EXHIBIT NO. ___(TAD-1T)
DOCKET NO. UE-11___/UG-11___
2011 PSE GENERAL RATE CASE
WITNESS: TOM DE BOER

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-11____** **Docket No. UG-11____**

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF TOM DE BOER ON BEHALF OF PUGET SOUND ENERGY, INC.

JUNE 13, 2011

PUGET SOUND ENERGY, INC.

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PUGET SOUND ENERGY, INC.

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Tom De Boer. My business address is 10885 NE Fourth Street, P.O. Box 97034, Bellevue WA 98009-9734.

Q. By whom are you employed and in what capacity?

A. I am employed by Puget Sound Energy, Inc. ("PSE" or the "Company") as Director, Federal and State Regulatory Affairs.

Q. Have you prepared an exhibit describing your education, relevant employment experience, and other professional qualifications?

A. Yes, I have. It is Exhibit No. ___(TAD-2).

Q. What are your duties as Director, Federal and State Regulatory Affairs for PSE?

A. As Director, Federal and State Regulatory Affairs, I manage PSE's Rates and Regulatory Department. My present responsibilities include oversight of various regulatory proceedings before the Washington Utilities and Transportation Commission ("WUTC" or "Commission"), the Federal Energy Regulatory Commission ("FERC") and certain rate related issues with the Bonneville Power

Administration.

Q. Please provide an overview of your testimony in this proceeding.

A. My testimony provides an overview of the Conservation Savings Adjustment ("CSA") Rate that PSE is requesting in this case. First, I provide a historical perspective of PSE's leadership in the field of conservation and I discuss the significant conservation savings PSE is currently pursuing. Second, I discuss the financial disincentives that PSE faces as it pursues conservation under the current modified historical test year method of ratemaking. Third, I briefly review various approaches that have been proposed for dealing with barriers to conservation, including the approaches outlined in the Commission's recently issued *Report and Policy Statement on Regulatory Mechanisms, Including Decoupling, To Encourage Utilities To Meet Or Exceed Their Conservation Targets* ("Report and Policy Statement"). I discuss why mechanisms such as decoupling do not address PSE's concern that expenses per customer are growing faster than revenue per customer—and that conservation exacerbates this problem. Finally, I provide an overview of PSE's proposed CSA Rate, including information about the impacts and benefits such a rate would have on PSE's customers.

II. PSE IS A RECOGNIZED LEADER IN CONSERVATION

Q. Please describe PSE's conservation efforts.

A. The Commission has recognized the long-standing commitment of PSE to promoting energy efficiency. In the Final Order in PSE's 2006 general rate case,

the Commission noted: "PSE has an outstanding record in terms of encouraging conservation and achieving significant amounts of conservation on its system over time."[1] To illustrate its more recent commitment, PSE's current conservation rates and budgets are intended to acquire 71 aMW of electricity savings and 9.05 million therms of annual gas savings for the utility's customers by the end of the current 2010-2011 conservation budget cycle.[2]

Q. Does PSE remain committed to pursuing conservation?

A. Yes. PSE remains committed to acquire all the available cost-effective, reliable, feasible conservation that the Commission approves in setting PSE's biennial energy conservation target under the mandate of RCW 19.285. PSE is also committed to conservation because it is currently the least cost resource to meet PSE's future energy needs. Notwithstanding this commitment, PSE also believes that the Commission's obligation in RCW 80.28.020 to set rates that are just, reasonable, and compensatory requires the Commission to take into account the financial disincentive that results from PSE's aggressive pursuit of conservation. Just as a utility is generally allowed to recover the cost of expensive new environmental requirements through rates, so too should it be allowed to recover costs that it is otherwise prevented from recovering due to mandated conservation targets. PSE has had a proud history of aggressively pursing conservation despite the absence of a specific ratemaking provision that addresses the financial burden

[1] *WUTC v. PSE,* Dockets UE-060266 & UG-060267Order 08 (January 5, 2007) at ¶ 65.

[2] Appendix B to PSE's conservation tariffs, Dockets UE-091859 & UG-091860

such conservation places on the Company. We believe the CSA proposal will help bring into alignment the ratemaking disconnect between RCW 19.285 and RCW 80.28.020 by providing a mechanism to account for and compensate utilities for the unrecovered fixed costs that result from the pursuit of conservation.

III. THE FINANCIAL EFFECT OF COMPANY-SPONSORED CONSERVATION

Q. Would you please discuss your concern that the current ratemaking methodology creates a financial disincentive for PSE to pursue conservation?

A. Yes, the concern arises largely from the way traditional regulation sets rates. Rates are set on the basis of a modified historical "test year" that measures the relationship between revenues and cost. Inherent in this rate methodology is the premise that test year revenues and costs will maintain their relative relationship in the future "rate year," thereby providing the utility a reasonable opportunity to earn its authorized rate of return. In reality, sales growth often fails to keep up with growth in costs as discussed below:

> The troublesome aspect of using historic sales data, even adjusted for abnormal events, is the assumption that they are representative of the future. Although most systems anticipate sales growth, the sales growth may not keep up with growth in costs. Using historic data assumes that the interrelationship among sales, investment, and expenses will continue to exist into the period in which the rates are in use. This assumption would be valid if the sales, investment, and operating expenses were changing *at the same rate*; and if so, the historic data might be representative of future conditions. This, however, has not been the experience of most utilities.[3]

[3] ROBERT L. HAHNE, ET. AL., ACCOUNTING FOR PUBLIC UTILITIES § 7.08[1] (Nov. 2010).

Energy efficiency fundamentally alters the relationship required for historical rate making by bringing down the rate of growth in revenues between the test year and rate year, while not reducing growth in costs proportionally. This disproportionate impact on revenue and cost growth stems from the fact that the vast majority of a utility's revenues typically depend on the level of its sales whereas a large fraction of a utility's costs are typically fixed in nature (i.e., they are relatively insensitive to the level of sales).

Q. What effect does pursuing conservation under this ratemaking structure have on the Company?

A. Traditional utility ratemaking requires that rates be designed to capture most of the approved revenue requirements for fixed costs through volumetric rates, so that a utility can fully recover these costs only if its customers consume a certain level of energy sales. When customers use less energy, the utility's financial performance almost always suffers because recovery of fixed costs is reduced in proportion to the reduction in energy sales.

Q. Doesn't Washington use a "modified" historical test year that provides for a substantial amount of future cost recovery?

A. Yes. The "modified" component refers to the treatment of electric and gas supply costs. PSE uses a forward looking rate year for determining its power and gas supply costs although the recovery of electric production-related fixed costs and return on production rate base investments are limited to the dollar amounts

approved in the Company's most recent rate case (i.e., departing from traditional ratemaking principles, the recovery of these costs does not grow with loads). In contrast, the Company uses a pro forma and restated historic test year for the recovery of all other non-production costs. It is the effect Company-sponsored energy efficiency has on the recovery of PSE's costs unrelated to energy supply (i.e., the costs determined using a historical test year) that the Company is addressing in the CSA Rate proposals.

Q. Has the Company estimated the extent to which Company-sponsored energy efficiency undermines PSE's ability to recover costs?

A. PSE estimates that, absent its proposed CSA Rate, Company-sponsored energy efficiency will reduce its ability to recover $18 million of costs in the rate year in this case. The details of this calculation are discussed in the Prefiled Direct Testimony of Jon A. Piliaris, Exhibit No. ___(JAP-1T), and his Exhibit Nos. ___(JAP-9) and ___(JAP-10).

Q. PSE's analysis focuses on the effects of Company-sponsored energy efficiency. Are there other sources of energy efficiency that hinder the utility's ability to recover its costs?

A. Yes. Other sources include more energy efficient building codes and appliance standards, self-funded conservation and conservation sponsored by "stimulus" funding at the federal and state levels of government. Therefore, PSE's estimates of the impact of energy efficiency on its ability to recover costs are conservative.

IV. APPROACHES TO ADDRESSING THE CONSERVATION DISINCENTIVE

Q. Are there ways to mitigate the disincentive that conservation creates for a utility?

A. Yes. Since the disincentive is purely a function of the way rates are set, there are rate mechanisms that can mitigate or even eliminate this disincentive. These rate mechanisms are sometimes generically referred to as "decoupling" but can be broken down more specifically into a number of different mechanisms.

Q. Please begin by explaining what you mean by decoupling.

A. The basic idea of decoupling is to weaken the link between the revenue of a utility and the amount of energy that each customer purchases. In other words, remove the financial disincentive that results if the utility sells less electricity or gas due to conservation efforts. Three approaches to decoupling are well established: (1) Lost revenue adjustment mechanisms ("LRAMs"); (2) decoupling true up plans; and (3) straight fixed variable ("SFV") pricing.

Q. Please explain these approaches.

A. The following is a brief description of each of these three mechanisms.

<u>Lost Revenue Adjustment Mechanisms</u>

Under an LRAM, a utility is explicitly compensated for the estimated financial impacts resulting from its programs to promote energy efficiency and possibly other goals, such as peak load management or load displacement generation. This requires estimates of energy savings of the programs. Compensation for these

fixed cost under-recovery impacts is usually effected through a rate rider. The utility is fully at risk for unforeseen fluctuations in demand due to weather, local economic activity, energy market prices, and other drivers of the demand for utility services.

Decoupling True up Plan

A decoupling true up plan commonly has two basic components: a revenue decoupling mechanism ("RDM") and a revenue adjustment mechanism ("RAM"). The RDM addresses any *revenue*-related attrition between rate cases, while the RAM provides relief for *cost*-related attrition. As discussed later in my testimony, the Commission's approach to decoupling only makes use of the RDM, while ignoring the RAM component.

Straight Fixed Variable Pricing

SFV pricing is an approach to rate design that uses fixed charges to recover all costs that are fixed, at least in the short run, with respect to system use. For residential customers, these charges commonly take the form of basic charges as they are called in Washington. Basic charges are usually the same for all customers in a service class but there are precedents for SFV basic charges to vary in some rough fashion with a customer's historical usage pattern.

Q. Are there other ways to encourage Company-sponsored conservation that do not result in a financial impact to the utility?

A. The foregoing mechanisms address ways to remove the disincentive to pursuing conservation. A separate but related issue is an incentive mechanism to

encourage the utility to pursue even more conservation. But as the nomenclature suggests, these concepts are addressing two different issues. Until the financial disincentive is removed, an incentive is not effective unless it is sufficiently large to both completely mitigate the financial loss due to conservation savings and provide additional incentive.

V. THE COMMISSION REPORT AND POLICY STATEMENT

Q. Has the Commission examined the issue of the effect of conservation on its regulated utilities?

A. This issue has been a topic of discussion as long as conservation has been around. The Commission has considered this issue on an *ad hoc* basis several times as a result of individual utilities filing proposals to address the issue in various stand alone filings or as part of a general rate case. In addition, the Commission has undertaken several investigations and other proceedings to examine this issue, most recently in WUTC Docket No. U-100522, *Investigation Into Energy Conservation Incentives*.

Q. What was the outcome of the Commission's investigation in Docket No. U-100522?

A. Beginning in April 2010, the Commission solicited comments and held two work sessions to explore the issue. On November 4, 2010, the Commission issued its Report and Policy Statement, which articulated the Commission's policy regarding three types of regulatory mechanisms. These three mechanisms are: (1) limited decoupling; (2) full decoupling; and (3) incentives.

Q. Did the Company participate in the Commission's investigation?

A. Yes. The Company actively participated in both of the Commission's work sessions and submitted written comments in response to several rounds of questions from the Commission.

VI. OVERVIEW OF PSE'S PROPOSED CONSERVATION SAVINGS ADJUSTMENT RATE

Q. What is the Company proposing in this case?

A. The Company is proposing a Conservation Savings Adjustment ("CSA") Rate to mitigate the negative financial effects that conservation has on its ability to recover certain of its fixed costs. As discussed above, there are many ways to potentially address the conservation-disincentives, but the details of the mechanism and the current (and forecasted) operating environment matter immensely in making that determination. After carefully considering and analyzing the mechanisms in the Report and Policy Statement, the Company concluded that none of the specific mechanisms discussed by the Commission meet PSE's needs because they effectively hold use-per-customer (and, therefore, revenue-per-customer) constant while expenses-per-customer continue to grow. While circumstances can change, the CSA Rate proposal is the best fit for the Company's circumstances at this time.

Q. How do other utilities ameliorate the effect of energy efficiency on their ability to recover costs?

A. Exhibit No. ___(TAD-3) provides recent surveys by The Edison Foundation – Institute for Electric Efficiency ("IEE") and the American Gas Association ("AGA"). The IEE survey illustrates that electric utilities in many states have some type of mechanism to address the effect of energy efficiency on their ability to recover costs. The AGA survey similarly shows broad use of mechanisms to address the effects of energy efficiency and many other factors.

Q. Please elaborate on PSE's concerns about decoupling mechanisms described in the Report and Policy Statement.

A. As discussed in more detail later in my testimony, PSE's expense-per-customer growth unrelated to energy supply is exceeding its associated revenue-per-customer growth. Under the type of decoupling mechanism described in the Report and Policy Statement, revenue-per-customer is effectively held constant at test year levels. In the presence of continued growth in expense-per-customer, such a decoupling mechanism would guarantee that the Company's revenue would be unable to keep pace with its expenses between the test year and rate year. Simply put, absent flat or declining expense-per-customer growth between the test year and rate year, the form of revenue decoupling discussed by the Commission would "lock-in" the Company's chronic under-recovery of fixed costs due to conservation.

Q. Does PSE expect to experience continued expense-per-customer growth?

A. As discussed in more detail in the Prefiled Direct Testimony of Sue McLain, Exhibit No.___(SML-1T), PSE expects continued growth in spending due to the

ongoing need to replace aging infrastructure, comply with increasing federal and state reliability standards, and adhere to increasingly rigorous construction standards imposed by municipalities. Since the majority of this spending will not be directly tied to corresponding levels of new revenue (i.e., the spending is tied to regulatory, reliability or other requirements) and since it is unlikely that this spending will produce sufficient operation and maintenance expense reductions to offset the fixed capital costs associated with the new investments, these high capital spending levels will further increase PSE's expense-per-customer.

Q. Does the form of decoupling outlined in the Report and Policy Statement at least provide relief from declining revenue-per-customer due to declining use-per-customer?

A. Decoupling may provide relief from declining use-per-customer for PSE's gas system since the full effect of Company-sponsored energy efficiency would be reflected in the costs recovered through this form of decoupling. However, since use-per-customer would be increasing on the electric system in the absence of conservation, the relief for PSE's electric system is far less than the effect Company-sponsored energy efficiency has on its ability to recover its electric costs. In fact, use-per-customer does not necessarily need to be declining for there to be an adverse cost-recovery consequence from Company-sponsored energy efficiency.

For instance, in the Company's most recent electric load forecast, it is projecting that commercial use-per-customer will essentially be flat between the 2010 test

year and calendar year 2012, when rates in this case go into effect. However, in the absence of Company-sponsored conservation, PSE estimates that commercial use-per-customer growth during this time frame would be approximately two percent. If these projections became reality, the Commission's decoupling formula would provide essentially no relief from the effect of Company-sponsored energy efficiency programs on PSE's ability to recover costs from its commercial customers.

Q. The Commission has suggested that something called "found margin" offsets this effect. What are found margins?

A. In the Report and Policy Statement the Commission stated that "increased per-customer usage or the addition of new customers can lead to additional revenues ('found margin')…"[4]. In other words, the Commission ties so-called found margin to an increase in the number of customers served and/or use-per-customer.

Q. Is it appropriate to offset the effects of energy efficiency with the growth in customers and use-per-customer?

A. PSE believes it is not appropriate to offset the effects of energy efficiency with the growth in the number of customers and use per customer. Customer and use-per-customer growth have historically helped utility revenue growth keep pace, at least in part, with cost growth. Simply put, what the Commission considers found

[4] *In the Matter of the Washington Utilities and Transportation Commission's Investigation into Energy Conservation Incentives*, Docket U-100522. ("Commission Investigation Report") at ¶11.

margin is required for the successful application of historic test year ratemaking, particularly in an environment of increasing costs. Offsetting the effects of energy efficiency with found margin ignores this reality, hindering the ability of a utility's revenue growth to keep pace with its growth in costs.

Q. Does the Commission recognize that growth in customers and use-per-customer are necessary to aid in the proper matching of a utility's revenues and costs in the rate year?

A. Yes, at least in part. In the Final Order in PSE's 2009 general rate case, the Commission noted the following.

> The theory, well supported by ratemaking theory and past commission practice, is that once the relationship [between revenues and expenses] is set [in the historic test year], it will continue to provide appropriate income to the company in the future. If the utility hooks up new customers, the revenues and expenses will increase in the same proportion as existed in the test year.[5]

However, to be completely accurate, there is another crucial element to this theory that must be recognized. The same relationship between revenue-per-customer and expense-per-customer in the "modified" test year must be obtainable in the rate year.[6]

Q. Can you explain why the relationship between revenue-per-customer and

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[5] *WUTC v. PSE,* Dockets UE-090704 and UG-090705, Order 11 at ¶ 223 (April 2, 2010).

[6] It is equally true that revenues per unit of energy sold and expenses per unit of energy sold must grow at the same rate between the test year and rate year for this ratemaking theory to hold. However, to simplify this discussion and its application to decoupling later in this testimony, the focus here will be on the relationship of revenue-to-expense per customer.

expense-per-customer must be maintained to support this ratemaking theory?

A. Yes. For total revenues (i.e., customers multiplied by revenue-per-customer) to "match" total expenses (i.e., customers multiplied by cost-per-customer) in the test year and rate year, any increase in expense-per-customer between these two points in time must be accompanied by a similar increase in revenue-per-customer.

Q. Does expense-per-customer change between the test year and rate year?

A. Yes. Table 1 below illustrates how PSE's expense-per-customer has changed over time. Expense-per-customer that is unrelated to energy supply has increased between the test year in PSE's 2004 general rate case and its most recently concluded electric and gas rate cases.[7] As shown below, over this period, PSE's electric expense-per-customer unrelated to power supply has grown at an average annual rate of approximately 2.8 percent, while its gas expense-per-customer unrelated to gas supply has grown at an average annual rate of approximately 5.0 percent.

[7] As will be discussed later in this testimony, the Company is primarily concerned with the recovery of costs unrelated to energy supply, since: (a) forward-looking supply costs are used to derive PSE's retail rates; and (b) the effects of energy efficiency on its ability to recover supply-related costs is largely addressed through its energy supply-related cost tracking mechanisms. As such, unless otherwise noted, the discussion of expense-per-customer in this testimony is focused on expenses unrelated to energy supply.

Table 1 - PSE's Expense Per Customer Growth Since the 2004 GRC Test Year

	2004 GRC Docket Nos. UE-040640 & UG-040641	2009 GRC Docket No. UE-090704	2010 GTIF Docket No. UG-101644
Electric			
Approved Test Year Revenue Requirement	$ 1,472,878,464	$ 2,034,528,051	
Less: Approved Test Year Power Costs	994,621,953	1,428,033,627	
Expenses Net of Power Costs	$ 478,256,511	$ 606,494,424	
Test Year Customers	963,672	1,063,953	
Expenses per Customer Net of Power Costs	$ 496	$ 570	
Approx. Annual Average Growth Rate Since 2004 GRC		2.8%	
Gas			
Approved Test Year Revenue Requirement*	$ 296,832,057		$ 440,015,433
Test Year Customers	628,680		748,628
Expenses per Customer	$ 472		$ 588
Approx. Annual Average Growth Rate Since 2004 GRC			3.2%

* The rates approved in PSE's gas GRC's do not relate to gas supply costs. These are handled through PSE's Power Gas Adjustment Mechanism.

Q. How can a company's revenue-per-customer keep pace between the test year and rate year?

A. Since rates do not change between a "modified" test year and the corresponding rate year, the only way for revenue-per-customer to increase between the test year and rate year is for use-per-customer (i.e., the second part of the Commission's found margin) to increase between these two time periods or to add new customers at a cost less than what is embedded in rates. Ultimately, for the Commission's historic ratemaking theory to hold and for a utility's total revenues and expenses to remain matched in the rate year, its revenue-per-customer must grow at the same rate as its expense-per-customer between the test year and rate year.

Q. Has PSE's use-per-customer kept pace with its expense-per-customer unrelated to energy supply?

A. No. As shown in Table 2, PSE's electric use-per-customer has been essentially flat since PSE's 2004 general rate case, while gas use-per-customer has declined at an annual average rate of approximately 1.5 percent. This compares with the average annual expense-per-customer growth rates of 2.8 percent and 5.0 percent for PSE's electric and gas systems, respectively, as shown in Table 1. PSE's growth in use-per-customer is seriously lagging its growth in expense-per-customer.

Table 2 - PSE's Use Per Customer Growth Since the 2004 GRC Test Year

	2004 GRC Docket Nos. UE-040640 & UG-040641	2009 GRC Docket No. UE-090704	2010 GTIF Docket No. UG-101644
Electric			
Test Year Retail kWh Sales	21,483,173,826	23,742,572,967	
Test Year Customers	963,672	1,063,953	
Use per Customer	22,293	22,315	
Approx. Annual Average Growth Rate Since 2004 GRC		0.0%	
Gas			
Test Year Retail Therm Sales	1,019,920,884		1,090,182,856
Test Year Customers	628,680		748,628
Use per Customer	1,622		1,456
Approx. Annual Average Growth Rate Since 2004 GRC			-1.5%

Q. Has PSE's energy efficiency program affected its use per customer?

A. Yes, PSE's energy efficiency program has reduced the Company's use-per customer. One way to reflect this impact is to add the Company's verified conservation savings to its energy sales over time. Table 3 shows that if PSE's verified conservation savings since the test year in its 2004 general rate case are added to its actual weather-normalized energy sales over time, the Company's electric use-per-customer would have grown at an annual average rate of 0.9 percent, versus the absence of weather-normalized growth it actually experienced. For PSE's gas system, absent Company-sponsored energy efficiency that occurred

since the test year in its 2004 general rate case, its use-per-customer would have slowed to an average annual rate of decline of 1.2 percent. Again, note that, even after removing the load-reducing effects of Company-sponsored energy efficiency, PSE's use-per-customer growth still lags its expense-per-customer growth by a wide margin.

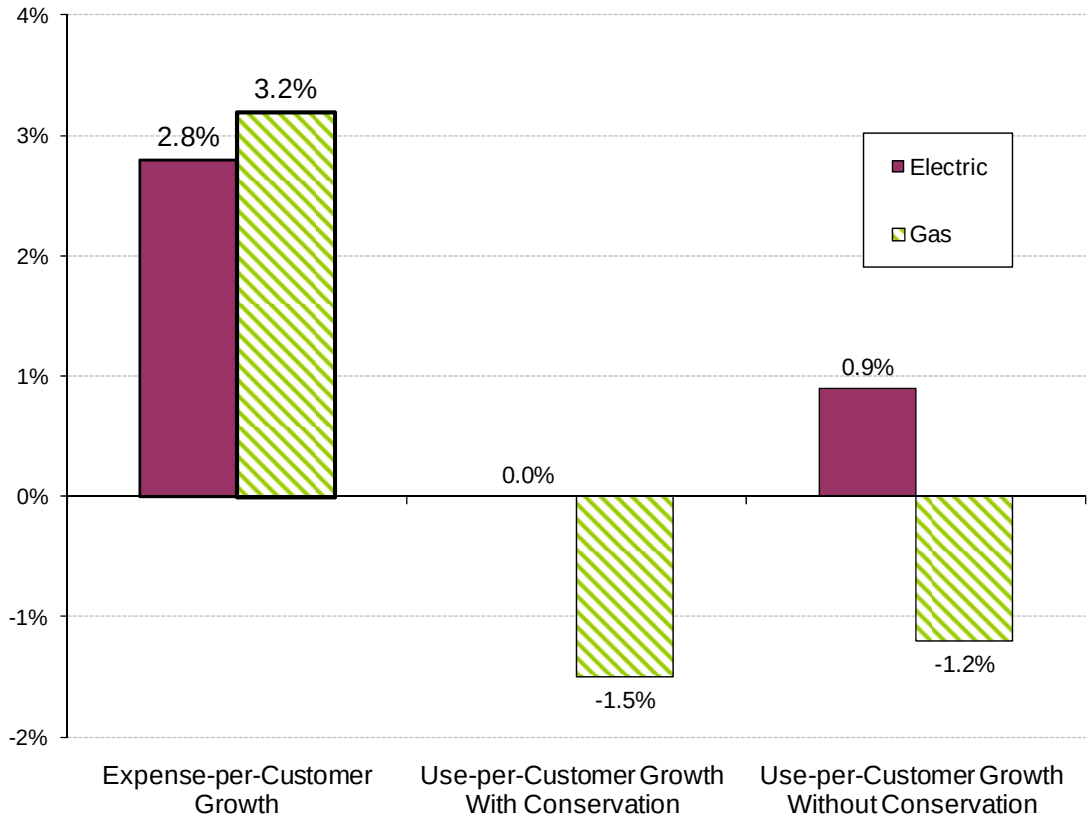
Table 3 - PSE's Use Per Customer Growth Since the 2004 GRC Test Year Without The Effects of Company-Sponsored Energy Efficiency

	2004 GRC Docket Nos. UE-040640 & UG-040641	2009 GRC Docket No. UE-090704	2010 GTIF Docket No. UG-101644
Electric			
Test Year Retail kWh Sales	21,483,173,826	23,742,572,967	
Plus: Accumulated Energy Effficiency Since 2004 GRC Test Year	-	1,024,950,973	
Retail kWh Sales Without Effects of Energy Efficiency	21,483,173,826	24,767,523,940	
Test Year Customers	963,672	1,063,953	
kWh Use per Customer Without Effects of Energy Efficiency	22,293	23,279	
Approx. Annual Average Growth Rate Since 2004 GRC w/o EE		0.9%	
Gas			
Test Year Retail Therm Sales	1,019,920,884		1,090,182,856
Plus: Accumulated Energy Effficiency Since 2004 GRC Test Year	-		22,458,394
Retail Therm Sales Without Effects of Energy Efficiency	1,019,920,884		1,112,641,250
Test Year Customers	628,680		748,628
Therm Use per Customer Without Effects of Energy Efficiency	1,622		1,486
Approx. Annual Average Growth Rate Since 2004 GRC w/o EE			-1.2%

Q. What is the basis for "offsetting" the effects of Company-sponsored energy efficiency with use-per-customer growth (i.e., one element of the Commission's found margin)?

A. Since use-per-customer before energy efficiency is already unable to keep pace with expense-per customer unrelated to energy supply, PSE believes there is no basis for this offset. The historic ratemaking "matching" theory would be further violated by driving a larger wedge between the rate year revenues and costs. Please see Figure 1 that illustrates that use-per-customer growth has not kept pace with expense-per-customer growth since PSE's 2004 general rate case.

Figure 1 - Comparison of PSE's Growth in Expense-Per-Customer and Use-Per-Customer, With and Without Conservation, Since its 2004 General Rate Case



Q. Are there other reasons why it is improper to offset the effects of Company-sponsored energy efficiency with what the Commission considers found margins?

A. Yes. To be a proper offset, Company-sponsored energy efficiency must increase customer growth or use-per-customer. The presence or absence of Company-sponsored energy efficiency does not create new customers or increase use-per-customer in any meaningful or measurable way.

Q. But isn't there still an opportunity for PSE to increase its profits by achieving more energy efficiency and selling its excess power into the market?

A. Under normal operating conditions, it is unlikely that surplus sales revenue or avoided power purchases resulting from energy-efficiency would create any net revenues for the utility. The reasons are twofold.

First, as noted earlier, the power costs used to derive PSE's electric rates are forward-looking and, hence, already reflect an expected level of energy efficiency achieved from the test year through the rate year. Therefore, only the energy efficiency achieved in excess of the levels reflected in its rate year power costs potentially affect its ability to generate extra revenues through market sales or avoided purchases.

Second, the power costs assumed in the rate year under normal operating conditions in this case are generally lower than the marginal revenue that PSE would experience if it instead sold the power at retail rates. To put this differently, the price signal the Commission intends to reflect in PSE's retail electric rates to encourage customers to conserve also provides a greater opportunity for PSE to recover its costs through retail sales than sales into the market.

The story is similar for PSE's gas system. PSE has a Purchased Gas Adjustment ("PGA") mechanism that passes through the wholesale cost of gas to its

customers. So, any impact of Company-sponsored conservation on its wholesale gas purchases and sales would flow directly to its gas customers.

VII. ELEMENTS OF PSE'S PROPOSED CONSERVATION SAVINGS ADJUSTMENT RATES

Q. Please describe the key elements of PSE's CSA Rate proposal.

A. For each calendar year, PSE first calculates the amount of unrecovered costs resulting from the load-reducing effects of Company-sponsored energy efficiency. PSE proposes to recover 75 percent of this amount in the following CSA Rate year, beginning each May 1st. PSE proposes to recover the remaining 25 percent in a subsequent CSA Rate filing, subject to a true-up and other conditions. The Prefiled Direct Testimony of Jon A. Piliaris, Exhibit No. ___(JAP-1T), discusses the calculations and other features of PSE's CSA Rate proposal in detail.

Q. Why does PSE recover only 75 percent of the load-reducing effects of energy efficiency in the following CSA rate year?

A. While PSE believes that its reported energy efficiency savings are sound and well documented, the Company is also sensitive to arguments that any cost recovery should reflect "verified" savings. PSE is attempting to strike a balance between timely cost recovery and confidence in its reported energy efficiency savings by holding back 25 percent of the cost recovery until the underlying savings have been verified. Deferring this level of cost recovery should provide ample assurance to PSE's customers that the costs being recovered in CSA Rate have been adequately reviewed before being fully recovered.

Q. What are the proposed conditions for recovering the final 25 percent of unrecovered costs?

A. First, PSE proposes that the recovery of these costs be conditioned upon third-party verification of the savings used to derive the CSA Rate. PSE believes that the verification standards used by the Commission to determine compliance with the requirements of RCW 19.285 should be sufficient for purposes of its proposed CSA Rate. These verification standards were just recently updated on October 13, 2010 by the Commission as part of its approving and adopting the settlement agreement in Docket No. UE-100177. However, PSE is open to the possibility of using a different standard that may be more acceptable to the Commission.

Second, PSE proposes that the recovery of the remaining costs be subject to an earnings test. While PSE does not believe that its authorized rate of return should represent a hard cap on earnings, it wishes to address any concerns that the proposed CSA Rate would contribute to its ability to exceed the expected level of earnings approved by the Commission in the Company's most recently completed general rate proceeding.

Q. How is this proposal different from the proposal for a conservation phase-in adjustment PSE requested in its 2009 general rate case?

A. First, and most importantly, the Commission rejected the Conservation Phase-In Adjustment proposed in PSE's 2009 general rate case as an improper pro forma adjustment of test year results, failing to meet the requirements of WAC 480-07-

510(3)(e)(iii). The CSA Rates proposed in this case are clearly not pro forma adjustments. They are essentially revenue trackers.

Second, over the course of the 2009 general rate case and the subsequent Commission process conducted under Docket No. U-100522, the Company became more sensitized to stakeholders concerns with mechanisms similar to the CSA Rate proposed in this case. As a result, PSE has proposed safeguards to ensure: (1) that the conservation savings used to calculate the CSA Rate will be verified to the Commission's satisfaction; and (2) that, in the year for which costs are being recovered, customers would pay no more than their expected cost of service (i.e., there could be no "windfall profit") as a result of the proposed CSA Rate.

Q. To which customers will the proposed CSA Rate apply?

A. PSE proposes that the CSA Rate apply to all natural gas or electric customers who are eligible to participate in PSE's energy efficiency programs and for whom the Company is at risk of not recovering costs as a result of their participation in these programs.

VIII. EFFECT OF PROPOSED CSA RATE ON PSE AND ITS CUSTOMERS

Q. How will PSE customers benefit from its proposed CSA Rate?

A. There are at least three benefits customers should experience as a result of PSE's proposed CSA Rate. First, customer rates will be more stable and predictable over time. With the CSA Rate gradually adjusting between rate cases to reflect

the Company-sponsored energy efficiency not reflected in its base rates, customers overall bills will not be as disconnected from their cost of service as without these rates (i.e., contributing to greater jumps in bills when new rates are approved). Second, as discussed in the testimony of Donald E. Gaines, Exhibit No. ___(DEG-1T), improved recovery of costs will assist in maintaining or perhaps up-grading the Company's credit rating, which in turn will benefit customers by reducing borrowing costs.

Third, PSE's proposed CSA Rate will more fully reflect the costs and benefits associated with the Company's energy efficiency programs. With the full "cost" associated with the Company's energy efficiency efforts reflected in its rates, the incentive to maximize the value of customers' conservation-related revenues should increase. This can only lead to better outcomes for PSE's customers.

Q. Will PSE's CSA Rate proposal also lead to more energy efficiency?

A. Notwithstanding PSE's historically high level of energy efficiency achievement, the Company believes that approval of the CSA Rate can only help encourage a faster level of the achievement in the future. However, it is impossible to determine how much. Certainly, removing a financial deterrent to faster achievement of energy efficiency should lead to a greater willingness by the Company to think "outside the box" and otherwise make extra efforts to aggressively pursue more cost-effective energy efficiency earlier.

Q. What are the impacts of the proposed CSA Rate on PSE's residential customers?

A. As discussed in the Prefiled Direct Testimony of Jon A. Piliaris, Exhibit No. ___(JAP-1T), the average monthly bill for a typical residential electric customer will increase by 31 cents, or by 0.3 percent as a result of the proposed Electric CSA Rate. The proposed Gas CSA Rate will also increase the average monthly bill for a typical natural gas residential customer by 10 cents, or by approximately 0.1 percent.

Q. In its Policy Statement in Docket No. U-100522, the Commission expressed an interested in understanding "whether or not [a company's] conservation programs provide benefits to low-income ratepayers that are roughly comparable to other ratepayers…." Do PSE's low-income conservation programs provide comparable benefits?

A. Yes, PSE's low-income electric and natural gas customers receive benefits from the conservation weatherization programs that compare favorably to benefits received by other residential customers. In 2011, PSE's electric low-income bill-assisted customers comprise approximately two percent of PSE's residential electric customers and are allocated approximately 13 percent of the budget for the direct residential conservation programs. PSE's natural gas low-income bill-assisted customers comprise approximately 1.1 percent of residential natural gas customers and are allocated approximately 10% of the budget for direct residential programs.

Q. What does PSE project to be the effect of its proposed CSA Rate on its financial results?

A. As shown in the Prefiled Direct Testimony of Jon A. Piliaris, Exhibit No. ___(JAP-1T), CSA Rate are projected to recover roughly $12 million for the effects of Company-sponsored energy efficiency that is not reflected in the rate revenues received by the utility in calendar year 2011. Of this amount, 75 percent will be recovered over the 12-month period beginning on May 1, 2012.

Q. Are there other ways in which approval of the CSA Rate will impact PSE?

A. This proposal aligns the interests of the Company, its stakeholders, its customers and this Commission with regard to the pursuit of conservation, both now and into the future.

IX. CONCLUSION

Q. Does this conclude your testimony?

A. Yes, it does.