission Determination*

- 302 PSE's proposal to increase the soft cap for the electric decoupling mechanism from 3 percent to 5 percent is unsupported by any evidence of financial harm to PSE or customers from the current 3 percent cap. PSE argues that deferral balances may grow on the electric side if fixed production costs are included but this is simply speculation and in that sense PSE's proposal is a solution in search of a problem. If such a problem does develop over time, we can revisit this issue with respect to the electric decoupling mechanism.
- 303 In contrast to electric decoupling results, large deferrals have developed under the natural gas decoupling mechanism with unrecovered balances remaining on PSE's books for more than one year. Because this creates an earnings challenge for PSE considering that GAAP requires revenues to be recovered within 24 months to be counted as current-year revenue, we find it appropriate to increase the soft cap for natural gas decoupling to 5 percent. The Commission will revisit this issue during its next review of the Company's decoupling mechanisms, no later than four years after the date of this Order

**b. Earnings Sharing**

- 304 When determining its overall earnings performance for the purpose of sharing excess earnings with customers under the current mechanism, PSE is required to apply normalizing adjustments that the Company argues distort its earnings and result in inaccurate outcomes. PSE proposes to remove the normalizing adjustments from the earnings test so that any earnings sharing is based on the Company's actual financial performance. The Company also proposes a 25 basis point dead band on the earnings test and to share earnings with customers based on each class' allocated revenues rather than volumetric revenues.
- 305 Staff opposes the Company's proposed changes to the earnings test, arguing that normalizing adjustments are important because they were used in the rate case that established the authorized revenue requirement, and should therefore be used when evaluating the utility's performance relative to that baseline.<sup>377</sup> Staff opposes the

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<sup>376</sup> Collins, Exh. SMC-1T at 25:13-17.

<sup>377</sup> Liu, Exh. JL-1CT at 58:18-59:11.

Company's proposed dead band for the earnings test on the grounds that the Company's authorized rate of return has been established to adequately compensate it for the risks it faces.<sup>378</sup>

306 Public Counsel witness Mr. Brosch also opposes the proposed changes to the earnings test – the removal of normalizing adjustments and the establishment of a dead band – arguing that the test provides an important safeguard against excess earnings that could result from the decoupling mechanism.<sup>379</sup>

307 Kroger witness Mr. Higgins opposes PSE's proposal to place a dead band on the earnings test because the decoupling mechanism transfers risk from the Company to ratepayers, and the dead band would further transfer risk. He argues, too, that the test should be asymmetrical, given the asymmetrical transfer of risk that decoupling instituted.<sup>380</sup> Finally, he concludes PSE's proposal to increase the rate cap should be rejected. However, these positions were stated prior to Kroger's position on settlement.<sup>381</sup>

*Commission Determinations*

308 We find the Company's testimony and evidence persuasive in support of removing the normalizing adjustment from the earnings test. The Commission Basis Reports (CBR) that PSE files annually with the Commission, provide both the actual and normalized results. These reports form the basis for the earnings test under the decoupling mechanism. Any party wishing to analyze the Company's performance may do so based on either result, thereby undermining Staff's argument that it would not be able to evaluate the utility's performance relative to the normalized baseline.

309 We find it is not appropriate for the earnings sharing mechanism to require the Company to share revenues based on "theoretical" earnings. To illustrate, in the event of a warm Pacific Northwest winter, PSE likely would not be able to earn its authorized rate of return even with the revenues captured through the annual decoupling mechanism true-up filing. However, because the current process requires the sharing to be based on a "normal" winter, these normalizing adjustments may result in a CBR filing reflecting increased normalized net operating income leading to earnings in excess of the authorized

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<sup>378</sup> Liu, Exh. JL-1CT at 60:4-9.

<sup>379</sup> *Id.*, 48:15-20.

<sup>380</sup> Higgins, Exh. KCH-1T at 16:15-21.

<sup>381</sup> Higgins, Exh. KCH-1T at 17:11-15.



rate of return. The Company would then be required to share revenues with ratepayers that it never received from ratepayers.

310 Conversely, the opposite scenario is unfair to ratepayers. In the event of a colder than normal winter, the Company may actually realize revenues in excess of its authorized rate of return. However, due to the normalizing adjustments for the earnings sharing mechanism, the Company potentially would not share any of those overearnings with ratepayers.

311 Further, we acknowledge that the central purpose of decoupling mechanisms is to reduce the “throughput incentive,” which is at odds with the objectives of energy efficiency programs. In our two weather scenarios above, the earnings sharing mechanism based on normalized conditions works against minimization of the throughput incentive. Thus, following these scenarios, the Company might relax its conservation efforts.

312 On the other hand, we are not convinced that PSE’s proposal for a 25 basis point dead band for the earnings test would result in fair, just, and reasonable rates. We agree with Staff that if we were to authorize an earnings sharing dead band of 25 basis points, we would be authorizing a higher rate of return than deemed appropriate from the cost of capital evidence in the record of this proceeding. While we agree that the earnings mechanism should be based on actual, not theoretical earnings, allowing an additional 25 basis points could transfer risk inappropriately from the Company to ratepayers.

313 We approve the Company’s proposal to remove normalizing adjustments from the earnings test, but reject the 25 basis point deadband.

### **B. Electric Cost Recovery Mechanism**

314 PSE proposes that the Commission establish an electric cost recovery mechanism (ECRM) modeled, to a significant degree, after its natural gas pipeline cost recovery mechanism (GCRM), which the Commission approved in 2013. Ms. Gilbertson described the Company’s reliability challenges that prompted its request for the ECRM. Ms. Koch testified concerning the Company’s approach to identifying needs and its proposed investment plan. Ms. Barnard presented an overview of the Company’s proposed filings and calculation of rates. Mr. Piliaris summarized the Company’s proposed method of allocating costs incurred through the ECRM. Mr. Doyle and Ms. Barnard defended the Company’s proposal on rebuttal.

315 Ms. Barnard stated that the ECRM would allow the Company to “accelerate the replacement of targeted reliability improvements intended to reduce the number and

length of outages” and recover their costs between rate cases.<sup>382</sup> She discussed that PSE’s proposed mechanism is closely patterned after the natural gas pipeline cost recovery mechanism that the Commission established for pipeline replacement in Docket UG-120715,<sup>383</sup> with minor changes to the timing of filings<sup>384</sup> and the cost allocation method.<sup>385</sup>

316 Ms. Koch stated that the Company’s two primary goals for the ECRM are to improve its worst-performing circuits and to replace aging underground cable that is at risk of failing.<sup>386</sup> The Company’s requested first-year revenue requirement is \$10.5 million.<sup>387</sup>

317 Staff, Public Counsel, ICNU, and Kroger all actively oppose the Company’s proposal. No party filed testimony in support of it.

318 Staff witness Mr. Schooley argued that patterning the ECRM after the pipeline cost recovery mechanism is inappropriate because the gas mechanism was designed to address a safety issue, while the ECRM is proposed to address a reliability issue – two very different goals.<sup>388</sup> Mr. Schooley also opposed the ECRM on the grounds that it would result in pre-approval of investments, that the Commission is evaluating distribution planning in the ongoing Integrated Resource Planning (IRP) rulemaking, and that PSE should not need a mechanism as an incentive to meet its obligation to provide safe and reliable service.<sup>389</sup>

319 Public Counsel witness Mr. Brosch echoed Staff’s argument that PSE does not need additional incentives to engage in prudent investment planning for its distribution system.<sup>390</sup> He also argued that such planning should remain in the purview of the utility, as other parties do not have enough information to provide meaningful review and

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<sup>382</sup> Barnard, Exh. KJB-1T at 73:14-20.

<sup>383</sup> Barnard, Exh. KJB-1T at 73:20-74:2.

<sup>384</sup> Barnard, Exh. KJB-1T at 77:1-78:6.

<sup>385</sup> Piliaris, Exh. JAP-1T at 148:1-13.

<sup>386</sup> Koch, Exh. CAK-1CT at 4:7-10.

<sup>387</sup> Barnard, Exh. KJB-1T at 81:2.

<sup>388</sup> Schooley, Exh. TES-1T at 26:15-17.

<sup>389</sup> *Id.*, 27:9-28:6.

<sup>390</sup> Brosch, Exh. MLB-1T at 55:22-23.

- feedback.<sup>391</sup> Public Counsel witness Ms. Alexander also testified against the ECRM, arguing that a mechanism developed for natural gas safety is not applicable to electric reliability and that the proposal lacks specific metrics for measuring its success.<sup>392</sup>
- 320 ICNU witness Mr. Gorman argued that riders like the proposed ECRM are only appropriate for costs that are volatile and outside the utility's control, which is not the case with planned distribution system investments.<sup>393</sup>
- 321 Kroger witness Mr. Higgins opposed the mechanism because, he argued, it would constitute single-issue ratemaking and its costs should be allocated on a demand basis, not an energy basis, as proposed by the Company.<sup>394</sup>
- 322 On rebuttal, PSE witness Mr. Doyle outlined the Company's defenses of the ECRM: that PSE's projected \$78 million in investments for distribution reliability improvement in 2017 will be subject to significant regulatory lag absent the mechanism;<sup>395</sup> that the ECRM will reduce the need for frequent rate filings;<sup>396</sup> and that it will spread cost recovery across smaller, more predictable increases, rather than large, lump sum increases.<sup>397</sup> He testified, too, that the ECRM is comparable to trackers for other programs with large, predictable expenditures, such as the Company's conservation rider.<sup>398</sup>
- 323 Ms. Barnard elaborated in her rebuttal testimony that absent the ECRM, the Company would face regulatory lag of 27 months, which would result in "significant earnings erosion" when applied to the level of investment contemplated in the Company's proposal.<sup>399</sup> She stated that PSE crafted the ECRM in response to the Commission's rejection of distribution investments in recent Avista rate cases – arguing that PSE's

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<sup>391</sup> *Id.*, 54:17-55:16.

<sup>392</sup> Alexander, Exh. BRA-1T at 31:9-33:12.

<sup>393</sup> Gorman, Exh. MPG-1T at 43:16-23.

<sup>394</sup> Higgins, Exh. KCH-1T at 22:9-23:2.

<sup>395</sup> Doyle, Exh. DAD-7T at 23:11-24:2.

<sup>396</sup> *Id.*, 24:3-5.

<sup>397</sup> *Id.*, 24:6-11.

<sup>398</sup> *Id.*, 24:12-25:8.

<sup>399</sup> Barnard, Exh. KJB-17T at 100:3-11.

testimony regarding both the need for the investments and a targeted approach to making them address the analytical faults that the Commission identified in those cases.<sup>400</sup>

324 Ms. Koch defended the Company's comparison between the ECRM and the gas recovery mechanism, arguing in her rebuttal testimony that the gas mechanism has provided PSE with a successful template for the ECRM. She testified that reliability is a key utility function that is deserving of the same targeted approach that characterizes the GCRM.<sup>401</sup>

325 Mr. Piliaris agreed with Kroger that if the ECRM is approved, its costs should be collected through demand charges from schedules that have that component.<sup>402</sup>

*Commission Determinations*

326 PSE presents an interesting argument – that absent some mechanism for prioritizing or better valuing distribution reliability investments, those investments may not be funded in the highly competitive capital budgeting process. That said, Ms. Barnard's representation that the Company would face 27 months of regulatory lag is an exaggerated, worst-case scenario that assumes average of monthly averages (AMA) treatment for the investments, while failing to consider other tools the Commission has adopted for attenuating regulatory lag, such as end-of-period rate base and pro forma adjustments.

327 Further, we are not persuaded that PSE is unable to prioritize in its capital budgeting process funding to address the worst-performing circuits and to replace aging underground cable that is at risk of failing. PSE has not demonstrated any efforts to review that process to reprioritize projects to secure funding for these specific projects.

328 Though PSE's proposal may have some merit, it is not yet timely. As Mr. Schooley points out, the Commission is considering distribution planning requirements in the IRP rulemaking. That process is exploring how utilities, Staff and other stakeholders might collaborate on distribution plans that identify needs and cost-effective solutions to a wide range of challenges, not just reliability concerns. It may be appropriate to build a framework for distribution planning before adopting a mechanism that depends on distribution planning.

329 We determine that the Commission should not approve PSE's proposed ECRM.

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<sup>400</sup> *Id.*, 101:3-102:6.

<sup>401</sup> *Id.*, 11:10-12:13.

<sup>402</sup> Piliaris, Exh. JAP-46CT at 66:8-16.

### C. Cost of Service, Rate Spread, and Rate Design

- 330 Cost of service studies identify the costs incurred to provide service to each class of customers, and inform a balanced allocation (*i.e.*, rate spread) of the electric and natural gas revenue requirements among customers. Perspectives on how best to perform cost of service studies vary widely, leading to a broad range of possible results. Much of the disparity among the various cost of service studies in the record can be traced to the fact that it has been decades since the Commission has analyzed comprehensively, or in any depth, the principles that should be used in developing cost of service studies.<sup>403</sup>
- 331 In this case, the parties queued up for decision quite a number of issues related to cost of service, rate spread, and rate design. A few of these issues are addressed in the Settlement Stipulation, discussed above, but many remain in dispute. There is at least a consensus, however, that we should resolve these issues only for purposes of this case. PSE, Staff, and NWIGU all urge us to defer more enduring policy decisions concerning methodologies and their application to ongoing generic proceedings initiated in January of this year.<sup>404</sup>
- 332 We agree that the Commission should limit the application of its decisions on the contested issues discussed below to this case and allow the ongoing generic proceedings to continue. This not only is a sensible approach, it is a necessary approach given the less than fully developed state of the record on these issues in this proceeding.

#### 1. Electric Cost of Service Study, Rate Spread, and Rate Design

- 333 PSE developed its Electric Cost of Service (COS) Study for this case as provided by the Commission-approved settlement resulting from the 2014 Electric Cost of Service and Rate Design Collaborative (Rate Design Settlement).<sup>405</sup> The Company proposed, however, to update the data used in the peak credit method that allocates generation and transmission fixed costs with information from the Company's 2015 and 2017 Integrated

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<sup>403</sup> Without reviewing every final order entered in a utility general rate case over the past two decades to find any exceptions, it is fair to observe that cost of service, rate spread, and most rate design issues have been resolved among the parties to individual cases by negotiation and settlement. Most often the result has been to maintain the status quo from one case to another.

<sup>404</sup> The Commission initiated electric Docket UE-170002 and natural gas Docket UG-170003 on January 3, 2017. *See* PSE Initial Brief ¶ 6; Staff Initial Brief ¶¶ 4-5; NWIGU Initial Brief ¶¶ 3, 12.

<sup>405</sup> *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Docket UE-141368 (Jan. 29, 2015).

Resource Plans and uses the Company's proposed rate of return.<sup>406</sup> These proposed updates changed the demand/energy allocation ratio from 25 percent demand and 75 percent energy to 18 percent demand and 82 percent energy.

334 Mr. Ball testified that Staff agreed with these changes in principle because the Rate Design Settlement used information that will be three to five years old by the end of this proceeding.<sup>407</sup> Mr. Ball stated that using more current information was a primary objective of the Rate Design Settlement and doing so will provide a cost of service study that is more reflective of the present day costs to serve customers.<sup>408</sup> Finally, Mr. Ball testified that while he did not challenge the Company's COS methodology, he did prepare a version of the COS study that shows the effect of Staff's rate design proposal and incorporates Staff's revenue requirement results.<sup>409</sup>

335 FEA argued that the Commission should enforce the terms of the Rate Design Settlement in Docket UE-141368 based on its plain terms and meaning, not based on PSE's interpretation of the "spirit" of the settlement.<sup>410</sup> Mr. Al-Jabir testified for FEA that the settlement agreement in Docket UE-141368 explicitly requires that the demand and energy classification percentages be set at 25 percent demand and 75 percent energy in this proceeding.<sup>411</sup> FEA argues that fairness and the importance of strictly enforcing the plain terms of a Commission-approved settlement require that the Commission reject PSE's proposed change to update the demand/energy allocation ratio.

*Commission Determination*

336 We agree with FEA that the Commission should enforce the terms of the Rate Design Settlement in Docket UE-141368 based on its plain terms and meaning. The settlement agreement explicitly requires that the demand and energy classification percentages be set at 25 percent demand and 75 percent energy in this proceeding. We enforce that term as written.

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<sup>406</sup> Piliaris, Exh. No. JAP-1T at 27:17-28:2.

<sup>407</sup> Ball, Exh. JLB-1T at 8:228-33.

<sup>408</sup> Ball, Exh. JLB-1T at 8:228-33.

<sup>409</sup> Ball, Exh. JLB-1T at 8:235-40 (with reference to Exh. JLB-2).

<sup>410</sup> FEA Initial Brief at 8.

<sup>411</sup> FEA Initial Brief at 8.

337 We emphasize the importance of strictly enforcing the plain terms of Commission-approved settlements.<sup>412</sup> The parties in this proceeding are familiar with the Commission's processes and procedural rules that require any departure from the terms of a Commission-approved settlement be supported by a Commission order amending the settlement. Amendments typically are proposed by a motion from one or more parties. Unless such a motion is joined by all parties, non-moving parties can answer and avail themselves of their rights to due process. Even when all parties agree to a motion to amend, the Commission has the opportunity to consider whether it should grant the motion.

**a. Electric Rate Spread**

338 The Settling Parties agreed to resolve rate spread and rate design issues for PSE's electric operations addressing six principal areas. Specifically, the Settling Parties agreed that:

- Schedules 7A, 11, 25, and 29 (General Service, 51 – 350 kW) and Schedules 12 and 26 (General Service, >350 kW), all of which are at 108 percent of parity; and Schedules 10 and 31 (Primary Service, Gen & Irr.) and Schedules 46 and 49

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<sup>412</sup> We note in this connection that we have an instance in this case of a party, PSE, not adhering to the terms of the settlement stipulation without first obtaining a Commission order authorizing a departure from the terms of the agreement. The settlement in Docket UE-141368 required PSE to propose a residential rate design that included “a third block using an inverted rate structure” with cutoffs for the second and third block at 800 kWh and 1800 kWh, respectively. PSE, however, did not propose such a rate structure. Mr. Piliaris testified that the Company attempted to design a third block based on the assumption that it should be set equal to the Company's estimated long-run avoided costs, but that it resulted in a third block that was lower than the first two blocks. Piliaris, Exh. JAP-1T at 58:19-60:3. As a result, the Company retained its two-block structure. That it was entirely possible for PSE to design and propose a third block rate using an inverted rate structure is shown by the fact that Staff witness Ball included such a proposal in his testimony. *See* Ball, Exh. JLB-6. After this case was docketed and its testimony filed with the Commission, PSE, jointly with Staff, Public Counsel, and The Energy Project filed an unopposed motion seeking to amend Order 03 in Docket UE-141368 to strike the language addressing a third block rate, including the requirement that PSE file such a rate in this case. Not only was this filing untimely, it also misrepresented that “PSE proposed such rates in its 2017 general rate case filing” when, in point of fact, it did not. Thus, we have PSE's violation of a Commission order compounded by a material misrepresentation in a motion joined by four parties. Because we resolve PSE electric rate design in this Order, we find the pending motion in Docket UE-141368 to be moot. We will refrain from taking any further action with respect to this matter, but we caution against any repeat of such inappropriate interaction with the Commission in the future.

(High Voltage), all of which are at 109 percent of parity,<sup>413</sup> will be moved closer to parity (*i.e.*, 107 percent of parity) by allocating to them 65 percent, rather than 75 percent, of the average rate increase.<sup>414</sup>

- For Schedule 25 customers, such as Kroger, which advocated the changes, the current tail block energy rate will be maintained, the basic charge will be increased, and demand charges will be increased.<sup>415</sup>
- Staff's proposal to begin phasing out Schedule 40 will be implemented.<sup>416</sup>
- Staff's proposal to increase demand charges for Schedules 46 and 49 will be implemented.<sup>417</sup>
- The allowed revenue-per-customer figures will be recalculated for other customers subject to decoupling when Microsoft leaves PSE's system.<sup>418</sup>
- The Ardmore Substation costs will be subject to a one-time adjustment that preserves each party's right to argue for allocating Ardmore Substation costs differently in future proceedings.<sup>419</sup>

339 There was little, if any, controversy concerning the fundamental importance of rate spread adjustments being grounded in principles of cost causation. The Settling Parties agreed to move modestly in the direction of achieving greater parity in non-residential rates with parity ratios greater than 1.0 while recognizing the importance of gradualism and rate stability to all customer classes.

340 Public Counsel notes in its Initial Brief that it does not address the non-residential electric rate design terms in Paragraphs 95, 97, and 99 of the Settlement.<sup>420</sup> Public Counsel takes no position with respect to Paragraph 98. In addition, Public Counsel affirmatively

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<sup>413</sup> We note that Schedules 8 and 24 also are at 109 percent of parity. However, a 75 percent allocation of the average rate increase results in these customers being at 107 percent of parity. *See* Ball, Exh. JLB-1T at 15:1 Table 2.

<sup>414</sup> Settlement Stipulation ¶ 94.

<sup>415</sup> Settlement Stipulation ¶ 95.

<sup>416</sup> Settlement Stipulation ¶ 96.

<sup>417</sup> Settlement Stipulation ¶ 97.

<sup>418</sup> Settlement Stipulation ¶ 98.

<sup>419</sup> Settlement Stipulation ¶ 99.

<sup>420</sup> Public Counsel Initial Brief ¶ 82 n141.



supports the Settlement Stipulation's provision in Paragraph 96 providing for the discontinuance of Schedule 40.<sup>421</sup>

341 PSE proposed that retail schedules within 5 percent of full parity, plus or minus, would receive the adjusted average rate increase. While PSE disagreed with the results of Public Counsel's cost of service study on which its parity ratios are set, PSE did not object to the use of a 10 percent deadband as proposed by Public Counsel,<sup>422</sup> which would result in most schedules not otherwise addressed in the Settlement Stipulation, including Residential (Schedule 7), Small General Service-4 Secondary (Schedule 24), Campus Rate (Schedule 40), All Electric Schools (Schedule 43) receiving an adjusted average rate increase.<sup>423</sup> Additionally, PSE agreed to Public Counsel's proposal to give Schedule 35 a rate increase that is 150 percent of the average because Schedule 35 has a parity ratio well below 1.0 using PSE's cost of service study.<sup>424</sup> PSE proposes that all other schedules not included in the Settlement Agreement, including Schedule 449, should receive the adjusted average rate increase.

342 PSE recommended that the Commission reject Public Counsel's proposal to give Schedule 449 customers a rate increase equal to 150 percent of the average.<sup>425</sup> PSE argued that the vast majority of the revenues associated with Schedule 449 are not subject to the Commission's jurisdiction but, rather, are subject to the jurisdiction of the Federal Energy Regulatory Commission (FERC), pursuant to PSE's Open Access Transmission Tariff (OATT). PSE argued that Public Counsel's proposal would effectively subject an otherwise FERC jurisdictional customer to Commission-based rates.<sup>426</sup>

*Commission Determination*

343 With respect to the only disputed issue here, we find that PSE is correct to oppose Public Counsel's proposed 150 percent increase for Schedule 449 because most of the revenues associated with this rate schedule are FERC jurisdictional and subject to PSE's OATT. Because the Settlement Stipulation's remaining issues and PSE's proposed resolutions of

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<sup>421</sup> Public Counsel Initial Brief ¶ 90.

<sup>422</sup> See Public Counsel Initial Brief ¶ 86.

<sup>423</sup> Piliaris, Exh. JAP-46CT at 37:12-38:1.

<sup>424</sup> *Id.* at 38:1-3.

<sup>425</sup> See Public Counsel Initial Brief ¶ 87.

<sup>426</sup> Piliaris, Exh. JAP-46CT at 38:6-39:2.

issues not fully addressed in the Settlement Stipulation are uncontested and supported by the record, we find PSE's electric rate spread should be approved as described above.

**b. Fully Contested Rate Design Issues: Residential Rates**

**i. Basic Charge, Minimum Bill, Seasonal Rates**

344 PSE proposed to increase its basic charge for single-phase electric service to \$9.00 per month. Mr. Piliaris testified that this reflects the current level of costs traditionally recovered through the Company's residential electric basic charges, including customer service, customer accounting, meter reading, billing, plus the costs of line transformers.<sup>427</sup> This would result in a \$1.51 per month increase over current rates.

345 Mr. Piliaris stated that "the proposed increase is reasonable for several reasons"<sup>428</sup>:

- PSE currently is collecting \$0.38 per month of that amount through Schedule 141 (Expedited Rate Filing), which will be zeroed out in prospective rates effective after this general rate case, leaving a net impact on customer bills of \$1.13 per month.<sup>429</sup>
- PSE's current overall residential basic monthly charge of \$7.87 is based on a test year ending June 2012 and costs have grown since then.
- PSE's electric cost of service study in this filing supports a basic charge over \$2 per month higher than the \$9.00 being proposed in this filing.
- Had the 3 percent annual increases allowed under the Rate Plan been applied to basic charges, where the underlying costs are usually recovered, instead of being recovered through volumetric rates under the Rate Plan (a compromise reached in support of decoupling approval) the basic charge in effect in 2017 would have been \$9.12 per month.<sup>430</sup>

346 Mr. Piliaris also reviewed the basic charges of national and local investor-owned electric utilities, and government and customer-owned utilities in Washington state and determined a national average of \$9.17 for basic charges. Based on this review, he

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<sup>427</sup> Piliaris, Exh. JAP-1T at 66:8-13.

<sup>428</sup> Piliaris, Exh. JAP-1T at 66:15.

<sup>429</sup> Piliaris, Exh. JAP-1T at 66:16-67:2.

<sup>430</sup> Piliaris, Exh. JAP-1T at 67:9-17.

determined that the average basic charge of the Washington utilities he surveyed is \$17.76, “or almost double the basic charge being proposed by PSE in this filing.”<sup>431</sup>

347 Staff proposed that the Commission establish a higher basic charge and a minimum bill with a seasonal rate two-block structure for both summer (April – September) and winter (October – March).<sup>432</sup> Mr. Ball testified that a minimum bill ensures that all customers contribute their full share of customer costs, while maintaining enough flexibility in energy rates to send appropriate economic signals in support of conservation.<sup>433</sup> Staff’s identified customer cost of \$10.88 includes line transformers, which Mr. Ball argues is appropriate given his analysis that establishes a strong correlation between customer count and transformer plant balances.<sup>434</sup>

348 Staff argues that seasonal rates are more appropriate than higher marginal rates because customers do not have enough information at a point in time to make informed decisions based on which price tier they are facing. Rather, Staff argues, customers respond to overall bills, and seasonal rates will send an intelligible price signal to customers that corresponds with the Company’s higher power costs in the higher-demand winter months.<sup>435</sup> Mr. Ball provides detailed analysis in support of the seasonal rate calculation in Exh. JLB-4 and various analyses gaging the impact of seasonal rates on different customers.<sup>436</sup>

349 PSE argues that Commission Staff’s proposal is too confusing and that the costs of implementing it outweigh the benefits. PSE estimates the additional \$300,000 in revenue that is likely to result from the minimum bill, over and above what PSE would have recovered from the same customers without a minimum bill through volumetric rates, does not outweigh the confusion customers are likely to experience or the cost that PSE would incur in adding a minimum bill component into its residential rate structure.<sup>437</sup>

350 Mr. Watkins, testifying for Public Counsel, contends that three of Mr. Piliaris’ four justifications for increasing the basic charge have little merit because they simply “relate to

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<sup>431</sup> Piliaris, Exh. JAP-1T at 68:1-12.

<sup>432</sup> Staff Initial Brief ¶ 32.

<sup>433</sup> Ball, Exh. JLB-1T at 37:8-43:11.

<sup>434</sup> Ball, Exh. JLB-1T at 26:1-28:10.

<sup>435</sup> Ball, Exh. JLB-1T at 33:1-34:3.

<sup>436</sup> Ball, Exh. JLB-1T at 37:8-43:11.

<sup>437</sup> See Piliaris, Exh. JAP-46CT at 42:1-44-7.

the time elapsed between the last rate case and the effects of various settlements,” which are negotiated amounts that may, or may not, reflect the costs that should be included in the basic charge.<sup>438</sup> Mr. Watkins disputes Mr. Piliaris’s cost justification, purportedly supporting a basic charge of \$11.24 per month, because his “analysis inappropriately includes many costs that should not be deemed customer-related for purposes of evaluating the reasonableness of residential customer charges.”<sup>439</sup>

351 Mr. Watkins identifies specific capital costs that Mr. Piliaris included in his customer cost analysis, including gross plant investments “in Meters (\$88.5 million), Services (\$175.6 million), Distribution Line Transformers (\$333.2 million), and an allocated portion of General plant (\$74.3 million)”<sup>440</sup> as being either otherwise accounted for in customer connection fees, contrary to accepted industry standards and practice, or overhead costs that should not be considered in a customer cost analysis.<sup>441</sup> Mr. Watkins also identifies operations and maintenance costs that he argues should not be included because they are “more appropriately considered demand-related (*e.g.*, transformer expenses) or are general overhead expenses required in order to sell electricity.”<sup>442</sup> He acknowledged, however, that certain other Meter Reading and Customer Records & Collections expenses are properly included in Mr. Piliaris’s customer cost analysis.

352 Mr. Watkins testifies that he conducted a “direct customer cost analysis,” taking guidance from the Commission’s treatment of this issue in Pacific Power’s 2014-15 general rate case, calculating the direct residential customer cost with and without the inclusion of services cost, and under current and Company-proposed depreciation rates. He also used the Company’s proposed cost of capital in this case (*i.e.*, 7.74 percent). Mr. Watkins’s analysis produced a direct residential customer cost between \$4.05 and \$5.61 per month at the Company’s requested rate of return. He proposed on this basis, and for policy reasons related to price signals and conservation, to essentially retain PSE’s current \$7.49 customer charge, suggesting that for purposes of “a more logical rate” the charge should be rounded up by one cent, to \$7.50 per month.<sup>443</sup>

353 Mr. Shawn Collins testified for The Energy Project that PSE’s proposal to raise the residential electric basic monthly charge to \$9.00 makes an essential service “less

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<sup>438</sup> Watkins, Exh. GAW-1T at 42:12-43:2.

<sup>439</sup> Watkins, Exh. GAW-1T at 43:5-12.

<sup>440</sup> Watkins, Exh. GAW-1T at 43:15-17.

<sup>441</sup> Watkins, Exh. GAW-1T at 43:18-54-5.

<sup>442</sup> Watkins, Exh. GAW-1T at 46:4-9.

<sup>443</sup> Watkins, Exh. GAW-1T at 51:13-19.

affordable and penalizes low-volume users within the residential rate class, since a greater portion of the bill is fixed, relative to higher use customers.” Mr. Collins also testifies that increased basis charges:

[R]educe customers’ ability to control their own household utility bills. For lower usage customers, a reduction in usage has a relatively smaller impact on the bill, since a larger percentage of the bill is unaffected by their behavior. As a result, customers have a diminished price incentive to reduce their usage, and therefore their utility bill, through conservation. Increases in basic charges, therefore, tend to run counter to state policies and utility programs that promote energy efficiency and encourage customers to weatherize homes, purchase energy efficient appliances and reduce usage in other ways.

354 NWEC/RNW/NRDC argued that PSE’s and Staff’s proposals to increase monthly charges for residential electric customers are based on an “unprecedented treatment of line transformer costs as customer-related costs.”<sup>444</sup> NWEC/RNW/NRDC said that if transformer costs are not treated as customer-related costs, there is no basis for increasing the monthly basic charge or imposing a new minimum bill.<sup>445</sup> In addition, NWEC/RNW/NRDC argues the proposals to increase monthly charges are regressive rate designs that would hurt low-income customers and impose barriers to conserving energy.

355 NWEC/RNW/NRDC echoed The Energy Project’s argument that increasing basic charges disproportionately impacts low-income customers.<sup>446</sup> NWEC/RNW/NRDC also argued that increasing basic monthly charges sends the wrong price signal to customers.<sup>447</sup> NWEC/RNW/NRDC related in this connection that the Commission rejected a proposal from PacifiCorp and Staff to increase the basic charge as a disincentive for customers to conserve energy. NWEC/RNW/NRDC quotes from the Commission’s order, as follows:

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<sup>444</sup> NWEC/RNW/NRDC Initial Brief ¶ 20.

<sup>445</sup> NWEC/RNW/NRDC Initial Brief ¶ 23 (citing Levin, Exh. AML-13T at 2:18 to 3:3; Ball, Exh. JLB-1T at 31:23 to 32:2).

<sup>446</sup> NWEC/RNW/NRDC Initial Brief ¶ 32.

<sup>447</sup> NWEC/RNW/NRDC Initial Brief ¶ 33 (citing *See* Levin, Exh. AML-1T at 9:18 to 10:15; Watkins, Exh. GAW-1T at 49:13 to 52:2; Collins, Exh. SMC-3T at 6:6-7).

We reject the Company's and Staff's proposals to increase significantly the basic charge to residential customers. The Commission is not prepared to move away from the long-accepted principle that basic charges should reflect only "direct customer costs" such as meter reading and billing. Including distribution costs in the basic charge and increasing it 81 percent, as the Company proposes in this case, does not promote, and may be antithetical to, the realization of conservation goals.<sup>448</sup>

356 In sum, NWEC/RNW/NRDC asks the Commission to reject PSE's and Staff's proposals to increase the basic charge and imposes a new minimum bill because these proposals would hurt low-income customers and frustrate efforts to conserve energy.

*Commission Determination*

357 We determine that neither PSE's proposal to increase basic charges for residential customers, nor Staff's recommendations to add a minimum bill to basic charges and establishing seasonal rates, should be adopted. We are not persuaded on the basis of the current record that transformer costs should be recovered in basic charges, or through a minimum bill. We have never approved such a proposal and continue to believe these costs are not customer-related costs as that term is generally understood. Transformer costs should be recovered as distribution charges subject to PSE's electric decoupling mechanism, which adequately protects the Company's recovery of its fixed costs.

ii. **Miscellaneous Electric Rate Design Issues.**

**(a) Addition of a Third Block Rate**

358 NWEC/RNW/NRDC recommends that the Commission convene another technical conference to address three-tier rate design. NWEC/RNW/NRDC points out that the Rate Design Settlement in Docket UE-141368 required PSE to propose an inverted three-tier rate structure in this docket, but it failed to do so.<sup>449</sup> According to NWEC/RNW/NRDC, "there are several ways in which PSE could calculate a three-tier rate structure that would promote energy conservation by making each successive block more expensive than the preceding block."<sup>450</sup> Considering that Staff proposed an alternative rate structure with

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<sup>448</sup> NEWC, Initial Brief ¶ 33 (quoting *WUTC v. Pacific Power*, Docket UE-140762, Order 08 ¶ 216 (Mar. 25, 2015)).

<sup>449</sup> *See supra* ¶ 283.

<sup>450</sup> NWEC/RNW/NRDC Initial Brief ¶ 41.

three tiers in this case,<sup>451</sup> and that “PSE is not opposed to a three-block rate structure,”<sup>452</sup> NWEC/RNW/NRDC urges us to convene a technical workshop to consider options for a three-tier rate design based on a more robust record concerning the policy and technical issues surrounding a three-tier rate design, including any data that would need to be collected and analyzed to design such a rate structure.

*Commission Determination*

359 We agree that just as in the case of cost of service issues, this is an issue that could benefit from additional discussion among interested stakeholders outside the context of a general rate case. Commission Staff may wish to expand the subject matter stakeholders will consider in Dockets UE-170002 and UG-170003, or initiate a separate process for this purpose.

**(b) Should the Commission require PSE to propose a net metering rate schedule?**

360 Staff witness Mr. Ball testified that “[n]et metering customers should be prioritized for advanced metering infrastructure (AMI) installations, if possible, before the next general rate case. He recommended that if the Company is unable to deploy AMI to these customers before the next rate case, then PSE should perform a demand study for these customers and recommend a separate tariff schedule for net-metering customers in its next general rate case.”<sup>453</sup>

361 PSE stated it is willing to perform a demand study for net metering customers as suggested by Commission Staff and has already begun designing a program to collect the requested information for these customers. However, PSE argued, the Company cannot reprioritize the roll out of AMI. PSE says “this will occur over several years in a deliberate manner and reprioritizing the AMI roll out would significantly increase the costs and delay the roll out.” Finally, PSE argued it is premature to establish a separate rate schedule for net metering customers. PSE said, however, that the Company is committed to compiling interval load data and responding to Staff’s proposal in its next general rate case.<sup>454</sup>

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<sup>451</sup> Ball, Exh. JLB-1T at 44:1-2.

<sup>452</sup> Piliaris, Exh. JAP-1T at 60:11-15.

<sup>453</sup> Ball, Exh. JLB-1T at 51:6-13.

<sup>454</sup> *Id.* at 67:2-68:3.

*Commission Determination*

362 Given PSE’s commitments discussed above, we find it unnecessary to address this  
question further in this Order.

**(c) Electric Lighting Schedules**

363 PSE proposed three general changes to electric lighting Schedules 50 – 59:

- Consolidate the range of wattage offerings for the Light Emitting Diode (LED) rates into contiguous groups;
- Update rates using current cost study information; and
- Remove the “Wattage Including Driver” rate component.<sup>455</sup>

364 Mr. Ball testified in response that PSE presented a principled cost study that fairly allocates costs across the various lighting schedules and simplifies the rates for both customers and PSE. Mr. Ball also said that the proposed revisions could reduce regulatory burden by eliminating the need for PSE to modify its tariff to offer different LED wattage levels. Mr. Ball recommended that the Commission approve the Company’s proposed revisions to the existing electric lighting schedules.

*Commission Determination*

365 No party opposed PSE’s recommended changes to these lighting schedules and they are supported by the record. We find they should be approved.

**(d) Revisions to PSE’s Bills**

366 Public Counsel argued that the Commission should adopt Mr. Watkins’ recommendations “that would make electric residential customers’ bills easier to read and comprehend.”<sup>456</sup> Doing so would allow customers to have better information about their energy usage, which could positively affect conservation efforts.<sup>457</sup>

367 PSE argued that the Commission should reject Public Counsel’s proposal that PSE provide a summary sheet within its tariff that shows the all-in price of electricity. PSE

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<sup>455</sup> Piliaris, Exh. (JAP-1T) at 78:6-9.

<sup>456</sup> Watkins, Exh. GAW-1T at 51:20 64:2.

<sup>457</sup> Watkins, Exh. GAW-1T at 51:20 64:2.



argues that this is unnecessary and duplicative of information already available to customers on their bills and on the Company's website.<sup>458</sup>

*Commission Determination*

368 We agree with PSE that Public Counsel's proposal is unnecessary considering that this information already is available to customers.

**2. Natural Gas Cost of Service, Rate Spread, and Rate Design**

369 The parties' Settlement Stipulation does not address natural gas cost of service, rate spread, or rate design issues. We resolve these issues here considering the full record and the parties' Initial and Reply Briefs that result in some issues becoming uncontested.

**a. Cost of Service Study; Rate Spread**

370 PSE reviewed and updated the classification and allocation factors used in its Purchased Gas Adjustment (PGA) filings for the first time in a decade because of significant changes in its resource mix.<sup>459</sup> PSE classified purchased gas costs into two components: demand and variable.<sup>460</sup> Mr. Piliaris' testimony details the costs that are included in each component<sup>461</sup> and how the costs are allocated to the customer classes.<sup>462</sup> None of the other parties disputed PSE's proposed classification and allocation. PSE requests that we approve this methodology for use in future PGA filings.

371 Staff and NWIGU raised objections to PSE's natural gas COS study that relate to allocation of the costs of gas distribution mains. PSE used the peak and average methodology for allocating these costs. This methodology allocates gas demand costs based on a combination of peak demand and average demand (or average throughput).<sup>463</sup> Using this approach, PSE's demand-related gas distribution mains were allocated 33

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<sup>458</sup> *Id.* at 68:5-17.

<sup>459</sup> *See* Piliaris, Exh. JAP-1T at 49:9-50:4.

<sup>460</sup> *See* Piliaris, Exh. JAP-1T at 50:5-7.

<sup>461</sup> *See* Piliaris, Exh. JAP-1T at 50:8-20; Piliaris, Exh. JAP-12.

<sup>462</sup> *See* Piliaris, Exh. JAP-1T at 51:1-52:9; Piliaris, Exh. JAP-14.

<sup>463</sup> *See* Piliaris, Exh. JAP-1T at 43:5-15.

percent on average demand and 67 percent on design day peak demand.<sup>464</sup> In support of this approach, Mr. Piliaris testified as follows:

The peak and average methodology's use of system load factor provides a reasonable basis for classifying and allocating these costs. This peak and average approach reflects a balance between the way the gas system is designed (to meet peak demand) and the way it is utilized on an annual basis (throughput based on gas usage that occurs during all conditions, not only peak conditions). It also acknowledges previous Commission guidance that some portion of gas demand costs should be allocated based on energy use.<sup>465</sup>

372 PSE argued that its approach recognizes that all customers benefit from the gas distribution system of medium to large mains as a whole, not just from the part of its gas mains through which gas flows to reach the individual customer. PSE explained that:

The Company's gas distribution system is a network of pipes that provides benefits to customers in addition to providing the stretch of pipe through which molecules flow to reach the individual customer. PSE's approach [to cost allocation] avoids the practice of using a customer's physical location on the system to determine the costs assigned to that customer, which has been opposed in past cases. Further, it exempts large gas customers from the cost of the smallest diameter mains (less than two inches), because the smallest main[s are] in isolated locations on the system and [are] unlikely to benefit large commercial and industrial customers.<sup>466</sup>

373 PSE said that the Company's approach to cost allocation addresses concerns regarding cost responsibility for two-inch mains by allocating a portion of it to all customers and excluding the largest interruptible customers from a portion of it.<sup>467</sup> PSE said its approach was recently validated by a third-party consultant.<sup>468</sup>

374 Mr. Ball testified for Staff disputing the Company's use of the design day standard to determine the peak portion of the peak and average allocation, arguing that it does not

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<sup>464</sup> See Piliaris, Exh. JAP-1T at 43:17-20, 44:12-47:15.

<sup>465</sup> Piliaris, Exh. JAP-1T at 44:3-9.

<sup>466</sup> PSE Initial Brief ¶ 125.

<sup>467</sup> See Piliaris, Exh. JAP-1T at 47:18-48:13.

<sup>468</sup> See Piliaris, Exh. JAP-46CT at 74:24-75:13, citing final report by Brown, Williams, Moorehead & Quinn in Docket UG-151663.

reflect the way that the system is used, and is therefore not sufficiently reflective of cost causation.<sup>469</sup> Staff allocates capacity costs in its COS study using the average class use in the highest five-day period for each of the last three years.<sup>469</sup> Under this proposal, Mr. Ball testified, “the average represents each class’s actual use during periods of peak demand on the system.”<sup>470</sup>

375 Mr. Ball testified, however, that PSE’s “allocation methodology uses various factors, including the size of distribution mains, annual throughput, peak demand, and customer type to assign distribution plant costs to each of the customer classes.”<sup>471</sup> Further, he said “[t]he Company presented what appears to be a fair and consistent methodology that recognizes both how a system is designed and how it is actually used.”<sup>472</sup> Staff therefore finds PSE’s main allocation methodology “acceptable” for purposes of this case.<sup>473</sup>

376 Public Counsel stated in its Initial Brief that, based on Mr. Watkin’s review, Public Counsel finds PSE’s approach to assigning the costs of distribution mains reasonable. In addition, Public Counsel said that “[t]he proposed rate spread distributes the increase across the customer classes to reflect the proper weight and consideration given to the cost of service study in light of the Commission’s practices and policies.”

377 NWIGU’s expert witness, Mr. Brian Collins, allocated the cost of distribution mains based on class peak responsibility, which allocates capacity-related costs based on the coincident demands of the various classes expected on the design day peak.<sup>474</sup> NWIGU argued that this approach to allocation “more accurately reflects cost causation, and as a result, produces better price signals and encourages customers to make economic consumption decisions.”<sup>475</sup> NWIGU explains briefly its rationale for allocating a significant portion of the total fixed cost of PSE’s gas distribution system based on design day peak and describes its approach as being “defensible.”<sup>476</sup> Having said that, NWIGU nevertheless recommends that we “not adopt any specific methodology in this case and,

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<sup>469</sup> Ball, Exh. JLB-1T at 12:2-3.

<sup>470</sup> Ball, Exh. JLB-1T at 12:3-4.

<sup>471</sup> Ball, Exh. JLB-1T at 12:12-14.

<sup>472</sup> Ball, Exh. JLB-1T at 12:20-22.

<sup>473</sup> Ball, Exh. JLB-1T at 12:19-20.

<sup>474</sup> Exhibit No. BCC 1-T at p.3, lines 12-27.)

<sup>475</sup> NWIGU Initial Brief ¶ 10 (citing Exh BCC 1-T at 16:3-14).

<sup>476</sup> NWIGU Initial Brief ¶ 12.

instead, apply any rate changes in this case on an equal percent of margin basis.<sup>477</sup>

NWIGU argued that this will maintain the status quo and allow all parties the opportunity to continue participating in the ongoing generic proceeding to help develop clear guiding principles for cost of service studies to be used in future rate cases.

*Commission Determination*

378 We determine that we should accept NWIGU's recommendation that we not expressly choose any one cost of service methodology over the other for purposes of allocating the costs of gas distribution mains and defer any decisions on methodology to the ongoing generic proceedings in Docket UG-170003. Further, we accept NWIGU's suggestion that we effectively ignore the COS studies presented in this case and apply a rate spread based on an equal percent of margin basis. This effectively serves to continue the status quo that is grounded in PSE's peak and average approach, but does not mean that we endorse it, or favor it over other possible approaches.

**b. Special Contracts**

379 In supplemental testimony, Mr. Ball provided an updated COS study, arguing that special contract customers are paying significantly below their cost of service, which is contrary to Staff's interpretation of WAC-480-80-143.<sup>478</sup> He recommended that the Commission impute revenues from the class to equal its cost of service per Staff's study, which would force shareholders to absorb the differential or renegotiate their special contracts.<sup>479</sup> Alternatively, he recommends that the Commission impose a 59 percent rate increase on the class.<sup>480</sup>

380 In supplemental rebuttal, Mr. Piliaris recommends that the Commission reject Staff's proposed treatment of the Special Contracts class because, PSE contends, Staff misinterprets the special contract rule, which results in Staff failing to recognize that Special Contract customers are covering their cost of service and contributing to the Company's fixed costs as required by rule. Furthermore, Mr. Piliaris argues, Staff has

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<sup>477</sup> NWIGU Initial Brief ¶ 12.

<sup>478</sup> Ball, Exh. JLB-8T at 2:25-4:5.

<sup>479</sup> *Id.*, 4:7-22.

<sup>480</sup> *Id.*, 5:19-6:6

had multiple opportunities to address this issue, and its proposal now is unfair and unprecedented.<sup>481</sup>

381 PSE argued in its Initial Brief that Staff’s proposal is contrary to the public interest. According to the Company, “it would be an unprecedented step by the Commission to unravel a Special Contract that the Commission has approved, in the middle of the contract term.”<sup>482</sup> With respect to Commission Staff’s alternative proposal to raise the Special Contract rates in this proceeding so that the rates reflect a 2 percent rate of return, PSE argued that “there is no basis for this arbitrary increase in the Special Contract contribution to rate of return.”<sup>483</sup> Moreover, PSE said, the Special Contract is just that, a contract, and it cannot be unilaterally revised in this proceeding. According to PSE, “the only way to increase the rate for this Special Contract, which is not suspended in this case, would be to dramatically increase rates to Schedules 87 and 87T simply to change rates for the Special Contract, which rate is based on Schedule 87 and 87T.” Such an approach is, in PSE’s view, “arbitrary and unreasonable.”<sup>484</sup>

*Commission Determination*

382 Although Staff presented a significant volume of testimony raising and developing this issue, and devoted a significant part of its Initial Brief to arguing it, we have no need to discuss Staff’s recommendations or advocacy in detail. We find PSE’s testimony and arguments in rebuttal to Staff, summarized briefly above, persuasive to the point that we simply reject Staff’s recommendations without further discussion.

**c. Rate Design: Basic Charges and Demand Charges**

383 Mr. Piliaris proposed for PSE that we order an increase to the residential monthly basic charge for natural gas customers from \$10.34 to \$11. PSE relies generally on the same arguments that the Company advanced in support of its requested increase for the residential electric basic charge.<sup>485</sup> He also proposes to increase demand charges for non-residential gas customer classes to better align them with the demand costs identified for

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<sup>481</sup> Piliaris, Exh. JAP-54T at 2:3-25

<sup>482</sup> PSE Initial Brief ¶ 133 (citing Piliaris, Exh. JAP-54T at 13:8-16).

<sup>483</sup> *Id.*

<sup>484</sup> *Id.* (citing Piliaris, Exh. JAP-54T at 15:4-21).

<sup>485</sup> Piliaris, Exh. JAP-1T at 92:1-93:19.

those customers in the cost of service study,<sup>486</sup> and re-allocate the gas procurement charge among the non-residential firm sales customers that pay it.<sup>487</sup>

i. **Residential Basic Charge**

384 PSE proposes to increase the residential basic charge to \$11 per month from its current rate of \$10.34 per month.<sup>488</sup> According to the Company's analysis, the cost of providing this service is \$15.62.<sup>489</sup> PSE thus characterizes its proposal as a gradual move towards the cost of service. Commission Staff proposes a higher basic charge of \$12.04 per month,<sup>490</sup> and PSE approves of the greater alignment of customer costs and customer-related revenue presented in that proposal.

385 Mr. Ball testified that his COS study supports increasing the residential basic charge from \$10.34 to more than \$15, but supported a smaller increase of \$1.70, for a total recommended basic charge of \$12.04.<sup>491</sup> In its Initial Brief, however, Staff recommends that we accept PSE's proposed increase to \$11.00.

386 Mr. Watkins, for Public Counsel, supports the Company's request to increase the monthly basic charge for residential natural gas customers to \$11.<sup>492</sup> Mr. Watkins performed a residential customer cost analysis to evaluate the reasonableness of PSE's proposed natural gas basic charge. Because PSE's proposal is lower than the results of Mr. Watkins's analysis, Public Counsel accepts PSE's proposed \$11.00 residential basic monthly charge.<sup>493</sup>

387 The Energy Project acknowledged that PSE's proposed increase in the natural gas customer charge is more modest than what it proposed for residential electric customers and that Public Counsel witness Glenn Watkins' cost analysis concludes that the requested amount is reasonable in terms of cost recovery. The Energy Project argues, however, that as a policy matter it continues to have concerns about the disproportionate

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<sup>486</sup> Piliaris, Exh. JAP-1T at 95:1.

<sup>487</sup> Piliaris, Exh. JAP-1T at 96:9-97:6.

<sup>488</sup> See Piliaris, Exh. JAP-1T at 91:1-93:22.

<sup>489</sup> See *id.* at 91:4-5.

<sup>490</sup> See Ball, Exh. JLB-1T at 22:1-2.

<sup>491</sup> Ball, Exh. JLB-1T at 24:1-8.

<sup>492</sup> Public Counsel Initial Brief ¶ 34; see also Watkins, Exh. GAW-1T at 69:18-23.

<sup>493</sup> *Id.*

impact of a fixed cost increase on low-income natural gas customers who use limited amounts of gas, as well as the negative impact on conservation.<sup>494</sup> In addition, The Energy Project argued that since the parties to the Settlement Stipulation proposed a significant natural gas rate decrease, it is an inopportune time to include an increase in another part of the rate structure.<sup>495</sup> The Energy Project believes this is likely to be viewed by customers as contradictory and confusing. The Energy Project recommends that the natural gas customer charge remain at its current level.

*Commission Determination*

388 We find PSE's proposed increase to the basic charge for residential natural gas service to be reasonable, based on actual customer costs that are significantly higher than the current rate of \$10.34 and that the charge would be significantly lower than what the actual costs suggest would be appropriate. PSE's attention to the principles of gradualism and rate stability is appropriate. Considering these facts and the consensus supporting PSE's proposed increase among parties who elected to address this issue, we determine the increase to \$11.00 should be approved.

ii. **Demand Charges for Non-Residential Rate Schedules; Gas Procurement Charges**

389 PSE proposed to move non-residential demand charges 25 percent towards their calculated cost of service (*i.e.*, closer to parity). Commission Staff supports PSE's proposal.<sup>496</sup> No other party provided evidence on this issue.

390 PSE first implemented its Gas Procurement Charge in 2005 as part of the Company's 2004 general rate case. Before then, the costs now recovered by this charge were recovered from all customers through base rates. The Gas Procurement Charge recovers the costs associated with procuring and managing gas supply for sales customers. It also recovers the cost associated with PSE's storage facilities used to manage gas supply for its sales customers. This charge currently applies to non-residential gas customers served under gas Schedules 85, 86, and 87.<sup>497</sup>

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<sup>494</sup> The Energy Project Initial Brief ¶ 10.

<sup>495</sup> *Id.*

<sup>496</sup> Ball, Exh. JLB-1T at 55:1-56:6.

<sup>497</sup> Piliaris, Exh. JAP-1T at 97:11-20.

391 PSE proposed in this case to extend the application of this charge to non-residential customers served under Schedules 31 and 41. PSE also proposes to eliminate the Gas Procurement Credit for customers served under Schedule 31T and 41T and to update the Gas Procurement Charge to reflect current costs for each schedule to which it applies.<sup>498</sup>

392 Mr. Piliaris testified that PSE proposed to add this charge to the bills of Schedule 31 and 41 customers to align better with the rate structure of the interruptible sales schedules that have a similar charge. He explained that, as currently applied, customers find it confusing that firm transportation customers get a credit for these procurement costs while interruptible sales customers receive a charge. When this charge was originally proposed in 2004, it was intended to recover the associated supply-related costs only from sales customers so that these costs were not borne by transportation customers who did not receive the services associated with these costs.<sup>499</sup>

393 Mr. Piliaris explained further that when PSE's then-current transportation Schedule 57 was reorganized in the Company's 2007 general rate case into the current set of parallel rate schedules (*i.e.*, Schedules 31T, 41T, 85T, 86T and 87T), PSE's cost of service studies retained the pairing of sales and transportation customers (*e.g.*, Schedule 85 and 85T) to maintain consistent delivery rates for each pairing of parallel schedules. To ensure that the new Schedules 85T, 86T and 87T did not bear the supply-related costs associated with the procurement charge, they were only recovered from their parallel Schedules 85, 86 and 87. However, two other transportation schedules were also created in 2007 (*i.e.*, Schedules 31T and 41T) that did not receive the same treatment. As a result, since that time, Schedules 31T and 41T have been absorbing these costs in their delivery charges. Mr. Piliaris noted that service taken under these transportation schedules has grown greatly since they were first created, which has raised the importance of addressing this issue. He noted that the current proposal simply corrects this oversight by extending the procurement charge to Schedules 31 and 41 so that the procurement-related costs that are allocated to their respective cost of service classes are not absorbed into the shared delivery charges of their paired transportation schedules.

394 Finally, Mr. Piliaris testified that PSE is extending the current methodology for calculating this charge to customers served under Schedules 31 and 41. He explained that, "in simple terms, these rates are calculated by first identifying the allocated gas

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<sup>498</sup> Piliaris, Exh. JAP-1T at 98:3-8.

<sup>499</sup> Piliaris, Exh. JAP-1T at 98:10-17.



supply and storage costs allocated to each rate group, subtracting certain cost associated with gas balancing and dividing the total by the group's pro forma sales therms.<sup>500</sup>

*Commission Determination*

395 PSE's proposed changes to procurement charges, as discussed above, are uncontested and supported by the record. We determine that they should be approved.

iii. **Miscellaneous Rate Design Issues for Non-Residential Natural Gas Rate Schedules**

396 PSE is proposing three additional, related changes to its base natural gas tariffs for non-residential gas customers. First, PSE proposes to implement annual maximum volume limitations on Schedules 41 and 41T, effectively requiring customers exceeding these volume limits to take service on Schedule 85 or 85T. Second, and related to the first, PSE proposes to eliminate the existing annual minimum load charge on Schedules 85 and 85T. Third, to ease the transition of customers from Schedules 41 or 41T to Schedules 85 or 85T, PSE proposes to charge fully-firm customers on Schedules 85 and 85T based on their actual demands and to relieve gas sales customers receiving fully-firm service of the obligation to sign a separate customer agreement for service under these schedules.

397 PSE proposed to limit the size of customers that can take service under Schedules 41/41T. At present, Schedules 41/41T have an eligibility threshold of 12,000 therms per year, but no maximum limit. In this case, PSE proposes to impose a load limit of 150,000 therms per year, which in effect would automatically move customers that are large enough for Schedules 85/85T to those schedules. Currently, customers are only automatically moved to another tariff if they fail to meet the minimum load requirements of their current tariff.

398 PSE argues that the change is in the interest of customers because they will pay lower rates on Schedules 85/85T than on Schedules 41/41T, but may not have the sophistication to know this is the case.<sup>501</sup> The Company states that 92 customers would be automatically moved if the requested change is granted.<sup>502</sup>

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<sup>500</sup> Piliaris, Exh. JAP-1T at 99:13-17. *See also* Exh. JAP-27 (summarizing calculations of these charges).

<sup>501</sup> Piliaris, Exh. JAP-1T at 102:1-103:1.

<sup>502</sup> Piliaris, Exh. JAP-1T at 101:19-20.

399 To facilitate the transition of firm customers to an interruptible schedule, PSE also proposes two administrative changes to Schedules 85/85T. First, PSE proposes to eliminate the minimum annual load charge, which requires customers on the schedule to pay for at least 180,000 therms each year.<sup>503</sup> Second, the Company proposes to allow customers on Schedules 85/85T to pay demand charges based on actual usage, allowing them to remain firm customers despite being on an interruptible tariff.<sup>504</sup> Currently, customers on Schedules 85/85T default to interruptible service, but can sign service agreements with the Company to make some or all of their usage firm. PSE proposes to flip that, allowing customers to default to firm service, but sign agreements with the Company to move some portion of their load to interruptible service.

400 Other than Mr. Piliaris’ testimony for PSE, the record is not well developed on this issue. No party explicitly responded to PSE’s proposal to cap usage on Schedules 41/41T or the related changes to Schedules 85/85T.

*Commission Determination*

401 Based on our detailed review of PSE’s proposals we have several concerns. First, PSE’s representation that customers moving from Schedules 41/41T to 85/85T would be paying lower rates appears to be misleading. Our analysis shows that a customer with annual demand of 150,000 therms – the cutoff between the two schedule groups – would face a monthly rate increase of \$261.60 (11.63 percent) under the proposal. Table 5 summarizes the increase:

**Table 5. Monthly bill impact of moving a customer from schedules 41/41T to 85/85T<sup>505</sup>**

		Basic Charge	1st Block <sup>506</sup>	2nd Block	3rd Block	Gas procurement	Demand Charge	Total Bill
<b>41/</b>	Rate	\$116.92	\$0.14145	\$0.11386	N/A	\$0.00671	\$1.17	
<b>41T</b>	Subtotal	\$116.92	\$707.25	\$853.95	--	\$83.88	\$487.89	\$2249.89
<b>85/</b>	Rate	\$593.83	\$0.10756	\$0.05322	\$0.05092	\$0.00582	\$1.20	

<sup>503</sup> Piliaris, Exh. JAP-1T at 104:3-105:11.

<sup>504</sup> Piliaris, Exh. JAP-1T at 105:12-106:11.

<sup>505</sup> This analysis makes the following simplifying assumptions: A customer with annual usage of 150,000 therms and a load factor of 1 (*i.e.*, constant load across all hours of the year), resulting in monthly usage of 12,500 therms and demand of 417 therms.

<sup>506</sup> The first block of Schedules 41/41T applies to the first 5,000 therms per month. The first block of Schedules 85/85T applies to the first 25,000 therms per month.

85T	Subtotal	\$593.83	\$1344.50	--	--	\$72.75	\$500.40	\$2511.48
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402 As the table shows, Schedule 41/41T customers would face significantly higher basic charges on Schedules 85/85T and incrementally higher demand charges. With a second block rate in Schedule 41/41T that is only 0.63 cents higher than the first block in Schedules 85/85T, customers would not be able to make up the difference in those increased fixed costs through lower volumetric rates. Since the lower block rates of Schedules 85/85T do not apply until 25,000 and 50,000 therms per month, respectively, customers would have to have very high usage before they would be better off on Schedules 85/85T. In fact, our analysis shows that a current Schedule 41/41T customer would have to use 27,800 therms per month – about 334,000 therms per year – before they would break even on Schedules 85/85T. Of course, this analysis is predicated on a customer maintaining the same level of service (fully firm) after moving to Schedules 85/85T, and does not consider the potential for customers to respond to enhanced price signals on Schedules 85/85T and transfer some of their load to interruptible service.

403 While we do not foreclose the possibility that the changes PSE proposed in this case, or similar changes that take impacts more fully into account than is evident on the record here, might be implemented in a future case, we will not approve them at this time. We are not aware whether any Schedule 41 customers were represented in this case, but it does not appear so. Nor does it appear that any party focused attention on these issues in such a way as to afford these customers some degree of protection from changes in PSE's tariffs that could have significant rate impacts. If PSE brings these proposals forward in a future case, we will expect the Company to demonstrate that it has reached out to and fully informed potentially affected customers so they can make informed decisions concerning participation in the proceeding.

### **FINDINGS OF FACT**

404 Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated findings and conclusions upon issues in dispute among the parties and the reasons therefore, the Commission now makes and enters the following summary of those facts, incorporating by reference pertinent portions of the preceding detailed findings:

405 (1) The Washington Utilities and Transportation Commission (Commission) is an agency of the State of Washington vested by statute with the authority to regulate rates, regulations, practices, accounts, securities, transfers of property and

affiliated interests of public service companies, including electric and natural gas companies.

- 406 (2) Puget Sound Energy (PSE) is a “public service company,” an “electrical company,” and “gas company” as those terms are defined in RCW 80.04.010 and used in Title 80 RCW. PSE provides electric and natural gas utility service to customers in Washington.
- 407 (3) PSE’s currently effective rates were determined on the basis of the Commission’s Final Order *In the Matter of the Petition of Puget Sound Energy and NW Energy Coalition For an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms*, Dockets UE-121697 and UG-121705 (consolidated) (Decoupling) and *Washington Utilities and Transportation Commission v. Puget Sound Energy*, Dockets UE-130137 and UG-130138 (consolidated) (ERF), Order 07 - Final Order Granting Decoupling Petition and Final Order Authorizing ERF Rates (June 25, 2013) (Order 07-2013 Rate Plan).
- 408 (5) The rates established by Order 07-2013 Rate Plan, updated PSE’s rates previously established in 2012 consistent with *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049 (consolidated), Order 08 (May 7, 2012). Under the Rate Plan, PSE’s rates were adjusted annually reflecting implementation of full decoupling of the Company’s electric and natural gas rates and allowed percentage increases designed to encourage careful cost management practices and efficiency efforts.
- 409 (6) The Rate Plan resulted in the following financial results:
- An approximate \$30 million net electric and gas rate increase from the expedited rate filing in July 2013.
  - Annual K-factor increases to delivery revenues of 3.0 percent for electric and 2.2 percent for gas in July 2013, January 2014, January 2015, January 2016, and January 2017.
  - Recognition of net electric decoupling revenue of approximately \$59 million and net gas decoupling revenue of approximately \$116 million from July 1, 2013, through September 30, 2016.

These financial results, coupled with cost savings and efficiencies realized during the Rate Plan effective period, allowed PSE to consistently earn rates of return and returns on equity slightly below its authorized rate of return and return on

equity on an adjusted actual basis across all time periods demonstrating that the Rate Plan mitigated the effects of regulatory lag and attrition during the Rate Plan effective period.

- 410 (7) On January 13, 2017, PSE filed this general rate case with the Commission proposing revisions to its currently effective Tariffs WN U-20, Electric Service, and Tariff WN U-2, Natural Gas Service, as required under the terms of the Rate Plan and a subsequent order that postponed the original required filing date by approximately 10 months.
- 411 (8) On September 15, 2017, PSE, Staff, ICNU, FEA, Kroger, Energy Project, Sierra Club, State of Montana, NWEA/RNW/NRDC, and NWIGU filed a Settlement Stipulation and a joint narrative statement in support. The State of Montana filed a letter supporting the settlement. Settling Parties filed individual party testimonies on September 15 and 18, 2017. Public Counsel filed testimony opposing the settlement, in part, on September 22, 2017. The Settlement Stipulation is attached to this Order as Appendix B.
- 412 (9) The Settlement Stipulation addressed all issues relevant to PSE's revenue requirements for electric operations and natural gas operations, and a number of non-revenue issues. Some non-revenue issues were not addressed by the Settlement Stipulation and remained fully contested, including most decoupling proposals, PSE's proposed Electric Cost Recovery Mechanism, and some electric and all natural gas cost of service, rate spread, and rate design issues identified by the parties.
- 413 (10) Thirty-three adjustments to electric revenue requirements and twenty-one adjustments to natural gas revenue requirements reflected in the parties' Settlement Stipulation are uncontested. One additional adjustment to both electric and natural gas revenue requirements is a "pass-through" adjustment based on an uncontested methodology. These 56 adjustments are depicted in Appendix A to this Order, including revenue requirements metrics. These uncontested adjustments are supported by substantial competent evidence in the record of this proceeding. We find they should be approved without exception or condition.
- 414 (11) Two issues addressed by the Settlement Stipulation, but contested by Public Counsel, are the principle drivers of overall revenue requirements in this proceeding. The first is the cost of capital; specifically, the rate of return on equity. The second is the depreciation expense attributable to certain coal-fired power plants known as Colstrip Units 1 through 4, in which PSE has ownership

interests. Colstrip raises non-revenue issues as well, including the proposed use of Treasury Grants and not yet monetized Production Tax Credits to pay for increased depreciation expenses that arise under the terms of the Settlement Stipulation and, later, decommissioning and remediation costs. The Settling Parties propose reasonable resolutions of these issues in their Settlement Stipulation, as discussed in detail in the body of this Order.

- 415 (12) The Settlement Stipulation proposes reasonable resolutions to the following revenue requirements issues: Electric Adjustment 13.06 and Natural Gas Adjustment 11.06 (Depreciation Study); Electric Adjustment 13.15 and Natural Gas Adjustment 11.15 (Pension Plan); Electric Adjustment 13.19 and Natural Gas Adjustment 11.19 (Environmental Remediation); Electric Adjustment 14.05 (Storm Damage); and Public Counsel Adjustment B-5 (Plant Held for Future Use), as discussed in the body of this Order.
- 416 (13) The Settlement Stipulation's proposed resolution of the issues identified above in Findings of Fact (11) and (12) are well-supported by substantial competent evidence and provide reasonable resolutions of the issues considering the facts. Public Counsel's "alternative viewpoints" or arguments opposing the Settlement Stipulation's proposed resolution of these issues are not well-supported by the record and are not persuasive.
- 417 (14) The Settlement Stipulation is neither ambiguous nor unclear with respect to the guidance it provides PSE and the parties should PSE elect to seek approval of an Expedited Rate Filing (ERF) during the 12 months following the date of this Order.
- 418 (15) A collaborative process to give considered attention to the question whether to continue PSE's water heater program, as provided by the Settlement Stipulation, is a superior alternative to Public Counsel's proposal to simply discontinue the program on the basis of the current record, which is sparse, at best.
- 419 (16) The Settlement Stipulation's proposal to update the Service Quality Index No. 5 metric is reasonable considering advances in communications technology and practice since the current metric was established 20 years ago and is unlikely to result in any deterioration in service quality. The revised standard proposed by the Settling Parties is supported by substantial competent evidence as discussed in the body of this Order.

- 420 (17) No party challenges, and there is substantial competent evidence supporting, a determination of prudence with respect to each of the following eight projects, as discussed in the body of this Order:
- Snoqualmie Falls hydroelectric redevelopment project.
  - Acquisition of the Buckley Natural Gas Distribution System.
  - Acquisition and development of the Glacier Battery Storage System.
  - Development and construction of the Ardmere Substation.
  - Power purchase agreement with Public Utility District No. 1 Public Utility District No. 1 of Douglas County, Washington to purchase power from the Wells Hydroelectric Project.
  - Acquisition of transmission capacity from Bonneville Power Administration (BPA) for the Goldendale Generation Facility (38 MW) and the Mint Farm Generation Facility (15 MW).
  - Renewal of agreements for transmission capacity from BPA associated with the Coal Transition Power Purchase Agreement (100 MW), the Mint Farm Generation Facility (20 MW), and purchases from Garrison, Montana (94 MW).
  - Total amount of actual costs accumulated and deferred until September 30, 2016, associated with PSE’s electric and natural gas Environmental Remediation program.
- 421 (18) The record establishes that PSE’s decoupling mechanisms are working as intended. We find these mechanisms should be continued at this time but also find it prudent for the Commission to review the operation of the mechanisms again after four years from the date of this Order.
- 422 (19) Greater homogeneity among customers within individual groups will reduce rate volatility and cross-subsidization by better aligning customers with similar load profiles following PSE’s proposal for five electric groups and two natural gas groups.
- 423 (20) We find that the Commission’s approach to decoupling, going forward, should continue to use a revenue-per-customer approach for most costs and a revenue-per-class approach for fixed production costs. We reject the “complete decoupling” approach advocated by Public Counsel and The Energy Project because it fails to take into account all relevant factors and ignores salient facts, as discussed in the body of this Order.
- 424 (21) PSE’s proposal to increase the soft cap for the electric decoupling mechanism from 3 percent to 5 percent is unsupported by any evidence of financial harm to PSE or customers from the current 3 percent cap.

- 425 (22) We find it appropriate to increase the soft cap for natural gas decoupling to 5 percent because large deferrals have developed under the natural gas decoupling mechanism with unrecovered balances remaining on PSE's books for more than one year creating an earnings challenge for PSE considering GAAP requirements.
- 426 (23) PSE's earnings sharing mechanism should be based on actual, not theoretical earnings, thus requiring that normalizing adjustments be removed from the earnings test.
- 427 (24) PSE's proposed 25 basis point dead band for its earnings test could result in a higher rate of return than shown to be appropriate by the cost of capital evidence in the record and is, therefore, unacceptable.
- 428 (25) PSE failed to carry its burden to show the need for the Company's proposed Electric Cost Recovery Mechanism.
- 429 (26) It is necessary to limit the application of the Commission's decisions on the contested cost of service study and rate spread issues by giving them effect only with respect to this case while allowing ongoing generic proceedings concerning these issues to continue.
- 430 (27) The record does not support the recovery of transformer costs in residential electric basic charges and PSE otherwise failed to carry its burden to justify a proposed increase in the basic charge for residential electric service.
- 431 (28) PSE's proposed increase to the basic charge for residential natural gas service was shown to be reasonable based on actual customer costs that are significantly higher than the current rate of \$10.34 and that the charge would be significantly lower than what the actual costs suggest would be appropriate thereby reflecting appropriately the principle of gradualism.
- 432 (29) The record does not support PSE's proposed changes with respect to non-residential natural gas schedules 41, 41T, 85, and 85T.
- 433 (30) PSE's currently effective electric rates do not provide sufficient revenue to recover the costs of its operations and provide a rate of return adequate to compensate investors at a level commensurate to what they might expect to earn on other investments bearing similar risks. In contrast, PSE's currently effective natural gas rates over recover the Company's costs of operations and provide returns greater than what is required to continue attracting investors.



**CONCLUSIONS OF LAW**

434 Having discussed above all matters material to this decision, and having stated the  
following summary conclusions of law, incorporating by reference pertinent portions of  
the preceding detailed conclusions:

- 435 (1) The Washington Utilities and Transportation Commission has jurisdiction over  
the subject matter of, and parties to, these proceedings.
- 436 (2) PSE is an electric company, a natural gas company, and a public service company  
subject to Commission jurisdiction.
- 437 (3) At any hearing involving a proposed change in a tariff schedule the effect of  
which would be to increase any rate, charge, rental, or toll theretofore charged,  
the burden of proof to show that such increase is just and reasonable will be upon  
the public service company. RCW 80.04.130 (4). The Commission's  
determination of whether the Company has carried its burden is adjudged on the  
basis of the full evidentiary record.
- 438 (4) PSE's existing rates for electric service are neither fair, just, and reasonable, nor  
sufficient, and should be adjusted prospectively after the date of this Order.
- 439 (5) PSE's existing rates for natural gas service are not fair, just, and reasonable, and  
should be adjusted prospectively after the date of this Order.
- 440 (6) The Settlement Stipulation's proposed resolution of the issues identified above in  
Findings of Fact (11) and (12) are lawful and in the public interest reaching, as  
they do, end results in terms of overall rates that are fair, just, reasonable, and  
sufficient.
- 441 (7) There is no legal impediment to PSE seeking approval of an ERF filed within 12  
months following the date of this Order following the guidance offered by the  
terms of the Settlement Stipulation.
- 442 (8) The Commission should approve and adopt the Settling Parties' Settlement  
Stipulation as its resolution of the issues addressed by its terms. The Settlement  
Stipulation should be incorporated by reference into the body of this Order, as if  
set forth in full.

- 443 (9) The legal and policy bases supporting the continued operation of PSE's decoupling mechanisms are firmly established by the Commission's prior orders and policy statements and as discussed in the body of this Order.
- 444 (10) The Commission should enforce the terms of the Rate Design Settlement in Docket UE-141368 based on its plain terms and meaning, including the explicit requirement that the demand and energy classification percentages will be set in this proceeding at 25 percent demand and 75 percent energy.
- 445 (11) The Commission's resolution of contested issues concerning cost of service studies, rate spread, and rate design should be limited to the resolution of these issues in this proceeding in deference to ongoing collaboratives in Dockets UE-170002 and UG-170003.
- 446 (12) PSE should be authorized and required to make a compliance filing in these consolidated dockets to recover in prospective rates its revenue deficiency of \$20,160,334 for electric operations and to remove from prospective rates its revenue sufficiency of \$35,465,639 for natural gas operations.
- 447 (13) The Commission Secretary should be authorized to accept by letter, with copies to all parties to this proceeding, a filing that complies with the requirements of this Order.
- 448 (14) The Commission should retain jurisdiction over the subject matters and the parties to this proceeding to effectuate the terms of this Order.

**ORDER**

THE COMMISSION ORDERS THAT:

- 449 (1) The proposed tariff revisions Puget Sound Energy (PSE) filed in these dockets on January 13, 2017, and suspended by prior Commission order, are rejected.
- 450 (2) PSE is authorized and required to make a compliance filing in this docket including all tariff sheets that are necessary and sufficient to effectuate the terms of this Final Order. The stated effective date included in the compliance filing tariff sheets must allow five business days after the date of filing for Commission review.

- 451 (3) The Commission Secretary is authorized to accept by letter, with copies to all parties to this proceeding, a filing that complies with the requirements of this Final Order.
- 452 (4) The Commission retains jurisdiction over the subject matters and parties to this proceeding to effectuate the terms of this Order.

DATED at Olympia, Washington, and effective December 5, 2017.

**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

DAVID W. DANNER, Chairman

ANN E. RENDAHL, Commissioner

JAY M. BALASBAS, Commissioner

**NOTICE TO PARTIES: This is a Commission Final Order. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 and WAC 480-07-870.**

**APPENDIX A**

**ADJUSTMENTS TO REVENUE REQUIREMENTS**

**Electric Settlement Adjustments and Revenue Requirement**

Adjustment (a)	Description (b)	NOI (c)	Rate Base (d)	Revenue Requirement (e)
	<b>Results of Operations</b>	<b>401,002,972</b>	<b>5,153,204,462</b>	<b>(15,119,001)</b>
<b>Uncontested Settlement Adjustments</b>				
13.01	Revenues & Expenses	(29,139,114)	-	47,070,619
13.02	Temperature Normalization	17,527,344	-	(28,313,247)
13.03	Pass-Through Revs. & Exps.	(1,000,540)	-	1,616,249
13.04	Federal Income Tax	(27,023,239)	-	43,652,686
13.05	Tax Benefit of Proforma Interest	54,067,781	-	(87,339,785)
13.06A	Reg. Asset Colstrip	-	-	-
13.07	Normalize Injuries & Damages	69,387	-	(112,087)
13.08	Bad Debts	681,065	-	(1,100,176)
13.09	Incentive Pay	(109,903)	-	177,535
13.10	D&O Insurance	16,141	-	(26,074)
13.11	Interest on Customer Deposits	(176,606)	-	285,284
13.12	Rate Case Expenses	(264,905)	-	427,920
13.13	Deferred G/L on Property Sales	171,200	-	(276,552)
13.14	Property & Liability Ins	66,147	-	(106,852)
13.16	Wage Increase	(1,357,716)	-	2,193,221
13.17	Investment Plan	(96,705)	-	156,214
13.18	Employee Insurance	(121,751)	-	196,674
13.20	Payment Processing Costs	(2,010,221)	-	3,247,263
13.21	South King Service Center	434,046	15,915,060	1,252,721
13.22	Excise Tax and WUTC Filing Fee	10,262	-	(16,577)
13.23	ISWC and RB Adjustment	-	19,006,090	2,333,350
13.24	Legal Cost Adjustment	-	-	-
14.01	Power Costs	1,185,175	-	(1,914,503)
14.02	Montana Electric Energy Tax	148,016	-	(239,101)
14.03	Wild Horse Solar	137,890	(1,969,341)	(464,518)
14.04	ASC 815 (Prev. SFAS 133)	(41,672,584)	-	67,316,883
14.06	Reg Assets & Liabilities	1,736,212	(44,085,326)	(8,216,927)
14.07	Glacier Battery Storage	(145,490)	2,842,787	584,026
14.08	Energy Imbalance Market	-	-	-
14.09	Goldendale Capacity Upgrade	2,156	18,140,954	2,223,656
14.10	Mint Farm Capacity Upgrade	-	19,004,590	2,333,166
14.11	White River	(3,288,310)	(4,108,724)	4,807,435
14.12	Reclass of Hydro Treasury Grants	(2,131,857)	5,739,615	4,148,394
14.13	Production Adjustment	32,769	-	(52,934)
<b>Contested Settlement Adjustments</b>				
13.06	Depreciation Study	(34,311,788)	(17,155,894)	53,320,227
13.15	Pension Plan	(1,184,945)	-	1,914,132
13.19	Environmental Remediation	(925,460)	-	1,494,966
14.05	Storm Damage	(6,137,438)	-	9,914,269
<b>Black Box Settlement Adjustment</b>				
13.25	Black Box Adjustment	619,051	-	(1,000,000)
<b>Other Adjustment</b>				
	Revenue Effects of 4-Yr Rate Plan & Other Mechanisms <sup>1</sup>			(86,208,222)
<b>Overall Electric Revenue Requirement</b>				<b>20,160,334</b>

<sup>1</sup> This adjustment reflects the offsetting rate impacts of the 2013 ERF Filing (Schedule 141), Decoupling, K-Factor and Earnings Sharing (Schedule 142), and Power Cost Adjustments (Schedule 95) which occurred during the four-year rate plan in effect since the last GRC in 2011 in Dockets UE-111048 and UG-111049.

**Gas Settlement Adjustments and Revenue Requirement**

<b>Adjustment (a)</b>	<b>Adjustment (b)</b>	<b>NOI (c)</b>	<b>Rate Base (d)</b>	<b>Revenue Requirement (e)</b>
	<b>Results of Operations</b>	<b>119,145,769</b>	<b>1,727,319,760</b>	<b>19,551,185</b>
<b>Uncontested Settlement Adjustments</b>				
11.01	Revenues & Expenses	(32,674,131)	-	52,661,989
11.02	Temperature Normalization	16,046,445	-	(25,862,592)
11.03	Pass-Through Revs. & Exps.	736,148	-	(1,186,474)
11.04	Federal Income Tax	700,822	-	(1,129,538)
11.05	Tax Benefit of Proforma Interest	18,475,298	-	(29,777,255)
11.07	Normalize Injuries & Damages	(57,738)	-	93,058
11.08	Bad Debts	35,240	-	(56,797)
11.09	Incentive Pay	104,023	-	(167,657)
11.10	D&O Insurance	11,636	-	(18,754)
11.11	Interest on Customer Deposits	(50,137)	-	80,807
11.12	Rate Case Expenses	(280,617)	-	452,280
11.13	Deferred G/L on Property Sales	(105,090)	-	169,377
11.14	Property & Liability Ins	45,174	-	(72,809)
11.16	Wage Increase	(907,409)	-	1,462,502
11.17	Investment Plan	(46,689)	-	75,250
11.18	Employee Insurance	(58,781)	-	94,740
11.20	Payment Processing Costs	(1,449,117)	-	2,335,590
11.21	South King Service Center	212,048	7,775,116	610,622
11.22	Excise Tax and WUTC Filing Fee	33,509	-	(54,008)
11.23	ISWC and RB Adjustment		4,743,346	581,021
11.24	Legal Cost Adjustment	-	-	-
7.01	Gas Cost Recovery Mechanism	(4,003,724)	19,011,708	8,781,713
<b>Contested Settlement Adjustments</b>				
11.06	Depreciation Study	13,174,098	6,587,049	(20,426,274)
11.15	Pension Plan	(572,091)	-	922,058
11.19	Environmental Remediation	(5,592,128)	-	9,013,019
<b>Black Box Settlement Adjustment</b>				
11.25	Black Box Adjustment	930,675	-	(1,500,000)
<b>Other Adjustment</b>				
	Revenue Effects of 4-Yr Rate Plan & Other Mechanisms <sup>2</sup>			(52,098,690)
<b>Overall Gas Revenue Requirement</b>				<b>(35,465,639)</b>

<sup>2</sup> This adjustment reflects the offsetting rate impacts of the 2013 ERF Filing (Schedule 141), Decoupling, K-Factor and Earnings Sharing (Schedule 142), and Cost Recovery Mechanism (Schedule 149) which occurred during the four-year rate plan in effect since the last GRC in 2011 in Dockets UE-111048 and UG-111049.

**APPENDIX B**

**SETTLEMENT STIPULATION AND EXHIBITS**